Thursday, 29 March 2018

Brexit and financial services: One year to go, but where are we going?

It has been exactly twelve months since the UK submitted its notification of withdrawal from the EU under Article 50 of the Treaty on European Union. In twelve months' time, assuming that there has been no agreed extension of the negotiating period or permitted revocation of the withdrawal notification, the UK will officially leave the EU and become a "third country".

In this briefing, we summarise:

- the areas relating to the Withdrawal Agreement between the UK and EU which have been agreed to date and those which remain outstanding;
- the legal steps necessary to reach an agreement on withdrawal;
- the UK and EU proposals for a free trade agreement; and
- the legal steps required to reach a free trade agreement.

We also discuss areas which firms should be considering whilst these negotiations continue. Ultimately, irrespective of the precise form of any transitional arrangements and any final free trade agreement, financial services firms will need to continue

KEY POINTS

- Barring dramatic developments, there are 12 months left before the UK will leave the EU and become a "third country"
- Key elements for a transitional period have been agreed – this would essentially preserve the status quo for financial services until the end of **31 December 2020**
- However, the legal Withdrawal Agreement containing the transitional arrangements has not yet been finalised and therefore the parties may still fail to conclude a legally binding text on transition
- The Withdrawal Agreement will only formalise the terms of the UK's withdrawal from the EU – it will not determine the UK's future trading relationship with the EU following withdrawal
- Assuming the Withdrawal Agreement is finalised, the substantive negotiations on the future trading relationship between the UK and the EU will begin
- The UK government has to date ruled out continued membership of the Single Market and has conceded that passporting will no longer be available
- However, the UK is arguing for bespoke arrangements with the EU which will continue to allow mutual access and continued supervisory cooperation, although potentially on different terms from current arrangements. The EU's preferred position is third county equivalence
- If they have not already begun to do so, firms should be undertaking Brexit planning, including understanding the implications of a possible "worst case scenario" where there is a failure to agree transitional arrangements

assessing the likely impact on Brexit on their operations. Where appropriate, firms operating in the UK and EU may also need to take action to ensure that they can continue providing services on a cross-border basis without any unacceptable disruption following Brexit.

TRANSITIONAL ARRANGEMENTS

On 19 March 2018, Michel Barnier, the chief negotiator for the EU, and David Davis, the UK's Minister for Exiting the European Union, announced that they had reached an agreement in principle on the terms of transitional arrangements (or, in the preferred terminology of the UK government, "implementation arrangements"; some might say "extended negotiation period") for the UK's withdrawal from the EU (the **Withdrawal Agreement**). On the same day, the European Commission published a revised draft of the proposed Withdrawal Agreement, colour-coded according to items:

- that have been settled between negotiating principals and which are therefore expected to be subject only to revisions of a technical nature (highlighted in green);
- where the policy objective has been agreed between the EU and the UK, but where further drafting changes or clarifications are still required (highlighted in yellow); and
- that have been proposed by the EU, but where the EU and UK have not yet reached agreement on the relevant policy (where the text is shown without highlighting).

As its name suggests, the Withdrawal Agreement covers only the arrangements necessary to facilitate the UK's withdrawal from the EU; it does not cover any future trading relationship. As a result, the UK and EU will still need to conclude a separate trade agreement to govern their trading relationship after the expiry of the transitional period.

On 23 March 2018, the European Council published a set of guidelines welcoming the terms of the Withdrawal Agreement agreed so far and noting that further issues still require negotiation and agreement. In particular, it called for "*intensified efforts on the remaining withdrawal issues as well as issues related to the territorial application of the Withdrawal Agreement, notably as regards Gibraltar, and reiterates that nothing is agreed until everything is agreed*".

ELEMENTS OF THE TRANSITIONAL ARRANGEMENTS THAT HAVE BEEN AGREED

As regards the relevant transitional arrangements, the key agreed elements (at least in so far as relevant to financial services) contained in the draft Withdrawal Agreement are as follows:

- as so far agreed, the transitional period will end at the end of **31 December 2020**;
- there is no express provision in the draft Withdrawal Agreement to extend the transitional period, although this may not necessarily preclude a subsequent "rollover" transitional agreement between the UK and EU which has that effect if it is politically convenient for both sides;
- **EU law will continue to apply in the UK during the transitional period**. This would mean that UK financial services firms would continue to be able to rely on passporting and Treaty rights to provide services into the EU during that period, and EU firms would equally be able to rely on such rights to provide services in the UK;
- the UK will lose its representation in EU institutions, bodies, offices and agencies from 30 March 2019. This means that from that date, there will be no UK representation in the European Parliament or Council and therefore the UK will not be directly involved in negotiating new EU law. Therefore, subject to the next bullet point, **the UK will be a "rule-taker" during the transitional period**, although arguably it is not very influential today, having already served notice of its intention to leave the EU;

- the UK may be invited to send representatives or experts to attend meetings of EU bodies, offices or agencies where the discussion involves EU acts which are addressed to the UK or where the UK's presence is considered necessary and in the EU's interests (for example, in order to ensure the effective implementation of EU law). In any such case, UK representatives will have no voting rights;

- the UK will **continue to be bound by and benefit from external agreements concluded by the EU** during the transitional period (and therefore can rely on the terms of trade agreements concluded between the EU and third countries). However, the UK may negotiate and sign its own trade agreements during that time, provided that these do not enter into force until after the expiry of the transition (unless otherwise permitted by the EU). This is designed to allow the UK to begin putting in place arrangements to replace the trade agreements with non-EU jurisdictions to which it is currently a party by virtue of its EU membership. Depending upon the terms of any future agreements that are subsequently negotiated by the UK, these may include provisions granting access for financial services firms to overseas jurisdictions;

- there will be a **Joint Committee**, comprising both EU and UK representatives, which is responsible for supervising and facilitating the implementation and application of the Withdrawal Agreement. The Joint Committee may adopt decisions or make recommendations in relation to the Withdrawal Agreement. However, the status of the Joint Committee in relation to the Court of Justice of the EU (**CJEU**) remains an outstanding issue to be agreed between both sides (see below); and

- both the UK and the EU will be subject to a **duty to assist each other in good faith** in carrying out the obligations arising under the Withdrawal Agreement.

Of course, to echo the now familiar mantra of the EU, nothing is agreed until everything is agreed. This means that while the announcement on 19 March 2018 suggests that the UK and EU are significantly closer to finalising a transitional period, it is still possible that the parties may be unable to agree a binding text and that we may instead reach a "cliff edge" on 30 March 2019 (see below in relation to elements that have not yet been agreed). However, the risk of that occurring would appear to have decreased substantially from the perceived position several months ago.

ELEMENTS OF THE TRANSITIONAL ARRANGEMENTS THAT HAVE NOT BEEN AGREED

Outstanding issues that have yet to be resolved between the UK and the EU and which might still frustrate a final agreement include:

- The EU and UK have agreed to the **establishment of the Joint Committee** (see above). However, there remains a potentially significant point of contention. The suggested EU text states that disputes in the interpretation of the Withdrawal Agreement may be settled through a recommendation of the Joint Committee, but that the CJEU will have jurisdiction if a dispute is not settled within 3 months or if the Joint Committee otherwise decides to refer a dispute to the CJEU. Given the political sensitivity in the UK relating to the CJEU having continuing jurisdiction, it is unclear whether the UK government would ultimately be willing to concede this point or whether this might become a significant potential stumbling block to the adoption of a final binding text.

- The EU has retained the drafting of its so-called "punishment clause" whereby the **EU may suspend the UK's enjoyment of certain benefits under the Single Market** if the UK fails to comply with a judgment of the CJEU relating to the terms of the Withdrawal Agreement. In principle, this could include suspension of passporting rights, although the clause makes it clear that any suspension must be proportionate to the severity of the UK's breach. Where the EU wishes to impose such a suspension, it must give the UK at least 20 days to remedy the situation. Any suspension cannot last longer than 3 months, although in practice it may be renewed (presumably if the breach is continuing). The UK has not agreed to these provisions and therefore this remains another area where further negotiation will be required.

- While the Withdrawal Agreement does not contain a settled position on the issue of Northern Ireland, it is prefaced by a note which states that the UK and EU have agreed that the **"backstop solution" of regulatory alignment between Northern Ireland and the EU** will be included in the EU's legally operative text of the Withdrawal Agreement unless another solution is found. Although the UK government has mooted a number of potential solutions, it is unclear what option, if any, the UK considers to be the most viable. Given the enormous political sensitivity in relation to Northern Ireland and previous statements made by the UK Prime Minister, Theresa May, that no government could accede to a regulatory regime in Northern Ireland which differed from that which applies in the rest of the UK, it is clear that this may also be an issue which could derail any final agreement. Even if the "backstop" regulatory alignment option is eventually adopted, the EU's proposed provisions would only create a common regulatory area covering the EU and Northern Ireland in relation to the free movement of goods. This would mean that financial services firms would not be able to take advantage of any resulting alignment in order to continue to provide services into the remaining EU Member States from establishments in Northern Ireland.

NEXT STEPS

In order for the Withdrawal Agreement to become effective, the European Council will need to approve the final text of the agreement by a qualified majority vote, having first obtained the consent of the European Parliament. Briefing Paper No. 7551 (published in January 2017) in the House of Commons Library notes that Article 50 of the Treaty on European Union is silent as to whether or not individual EU Member States will need to ratify the Withdrawal Agreement. Some commentators have suggested that since Article 50 is silent on the need for Member State ratification and provides for approval through a "super-majority" vote, this implies that individual Member State participation is not required. In a speech to the House of Commons on 13 December 2017, David Davis confirmed that UK government's view that **no separate approval or ratification by individual Member States is required** for the Withdrawal Agreement. If this interpretation of Article 50 is correct, the effect is that no single EU country will have a right of veto over the transitional arrangements, although the European Parliament as a whole does effectively have a veto right.

From the perspective of the domestic UK process, the explanatory notes to the draft European Union (Withdrawal) Bill, which is currently undergoing the legislative process in the UK Parliament, indicate the UK government will ask Parliament to approve the terms of the Withdrawal Agreement. This was confirmed in a statement to the House of Commons made by David Davis on 13 November 2017. The power of UK ministers or the devolved administrations to make secondary legislation for the purposes of implementing the Withdrawal Agreement is subject to the UK Parliament first adopting a statute (currently expected to be termed the **Withdrawal Agreement and Implementation Act**) approving the terms for the domestic implementation of that agreement.

The precise form of the proposed Withdrawal Agreement and Implementation Act will depend upon the final agreed content of the UK-EU Withdrawal Agreement. In seeking to implement the terms of any agreement, it seems highly likely that the Act would need to contain provisions that fall within the competence of the devolved Scottish, Welsh and Northern Irish legislatures. Under the Sewel Convention, the consent of each devolved legislature would be required before the Act could be passed. However, as confirmed in the UK Supreme Court judgment in the *Miller* case in January 2017, the Sewel Convention is only a political convention and does not give rise to any obligation that could be enforced in the courts by the devolved governments. It remains to be seen whether, if the necessary legislative consents were not forthcoming, the UK government would be prepared to proceed with passing the necessary statute, notwithstanding any potential adverse political or constitutional effects.

In December 2017, David Davis indicated that he expected the UK and EU ratification procedures to run in parallel. At around the same time, Michel Barnier announced that the Withdrawal Agreement would need to be finalised by **October 2018** in order to allow sufficient time for the necessary approvals.

END STATE RELATIONSHIP BETWEEN THE UK AND EU

Assuming the conclusion of a binding Withdrawal Agreement between the UK and EU, the focus will turn to settling the future trading arrangement between the two parties. The current UK Conservative government and the Official Opposition, the Labour Party, have both explicitly ruled out continuing membership of the EU Single Market, meaning that the so-called "Norway model" appears to have been taken off the negotiating table.

Instead, it is anticipated that if negotiations are successful, the UK and EU will conclude some form of free trade agreement (**FTA**). However, the extent to which the FTA might facilitate cross-border provision of financial services on terms reasonably similar to existing arrangements remains unclear.

UK POSITION

In her speech at Mansion House on 2 March 2018, Theresa May conceded that the UK needed to "*face up to some hard facts*" and that "*in certain ways, our* [i.e. the UK and EU's] *access to each other's markets will be less than it is now*". She ruled out passporting and suggested an alternative collaborative framework (see the side bar opposite).

> *"We are not looking for passporting because we understand that this is intrinsic to the Single Market, of which we would no longer be a member [...]*
>
> *But given the highly regulated nature of financial services, and our shared desire to manage financial stability risks, we would need a collaborative, objective framework that is reciprocal, mutually agreed, and permanent and therefore reliable for businesses."*
>
> Theresa May, UK Prime Minister, in a speech given at Mansion House, London on 2 March 2018

The UK Prime Minister's speech was followed by a further speech, this time by the UK Chancellor of the Exchequer, Philip Hammond, at Canary Wharf on 9 March 2018. Mr Hammond's speech argued that it was in the UK and EU's mutual interests to continue to collaborate closely on financial services issues and that it would be mutually beneficial if financial services access was covered as part of any negotiated FTA. In particular, he identified three principles for a future partnership covering financial services:

- a process for establishing regulatory requirements for cross-border trade between the UK and the EU;
- reciprocal cooperation arrangements that are reliable and prioritise financial stability; and
- a legal framework that makes the structure durable and reliable for market participants and businesses which use their services.

Mr Hammond went on to argue that the EU's existing third-country equivalence regime was unsuitable for this purpose, particularly because it was unilateral and the EU could potentially withdraw access with little to no notice. Instead, he suggested moving to a model of "***mutual recognition and reciprocal regulatory equivalence****...with proper governance structures, dispute resolution mechanisms, and sensible notice periods to market participants*". The implication is that the UK may seek to agree an **outcomes-focused framework** whereby the UK and EU would have rules which have the same broad policy objectives in relation to financial services, but where granular individual requirements might differ. In the light of the EU's current professed preference for a regime based on regulatory equivalence (see below), it seems unlikely that the UK's preferred model would ultimately be acceptable to the EU and would instead be viewed as a form of "cherry-picking" which the EU has, to date, been vociferous in rejecting. It is also unclear whether any such model could be as efficient as existing forms of passporting under the various pieces of Single Market legislation or whether, in practice, there would inevitably be additional cross-border friction.

EU POSITION

The EU is proposing a model based on **regulatory equivalence**. As regards financial services, the EU's third country equivalence model varies somewhat according to each piece of Single Market legislation (although not all sectorial legislation includes an existing equivalence regime). Broadly, however, it involves the EU assessing whether a non-EU jurisdiction has rules which are sufficiently similar to the EU's requirements to be considered equivalent in order to permit access to EU markets. Although there is typically some ambiguity in relation to the precise manner in which these equivalence assessments should be performed, latterly (for example, in proposals amending the Markets in Financial Instruments Regulation) the EU appears to have been moving closer to more granular "line-by-line" assessments of rules in certain cases. This can be distinguished from the outcomes-focused model favoured by the UK, which gives greater importance to broader policy objectives, rather than the form of individual rules. As Philip Hammond noted in his Canary Wharf speech, the EU's equivalence regime also allows the EU to withdraw access at any time if it deems that a non-EU jurisdiction has ceased to be equivalent.

Various EU representatives such as Michel Barnier and the president of the European Council, Donald Tusk, have indicated that the UK government's stated "red-lines", such as not being subject to the jurisdiction of the CJEU, will entail consequences for the level of access that may be granted to UK firms. To date, the EU has essentially presented possibilities for the end state relationship as forming a "menu" of potential FTAs modelled on existing EU arrangements with other non-EU countries (e.g. Norway, Turkey or Canada), the availability of which is dependent upon the extent to which the UK maintains its current red lines. The UK government has rejected that approach, arguing that the UK and EU should conclude a bespoke negotiated agreement that reflects unique characteristics of their particular relationship. It is currently unclear whether the EU will be amenable to considering such bespoke arrangements once substantive negotiations begin on a potential FTA, although there have been some informal reports that certain EU Member States may be pushing for a more flexible concept of equivalence in order to ensure continued mutual access.

In its guidelines agreed on 23 March 2018, the European Council noted that it was ready to initiate work on a "*balanced, ambitious and wide ranging free trade agreement insofar as there are sufficient guarantees for a level playing field*". However, it went on to state that "*[s]uch an agreement cannot however offer the same benefits as Membership* [of the EU] *and cannot amount to participation in the Single Market or parts thereof*". As regards the specific position of trade in services, the guidelines expressed "*the aim of allowing market access to provide services under host state rules, including as regards right of establishment for providers, to an extent consistent with the fact that the UK will become a third country and the Union and the UK will no longer share a common regulatory, supervisory, enforcement and judiciary framework*". The implication appears to be that while services may form part of a future UK-EU FTA, the level of access to EU Member States may be reduced and may potentially be dependent upon national legal regimes.

LEGAL PROCESS FOR RATIFICATION OF AN EU-UK FTA

The legal process for the ratification of a future FTA by the EU depends upon whether the subject matter of the FTA falls within the exclusive competence of the EU as a legal entity, or whether part or all of the subject matter is subject to the shared competence of the EU and the individual Member States (a so-called "**mixed agreement**"). The delineation of the EU's exclusive competence and the shared competence of the EU and its individual Member States is set out in Articles 3 and 4 of the Treaty on the Functioning of the European Union (**TFEU**).

Article 3 TFEU sets out the areas in which the EU has **exclusive competence**, which include, amongst others, the following:

- the Customs Union;
- establishing competition rules necessary for the functioning of the EU's internal market;
- conservation of marine biological resources under the common fisheries policy; and
- the EU's common commercial policy.

By contrast, Article 4 TFEU sets out areas in which the EU and Member States **share competence**, except in so far as exclusive competence has been retained for the EU under Article 3. These include areas such as:

- the internal market;
- agriculture and fisheries (excluding the conservation of marine biological resources);

- the environment;
- consumer protection;
- transport;
- energy;
- freedom, security and justice; and
- certain safety concerns relating to public health matters.

The provisions in the EU Treaties regarding the conclusion of external agreements with third countries are complicated. In summary, **where an agreement falls within the EU's exclusive competence**, it is not necessary for individual Member States to ratify the resulting agreement. Instead, it is **sufficient for the Council to vote to conclude the agreement**, typically acting by a qualified majority. Generally, the Council is only required to consult with the European Parliament, although the consent of the Parliament is required in some circumstances – for example, where the agreement has important budgetary implications for the EU or where the agreement relates to an area that would be subject to the ordinary legislative procedure or another special legislative procedure that would require the Parliament's consent. It seems likely that any wide-ranging FTA between the EU and UK would require the consent of the European Parliament, rather than merely consultation, effectively giving the Parliament a veto right.

Conversely, a **"mixed agreement" must also be ratified by each individual EU Member State** in accordance with its own constitutional requirements. This can lead to the situation where a single Member State (or even a region within one) may delay or prevent the ratification of an agreement. Examples include the Netherlands' rejection of the Ukraine-EU Association Agreement in April 2016 and the Belgian region of Wallonia's initial rejection of the EU's Comprehensive Economic and Trade Agreement (CETA) with Canada in October 2016. As a result, it is likely to be procedurally (and probably politically) much easier for the UK to conclude a binding FTA with the EU if the FTA can be classified as falling within the EU's exclusive competence.

In Opinion 2/15 in May 2017, the CJEU gave an expansive interpretation of the EU's exclusive competencies under Article 3, especially as regards matters falling within the EU's common commercial policy, in the context of the EU's negotiations for an FTA with Singapore. However, even in that opinion, the CJEU noted that certain issues fell within the EU and Member States' shared competences, including certain provisions relating to non-direct foreign investment. A number of commentators have suggested that the UK's desire for a wide-ranging and deep FTA with the EU may point towards the use of a "mixed agreement", which would entail a **lengthy ratification process** by each individual Member State. Nonetheless, depending on the exact content of the proposed FTA, it may theoretically be possible to construct an agreement within the EU's exclusive competence if the agreement is more limited in scope.

The UK government's position on UK domestic ratification of the FTA is less clear, although certain statements made by ministers in the UK Parliament could be interpreted as being supportive of a parliamentary vote. It is likely that Parliament will have the power to block ratification of any FTA, although it will have very limited ability to influence the content of the relevant agreement, other than through the potential threat of non-ratification. Since the terms of international treaties are not incorporated automatically into UK domestic law, if the FTA requires the UK to give effect to its provisions by amending domestic law, it is likely that new primary legislation would be required (unless ministers have been granted sufficient powers to make appropriate secondary legislation under an existing statute).

KEY BREXIT ISSUES FOR FIRMS

From the present vantage point, without the benefit of clear parameters about the future financial services relationship between the UK and the EU, it is difficult to provide a concrete assessment of whether, and to what extent, firms may need to adapt their business models. However, we have set out below some considerations which may be relevant to firms' ongoing planning in the coming months.

DURING THE TRANSITIONAL PERIOD

Assuming that the UK and the EU conclude a legally binding agreement on transitional arrangements until the end of **31 December 2020**, there will be no change to the existing regime and firms may continue to rely on their current structures. This is subject to several important caveats:

- as stated above, it is still possible that although the transitional arrangements have been agreed in principle, the parties may fail to agree a legally binding version of the text, such that there is a regulatory "cliff edge" from 30 March 2019;
- before and during the transitional period, firms will need to continue thinking about how their business models will transition to the end state relationship between the UK and the EU after 31 December 2020. In practice, this may still be challenging because the final parameters of that end state may not become obvious until nearer the end of the transitional period. Firms may need to model a "worst case scenario" fall-back plan and leave sufficient time to activate it if it appears that the end state relationship will ultimately be unfavourable; and
- the UK will effectively be a "rule taker" in relation to EU laws that are adopted during the transitional period (and for all practical purposes, before it begins), meaning that it will have very limited ability to influence the development of rules that become effective during that time. In certain cases, firms may need to adapt their structure in order to comply with these new rules or to ameliorate their impact upon certain business activities.

PREPARING FOR A POSSIBLE "CLIFF EDGE"

If the UK and EU fail to agree a legally binding transitional period or if a transitional period expires without agreement on a new end state relationship between the parties, there will be a regulatory "cliff edge" (either on 30 March 2019 or on 1 January 2021, respectively). While a cliff-edge is not inevitable, as part of their scenario planning, UK firms that operate on a cross-border basis into the EU (and EU firms operating in the UK) will need to consider a range of issues, which may include those listed below.

- **Where are the activities undertaken by the firm deemed to take place?** Different jurisdictions adopt different approaches in relation to the same activity. For example, from a UK perspective, the activity of discretionary portfolio management is generally understood to be carried on where the discretionary decisions are made. This would mean that if these decisions are taken in the UK by individuals acting on behalf of a UK firm, the UK regulatory position is likely to be that the activity is not carried out on a cross-border basis, even if it is carried on for a client based in the EU. However, the jurisdiction in which the non-UK client is based may take a different approach (for example, by deeming the activity to be carried on where the recipient of the service is located), so firms will need to assess any potential regulatory risk carefully. Where a UK firm concludes that it is carrying on activities in another EU Member State, it will need to consider what regulatory licences, if any, will be required in that jurisdiction after Brexit.
- **How does the firm attract investors or clients in other jurisdictions?** The existing mechanisms for marketing financial products and services may vary depending upon the type of client to whom the marketing is directed and whether the relevant regulatory regime (e.g. AIFMD, UCITS, MiFID etc.) provides for passporting of marketing activities. Since any passports between the UK and EU will fall away, the firm will need to consider if there are other established mechanisms for marketing (e.g. the national third country private placement regimes (**NPPRs**) under AIFMD, if available in the jurisdiction) or, absent such a mechanism, whether the possibility of carrying on marketing will be entirely subject to the jurisdiction's national rules. Some jurisdictions may effectively be closed to active marketing. The firm will also need to consider whether its marketing activities may be considered to amount to the provision of services in the relevant jurisdiction (e.g. reception and transmission of orders, investment advice and/or

placing on a non-firm commitment basis, or equivalent regulated activities undertaken in the UK) and if so, the mechanisms (if any) for providing such services lawfully and in accordance with relevant conduct of business rules. In some cases, it may be possible to rely on an argument that "reverse solicitation" has occurred – i.e. that the relevant client has contacted the firm on the client's own initiative without any prior engagement by the firm – such that no marketing is subsequently deemed to have occurred, although this would need to be approached cautiously. It may also be possible to engage local entities to undertake permitted marketing activities on the firm's behalf.

- **Will the regulatory status of the product offered by the firm fundamentally change?** Some funds will undergo a fundamental overnight change in their status once the cliff edge is reached. For instance, under the existing regulatory definition, a UCITS fund must be domiciled in an EU Member State. Any UK UCITSs will effectively be viewed in the remaining EU jurisdictions, at least, as AIFs and be governed by the regime for non-EU funds under AIFMD. This may have an impact on whether existing institutional investors can remain invested, or can continue to invest in the future, in the relevant fund, as their investment mandates may prohibit them from investing in non-UCITS funds or limit the level of assets that they can commit to such investments. It is unclear whether, for UK domestic purposes, the UK will continue to recognise remaining EU funds as UCITS funds (or a UK domestic equivalent) or otherwise how they would be treated from a regulatory perspective – for instance, will they be subject to the UK's domestic law version of the AIFMD regime (to match the likely view of the EU) or UCITS regime, or a hybrid of the two? There may also be an effect for existing securitisation structures where, in order to comply with retention requirements, a UK-based sponsor holds the required risk retention. It is possible that such a structure could cease to comply with investor representations in the relevant securitisation documentation and/or EU regulatory requirements for risk retentions (although this may, in part, depend upon the correct interpretation of the new EU Securitisation Regulation in this regard).

- **Will re-registration or other procedural steps be required and could this disrupt ongoing activities?** A change to the firm's regulatory status may mean that it is required to re-register under national rules in some circumstances. For example, where an AIF is currently marketed by a UK AIFM into other EU Member States in reliance on the marketing passport, following the cliff edge, it would need to be marketed under individual Member States' NPPRs (if permitted). This would require the AIF to be registered for marketing with each relevant national regulator separately. Until the registration process is completed (which could, depending upon the jurisdiction, take several months), the AIFM would be unable to continue marketing activities in those Member States. Therefore, if the AIFM were engaged in fundraising activities that straddled the cliff-edge, marketing of the fund could be severely disrupted during that period. It is also unclear whether the AIFM would need to register for marketing in those jurisdictions where it had already picked up investors under the passport but is no longer actively marketing, on the basis that the NPPR notification creates the necessary ongoing relationship between the AIFM and the relevant jurisdiction's national regulator for supervisory purposes.

- **Can the firm rely on delegation arrangements with an affiliated entity in another jurisdiction?** One potential solution that has been suggested to the lapse of passporting arrangements is for a firm to establish an affiliated entity (or use an existing affiliated entity) in the EU and indeed a number of firms have already pursued this option. Under this model, the EU affiliate benefits from passporting arrangements throughout the remaining EU Member States, but delegates the performance of certain functions back to the UK firm. Clearly, this has potential advantages in terms of allowing firms to minimise the relocation of operations from the UK to the EU. However, the firm would need to consider a number of factors before adopting this approach. For example, it would need to assess the level of substance that it would be required to maintain in the relevant EU jurisdiction in order to satisfy the threshold requirements for authorisation of the affiliated entity. It would also need to consider the potential conditions for, or limitations on, delegation under applicable EU or national rules and the manner in which UK-based staff might otherwise act on behalf of the EU entity.

- **What would be the likely timeline for relocating operations and/or obtaining authorisation for a new entity?** Where the firm is considering a potential structural solution which involves relocating certain of its operations to another jurisdiction and/or getting a new entity authorised, it will need to consider the likely timeline involved. In practice, where regulatory authorisation is required, this may necessitate a longer lead time, which may minimise the firm's ability to pursue a "wait and see" strategy with regard to possible developments in negotiations. The firm will also need to consider whether timescales for authorisation may be affected by an increased volume of applications as the cliff edge draws closer and/or whether professional advisers in the relevant jurisdiction will have sufficient capacity to assist with any application where necessary. Alongside this, firms will also need to consider practical issues such as budgeting and allocation of sufficient management time to the relevant issues.

- **Will the enforceability of any existing agreements be affected?** Firms should consider whether the terms of any existing agreements (including those with clients, investors or service providers) are such that they would become invalid or unenforceable as a result of the regulatory cliff edge. Where necessary, firms may need to renegotiate agreements in advance of the withdrawal date in order to ensure that there will be sufficient legal certainty after that time.

ASSUMING AGREEMENT ON AN END STATE RELATIONSHIP

If an FTA is ultimately concluded between the UK and the EU that covers financial services, clearly it will be necessary for the firm to consider the viability of its existing business model under the terms of that FTA. At the present time, before substantive negotiations on the end state relationship have begun, it is difficult to predict what arrangements, if any, might eventually be agreed.

One of the potential difficulties with transitioning to the end state relationship is that, as with the current proposed transitional arrangements, nothing will be agreed until everything has been agreed. This means that while firms may be able to assess how proposals develop during negotiations in the coming months, there may be limited certainty on the final shape of the relationship until late in the process. A degree of contingency planning may therefore be required so that firms have a "worst-case scenario" fall-back option in case negotiations are ultimately unsuccessful or conclude with a sub-optimal outcome for financial services. Even if an FTA is eventually agreed, depending on its precise terms, firms may still need to consider many of the issues identified in the section above.

HOW WE CAN HELP

If you require any advice or assistance in relation to your Brexit planning, whether in terms of proposed restructuring of business operations or otherwise, please contact any of the partners named below.

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