



EURO TREASURY WORKING GROUP

HOUSE OF FINANCE, 14 JUNE 2019



Brexit and its consequences for financial markets

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14 JUNE 2019, HOUSE OF FINANCE



Agenda

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 - Timeline
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 - Market infrastructures and post-trading
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 - Brexit and national measures
3. Brexiting hard – the WTO solution
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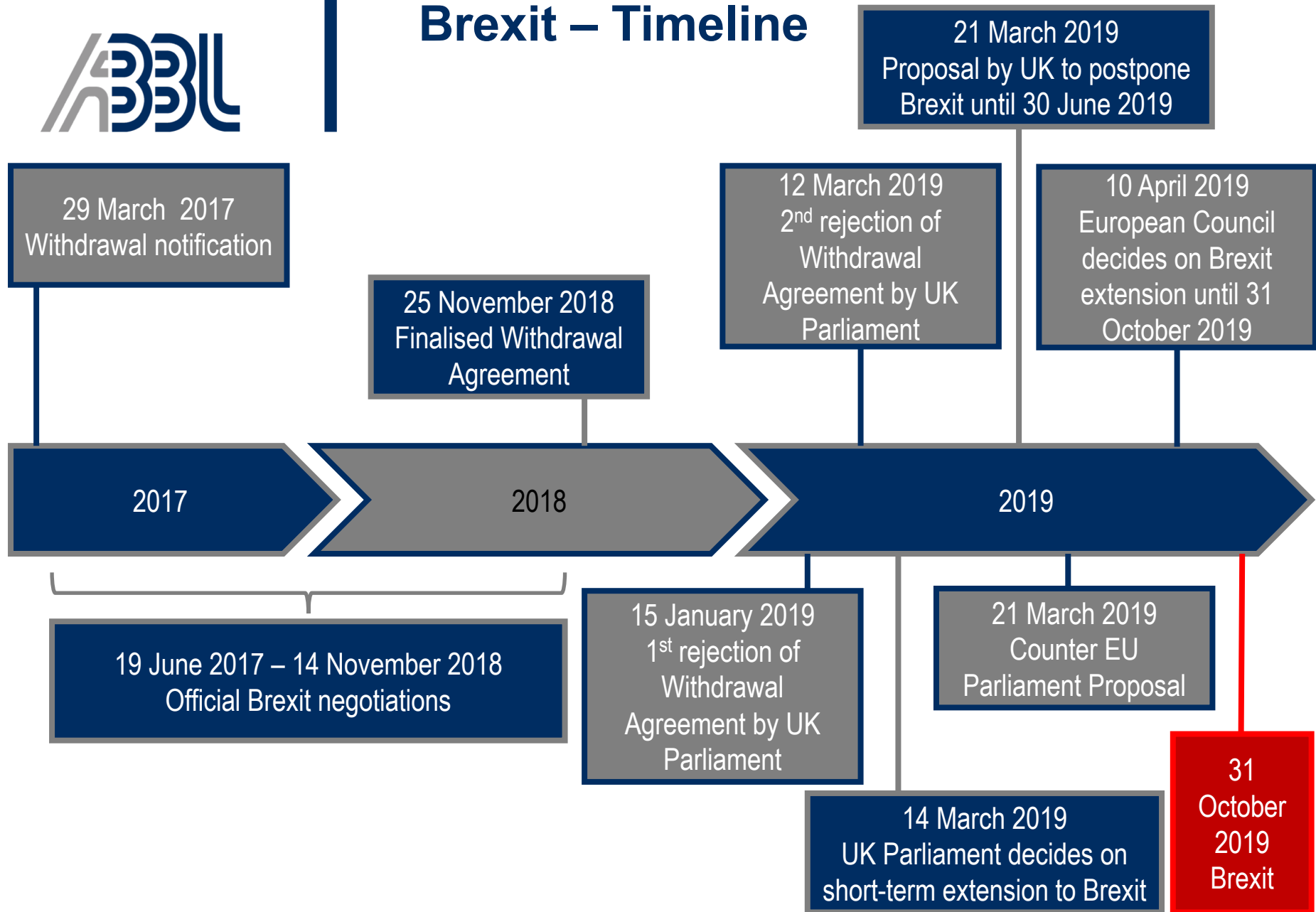
1. The political dimension

Brexit





Brexit – Timeline





Extended Brexit timeline

Key elements of the European Council's formal decision of 10 April 2019 to extend the period for Brexit:

Why 31 October
2019?

To avoid that the UK
needs to send a UK
Commissioner to
the EC

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Maximum
extension of
Brexit until **31
October 2019**
...

UNLESS

... the UK ratifies the deal before 31 October 2019, in which case the UK leaves the EU on the first day of the month following the ratification and at the latest on 31 October

**Subject
to**

... the UK acting in a “constructive and responsible manner” reflecting “its situation as a withdrawing member state”.
This includes refraining from any measure that would jeopardise the attainment of the EU's objectives

... the withdrawal treaty not being reopened. Any negotiations on the future relationship are prohibited under the EC's decision

... Brexit being back on the agenda of the June 2019 Council meeting following the nomination of the new president of the European Commission



Political changes – UK side

7 June 2019

Theresa May officially resigned as Conservative party leader, but stays on as Prime Minister until a replacement is chosen

10 June 2019

Nominations for the Tory leadership closed with 10 candidates stepping forward

End of June 2019

End of parliamentary selection process with two (or four) candidates ending on the ballot paper for pitch to membership

Late July 2019

New conservative leader and new prime minister in time for the summer parliamentary recess



Political changes – EU side (1)

23 - 26 May 2019

European Elections



June 2019

Elected candidates negotiate to form political groups for the upcoming Parliament's 9th term



20-21 June 2019

European Council Summit



24 June 2019

Political groups notify their composition



1 July 2019

End of Parliament's 8th term



2 July 2019

Inaugural plenary session of the newly-elected Parliament



Second half of July 2019

First opportunity for the Parliament to elect the European Commission President



September/October 2019

Hearings of Commissioners-designate in parliamentary committees



Second half of October 2019

New EC is elected, new Commission President gives inaugural speech

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Political changes – EU side (2)

- Other European top positions that are being subject to change in the coming months:
 - **European Parliament presidency** (currently Italian MEP Antonio Tajani)
 - **European Central Bank presidency** (Draghi's mandate ends on 31 October 2019)
 - **European Council presidency** (Tusk's mandate ends on 30 November 2019)
 - **High Representative of the Union for Foreign Affairs and Security Policy** (Mogherini's mandate ends on 1 November 2019)



2.

**The impact on European
financial markets**



Brexit and financial markets

Main impacts

Contractual arrangements

- Modification or termination of cross-border contracts ("repapering")
- Contract management
- Applicable law
- Loss of passporting rights and trigger of MAC clauses

Banking models

- Adaption of business models
- Financial stability
- Prudential aspects
- Bank recovery and resolution planning
- UK as third country

Trading and investment services

- Derivatives trading
- Equity trading
- Access to market infrastructures
- Cross-border service provision

Infrastructures

- Credit rating agencies
- Stock exchanges
- Central Counterparties (CCPs)
- Central Securities Depositories (CSDs)



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Derivatives trading (1)

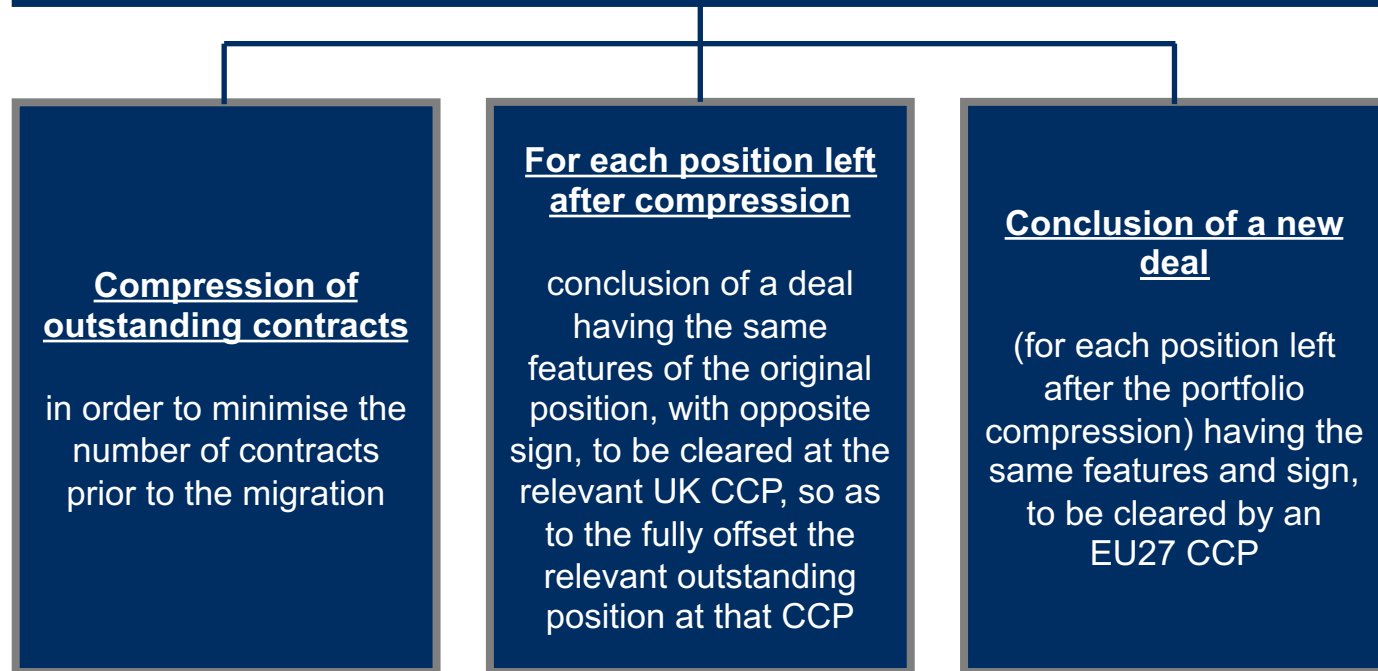
- Short-term impact assessment for cleared and uncleared derivatives
- Issues identified:
 - At Brexit, UK CCPs will no longer fall under the EMIR provisions for EU-based CCPs (several steps of equivalence would be required)
 - Additional licensing issues (depending on the services that UK CCPs are providing to their members) may arise (e.g. banking licence)
 - Vast majority of OTC derivative contracts (especially interest rate derivatives) are still cleared via UK CCPs, in light of the liquidity depth of the UK CCPs (not available in non-UK CCPs)
 - Brexit would force either (i) a transfer of the book to less liquid on-shore CCPs or (ii) existing positions are likely to be terminated in application of the default mechanism provided by the CCP rulebook (including the auctioning process)
 - Similar issues for ETDs traded via UK trading venues – upon Brexit, UK traded ETDs would become, lacking a transitional period, OTC instruments
 - For existing cleared and uncleared derivatives transactions, the loss of the EU-passport for UK counterparties can mean that the continuation of the existing transactions especially, typical life-cycle events, can be considered to constitute licensable banking activities



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Derivatives and market infrastructures

Practical elements and challenges of a large scale novation/migration of legacy cleared contracts from a UK CCP to an EU27 CCP



Pricing - typically terms for contracts to be cleared by EU CCPs are different from UK CCPs, often as a result of the much smaller liquidity pool generally offered and the less attractive conditions offered.

Liquidity – it is very likely that EU27 CCPs will ask to deposit initial margins one day ahead of the date the UK CCPs will be able to release the initial margins deposited with them

Cost/fees – the transfer of positions will almost certainly result in considerable additional cost and fees for all involved parties,



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Post-trading

- Current contingency measures:
 - EC Action plan on ongoing preparedness and contingency work in the event of a no-deal scenario – adopt temporary and conditional equivalence decisions to ensure no disruption in central clearing and depositary services and recognition of UK clearing infrastructure
 - but authorisation and exemption issues around life cycle events (such as contract amendments, roll-overs and novations) will not be resolved**
 - ESMA Draft RTS on clearing and the margin obligation under EMIR – exempt legacy contracts from the EMIR clearing and margin obligation where they are novated from a UK counterparty to an EU27 counterparty. The exemption is limited to a no-deal scenario and to transactions novated within a 12-months time-window (as of Brexit occurring)
 - but contract continuity issues for uncleared derivative contracts (especially as regards life-cycle events) remain not addressed**



Brexit and the financial markets

Derivatives and client impact

- Narrow scope of current solutions creates significant challenges:
 - Incomplete measures on contract continuity cause issues and uncertainties especially for SMEs, which can affect their group-wide risk management
 - Inconsistent time-windows for transitional measures (EC measures until end of 2019 and ESMA measures until end of 2020)
 - EU clients with a pan-EU27 footprint have solutions in some Member States, but not all
 - EC proposal only applies to contract that are being transferred from a UK CCP to a EU CCP and not those for which an EU client needs to remain in situ (e.g. the contract undergoes a life-cycle event), thereby becoming subject to EU clearing and margining requirements



Brexit and financial markets Solutions

- Grandfathering provisions on EU level regarding the continuation of cleared positions with UK CCPs – any and all contract (cleared and uncleared) entered into between EU and UK entities before the UK leaves the EU are grandfathered in line with their original terms, thereby covering any life-cycle event post-Brexit:
- CCP clearing:
 - Transitional period to allow the clearing of cleared derivative contracted executed on 30 March 2019 and afterwards at UK CCPs, thereby allowing EU27 CCPs to adjust their business capacity and offering to the higher prospective volumes and new products as well as to acquire any new members
 - Alternative: grandfathering transitional period allowing for an ordered and structured legal and operational adjustment and targeted grandfathering for existing cleared contracts and uncleared OTCs at the withdrawal date
- Uncleared derivatives
 - Align national measures
- ETDs
 - Issue preliminary/conditional equivalence decision for UK trading venues complementing those regarding CCPs (especially relevant for client requiring access for hedging purposes)



Brexit and financial markets

Trading obligation

- In March 2019, ESMA released a public statement that reduced the scope of share-trading-obligation (STO) with a limited application of the STO to 14 large UK ISINs. In May 2019, ESMA confirmed that it would not be applying the STO restrictions to the 14 UK ISINs
- ESMA confirmed that stocks with an ISIN corresponding to a member national of the EU, in addition to those from the EEA will be included under the STO, while British ISINs will fall outside the EU27 STO scope.
- UK FCA stated that the STO regime will still cause disruption to investors, some issuers and other market participants, that would lead to market and liquidity fragmentation across the UK and the EU. A number of shares with EU-27 ISINs have both a listing, as well as their main or only significant centre of market liquidity, on UK markets. In our view, the ISIN that a share carries does not and should not determine the scope of the STO. Some shares have their main or only centre of market liquidity outside the country in which the issuer is incorporated. This approach would place restrictions on a company's access to investors and freedom to choose where they seek a listing on a public stock market



Brexit and Luxembourg measures

First draft bill of law
with regard to
transitional measures
taken in case of a
disorderly Brexit

31.01.19

- Freedom to provide services and freedom of establishment provisions under Luxembourg law may be extended by the CSSF for a maximum period of 21 months for UK institutions when providing investment and/or banking services (as well as payment and securities settlement activities) into Luxembourg
- Regime only applicable for legacy contracts and contracts concluded after Brexit where they present a close link with existing legacy contracts
- New regime for “third-country systems” (applicable to payment systems and securities settlement systems) whereby collateral rights held in those systems are sheltered from insolvency effects

Second draft bill of law
with regard to
transitional measures
taken in case of a
disorderly Brexit for
UCIs and SIFs

20.03.19

- Mitigation of Brexit impact on investment policies for UCITS, Part II-funds and SIFs
- Transitional measures applicable in hard or soft Brexit scenarios
- Limited to 12 months (period during which the UCIs need to adapt their investment policies)
- Transitional measures restricted to positions taken before Brexit and which are directly linked to the UK’s withdrawal
- Specific provisions for UK UCITS currently commercialised in Luxembourg to retail customers and that would qualify post-Brexit as third-country AIFs



3.

**Brexit hard – the
WTO solution**



WTO and its relevance for the future relationship

- In case of hard Brexit, the WTO will be the only trade agreement applicable to the EU and the UK
- If hard Brexit occurs, the WTO will be the baseline for any future negotiations – no need to negotiate for what is already in place
- The WTO will shape the negotiations/discussions in other ways:
 - It determines what can be the future relationship
 - It provides arguments that will influence the outcome
- Types of WTO + agreements:
 - CETA (for Canada)
 - EEA (for Norway, Iceland and Liechtenstein)
 - EU-Ukraine
- Current specific agreement relevant for banking services is the GATS (General Agreement on Trade in Services)
 - GATS contains rules that are relevant for trading in banking services
 - GATS contains general obligations and "opt-in" obligations

WTO and banking services (2)

| | | |
|-----------------------------------|---|--|
| MFN (Most Favorite Nation) | No discrimination against services and service providers from a WTO member compared to “like” services and service providers from any other country | Generally applicable (but subject to limited exclusions) |
| Recognition | Recognition of qualifications, prudential measures, etc. permitted notwithstanding MFN. Generally subject to requirement of no-discrimination between countries and anti-abuse provisions (some questions of applicability to financial services) | Generally applicable |
| Market access | Prohibition on 6 specific types of market access measures (e.g. ban on foreign service suppliers and requirement for a certain of establishment) | Opt-in |
| National treatment | Like MFN, but pertains to discrimination between domestic and foreign | Opt-in |
| Domestic regulation | Various requirements related to licensing and administration, among others | Mostly opt-in |
| Payments and transfers | No restrictions on international transfers for current transactions relation to specific commitments | Opt-in |

WTO and banking services (3)

| Mode | Supply of service | EU commitments |
|---------------------------------|--|---|
| (1) Cross-border supply | ...from the territory of one member into the territory of any other member | Commitments are generally limited to provision of services related to financial information and advisory, intermediation and other auxiliary financial services |
| (2) Consumption abroad | ...in the territory of one member to the service consumer of any other member | Banking and other financial services: full commitments in principle |
| (3) Commercial presence | ...by a service supplier of one member, through commercial presence in the territory of any other member | Basic commitments for all financial services |
| (4) Presence of natural persons | ...by a service supplier of one member, through presence of natural persons of a member in the territory of any other member | No financial service sector necessarily excluded but commitments limited in reality |

WTO and banking services

The significance of the EU's WTO commitments on banking services

Where there is a commitment, the EU cannot impose quantitative limits on market access and must accord "national treatment" that does not discriminate against third country services and service suppliers

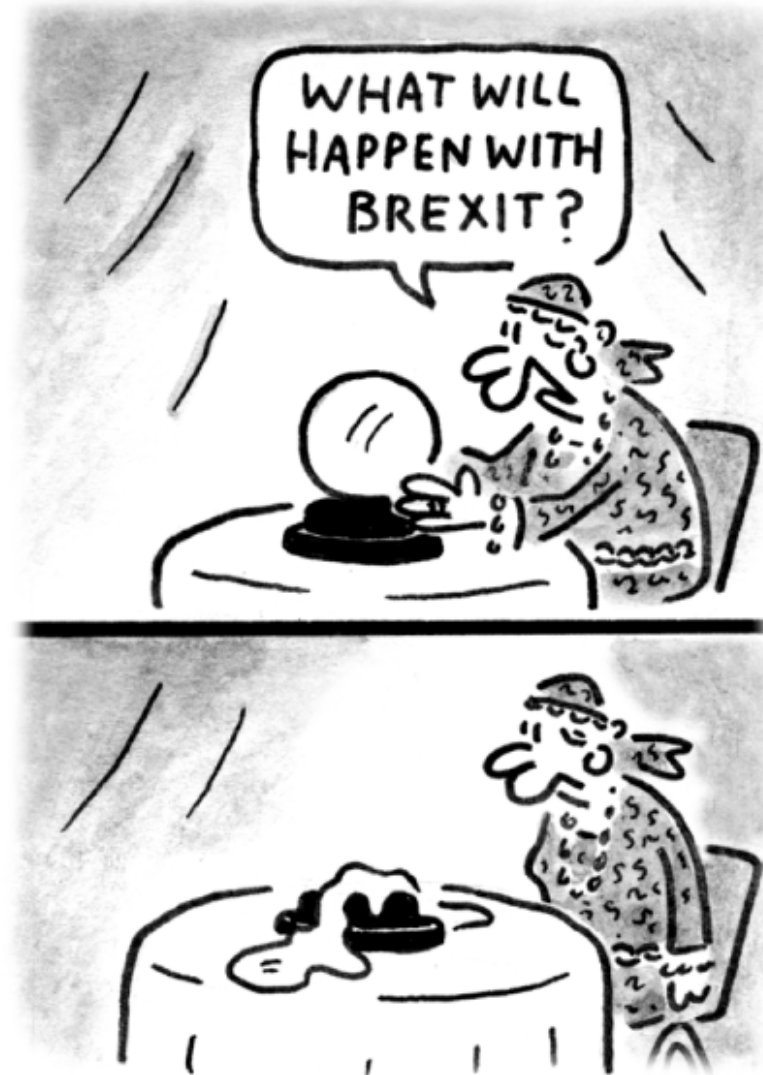
Requiring third country service suppliers to have a licence is not a violation of national treatment. Domestic regulation must however be proportionate and has to apply to all third country service suppliers equally (MFN obligation)



4. Conclusion



What comes next?



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