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Brexit: what might change
Banking & Finance

Introduction

On 23 June 2016 the UK population voted for the UK's exit from the European Union (EU). The applicable exit procedure and certain possible legal consequences of Brexit for Banking & Finance will be discussed below in the form of a Q&A.

In the short term, we do not identify material changes for the legal practice. The European law and regulations will remain in force until the negotiations between the EU and the UK have been completed and the withdrawal procedure has come to an end. To which extent European law and regulations will also apply following the UK's exit from the EU, will largely depend on the outcome of the negotiations. One of the fundamentals of the EU is the internal market, allowing for the free movement of goods, services, workers and capital (Internal Market). In this context we note that in January 2017, Prime Minister May announced that the UK will opt for a "hard Brexit", meaning that the UK will no longer maintain membership of the Internal Market, nor accede to any associated status. Instead, the UK will seek a free-trade deal with the EU outside the Internal Market.

Brexit – background

Since 2007 (Treaty of Lisbon), the EU Treaty offers a Member State an explicit legal basis to leave the EU (Article 50 TEU). Pursuant to Article 50(2) TEU, the UK can start the exit procedure by giving notice to the European Council. The exit agreement will be concluded on behalf of the EU by the Council[1], acting upon a qualified majority[2] and after having obtained the consent of the European Parliament. The agreement must set out the arrangements for the UK's exit and take account of the framework for the UK's future relationship with the EU. The UK cannot participate in the relevant discussions or decisions of the European Council or Council.

The EU Treaties cease to apply to the UK from the date of entry into force of the exit agreement or, if there is no such agreement, 2 years after the date of notice under Article 50 TEU, unless the European Council, in agreement with the UK, unanimously decides to extend this period. The exit procedure has never been called for and the way forward is full of uncertainties. Apart from Article 50 TEU, no further provisions or guidelines apply.

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1 The Council consists of a representative of each Member State at ministerial level, who may bind the government of the Member State in question and cast its vote (Article 16 TEU).

2 The qualified majority shall be defined as at least 72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States (Article 238(3)(b) TFEU).

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Q&A – Banking & Finance

What will passporting rights for financial services firms look like post-Brexit?

Passporting rights are based on mutual recognition and the "single passport" granting licensed or registered financial services firms in one Member State the right to carry on their business in other EU Member States without having to apply for an authorisation in such other Member State, either on a cross-border basis or by opening a branch in such other Member State. Such passporting regime can remain in place if the UK would join the EEA, but this seems unlikely to be the case.

Absent any agreement and dependent on the type of financial services firm, in principle, financial services firms will lose the right to passport their activities into the EU or the UK, as the case may be. Consequently, in order to maintain market access in the relevant jurisdictions, such parties will have to obtain separate authorisations. This will apply to banks, but also to other financial services providers, such as insurance companies (and insurance intermediaries), payment service providers, and fund managers. The European legislator sometimes also grants "passport-like" rights to entities established in third countries the legislation of which is deemed equivalent to the EU regime. This is e.g. the case under (the future provisions of) MiFID II (limited to the provision of services to professional clients) and Solvency II (only applicable to reinsurance undertakings).

Furthermore, UK parties dealing with EU counterparties will need to continue working with central counterparties (**CCPs**) that are authorised under EMIR (No. 648/2012). It is possible for UK CCPs to be recognised as third country CCPs to the extent the European Commission deems the UK legal and supervisory rules for CCPs equivalent to the EU rules.

What will passporting rights for prospectuses look like post-Brexit?

The Prospectus Directive (2003/71/EC, as amended) has introduced a "single passport for issuers", making securities available to investors either through a public offer procedure or by admitting their shares to trading. This means that once approved by the regulatory authority in one Member State, a prospectus then has to be accepted everywhere else in the EU. This concept will not change under the Prospectus Regulation as is currently being drafted.

After Brexit most likely, an UK issuer will no longer be able to passport its prospectuses into the EU when targeting EU investors or wish to obtain a listing on a EU regulated market. However, if the information requirements of the UK, as a third country, are deemed equivalent as the requirements of the Prospectus Directive (or Prospectus Regulation, as the case may be), it will be possible for a UK issuer to passport their prospectuses in the EU after approval by one EU Member State's competent authority. Equally, after Brexit most likely, EU issuers will need to comply with the national UK prospectus regime when offering securities to UK investors or seeking admission to trading on a UK trading platform.

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Will any governing law and submission to jurisdiction clauses in financing agreements remain valid after a Brexit?

Governing law clauses should not be impacted as Rome I and Rome II Regulations recognize the choice of a third country law (such as the laws of the UK post-Brexit) as binding. However, there may be a growing impact of mandatory EU law on the choice of law as the divergence between both legal regimes becomes more important. Furthermore, submission to a court in England or Wales will no longer be automatically recognized under the Recast Brussels Regulation (No. 1215/2012), which only affords such recognition to a choice for Member State courts. Any applicable bilateral treaties will likely revive (such as the treaty between the UK and the Netherlands) – absent such treaties, national private international law will govern submission to jurisdiction clauses.

Will any Material Adverse Change clauses be triggered by a Brexit?

It is unlikely that Brexit constitutes an event of default under financing documentation based on the Loan Market Association's or the International Capital Markets Association's recommended forms. Even if the agreements would provide for Material Adverse Change or force majeure provisions, the general view is that Brexit was already priced in/taken into account prior to the Brexit vote.

Are any other standard provisions of financing or other transaction documentation possibly triggered by a Brexit?

Many financing arrangements contain provisions to pass the costs of regulatory changes to borrowers/issuers – the so-called "Increased Cost" provisions. As UK lenders may be faced with additional regulatory burdens in the EU (and EU lenders in the UK), these provisions may be triggered. In addition, lender's or noteholders' consent may be required if any business wishes to relocate from the UK into the EU. Finally, the Banking Recovery and Resolution Directive (2014/59/EU) provides for a so-called "bail-in clause" to be included in agreements with EU banks and investment firms, where such agreements are governed by the law of a third country. As a result, financing and other transaction documentation governed by the laws of England and Wales, such as certain ISDA Master Agreements, Purchase Agreements and Underwriting Agreements, will also need to contain such bail-in clause.

What next?

Once the UK invokes Article 50 TEU, the UK and the EU will negotiate the terms of Brexit. It will be a highly political process and the outcome is as yet unclear. Therefore it is of the utmost importance to monitor the developments and the potential impact on your company's position closely. We will keep you informed about further developments.

Please contact your trusted adviser at Loyens & Loeff or send an e-mail to Brexit@loyensloeff.com if you have any queries.