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Regulatory News Alert

Brexit: News EU Commission note 8 February – Banks

23 February 2018

On 8 February 2018, the EU Commission released several papers, among which, three addressed specifically to banks, MiFID firms, and investment managers of both UCITS and AIFs. All three papers are official notices that highlight the expected impacts of Brexit on various financial business activities.

The target date to be prepared for Brexit is now firmly set at 30 March 00:00 CET, exactly two years after the UK withdrawal letter was sent to the EU Commission. Unless there is a transition period, this would mean the split of EU law from the UK law, hence the end of passporting to and from the UK, and the UK becoming a third country with all the consequences for banks, MIFID firms, and fund managers (UCITS and AIFM).

In these papers, the EU Commission recalls some principles regarding authorization, contract laws, provisions on outsourcing arrangements, and potential consequences for private entities stemming from a collapse of the EU-integrated law order. Independent of any transitional arrangement, it is time to prepare for Brexit, not only from an operational perspective, but also from a strategic point of view.

Impact on bank authorizations

From 30 March, UK entities providing banking, payment services, or e-money will no longer have authorization to offer their services or products to the remaining members of the EU; they will lose the passport and become third country banks. As such, these entities will no longer be able to provide services to remaining EU member states, unless they apply locally for authorization.

As discussed in a former **alert** dated 29 January, EU/EEA entities (branches at least) authorized in the UK will have to revise their need for licenses and provision of services in the UK. For branches of UK firms in the EU member states, Brexit means they will have to seek a new license or an extension of their current license. On top of that, they have to comply with rules applicable to a third country entity, which could have a material impact on the levels of funding and of prudential capital, organization, and governance. Given potential long lead-time and uncertainties, it is imperative to consider the need to submit or renew the application for a license with the competent authority, to the risk of being unable to provide services post-Brexit.

Generally, UK-originating entities located in the EU have to ensure that both their governance and organization are sustainable as an ongoing concern and are able to operate without interruption in the member state where they are present. With the new EU regulatory framework, local authorities have more power to restrict the activities, require additional funding through SREP reviews, require additional robustness in the risk management organization, and impose a review of recovery and resolution plans.

Other impacts

Because Brexit means that the UK will become a third country, potential impacts for UK branches or EU branches in the UK will mean that plans for resolutions, operational capital to support trading book/hedging, or prudential treatment of third party exposures (to the UK) might have to be assessed and compensated. Member states' Competent Authorities (including the ECB or SRB) might challenge the support between entities' parents-branches-subsidiaries, namely for crisis management should a UK-headquartered bank or e-money provider be allowed to let its Continental-EU-based entity deal with the resolution regime on its own.

As Brexit implies the end of contractual continuity, the passport will be lost, hence the free provision of services to or from other EU member states will be impaired. However, there are additional legal consequences; the fact that some contracts are under UK law (ISDA derivative contracts for example) might represent new challenges once the UK becomes a third country.

Then, if from a banking union/prudential perspective, Brexit impacts might take the form of additional capital and new organization, that should not obliterate the fact that the provision of services by these entities will themselves be influenced by other regulations, including MIFID II, EMIR, UCITS, AIFMD, and GDPR, all of which will in turn be profoundly challenged by Brexit.

Next steps

EU banks enter into a new strategic phase, as Brexit will have an impact on all banks—the ones with deep links with the UK, as well as all others that need to reorganize and restructure their business model. Given the current organization of EU financial services, the value chain of banks will be influenced by changes in the relationship between the EU and UK, whether it only be through access to products or the cost of capital.

At Deloitte, we think that the interplay of Brexit, digital, prudential, and Banking Union regulation will create systemic changes for banks in terms of organization and access to clients and competition, potentially affecting the cost of capital.

To maximize the benefits of a de facto required reorganization, there might be several areas to consider:

- Choice of location, ideally stable (e.g. AAA credit rating), with international expertise and awareness at the private and public sector level
- A place where an entity already exist to facilitate the licensing
- A member state where a positive eco-system that is able to be scaled-up is present

- A place close to major segments of clients

At this moment, only about a year before Brexit becomes live, it is urgent to assess the business structure, anticipate potential disruption in the access or provision of services or products, ensure that available sources of funding remain available, and design and implement remediation plans. Any transition period, however short it is, is an opportunity to deploy a new business model.

How Deloitte can help

In this rapidly evolving time at the crossroads between regulations and Brexit news, Deloitte can help you to stay on top of the curve with its RegWatch service to spot and analyze upcoming changes.

Deloitte advisers will help you design and implement your strategy and proceed to a reorganization of your business in light of the new environment.

We have deep experience in regulatory and organization projects including MIFID II, EMIR, CRD/CRR, and other regulation, as well as in business processes or digital-enabled solutions to strive in the new environment.

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