

Regulatory News Alert

Article EU Commission Brexit note 8 February – MIFID II, Markets and Derivatives

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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/AIF Funds. These three papers are an official notice that attempts to anticipate the expected impacts of Brexit on 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 withdraw 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, and potential consequences for private entities. 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 MIFID firms and the market

Until the end of a potential transition period, UK MiFID firms will forego their right to access the remaining EU investors. UK will become a third country; therefore, UK firms will no longer be able to freely access EU markets on the current basis. This will challenge distribution, organization, and contractual relationships, both at the level of the retail client and at the professional/institutional level.

MIFID subsidiaries of UK firms might only continue to provide their services provided they have a formal MIFID authorization in the member state where they are present. Reliance on the parent company to provide support might become more difficult if not impossible, hence a need to assess the organization (governance, outsourcing, compliance) in light of Third Country provisions. Particular attention should be addressed to brokerage agreements; access to trading platforms, and provision of clearing services with UK based entities.

The case of MIFID firm branches will be even more acute; they will have to abide by the rules of MIFID, among which the limitation of the scope of their activities to the member state where they are located. Alternatively, they might have to transform into subsidiaries, leading to a higher cost of capital and enhanced governance.

More importantly, MIFID UK-based market operators will no longer be under a MIFID license. The consequence is that these operators will cease to be eligible for trading, at least until potential equivalence is granted. A side effect of the trading changes is that CCP (Clearing Houses) will no longer benefit from the open non-discriminatory access; in other words, they will no longer be able to clear trades of EU instruments. This impacts not only equity markets, but also all markets including derivatives, which for the euro segments might be challenged in their own right by a required migration of euro clearing.

Post-trade and Derivatives

From a derivatives and post-trade perspective, Brexit will transform otherwise EU trading venues into third country venues with a significant consequence—to transform ETD (Exchange Traded Derivatives) into OTC derivatives. This would trigger the application of EMIR for clearing and the transformation of the ETD into OTC derivatives, implying new obligations in terms of margining, collateral, and portfolio compression.

EMIR forces the clearing of OTC-traded derivatives on an EU CCP (Central Clearing Counterparty), which by the nature of Brexit translates into the fact that current UK-based CCPS will no longer be eligible. The impact on processes and clearing (direct or indirect) have to be assessed and solutions or providers identified, unless UK based CCPs are recognized as equivalent before Brexit enters into force. This might be impossible to warrant from a political perspective, hence a probable delay between Brexit and the date of recognized equivalence.

If the obligations at the institutional level are straightforward, EMIR and MIFID II also apply at a product level, hence EU financial instruments currently traded in the UK will have to comply to EU rules in the future, notably regarding reporting, which might create an inconsistency unless the reporting is made to a recognized EU TR (trade repository).

Finally, the consequences of removing part of the contracts from the ETD or EU OTC status will impose additional costs in the form of margin or collateral or additional prudential capital for banks.

To conclude, there are additional areas of concerns in the post-trade activities, including the status and possibilities to use CSDs out of the EU to issue instruments or to settle EU instruments. The eligibility and access to the ECB T2S platform might also be challenged in the future. A last foreseeable consequence of Brexit might lead to a new definition of the segregation requirements under UCITS, AIFMD, and CSD-R (the regulation of Central Securities Depositories), leading to renewed challenges for EU-based depositaries.

Contractual and organizational impacts

Brexit implies a collapse of the legal basis upon which trading services or agreements under MIFID are organized. Direct electronic access through a UK-based broker might be put into question. In a different segment of the market, UK UCITS will become AIFs, potentially removing them from investors. The status of UCITS funds in the UK will also change, as they will become non-UK funds.

Furthermore, as discussed during the summer by several ESMA opinions, the provision of outsourcing services to and from the UK will have to be reconsidered in light of the UK becoming a third country. This might imply a careful review of MIFID II Delegated Regulation 2017/565 article 32 on delegation on aspects like proportionality, cooperation between authorities, or the anti-letter box provisions set up by ESMA or EU Commission.

Another sensitive area, the disclosure of client information, at the juncture between MIFID and GDPR will be influenced by the UK becoming a third country. For example, firms will have to pay closer attention to the changes to execution policies and contracts; having a non-EU entity in the value chain might be considered a substantial element triggering client notification.

In the end, regarding reporting mechanisms under MIFID II, EMIR, or SFTR, the TR, ARM, AP, and CTP will all have to comply with EU rules; as they are based in the UK, they may no longer be considered valid reporting entities.

Next steps

After the completion of MIFID II programs, EU firms will enter into a new strategic phase. We think Brexit will affect all firms; the ones with heavy links with the UK and all others in their value chain will need to reorganize and restructure their business model.

At Deloitte, we think that the interplay of Brexit, Digital, and MIFID II transparency will create systemic changes for MiFID investment firms in terms of organization, access to clients, services, and products, and deeply alter the competition dynamic.

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

- Choice of location, ideally stable, with international expertise and awareness at private and public sector level
- A place where an entity already exists 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, a year before Brexit becomes live, it is urgent to assess the resilience of the business structure, evidence potential disruption in the access or provision of services or products in order to 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 thrive in the new environment.

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