Deal Out

CONSEQUENCES OF BREXIT AGREEMENT FOR THE FINANCIAL SECTOR

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Foreword

The United Kingdom is expected to leave the European Union and its single market by 31 October 2019 at the latest. To date, the „how“ of Brexit has not been clarified; a hard, i.e. a „no-deal Brexit“ is still possible, even if nobody wants it. A no-deal Brexit seemed unlikely a few weeks ago because of the political aspirations of all sides, but the result of the European elections, in which the Brexit party emerged victorious in Great Britain, shows not so much the British willingness to withdraw but the dissatisfaction with the political work of Tories and Labour. The general uncertainty is further heightened by Theresa May‘s resignation on 7 June 2019 from the leadership of the conservative Tories and as Prime Minister, and the resulting question of who will succeed her. In view of this current development, even a no-deal Brexit is once again becoming a possibility.

For businesses this means: prepare for all eventualities and review all areas of economic ties with the United Kingdom. An analysis and assessment of the need for action arising from Britain‘s departure from the EU is important for the continued success of all UK and EU ventures.

This white paper explains the most important implications of Brexit for the financial industry in a clear and understandable manner and helps identify possible needs for action. Ashurst will be happy to answer any questions that may arise from this topic. We accompany and support your company during the further process of Brexit and all possible outcomes. We offer you competent insight in all relevant areas to help you take preparatory measures.

The Big Picture

BREXIT FROM PLEBISZIT TO TODAY

On 23 June 2016, around 52 per cent of the British voted in favour of leaving the European Union. With Brexit, the British are leaving the EU after more than four decades of membership. The negotiations on Brexit, the individual steps of which are governed by Article 50 of the EU Treaty, were officially launched by British Prime Minister Theresa May on 29 March 2017.

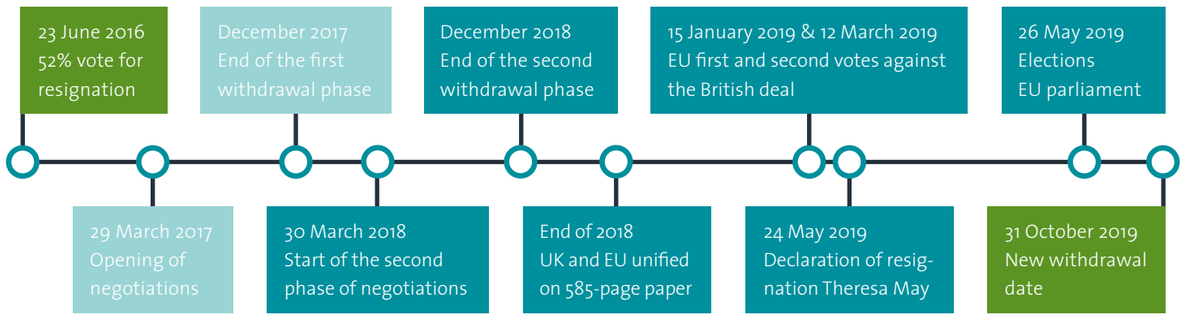
They were launched in two phases: The first phase regulated the basic issues of resignation. It ended in December 2017. Since then, the official departure date, originally set to 29 March 2019, has been delayed several times. In this phase, agreement was reached about the UK's payment of outstanding commitments to the EU, but the exact amount still needs to be negotiated. It also clarified the residence status and labour law issues of EU and UK citizens. It was further agreed to preserve the joint peace agreement between the UK and the Republic of Ireland and not to introduce border controls or border fortifications between the two countries. However, the Irish "backstop" remains a huge challenge in all further Brexit negotiations.

The second phase of negotiations began on 30 March 2018 and intended to regulate the exact terms of the withdrawal and the future relationship between the European Union and the United Kingdom. The negotiations ended in December 2018 with a draft resignation agreement. Various exit models and various models for regulating future trade relations were discussed. The Norway model would have guaranteed the British further membership in the single market and the continuation of membership in EFTA and the EEA. The list of possible withdrawal scenarios also included membership of a customs union or a bilateral free trade agreement along the lines of the CETA or the trade agreement between the EU and South Korea.

The German business community was in favour of a regulatory model that would have included a common internal market in combination with a customs union – with minor restrictions on trade in goods. At the end of 2018, the UK and the EU agreed on a 585-page paper that focuses on a transition phase for Brexit until 2020. During this transitional period, the UK will remain in the EU internal market and customs union for the time being to avoid a hard cut for the economy, but would no longer have a say in EU decision-making. A 26-page political statement also outlines the future for both sides after the withdrawal. It is not legally binding and leaves much room for interpretation.

In the decisive vote before the British Parliament on 15 January 2019, this deal was defeated by 432 votes to 202. Two further attempts to obtain approval for the withdrawal treaty also failed. At the EU summit on 10 April 2019, the heads of state and government finally granted the British postponement until 31 October 2019 at the latest. However, if the British parliament approves the withdrawal deal already negotiated ahead of schedule, the UK could leave the European Union earlier. But, due to the British Parliament's refusal, the resulting resignation of Theresa May on 7 June 2019 and the still unresolved question of her successor, a timely decision is becoming improbable.

If, in the end, no deal is ratified, a withdrawal from the European Union without agreement is very likely. Such a hard Brexit has far-reaching consequences for both parties at many levels. The UK would fall back to third country status with a hard Brexit. Between the EU and Britain only the general rules of the World Trade Organisation (WTO) would apply. However, various EU states (including Germany) have also prepared themselves for this case and at least provided for national transitional regimes for the financial sector, which are accompanied by international votes, e.g. by the ESAs, and at least in part still permit mutual recognition.



TRANSITION PERIODS UNCLEAR

In the event of a hard Brexit, the negotiated agreements are also likely to lose their validity for a transitional period. The motto is: „Nothing is agreed upon until everything is agreed upon." One thing is certain: with the UK's withdrawal, the EU will lose an important net contributor, the third largest after Germany and France. On the other hand, Great Britain is losing its most important trading partner. More than 40 per cent of British exports of goods and services go to the EU. Conversely, Great Britain ranks fifth in Germany's list of trading partners.

The EU and the UK had therefore agreed on a transitional period until 2020 with an optional extension until 2022 to cushion the impact of the withdrawal for both sides. There are no agreements for the time after that. Until the end of the transitional period, the UK will retain all EU rules, retain access to the internal market and remain part of the Customs Union. However, their right to have a say in EU decision-making would cease to exist. Financial contributions would continue to be paid to Brussels during this transitional period.

The agreed transitional phase of the so-called Northern Ireland Backstop is controversial. The clause in the withdrawal agreement provides that Britain will remain in the Customs Union with the EU and that some of the European Market rules will continue to apply to Northern Ireland until a solution is found on how to deal with the border between Northern Ireland and EU member Ireland. A physical division of the island or the introduction of border controls would pose a major threat to peace in the former civil war area. Proposals by the British, who have now identified the backstop clause as a central problem in the withdrawal agreement, range from renegotiations to postponement of the withdrawal date. So far, no proposal has been supported by a majority and the EU is keeping a low profile.

The financial sector needs to define and implement transitional measures to mitigate the impact of Brexit on the financial sector, if only because of the large number of contracts to be adjusted. It must be examined, inter alia, whether existing contracts may benefit from being grandfathered in accordance with the respective national authorisation provisions under which they were signed. In view of this, even a transitional period until 2022 is very short.

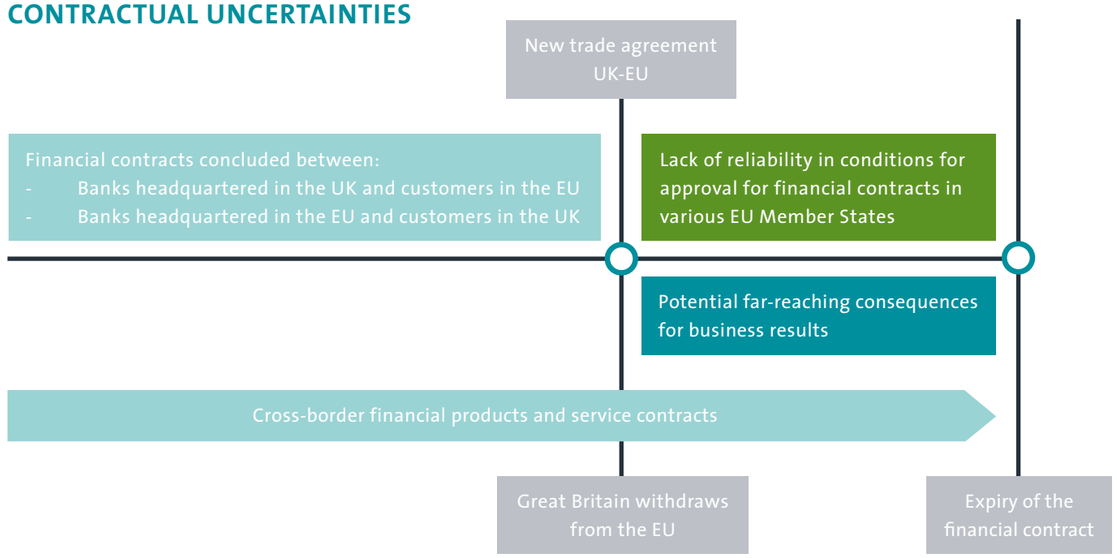
In the meantime, transitional regulations have been implemented for banking and financial service providers from the UK, among others, in order to keep the German financial market as stable and functional as possible, even in the event of a no-deal exit.

In terms of content, the transitional regulations authorise the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) to enable companies based in the UK which have previously been active across borders to continue their existing business for a currently envisaged transitional period of up to 21 months by means of a separate legal act in the form of a general ruling, if and to the extent that this is necessary to avoid disadvantages for the functioning or stability of the financial markets.

In this context, it is envisaged that in the event of a no-deal Brexit, BaFin will be able, in principle, to order a corresponding application of the European passport regulations to companies based in the UK for banking transactions and financial services that are closely related to contracts existing at the time of withdrawal. Word from an informed source indicates that BaFin may initially only wish to make use of the transitional provision for a period of one year and may subsequently extend it again.

The question as to which companies or sectors will benefit from the BaFin legal act cannot be answered until it has been issued or prepared. It cannot be stated from the outset that individual services or even individual products within a particular service will not be covered by the legal act. In addition, the continuation of contracts is only envisaged for business relationships with existing customers, as BaFin still has to record the corresponding order on the basis of §53b (12) KWG. The acquisition of new customers on the basis of a possible BaFin legal act – if indeed it is passed at all – will only be possible in extreme, exceptional cases.

CONTRACTUAL UNCERTAINTIES



Worst Case No-Deal

The worst case would be a no-deal Brexit, a withdrawal without a withdrawal agreement between the EU and the United Kingdom. In this case, the UK will revert to third country status and trade will be subject to World Trade Organisation rules, which means that the UK will have to completely re-regulate its trade with the EU. This would affect all areas of public life such as security, healthcare, freedom to travel and regulation of the labour market. In the worst case, trade would come to a standstill. Analysts draw a horror scenario of chaos at ports, air traffic disruption and food and drug shortages.

GENERAL ECONOMIC AND POLITICAL IMPLICATIONS

An exit without a valid trade agreement would have an impact on border traffic, especially regarding the issues of passport control, customs duties, customs procedures, trade with third countries and preferential rules of origin, as the regulation of joint trade relations between the EU and Great Britain would be reduced to the basic rules of the World Trade Organisation. In addition, in this case the UK will lose membership in numerous plurilateral agreements on public procurement. There are currently 34 free trade agreements and three customs unions to which Great Britain belongs through the EU. With a hard Brexit the membership of Great Britain in these agreements expires. The right of access to the relevant agencies monitoring trade in the various sectors will also be terminated. Britain would be forced to set up its own agencies. British pre-products would no longer qualify as Union goods. It is therefore likely that British companies would fall out of the value chain, as companies could switch to EU suppliers. Since each individual product must then be tested, increased bureaucratic effort is to be expected. Also, the licence-free export of dual-use goods is not applicable if there is no country-specific regulation with the UK.

Massive distortions are also to be expected in market access conditions, which have been harmonised by EU law to date.

IMPLICATIONS FOR COMPANIES FROM GERMANY / THE EU

Sound knowledge of customs regulations and foreign trade law is needed, since imports from Great Britain will generally be subject to customs duty. Knowledge of the extensive regulations for determining the customs value and the assessment basis for import turnover tax is also required. Customs formalities and capacity bottlenecks lead to cost increases as well as to delays and risks in the supply chain that are difficult to calculate. Further restrictions such as tariff quotas or the requirement for import authorisations must also be considered. For medium-sized companies in particular, this means considerable internal extra work and additional costs, which is why companies should check their trade relations with Great Britain at an early stage.

IMPLICATIONS FOR COMPANIES FROM THE UK

British products would no longer have preferential access in the FTA and EU Customs Union. This results in higher costs and more time expended for customers from the EU. There is a danger that the market will turn away from Great Britain, i.e. that companies will look for alternatives in the remaining EU states in order to avoid Brexit effects if no corresponding trade agreement is concluded or customs union is established.

The accreditation system in Great Britain is also influenced by Brexit. If Great Britain receives the status of a neighbouring country, cooperation between accreditation authorities may continue. If, however, the United Kingdom will be regarded as a third country through a hard Brexit, numerous new certifications would be necessary on the British side. So far, there is no guarantee that the transfer of rights planned in the withdrawal contract will take place or that it will be fully in line with the EU legal framework in detail. In other words, there is no guarantee regarding possible future changes through UK national legislative changes. As a result, companies on both sides are forced to secure their contracts accordingly.

In fact, there is no generally binding EU contract law. Nevertheless, European legislation affects many areas of economic life. What happens to these influences after Brexit is a matter of great uncertainty. The British government has announced a so-called „Great Repeal Bill“, a law that converts European law into British law. However, the actual adoption of such a law is not yet foreseeable. Whether this law only applies to existing EU law or also provides for an automatism for the future is also unclear to date. Since the British will lose any say at European level after Brexit, it is unlikely that all EU law will be adopted unchanged. On the contrary, it is more likely that harmonisation between the European and British jurisdictions will decline. Companies must therefore consider whether they wish to continue to use British law as the law of choice in many cases, or to use other jurisdictions as a precaution. The effects of the Lugano Convention, and Rome I and Rome II as well as a possibly necessary „UK nexus“ must also be taken into consideration.

DATA PROTECTION LAWS

75 per cent of the UK's cross-border data traffic is with EU Member States. After Brexit, Great Britain also becomes a third country under data protection law. This also applies to the circulation of personal data. Data flows will therefore only be possible if all data subjects agree, if they use EU standard clauses or if binding data protection rules are in place, approved by the competent supervisory authority and applicable to the whole group. The approval of certain codes of practice or the certification of certain processing operations are also possible options. Companies should therefore develop solutions for legally compliant data transfer at an early stage.

MACROECONOMIC CONSEQUENCES

Should there actually be a no-deal Brexit, in which Great Britain withdraws without an agreement and without a transitional period, an economic crash could follow, as various studies predict. The decline in British economic output by 2030 is estimated at 2.2 to 10 per cent, depending on perspective.

It seems certain that the UK will have to reckon with weaker economic growth, an increase in national debt, the depreciation of the British currency and, coupled with this, a fall in prices on the real estate market. These results threaten to produce a downward spiral when the British economy slides into recession, the consequences of which are only conditionally foreseeable. If foreign trade comes to a standstill weeks after leaving the EU, the pound will depreciate, resulting in a significant reduction in consumption and a rise in unemployment. The real estate market and investments would also suffer as a result. A widening of the high account deficit also puts the country's financial stability at risk with consequences for the rating and affected companies. However, new forecasts, such as those from HSBC in February 2019, are much brighter about the future of the pound. The bank calculates an average value from the three possible scenarios of Brexit rejection, deal, and no-deal and forecasts a value of 1.37 for the pound against the US dollar, a positive forecast compared to the previous value of 1.25 to 1.30.

A Brexit study by the Bank of England calculates numbers that correspond to this negative picture in the event of an exit without an agreement. The study expects the gross domestic product to collapse by around 8 per cent in 2019, a figure confirmed by the study of the British government. A decrease in housing prices by a third and a fall in the value of the pound by a quarter are also on the list of negative effects, as is a narrow doubling of unemployment in Great Britain to 7.5 per cent. An inflation rate of 6.5 per cent would ultimately force the Central Bank to raise its key interest rates significantly, which could rise to as much as 5.5 per cent. The result would be an increase in the cost of loans. Although the seven largest banks in the UK have passed the stress test launched, which means that in the worst-case scenario they would be able to do without bail outs, the situation is quite different for companies and public authorities.

As a precautionary measure, the Central Bank has therefore lowered the key interest rate as a measure against growing uncertainty and dwindling confidence. Currency fluctuations, as predicted by the study, would increase the volatility of the stock markets, which would result in stocks falling to lows.

Financial service providers are particularly affected by Brexit because of the enormous financial volume of 22.5 billion euros in trade with EU countries. This is a quarter of all existing derivative contracts beyond 31 October 2019. The national transitional provisions, e.g. for derivatives under section 53b(12) of the KWG, however, are intended to cushion this impact.

POSSIBLE EXIT SCENARIOS

	Access to the internal market	EFTA plus EEA (Norway model)	EFTA(Swiss model)	Customs Union (Turkey)	Free trade agreements (CETA or South Korea model)	WTO model (hard Brexit)
Access to the internal market	✓	✓ Yes, almost completely	✓ Yes, with exceptions	✗	✗	✗
Adaptation of common legal status	✓	✓	✗	✗	✗	✗
Common jurisprudence in commercial law	✓	✗	✗	✓ Yes, in parts	✗	✗
Common external trade tariff	✓	✗	✗	✓ Yes, with exceptions	✗	✗

CONSEQUENCES FOR THE UK

9,2 % less gdp at no-deal

25 % of all Brexit contracts affected

Real estate market collapses by **1/3**

Doubling of the unemployment rate to **7,5 %**

6,5 % inflation

Increase in key interest rates to **5,5 %**

study Bank of England

BREXIT FROM THE GERMAN POINT OF VIEW

50 % of German companies expect a relocation of companies from the UK to Germany as a result of Brexit and thus a strengthening of the German financial centre.

35 % of German companies see this as making Germany more attractive for foreign investors.

Only **13 %** see an increased attractiveness of Germany as a European start-up hub.

63 % of German companies in the banking sector expect high losses in the event of a hard Brexit.

62 % of German companies have already analysed the risks and effects of the Brexit on their companies.

47 % of these companies have reviewed UK investments and **40 %** have initiated organisational changes in their UK subsidiaries.

40 % of German banks have their own Brexit Task Force; **46 %** rely on external advice.

Study Deloitte

Impact on the Financial Sector

CONSEQUENCES FOR THE FINANCIAL CENTRE LONDON AND EU FINANCIAL CENTRES

Brexit will hit the financial metropolis of London the hardest. With an annual surplus of around 65 billion euros, the financial sector is the country's most important export factor. Should Britain lose access to the EU single market, London will also lose its status as the most important financial centre in Europe. By 2018, several banks had already relocated to Frankfurt or Paris. Although the United Kingdom currently still provides good conditions for banks and stock exchanges in global comparison, London is already showing a large loss of points compared to the previous year. Great Britain must expect and reckon with the danger of the emigration of highly qualified workers and well-known financial companies.

Although the stock market reacted in a relaxed manner to the rejection of the exit paper in January 2019, and the pound also remained stable and despite the reduction in the risk of a hard Brexit, most banks are already preparing for the worst-case scenario as a precaution.

A clear winner is Germany as a financial centre. 5,000 to 10,000 new jobs are expected in Frankfurt am Main alone due to the relocation of banks and financial service providers from London. As early as 2018, investments in commercial real estate in the Main River metropolis rose to a record level of 61.5 billion euros. Brexit therefore has an impact on the strategic direction of the financial and services industry in the EU and the UK.

The fields of action in which financial service providers must act urgently in the event of a hard Brexit include:

- Data protection
- Civil and procedural law
- Banking supervisory law and securities law market access rules
- Regulatory capital requirements
- Restructuring and settlement regime
- Derivatives and securities financing transactions
- For Germany, however, the last four points are largely solved by the national transitional regulations, e.g. §53.b Para. 12 KWG

In the case of interest rate derivatives alone, the proportion of contracts with UK parties is around **40 %**

Derivatives contracts have to be renegotiated, for which the individual national schemes in the event of a No-Deal-Brexit, however, provide for transitional provisions.

THIRD COUNTRY STATUS AND EQUIVALENCES

With Brexit, Great Britain loses its approval for financial passporting in the EU and is therefore also downgraded to third-country status on the financial markets (however for Germany with partial transitional arrangements, i.e. as a „third country with special status", cf. Section 53b (12) KWG). Financial service providers from the UK thus lose unhindered access to the EU financial market, as licenses from UK supervisory authorities are no longer effective and the EU framework for financial services no longer applies. As a consequence, each financial service and each financial product must be individually licensed by each of the remaining EU countries if EU-wide rules do not apply (e.g. the market access rules according to MiFIR). Alternatively, UK financial institutions and banks can retain passporting licenses by setting up subsidiaries in one of the remaining EU countries.

The European Central Bank is already emphasising that these subsidiaries must actually have central functions such as regional management or internal audit. They will not be allowed to get away with simply creating a letter-box company. This also affects foreign credit institutions that have chosen Great Britain as their European branch. They can no longer operate on the basis of passporting on the UK market and within the EU. Conversely, for EU-based companies, this creates considerable uncertainty, as cross-border financial contracts are the basis for financing and risk management. Although agreements at bilateral level are envisaged to enable the UK to shape its financial relations independently, all proposals so far fall short of the EU passport.

In view of the forecast changes caused by Brexit, the German Bankers Association recommends a fundamental revision of the EU equivalence regime by the end of the planned transition phase after Brexit. So far, the basic position of the Association has been to make individual case decisions when it comes to equivalence decisions for institutions operating in Germany on the basis of a British banking licence in order to continue costly contracts.

The change of regime would provide for equivalence recognition to be granted in the future independently of political considerations. In order to improve transparency and predictability, the technical equivalence test should also involve the competent supervisory and regulatory authority of the third country, in this case the United Kingdom, in addition to the competent EU authorities and ESAs. In order to give the third country a greater say in this matter, an extension of the 30-day rule, which allows equivalence to be withdrawn without justification within 30 days, to 180 days is currently negotiated, coupled with the possibility for the third country to submit corrections. The reason for re-negotiation is the need of financial institutions for planning and legal certainty as well as stability.

Passporting

Several different passport models for banks and financial service providers enable companies licensed in one EU or EEA Member State to trade freely in other countries with minimal additional licensing requirements. These include core banking activities such as lending, deposit-taking, market services such as sales and trading, asset management, payment services and e-money services.

The passporting model is the basis of the internal market for financial services. Each of the nine passports transposes a specific prudential system into national law. Firms outside the EU can provide a few selected services if the legislation of the country of origin is recognised as equivalent to EU standards. Passporting has been extended to the EEA (including Norway, Iceland and Liechtenstein) as these countries have undertaken recognising the basic freedoms of the EU (free movement of goods, persons, services and capital) and to transpose EU rules for financial service providers into national law.

Should Great Britain fall back to third country status through Brexit, it will also lose the right to passporting and thus the authorisation for financial passporting in the EU. Financial service providers from the UK are thus losing unhindered access to the EU financial market, as licences from the UK supervisory authorities are no longer effective. Each financial service and each financial product must therefore be approved individually by each EU state. However, the same does not yet apply to EEA credit institutions in the UK. It remains possible for companies to contact a bank in London unsolicited without passporting in order to buy an instrument to hedge interest rates. However, active distribution in the EU is no longer possible.

Since all variants have a potential impact on bank liquidity and financial market stability, banks need to be better capital-protected.

Status: 15 April 2019

EURO-CLEARING / CCPS

As a precautionary measure against growing uncertainty and dwindling confidence, the Central Bank has lowered the key interest rate. Currency fluctuations, as predicted by the study, would increase the volatility of the stock markets, which would lead to stocks falling to lows. In the case of a hard Brexit, UK Central Counterparties (CCPs) would no longer be subject to the regulatory and supervisory framework that applies to EU-based CCPs. The consequence would be that European supervisors would no longer have the right to intervene in London clearing-houses. In order to avoid the threats to financial stability that an abrupt withdrawal of the UK from the EU would entail, ESMA is therefore prepared to make concessions for a transitional period, but only as long as the equal treatment of institutions and equal conditions of competition are guaranteed. A recognition of third-country CCPs by ESMA in accordance with ESMA standards and an equivalence decision by the EU Commission are currently the prerequisites for the legality of CCP clearing services provided from outside the EU.

As early as December 2018, the EU Commission took the necessary positive equivalence decision. In February 2019, ESMA and the Bank of England also initiated recognition of UK CCPs and the Central Securities Depository (UK CSD) with two Memoranda of Understanding (MoUs). The MoUs are to come into force in the event of a hard Brexit. ESMA thus supports further access to CCPs and CSDs in the UK in order to contain any disruption risks associated with a hard Brexit in central clearing and to avoid any negative impact on the financial stability of the EU.

The MoUs are letters of intent which are supposed to provide advice, cooperation and exchange of information and enable ESMA to have direct and ongoing access to all information relating to the UK CCPs and the UK CSD. They also lay down in detail the scope of the cooperation and information exchange agreements with the Bank of England and implement the conditions set out by the EU Commission in its equivalence decisions. The MoUs also provide ESMA with the necessary tool for compliance monitoring and thus enable it to monitor the risks to the EU or one of its Member States, including any risks to financial stability, associated with the recognition of UK CCPs in particular.

ESMA aims to adopt the necessary recognition decisions, for which the MoUs are one of several prerequisites, in a timely manner before a possible hard Brexit. It should be noted, however, that this will be a one-year decision. It also remains to be seen what consequences the current EMIR 2 negotiations will have for third country CCPs.

INTERNATIONAL TAX

With Brexit, the common EU VAT refund system loses its validity. This results in higher VAT burdens for German companies in Great Britain. Since Great Britain is also unlikely to participate in the EU-MIAS (VAT Information Exchange System) any longer, the confirmation via VAT number that the purchaser in Great Britain is an entrepreneur subject to VAT is missing, which entails as a consequence the reclassification of the export according to third country regulations.

Distributed profits of UK companies will then be subject to German income tax law and double taxation proceedings will cost more time and money. This is because an automatic correction of the business income from dividends received from the UK will no longer take place under the Trade Tax Act. In case, the transitional period is omitted, there will be substantial time pressure for compliance with legal obligations, which in the worst case will lead to back taxes being paid.

The conversion of the legal form also has tax implications, especially with regard to the disclosure of hidden reserves. Tax advantages, e.g. withholding tax deductions on dividends, interest and licences are eliminated, as are benefits in the case of conversions or additional taxation.

CONSEQUENCES FOR CREDIT CONTRACTS AND INVESTMENTS

The validity of cross-border financial contracts must be ensured beyond Brexit and contractual uncertainties must be eliminated immediately. This uncertainty and the need to transfer and restructure existing contracts has a significant impact on the client. As a transitional solution, a transitional period is therefore required in order to gain more time for restructuring and alternative financial arrangements. This should also make it possible to fulfil existing contracts under the law that was valid at the time the contracts were agreed upon and to ensure the protection of existing contracts in accordance with the appropriate existing national licensing provisions. For Germany, a transitional provision has been created in the form of Section 53b (12) of the German Banking Act (KWG); other EU states have also provided for various systems, see our Brexit Map: https://www.ashurst.com/en/news-and-insights/legal-updates/jurisdictional-analysis-of-local-transitional-arrangements-in-the-event-of-a-hard-brexit/

Overall, Brexit leads to less efficiency and, especially in the transitional period, to higher costs for the financial markets. Banks and insurance companies are particularly affected by the consequences for the derivatives market, capital requirements and the lending business. Therefore, there will have to be a framework for cross-border trade in these sectors in the long term. It is intended to agree on regulations that grant the mutual recognition of financial service providers as well as licenses. This requires close cooperation, equal opportunities between cross-border and local companies and, finally, clearly regulated procedures for dealing with deviations and disputes.

A high level of cross-border trade in financial services avoids disruption and has a positive impact on the choice and diversity of services on both sides. The aim is to guarantee uniform conditions of competition and to ensure a fundamental consequence of mutual recognition without further local authorisation or licensing requirements, i.e. to avoid duplication of regulations.

However, since the framework provides for autonomy for both sides with regard to their regulations, there is no guarantee that the framework put in place is reliable, transparent enough to regulate or offers customers sufficient scope to withdraw their rights.

Brexit makes it necessary to review each individual financial services contract and, if necessary, to restructure or even terminate it. If contracts to be terminated contain a MAC clause, this can lead to an unforeseeable, substantial and disadvantageous change in the contractual circumstances. It is questionable, however, whether this clause even applies in the case of Brexit, since it is actually intended for cases such as insolvency, incorrect assurances or breach of obligations.

Companies may also need to look for alternative financial services providers to ensure that they achieve their business goals and ensure financial flexibility.

If demand increases sharply, these alternative service providers may reach their capacity limits in terms of conditions and prices.

Insolvency proceedings are also affected by a hard Brexit. The EUInsVO, which guarantees simplified enforceability of court decisions from the EU and Great Britain and vice versa, then loses its applicability because insolvency proceedings must be conducted according to national law.

CONSEQUENCES FOR FINANCIAL INVESTORS AND PORTFOLIO COMPANIES

Financial investors and their portfolio companies can carry out mergers, acquisitions and restructurings with EU law still in force in the UK in a tax-neutral manner until the end of the transition period. This can result in short-term purchase opportunities.

There are two possible scenarios for financial investors:

- Financial investors who are structurally flexible enough and able to secure advantages and avoid risks in an increasingly complex environment of several jurisdictions have a clear competitive advantage.
- Financial investors who have used the UK market organisationally as their only access to entrepreneurial holdings in the EU or to EU investors' funds are forced in the medium term to consider relocating their activities to the EU single market.

Although not much will change for existing portfolio companies, they should insure themselves against potential risks from future regulatory breaches between the EU and the UK, e.g. by adapting the protection of intellectual property in the UK.

Should there be a transitional period after Brexit, mergers, acquisitions and restructurings can be carried out in a tax-neutral manner, which could enable interesting purchase opportunities. This is made possible by the Brexit Tax Accompanying Act, which is intended to mitigate the consequences of the departure. It removes the Merger Directive, which makes it possible to restructure from and to the UK with virtually no tax burden.

Normally, tax neutrality requires compliance with a 7-year blocking period which, *inter alia,* ensures that the restructuring participants are still on board seven years after restructuring. Brexit would undermine this condition, which would lead to back taxes being paid. This is where the Brexit Tax Accompanying Act comes in, which stipulates that the withdrawal of Great Britain from the EU alone does not lead to back tax payments. The ulterior motive is to avoid additional payments for companies that have already changed their structure in preparation for Brexit.

CONSEQUENCES FOR VENTURE CAPITAL INVESTORS

For venture capital investors, the UK's exit from the EU could also have a significant impact on opportunities to obtain EU funding for UK transactions. For this reason, appropriate alternative courses of action should be worked out and the business model should be reviewed on a sustained basis against this background and adjusted if necessary. This may also include moving to an EU country. The emigration to the EU, primarily to Germany or France, would strengthen the EU as a start-up location vis-à-vis Great Britain and tie up capital to the EU.

CONSEQUENCES FOR THE INSURANCE INDUSTRY

Passporting is also the basis on which German insurance companies enter into contracts with British customers and vice versa. A hard Brexit eliminates this basis, which has direct consequences for the German insurance market. With the abolition of passporting, German insurance companies will lose their approval on the British market unless they already conduct their business through a British subsidiary. Conversely, British insurance companies also lose their German approval if they do not operate through a European subsidiary. In the insurance industry, about 10 million EU citizens and one million Britons have insurance contracts with terms beyond the date of Britain's exit from the EU. Also, 45 per cent of all maritime and air transport insurance in the EEA is UK-based.

As the country of origin principle is abolished, legal certainty for existing policies is also eliminated, which may make it necessary for the insurance company to move to an EU country.

The elimination of passporting puts the feasibility of these policies to the test. While policies with short maturities will be less affected, long-term policies in particular are in danger of no longer being feasible. British insurers are already reacting and transferring existing contracts to another legal area (Part-VII transfer), which ensures that the insurance companies continue to operate smoothly. In the case of a legally binding transitional solution, these transactions are not necessary, but with the threat of a hard Brexit, they become a necessary precautionary measure.

The problem mainly affects business with existing customers. The founding of new subsidiaries on both sides will hardly change the variety of products on offer in new customer business.

However, Brexit has an influence on future competition. Since Great Britain also leaves the European insurance supervision (Solvency II) when it leaves the EU, there is a possibility that the British will relax the requirements in comparison to the European supervision and thus create a competitive advantage through potentially released capital. However, the UK must also use this competitive advantage to avoid or mitigate a recession.

In addition, market access to the EU is questionable and reduces this potential competitive advantage again.

Consequences for LIBOR and Benchmarks

Brexit may also have an impact on bank liquidity and financial stability. This could also affect the benchmarks as important factors for the settlement of loans and derivatives. LIBOR plays a special role in this consideration, even if the result is not yet foreseeable. A possible revision of contracts with LIBOR as a benchmark can lead to additional costs for medium-sized customers.

Benchmarks are key to the settlement of loans and derivatives. With Brexit, the Benchmark Regulation (VO (EU) 2016/1011 – „BMR") raises some uncertainty for legal practice. LIBOR may expire at the end of 2021, but still raises legal issues for existing contracts and contracts to be concluded by then. According to Art. 51 BMR, administrators are granted a transitional and grandfathering regime, i.e. they are given sufficient time to implement the new requirements. A reference to LIBOR is therefore unproblematically possible until 31.12.2020, unless an application of ICE LIBOR as administrator of LIBOR for admission within the meaning of Art. 34 BMR has been prohibited. Deviations from standards and benchmarks for capital requirements in financial supervision and derivatives trading may in the future stand in the way of mutual market access.

If administrators in the EU and the UK want to ensure that supervised entities can continue to use the reference values they provide after the transitional period, they need to take timely steps to ensure that their reference values are authorised, registered or formally recognised under the third country regime. For British administrators, this means: an adoption of important reference values according to Art. 33 BMR, e.g. the establishment of an EU subsidiary and thus the relocation of business activities to the EU.

For banks, these developments mean higher expenses for equity capital hedging, which is transferred to the costs for the customer.

Further legal Implications

LABOUR LAW

Until now, every EU citizen has enjoyed freedom of movement for workers, i.e. they can work in any Member State under the same conditions as a national of that State (Art. 45 TFEU). If this regulation does not apply, German employees can no longer work in Great Britain without a visa. British employees will then also need the „Blue Card EU" (EU Blue Card) prescribed by EU law in order to be able to work in Germany.

Postings can no longer be handled in accordance with EU Regulation 883/2004; currently, the German-British Social Security Agreement of 20 April 1960 also applies. If the deployment of employees in Great Britain and the employment of British citizens in Germany are still permitted at all in accordance with the stricter legal requirements then in force, greater bureaucracy and time requirements are to be expected. The resignation does not affect (individual) labour law provisions of employment relationships which in Germany are governed by German labour law. If, for example, a British company has established a branch or a German subsidiary in Germany, the Previous legal provisions, i.e. those of German labour law, will continue to apply to employment relationships in Germany (subject to deviating contractual provisions).

German workers in the United Kingdom are normally subject to the rules of the United Kingdom. To date, this right has been strongly influenced by European regulations in some areas (e.g. maximum working hours, transfer of undertakings or collective redundancies). A loss of this provision occurs when the national regulations are changed with a direct effect on the employee. How this will develop can only be speculated about at present. National law based on European directives will continue to apply as long as it is not amended. Irrespective of the applicable law, however, the provisions of residence law and social security law must still be considered.

CONTRACT LAW

UK national contract law will change after Brexit comes into effect. Although the changes are not yet foreseeable, companies should nevertheless review their contract portfolio in a timely fashion to see if there is any need for action. This includes checking whether contracts exist with partners headquartered in Great Britain, whether contracts refer to Great Britain and which law these contracts are subject to. It is also important to find out whether existing treaties require a barrier-free market between Germany and the United Kingdom. It should also be clarified whether uncertainties caused by regulatory changes by Brexit can be mitigated by MAC (Material Adverse Change) clauses in contracts (currently under negotiation).

TRADEMARK AND INTELLECTUAL PROPERTY RIGHTS

Until now, one application to the European Intellectual Property Office (EUIPO) has been sufficient to obtain intellectual property rights in all EU Member States. The registration procedures are regularly rapid and the registration costs are manageable. What happens when a Member State leaves the EU is currently a matter of uncertainty.

With the withdrawal of Great Britain from the scope of EU trademark law, its membership in the Paris Convention, the Trips Agreement and other international treaties securing industrial property rights for patents, trademarks and designs will be maintained. In addition, Great Britain will have to guarantee a kind of protection of existing European industrial property rights.

If a deal is reached, there will also be a transitional period. Trademarks registered nationally in Great Britain retain their industrial property rights, as do internationally registered trademarks (IR), the protection of which has been extended to Great Britain. Union trademarks with EU-wide validity lose their protection in Great Britain after Brexit. An announced protection regulation for Union trademarks in Great Britain has not yet been passed by the British Parliament.

As a precautionary measure, owners of Union trademarks are advised to file a national application for an identical trademark in Great Britain or to extend the existing international registration to Great Britain.

COMPANY LAW

With their withdrawal from the EU, British Limiteds are losing the fundamental freedoms of the internal market, including freedom of establishment. It is no longer possible to incorporate a company under English law outside the United Kingdom. The existing Ltds., whose administrative headquarters are in Germany, are threatened with nonrecognition and conversion into a German partnership with unlimited liability, exposing the private assets of the shareholders of these companies to liability. In order to avoid this significant liability risk, a GmbH would have to be founded, which is associated with correspondingly high capital requirements and costs. Or the Limited concerned would have to move to somewhere within the EU, e.g. to Luxembourg.

ANTITRUST AND COMPETITION LAW

Competition law is also affected by Brexit. Changes in merger law are likely, as the EU Commission will lose access to Great Britain. EU law continues to apply whenever non-EU companies do business in the EU or their business involves production or trade in the EU. Consequently, these companies will have to respect EU and UK competition law in parallel. The number of cases with parallel EU and UK investigations and parallel decisions will therefore increase after Brexit.

In practice, through Brexit, companies will be exposed to two different authorities, with presumably different standards and remedies. As a consequence, it will no longer be possible to bring antitrust actions for damages for breach of competition law before British courts, as the decisions of the EU Commission after Brexit ruling no longer have binding effect before British courts.

Recommendations

- Identification of early warning indicators for a fast adjustment process
- Review of cash flows in the wake of Brexit, increased refinancing and investment needs
- Examination of necessary changes to the general terms and conditions
- Examination of a possibly necessary change of legal form for Ltds. in Germany
- Examination of tax effects of Brexit on existing contracts and changed company forms
- Determination of whether relocating activities of the entire company headquarters to the EU internal market is necessary or not
- Review of creditor's credit for possible British lenders and, if existing, possible premature repayment regulations
- Examination of the need for supplement contractual agreements with British partners that are in force beyond the withdrawal date and refer to EU regulatory frameworks
- Checks should include possible credit securities in the event of a hard Brexit
- Determination of whether derivatives subject to clearing are used or not and what effects this has on risk management
- Utilization of advantages of both jurisdictions through flexible positioning, especially in the financial investment sector

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CONTACT

Dr. Detmar Loff
detmar.loff@ashurst.com

Dr. Tobias Krug
tobias.krug@ashurst.com

Dr. Andreas Mauroschat
andreas.mauroschat@ashurst.com

Anne Grewlich
anne.grewlich@ashurst.com

Derk Opitz
derk.opitz@ashurst.com

Ashurst LLP
OpernTurm
Bockenheimer Landstraße 2-4
60306 Frankfurt am Main

T: +49 (0)69 97 11 26 00
F: +49 (0) 69 97 11 27 77
www.ashurst.com

ashurst