This week in outline: There has been speculation as to how the UK proposals for financial services might evolve in the light of continued opposition from the EU. This has rekindled the debate about the UK as a ‘rule-taker’. A speech from the ECB has explained the central bankers’ perspective on the regulation of third country CCPs in the context of Brexit. This places great emphasis on ECB interventions being ultimately for monetary policy purposes; great care is being taken not to fall foul of legal constraints, including the CJEU judgement following the UK’s successful challenge to previous ECB proposals in this field. A short paper from the European Payments Council confirmed the basis for UK payment service providers remaining in SEPA.

Where we stand: The draft Withdrawal Agreement provides for a transition period from 29/03/19 to 31/12/20 during which the EU single market legislation, and its dual regulation coordination (DRC)/mutual recognition, would continue to apply to the UK. The agreed framework for the future relationship is due to be recorded in a political declaration annexed to the Withdrawal Agreement. The UK has proposed (see Philip Hammond's speech of 7 March) that after the transition period, the EU/UK relationship in financial services should be a bespoke bilateral arrangement for DRC and mutual recognition of each side’s rules, based on international standards and equivalent outcomes (without requiring identical rules on each side). The rationale is that the EU and UK will start with fully aligned regulatory regimes (because the UK is transposing all EU regulation into the UK domestic regime) and DRC should therefore continue, until there is divergence in the regulatory regimes. This would provide much greater access for UK firms than the EU’s current regime for third country mutual recognition/DRC. The EU position is that market access will be granted under mode 3/via local establishment (and not for services business) and this will be subject to host state regulation. This will offer the UK no more than is available to other third countries - regulatory cooperation on a voluntary basis and DRC limited to (unilateral and revocable) decisions by the EU under its third country “equivalence” legislation. In our report on Brexit and FS in April 2017, we provide detailed analysis of these two regimes and the extent of mutual recognition/DRC under each proposal.

Speech by Yves Mersch, Member of the Executive Board of the ECT: “Euro Clearing the Open Space”

Yves Mersch has delivered a speech addressing CCPs, the impact of Brexit on them and some potential solutions. Click here to access the full speech

This speech provides a good central bank perspective on the policy behind the proposed reform of EU regulation of CCPs under EMIR and the introduction of ‘localisation powers’ in relation to systemic CCPs (see our previous update for week ending 12 April 2018). It looks in some detail at the parallel changes to the ECB legislation.

The EU has 2 UK based CCPs in mind – ‘In Europe two of these CCPs are based in the UK. Currently, they clear around 95% of euro-denominated interest rate derivatives and around 30% of euro-denominated repos. Thus, a significant disturbance involving a major UK CCP could affect financial stability and market functioning across the EU. The UK’s withdrawal from the EU means the supervisory framework for non-EU countries must be adapted. EU authorities must continue to be able to not only closely monitor UK CCPs but ensure they comply with EU regulations.” “The Commission acknowledges the essential role played by central banks of issue (or CBIs) in
monitoring and addressing risks posed by CCPs to their currency, and has proposed an enhanced and binding role for CBIs under the EMIR framework.”

Mr. Mersch is at pains to justify the role of the ECB/CBIs, for example in providing emergency liquidity to systemic CCPs or to their members, in terms of the ECB’s primary competence for monetary policy and its established role (under Article 22 of the ESCB/ECB statute) in relation to payment systems.

The ECB previously planned to take on a regulatory role in relation to CCPs but this had been thwarted by the UK’s challenge to the legal basis under Article 22. The CJEU found that the ECB did not have the authority1 and that the wording of Article 22 was too narrow. In 2015, the General Court held that the ECB does not have the competence to regulate the activity of securities clearing systems, including CCPs. Moreover, the Court stated that the ECB would need to request an amendment to Article 22 of the Statute of the ESCB and of the ECB, which already enables the ECB to make regulations for clearing and payment systems, if it considers this necessary for the proper performance of its tasks under the Treaties.”

It is therefore proposed to extend Article 22 by adding a reference to derivative markets (as well as payment systems and clearing). The speech emphasises the monetary policy rationale for ECB interventions.

Mr. Mersch explains the legal constraints when amending Article 22; it constitutes primary – treaty level - EU law, and can only be amended without a treaty change under the simplified amendment procedure. ECB measures must comply with the principle of proportionality; the key point is that “Article 22 cannot confer general regulatory competences on the ECB – it can only adjust the ECB’s monetary policy toolkit by clarifying that the competence for clearing and payments covers derivatives. …This objective, in turn, contributes to the primary monetary policy objective of maintaining price stability. The reason why monetary policy needs to cover CCPs’ liquidity is that derivatives clearing has become a cornerstone of the financial system.”

FT reports tension between the Bank of England and the Treasury over the direction of UK proposals on financial services

This FT article looked at the evolution of the UK’s proposals for financial services – the ‘bespoke dynamic mutual recognition proposal’ (as described above). It ran under the caption ‘BoE and Treasury at loggerheads over plan B for City Brexit’.

As reported in our previous updates, the UK has so far been somewhat vague about its proposals. HMG has not been clear either about the initial scope and depth of DRC/mutual recognition/access that it is proposing from 1/1/21 (i.e. after the transition period) or about the legal process for divergence thereafter. It appears to envisage that neither side would be committed to follow the other and that there would be some objective mechanism to determine whether divergence should ultimately trigger a loss of DRC. We observed in our April 2017 report, that it may be more difficult to agree broad DRC at the outset, if DRC withdrawal is to be dependent on objective criteria/assessment of the impact of divergence.

The article reported greater concern on the part of the Bank of England about the UK being a ‘rule-taker’. It is perhaps hardly surprising that a national regulator should be keen to maximise its rule-making flexibility/discretion; on occasions the BoE as been frustrated by EU limitations on its powers.

The article is unclear as to what form of ‘rule-taking’ HMT might be considering (and to which the BoE is objecting). Commentary: Rule-taking, on one basis or another, is a part of membership of the EEA/single market and of the EU itself. EU members cannot block new EU rules, because rules are adopted by qualified majority; the related DRC/mutual recognition is permanent and they cannot therefore withdraw/diverge from EU requirements. EEA states are in the same position, except that they do not participate in voting on new rules and have a less automatic process for adopting new EU legislation. It would be possible to develop the UK’s proposals with a more one-way benchmark based on EU standards and additionally to include greater commitment by the UK to these EU standards (current and future) and even to the detailed rulebook, ‘Rule-taker’ concerns arise either because DRC is tied too closely to detailed EU rules or where there is a ‘follow-EU’ commitment of some sort which would limit the UK’s freedom to diverge from EU. For example, this might be limited in terms of the rules to be followed, the sector/type of business, the length of time of the commitment and might differentiate between current and new rules (i.e. the difference between abandoning rules adopted when the UK was a member of the single market and not following new rules adopted by the EU thereafter).

Speech by Michel Barnier at the 28th Congress of the International Federation for European Law

In the speech Michel Barnier goes into detail about the current Brexit negotiations, addressing both what has been agreed and what the goals of the EU are for what is going to be agreed. He focuses in particular on the governance of the agreements. He also makes some comments regarding some of the EU red lines. The full speech can be accessed here.

Mr. Barnier starts his speech by stating that while 75% of the text of the Withdrawal agreement has been agreed they are still not “at the end of the road.” He also remarks that “if we want to lay the foundations of our future

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1 Case T-496/11 United Kingdom of Great Britain and Northern Ireland v European Central Bank
relationship before the UK’s withdrawal, we need to accelerate." He stresses that "the European Council clearly indicated that the UK could change its mind."

With respect to the Withdrawal Agreement, he states that the UK and the EU have agreed on the existence and functioning of a mixed committee which represents a forum for political dialogue. However Mr. Barnier goes on to state that "in no circumstances is it sufficient to ensure the appropriate governance of the Withdrawal Agreement." For the EU it "is a fundamental principle: governance should include a jurisdictional system of dispute settlement." "It is essential to settle disputes in a legal or arbitration-based framework."

He goes on to explain that "for these provisions or concepts of the Withdrawal Agreement which come from EU law, we cannot accept that another jurisdiction, other than the Court of Justice of the European Union, says what the law is, or imposes its interpretation on the institutions of the Union." British judges would be responsible for the application and enforcement of the Agreement in the UK, but they would need to take into account CJEU case law.

House of Commons Library Briefing paper CETA: the EU-Canada free trade agreement

The House of Commons Library has published a briefing paper on CETA. It deals with CETA in general and the different aspects of the agreement. The full paper can be read here.

CETA is the first agreement where the EU has agreed to open up its services markets using the 'negative list' approach. This means that all service markets are liberalised except those explicitly excluded. Some services that are excluded are audio-visual and other cultural services, services supplied in the exercise of governmental authority and public services. The briefing paper does not look at the impact for financial services, but you can read an analysis on this topic in Chapter 2 of our April 2017 report.

The briefing paper states that in terms of Brexit "the UK will be subject to all rights and obligations arising from CETA while it remains in the EU. During the transitional/implementation period, the UK will be bound by the obligations of the EU's agreements with third countries under the terms of the draft Withdrawal Agreement. The UK Government wishes that UK be treated as if it were an EU Member State during the transition period." The paper also states that "the Government's aim is to roll over the EU's trade agreements into equivalent UK-third country agreements. The Trade Bill has been introduced to facilitate this. It was reported in September 2017 that the Canadian Government was looking for a 'seamless transition' of its trading relations with the UK after Brexit."

The UK Government has stated that "in parallel to arrangements for the Implementation Period, the Government continues the important work with partner countries to ensure continuity of effect of our international agreements beyond the Implementation Period, to avoid any disruption in trade from January 2021 onwards."

The discussion of trade agreements with non-EU countries such as Canada does not address similar issues which arise in the FS sector in relation to regulatory arrangements/DRC between the EU (and therefore currently covering the UK) and third countries – see our April 2017 report.

European Payment Council Position on Brexit and UK PSPS Participating in SEPA Schemes

The European Payment Council (EPC) has published a position paper on UK payment system providers participating in SEPA Schemes post Brexit. It concludes that no matter what the outcome on Brexit there are options to continue participation. Click here to access their report

The EPC has stated that "if the UK leaves the EU but remains in the EEA the UK laws and regulations should remain aligned with the EU legal framework which would allow the UK scheme participants to continue their participation in the SEPA scheme."

"If the UK leaves the EU and the EEA but puts in place a free trade agreement between the EU and UK which results in 'functional equivalence' of the EU legal framework, it would allow the UK scheme participants to continue their participation in the SEPA schemes. However, it is not excluded in this scenario that the EPC may have to assess and confirm any functional equivalence of the UK's legal framework with European Union law."

"If the UK leaves the EU and does not remain in the EEA or does not agree on an alignment of its relevant legal framework with that of the EU, the eligibility of the UK to be part of the geographical scope of the SEPA schemes will need to be assessed by the EPC on the basis of an application from the UK PSPs' community. But the EPC also stresses that 'as geographical scope of SEPA already extends beyond the EU and EEA including several third countries and territories, the option remains that the UK continues in the scope of the SEPA schemes, provided it fulfils the eligibility criteria.'"

Other publications from the RegZone Brexit news feed

House of Commons Treasury Committee Oral evidence: The UK’s economic relationship with the EU, HC 453

TSC has published a transcript of the hearing that took place on 23 May 2018, attended by representatives from HMRC. Click here to access the full transcript.
CMS RegZone publishes weekly updates on Brexit developments for financial services firms. These provide analysis and commentary on significant developments during the week in question. A daily digest of Brexit news (without analysis or commentary) is also available by email here and online via the RZ news wizard here (both of these can be filtered using the Brexit topic).

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