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## Brexit update for financial services firms - week ending 8 June 2018

**The week in outline:** Verena Ross of ESMA has emphasised that Brexit requires ESMA to strengthen the Capital Market Union and reform third country treatment. This begs the question whether the EU is toughening its third country regime in financial services as a negotiation strategy and a failsafe against a ‘no deal’ scenario or whether it really is determined that DRC/mutual recognition with the UK will go no further than is available to other third countries. The House of Commons Library has published a briefing note on the EEA, which includes analysis of whether the EEA would be a suitable arrangement for a longer transition period. This is topical with the anticipated vote in the House of Commons this week on HoL and Labour party amendments on the EEA/single market. Finally, there has also been a report by the House of Lords European Union Committee on the future UK-EU relations. It discusses various models and concludes that *“from the UK’s perspective, the greater the benefits sought, for instance in respect of trade in services, the greater the compromises that will be needed.”*

**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 Verena Ross: ESMA Towards a genuine European financial market – the role of regulation and supervision

*Text of this speech, given on 6 June 2018, follows. Topics include: the rationale for supervisory convergence (including with regard to MiFID) and Brexit issues. She states: “in the context of Brexit, it remains essential that EMIR 2.2 is implemented in time before March next year. EMIR 2.2 would allow the EU to supervise UK CCPs and to ensure that their risks to the EU financial system can be assessed and, when needed, mitigated”. The full speech can be accessed [here](#)*

*"Brexit poses two key challenges for the CMU [Capital Markets Union]. First, it increases the importance for the EU27 of strengthening further the EU internal capital market. [...] Second, it underlines the need to ensure an appropriate framework for third-country regulation and supervision."*

In her view, *"ESMA's work on supervisory convergence is critical in the Brexit context. This focus on supervisory convergence comes from the recognition that individual firms' freedom of establishment across the Union should not provide any room for regulatory and supervisory arbitrage among member States."*

One way ESMA has tried to deal with these issues is that they *"[...] created the Supervisory Coordination network (SCN) [...]"* Ms. Ross explains that *"this network, chaired by myself, brings together experts from a broad range of competent authorities who table actual cases that they are facing involving UK entities looking to move to EU27."* She elaborates that *"through these discussions and exchanges, ESMA aims to foster similar authorisation approaches and supervisory treatment by national competent authorities across the EU27."*

Moving away from the SCN, Ms. Ross also noted that *"Brexit has also shone a spotlight on the EU's relationship with third countries more generally. Based on the current framework which is open to the global market via the EU equivalence regime, a number of non-EU financial market infrastructure provides offer critical and systemic functions in the EU single market. However, the supervision of these non-EU entities is conducted by authorities that will not have EU financial stability, market order or investor protection foremost on their mind."*

She concluded by saying that *"It remains essential that EMIR 2.2 is implemented in time before March next year. EMIR 2.2 would allow the EU to supervise UK CCPs and to ensure that their risks to the EU financial system can be assessed and, when needed, mitigated."*

**Commentary:** As discussed in previous updates, this speech reflects the efforts of the EU institutions to try to get national authorities across the EU-27 to take a consistent (and hard-line) approach to UK firms which are restructuring for Brexit.

Secondly, the EU seems to be keen to develop its third country regime - toughening up its requirements rather than promoting more access. This begs the question whether the EU is doing this in order to improve its negotiating position with the UK and as a failsafe against a 'no deal' scenario or whether it is really determined that DRC/mutual recognition with the UK will go no further than is available to other third countries.

The EU has previously used financial services access as a negotiating tactic, namely in its current negotiations with Switzerland. In 2017, the European Commission approved only a limited 12-month agreement (from January 2018) for Swiss stock exchanges to be able to continue trading shares of EU companies. In comparison, Australia, Hong Kong and the US exchanges enjoy unlimited access. The EU has tied talks over financial market access with the broader negotiations about the EU-Swiss relationship. Most notably, the EU wants Switzerland to adhere to the EU acquis and accept the role of CJEU, which is currently not the case. Swiss President Doris Leuthard has openly accused Brussels of using market access as leverage in the treaty talks and suggests that that is unacceptable. She argued that Switzerland fulfilled all the conditions for recognition and that the EU's action is discriminatory.<sup>1</sup>

The reforms to EMIR (EMIR 2.2) were considered in [last week's update](#).

## House of Commons Library Briefing Note: The European Economic Area

*This briefing paper describes the main features of the EEA, its institutional structure, pros and cons of EEA membership, and the arguments around the process of withdrawing from the EEA. The full briefing paper can be accessed [here](#).*

The UK Government has ruled out EEA membership, as can be seen from the Prime Minister's Florence and Mansion House speeches. The paper states that *"In the Commons, the leader of the Opposition and shadow Brexit secretary, among others, have argued against EEA membership on the grounds that non-EU EEA States are 'rule takers, not rule makers'".* In the latest reading of the European Union (Withdrawal) Bill in the House of Lords, the Lords passed amendment 110A, calling on the Government to make continued participation in the EEA a negotiation objective. However, it also explained that *"Jeremy Corbyn tabled a new amendment to Lords Amendment No. 51 to the EU (Withdrawal) Bill calling for 'full access to the internal market of the European Union, underpinned by shared institutions and regulations, with no new impediments to trade and common rights, standards and protections as a minimum' The amendments fall short of calling for EEA membership."* This seems to have reduced the prospects of the House of Commons supporting EEA membership as a negotiation objective.

One of the benefits of the EEA would be that it would maintain full single market DRC/mutual recognition in financial services.

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<sup>1</sup> Financial Times, "EU sparks Swiss anger with temporary market access deal" (21 December 2017)

EEA membership does not amount to full EU membership and one of the key areas where this is highlighted is in the decision making procedure. As the briefing paper states *"the EEA Agreement does not grant the EEA EFTA States formal access to the decision-making process within the EU institutions. They can neither sit nor vote in the European Parliament, Council or European Council. However, the EEA EFTA States can participate in shaping a decision at the early stages or preparing a legislative proposal. The EEA Agreement provides for input from the EEA EFTA side at various stages of the preparation of EEA-relevant legislation."*

As the briefing paper elaborates *"they have the right to participate in expert groups and committees of the European Commission. They participate extensively in the preparatory work of the Commission and should be consulted in the same manner as EU experts. [...] The experts may also be associated with the preparatory work through regular committee meetings."* Furthermore, *"the EEA EFTA states have the right to submit EEA EFTA comments on upcoming legislation."*

**Commentary:** If one looks at the position during the proposed transition period under the current text of the draft Withdrawal Agreement, Article 123(5) of the Agreement states that *"during the transition period, representatives or experts of the United Kingdom, or experts designated by the United Kingdom, may, upon invitation, exceptionally attend meetings or parts of meetings of the committees referred to in Article 3(2) of Regulation (EU) No 182/2011, of Commission expert groups, of other similar entities, or of bodies, offices or agencies where and when representatives or experts of the Member States or experts designated by Member States take part, provided that one the following conditions is fulfilled: (a) the discussion concerns individual acts to be addressed during the transition period to the United Kingdom or to natural or legal persons residing or established in the United Kingdom; (b) the presence of the United Kingdom is necessary and in the interest of the Union, in particular for the effective implementation of Union law during the transition period."*

The Article also notes that *"during the transition period, the United Kingdom shall not act as leading authority for risk assessments, examinations, approvals and authorisations at the level of the Union or of Member States acting jointly referred to in the [acts/provisions] listed in Annex [y+6]."*

While the conditions to allow UK participation in meetings are fairly broad, the EEA offers a more established basis for participation.

There have been suggestions that the EEA could form the basis of a longer transition period. The briefing paper mentions that *"in view of the difficulties in solving the Irish border and customs issues, there have been suggestions - including from the Irish Foreign Minister Simon Coveney - that the transition period might need to be extended beyond the 21-month period to the end of 2020."* The paper reports on the views of Piet Eeckhout and Oliver Patel on the issues for the UK in using the EEA as a vehicle for a longer transition. The report goes on – *"A 2017 Liberal Democrat study thought an extended transition period with temporary EFTA and EEA membership would "offer stability and certainty to business and citizens concerned by the economic and political implications of a chaotic 'hard' Brexit", but that to allay fears of leave supporters that such a transitional strategy might become permanent, "a 'sunset clause' could be inserted into the transitional agreement to specify that EFTA membership should lapse after a reasonable period of time (say between 5 and 7 years)"<sup>2</sup>.*

Catherine McGuinness, Chair of the Policy and Resources Committee of the City of London Corporation, is quoted in the House of Lords European Union Committee Report below as follows *"Single Market membership via the EEA would 'give us what we are looking for', in particular access to talent and free trade in services."*

During the transitional period, under the current draft of the Withdrawal Agreement, the UK has no right to object to new EU legislation and must implement it fully<sup>3</sup>. In its 19<sup>th</sup> Report of Session 2017-2019, the House of Commons European Scrutiny Committee has recommended *"that the Government seek to create a mechanism which amounts to an opt-out during the implementation period for any new EU law which requires unanimity amongst Member States."*<sup>4</sup> What is the position for an EEA member? Article 102 EEA sets out that the EEA EFTA states need to consent to new legislation, speaking as one voice through the EEA Joint Committee. However, if the EEA Joint Committee does not accept the new legislation the part of the EEA Agreement that is affected can be suspended under Article 102(5) EEA.

On the one hand, as discussed in one of [our previous RegZone reports](#), this gives the EEA EFTA states some negotiation power. In 2010 the EU established the European System of Financial Supervision (ESFS) in response of the banking crisis. The ESFS consists of three European Supervisory Authorities (ESAs), the EBA, ESMA and EIOPA. The various components of the ESFS have largely been in operation since 2011. However, the regulations establishing the three authorities were not adopted by the EEA Joint Committee because the EEA EFTA states did

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<sup>2</sup> Liberal Democrats, "Brexit Challenge #6: EFTA and the EEA" <https://openreason.uk/wp-content/uploads/2018/04/Brexit-Challenge-6-EFTA-and-the-EEA.pdf>

<sup>3</sup> Although in the field of foreign and security policy the UK does have an opt out under Article 124(6) which states that the UK *"may make a formal declaration to the High Representative of the Union for Foreign Affairs and Security Policy, indicating that, for vital and stated reason of national policy, in those exceptional cases it will not apply the decision."*

<sup>4</sup> However, even if this clause is agreed it will for the most part not apply to financial services since financial services regulations are generally passed by qualified majority.

not allow for an outside authority to impose sanctions against legal persons within them. It was estimated in June 2014 that the failure to adopt the ESA regulations into the EEA Agreement had resulted in a backlog of more than 50 pieces of secondary financial services legislation still pending acceptance into the EEA Agreement.

On the other hand, some officials of the EEA have stated that the threat of being excluded from a part of the whole of the EEA Agreement is too big a threat to actually reject a piece of EU legislation.<sup>5</sup> This is also partially reflected by the resolution of the ESFS conflict above. A compromise was eventually found in October 2014 whereby the three ESA regulations were adopted into the EEA Agreement. Formally the EEA EFTA states retained their sovereignty as the three ESA were only allowed to perform non-binding actions. However Article 5 of the agreement states that EFTA Surveillance Authority decisions and opinions will be based on drafts prepared by the relevant EU ESA.<sup>6</sup>

As a result one can argue that the EEA EFTA states have some power to negotiate with the EU, but the scope is limited.

## House of Lords European Union Committee 17<sup>th</sup> Report of Session 2017-2019 UK-EU relations after Brexit

*The House of Lords European Union Committee has released a report discussing possible UK-EU relations after Brexit. The full report can be accessed [here](#)*

*Discussing the current status of the single market the report concludes that “there is general acceptance that the EU’s Single Market in services lags behind that in goods: barriers to free movement of services remain in many sectors. Nevertheless, the UK’s export of services, including financial services, to the EU, not only generates employment and revenue domestically, but, by facilitating access to capital, drives investment across the EU. A relationship that preserves the freest possible trade in services, financial and non-financial, would deliver substantial benefits to both sides.”*

*Commenting on a future deal between the EU and the UK, the report states that “from the UK’s perspective, the greater the benefits sought, for instance in respect of trade in services, the greater the compromises that will be needed.”*

*It also notes that “the existing models, such as EEA/EFTA, or a Canada-style Free Trade Agreement, are helpful in clarifying the options, but they must not be allowed to dictate the terms of the negotiations. Existing models fail to capture the full possibilities of the UK-EU relationship—but a gesture of good will, from one or other side, may be needed to unlock these possibilities.”*

*The report concludes by stating that “we note the European Parliament’s support for a UK-EU Association Agreement, and applaud the Parliament’s readiness to contemplate innovative approaches to the future UK-EU relationship. We also note that Association Agreements are by their nature dynamic and evolutionary, and that a UK commitment to such a partnership could bring about a positive change in the tone and language of the negotiations.”*

## Other publications from the RegZone Brexit news feed

### **Letter by Jon Thompson, Chief Executive Offer & First Permanent Secretary to Nicky Morgan MP Chair of the Treasury Select Committee re: Highly Streamlined Customs Arrangement Facilitations**

*Sets out information on a Highly Streamlined Customs Arrangements facilitations, as well as the costs in more detail. The full letter can be accessed [here](#).*

### **FCA Board minutes**

*FCA has published the minutes of its 25/26 April 2018 meeting. Topics include: Brexit; machine executable regulatory reporting; the high cost credit review and the FSCS funding review. The full minutes can be accessed [here](#).*

### **House of Commons Library Briefing Paper: European Union (Withdrawal) Bill 2017-19: Commons considerations of Lords amendments**

*The paper summarises amendments to the Bill during its passage through Parliament and provides information about procedures for HoC consideration of HoL amendments. The full briefing paper can be accessed [here](#).*

### **House of Commons Library Briefing Paper: European Union (Withdrawal) Bill: scrutiny of secondary legislation (Schedule 7) update**

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<sup>5</sup> Dr Johanna Jonsdottir, “Evidence to Foreign Affairs Committee” (25 April 2012) paras 9, 11 and 12.

<sup>6</sup> General Secretariat of the Council “Council Conclusions on the EU and EEA-EFTA Ministers of Finance and Economy (14 October 2014)

The paper reviews the amendments made to Bill that concern how the two Houses sift statutory instruments made under what will become the Act. The full briefing paper can be accessed [here](#).

#### **FIA Members Seek Clarity from UK and EU27 to Help Brexit Contingency Planning**

FIA has published the results of a survey of a number of institutions representing a cross-section of the industry's clearing firms by jurisdiction, market segment and size to discuss their Brexit implementation plans with respect to their client clearing business. FIA requests UK and EU policymakers to provide clarification on a number of matters, including with regard to passporting under MiFIR and the recognition of UK CCPs under EMIR. The full publication can be accessed [here](#).

#### **HM Government Technical Note: Benefits of a new Data Protection Agreement**

This technical note outlines options for future UK-EU cooperation on data protection. The full note can be accessed [here](#).

#### **HM Government: Technical Note on Temporary Customs Arrangement**

The full note can be accessed [here](#).

#### **HoL: Debate on the EU Committee report on financial regulation and supervision**

The Hansard transcript of the debate that took place on 6 June 2018 [follows](#).

#### **EIOIPA: Interview with Gabriel Bernardino**

EIOIPA has published the [text](#) of an interview with Gabriel Bernardino. Topics include: Solvency II; supervision of the insurance and occupational pensions sectors (he notes "we also need to look into new areas of risk such as cybercrime, Big Data, Fintech and Brexit") and the Pan European Pension Product.

#### **EC: Statement by Michel Barnier**

[Text](#) of Michel Barnier's statement on Article 50 negotiations of 8 June 2018 follows in which he discusses the UK customs technical note.

[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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