

# Brexit: The Implications of the Draft Withdrawal Agreement on Financial Services

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On February 28, 2018 the European Commission published its initial draft of the withdrawal agreement which is expected to form the basis of a treaty that will govern both the withdrawal of the UK from the European Union and the transition period following that withdrawal (the “**Agreement**”).

The Agreement provides that a transition period will run from the date that the Agreement enters into force until December 31, 2020. During that transition period, EU law will continue to apply, and the UK will be subject to the jurisdiction of the European Court of Justice (“**CJEU**”).

The initial draft of the Agreement may be revised by the European Commission and will in any event be subject to detailed scrutiny by the European Parliament and the national governments of the 27 remaining member states. Further amendment and modification is likely to result from negotiations with the United Kingdom government. The UK government has stated that it would not accept certain sections of the Agreement.

In this short note, we explore the implications of the Agreement and its potential impact on the provision of financial services and products by financial institutions.

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## 1. Introduction

The Agreement is intended to add further detail to the arrangements set out in the joint report on the negotiations under article 50 of the Treaty on the European Union (the “**Joint Report**”) which was published on December 8, 2017. The Agreement has broader scope than the Joint Report as it covers a significant number of areas in relation to which there is intended to be future co-operation between the UK and European Union. However, the Agreement does not specifically address the framework which will apply during the transitional period that will govern the provision of financial services or products from the UK into the European Union or *vice versa*. Accordingly, it is likely that the financial services sector will be the subject of a series of further agreements.

## 2. Transition period

The Agreement provides for a transition period which “*shall start on the date of entry into force [of the Agreement] ... and end on 31 December 2020*”.<sup>1</sup> There is no explicit provision allowing for the extension of the period itself. During that transition period, European Union law will continue to apply in the United Kingdom, subject to a limited number of exceptions which reflect the “*opt-outs*” that the UK had previously negotiated under existing European Union treaties. For these purposes, EU law is broadly defined and includes “*acts adopted by the institutions, bodies, offices and agencies of the Union*”.<sup>2</sup> Furthermore the Agreement expressly provides that the “*institutions, bodies, offices and agencies of the Union shall have the powers conferred upon them by Union law*” during the transition period, which may be exercised in respect of the United Kingdom. The text also prevents the UK from participating directly in the EU legislative process. However, it does envisage that UK representatives may play a limited role during the transition period, to be determined on a case-by-case basis where the relevant legislation is “*addressed to the United Kingdom*” or “*the presence*

*of the United Kingdom is necessary and in the interest of the Union*”.<sup>3</sup>

In principle, the Agreement would allow UK financial institutions to maintain access to EU markets by preserving existing passporting rights until the end of the transition period. Such rights would be reciprocal given that EU law will continue to apply in the UK, although any such arrangements would need to be provided for by UK law. In December 2017, HM Treasury and the UK Financial Conduct Authority (“**FCA**”) announced their intention to create a temporary permissions regime for EU investment firms that are currently passported into the UK under European directives and for funds “*operating in the UK*”. Further clarification as to whether this regime could apply during the transition period will be required.<sup>4</sup>

## 3. Application of EU law and regulation

As noted above, the Agreement contemplates that EU law will continue to apply in the UK until the end of the transition period. It also provides that the “*United Kingdom’s judicial and administrative authorities shall have due regard to the relevant case law*” of the CJEU.<sup>5</sup>

A further consequence of the application of EU law and regulation would be the continued supervision during the transition period of the UK financial services sector by the European supervisory authorities. The Agreement contemplates that European institutions, such the European Securities and Markets Authority, the European Central Bank and the European Banking Authority, would retain “*the powers conferred upon them by Union law*” and their existing competence to supervise relevant UK competent authorities.<sup>6</sup>

The Agreement does not provide further clarity on continuity in financial services contracts beyond stipulating that EU law will apply during the transition period. Certain sectoral directives, specifically those dealing with contractual and non-contractual obligations (known informally as “*Rome*

<sup>1</sup> Article 121, Draft Withdrawal Agreement, p.68.

<sup>2</sup> Article 2(a)(iii), Draft Withdrawal Agreement, p.3.

<sup>3</sup> Article 126, Draft Withdrawal Agreement, p.71.

<sup>4</sup> <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/>.

<sup>5</sup> Article 4(4), Draft Withdrawal Agreement, p.5.

<sup>6</sup> Article 126, Draft Withdrawal Agreement, p.71.

I” and “Rome II”), will apply to agreements and instruments “*concluded before the end of the transition period*”.<sup>7</sup>

#### 4. Post-transition arrangements

The Agreement creates a committee comprising of representatives of the EU and the UK which will be responsible for the “*implementation and application*” of the Agreement (the “**Joint Committee**”). The Joint Committee’s terms of reference are broadly defined so as to encompass “*any matter of interest relating to an area covered*” by the Agreement.<sup>8</sup> It is also empowered to settle any dispute between the European Union and the UK by way of a recommendation and may “*decide to submit the dispute brought before it*” to the CJEU.<sup>9</sup> It is unclear whether the Joint Committee would have jurisdiction to determine an issue in relation to one of the single market directives or, for example, with respect to potential infringement proceedings against the United Kingdom for failure to implement EU sectoral legislation, either during the transition period or once it has ended.

The Agreement also contemplates the establishment of a “*common regulatory area*” between the EU and United Kingdom in respect of Northern Ireland which will “*constitute an area without internal borders in which the free movement of goods is ensured and North-South co-operation is protected*”.<sup>10</sup> It is unlikely that the reference to “*North-South co-operation*” is intended to include co-operation between the EU and UK with respect to the provision of services. The term “*common regulatory area*” is not defined in the Agreement but, as noted in our [previous alert memorandum](#) on the Joint Report, such a commitment is not expected to extend to co-operation between the parties with respect to the provision of financial services.

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<sup>7</sup> Article 63(3), Draft Withdrawal Agreement, p.41.

<sup>8</sup> Article 157, Draft Withdrawal Agreement, p. 93.

<sup>9</sup> Article 132, Draft Withdrawal Agreement, p. 162.

<sup>10</sup> Protocol on Ireland/Northern Ireland, Draft Withdrawal Agreement, p. 98.