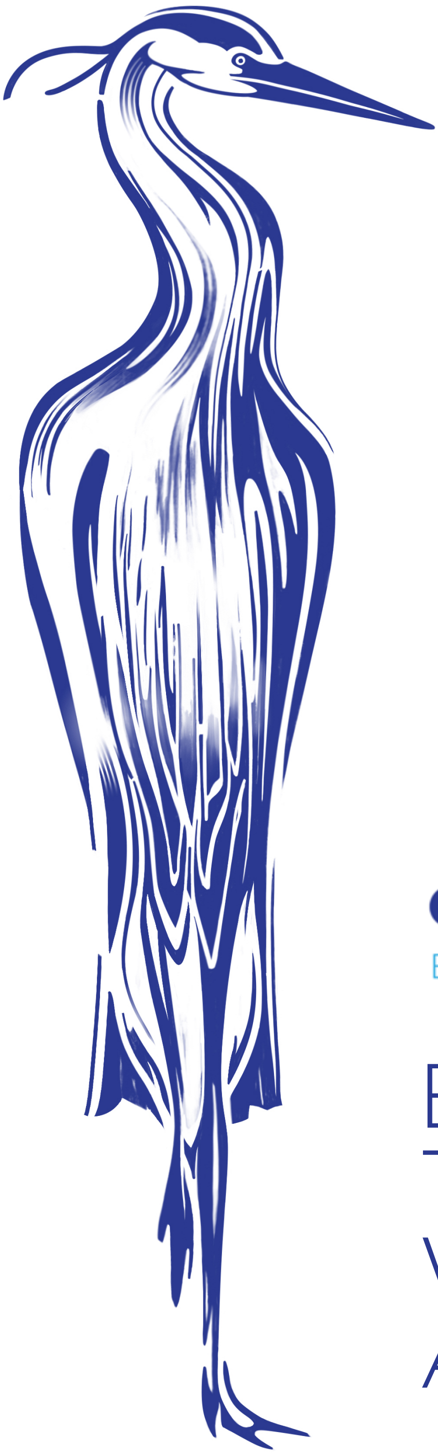

CLEVELAND & CO™

External in-house counsel

BREXIT UPDATE: THE REVISED WITHDRAWAL AGREEMENT

December 2019

After three years of negotiations, three rejections of the withdrawal agreement negotiated by Ms. Theresa May with the EU and one request to extend the negotiation period, the UK is somehow nowhere closer to agreeing the terms of its withdrawal from the EU. On 17 October the new UK Prime Minister, Mr. Boris Johnson, agreed a revised version of the same withdrawal agreement with the EU's negotiators, this time with a different arrangement for Northern Ireland and the future UK-EU land border.[1] However, in a dramatic defeat of the Prime Minister's intention, on 19 October the UK Parliament has withheld approval of the new withdrawal agreement, until the full Brexit legislation is to be enacted. This in turn triggered the need for the Prime Minister to ask the EU for another extension to the negotiation period, as prescribed by the so called "Benn Act", a bill forcing the British government to seek an extension of the negotiation period, in case the UK and the EU did not reach an agreement by 11 p.m. on 19 October, or else the UK parliament could not authorize the UK leaving the EU without an agreement in place.

The EU Council has now agreed a further flexible extension of the negotiation period until 31 January 2020. However, the scenario remains highly uncertain. The UK is now holding a general election on 12 December, and it is not clear if and when the revised withdrawal agreement will be approved. Even with a new extension granted until 31 January 2020, a no deal Brexit might still happen, considering the repeated rejections of the withdrawal agreement by the UK Parliament, that consecutive UK Prime Ministers have not succeeded in achieving a cross party agreement on the next steps to take, and that now the new UK parliament will have scarcely three weeks to scrutinize the updated withdrawal agreement.

This newsletter focuses on an overview of the revised withdrawal agreement concluded by the UK Prime minister on 17 October, with a focus on financial services.

In light of these developments, in this newsletter we outline what the current status quo is in the UK and in the EU in respect of the Brexit negotiation, and the risk of a no deal scenario in January 2020.

THE REVISED WITHDRAWAL AGREEMENT: THE VIEW FORM THE UK

Overview

The full text of the revised EU/UK withdrawal agreement only emerged on 19 October shortly before the exceptional sitting of the British Parliament on that day. It was clear that the scope of the 'renegotiation' by Mr. Johnson's government had been extremely narrow. The entire treaty and all of its protocols were untouched by the renegotiation process, except for minor/technical changes.

Considering that the bulk of the negotiation was left until very late, the only substantial change was made to the protocol on Northern Ireland and its relationship with the Republic of Ireland. There were also changes to the separate political declaration attached to the agreement, that is the text on the future relationship the UK and the EU wish to forge post Brexit. This part of the agreement however is not legally binding nor operative. Furthermore, there were no changes at all to the text on financial services sector, part and parcel of the political declaration. This aspect is rather disappointing.

In fact, Mrs. May's negotiation approach had sacrificed a more comprehensive agreement on the services sectors to pursue her policy of close alignment/all-UK customs arrangements for goods, which avoided a customs border between Northern Ireland and Great Britain.

Mr. Johnson abandoned these hard-won concessions, and therefore could have tried to improve the outcome for the services sector, and for financial services in particular. However,

[1] For a full summary of the previous episode of this saga, please see our previous newsletter: Brexit update - FCA extends deadline- EU equivalence- Czech Rep, Malta updated.

this has not happened. In fact, the current manifesto of the conservative party pledges that, under a Parliament with a conservative majority the UK will leave the custom union and the single market at the end of the transition period, which is envisaged to be December 2020.

As a result, the text of the political declaration previously agreed by Ms. May remain the basis for the negotiation of the future relationship.

The transition period, the political declaration and the future of financial services

The scenario presented by the political declaration is very bleak: for financial services, it is the hardest and most complete break from the single market; in addition, the EU has not made any binding commitment to grant the UK equivalence decisions of any sort (or any transitional or no-deal protections). Therefore, the EU will be in a position to use the leverage of financial services if the need arises.

Moreover, similarly to what happened with the previous extension of the negotiation period back in March 2019, the terms of the transition (or ‘implementation’) period remain unchanged; therefore, what was originally envisaged to be a two year period, will now eventually be little less than one year.

There are provisions for extending this transition to the end of 2022 (or an earlier date); however, the conservative party manifesto pledges not to seek this extension. Given the doubt raised about the feasibility of negotiating a comprehensive free trade agreement with the EU that reconciles market access to the single market with the announced planned divergence from its regulation, there are now new concerns about the risk of a departure without a deal in place at the end of the transition period (whenever that occurs).

In the previous version of the agreement, if at the end of the transition period there were still to be no agreement in place, the Irish protocol provided a (legally operative) default fall back option which involved a UK wide custom arrangement with the EU (that became the infamous “Irish backstop”). This was effectively a form of secondary transition period (without a time limit) for the goods sector, which has however proven to be politically toxic for the UK Parliament to approve. The revised protocol now will only apply to the Northern Ireland/Irish Republic border, leaving no default to cover the UK/EU customs relationship and border. Hence the new text has created the possibility of a ‘second’ no-deal scenario in the goods sector. Such possibility may arise because the British government may seek a no-deal exit at that point, or would not seek an extension to the transition period or simply because of a genuine breakdown in the EU/UK negotiations over the new relationship and free trade agreement.

Conversely, for financial and other services firms, the risk of a second ‘no-deal’ scenario at the end of the transition period pre-existed and still remains. Currently, at the end of the transition period the UK is scheduled to exit the single market with no legally operative default arrangements for any sector or activity. It seems that this scenario raises less concerns because the government had already given up obtaining any concession for the financial sector. Furthermore, for financial services firms the difference between ‘no-deal’ and a situation governed by a free trade agreement is not seen as being seen as substantial. For most firms there will be no equivalence in place at all (the UK would be worse off than a range of countries from Switzerland, Bermuda and Japan and – even conceivably Argentina, Thailand, Indonesia and the Faroe Islands.) Certain market infrastructures in the City of London, such has clearing houses, do have vital EU equivalence arrangements in place for exit, but these are designed to expire in March next year. At the opposite end of the spectrum, trading venues still remain without equivalence determinations by either the UK or the EU. In a no deal scenario, UK venues will no longer be considered European venues for the purposes of MiFID II[2] and will instead be third country trading venues. Likewise, in the UK, the onshoring of the MiFID II legislation into UK statutory provisions, European venues

[2] Markets in Financial Instruments Directive 2004/39/EC, as subsequently amended.

will be considered third country trading venues. This has significant ramifications in the context of both the share and derivatives trading obligations under MiFID II.

It is clear that equivalence in financial services, and the broader regulatory discretion over UK groups with EU operations, may be a powerful tool for the EU in an escalating dispute with the UK in a no deal scenario exit, in the post Brexit negotiation phase, and even post Brexit altogether.

Electoral pledges

Given that the UK is going through an election campaign, it is worth highlighting the position the main opposition party has taken. The labour party has pledged that in a Parliament with a labour majority, the current withdrawal agreement will be renegotiated. The new agreement will then be submitted to a new confirmatory referendum with the option to remain on current terms, on which the party leadership will take no side though. Conversely, a labour government elected at a later stage might well redefine the parameters of a free trade agreement with the EU or even seek to replace or amend a previous one concluded by a conservative government. The labour party proposes, instead of the current membership of the single market, ‘a close single market relationship’ or ‘close alignment with the single market’ which appears to cover services as well as goods, but presumably without EU free movement or state aid rules. However, it seems unlikely that any such cherry picking would persuade the EU to reverse its current hardline on the financial services sector.

In short, it seems that under either a conservative or a labour government, if and when the UK leaves the single market (which might be on exit or at the end of a transitional period), there will be a major change for UK firms – at the extreme end of original predictions in terms of the new regulatory barriers to trade, particularly for cross border services business. The unknowns are about timing and the political context when the guillotine falls.

THE REVISED WITHDRAWAL AGREEMENT: THE VIEW FORM THE EU

The European Commission has recommended that the Council endorses the withdrawal agreement reached at negotiator level, including the revised protocol on the Republic of Ireland/Northern Ireland border, and approves the revised political declaration attached to it on the framework of the future EU-UK relationship. The Commission also recommends that the European Parliament gives its consent to this agreement. It notes that, apart from the revised Northern Irish protocol, all other elements of the withdrawal agreement remain unchanged in substance, with regard to the agreement reached on 14 November 2018 with Ms. May.

NEXT STEPS

Until the result of the general election in the UK is clear, and the British Parliament returns to examine the withdrawal agreement, the risk of a no deal Brexit still persist. Therefore, action should be taken in the UK, closely monitoring the situation and adhering to the temporary permission regime that the FCA has adopted, in order to grans (albeit temporarily) more certainty for EU firms passporting in the UK on the basis of the EU legislation.

For more information, and any guidance or advice on the impact of Brexit on your business, Cleveland & Co, your External in-house counsel, are here to help.

DISCLAIMER

No individual who is a member, partner, shareholder, director, employee or consultant of, in or to any constituent part of Cleveland & Co Associates Limited accepts or assumes responsibility, or has any liability, to any person in respect of this document. Copyright in the materials is owned by Cleveland & Co Associates Limited and the materials should not be copied or disclosed to any other person without the express authorisation of Cleveland & Co Associates Limited. This document is not intended to give legal advice and, accordingly, it should not be relied upon. It should not be regarded as a comprehensive statement of the law and practice in this area. Readers must take specific legal advice on any particular matter which concerns them. If you require any advice or information, please speak to your usual contact at Cleveland & Co Associates Limited

WHY WE'RE DIFFERENT

Cleveland & Co are specialists in financial services, investment management and commercial contracts and related courses. Our team's in-house experience means we understand client challenges and we work alongside you to create solutions. We can provide insight on real vs hypothetical risks and help your team evolve.

WE OFFER

Cleveland & Co offer you fixed fees and retainer structures that provide you with certainty of cost and we offer industry experience that cuts through common legal complexity.

CONTACT

EMMA CLEVELAND

Founder and Managing Director

ecleveland@cleveland-co.com
www.cleveland-co.com