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BREXIT UPDATE:

FCA EXTENDS DEADLINE; EU COMMISSION PROVIDES CLARITY ON EQUIVALENCE DECISIONS; CZECH REPUBLIC AND MALTA APPROVE NO DEAL LAWS.

November 2019

This newsletter focuses on the updated no deal measures in the United Kingdom ("**UK**") and in the European Union's ("**EU**"). We consider the updates issued by the Financial Conduct Authority (the "**FCA**") in the UK; clarification issued by the EU Commission on its criteria for equivalence decisions, and the Czech Republic and Malta approving a no deal law.

After the withdrawal agreement the UK Prime Minister concluded with the EU's negotiators back in November 2018 had been rejected three times by the British Parliament, on 10 April 2019 the EU council granted the UK a new flexible extension until 31 October 2019, in order to approve the legislation required to leave the EU.

While having the immediate effect of avoiding a "no deal Brexit", i.e. the UK leaving the EU without a deal in place for its orderly withdrawal, the intention was to allow some extra time for the British Parliament to reach an agreement and ratify the November 2018 withdrawal agreement. In case that agreement was to be ratified before the end of October, the extension was to end as soon as it was approved. Conversely, should the UK Parliament not have found a majority to support the withdrawal agreement, the UK could seek another extension or risk again a no deal Brexit.[1]

RECENT POLITICAL DEVELOPMENTS

As soon as Boris Johnson took his new office, the new UK Prime Minister expressed his intention to ask EU officials to renegotiate certain parts of the withdrawal agreement. In particular, he sought to amend or remove from it the so called "Irish backstop", i.e. a fall back option for which, if the UK and the EU did not agree a trade relationship by the end of the transition period in December 2020, all of the UK would fall into a custom union with the EU. The measure was directed at preventing the need for border and custom checks between the Republic of Ireland and Northern Ireland, which is part of the UK and therefore, would otherwise be outside the EU single market.

Recent events have muddied the waters even more. On 4 September 2019 the UK Parliament passed a bill (the "**Benn Act**'), according to which if the UK and the EU did not reach an agreement, or the UK Parliament did not authorise the UK to leave the EU without an agreement in place by 11 p.m. on 19 October 2019, the UK Prime Minister would need to seek a further extension to the negotiation period until 31 January 2020. However, if the EU proposed a different date, the Prime Minister would have two days to accept that proposal, during which the British Parliament would have the opportunity to reject the EU's proposed alternative date.

On 17 October the UK Prime Minister agreed with the EU's negotiators a revised version of the withdrawal agreement, containing a different arrangement for Northern Ireland and the future UK-EU land border. However, in a dramatic defeat of the Prime Minister's proposed deal, on 19 October the UK Parliament withheld approval of the new withdrawal agreement, until the full Brexit legislation was to be enacted. This in turn triggered the need for the Prime Minister to seek another extension to the negotiation period from the EU Council, as prescribed by the Benn Act.

The EU Council has now agreed to a further flexible extension of the negotiation period until 31 January 2020 ("**Exit Day**").

However, the scenario remains highly uncertain. The UK is now heading towards a general election on 12 December 2019, 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, and that consecutive UK MPs do not seem to be able to arrive to a cross party agreement on the next steps to be taken.

In light of these developments, and especially of how quickly the scenario keeps evolving, preparations for a no deal Brexit continue, and if possible have intensified. Some EU countries and the UK have updated and further clarified their no deal preparation, in particular with a focus on the financial services sector. Most deadlines for temporary permission regimes were set to 31 October 2019 at the latest which have now been reset to the current extension of 31 January 2020. It

[1] For a summary of where the UK stands on the extension, please see our previous newsletter: BREXIT-UPDATES-UK extension-Belgium-Gibraltar-Portugal-Romania-Sweden.pdf

therefore still makes sense to monitor what the current *status quo* is in the UK and the EU in respect of the risk of a no deal scenario next January.

FCA UPDATES BREXIT DEADLINE

On 25 March 2019 the FCA confirmed the deadline for notifications for the temporary permissions regime ("**TPR**")[2] would be extended until Exit Day. On 30 October 2019, the FCA confirmed that, for entities regulated only by the FCA, the deadline for notifications for the TPR would be extended to 30 January 2020. Fund managers will have until 15 January 2020 to inform the FCA if they want to make changes to their existing notification. This is in contrast with the decision made by the PRA, which back in April, at the time of the second extension with regards to incoming EEA credit institutions and insurers, confirmed that it would not be extending the window further to take account of a revised timeline.

The TPR allowed EEA-based firms passporting under MiFID[3] into the UK to continue new and existing regulated business within the scope of their current permissions in the UK for a limited period of time, while they sought full FCA authorisation.

The TPR also allowed EEA-domiciled investment funds that market in the UK under a passport to continue doing so in the UK, albeit temporarily.

Trade repository and credit ratings agencies have also had their deadline for applications extended to 30 January 2020.

For EEA payment services and e-money firms[4], the notification window for temporary permission closed earlier this year, but has opened again under the relevant HM Treasury Regulations on 31 July, to then end on 30 January 2020.

In order to continue planning for all Brexit scenarios, which includes a no-deal Brexit, or eventually the circumstances that negotiations continue beyond 30 January 2020, the extension of the deadline for firms intending to enter the TPR is part of this ongoing preparatory work.

Notably, as more information emerges about what Brexit means for financial services, it is the FCA's opinion that firms need to make sure they understand the implications and plan accordingly.

The British Parliament has also legislated to give the UK's financial regulators powers to issue transitional directions connected to changes in financial services legislation made under the EU (Withdrawal) Act 2018, i.e. the UK legislation dealing with many aspects of Brexit. The FCA has stated that it intends to make use of the temporary transitional power to ensure that firms and other regulated persons can generally continue to comply with their regulatory obligations as they would before Exit Day. This would enable firms to adjust to post-exit requirements in an orderly way.

The FCA has also published information on those areas where the UK has not provided transitional relief (for example, firms subject to the MIFID II transaction reporting regime and connected persons). In these areas, the FCA expected firms and other regulated entities to take reasonable steps to comply with the changes to their regulatory obligations by Exit Day.

Please note, in the event of a no deal Brexit, where there is evidence that firms and other regulated entities have taken reasonable steps to prepare to meet the new obligations by Exit Day, the FCA has explained previously that it would not take a strict liability approach, and does not intend to take enforcement action against such firms and other regulated entities for not meeting all requirements straight away. However, firms should have used the additional time they had until the end of October to prepare to meet these obligations. If firms are not ready to meet these obligations in full, the FCA will expect to see evidence of why this was not possible

[2] For a summary on the TPR in the UK, please see our previous newsletter: UK TPR

[3] Market in Financial Instruments Directive I (2004/39/EC) and II (2014/65/EU).

[4] Authorized pursuant to their national legislation which implemented the Second Electronic Money Directive and the revised Payment Services Directive, respectively.

EU COMMISSION ISSUES EQUIVALENCE STATEMENT

An important development in the conversation about the future of the financial services industry in the UK has been a recent statement published by the EU commission on 29 July 2019.[5] In the early days of the Brexit debate, the sector as a whole put its hopes in the EU granting the UK the status of "equivalent" country for its financial sector. This means that for non-EU countries the EU may recognise that their regulatory or supervisory regime is equivalent to the corresponding EU regime ("**the Equivalence Status**"). This brings benefits to both parties, as:

- it allows authorities in the EU to rely on supervised entities' compliance with equivalent rules in a non-EU country;
- it reduces, or even eliminates overlaps in compliance requirements for both EU and foreign market players;
- it makes certain services, products or activities of non-EU companies acceptable in the EU for regulatory purposes; and
- it allows the less burdensome prudential regime to apply to EU banks and other financial institutions with exposures in equivalent non-EU countries.

However, this system falls short of the full potential of the "passporting rights" granted to EU countries, which allows unconditional access to the EU single market in financial services.

On 29 July 2019, the European Commission (the "**Commission**") issued a statement that clarified the criteria for an equivalence decision to be granted by the EU (the "**Equivalence Statement**").[6] The Equivalence Statement considers the following: the purpose of equivalence, assessments and decision-making on equivalence; equivalence decisions adopted since January 2018, and their monitoring and reviews; priority areas on which monitoring should be focused, including areas where the EU legislative framework, on which equivalence was based has now changed; areas and countries covered by equivalence decisions with a light impact on the EU; areas where equivalence decisions include a review deadline or where a time limit is approaching; and market segments that are developing.

Following recent updates to EU legislation, the Investment Firms Regulation[7] has introduced new assessment criteria, along with additional safeguards and reporting obligations, for third-country firms established in equivalent jurisdictions, within the existing framework under MiFIR for the cross-border provision of services and created different categories of third-country jurisdictions under the new equivalence regime. In particular, for jurisdictions where the scale and scope of the services provided is likely to be of systemic importance for the EU, equivalence can only be granted following a detailed and granular assessment by the Commission. In addition, an increased role is given to the European Supervisory Authorities ("**ESAs**") and to the European Securities and Markets Authority ("**ESMA**").

In line with views expressed by the ESMA Chair in June, the Commission's statement identifies "*the need [for the EU] to put in place arrangements to monitor the ongoing fulfilment by the third countries of the conditions underlying any positive equivalence decision*". More importantly, it stressed that:

- equivalence empowerments do not confer a right on third countries to receive an equivalence determination, even if those countries are able to show that their framework fits the relevant criteria; and

[5] For full summary of what equivalence in the EU legislation means, please see our previous newsletter: Impact of Brexit on financial services.

[6] Please see the full text here: EU Commission statement, and for a summary the press release here: press release on EU Commission on Equivalence.

[7] On April 16, 2019, the European Parliament voted in its plenary session to adopt the text agreed by the European Commission (EC), the European Parliament and the Council of the EU on February 26, 2019, on a new legislative package revising the prudential framework for EU investment firms. This will take the form both of the Investment Firm Regulation and the Investment Firm Directive.

- proportionality in the application of the criteria may result in the circumstance that the EU expects stronger assurances from high impact countries, in order for them to show that they are able to deliver the required outcomes.

The Commission also noted the benefits equivalence brings to the EU and third-country jurisdictions, in terms of narrowing cross-border divergences and incompatibilities, as well as contributing to reducing global market fragmentation.[8] However, this mutually beneficial outcome is reliant on equity and fairness. Accordingly, when deciding on the equivalence decisions with a third country, the Commission will discuss with that third countries what prudential treatment it grants to EU market participants.

It is important to highlight that for the first time the Commission has repealed prior equivalence decisions, in this case for Argentina, Australia, Brazil, Canada and Singapore. Since the EU had amended its own regulations regarding credit rating agencies in 2013, the above countries did not amend their own regulation to reflect this change, to the effect that their equivalent status in this area was removed.[9] In consideration of these decisions and the Equivalence Statement, it indicates a move towards a more systematic and risk-based approach to the assessment of third countries by the Commission for the purposes of reliance on third-country rules and the work of the third-country supervisor. Coupled with the views on asset management and investment funds expressed by the ESMA's Chair in June, this is also a stark reminder of the difficulties which will be faced by third countries seeking to rely solely on 'point-in time' equivalence decisions as a solution for continuing access to EU markets. However, the Commission also announced that it had adopted equivalence decisions for financial benchmarks administered in Australia and Singapore.

In practice, this helps to better understand the extent to which the UK can access the EU market in a post Brexit scenario. The UK will have to strictly conform with the equivalence regulations and actively keep up with any changes and amendments issued by the Commission or risk losing its equivalence status. It also somehow quashes the hope that this path is going to be a straightforward one to go down to in a post Brexit scenario.

CZECH REPUBBLIC

At the end of February 2019 the Czech Parliament approved a Brexit Act (the "**Act**") that temporarily regulated relations between the Czech Republic and the UK in case of a no deal Brexit. The Act permitted UK financial services providers to carry out activities necessary to settle their existing receivables and debts arising from the activities performed before a no deal Brexit date, and it applies to all types of financial services providers with existing passporting rights, including credit institutions, investment firms, payment services providers and insurance companies. Those providers would not need to take any action to take advantage of the proposed regime.

The Act extends to a no deal situation the same regime that would apply to a Czech financial services provider after its license has been withdrawn. The Act provides that solely for that purpose, the UK financial services providers would be regarded as being providers from another EU Member State, meaning that they would have the same rights and obligations as they had prior to a no deal Brexit, and that the applicable Czech regulatory obligations will continue to apply as if the Czech Republic were to be their host Member State. Therefore, the Czech National Bank would supervise UK financial services providers as if they were established in the Czech Republic. The extent of such supervisory powers would broaden in scope, in particular with regard to the administrative sanctions that may be imposed by the Czech National Bank for breach of regulatory obligations.

It has to be noted that the rules described in the Act are very general, and as such have left the scope of permitted conduct and regulatory rules applicable to such conduct uncertain. The legislative report accompanying the Act was not particularly helpful as it stated that, in practice, UK financial services providers will not be allowed to establish new obligations or change existing

[8] EU Commission Statement.

[9] EU Commission Statement.

obligations, as such, the scope of the Act seems to be limited to carrying out such activities aimed at performing obligations for existing clients. It is yet to be seen how this regime will be applied by the Czech National Bank and to what extent lifecycle events will be permitted.

In addition, the Act will cease to have effect on the earlier of (i) a deal being reached between the EU and the UK, and (ii) 31 December 2020 (with exceptions).

MALTA PUBLISHES LAW ESTABLISHING ITS TEMPORARY PERMISSION REGIME AND CLARIFIES NO DEAL REGIME

On 28 March 2019 the Malta Financial Services Authority ("**MFSA**") issued a circular (the "**Circular**") which provided a much needed update to investment funds, investment firms and asset managers licenced in the UK passporting into Malta ("**UK entities**").[10]

As per many other EU countries, the intention of the MFSA was to grant temporary permission to UK entities that already passport their services and activities under MiFID into Malta. However, only existing clients/contracts will be able to benefit from the Maltese Temporary Permission Regime (the "**Maltese TPR**"), and it will only apply in a no deal scenario by the relevant exit date. Furthermore, any temporary permission granted by the MFSA would remain only valid for a period of 12 months after the relevant date.

The Maltese TPR would thus apply to UK entities wishing to obtain the necessary authorisation, terminate existing contracts in an orderly manner, and/or proceed with the assignment of the contracts to a duly authorised entity. However, in a post-Brexit scenario, UK entities passporting into Malta would not be allowed to offer their services to new investors or clients in Malta.

Therefore, any entity providing cross-border services from the UK to Malta under the current passporting arrangements wishing to avail itself of the TPR have to assess their position and subsequently notify the MFSA of its future intentions, such as whether it intends to apply for a Maltese licence or otherwise.

The Maltese TPR will apply only if all the following conditions are fully satisfied:

- a no-deal Brexit scenario arises;
- the UK entities would be in possession of a European passporting right to provide services and products on a cross-border basis prior to the no-deal Brexit date;
- the Maltese TPR would only apply to existing clients/contracts and the UK entities would be servicing those clients/contracts that have been on-boarded and/or entered into up until the respective cut-off date, i.e. until 30 September 2019; and
- UK entities availing of the Maltese TPR may not provide or offer their services and products to any new investors/clients after the 30 September 2019.

The MFSA has also now extended the TPR time period following Brexit to 31 March 2020. Therefore, UK entities may continue to service existing clients/contracts with Maltese clients until this date. This TPR requires UK entities to undertake any of the following until the 31 March 2020:

- terminate existing contracts in an orderly manner;
- obtain the required authorisation to provide the service and promote the product; and/or
- assign the existing contract to a duly authorised entity.

After 31 March 2020, all UK entities passporting into Malta will be treated as third country firms and consequently, the regime applicable to such firms will apply to them.

The MFSA has issued a notification form to be completed by UK entities once the necessary legislation is enacted, which must be submitted to the MFSA no later than 3 weeks from the date of a no-deal Brexit.

[10] Please see for the full text: 28 March 2019 Circular

The Circular was followed by the release of a list of frequently asked questions ("**FAQs**"), following a number of questions the MFSA received from industry players, outlining further the position on the Maltese TPR to be applied. Further guidance on a number of issues was laid out, among which:

- **Marketing of UK UCITS and/or UK AIFs in Malta:**
  - Following a no-deal Brexit scenario, UK UCITS and UK AIFs would no longer be considered EU UCITS and EU AIFs and thus would not be able to make use of passporting rights under Chapter XI of the UCITS Directive and Article 32 of the AIFM Directive.
  - UK UCITS will then automatically become UK only AIFs and, being treated as third country funds, would be able to continue marketing into Malta using only the Maltese National Private Placement Regime and subject to the notification procedures outlined in Article 42 of the AIFM Directive.
- **Management of a Maltese AIF by a UK AIFM:**
  - Malta has not implemented Article 37 of the AIFM Directive, with regard to the authorisation of non-EU AIFMs intending to manage AIFs managed by them in the EU. Therefore, Maltese AIFs managed by UK AIFMs must:
    - a) appoint an EU AIFM;
    - b) convert the Maltese AIF into a Maltese Professional Investor Fund ("**PIF**"); or
    - c) convert the Maltese AIF into a self-managed AIF.
  - Any of the above changes must be implemented by 31 March 2020.
- **Management of a Maltese UCITS by a UK UCITS management company:**
  - Maltese UCITS that are managed by UK UCITS management companies would have to either convert into a self-managed Maltese UCITS or appoint an EU UCITS management company.
  - These changes must be implemented by the 31 March 2020.
- **Maltese UCITS management companies delegating investment management functions to UK licenced entities:**
  - Delegation of the management function to a UK MiFID firm can only take place if a cooperation agreement between the MFSA and the UK FCA is in place. The MFSA along with ESMA, other EU/EEA securities regulators and the FCA, have entered into a multilateral memorandum of understanding outlining the supervisory cooperation, enforcement and exchange of information.[11] A fund manager outsourcing and delegating to UK MiFID firms may thus continue doing so.
  - Furthermore, should the delegation of portfolio management services be initiated by and at the request of a Maltese client (reverse solicitation), such services would not be impacted by a no-deal Brexit scenario as these services would be provided to a Maltese client by and from a UK entity and no provision of services occurs in Malta.
- **Maltese AIFMs delegating investment management functions to UK licenced entities:**
  - Under the AIFMD, the delegation of investment management functions to third country managers is permitted, provided that certain conditions are satisfied. Such conditions include the notification to the regulatory authority of both the EU AIFM and EU AIF, as well as a memorandum of understanding between the relevant competent authorities (in this case already in place).

[11] For a full commentary, please see our previous newsletter: ESMA and FCA sign memorandum in case of no deal Brexit.

- The same principles of reverse solicitation as outlined above apply to AIFMs delegating investment management functions to UK licenced entities.

NEXT STEPS

UK entities operating in EU countries are advised to continue to closely follow the development of Brexit in the UK and plan accordingly, depending on the EU countries their activities are based. No action is currently required in the Czech Republic, given that the temporary permission will apply automatically in a no deal scenario. Whereas in Malta, firms currently operating under the EU passporting regime are urged to apply for the national TPR, since the application process is already open and will allow them to continue operating there at least in the eventuality of a no deal Brexit and will, albeit temporarily, provide some certainty despite the current impasse.

Similarly, EU firms operating in the UK should have already applied for the TPR, since the application process is now closed and would allow them to continue operating in the UK at least in the eventuality of a no deal Brexit and will temporarily buy some time despite the uncertainty such a situation would bring.

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

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