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UK's Dire Warning Of No-Deal Brexit Sparks Call For Action

By **Joanne Faulkner and Paige Long**

Law360, London (August 24, 2018, 9:31 PM BST) -- The U.K. government's dire warnings of severe disruption to financial services in the case of a no-deal Brexit have sparked new calls from the financial and legal sectors for the government to redouble efforts to negotiate an agreement to leave the European Union that includes a transition period.

The British government on Thursday issued a technical paper of repercussions from crashing out of the EU without a deal next March, claiming that it is preparing for the worst.

U.K. Brexit Secretary Dominic Raab said the government is still confident that a "good deal" with the EU that includes a transition period is possible. But analysts point to the Irish border question and other unresolved issues that have blocked progress.

And while the U.K. has signaled willingness to legislate for a temporary permissions regime for EU-based firms serving U.K. clients to ease the impact on critical services, the EU so far has declined to reciprocate.

Catherine McGuinness, policy chair for the City of London Corporation, said the government's paper shows how the U.K. is putting in place measures to protect against negative impacts in a no-deal scenario for U.K.-based customers and businesses, including EU firms doing business here.

"It is clearly over to the EU now to do the same," she said.

Failure to secure reciprocal arrangements from the EU could be incredibly disruptive. The government's document warned firms and customers to prepare for higher costs and greater delays when doing business in the event of no deal.

The technical paper said that Britons living abroad may lose the ability to access existing insurance contracts, such as a life insurance and annuities, due to U.K. firms losing their rights to passport into the European Economic Area.

The paper also warned that individuals and businesses could face increased costs for slower cross-border payments, because the U.K. would lose access to critical banking infrastructure and no longer be covered by the surcharging ban — which came into force in January — that prevents companies charging consumers for using a specific payment method.

Some in the market may not have been aware that the cost of euro transactions and other card payments between the U.K. and the EU is likely to increase if no agreement is sealed, according to Arup Sen, a lawyer at Taylor Wessing LLP.

“But it remains to be seen whether card issuers and card schemes would actually take the opportunity provided by Brexit to take the backward step of imposing higher fees,” she added.

When the U.K. leaves the bloc it will become what is known as a “third country,” which means it will become bound by the same market access rules and restrictions as the U.S. and other trading partners outside the bloc. Banks and other financial institutions in the U.K. thus have been calling on a bespoke trade deal that will maintain their access to the EU markets.

The City has been lobbying negotiators on both sides to work together and agree to a solution that prevents disruption and additional costs for clients in both the EU and the U.K., including a transition deal that will give them enough time to make executive contingency plans that minimize the impact to their business.

“The financial services industry will absolutely be concerned about the lack of evident progress,” Sen said.

Tim Cant, financial regulatory partner at Ashurst LLP, said the lack of EU action is likely to have significant effects across financial services areas, from the ability to execute trades on a venue, to clearing derivatives and settling securities.

“The U.K. government has gone to great pains to ensure that the message is a no-deal Brexit is unlikely,” Cant said. “However, it takes two to tango, and we are not sure whether our dancing partner will show up.”

The Treasury has said banks and insurers should assume that a transitional period will be in place from the first day after Brexit until December 2020. It also expects firms to comply with new rules from Brussels that take effect during that time, in a move that could help ease tensions with Europe.

But the deal still needs to be finalized between the U.K. and the EU, and then approved by all the remaining EU member states and U.K. Parliament.

Some lawyers believe the government and Raab failed in the technical document to dispel the scare stories about the likely effects of the U.K. exiting without such a deal being secured. Raab for example said that although a no-deal scenario — meaning no transition — was “unlikely,” as the withdrawal agreement is 80 percent complete, a "short-term disruption" to the markets was possible if it isn't secured.

“This latest set of guidance cannot conceal that in the event of a ‘no-deal’ Brexit, this country and its economy will be sailing into uncharted waters with unpredictable results,” said Robert Bell, partner at Bryan Cave Leighton Paisner LLP. “Far from reassuring the business community, this guidance is likely to heighten anxiety about the government’s conduct of the exit negotiations and provoke real doubts as to whether the government is as close to a successful deal as they contend.”

He added that the government’s publication was more about improving the U.K.’s negotiating hand with Brussels and convincing EU negotiators “that the U.K. is ready to go it alone if Brussels plays hardball over the U.K.’s future trading arrangements with the EU 27.”

The government has been busy publishing draft secondary legislation to guarantee the functioning of the legal framework underpinning the financial markets. So far the Treasury department has issued draft statutory instruments in the areas of consumer credit, short-selling and capital requirements, as well as the U.K.'s deposit guarantee scheme.

A lot of the proposed amendments are aimed at removing or updating references to the EU and its regulatory bodies and procedures that will become redundant after Brexit.

The Treasury published its approach for a temporary permissions regime in July, aimed at banks and insurers in the European Economic Area that want to continue operating in the U.K.

The proposals would allow businesses in the financial sector to provide services in Britain for a limited period after Brexit and while they wait for authorization from the Prudential Regulation Authority and the Financial Conduct Authority. This will be the case even if Britain leaves the bloc without a deal, the government said.

Because the proposals for these “unilateral actions” have been known for months, some lawyers said that Thursday’s announcements didn’t unveil anything that they didn’t already know.

“The paper reflects the position we expected,” said Jonathan Herbst, partner and global head of financial services at Norton Rose Fulbright. “The U.K. is committed to a pragmatic approach under which EEA providers are offered a broad interim permission regime in order to allow them to carry on providing services to the U.K. market.”

William Yonge, regulatory partner at Morgan Lewis, said the paper shows the U.K. government is committed to making it straightforward for EEA firms to continue to do business in the U.K. and access U.K. markets and infrastructure post-Brexit

That will be the case whether there is a transitional period until December 2020 or not — even to the extent of empowering U.K. regulators to phase in U.K regulatory requirements for such European firms which would otherwise have applied from the outset, he said.

“In terms of financial services, the U.K. government knows that it can nimbly and unilaterally structure Brexit so as to ensure at least that the U.K. remains an attractive place for EEA firms to continue to do business post-Brexit,” Yonge said.

Another possible knock-on effect of a no-deal Brexit could be on wider EU financial regulations, such as the recently revised Markets in Financial Instruments Directive, according to regulatory counsel Lorraine Johnston, also of Ashurst. MiFID II is a vast set of transparency-centered trading rules that came into force in January.

“The MiFID II trading provisions will likely cause market disruption that no amount of unilateral action by the U.K. government can solve, without the buy in from their European counterparts,” Johnston said. “This is the issue to watch as we head toward March 2019."

--Editing by Rebecca Flanagan and Alanna Weissman.