

EU/UK FUTURE RELATIONSHIP - FINANCIAL SERVICES

THE END OF THE TRANSITION PERIOD AND PASSPORTING

The UK left the EU on 31 January 2020 with a Withdrawal Agreement and entered a transition period that ended on 31 December 2020. On 24 December 2020, the UK and the EU agreed on the terms of the UK-EU Trade and Cooperation Agreement (the "TCA"). The UK has approved the agreement and it came into effect provisionally at 11pm on 31 December 2020, pending the EU taking the necessary steps to fully approve it. It provides for tariff free trade in goods, but to the dismay of many commentators, it does not cover the provision of services. As a result, passporting, which allowed firms authorised in European Economic Area ("EEA") states to conduct business in other EEA states based on their "home" member state authorisation, ended with the close of the transition period at 11pm on 31 December 2020.

This affects firms and funds based in the UK that provide financial services in the EEA, and EEA firms and funds that provide financial services in the UK.

EQUIVALENCE

It should not have come as a surprise that financial services would not be covered in the TCA; on 9 November in a speech in the House of Commons, the Chancellor, Rishi Sunak, set out his conviction that it would be in the best interests of both the UK and the EU to reach a comprehensive set of mutual decisions on equivalence. Equivalence is the process whereby the EU grants foreign financial firms market access if it deems their home rules "equivalent", or aligned closely enough with its own rules. It is a useful tool, but has a number of disadvantages, principally that it is discretionary, can be withdrawn with immediate effect and there is no appeal process. Although the TCA did not cover services, the Union and United Kingdom, in a separate Political Declaration, agreed to establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions. The parties have undertaken that they will, by March 2021, agree a Memorandum of Understanding establishing the framework for this cooperation. In the meantime, the UK has reached a set of unilateral equivalence decisions (<https://www.gov.uk/government/publications/hm-treasury-equivalence-decisions-for-the-eea-states-9-november-2020>) and the Treasury has also published its guidance document for the UK's equivalence framework (<https://www.gov.uk/government/publications/guidance-document-for-the-uks-equivalence-framework-for-financial-services>).

ONSHORING

When the transition period ended, the UK's onshored EU legislation came into force. "Onshoring" is the process of amending EU legislation and regulatory requirements so that they work in a UK-only context, including directly applicable EU legislation such as EU Regulations and Decisions that form part of UK law by virtue of the European Union (Withdrawal) Act 2018.

The onshoring process means that there are some areas where the requirements on firms and other regulated persons have changed. To help firms adapt to their new requirements, the Treasury gave the Financial Conduct Authority ("**FCA**") the power to make transitional provisions to financial services legislation for a temporary period. This is known as the Temporary Transitional Power ("**TTP**").

THE TEMPORARY TRANSITIONAL POWER

The FCA has applied the TTP on a broad basis from the end of the transition period until 31 March 2022, meaning firms and other regulated persons do not generally need to adjust to the changes to their UK regulatory obligations brought about by onshoring straight away, although there are some exceptions to this. Where the TTP does apply, firms and other regulated persons can continue to comply with their pre-existing requirements for a limited period, but are expected to use the duration of the TTP period to prepare for full compliance with the onshored UK regime by 31 March 2022.

In the areas listed below, the TTP does not apply, and firms need to be in compliance with the amended regulations with effect from 1 January 2021:

- MIFID II transaction reporting requirements;
- EMIR reporting obligations;
- SFTR reporting obligations;
- Certain requirements under MAR;
- Issuer rules;
- Contractual recognition of bail-in;
- Client Assets Specialist Sourcebook rules (CASS);
- Market-making exemption under the Short Selling Regulation;
- Use of credit ratings for regulatory purposes;
- Securitisation;
- Electronic commerce EEA firms;
- Mortgage lending after the transition period against land in the EEA; and
- Payment Services – strong customer authentication and secure communication.

EEA FIRMS CONDUCTING BUSINESS IN THE UK

A number of measures have been introduced to limit the impact of the end of passporting on financial products and services provided to UK-based customers from EEA firms; these include the temporary permissions regime ("**TPR**") and the financial services contracts regime ("**FSCR**"). The TPR allows EEA-based firms who had been passporting into the UK to continue new and existing regulated business within the scope of their previous permissions, until they obtain full FCA authorisation. It also allows EEA-domiciled investment funds that market in the UK under a passport to continue temporarily marketing in the UK. To take advantage of the TPR, firms had to notify the FCA before 1 January 2021. The FSCR permits EEA passporting firms that have not entered the TPR to continue servicing UK contracts entered into before 1 January 2021. The regime is only to run off existing contracts and new business cannot be

conducted under the FSCR; it is intended only to enable firms to conduct an orderly exit from the UK market.

The FCA has already used the TTP to take specific action in relation to Euro-denominated derivatives. The UK has implemented the G20 commitment to improve over-the-counter derivatives markets by onshoring the Markets in Financial Instruments Regulation ("**MiFIR**") derivatives trading obligation ("**DTO**") under the EU Withdrawal Act. The UK DTO applies to the same classes of derivatives as the EU DTO. Without mutual equivalence, some firms, in particular the branches of EU firms in London, would be caught by a conflict of law between the EU and UK DTOs. Where firms that are subject to the UK DTO trade with, or on behalf of, EU clients that are subject to the EU DTO, they will be able to transact or execute those trades on EU venues, provided that they take reasonable steps to satisfy themselves that the client does not have arrangements in place to execute the trade on a trading venue to which both the UK and EU have granted equivalence, and the EU venue has the necessary regulatory status to do business in the UK – such venues include those that are a Recognised Overseas Investment Exchange, have been granted the relevant temporary permission, or are certain that they benefit from the Overseas Person Exclusion.

The FCA has published extensive guidance on its website:

<https://www.fca.org.uk/firms/considerations-firms-after-transition-period>

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