



Brexit Preparedness Seminar on Financial Services

Council Working Party
(Article 50 Format)
15 November 2018

Agenda

- *1. Key issues*
- *2. What has been done*
- *3. Residual sectoral issues*
- *4. Additional action and communication*
- *5. Looking ahead*

Key issues

1) The loss of the EU passport in Financial services

- *UK will become a third country and leave the Single Market*
- *Provision of financial services from the UK will be subject to authorization under EU or national law, depending on the activities undertaken*
- *EU firms active in UK will be subject to UK rules*
- *Equivalence that allows firms to provide their services from a third country exists only in a limited number of areas*

2) Need to prepare for all possible scenarios

- *Transition period only if WA ratified by EU and UK, otherwise treatment as a third country as of 30 March 2019*
- *Impact on all regulated activities, i.e. most financial services*
- *Market access may require establishment in the EU (e.g. insurance), authorization under national regimes (e.g. investment services), or recognition by ESAs after equivalence assessment by the Commission (e.g. clearing services)*
- *Need to prepare for all scenarios applies to firm providing services on a cross-border basis in both directions*

What has been done to address these issues – by industry

1) Responsibility lies first with the industry

- *Analysis of legal, regulatory and supervisory implications*
- *Assess impact on their own business model, especially for cross-border activities*
- *Application for authorisations where needed*
- *Transfer of contracts or other action*
- *Practical steps – office space, IT systems, staff relocation*

What has been done to address these issues – by EU institutions and bodies

2) Analysis, communication and exchanges between stakeholders and EU institutions and bodies

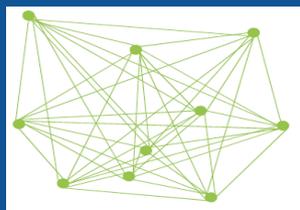
- *Analysis of legal, regulatory and supervisory implications (including surveys of national frameworks and individual firms)*
- *Analysis of financial and economic risks (including through the Technical group chaired by the ECB and the BoE)*
- *Commission notices to stakeholders (February 2018)*
- *ESAs, ECB and SRB : opinions, guidance, Q&A to NCAs and/or stakeholders*
- *Continuous exchanges with industry and Member States and between ESAs and NCAs (including via specific platforms)*
- *COM communications on preparedness and contingency planning of 19 July and 13 November*

Residual sectoral issues 1: Central clearing (1/2)

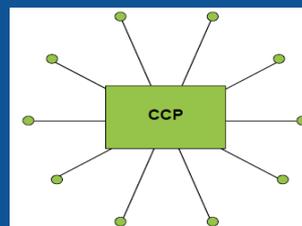
1) Role of Central Clearing counterparties (CCPs)

- A CCP centralises transactions and reduces
 - (i) credit risk
 - (ii) liquidity risks
 - (iii) operational risks

2) G20 commitments and the EMIR framework



No central counterparty



With a central counterparty

Default Management :
the waterfall

Defaulting member's margins

Defaulting member's contribution to default

« Skin in the game »

Default fund

Cash calls

Residual sectoral issues 1: Central clearing (2/2)

1) High reliance on UK CCPs

- *Most derivatives cleared in UK CCPs; no alternative CCPs in some segments*

2) Industry preparation

- *EU27 clearing members are securing access to alternative CCPs; off-boarding of EU27 clearing members in an uncoordinated closing-out/in the short period ahead of Brexit would create financial stability risks*

3) Short term mitigating measures

- *Time-limited and strictly conditional Commission equivalence decision and temporary recognition by ESMA: under existing framework; can be implemented at short notice by end of March 2019; ESMA to start discussions with UK CCPs*

Residual sectoral issues 2:

Uncleared OTC derivatives (1/2)

1) What are we talking about

- *Key role of OTC derivatives for hedging risks (FX, interest rate, credit risk...)*
- *Important for financial institutions/intermediaries, as well as for the real economy*
- *The volume of contracts with EU27 and rest of the world counterparties is about twice the size of the market with UK counterparties, and increasingly important for EU27*

2) Consequences of the loss of passporting rights

- *UK counterparties will face 27 different frameworks after Brexit: national third country regimes kick-in automatically, including for life-cycle events on legacy contracts:*
- *Contracts remain valid and, as a general rule, can be executed until maturity*
- *Life-cycle events, like new contracts, may require authorisation under national regimes*

Residual sectoral issues 2:

Uncleared OTC derivatives (2/2)

3) Short-term implications: no EU regulatory measures needed on Brexit date

- *No cliff-edge risk nor risk of mass termination: contracts remain valid and can be held until maturity*
- *Various strategies can be implemented by market participants to deal with legacy contracts*
- *EU players do not depend on UK institutions to hedge their risks*
- *MS to process requests for authorization/exemption where required and coordinate with ESMA*

4) Additional measures to smoothen adaptation in case of no-deal

- *Targeted amendments to delegated regulations (RTS from ESAs) could extend the existing grandfathering of derivative contracts under EMIR (exemptions from the clearing obligation and from bilateral margin requirements) to those novated from the UK to the EU27*

Residual sectoral issues 3:

Insurance (1/2)

1) What is the issue?

- *Cross-border provision of insurance services from the UK no longer authorised after Brexit*
- *Solvency II: establishment required in the EU for direct insurance business. Rationale: ensure policyholder protection through EU supervision and allow passporting across the EU*
- *After Brexit: contracts between UK insurers and EEA policyholders must be serviced from a branch/subsidiary established in the EEA*

2) Residual risks : 9 million EEA policy holders affected (EIOPA)

- *Initial figure was 38 million: many insurers have taken the necessary measures*
- *Liabilities of EUR 7.4bn, only 0.16% of the EEA market*
- *5.5 million contracts are short-term, low-premium, non-life: no action needed*

Residual sectoral issues 3:

Insurance (2/2)

3) What is done - breaking down the residual risks by issuers

- *100+ insurers still with small number of contracts – likely approach could be run-off of contracts*
- *Four large insurers late in transferring the back book (representing 75% of the volumes) – supervisors should urge insurers to take action*

4) Short term measures: no EU regulatory measures needed

- *EIOPA is working with relevant NCAs on possible national measures based on national law and in line with Solvency II*
- *There should be no problems for EU policyholders to get replacement insurance in the EU27 if needed*

Residual sectoral issues 4:

Bank MREL issuances governed by UK law

1) Issue related to the stock of debt instruments issued under UK law

- *Analysis of the existing stock of debt issued in the UK, both before or after the referendum*
- *No legal certainty that such instrument can be bailed-in*
- *Main problem: potential MREL shortfalls for banks as issuances under UK law might be considered ineligible*

2) Short term : no need for specific measures

=> SRB and other EU27 RA can provide guidance on MREL: bank-by-bank approach under a reasonable timeframe

Residual sectoral issues 5:

Consumer protection & payment services

Consumer protection

- *Avoiding potential disruption of financial services to consumers is a key objective*
- *Beyond insurance and payment services, no other significant risk has been identified; however if Member States identify additional issues Commission ready to assess*

Payment services

- *No disruption of service expected on mass-market cards: UK-issued credit and debit cards based on well-established international card schemes will remain valid to pay or withdraw cash in the EU27 – but there might be a potential effect on fees*
- *Payment services firms otherwise have to establish an EU27 subsidiary if they want to continue providing services to EU clients*

What additional action / communication is required (1/2)

1) Completion of contingency plans by industry

- *A lot of preparatory work has been done (having entities in place with appropriate authorisation, governance and operational/IT structures...) and many market participants are ready to operate in case of no-deal*
- *When contingency plans are not yet completed, firms should step-up their preparations (e.g. relocation of staff, transfer of contracts, finalisation of authorisation procedures etc.)*
- *As indicated in the Communication, “contingency measures will not remedy delays that could have been avoided by preparedness measures and timely action by the relevant stakeholders”*

What additional action / communication is required (2/2)

2) Supervisory actions and measures at EU or national level

- *Additional communication / warning to industry and consumers by ESAs and/or NCAs could be necessary depending on the sectors*
- *Assessment of the implementation of contingency plans of incoming firms and cooperation with ESAs*
- *Where relevant, supervisory actions (e.g. run-off schemes or sanctions in insurance, authorization of incoming firms under national third country regimes for uncleared OTC derivatives)*
- *MoUs with UK authorities, prepared / coordinated by ESAs*
- *Assessment of any residual risk, including potential consumer protection issues*

Looking ahead: strengthening the EU framework

1) Finalization of ongoing legislative files as soon as possible

- *EMIR 2.2 currently under negotiation in Council and Parliament: provides for appropriate supervision of third-country CCPs (and ultimately for the possibility to relocate clearing if risks are deemed excessive for the EU)*
- *Improved equivalence regime under the Investment Firms Review*
- *Supervisory convergence and stronger powers in ESA Review*

2) Completion of the Capital Market Union

- *All the more urgent given the departure of the UK from the Single Market*
- *Deep and efficient capital markets will also require more integrated supervisory oversight, especially in case of intense competition among specialized financial centers*
 - **Need to adopt EMIR 2.2, Investment Firm Review and ESAs Review!**

Conclusion

1) Clearing

EC to take a time-limited and strictly conditional equivalence decision, followed by temporary recognition by ESMA

2) Uncleared OTC derivatives

No EU regulatory measure needed, as national third country regimes provide the legal framework for third country services; Member States should ensure that authorization procedures, where needed, are on track, and coordinate with ESMA

Level 2 amendments will facilitate transfer of contracts in a no-deal scenario

3) Insurance

No EU regulatory measures needed, as national measures in line with Solvency II seem appropriate in case of no-deal. EIOPA is working with relevant NCAs on possible national measures

4) MREL

Bank-by-bank guidance by resolution authorities

Background and reference information

Brexit preparedness

https://ec.europa.eu/info/brexit/brexit-preparedness/preparedness-notices_en#fisma

Communication of 13 November 2018 "Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan"

https://ec.europa.eu/info/publications/communication-preparing-withdrawal-united-kingdom-european-union-30-march-2019-contingency-action-plan-13-11-2018_en