Briefing Note

The European Union (Withdrawal) Act 2018

10 July 2018

Key points:

- The EU (Withdrawal) Act ends the supremacy of EU law in the UK and provides for the transfer of EU-derived law in effect at the date of Brexit into the UK legislative framework. It is an important aspect of the UK's planning for a "no deal" Brexit scenario.
- The EUWA was passed into law on 26 June and provides powers to the UK government to make amendments to the acquis in areas where it would be unworkable to directly transfer EU legislation into UK law.
- Given the very substantial volume of financial services law and regulation which is derived from EU law, the EUWA has important implications for firms operating in the UK.
- Industry input is important to ensure that the government's approach to adaptation of the law through secondary legislation is carefully assessed and avoids unintended consequences.
- We expect that the first set of secondary legislation will be published shortly with a compressed period in which to provide input.
- We will utilise our existing committees to examine relevant issues and provide feedback to secondary legislation, and are engaging with the UK government and regulators. We are also closely coordinating with other relevant trade associations.

1. Introduction

This note provides an overview of some of the potential implications of the European Union (Withdrawal) Act 2018 (the "EUWA"). The EUWA was proposed by the UK Government to bring an end to the supremacy of EU law in the UK and prepare the UK legislative framework for Brexit, particularly in a "no deal" Brexit scenario. The EUWA was passed into law on 26 June.

The key elements of the EUWA are[1]:

a) **Repeal of the European Communities Act 1972**: this brings an end to the supremacy and binding effect of EU law in the UK.

b) **"Importing" EU law**: converting or "onshoring" the existing acquis of EU law in effect at the date of Brexit into UK domestic law. This includes EU regulations, UK implementing legislation and EU decisions.

[1] Further detail can be found at https://www.gov.uk/government/news/the-eu-withdrawal-bill-receives-royal-assent

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c) **Amending powers:** introducing broad powers to amend primary and secondary legislation through statutory instruments. These broad powers allow the government to make changes to retained EU law to enable it to operate effectively or to remedy any other deficiency arising from Brexit.

The objective is for the existing body of law in effect at the date of Brexit to continue to apply as it did immediately before, subject to changes made through secondary legislation. Due to their non-binding nature, "level 3" measures such as guidelines or FAQs will not be imported into UK law under the EUWA.

Given the very significant amount of financial services law and regulation which is derived from EU law, there is a significant body of relevant legislation that will be "onshored" and adapted to the UK legislative and regulatory framework. In addition to more technical changes/corrections, there are a number of important policy choices that will have to be made as the EU legislation is adapted to the UK framework, with potential implications for members.

2. Scope of the amending powers

The EUWA provides powers for the government to modify retained EU law through secondary legislation. These powers enable the government to make such changes as it considers "appropriate to prevent, remedy or mitigate" any failure of retained EU law to operate effectively or any other deficiency arising from Brexit.[2] The powers are therefore very broad and permit the government to make changes to legislation as they determine to be appropriate to address an issue "arising from Brexit". The powers are time-limited to two years after Brexit.

The Treasury proposes to delegate powers to address deficiencies in "level 2" Binding Technical Standards and EU-derived sections of their handbooks. The government has published a draft statutory instrument which confers powers on the PRA, the FCA, the Bank of England, and the Payment Services Regulator to make "EU exit instruments".[3] This would allow the regulators to adopt measures to remedy deficiencies in EU financial services legislation already implemented into their handbooks, and give them the ongoing power to make binding technical standards in place the European Commission.

3. Addressing deficiencies

HM Treasury has published a statement outlining its approach to transposing EU financial services legislation to UK law under the EUWA.[4] The first set of statutory instruments ("SIs") will provide for a temporary permissions regime and a recognition regime for central counterparties. HM Treasury plans to publish further SIs over the summer and during the autumn, including those relating to capital markets and prudential regulation. The government has stated that they plan to publish draft SIs before they are formally laid before Parliament to give an opportunity for stakeholders to engage.

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[2] Section 8 of the EUWA.

[3] Available at : https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/701834/draft_Financial_Regulators__Powers__Technical_Standards__Regulations.pdf

[4] HM Treasury,'s approach to financial services legislation under the EUWA, 27 June 2018 available at https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act

The government's stated objective of continuity of the status quo with the aim of reducing uncertainty is helpful. However, in practice the onshoring process will require the government to take a number of policy decisions, for example how they treat reciprocal rights under EU legislation. Due to the expected short timeframe for industry to comment on the proposed changes to legislation, there is likely to be a significant challenge in ensuring that unintended consequences are avoided.

A significant number of changes will be required to be made to EU-derived law to reflect the fact that the UK will no longer be a Member State. Examples of deficiencies are expected to include:

a) functions carried out by EU authorities;
b) references to Member States, EU institutions, ESAs, the EU treaties etc.;
c) reciprocal rights/agreements e.g. information sharing, mutual recognition or similar provisions where the policy is based on membership of the EU; and
d) other changes that are required to adapt legislation to a domestic context (e.g. references/thresholds which refer to EU-wide criteria).

In addition to these general questions, it is necessary to consider specific areas of relevant legislation that may need to be adapted to address deficiencies, particularly where policy choices are likely to be required. For example, potential deficiencies include the approach to pre and post trade transparency thresholds and transaction reporting under MiFID II, treatment of EU firms and their branches in the UK, recognition of third country CCPs etc.

The statement from HM Treasury provides an indication of the approach that the government will take to fixing deficiencies, including that "as a general principle, the UK would … need to default to treating EU Member States largely as it does other third countries". However, they identified the following principles which could justify taking a different approach:

- having a functioning legislative and regulatory regime in place, in particular the regulators' capability to fulfil their statutory objectives as set out in FSMA;
- enabling regulators and firms to be ready – by minimising disruption and avoiding material unintended consequences for the continuity of service provision to UK customers, investors and the market;
- protecting the existing rights of UK consumers; and
- ensuring financial stability.

The FCA has confirmed that it will take a consistent approach to changes to its handbook. Adapting to treating the EU as a third country will in some areas result in significant changes and it remains to be seen how the government will approach the areas where it may take a different approach. It is also uncertain how "level 3" guidance and Q&As will be dealt with by the regulators.

The Bank of England and the FCA have stated that they plan to consult on legislative changes to EU binding technical standards, likely during the autumn.[5]

[5] Bank of England statement: https://www.bankofengland.co.uk/news/2018/june/boes-approach-to-financial-services-legislation-under-the-eu-withdrawal-act and FCA statement: https://www.fca.org.uk/news/statements/fca-role-preparing-for-brexit

4. Implications for firms' planning

Transition period?

The UK and EU have agreed the terms of a transition period from 29 March 2019 to 31 December 2020 during which time EU law will continue to apply in the UK. The transition period is part of the draft Withdrawal Agreement which is still under negotiation. Firms will therefore only have legal certainty of the transition period once the Withdrawal Agreement has been finalised and ratified.

The EUWA is therefore focused on ensuring that there is a functioning legislative framework in the UK in the absence of a transition period, although it could also be important following the expiry of the transition period. However one important area of uncertainty is whether (and if so how) the UK will onshore EU-derived legislation which is not in effect on 29 March 2019 but takes effect thereafter. Such EU-derived law is outside the scope of the EUWA and would therefore require further provision in the UK for the UK to remain aligned.

The Bank of England has stated that "firms should … plan on the assumption that requirements arising from new EU legislation that come into effect during [the proposed transition] period will apply to UK firms and FMIs".[6]

Temporary permissions regime

In the absence of a transition period, the government has announced that it will introduce a Temporary Permissions Regime to allow EEA firms to continue operating in the UK for a time-limited period after the UK has left the EU. The statement from HM Treasury also states that "firms do not need to prepare now to implement onshoring changes in the event no deal is reached with the EU". However, no detail has been provided on the nature and length of the proposed regime.

Consequential changes arising from the onshoring process

Firms will need to assess whether the onshoring process could impact their operations and documentation. For example, if the UK does not provide automatic recognition of EU resolution actions, firms may need to amend contracts to include contractual recognition clauses under article 55 of the Bank Recovery and Resolution Directive.

While detail has not been provided, the recent statement from HM Treasury stated that the Treasury "intends to provide the financial services regulators with a general power to phase in post-exit requirements, allowing flexibility for firms to transition to a fully domestic framework." The Bank of England has stated that "We do not expect firms providing services within the UK's regulatory remit to have to prepare now to implement these changes. HMT has set out that it intends to provide regulators with powers to grant transitional relief, where appropriate, to ensure that, in a scenario in which an implementation period is not in place, firms and FMIs have sufficient time to comply with the changes." Similarly the FCA stated "we do not expect firms and other regulated entities providing services within the UK's regulatory remit to have to prepare now to implement these new requirements".[7]

However while this might assist with UK requirements, similar transitional provisions may not be available for EU27 regulators so firms will need to assess how they might be impacted.

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[6] Bank of England statement, as above.

[7] FCA statement, as above.

5. AFME's approach

Given the importance of minimizing uncertainty and avoiding unintended consequences arising from the process, AFME has been engaging with the government and regulators. We are providing input on relevant issues and legislative files which are key to AFME's focus. We are coordinating our engagement with other trade associations to prioritise input in relation to key issues on the files of most importance to AFME's focus and minimise duplication.

In addition to identifying general cross-cutting issues, we are utilising our existing committees to examine relevant issues. To date we have engaged in greater detail on MiFIR/MiFID II, BRRD and securitisation issues but we expect further engagement as the SIs are published.

We expect that the turnaround period to provide input on draft SIs will be very short. Committees may wish to consider issues arising in relation to the scope of their remit, for example identifying key policy choices that may need to be made under the relevant legislation. AFME's Brexit team will coordinate and collate feedback to support our engagement with the official sector.