

# How might wholesale financial services contracts be impacted by Brexit?

FAQs for clients

February 2018



## Foreword

With just over a year until the UK is due to leave the European Union, there remains uncertainty as to the future relationship and the nature of any transitional arrangements between the UK and EU27.

As explained in our previous report, “Planning for Brexit, Operational Impacts on Wholesale Banking and Capital Markets in Europe”, financial services firms have already developed plans to adapt to the likelihood of the UK leaving the Single Market and therefore existing “passports” for cross-border financial services between the EU and UK coming to an end.

These plans seek to ensure that firms can continue to service their clients across Europe but will have an impact on their clients which currently benefit from passported services, for example EU27-based clients receiving services from a UK-based entity or branch, and UK-based clients receiving services from an EU27-based entity.

This publication gives guidance to businesses and other market participants, explaining the potential significant impact on contractual relationships for financial services. The guide provides answers to a number of “Frequently Asked Questions” highlighting potential operational and documentation impacts.

Clients are likely to see impacts in respect of existing cross-border contracts and will need to put in place arrangements for new business following Brexit. The FAQs address issues such as which clients may be in scope, which contracts may be affected, how they may be impacted and consequential operational impacts that need to be considered.

We hope that these FAQs provide a helpful guide and assist businesses and market participants in their own Brexit planning. I would like to thank Clifford Chance for their support with this publication.



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## Introduction

The United Kingdom's decision to withdraw from the European Union raises a number of challenges for the financial services industry. The UK government's stated intention to leave the single market will mean that UK-based firms ("**UK-based Firms**") will no longer be able to rely on passports for the provision of cross-border financial services throughout the EU. Similarly, it is likely that EU27/EEA-based firms ("**EU27-based Firms**") will no longer be able to rely on a single market passport for providing financial services into the UK from the EEA.

While there continues to be significant uncertainty on the future relationship and any transitional arrangements between the UK and EU27 post-Brexit, most contingency plans developed by sell-side market participants ("**Firms**") envisage that Firms are unlikely to be able to continue to rely on the MIFID2/CRDIV cross-border passporting regimes to provide their investment/banking services.

The loss of reliance on these passporting regimes will impact how UK-based Firms continue to access the EU27, most likely requiring a structural solution such as establishing or growing a local EU27 presence to face their EEA clients ("**Clients**"). EU27-based Firms will face similar UK market access issues. AFME published a report in January 2017 assessing the operational impacts of Brexit on wholesale banking and capital markets in Europe<sup>1</sup>. One of the issues highlighted was the potential impact on contractual relationships and this was also highlighted as an important impact by Clients in a subsequent report on the impact of Brexit on corporates and investors<sup>2</sup>.

The loss of passporting and changes to the structure of a Firm's service provision will impact upon contractual relationships with certain Clients.

The overall objective of Firms is to ensure that the changes in booking location/model and repapering of Clients will provide continuity of service and service levels with a minimum of business and technical disruption. Logistically, Firms will require sufficient lead time to execute their Brexit plans especially if their operations need to be upgraded.

In September 2017, AFME and UK Finance published a paper highlighting the potential impact of Brexit on existing cross-border financial services contracts<sup>3</sup>. These FAQs address operational impacts on Clients in greater detail. They are designed to assist Clients in their own planning and timetabling of changes to be made as a result of changes in a Firm's post-Brexit business structure. They primarily focus on questions relevant to EU27 Clients of UK-based Firms in relation to sales and trading in wholesale markets and related credit given for settlement purposes. The FAQs also highlight questions for UK-based clients of EU27-based Firms and primary market and financial market infrastructure impacts. These FAQs do not consider the Brexit impact on loans booked in the banking book.

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<sup>1</sup> See <https://www.afme.eu/globalassets/downloads/publications/afme-pwc-planning-for-brexit.pdf>

<sup>2</sup> See <https://www.afme.eu/globalassets/downloads/publications/afme-bcg-cc-bridging-to-brexit-2017.pdf>

<sup>3</sup> See <https://www.afme.eu/globalassets/downloads/publications/afme-brx-impact-of-brexit-on-cross-border-financial-services-contracts.pdf>

## Frequently Asked Questions

### 1 **Would my relationship with the Firm be impacted by Brexit changes? For example, would I need to change booking locations if I am a UK-based investment manager or adviser dealing with a UK-based Firm but have underlying funds located in the EU27?**

Firms are in the process of identifying which Clients based in EU27 jurisdictions may be impacted by their Brexit plans ("**In-scope Clients**"). Whether a particular Client is in scope is fact-specific for each Firm depending on the kind and level of interaction that the Firm has with the Client and the nature of investment/lending services provided and transactions entered into.

Some factors that will be relevant to this determination include:

- Is the Client acting as principal or as agent?
- What type of transaction is entered into?
- Who is the counterparty to the transaction and where are they located?
- Who is the recipient of any marketing/solicitation or other contact with the Firm e.g. negotiation?
- Who signs the contract and where?
- Which financial markets infrastructure is required?

These factors vary significantly from Firm to Firm. In any event, you should not assume that you are automatically out of scope, for example, because you are a UK-based manager.

### 2 **What aspects of my relationship with the Firm may be impacted by Brexit?**

If you are an In-scope Client, you will be impacted. Each Firm will make different choices and therefore the impact will vary per Firm and will change over time given the fluid regulatory environment. It is possible that your service provider and counterparty to your transactions may change from a UK service provider to an EU27 service provider. If your service provider and/or counterparty changes, some of the main potential impacts include:

- There may be operational implications for how you connect or interact with the new service provider/counterparty, such as new standard settlement instructions and bank codes. The change in service provider/counterparty may also impact your own books and records and have other consequential effects on regulatory and/or client reporting and deposit/investor protection schemes. Changes in your service provider's financial infrastructure relationships (such as CCPs and payment systems) may have consequential impacts on you. For example, if a Firm starts using a different clearing firm, some operational aspects of its clearing activities may change, and this may have knock-on operational impacts on you.
- You may need to consider whether any product disclosures or marketing documents (e.g. Fund prospectuses and Key Investor Information Documents) should be enhanced for your new service provider/counterparty. This may require prior regulatory approval.
- There may be implications which you need to assess; for example, possible triggers for collateralisation requirements and netting implications, and accountancy and regulatory impacts on your operations. In addition, there may be tax impacts on financial transactions and financial documentation if your service provider/counterparty plans to rebook/transfer transactions or merge entities. The results can be complex and specific tax advice should be obtained.

If you have to make changes, these impacts will require time to work through.

### **3 Which types of existing contracts may be impacted?**

Both customer terms and transactional documentation may be impacted to a greater or lesser extent by Brexit repapering:

- Terms of business – These identify which legal entity provides services to Clients and under which terms. You may have more than one set of terms of business in place with your service provider, depending on the products that you trade and services that you receive. All sets of terms will clearly need to be adjusted for the new service provider.
- Transactional documents – If the counterparty to a transaction changes, underlying transactional documents such as ISDAs, GMSLAs, GMRAs, prime brokerage agreements, futures and listed options agreements, clearing agreements, loan agreements and security agreements may all be impacted. Whether the counterparty to existing transactions will need to change depends on the outcome of the Brexit negotiations and the nature of the activity. The industry has been working on an analysis of transaction lifecycle events which may trigger cross-border licensing requirements and consequential changes in transactional documentation post-Brexit. Please see question 7 for further details.

### **4 What may be the process for changing from a UK to an EU27 service provider/counterparty?**

The change process may differ depending on how your service provider/counterparty effects any transfer/migration of its EU27 Clients to its EU27 entity/branch. There are five main potential transfer structures: (i) bilateral negotiations; (ii) branch to branch; (iii) Part VII Banking Business Transfer Schemes under the Financial Services and Markets Act 2000; (iv) Cross-border merger; and (v) change of legal status to a Société Européenne. The choice of transfer mechanism will impact the new documentation and on boarding processes that are required and the operational changes that need to be made.

For example, if you agree a transfer with a Firm, you are likely to need specific documents to effect the transfer such as novations, transfer certificates, etc. Your agreement to the transfer documents may be obtained by way of one-way notice or two-way agreement, depending on what is contemplated under your terms of business and/or the relevant transactional document. A two-way signature may nonetheless be required for certain types of contracts and/or if the new service provider/counterparty is located in certain EU27 countries.

### **5 As a client of multiple Firms, can I expect my relationships to be impacted in the same way across different Firms and counterparties?**

It is unlikely that a Client of multiple Firms can expect its contractual arrangements to be impacted in the same way for each Firm. This is because each Firm has a different EU27 footprint and operating model and accordingly is likely to change their operating model of their European business differently. They may also be subject to different regulatory requirements depending on the different regimes that they are subject to.

### **6 Given the Brexit political process is still ongoing, when will I need to act?**

You should start reviewing your documentation and operations to understand the impact of a potential transfer, including whether operations may need to change, for example, to connect with a new entity. This is to ensure that you have sufficient lead time to address documentation, technical and other issues for minimal business disruption.

You will be contacted by your service provider/counterparty in due course about its plans and next steps. If you are planning to change your operating model as a result of Brexit, please contact your service/provider/counterparty as soon as possible.

## **7 Could a transitional arrangement or grandfathering allow transactions and client relationships to continue with my current counterparty or Firm booking entity?**

Yes, a transitional arrangement or grandfathering could allow your current contractual arrangements to continue with your current service provider/counterparty, either for a defined period or potentially until maturity. However, there is significant uncertainty as to whether any agreement will be reached and the details of any such agreement. Clients and Firms need to continue their efforts to highlight the need for transitional arrangements and/or grandfathering solutions.

While Firms are hopeful of a political breakthrough, Firms are required to plan for a hard Brexit where they cannot operate on a cross-border basis from the UK. They are under a very compressed time frame to put in place Brexit solutions (including developing operational capabilities) to ensure continuity of service in the absence of a well-defined transitional arrangement and/or grandfathering. Any political agreement will need to provide sufficient certainty for Firms and their regulators to be able to rely upon it.

## **8 What are some of the changes that may be found in the documentation?**

While Firms may wish to replicate existing terms in the new documentation, particularly in order to provide continuity, meet tight deadlines and to minimise the economic impact of any position migration, a number of changes in new documentation may be required in order for the contractual arrangements to reflect the post-Brexit structure and to comply with regulatory requirements. You may have already noticed variations from standard form documentation (e.g. variations in transfer provisions) in relation to transactions being entered into at present. These changes seek to address potential Brexit impacts on transactions.

Some potential documentation impacts include:

- There may be conflict of laws and choice of jurisdiction implications.
- Asset protection regimes may also change with consequential documentation (and other) impacts.
- Security documents may need to reflect new collateral arrangements and there may be consequential implications; e.g. hardening periods may be restarted and/or security arrangements may need to be re-registered.
- From a regulatory perspective, data protection consents may need to be obtained; the application of new client money and depositor protection requirements may drive different disclosures; and recognition of bail-in in contracts pursuant to Article 55 Bank Recovery and Resolution Directive and contractual stays provisions will likely need to be included if English law remains the governing law of the contract.<sup>4</sup>

Changes in documentation may differ depending on whether existing contracts are amended as opposed to new documentation being entered into and/or whether legacy transactions are contemplated as opposed to new deals.

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<sup>4</sup> See [here](#) for further information on contractual continuity issues.

**9 Where can I find further details on how my standard industry documentation may be impacted?**

For product-specific documentation issues please contact the relevant industry association. ISDA FAQs discuss in detail potential impacts of Brexit on ISDA documentation and the Loan Market Association has issued Brexit guidance in relation to its standard form facilities documents. For other products which may be impacted, please contact AFME or the relevant industry association for contact information.

**10 Do continuity of contract issues impact primary markets?**

Cross-border primary market activities also raise continuity of contract issues; for example, if capital raisings are in flight over the Brexit period. Transitional arrangements and/or grandfathering in relation to existing mandates between issuers and arrangers would facilitate the completion of such transactions.

**11 Are the above questions relevant for EU27-based Firms facing UK Clients?**

After Brexit, EU27-based Firms will face the same market access and continuity of contract and service issues regarding the provision of cross border services into the UK as UK-based Firms will have when facing In-scope Clients. Clients of EU27-based Firms should similarly begin assessing documentation and operations to understand the impact of a potential transfer of business by an EU27-based Firm to a new UK establishment.

**To minimise disruption to your operations, we strongly recommend that you contact your service provider/counterparty to understand the specific impact of its Brexit plans. You should take independent legal advice on the points raised in these FAQs.**

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## / About AFME

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues.

We represent the leading global and European banks and other significant capital market players.

We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society.

We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

### Focus

on a wide range of market, business and prudential issues

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deep policy and technical skills

### Strong relationships

with European and global policymakers

### Breadth

broad global and European membership

### Pan-European

organisation and perspective

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