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Association for Financial Markets in Europe

Brexit: Remaining no-deal risks in financial services

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Introduction

Following the extension of the article 50 period to 31 October 2019, banks are continuing to implement their contingency plans for a no-deal Brexit scenario in light of the ongoing political uncertainty.

While a very substantial amount of work has already been undertaken to mitigate risks by both firms and regulators, a no-deal Brexit is likely to have a significant impact on the financial services sector and regulatory and operational challenges remain.

We remain focused on addressing the regulatory and operational issues which arise from a no-deal Brexit scenario to avoid cliff edge effects that would significantly affect the financing of the economy and the orderly functioning of markets in the EU27 or the UK. A selection of our publications addressing these issues is included in the appendix.

In this paper we take stock of no-deal risks in the financial services sector and highlight areas where further work is needed to mitigate risks of a no-deal scenario and minimise disruption to markets and clients.

Access to UK CCPs

We welcomed the temporary equivalence decisions for the UK CCPs and CSD to take effect in a no-deal scenario. The temporary recognition addresses a very important financial stability risk.

However, the equivalence decision for UK CCPs is currently due to expire on 30 March 2020. Unless certainty is provided as to the extension of recognition, UK CCPs might be required to start off-boarding processes for EU27 members by the end of 2019. We note the European Commission's recent statement that it would consider whether adjustments are needed to contingency measures to take into account the new timeline following the extension to Article 50[1] and encourage the European Commission to do so in this instance.

We also note that a revised equivalence framework is being introduced through EMIR 2.2 which would require a new equivalence assessment to be made. Further clarity is therefore required regarding the way the European Commission intends to ensure the absence of a gap between the current temporary equivalence and the application of the new EMIR 2.2 regime leading to a permanent solution. This is of pivotal importance given the significant threat that the start of an off-boarding process by UK-based CCPs would pose for EU financial stability.

Share Trading Obligation

We have highlighted concerns regarding the implications of the EU Share Trading Obligation (STO) under MiFIR in the absence of equivalence decisions by the EU and UK with respect to trading venues. While ESMA's recently announced revised approach to the scope of the STO[2] is welcome in removing the application to GB ISINs, we remain concerned that EU investors may still not be able to access major pools of liquidity for a number of EU27 shares (e.g. a number of Irish and dual-listed shares) and therefore may not be able to execute trades at the best available price.

[1] European Commission, Fifth Brexit Preparedness Communication, 12 June 2019
[2] ESMA, Public Statement, 29 May 2019

We also remain concerned about the prospect of overlapping share trading obligations with the UK STO under the UK MiFIR as onshored under the EU (Withdrawal) Act. Equivalence granted by the EU and UK would be the best solution to this issue. However, in the event that equivalence decisions are not available in time for a no-deal Brexit scenario, clarifying the scope of trading obligations to shares based on an ISIN and currency principle could reduce the number of shares where access to major pools of liquidity could be challenging.

We also recommend that the UK and EU27 authorities put in place necessary arrangements to ensure continued access of members from both UK and EU27 to infrastructures under their supervision.

Derivatives Trading Obligation

The risk of disruption to EU and UK markets because of overlapping and contradictory derivatives trading obligations has not been addressed[3]. In the absence of equivalence, conflicting EU and UK trading obligations would prevent EU27 and UK counterparties from trading in scope derivatives with each other on either EU or UK venues. This is not mitigated by national contingency measures in EU27 Member States or the UK Temporary Permissions Regime. The DTO significantly limits the ability of UK and EU-based banks to make use of national contingency measures which have been put in place to enable services to continue to be provided to EU or UK clients (respectively) for a temporary period. We urge the authorities to continue to work together and explore all avenues to avoid overlapping trading obligations and minimise disruption. This is particularly important for firms with branches in the UK and in the EU.

Continued servicing of existing contracts and national contingency measures

A further area of focus has been ensuring that existing cross-border contracts can continue to be serviced effectively, including the performance of common lifecycle events. While we remain disappointed that this was not addressed at EU level, we strongly welcome the efforts made at national level in many Member States and the UK to enable lifecycle events to continue to be performed, at least for a temporary period.

We note that a number of Member States have not yet put in place contingency measures for financial services and encourage them to do so well in advance of 31 October. EU27 Member States should review their national contingency measures to ensure that they remain effective and where relevant apply for a sufficient period of time following the extension to Article 50.

There remain some areas of uncertainty and outstanding guidance with respect to the application of the different national measures. We encourage Member States and NCAs to clearly set out how they intend to operate their national measures in the event of a no-deal scenario, including providing guidance on firms' regulatory compliance obligations when they are operating under their national contingency measures e.g. how the Derivatives Trading Obligation or post trade transparency requirements apply to firms operating under their national contingency measures, and continue to engage constructively with market participants to ensure a common understanding. We would further encourage Member States and NCAs to consider whether any transitional relief can be made available to firms operating under their national contingency measures to help ensure that the impacts of a no-deal Brexit are lessened.

EU27 investment firms and our members have also raised concerns that even where national measures permit a UK-based firm to provide new investment services to clients, UK firms will no longer be treated as an EU Systematic Internaliser, meaning that EU clients would have to set up reporting through an EU APA or use assisted reporting.

[3] See joint association letters to the European Commission and UK Treasury for further details.

We welcome the UK Temporary Permissions Regime and clarification of the approach that the UK regulators would take under their transitional powers. We would welcome confirmation of the approach to be taken to the application of transitional powers in the event of a no-deal scenario on 31 October 2019. We also believe that it is important for the PRA and FCA to maintain the 15 month period for firms to transition to new requirements arising out of the onshoring of EU regulation. While the extension has provided additional time to prepare for the rules for which it was made clear there would be no transitional relief, many other system changes are contingent on certainty on a no-deal scenario and firms will still need a period of time post that date to ensure they are able to meet all onshored rules.

Clarification of interdealer trading

We very much welcome the clarification by the French authorities regarding interdealer trading[4] and strongly encourage other Member States to provide similar clarification. It is important that clarity is provided that dealers in the EU and UK can continue to transact with one another to provide liquidity by dealing on own account. This is vital to enable liquidity provision and effective risk management.

Fragmentation of the interdealer and interbank market (e.g. limiting the ability of dealers from different zones to conclude transactions with one another) would be particularly damaging, having direct prudential consequences by likely increasing the reliance of the dealers of a given zone on their peers for their access to liquidity and the management of their risks, and hence the systemic risk within that zone. A lack of clarity could particularly impact smaller banks which rely on access to liquidity from larger dealers.

Supervisory cooperation

We welcome the work which has been undertaken to put in place memoranda of understanding between the supervisory authorities to enable cooperation to continue in a no-deal scenario. We encourage this work to continue and the authorities to consider opportunities for further strengthening cooperation such as enhanced information sharing.

Impact of a split MiFID regime

In a no-deal Brexit, there will be two distinct MiFID II/R regimes interacting with one another: the EU MiFID II/R regime and the onshored UK MiFID II/R regime. The implications of this bifurcation will require detailed consideration if it is not to pose a threat to the operational efficiency of the financial market ecosystem. It will be important to consider MiFID II/R provisions and calibrations designed for the EU28 following the UK's departure from the EU. In a no-deal scenario, particular concerns relate to:

- **Post trade transparency reporting**: there is a high risk of duplicative trade reporting. When an EU27 investment firm trades with a UK investment firm, each will have reporting obligations, leading to a misleading impression of volumes. This is likely to reduce the overall levels and accuracy of transparency reporting across Europe and introduce increased potential for regulatory arbitrage. The EU and UK authorities should work together to share data and avoid duplication.

- **Regime calibration impacts**: The bifurcation of UK and EU27 transparency infrastructure (FIRDS and FITRS) environments would also have second order impacts (as a result of the

[4] The ACPR and AMF have confirmed that : "if the only investment services or activities provided or carried out in France by a third-country firm are OTC transactions on financial instruments on own account (excluding execution of transactions on behalf of clients) with credit institutions or investment firms (…) no permission in France is required", available at http://www.amafi.fr/index.php/news/en/interdealer-market

geographical rescoping of the calibrations post Brexit) to "traded on a trading venue" (ToTV) universes, SI thresholds; double volume caps; non-equity liquidity annual assessments; equity transparency thresholds, STO equivalence; DTO equivalence, tick sizes; commodities position limit calculations and other MiFID II regime calibrations. These impacts will give rise to significant operational challenges and the broader impact needs to be carefully reviewed to avoid the release of duplicate information into the market that could be potentially misleading.

- **Transaction reporting**: Transaction (regulatory) reports are currently exchanged between competent authorities within the EU through an IT system established by ESMA (ex CESR), called the Transaction Reporting Exchange Mechanism ('TREM') in order to enable the competent authorities to detect and investigate potential cases of market abuse and to monitor the fair and orderly functioning of the markets. After Brexit, firms with operations both in the EU27 and in the UK will need to make arrangements to connect to their additional national competent authorities (directly or indirectly through an ARM) to report relevant transactions to the relevant NCA (which will require a change from firms' current operating model). This will have the effect of dual reporting (between UK and EU27 regimes) and we urge regulators to work together to address this issue.

Operational challenges of a mid-week exit

Brexit occurring at midnight on 31 October will mean, in contrast to previous potential scenarios on 29 March and 12 April, that markets will be open on 1 November in the UK and some EU27 Member States. This will give rise to additional operational challenges, in particular mid-week code release for new reporting as firms will not have a weekend in which to switch over systems. Additional challenges may arise from 1 November being a bank holiday in many, but not all, EU27 Member States.

Secondary impacts of a no-deal scenario

We have focused above on the direct regulatory impacts of a no-deal Brexit for financial services firms. However it is important not to lose sight of the likely secondary impacts arising from the potentially very significant impact on the broader economy, impact on clients and increased market volatility. As the European Commission has stated, "a withdrawal of the United Kingdom without an agreement would have a serious negative economic impact."[5] This could potentially have more systemic/macroeconomic implications which will impact on the financial services sector. The earlier certainty is provided on the above-mentioned issues, the better our members will be placed to service their clients and support the wider European economy in volatile times.

[5] European Commission, Fifth Brexit Preparedness Communication, 12 June 2019

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Appendix

Selected AFME publications and correspondence addressing issues arising in a no-deal Brexit scenario.

- Joint Trade Associations Letter: Recognition of EEA derivatives trading venues, 08 April 2019
- Letter to VP Dombrovskis: Application of the share trading obligation in a no-deal Brexit scenario, 27 March 2019
- Joint Trade Associations Letter on the Equivalence of UK Trading Venues, 28 February 2019
- Letter to VP Dombrovskis – Temporary Equivalence and Recognition in relation to UK CCPs, 7 December 2018
- Brexit: Recognition of Resolution Actions, November 2018
- AFME letter to VP Dombrovskis: Preparations for a "no-deal" Brexit scenario, 12 October 2018
- Contractual continuity in OTC derivatives – challenges with transfers, July 2018
- GFMA letter to ECB and Bank of England regarding technical working group on Brexit risks, May 2018
- Effective flow of personal data post-Brexit, April 2018
- How might wholesale financial services contracts be impacted by Brexit? FAQs for Clients, February 2018
- Key cliff edge risks in wholesale financial services, January 2018
- The need for early clarity on a Brexit transition, September 2017
- Impact of Brexit on cross-border financial services contracts, September 2017
- Bridging to Brexit: Insights from European SMEs, Corporates and Investors, July 2017:
- Implementing Brexit: practical challenges for wholesale banking, April 2017
- Planning for Brexit – operational impacts on wholesale banking and capital markets in Europe, January 2017

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The Association for Financial Markets in Europe (AFME) is the voice of Europe's wholesale financial markets.

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

We believe that liquid capital markets and a well-functioning banking system are central to any successful modern economy.

We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

Focus
on a wide range of market, business and prudential issues

Expertise
deep policy and technical skills

Strong relationships
with European and global policymakers

Breadth
broad global and European membership

Pan-European
organisation and perspective

Global reach
via the Global Financial Markets Association (GFMA)