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Brexit considerations for Australian banking and finance lawyers

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Introduction

On 23 June 2016, an unprecedented majority of 51.9% of voters in a Referendum on the United Kingdom's (UK) continued membership in the European Union (EU) voted for the UK to leave the EU, while the rest of the world was left wondering what will happen next?[1] The outcome of the referendum in favour of what is now being termed "Brexit" shook the world's financial markets and also provoked political turmoil in the UK and more widely across Europe,[2] including in Scotland and Northern Ireland who both voted to remain.

Given the great uncertainty as to the outcome of future exit negotiations between the UK from the EU, and the fact that the full ramifications of Brexit to the rest of the world will depend largely on what might replace EU membership for the UK, this article will not give an in depth review of Brexit implications for Australian banking and finance lawyers. However, we can start to explore some of the many significant questions of concern and possible impacts Brexit could raise for Australian banking and finance institutions, who are no doubt already starting to undertake business planning in anticipation of the risks and the range of alternatives that may result from UK negotiations with the EU.

EU background

The EU Commission first outlined its action plan for a single financial market in 1999.[3] Since then, the EU has introduced regulation to effect the integration of EU financial markets and to remove legal barriers that hindered the provision of cross border financial services activity across Europe.

The directives introduced create a single market by allowing financial services businesses legally established in one member state (their home state) to carry on their business in another member state (the host state), without the need for separate host state authorisation, either by establishing a local branch or on a cross border basis (called a "Passport"). The directives also establish the respective responsibilities of home and state regulators for business with a cross border element, and provide a framework for regulators to cooperate with each other.[4]

One of the Passport advantages for Australian banks and the UK, is the UK has become Europe's major international financial centre and therefore, most Australian banking and finance institutions currently doing business in the EU base their operations in the UK. In doing so, an Australian UK business can then take advantage of the four EU freedoms:

- freedom of movement of goods;
- freedom of establishment and services;
- free movement of capital; and
- free movement of workers and citizens to create a single European market.

There has also been an increased desire post Global Financial Crisis (GFC) to conduct financial services business on a global level, including through the G20, an international forum for the governments and central bank governors from 20 major economies formed to study, review and promote high-level discussion on policy issues pertaining to the promotion of international financial stability. Australia has also seen recent initiatives including Basel Committee on Banking Supervision, which relates to the resolution, prudential requirements and centralised clearing in derivatives, and Financial Stability Board (FSB).

Brexit

Surprising to many, the majority of voters in the UK voted to "leave the European Union". However, under the terms of Art 50 of the Treaty on European Union which governs the process, the UK must notify the European Council of its intention to leave the EU and thereby enact Art 50 as well as trigger the 2-year period for negotiation of the terms of the UK's withdrawal. This has not yet occurred, and while there is discussion that Art 50 might be invoked before the next general election in the UK, it is more likely that it will not happen until the new parliament is elected.[5]

In any case, the UK Government is eventually expected to ratify the referendum decision and invoke Art 50, and for years thereafter will be locked in negotiations with the EU to agree its terms for exit, including immigration and trade arrangements (for example,

will the UK join the European Free Trade Association (EFTA) or another free trade agreement?[6]). The UK will also need to negotiate with countries like the United States and China, which currently have trade agreements with the EU but not with the UK.

Aside from the political unrest as the UK faces a Prime Minister change, Northern Ireland and Scotland's contrary vote to remain in the EU, and fears that other countries within the EU like Spain or France might also try to leave the EU, there is also international investment that will be impacted as many international investors may move elsewhere to access a gateway to Europe, including Australia.[7] This is one of the key negative implications for Australian banking and finance institutions in the face of Brexit.

Brexit uncertainty

While some risks can be anticipated, there is still great uncertainty in terms of the full ramifications of Brexit for Australian banking and finance institutions. First, the referendum is not legally binding. If and when the UK invokes Art 50, negotiating the terms of the exit will take years and involves establishing new agreements, during which time the UK will continue to be bound by European legislation. However, given the UK will not be a member of the EU, they will not be in a position to influence policy.

Further, some financial markets tend to be volatile in the face of uncertainty and, after Brexit was announced, shares suffered an immediate impact throughout UK and Europe as well as globally. This is likely to continue until there is more clarity on Brexit and the next steps. While it may not be all bad for banking and finance institutions in Australia who may see an increase in safer asset classes such as bonds due to the volatility in the share markets, there will be negative effects as market volatility continues.[8]

Banking lawyers acting on behalf of Australian institutions and in particular, for banks with divisions, dealings or transactions in the UK or EU will need to keep a close eye on Brexit developments and to make decisions in a way to minimise risks going forward. Where possible, Australian banking lawyers will need to consider the full range of possible risks and outcomes as well as alternative relationships that could arise from negotiations between the UK and EU in order to ensure good business planning.[9] Below, we touch on some key areas of focus lawyers working in banking and finance should consider as they work through the complex issues Brexit may cause for their businesses.

Key issues for Australian banking lawyers

Passporting

An important question of obvious concern to Australian banks with businesses operating out of the UK for the purposes of accessing EU markets is the continued access to the European single market. That is, whether the Passport system continues. Currently, authorised Australian businesses such as banks, insurance companies and asset managers can operate across the EU into the 28-member bloc as long as they have a base in the UK. Under this arrangement, a British bank can provide services across the UK from its home and an Australian, Swiss or American bank can do the same from a subsidiary based in the UK. London is also a centre for clearing and settling trades involving EU securities.

Goldman Sachs and JP Morgan both gave evidence to the Parliamentary Commission on Banking Standards, prior to the referendum, highlighting the importance of the UK's EU membership.[10] Frances Central Bank Governor Francois Villeroy de Galhau said: "If tomorrow Britain is not part of the single market, the City [of London] cannot keep this European Passport, and clearing houses cannot be located in London either."[11]

After Brexit, businesses that rely on a UK business to do EU business may need to establish a separate subsidiary in a country remaining in the EU. To hold a Passport, it appears that banks would have to create a licensed bank to do business in the relevant EU state. That is, banks cannot simply set up a subsidiary and then send personnel to that member state to work. Different states have different rules on setting up business but in any case there would undoubtedly need to be local management and significant staffing. Further, the entity would need its own capital to meet the demands of the EU Bank Recovery and Resolution Directive (BRRD).

Institutions in Australia may already be seeking to put into effect contingency plans to have continued access to the EU single market. It has been reported that some banks, particularly large US banks, are currently setting in place contingency plans.[12]

Of particular concern for banking services in Australia is the fact that current Capital Requirements Regulation[13] (CRD IV), the current EU banking regulatory framework, does not contemplate a framework for third party access. The Markets in Financial Instruments Directive 2004/39/EC (MiFID), a major piece of European legislation and one which is absolutely fundamental to the ability of banks and investment firms to conduct investment business around the EU, seeks to provide third country access for wholesale business.

Importantly, MiFID allows banks in a member state to carry on business and sell services throughout Europe without obtaining a licence in each individual country.[14] City experts are however divided as to whether this could be relied upon. The provisions only relate to segments of business that currently benefit from passporting rights, it is uncertain if the UK could take advantage

of the provisions as it must meet the guideline for "equivalent" standards of regulation (which could change in the future) and there is currently no precedent.[15]

On this front, banking and finance lawyers will need to wait to see the nature and extent of incoming rules and, in the meantime, should be diligent in preparing for the possibility of regulatory change.

In light of Brexit, Australian institutions will need to undertake their own cost benefit analysis to see if it makes sense to remain in the UK or to leave. In doing so, banks and their lawyers will need to weigh up whether it makes sense to set up in another EU state, and if so where and how. For example, if an Australian bank's UK presence is predominantly for EU business then it may make sense to relocate, however, if not and if a UK presence is predominantly for access to other non EU markets, then relocation may not be necessary. Naturally Australian banking lawyers will also have to consider tariffs, taxation and differing legal systems when making the decision whether or not to stay.

Legal

In any case, it is anticipated that Brexit will cause a long, expensive and complicated exercise of unravelling over 40 years of legislation. Much of the EU law is comprised of directly effective EU law or UK law implementing EU Directives.[16] The unravelling will undoubtedly involve a process of deciding which legislation to keep and how to amend legislation, as well as how to fill any gaps and transitional arrangements. Saving legislation is likely to be enacted initially. Much of the existing EU legislation would need to be retained to allow, for example, the banking industry to continue to function. The UK, unless it becomes member of the European Economic Area (EEA), would become a third party to the EU and therefore, in order to do business, the UK would need to have a regulatory environment which is at least equivalent to the EU. All the while, the UK loses its benefit from being a member of the EU.

Australian banking lawyers working within and for banks operating in the UK will already no doubt be preparing board briefings on the risks and opportunities raised by Brexit and analysing the exposure. Due diligence should be conducted on UK business lines to determine which areas depend on UK membership for market access and which would be affected by a change to tariffs.[17] Stakeholder engagement will be paramount in the legal and risk assessment of Brexit by banking lawyers.

Impact on contracts

Lawyers acting for financial institutions should also review contracts to ascertain if any clauses within them are activated as a result of Brexit, including termination grounds, force majeure, material adverse change in circumstances or breach of financial ratios in financing agreements. Further questions for lawyers to consider in starting to review potentially impacted contracts might be whether a provision to comply with EU law is still binding in the face of Brexit, and whether EU principles will still apply in the interpretation of contracts. Australian banking and finance lawyers should start to assess the scope counterparties might have for avoiding contractual obligations based on Brexit, arguing material adverse change or force majeure or frustration of contract, which might result in contractual dispute.[18]

Australian lawyers should further consider questions of jurisdiction of contracts and how judgments will be enforced. For example, will a judgment in the EU be legally binding in the UK post-Brexit? European judgments are mutually recognised and enforced by EU Regulation, including Insolvency Regulation, which aims to establish procedural rules on jurisdiction, applicable law and mutual cross-border recognition in the EU member states for insolvency proceedings. As soon as the UK leaves, the regulations will need to be replaced by one or more multilateral treaties.

Intellectual Property

Another matter for consideration by banking and finance lawyers is intellectual property (IP) registrations. Lawyers should review all IP registrations to ensure they still comply with UK and European legislation, given the UK had joined the European Unitary Patent System and there were applicable EU patent and design regulations, as well as the imminent introduction of the Unitary Patent (UP) and the Unified Patent Court (UPC).[19] It is likely that the UK will no longer be a part of the UP and UPC post-Brexit.

Financial services

As mentioned under Passporting, if Australian financial institutions passport their licensing in the UK to other member states, they will need to obtain new licences in the relevant member state or in the UK if arrangements are being passported to the UK. Evidently, post-Brexit, raising capital and marketing financial services on a cross-border basis will be more complicated for Australian businesses operating out of the UK.

Employees

Where Australian based employees are using a European passport, the employing financial institutions will need to review the visas in place. There will be considerable uncertainty from an employment law perspective in the UK because key areas of employment law are derived from EU legislation and so could fall away

automatically, be abolished or amended.[20] We note that in doing so, it will, however, take a significant amount of time for a decision to be made on what happens regarding EU nationals in the UK.

Taxation

Thankfully, taxation remains primarily with the member states. The bilateral treaties in place between the EU, Australia and the UK will govern tax. However, if an Australian bank operating out of the UK is considering a move to another member state, its lawyers should consider the relevant bilateral taxation treaty with that member state.

Increased red tape

Australian institutions that do business with the UK and the EU will, in the future, be exposed to two sets of regulatory requirements as opposed to one. However, the UK may decide to make its requirements less onerous, only time will tell. As with Australia, the nature of the banking and financial services industry in the EU is currently highly regulated. Much of the regulation has come from Europe but it is unlikely that the UK will amend or repeal major parts of the financial regulatory law. Where EU law has direct effect through regulations, the UK will have to consider whether or not these regulations should be adopted. Further, if the UK wants to continue doing business with the remaining EU states, it will undoubtedly be required to meet an equivalence assessment. However, it will have lost its negotiating position in the EU.

What happens next and the UK's continued relationship with the EU

The full global impact regarding the Brexit referendum is still unknown. The UK's continued relationship with the EU all rests on how future negotiations progress. They may elect to adopt a model like Norway, who is a member of the EEA and has gained access to the single market without becoming a full EU member, or Switzerland who accesses the EU through bilateral agreements — negotiating sector by sector. The downside to the Norwegian option would be that the UK would have to adopt European legislation while having no say in it, and would have to accept the free movement of people which is unlikely given that immigration played a key role in the Brexit campaign.

The key impact for Australian banks operating in the UK will be renegotiation of trade deals between the UK with EU member states, as the UK will cease to benefit from existing EU trade agreements with third parties and will be excluded from those under negotiation. Australia and New Zealand are currently negotiating trade agreements with the EU.[21]

Conclusion

While uncertainty prevails in all discussions surrounding Brexit and the possible impacts the decision will have on the UK and globally, one thing is certainly clear — this unprecedented decision by the UK people to exit the EU *will* result in some negative impacts to Australian banking and finance institutions, the extent of which is yet unknown. All lawyers representing Australian banks with a UK presence are likely to have already considered many of the possible playbooks that will flow from Brexit, while the world waits for Art 50 to be enacted by the UK Parliament and then watches as intense and complex negotiations between the UK and EU follow.

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Leonie Chapman's experience extends to banking and finance, consumer credit and mortgage lending, contract negotiation, trade practices and fair trading legislation, intellectual property and trade marks, corporate and financial services. After completing her Bachelor of Laws and Bachelor of Commerce in 2002, Leonie went on to work both in private practice and as senior in-house lawyer supporting a specialist lender and then for six years, Macquarie Bank Limited. Having achieved a Master of Laws in 2009 specialising in banking and finance law, Leonie's main focus now as Principal of LAWYAL Solicitors is on regulation and compliance for banking and financial institutions.

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Footnotes

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