

HCJP's Synopsis on the Potential Impact of "Hard" Brexit

IN SHORT

The Situation: The Legal High Committee for Financial Markets of Paris ("HCJP") recently published a synopsis of its three Brexit reports on contracts continuity.

The Result: In the event of the United Kingdom crashing out of the European Union in March without an overall deal, the three reports examine potential effects of a "hard" Brexit on (i) banks & investment firms, (ii) asset managers, and (iii) insurance companies.

Looking Ahead: This must be put in perspective with the two draft regulations laid down before Parliament by the UK government on July 25 and the Brexit negotiations that have just resumed and are now due to be carried out continuously. The HCJP working groups are expected to publish full reports in the fall.

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The United Kingdom would be outside the European Union's framework for financial services in the unlikely scenario that the United Kingdom leaves the European Union without a deal. The capacity of UK firms to provide relevant regulated services to the EU 27 clients would then be determined by the default Member State and EU rules that apply to third-country firms.

[The HCJP](#) established three working groups to consider the potential impact on (i) banks and investment firms, (ii) asset managers, and (iii) insurance companies, respectively.

The working groups are expected to publish reports in the fall, but a [synopsis](#) of their conclusions was issued on July 19, 2018.

The working groups consistently concluded that risks need to be assessed differently for legacy trades (contracts validly entered into before the exit day) and new transactions (contracts to be entered into after the exit day).



UK firms are encouraged to begin the process of transferring their European business to a duly licensed entity in the European Union as soon as possible.



Legacy Trades

The HCJP working groups generally do not believe that insurmountable legal issues would be created if the United Kingdom leaves the European Union without a deal. Key report findings include:

- The loss of passport rights for UK firms will only affect their capacity to enter into *new* transactions, but should not prevent their ability to validly perform existing obligations;
- Brexit, whether "hard" or "soft," should not be a cause of termination, force majeure, or frustration of existing contractual arrangements; and
- UK firms, even after losing their passport rights, will be able to manage most lifecycle events of ongoing continued transactions.

The reports, however, acknowledge legal issues raised by the management of some lifecycle events—essentially those that require providing new investment services—and consider two more problematic types of contracts or services that would need specific attention, including:

- **Long-Term Insurance Contracts.** Although this is not a universally admitted opinion, some scholars consider that insurance activities do require permanent licensing and passport rights for policies to comply with the law and indemnities being paid until the maturity of the relevant contract. The fact that regulatory license and authorization were in effect at the time the contract was entered into cannot satisfy the requirement; and
- **Portfolio Management.** Portfolio management is an investment service rendered on a continuous and permanent basis. As a result, carrying on any mandate or management service in relation to a portfolio or a fund falling into the scope of the monopoly after the exit day will be a breach of such monopoly.

New Transactions

If the UK and the EU do not reach a deal, UK firms would need to wind down their EU-regulated activities and stop entering into new banking, financial investments, and insurance-related transactions. The loss of EU banking, investment services, and insurance passport rights will prevent any firm established in, or operating from, a third country from offering any related services to EU clients falling within the scope of the three monopolies. Breaches of these rules are criminal offenses.

The reports discuss in detail the uncertainties and legal concerns raised by businesses that would seek to maintain business as usual.

The reports finally conclude with a series of four key recommendations:

- UK firms willing to carry on activities on the continent are encouraged to begin the process of transferring their European business to a duly licensed entity in the European Union as soon as possible.
- The reports strongly advocate for EU legislation to create a new instrument authorizing any international group wishing to transfer part of its business or transactions portfolios run out of London to one of its EU incorporated entities, to be able to do so in a simplified, efficient, secured, and prompt manner.
- The HCJP is also calling for the European Commission to grandfather all transferred transactions vis-a-vis the European Markets and Infrastructure Regulation, the Markets in Financial Instruments Directive, and other similar regulations, so that a transfer could be done on an "iso" regulatory basis.
- Finally, the reports are pleading for market authorities to accommodate a transition period for activities such as portfolio management. The objective of such transition period would be to allow if currently active UK managers not replaced by EU managers on the exit day, to progressively run their business off could be organized in a way comparable with the way EU firms losing their regulatory approval or license are dealt with.

The HCJP synopsis, reports, and recommendations are to be put in perspective with the two draft regulations laid down before Parliament by the UK government on July 25 and respectively relating to [central counterparties](#) and [passport rights](#). We should welcome the fact that there seems to be more determination on both the EU and UK sides to work together to accommodate the financial industry's practical and operational issues created by Brexit.

TWO KEY TAKEAWAYS

1. Legacy trades should be able to continue without insurmountable legal challenges even if the United Kingdom were to leave the European Union without a deal.
2. The HCJP encourages UK firms to begin transferring their European business in the European Union to preserve their ability to carry on their activities and enter into new transactions without any disruption in the event of a "hard" Brexit.

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