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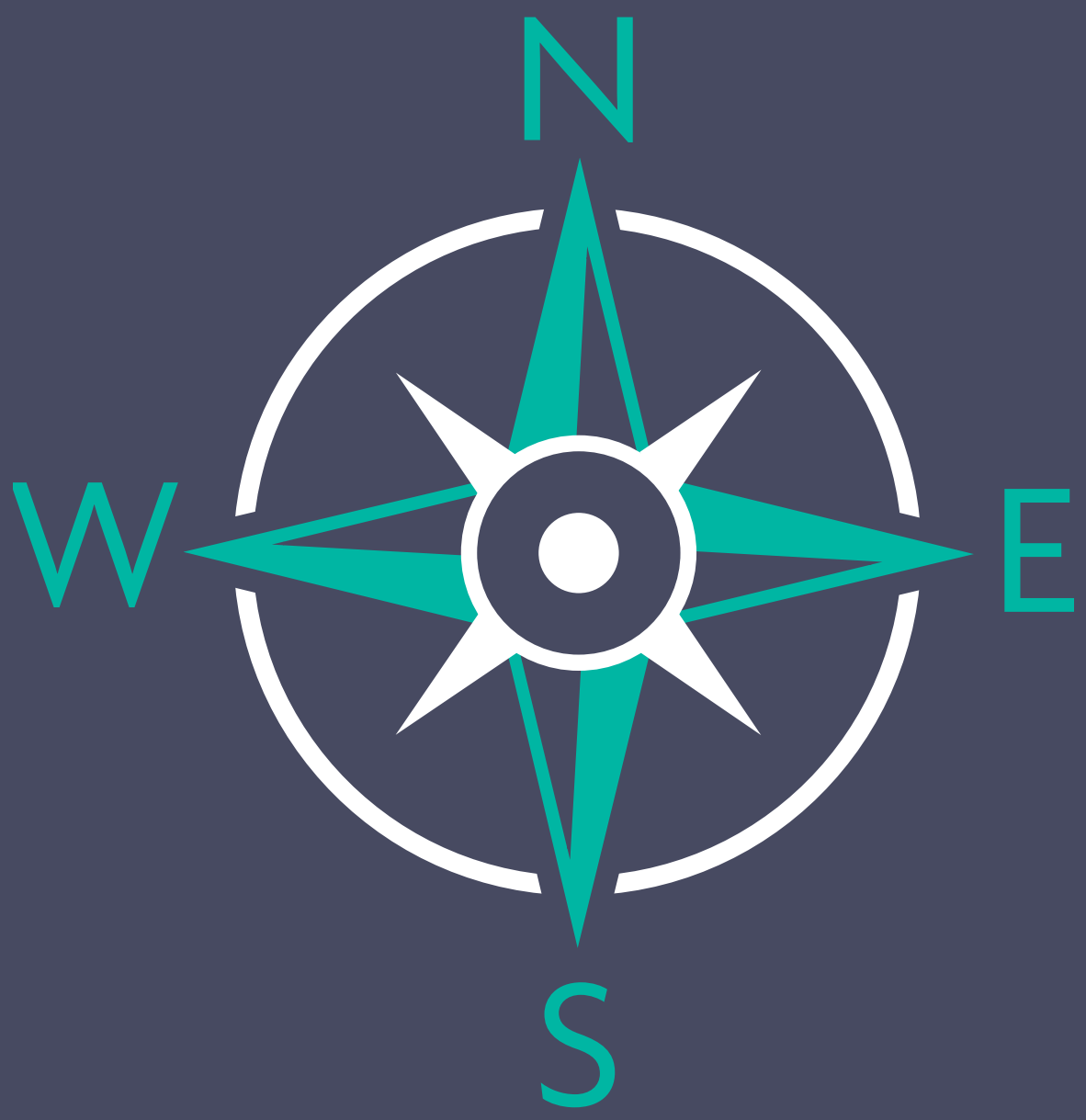

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SLAUGHTER AND MAY

Acknowledgements and contacts

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Foreword

This report has been produced to close an important gap in the developing public analysis and understanding of the implications of the UK's withdrawal from the EU for EU customers of UK-based banks. It identifies the very broad differences among individual EU Member States in their treatment of bank products and services offered by banks from 'third countries' (i.e. banks located outside the EU) – which will be the status of banks located in the United Kingdom following its withdrawal from the EU – and illustrates the implications of such differences for the continued availability of these products and services for businesses and other customers in individual EU Member States. In particular, the report explains how customers in EU Member States with less restrictive national licensing regimes are likely to be better positioned to mitigate the risks around the continued provision of key banking services for them in the period immediately following the UK's departure from the EU.

Why is this relevant in relation to Brexit and for customers of UK-based banks across the EU? The national regimes of a number of the EU27 countries provide mechanisms for market access for banks located outside the EU. These could provide critical, albeit limited, capacity following Brexit for EU27-based customers in those countries to access important banking services offered by UK-based banks. This will be especially important if Brexit arrives without the EU and the UK having been able to agree suitable transitional arrangements between the withdrawal and the time when new arrangements between the UK and EU take effect, and before a future equilibrium in commercial, economic and social activity is established.

Following the UK's withdrawal from the EU, EU27 businesses will still need to access these banking services either from UK-based banks or from alternative providers. If a new market access agreement has not been implemented, or if one has been agreed but suitable transitional arrangements have not been put in place, then there may be significant service distortions during any interim period due to temporary capacity imbalances. A consequence of such temporary distortions and imbalances is that the EU27 and UK economies risk a more disruptive and potentially destabilising adjustment process. This will have real consequences for EU27 and UK economies, and is likely to be particularly impactful on those businesses across Europe that are the drivers of EU international export growth. These export-oriented businesses typically require more sophisticated banking services (such as foreign currency, trade finance and risk management) for which UK-based banks have historically been very significant providers. EU Member States themselves could also be directly affected, with UK-based banks in some cases no longer permitted to serve as primary dealers for their sovereign debt issuances.

The risk of capacity imbalances and distortion in banking services for EU27 businesses is a consequence of the process of restructuring existing banking services relationships from current arrangements to achieve a new equilibrium in the future. In addition to being complex and expensive, for many banks this restructuring is expected to take considerably longer than the two years permitted under Article 50. Even those banks already located in the EU27 are expected to require significant time and additional resources to adapt their business capacity. As a result, between the date when the UK ceases to be a member of the EU and when a new agreement is reached between the EU and the UK providing for future trade arrangements, many of Europe's banking services will undergo a period of rebalancing. This may result in supply/demand shortages or even service disruptions in some sectors and markets before a new orderly and balanced equilibrium between supply and demand is reached.

Certain national licensing regimes contain market access mechanisms which would be available to mitigate, to a limited degree, some of the risks described above. As the availability and scope of

market access mechanisms vary widely among the EU27 countries, businesses located in some countries and in some market segments may struggle to benefit from these potential mitigants. To better understand these regimes, this report analyses the national licensing regimes for a representative cross-section of twelve EU Member States, identifying those with more liberal and those with more restrictive regimes. This will assist policymakers and affected EU27 businesses to understand the additional mechanisms that may be available to help manage national economies and individual businesses through the challenging scenario of a Brexit without orderly transition arrangements in place.

As this report sets out, EU Member States treat access for their nationals and businesses to banking services provided from outside the EU in different ways. While such access is frequently restricted, the precise level and scope of restriction varies from country to country. This has important implications for the way EU27 businesses and other customers in different Member States could access services from UK-based banks after the UK's withdrawal from the EU, with the degree of service access varying from state to state.

These national regimes will also be relevant where UK-based banks seek to establish branches or subsidiaries in individual EU Member States (or to expand existing branches or subsidiaries) in order to preserve their ability to offer services to EU customers. Similar to cross-border trade, the entities of most foreign banking groups established in the EU are governed by national, rather than EU, authorisation and regulation. For this reason, the speed, cost, complexity and thus feasibility of establishing (or expanding) branches and subsidiaries varies from state to state in important ways. The idea that establishing such entities is a simple solution to the problem of continuity of service for EU27 customers is quickly dispelled by the evidence presented in this report. Not surprisingly, establishing full subsidiaries is typically more complex, costly and time consuming than establishing branches. Many commentators continue to assert that the only viable "solution" for many financial institutions to continue to serve their business and other customers in the EU27 is for them to establish full-service subsidiaries with significant scale and capacity in the EU (not least because such subsidiaries will have the EU 'passport' for financial services which will no longer be available to UK-based banks). However, the cost and other resources required, combined with the uncertainty around the eventual shape of and timeline for any new agreement between the EU27 and the UK, is expected to result in decisions to subsidiarise being taken thoughtfully, with care, and over time until the future outlook becomes more visible.

Although the scenario assessed by this report would be highly disruptive, it is not unrealistic. It imagines an outcome of the UK's exit from the EU in which the EU and the UK cannot – for whatever reason – agree terms for cross-border trade in banking and financial services sufficiently similar to the existing tightly interconnected market. Reverting to operating on the basis of the national regimes of individual Member States is therefore a genuine possibility.

This report sets out why and how such an outcome would be more disruptive for existing EU customers of UK-based banks in some Member States, and somewhat less so for those in other Member States. However, in all cases it would be likely to limit future customer choice. Of course, such an outcome is not inevitable. As challenging as it may seem, a negotiated framework at the EU level via a transition or similar agreement for EU customers seeking to access services from banks in the UK would avoid the reversion to this uneven, restrictive and uncertain patchwork.

To inform this study, information was gathered from market-leading local law firms on the national regulatory regimes of twelve key jurisdictions in the EU: Belgium, the Czech Republic, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Poland, Portugal, Spain and Sweden[1]. The survey covered an extensive range of banking products and services, from corporate banking to capital markets, investment banking, sales and trading, asset management, market infrastructure to retail deposit-taking. Further details of the methodology applied in this survey are set out in Annex 1. The detailed results of this survey are summarised in the tables in the Appendix. This report includes a Glossary of words and expressions used in this report immediately before the Annexes.

[1] For more information please refer to Annex 1

Executive Summary

If there is no agreement on a future new trading arrangement at the point of exit, or clear transitional measures put in place, EU customers – particularly those needing sophisticated banking services to support international export-oriented businesses – may find accessing key products and services much more challenging as a result of the loss of access to UK-based banking services

Firms authorised in the UK are currently able to provide services into and within other EU Member States without the need for further licences. The use of these rights, not available to banks established outside the European Economic Area (EEA), is known as 'passporting'. The ability to 'passport' services in this way means that a firm can provide its services to an EU customer either directly on a cross-border basis, or (having received a licence from its EU home state regulator) via an established branch in another Member State without the additional requirements and costs associated with establishing a new subsidiary or separately licensed branch[2].

This ability has enabled the UK's banking sector to play a crucial role in the growth of the EU economy. Not only is the financial sector a material contributor of tax revenues, it is also a major growth enabler through the provision of a very wide range of services to hundreds of thousands of EU businesses and millions of individual EU consumers. These businesses and customers derive significant direct and indirect benefit from the banking and financial services that flow between the EU and the UK.

All are potentially affected by the UK's exit from the EU. EU Treaties and legislation and the rights they confer have had a profound and positive impact on the structure of EU financial services markets, the sudden withdrawal from which would potentially create a damaging 'cliff edge' effect for banks and their customers[3]. Similar issues will arise for insurance, asset management and providers of financial market infrastructure and other sectors of the EU's financial services industry, as well as the related professional services sector.

With the formal exit of the UK from the EU now less than two years away, the possibility of a dramatic revision to these rights is now very real. A sudden and significant change in the availability of financial services from UK-based providers poses the risk of serious disruption for EU customers, giving rise to damaging direct and indirect consequences for EU Member State economies. This potential disruption has wider implications for market confidence, business stability, productivity, jobs, investment and growth in both the UK and EU27[4].

In response to these risks to customers, many UK and EU banks are looking to restructure their businesses to prepare for the potential terms of a future UK-EU market access agreement, and to account for any interim period between the UK's withdrawal and up until those arrangements take effect. In the absence of a clear commitment on the part of the UK or the EU to allow for transitional arrangements, and lacking any clarity as to the potential terms of the future relationship, many banks are being compelled to execute their mitigation plans now, certain only that they must be complete by March 2019 if significant customer detriment is to be avoided.

This is a challenging undertaking. Even in the unlikely event that UK-based banks are able to completely transfer their existing product and services lines to EU27-based branches or subsidiaries in the time available, the increased costs, capital fragmentation and reduced economies of scale inherent to such restructured businesses may force UK-based banks to focus their service offering on their largest and most important customers. This may result in a narrowing of service provision to those small and medium-sized businesses whose needs are more cost intensive or intermittent, or who are sited in smaller EU27 markets.

[2] For more information about passporting, please see *Brexit Quick Brief #3: What is 'passporting' and why does it matter?* (https://www.bba.org.uk/wp-content/uploads/2016/12/webversion-BQB-3-1.pdf)

[3] In this report, references to 'UK-based banks' include both banks established in the UK (including subsidiaries of EU27 and non-EU banks), as well as UK branches of EU27 banks; references to EU-27 based banks includes banks established in the EU27 including subsidiaries of UK and non-EU banks and branches of UK banks in the EU27.

[4] For further information please see *Brexit Quick Brief #6 Time to adapt – the need for transitional arrangements* (https://www.bba.org.uk/wp-content/uploads/2017/03/BQB-6-new-version-online-FINAL.pdf)

Export-orientated EU27 companies that typically require more sophisticated banking services are likely to be severly impacted

It is not clear to what extent EU27-based banks will be able to quickly and seamlessly support these EU customers during this period of disruption. Faced with their own regulatory, capital and operational constraints, some EU27-based banks may require more than the two years available under Article 50 to expand their operational and balance sheet capabilities to fully support all those EU customers forced to seek alternative banking service providers. Other banks may find on-boarding all these displaced customers within the truncated timeframes of Article 50 challenging. Many EU27-based banks may similarly find themselves having to rationalise their service offerings to some of their EU customers in the short-to-medium-term.

Taken together, these factors pose a material risk to the large number of EU27 corporates and SMEs who either directly or indirectly obtain financial services from UK-based banks. In the absence of a final agreement on the future UK-EU relationship or the timely establishment of suitable transitional arrangements, it is possible that significant numbers of EU customers will suffer from reduced services until banks are able to adapt, which may take considerable time.

One EU business segment that is likely to be more severely impacted comprises businesses that contribute to the international export success of the EU economies. This is because such international export-oriented businesses typically require more sophisticated banking services (such as foreign currencies, trade finance, risk management etc.) where UK-based banks play a very significant role for European users today. Larger international export businesses may have direct relationships with UK-based bank providers, while smaller international export businesses may access such services indirectly through local bank relationships in their own country, with their local bank combining many such smaller customers and using the wholesale markets in the UK to manage the liabilities that it does not wish to retain on its balance sheet. Disruption to these important banking services is likely to negatively impact these internationally-oriented businesses that are the engines of Europe's export growth, both directly (by reducing the availability and increasing the cost of such services for them) and indirectly (by reducing the availability and increasing the cost of such services for their suppliers and customers located elsewhere within the EU27).

How national licensing regimes could help

In the face of these challenges, national licensing regimes may provide a partial 'lifeline' for some EU27 customers in certain Member States by offering an alternative mechanism for them to access the banking services they require. This is because until the terms of the future UK-EU relationship become clear, and in the event transitional arrangements are not agreed, some UK-based banks may seek to meet the sophisticated financing and banking needs of their EU27 customers using a hybrid model. This could consist of serving their EU27 customers partially from their transitioning EU27 branches or subsidiaries, and partially from their existing UK operations, with the latter dependent upon the terms of the relevant Member State's national licensing regime.

This is an aspect of the UK's withdrawal from the EU that is often under-appreciated – the availability of third-country banking services is in practice in many cases defined at the national level by the licensing regimes of each EU Member State and the restrictions imposed by these regimes on the activities of 'third country' banks. If there is no agreement with respect to transitional measures, and if as a practical matter the ability of EU27-based banks to seamlessly provide substitutes for all such services is limited, at least for some period of time, EU27 customers – who will still require the direct or indirect access to the types of sophisticated banking services UK-based banks currently provide – will need to rely on these individual national regimes to determine how they will be able to contract with and benefit from the services offered by UK-based banks.

For this reason, to understand how the UK's withdrawal from the EU could affect the key banking services available to EU-based customers of UK-based banks, it is necessary to understand how the national regulatory regimes of the EU27 Member States treat the provision of banking and investment services from foreign banks to customers located in their jurisdiction. This will allow EU customers and UK-based banks to consider their options properly, for although many UK-based banks have assessed and understood their potential exposure to this change, many EU27 customers of these banks have not yet done so.

Consideration of potential mitigants

As outlined above, once the UK has ceased to be a member of the EU, it will no longer be possible for UK-based banks to provide services to EU customers on the basis of passporting. Unfortunately, in this scenario some EU customers may find it challenging to access the full range of products and services necessary for the efficient running of their businesses.

A range of potential mitigants exists that at least partly bridges this gap, although none replicates the benefits that EU customers enjoy under the current passporting regime, with all constrained to some extent by the terms of Member State national licensing regimes. Similarly, all have inherent practical and operational limitations that render them inadequate as comprehensive solutions. These mitigants are considered below, and include:

- Reverse solicitation;
- EU customers engaging with UK banks from their own UK-based branch or subsidiary; and
- A UK-based bank establishing or expanding an EU27 local branch or subsidiary.

Reverse solicitation

'Reverse solicitation' describes a situation where an EU customer – acting exclusively on its own initiative – approaches a UK-based bank to procure the products and services it requires. Proponents of reverse solicitation suggest that it offers a solution which may completely exempt the UK-based bank providing these services from the requirement that it be licensed in that Member State.

This is mistaken. As evidenced by our survey, a number of EU Member States prohibit arrangements that allow non-EU banks to serve customers in the EU where the banks have not solicited business. In other Member States such arrangements are looked on by regulators with suspicion or are subject to a high degree of legal uncertainty. For banks, the combination of outright prohibition, legal uncertainty and regulatory hostility does not provide a sound foundation on which to base a business model for banking, or the relationships with businesses and their managers that effective banking is built on.

Reverse solicitation is equally unsatisfactory from a customer perspective. For those businesses most in need of cost-effective relationship banking – mid-sized companies looking for lending, trade finance and basic risk-management services – reverse solicitation is not a cost or resource-effective basis on which to secure critically-important banking products and services. These customers prefer to focus on their primary task of operating their businesses, and few have the in-house expertise to be able to efficiently and effectively meet their critical but often intermittent financial needs for more sophisticated banking or investment services. Building capacity in this area would only draw vital resources away from their core functions. This is particularly pertinent for those businesses that are instrumental to the EU's international export success as they are typically heavy users of these more sophisticated banking services.

EU businesses engaging with UK banks from their own UK-based subsidiary

In principle, the simplest way for an EU-based customer to continue to access the range of sophisticated banking or investment services provided from the UK would be to establish a new UK-based subsidiary. Indeed, many major EU market participants already have a UK-based subsidiary from which they operate part or all of their critical financial market functions.

While this may be a viable, cost-effective option for larger EU-headquartered multinational businesses that already have a presence in the UK, it is unlikely to be an attractive option for most EU firms. The establishment of a new UK subsidiary to access financial products and services from UK-based banks would involve consideration of numerous corporate, tax and regulatory factors, some of which will vary according to the product and service concerned, and would require ongoing management and cost. It would also represent a needless departure from long-standing relationship banking models which have so successfully served EU business customers for decades.

UK-based banks establishing a locally authorised entity from which to serve their EU27 customers

Setting up locally authorised entities of UK-based banks to serve EU27 customers directly offers *prima facie* the simplest solution to guaranteeing EU customer service continuity. In the case of subsidiaries, and in contrast to branches which are restricted to operating in the jurisdiction from which they received authorisation, this would have the added benefit of allowing banks to 'passport' across the EU27. However, the inconsistent treatment of branches and subsidiaries by Member State licensing regimes, combined with these entities' inherent operational and capital requirements, mean that these potential solutions come with their own significant challenges. We consider branches and subsidiaries further in the section below.

Establishing a locally authorised branch

There are a range of uncertainties around how the regulators in some EU27 Member States would approach an application for a new local branch licence for a UK-based bank

While there is a widely-held view that the process for establishing a locally-authorised EU27 branch is relatively simple and homogenous across the EU27, our survey reveals that this is incorrect. Indeed, in some Member States important aspects of such branch applications may be subject to key uncertainties. Some Member States dictate specific and relatively extensive corporate governance requirements which will affect how a local branch is set up and staffed. In many cases, these are significantly more onerous than the requirements which apply to the branches of UK-based banks in the EU Member States currently operating under EU passports.

Further reducing the attractiveness of branches as a mitigant is the finding from our survey that some EU27 Member States (e.g. Germany) impose capital and liquidity requirements for a branch which are substantially the same as for a locally incorporated bank. A fully-licensed local branch will also in many cases be required to book transactions carried out with customers in that jurisdiction on its local branch balance sheet, potentially fracturing capital across a banking group and reducing a key scale and efficiency advantage that branching is typically intended to provide over subsidiarisation.

Such requirements significantly negate any real advantage offered by branching as a mitigant. In addition since a foreign bank branch in the EU27 will have no 'passporting' rights to sell services onward across the EU's internal borders, service continuity for EU customers would require the foreign bank to establish additional branches in every EU market where EU customers are located. Furthermore, our survey identified broad inconsistencies in the process and timing of the application process, ranging from four to six months (in Luxembourg) to potentially 18 months (in Germany and some other EU27 Member States). Consequently, many UK-based banks will inevitably weigh these shortcomings against the potential benefits of market presence in individual markets and potentially exit or choose not to serve the smallest markets or those which offer the least efficient economies of scale.

Establishing a EU27 licensed subsidiary

Establishing or expanding EU subsidiaries as a means to serve EU27 customers during this gap will likely take longer than the two year period of Article 50

An alternative to branching is to establish a subsidiary incorporated and licensed in an EU27 Member State. While seemingly an attractive option due to the ability of a licensed subsidiary to passport across the EU27, subsidiaries are generally subject to more stringent supervisory requirements than branches on matters such as booking models and risk and compliance controls. Supervisory consent is almost always needed for senior management staffing. Even if these initial authorisation processes were fast-tracked, the subsequent operational transposition of product and service lines from a UK entity to a EU27 subsidiary is complex and multifaceted, with steps such as client outreach, education, and repapering requiring significant time and investment.

The time it would take to build up the subsidiary's supporting capital must also be considered. Not only must this capital be available to be deployed, but the legal mechanisms for its transfer must be developed, approved by supervisors and implemented in a relatively short space of time.

A number of studies have concluded that for many UK-based banks the process of establishing or expanding an EU27-based subsidiary with sufficient operational and balance sheet capacity to support all their existing EU27 customer activity is likely to require longer than the two-year period contemplated under Article 50[5]. As such, if suitable transitional agreements are not agreed, this could mean that many EU27 subsidiaries of UK-based banks may, for a period of time, not have the operational capacity or balance sheet and liquidity strength to support in full their existing EU27 customer business volumes. This may limit the services that EU27 customers will find available to them in the short-to-medium-term.

[5] AFME, Price Waterhouse Coopers (2016), *Planning for Brexit Operational impacts on wholesale banking and capital markets in Europe*, https://www.afme.eu/globalassets/downloads/publications/afme-pwc-planning-for-brexit.pdf, pp2-5

The true state of national licensing regimes

With subsidiarisation, branching and reverse solicitation offering sub-optimal foundations on which to provide EU customers with the products and services they need, EU customers who use the services of UK-based banks will either have to draw on their own individual Member States' banking sectors (which may themselves require additional time to build up capacity and capability to offer in particular the more sophisticated services needed by EU export oriented businesses on the same terms as a UK-based bank) or rely on their UK-based bank to serve them according to the terms of their Member State's national licensing regime.

As evidenced by our survey, this landscape is generally very restrictive but with significant variance among individual EU27 Member States. Far from presenting a single picture for EU27 customers seeking to continue using UK-based banks for some of their required banking services during any interim period, there are 27 pictures, many of which are evolving. What EU customers may be able to do will not only depend on what service or product they need, but also on where they need it from.

Far from the current single market from which European customers can seamlessly access the services they need, EU27 customers falling back to reliance upon national licensing regimes would need to navigate a much more fragmented and restricted market. The table below captures the general landscape for EU27 customers wishing to use UK-based banks in a scenario in which there is no new framework for cross-border trade in banking services between the UK and the EU.

As evidenced in this table and explored further in chapter 2, national regimes are most permissive in the scope they create for wholesale businesses to access non-EU providers for services such as corporate lending, investment banking and risk management products such as derivatives. This is especially the case in Germany, the Netherlands, Ireland and Luxembourg, all of which have arguably benefited from the more open and expansive characteristics of their national licensing regimes. In contrast, a number of other EU27 Member States have adopted a more restricted approach, with countries such Portugal, Sweden and Italy relatively closed off by comparison.

Table 1: National licensing regime country overview

PRODUCT LINE OFFERED BY UK-BASED BANK	Countries											
	BE	CZ	FR	DE	IE	IT	LU	NL	ES	PT	PL	SE
Corporate banking - lending												
Corporate banking - deposit-taking												
Corporate banking - risk management												
Investment banking - primary markets												
Investment banking - sales and trading												
Asset management												
Private banking and wealth management												
Market infrastructure												
Retail banking												

KEY	
	Prohibition or very significant restriction in all cases
	Prohibition other than in certain limited circumstances
	Permissible subject to an exemption which must be applied for and/or some significant restrictions
	Permissible subject only to minor exceptions (if any) and no need to apply for exemption

One area where the EU27 is relatively consistent is in relation to the provision of services to small businesses and retail customers. This is severely restricted across all EU Member States, especially with respect to retail products such as deposit-taking, the issuance of credit cards, payment services, e-money services, consumer lending, mortgage lending and the sale of structured products.

Many EU Member States limit the ability of their own governments to access banking services from outside the EU

Perhaps a more surprising lesson from the survey is the observation that many EU Member States limit the ability of their own governments to access banking services from outside the EU. For example, many EU Member States have rules on appointing primary dealers to manage issues of their national debt in primary capital markets and to participate in secondary market-making in that debt, generally restricting it to banks authorised in the EEA. In the absence of an agreement, the loss of access to UK-based primary dealers post-Brexit could result in Member States having to issue sovereign debt on less favourable terms if the incremental depth and liquidity created by those active primary dealer participants is curtailed.

Clearly, from the point of view of the EU27 customer currently using, or seeking to use in the future, services provided by UK-based banks, the prospect of an even partial reversion to national licensing regimes for determining access to banking services from UK-based banks would mean new restrictions, a large measure of uncertainty and considerable disruption. In this environment, Member States that offer the most open and expansive national licensing regimes (and the customers based in those Member States) are likely to benefit from greater capital inflows and service provision. Those whose national licensing regimes make little provision for non-EU banking and investment service provision may not.

One issue of note is that irrespective of the position of national regimes, the interaction of EU legislation with national frameworks can reduce the degree to which national variations in market access conditions can act as any kind of mitigant to disrupted services. Access to market infrastructure such as central counterparties (CCPs) is one such area where this is relevant, for even if national licensing regimes permit in principle the cross-border contracting of services with UK-based banks (as they do in the case of Belgium), because the EU recognises the equivalence of third country regimes for CCPs at the EU level, the absence of such recognition could materially reduce the value of a more permissive national regime.

Could national licensing regimes inform elements of a future arrangement between the EU27 and the UK?

While the national licensing regimes of EU Member States provide an uneven and limited basis for a long-term framework for trade in banking services between the EU and the UK, they have been a testing ground for a range of approaches to cross-border trade in financial services. For this reason, the attributes of some regimes could provide a source of possible ideas for facilitating cross-border trade in services between the two markets in a preferential trading agreement.

One example is the 'inter-professional' exemption that already effectively exists in the laws of a number of EU27 Member States. This allows sophisticated counterparties subject to adequate home supervision to contract for services from each other. Similarly, some national licensing regimes take a similar approach to specific economically vital services like commercial lending. Another example is based on the principle of recognition of regulatory cooperation with third country regulators of high international standing, and would involve allowing regulated financial institutions from the third country in good standing to contract with certain customers in the EU Member State.

The EU and the UK could consider extending these exemptions to all Member States as an element of any future agreement. Given the already highly integrated nature of UK and EU financial markets, any measures which minimise divergence between the two should be embraced, and solutions which guarantee continuity of access for EU27 customers to the wide range of financial services provided from London encouraged.

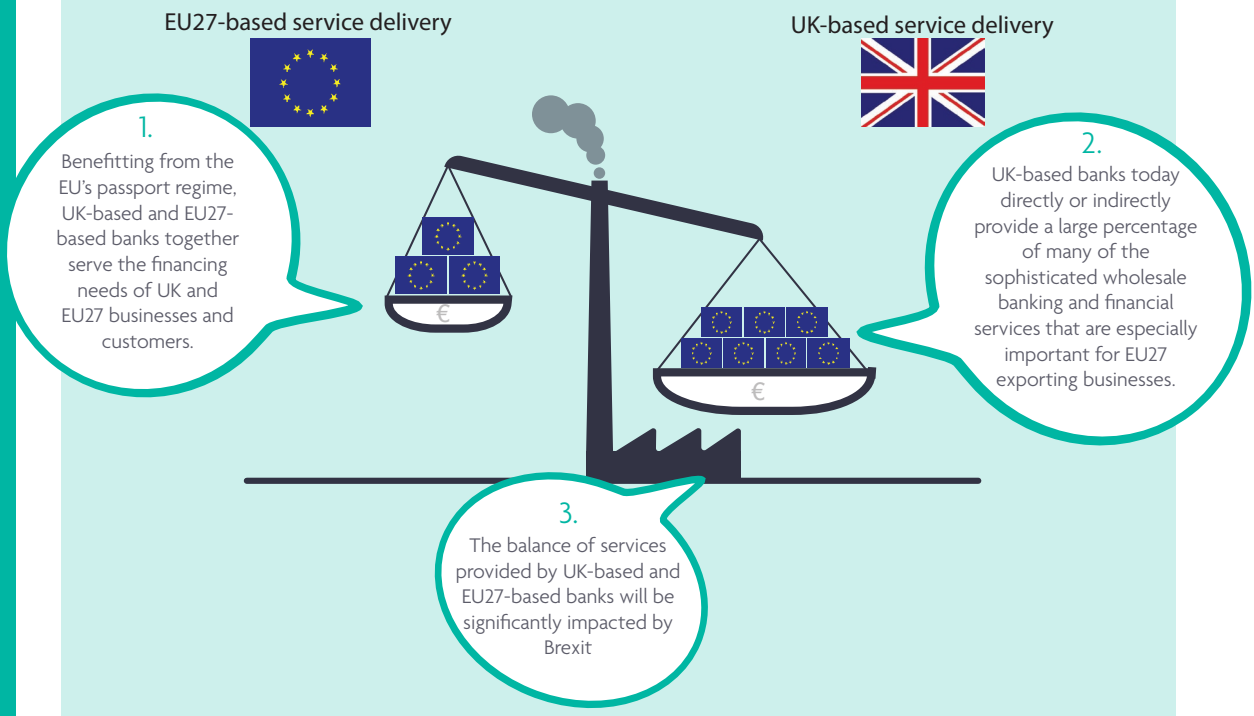
National licensing regimes offer an important but limited mechanism to mitigate the consequences of a scenario in which the UK and EU are unable to timely agree a new framework for cross-border trade in banking services. By considering these in detail, it is possible to draw some general but important conclusions as to their effectiveness, and what this means for the future relationship.

Changing the balance: the path to a new market equilibrium in financial services

Ranging from the administration of basic business bank accounts to the provision of complex corporate financing products, UK-based banks and financial services firms have long provided EU customers with a wide range of important products and services both directly and indirectly, often alongside EU-based firms. The UK's withdrawal from the EU will change the manner in which these services are provided. This may result in a temporary reduction of service capacity until such time as a new market equilibrium in financial services evolves.

Pre-withdrawal: equilibrium in provision of key banking services used by EU27 customers based upon EU passporting

The EU's wholesale banking services today balance supply and demand for UK and EU27 customers.

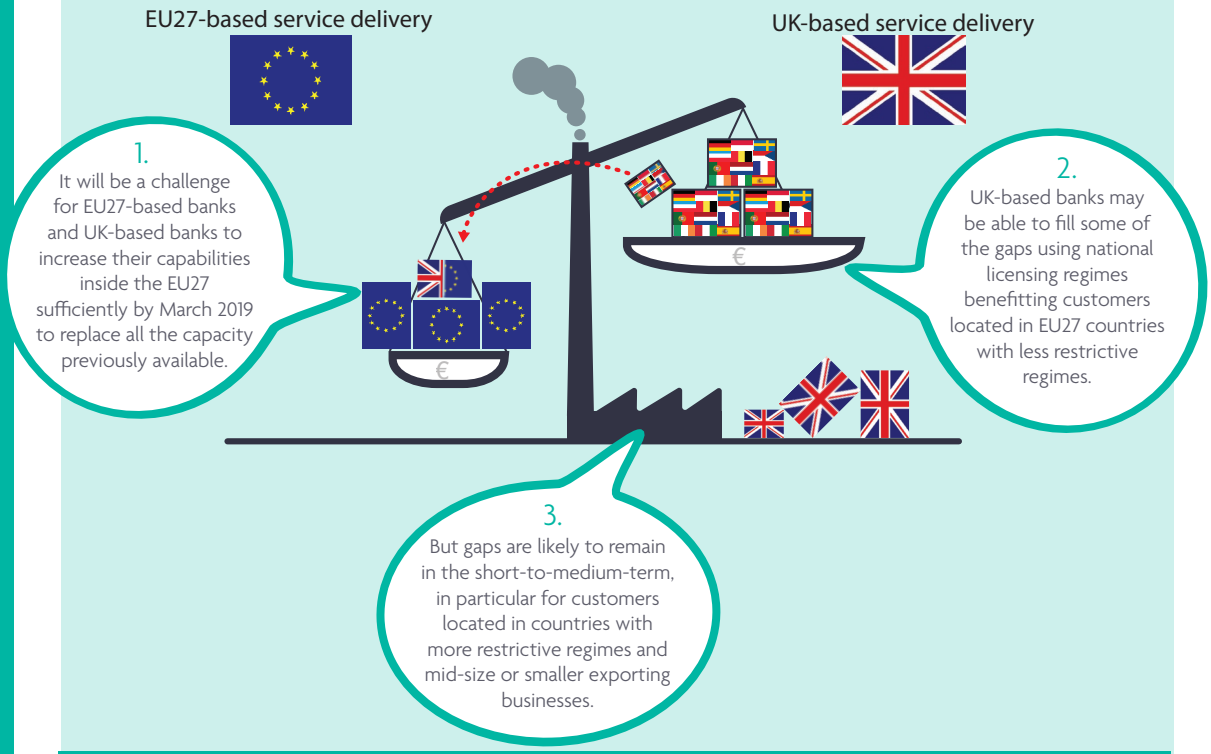


Key

- EU passport rights
- Limited increase in capacity of EU27-based banks and UK-based banks inside EU27 in period up to 2019
- UK-based bank capacity ineligible to provide services for EU27 customers.
- EU27 national licensing regimes
- Future EU/UK Free Trade Agreement

2019: UK withdrawal from the EU - risk of equilibrium disrupted

Without EU passporting rights the banking capacity previously provided by UK-based banks will need to be restructured.



The future: establishing a new equilibrium

In time, a new balance will be established, but on what basis and at what cost?

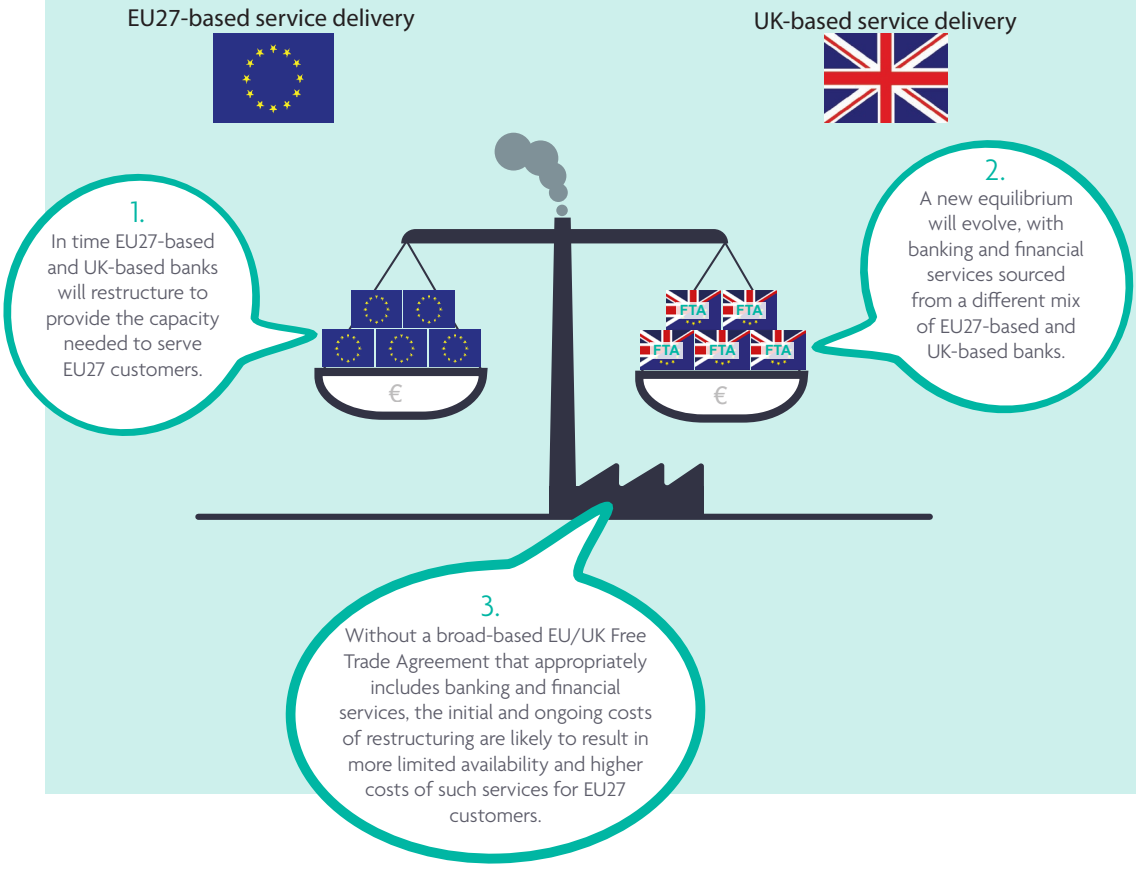
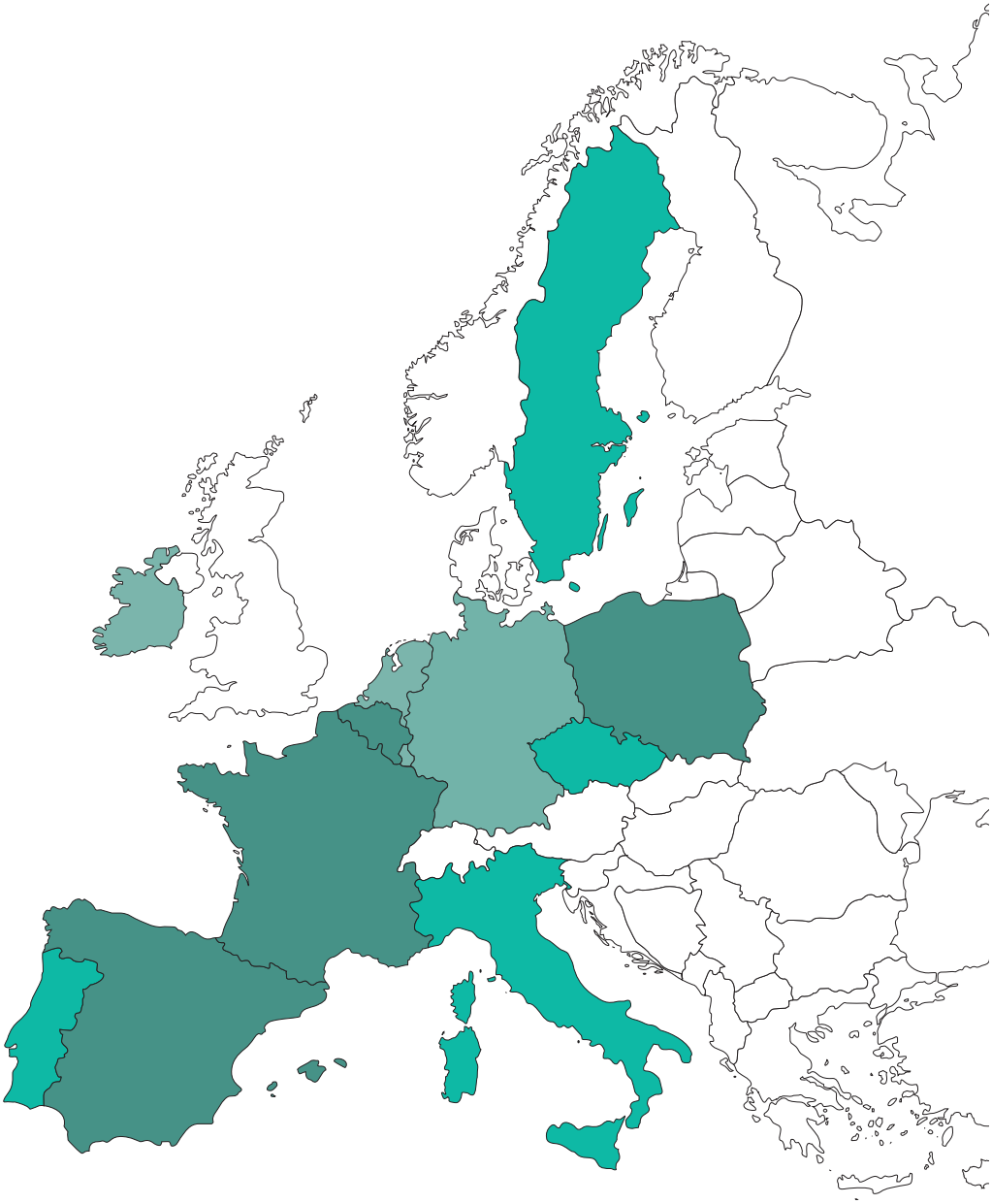


Figure 1: Representation of the relative openness of surveyed national licensing regimes

The figure below is a representation of the relative openness of the twelve surveyed national licensing regimes across product lines critical for EU27 exporting businesses. A breakdown of these business lines can be found in tabular form in Annex 2.



KEY	
	Prohibition or very significant restriction in all cases
	Prohibition other than in certain limited circumstances
	Permissible subject to an exemption which must be applied for and/or some significant restrictions
	Permissible subject only to minor exceptions (if any) and no need to apply for exemption

Conclusions

Conclusion	Comment
National licensing regimes will be an important but limited tool at the point of Brexit.	National licensing regimes can serve as a possible partial mitigant for some Member States and customers against some of the risks of system instability and disruption in a 'cliff edge' scenario.
This patchwork of rights is in each case limited, uncertain and poorly suited to the kind of services that EU exporting companies need.	While some national licensing regimes do create scope for EU27 customers to contract with UK-based banks after Brexit, they generally do so in a way that is partial, inflexible and uncertain. Other mitigants, such as reverse solicitation and the establishment or expansion of UK or EU-based branches and subsidiaries, offer imperfect solutions.
The nature of the risk at the time of the UK's withdrawal from the EU27 will depend upon the size of the gap between customer need and available banking sector capacity.	It will take time for EU27-based banks to expand their capacity and capabilities so as to absorb disruption in the most impacted product and service areas, and for UK-based banks to adapt their own existing product and service capabilities to evolve towards a new commercial, economic and social equilibrium. This evolving combination of increasing capacity from existing EU based banks, and UK-based banks expanding their branch or subsidiary capabilities in the EU27, is likely to result in some EU27 customers in some countries relying on their national licensing regimes as a partial solution to meet some (but not all) of their critical banking and investment services. This is likely to be a particularly relevant need for EU export oriented businesses that require more sophisticated banking services and that support key elements of EU economic growth and job creation.
In the short-to-medium-term, the provision of banking services for EU customers could become more costly and constrained.	EU27 customers will still need to access UK-based banking services to some degree, either directly or indirectly, and for some time post-Brexit. Until sufficient capacity becomes available in the right locations to fulfil customer needs, it is likely that the cost of banking services will increase while the choice of products and services will decrease due to a reduction in economies of scale and centralisation.
The most effective mitigant against the risk of a 'cliff-edge' effect at the point of the UK's withdrawal from the EU is to ensure that appropriate transitional arrangements are agreed well in advance, ultimately leading to a comprehensive UK-EU cross-border market access agreement on terms that are mutually acceptable to the UK and EU27.	The short-to-medium-term 'cliff-edge' macro and micro risks of Brexit and their likely consequences for EU economic activity (and especially for EU exports) can be avoided if the UK and EU can commit at an early stage to comprehensive transitional arrangements in the period immediately after the UK's withdrawal from the EU. A subsequent long-term solution guaranteeing continuity of access for EU27 customers to the wide range of financial services provided from UK-based banks is in the interests of customers.

Several provisions found within some EU national licensing regimes warrant consideration as a possible basis for any future UK-EU financial market access agreement. In many instances, these provisions set a more flexible and robust precedent than the relatively inflexible models that currently exist at an EU level.	Some national licensing regimes of EU Member States contain features that should be considered for inclusion in a future UK-EU cross-border services trade agreement.

EU27 customers of UK-based banks after Brexit: what then?

How can EU27 customers still benefit from UK-sourced products and services if the UK withdraws from the EU with no agreement?

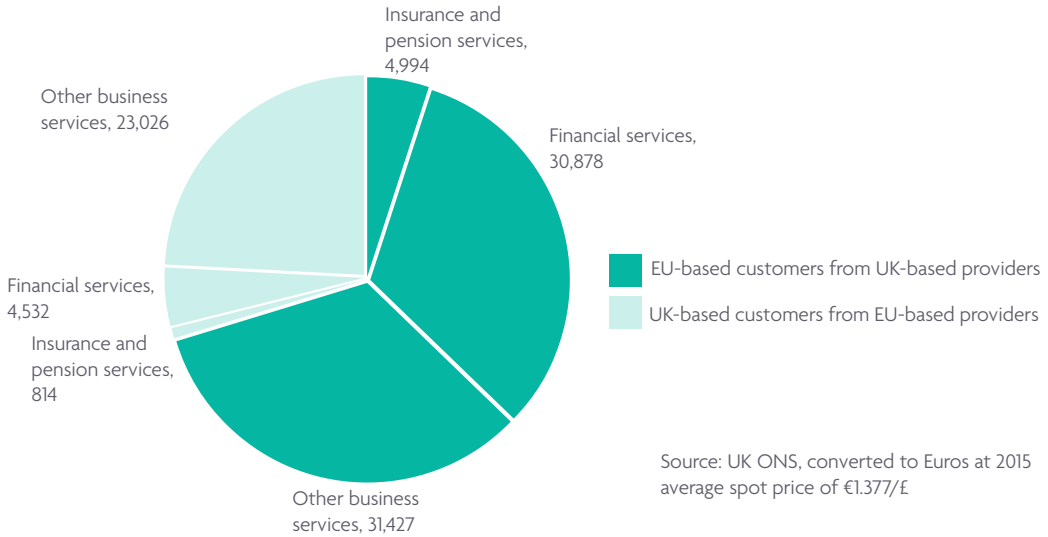
A country that is an EU Member State is also automatically a part of the EU single market. This market has a single external border for customs and tariffs, and goods and services can be traded between the member countries of the single market with relative freedom. The EU single market is much more developed than a free trade area; at its heart it is a harmonised set of rules designed to enable a very high level of economic integration among members. The UK is currently a full member of the EU and is therefore a constituent part of this EU single market.

Financial services firms authorised in the UK are currently able to provide services across the single market and within other EU Member States. These rights, which are not available to banks established outside of the EEA, enable UK-based banks to serve their EU customers without the need for further licences or authorisations. The ability to 'passport' services in this way means that a UK-based bank can either provide its services directly on a cross-border basis or via a branch established in another Member State.

This 'passporting' has facilitated the creation of an EU-wide market-place for financial services. In 2015, non-UK based businesses from the EU single market purchased services worth more than €35 billion of financial and insurance-related services from UK-based providers. The sellers of these services include domestic UK firms, businesses from elsewhere in the EU located in the UK and non-EU firms operating in or from the UK market.

This trade has gone both ways; businesses based in the UK also imported large volumes of financial services from the rest of the EU, purchasing around €5.3 billion in financial and insurance-related services from providers based in the rest of the EU during the same period. When the wider business services that support many parts of this activity are included, the true scale of the cross-channel marketplace is even more marked (See Figure 2, below).

Figure 2: The EU27 - UK cross-border marketplace for financial and related services 2015 (€ in millions)



Source: UK ONS, converted to Euros at 2015 average spot price of €1.377/£

Once the UK has ceased to be a member of the EU, absent agreement on transitional arrangements or a future cross-border framework between the EU and the UK which preserves these rights in some form, it will no longer be possible for UK-based banks to provide cross-border services to customers across the EU in this way. For EU customers currently enjoying the benefits of specialist services provided by UK-based banks, this raises the question of how they continue to access these services. Where their own domestic banking sector requires more time to build the appropriate capital and operational capacity to offer these services, EU customers may find it necessary to continue to engage with their UK-based bank. The question then becomes whether it is even possible to continue to be served by UK-based institutions, and if so, how.

Theoretically, the most straightforward way for an EU-based customer to continue to access the full range of banking and investment services provided by UK-based banks would be either a) for the EU-based customer to establish a new UK-based subsidiary (or utilise an existing one) to perform its required treasury functions with the desired level of access to UK banking services; or b) for the UK-based bank to establish a branch or subsidiary in the EU. In practice, both have cost, complexity and timing factors that are likely to limit their usefulness. Alternatively, the EU-based customer could seek to source equivalent services from their own domestic banking sector or from other banks with an existing presence in the EU27. While it is expected that such substitutes will be available in the longer term as a new commercial, economic and social equilibrium is established following the UK's departure from the EU, in the short-to-medium-term many domestic or other EU27-based banks will similarly require time to build the appropriate capital and operational capacity. This is particularly true with regards to the more sophisticated services used by EU international export oriented businesses and for which the UK has historically been an important direct or indirect supplier.

A range of options exist that EU27 customers could draw on to continue to access UK-based banking and financial services post withdrawal, but all have significant challenges

As regards the use by an EU27 customer of a UK-based subsidiary, while this may be a viable, cost-effective option for larger EU-headquartered multinational businesses that already have a presence in the UK, it may be less practical for smaller businesses. There are many reasons for this. The establishment of a treasury function in the UK via a subsidiary to access financial products and services from UK-based banks would require consideration of a number of corporate, tax and regulatory factors, some of which will differ according to the product and service concerned. Care would need to be taken to ensure sufficient substance in the UK-based entity to avoid the risk that exists in some EU countries of characterisation as the direct provision of the product or service to the EU-based company that is subject to legal restrictions.

Tax and other regulatory considerations would also need to be considered to allow the banking product or service to be delivered in a neutral and effective way via the treasury subsidiary in the UK to the location in the EU customer's businesses where it is required. Certain types of products and services (such as risk management and hedging services using derivatives) may give rise to especially complex considerations, and while more sophisticated EU customers may have the scale of business to justify the resources and expertise required to put in place a suitable UK based treasury function, other smaller EU customers may consider this to be a less suitable solution for their needs.

The capacity of UK-based banks to successfully transpose key product and service lines to a new or existing branch or subsidiary located inside the EU from which the product or service can be provided to EU27 customers is frequently perceived to be the most obvious solution for EU27 customers (as banks will naturally be incentivised to take action to preserve their ability to serve their customers). In practice, this is similarly likely to be constrained by complexity, timing and cost factors to limit the capacity that can realistically be relocated within the now less than two-year period available until the UK withdraws from the EU. As a consequence, this option is likely to be of limited use in the timeframe available.

Importantly, the scope for EU27 customers to continue to obtain some of their banking services from UK-based institutions would now be dictated chiefly by the national licensing regime of the Member State in which they operate, for it is at this level that cross-border trade in banking services is largely regulated. This is an aspect of

the UK's exit from the EU that is often under-appreciated. It matters because in circumstances in which the EU and the UK are unable for any reason to agree a trading framework between them that preserves 'EU level' market access rights similar to those created by the current passporting system, it is these national regimes that will dictate the way many EU customers can contract with and use banks based in the UK.

How an EU27 customer is able to directly access products and services from a UK-based bank directly will therefore depend on a number of factors, often in combination:

- How their national regulator defines whether a service is delivered cross-border or locally, and what it permits in each case ('defining local supply');
- Whether their national regulator exempts certain activities from authorisation where they are requested by the customer without any solicitation by the bank, and thus deemed to be undertaken purely at the customer's discretion and risk ('reverse solicitation'); and
- Whether their national regulator exempts certain cross-border activities from regulation and authorisation requirements based, for example, on what they are and who they are contracted between, and if so, what this covers (often called 'freedom to use' national licensing regimes).

No two EU Member States apply exactly the same approach to all of these questions. The remainder of this chapter and chapter 2 review approaches to the above factors relative to the functioning of national licensing regimes.

Defining local supply

In general, where an EU national regulator deems a service to be provided locally they will require the provider to have an authorised presence in their jurisdiction. Clearly, an EU27 customer with specific needs for services provided by a UK-based bank may not be able to access them if local laws require the UK-based bank to obtain a licence following the UK's withdrawal from the EU, and this authorisation is not feasible or practical for the UK-based bank.

When assessing the question of whether a local service is deemed to have been provided in their jurisdiction, the test applied by national regulators is usually one of 'characteristic performance'. This test assesses where the supply of a service actually takes place, looking at where the customer typically conducts their business and where the business is transacted, but there are nevertheless variations in how this is determined across EU states.

Of all the jurisdictions surveyed, only Luxembourg provided any support for the contention that services and activities carried on by a UK-based bank for a EU27 customer located in the EU could be regarded as being performed in the UK:

"...having customers domiciled in Luxembourg does not mean that [third country firms] perform ipso facto their activities on the Luxembourg territory[6]."

This is in direct contrast to the position in many of the other EU27 Member States surveyed. For example, the mere fact that a deposit-taking customer is based in the Netherlands (and many other EU Member States) may be sufficient to mean that deposit-taking activity is judged to be taking place there, and must thus be conducted by a locally authorised party[7].

Determinations of characteristic performance in each EU27 state are then overlaid with a set of rules about what requires local authorisation and what does not. These vary across Member States. However, in most cases surveyed here, a judgement that a UK-based bank must be licensed locally to provide a service to a local business following brexit requires the establishment of a local branch or EU subsidiary, both in respect of banking and investment services. The complexities and costs of this are assessed in more detail in chapter 3.

The only jurisdictions surveyed that would in theory permit the performance of cross-border regulated activities and services without a physical presence are Luxembourg, the Netherlands, and Spain.

[6] Circular 11/515 published by the CSSF states that the term 'come to Luxembourg' indicates that, in order to be subject to the licensing requirement, one or more agents of the third country firm must be physically present in Luxembourg when collecting deposits and/or providing financial services. Firms that have Luxembourg-domiciled clients do not *ipso facto* conduct their activities in the territory of Luxembourg. Pure cross-border activities carried out exclusively through communications (such as telephone, fax, e-mail) initiated from outside of Luxembourg will in principle not be subject to the licensing requirement.

[7] Approaching EU-based clients through a UK-based bank via a third party (i.e. a local distributor or intermediaries incorporated and licensed in the relevant jurisdictions) does not address the 'characteristic performance' test. Very few jurisdictions surveyed provided any support for the contention that a UK firm could approach potential customers via such a third party.

However:

- The most recent draft of the Dutch MiFID II implementing act in principle requires any third country firm performing MiFID services (regardless of client categorisation) in the Netherlands to establish a branch in the Netherlands. An exemption from the obligation to establish a branch applies for firms (i) based in a third country that is designated to provide adequate supervision (currently Australia, Canada, Japan, Switzerland or the US), provided that this firm is included in the ESMA register and (ii) that solely provide investment services to professional clients[8].
- In Spain, a physical branch presence may be required if the bank intends to provide services by means which are located permanently in Spain (for instance, an office, a network of agents, a call centre or employees that provide services in the Spanish territory).
- The Luxembourg regime is the most permissive surveyed in the EU, with a lighter licensing regime for third-country banks that do not have a physical presence in Luxembourg and who carry on a range of very limited activities there on an occasional and temporary basis.

Reverse solicitation

One key category of exemption from authorisation requirements that merits review at greater length is 'reverse solicitation'. Reverse solicitation arises where a customer approaches a bank to provide a service without being solicited in any of a number of defined ways. In such cases the customer is deemed to have undertaken the contract of their own volition and in sufficient awareness of any risk in a way that removes the requirement that the service provider be locally authorised. In practice, however, as our survey illustrates, reverse solicitation is likely to be of very limited practical use for many EU27 customers because of the limitations and uncertainties related to its use.

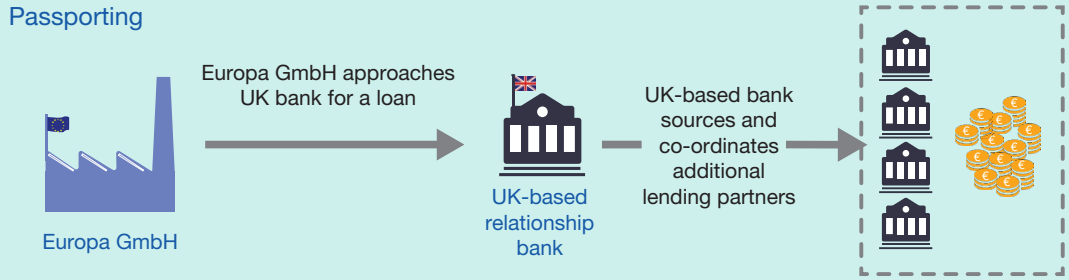
Case Study 1: Reverse solicitation in Germany

Europa GmbH is a German manufacturing company that has operations in the EU and Latin America. For many years it has routinely raised finance both from individual UK-based banks and syndicates of banks, including dollar-based loans to finance investments abroad. At present, these loans are contracted directly between Europa GmbH and the banks in the UK, relying on the passport held by the UK-based bank to operate across the EU. This does not require the banks in the UK to have an additional legal presence or be licensed elsewhere in the EU. Europa GmbH is also not required to have a legal entity in the UK to contract with. How might these relationships be affected if Europa GmbH was forced to rely on reverse solicitation exemptions from general prohibitions on cross-border activity? Under German law on licensed lending activities, Europa GmbH would find itself only able to contract with UK-based banks where the company itself had initiated contact with the bank and where the German regulator determined that the service in question was being supplied in the UK. So:

- If a UK-based bank wanted to proactively approach Europa GmbH to offer a lending service or product it would be prevented from doing so without establishing a licensed entity that is permitted to undertake commercial lending in Germany, where commercial lending is a regulated activity;
- It would not be possible for UK-based banks to market loan products to Europa GmbH, or to provide competitive alternatives to providers approached by Europa GmbH, unless explicitly requested by the company, without any solicitation by the bank.
- If Europa GmbH sought syndicated lending from a group of UK-based banks, only those banks selected by Europa GmbH to participate would be covered by the reverse solicitation exemption. Banks not covered by this exemption – because they had not been contacted proactively by Europa GmbH – would be unable to compete for the mandate to raise finance.

[8] The Dutch government has expressed an intention to amend the Dutch MiFID II implementing act so that only third country firms performing MiFID services to retail customers or opt-up customers (customers who indicated they wish to be treated as professional clients) in the Netherlands are required to establish a branch in the Netherlands. The amendment has not yet been formally implemented.

Figure 3: Syndicated lending under passporting



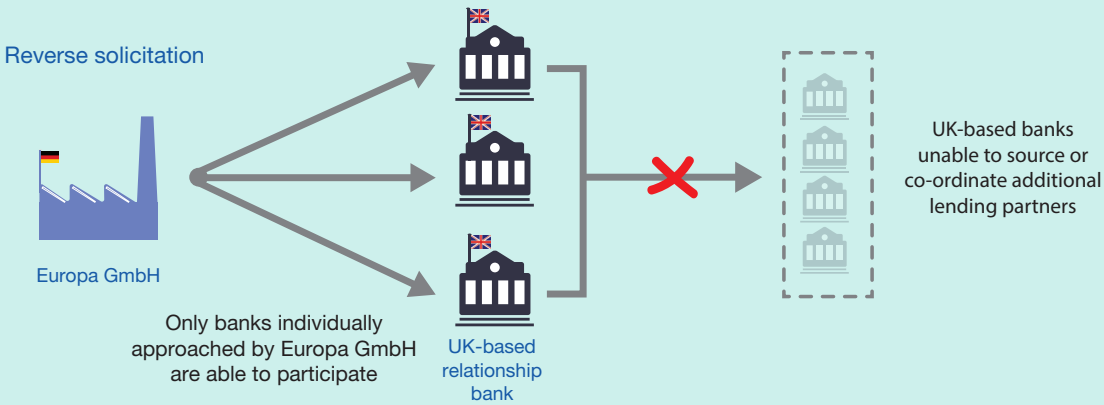
Suppose that Europa GmbH also wishes to purchase a swap or other form of risk management product to hedge this loan in some way. Such a purchase could be covered by Germany's reverse solicitation exemptions, provided Europa GmbH contacted a UK-based bank on its own initiative and provided the German regulator determined that the service was being delivered in the UK and met German reverse solicitation rules limiting the frequency with which the exemption can be used.

However, under reverse solicitation rules, the UK-based bank could only provide the product sought by Europa GmbH. If the UK-based bank wished to advise on a more appropriate product, or if the type of product suited to the loan changed, the bank could lose the reverse solicitation exemption, as it might be judged to be marketing products to the company other than that sought at the company's initiative.

In general this model works against some of the most important features of relationship banking for growing companies. It is incompatible with long term relationship building; it constrains a bank's flexibility to advise clients and offer them products and services other than those they seek, even where they may be better suited to their needs; and it is conducted in an atmosphere of legal and regulatory uncertainty and potential ambiguity.

The potential limitations of reverse solicitation for EU companies seeking to contract with UK-based banks post-withdrawal are revealed using this example. In this case, the German approach is not atypical in the EU. These approaches typically reinforce the inflexibilities of the reverse solicitation model and the way it can work against companies being provided with choice, competition and even quality advice on an appropriate product for their needs.

Figure 4: Syndicated lending under reverse solicitation



A combination of outright prohibition, legal uncertainty, regulatory hostility and operational inadequacy does not provide a sound foundation on which to base a business model for banking or the relationships with businesses and their managers that effective banking is built on. It is perhaps notable that for the businesses that most need cost-effective relationship banking – European mid-sized companies looking for lending, multi-currency capacity, trade finance and basic derivative services, frequently the archetypal EU *Mittelstand* or mid-sized international exporter – the reverse solicitation model is of limited benefit.

The basic alternative to reverse solicitation models for many EU27 customers seeking services from UK-based banks would be exemptions from local authorisation provided by national licensing regimes for accessing services from banks outside the EU. The next chapter of this paper looks at these exemptions in more detail.

A number of recent studies have suggested that UK-based banks would be able to sidestep national restrictions with respect to the marketing and provision of banking and investment services to EU-based customers through reliance on 'reverse solicitation'. This proposition is problematic on both legal and practical grounds. With the approach to reverse solicitation varying in each Member State and between different regulated activities, the question of whether reverse solicitation is permitted is essentially a matter of domestic law in each individual jurisdiction. How far a UK-based bank can go in dealing with a customer without being regarded as 'soliciting' a customer therefore differs between Member States.

Some Member States are more permissive than others in their approach to reverse solicitation, but most regard it with a degree of caution. So, for example, among the countries surveyed:

- For German customers it is in principle possible to carry out certain banking business and provide investment services on a reverse solicitation basis without triggering any local licensing requirements. However there are strict rules on non-solicitation and carefully defined restrictions on how a bank may serve a reverse solicitation customer (see Case Study 1);
- The concept of reverse solicitation is also recognised in Portugal in relation to the provision of all types of banking and investment services. This requires that a 'characteristic performance' test shows that it takes place outside Portugal however, and there are restrictions on the frequency of business that can be carried on in reliance on the exemption.
- Prospective customers in the Netherlands can solicit investment, but not deposit-taking, services on a reverse solicitation basis. An explicit condition to this is that the bank providing the service must not otherwise promote or market its services actively to clients based in the Netherlands.
- A similar regime applies in Sweden. Where a Swedish customer solicits specific banking or investment services from a third-country bank, those services are not considered to be provided in Sweden and accordingly are not subject to any local licensing requirement. However, the exemption only applies where the relevant service has not previously been offered or marketed in Sweden and in relation to the specific service subject to the customer's enquiry.
- Reverse solicitation is recognised but construed narrowly in Belgium, the Czech Republic and France.

Equally as significant as the legal considerations are the practical ones; reverse solicitation is generally not a model of service provision that meets the needs of most EU27 customers, whether large or small. This is because this model works against some of the most important features of relationship banking for growing companies:

- It is incompatible with long term relationship building and incongruent with most EU27 customers' service expectations.
- It constrains the flexibility for a bank to advise clients and offer them products and services other than those they seek, even where they may be better suited to their needs.
- It operates in an atmosphere of legal and regulatory uncertainty and potential ambiguity.
- It is inherently inefficient, drawing EU27 company executives and resources away from their primary objective of growing their businesses.
- It fails to recognise that EU27 customers – often lacking extensive expertise in complex financial products – can secure better outcomes by receiving unsolicited marketing material or pricing offers from competing service and product providers.

Freedoms and restrictions on the use of non-EU banking services under EU Member State licensing regimes

Even in countries that have comparatively open and permissive national licensing regimes, differences in national treatment can make it difficult or impossible for EU customers to obtain the products and services they require

With reverse solicitation and the establishment of a UK-based EU27 customer subsidiary both unsatisfactory solutions to the question of how EU27 customers are to meet their more sophisticated financing and banking needs, a deeper understanding of the opportunities afforded by Member State national licensing regimes is required.

In general, across these EU national licensing regimes, banks from outside the EU are heavily restricted from marketing to and serving domestic customers without local authorisation. There are a limited number of exceptions to this principle that provide limited scope for certain kinds of customers to be served in the way they are today. However, these apply only in a small number of areas, to specific kinds of customers, and vary materially across Member States.

This chapter considers this landscape in more detail as revealed by the survey of national regimes. This survey focused on two core aspects of current banking activity in the EU that are integral to the way that customers are served by their banks. These are: a) the marketing and promotion of banking and investment products and services to EU-based customers; and b) the actual provision of those products and services to such customers.

This chapter begins with a brief general overview of the approaches to marketing and then assesses the status quo for provision across a range of key banking services. Although for convenience this breaks down banking services into separate types of product or service, and illustrates the often differing legal or regulatory requirements applicable to each, the way many customers actually use such services will be as a 'package' where several products and services are bundled together to provide a comprehensive financing solution for a sophisticated business need. A good example of businesses that prefer such bundled offerings are those EU businesses involved in international export and trade – in effect one of the most important 'engine rooms' of Europe's economic growth and prosperity – which will often require a mix of lending, currency, payments, trade finance networks, risk management, derivatives and other products and services. The EU passporting regime facilitates this bundling in important ways by allowing 'passports' to be combined to create a single service to the customer.

However, as is evident from the survey results, most national licensing regimes do not view these from the perspective of an EU customer, as a single combined/bundled service offering, but rather as distinct offerings that may be subject to different and inconsistent requirements or restrictions. This can mean that, even in those countries that have comparatively open and permissive national licensing regimes, differences in treatment can make it difficult or impossible for an EU customer to obtain the combination of products and services that they require in the way that is most efficient and suited to the customer's needs.

The sale, marketing and promotion of banking and investment products and services to EU customers

As noted above, one of the many shortcomings of the reverse solicitation model for customers is the restriction on banks being able to make customers relying on such frameworks aware of the products that could be most useful and how they might best suit a customer's needs. Clearly the question of whether services can be marketed cross-border to a customer is closely linked to whether they can actually be provided cross-border.

Generally speaking, in EU national regimes, where an EU customer will not retain access to a particular UK-based banking or investment product or service following Brexit, it follows that the customer will also not be able to receive marketing or promotional materials relating to that service or product from the UK-based bank. The reverse is also generally true: where, following the UK's withdrawal from the EU, a customer may continue to access UK-based banking and investment products and services, the UK-based bank may freely market or promote such products and services to the customer.

This approach of seeing the act of marketing and the provision of marketed services as integrated activities is the norm in EU Member States. In the majority of jurisdictions surveyed – including Belgium, the Czech Republic, Germany, Ireland, Spain and Sweden – one of the key factors in determining whether a non-EU firm needs a licence for deposit-taking and conducting other types of banking services or investment services is whether that firm markets or promotes its products and services in that jurisdiction. For example:

- In Belgium, the licensing requirement is triggered where a firm merely offers to take deposits from the public (subject to the *de minimis* exception noted below).
- In Spain, the key factor in determining whether a non-EU firm needs a licence for conducting investment services (but not deposit-taking) is whether that firm markets or promotes its products and services in Spanish territory.
- In Ireland, there is a prohibition on carrying on or holding out as carrying on 'banking business' (broadly speaking, deposit-taking). The prohibition applies whether the person undertaking banking business or holding itself out as carrying on banking business is inside or outside Ireland. Simply using the word 'bank' in a name can trigger the 'holding out' limb of the prohibition.

There are limited exceptions to this generally restrictive picture of rights to receive marketing from banks outside the EU that are not authorised in the Member State in question. For example:

- Customers based in Luxembourg should be able to access information on banking products and services provided by a UK-based bank, so long as the relevant service is itself performed in the UK. Even in Luxembourg, however, the position is not clear-cut; the degree of customisation, together with the scale of any marketing, would need to be assessed on a case-by-case basis. With respect to investment services covered by MiFID II, the more liberal approach to marketing is likely to prevail in respect of professional clients (as defined by MiFID II) only. Vis-à-vis retail clients or professional clients by option, the reverse solicitation model combined with the branch requirement will entail a licensing requirement as soon as an investment service is rendered upon a marketing activity by a third country firm.
- Germany is more accommodating where the marketing of a service or product by a foreign bank takes place in the course of a pre-existing bank-customer relationship. This will not assist where EU-based customers wish to access services from new bank relationships or new market entrants in the UK.
- Notwithstanding the restriction described above, there is also a *de minimis* exception in Belgium which allows limited rights to market and promote deposit-taking services to up to 50 individuals without a licence. This does not apply in relation to other regulated activities such as investment services.
- The legal regimes of Belgium, Luxembourg, Italy and the Netherlands are more permissive where marketing of banking and investment services is of a general or non-specific nature. While this would in principle allow some forms of marketing by UK-based banks after Brexit, it would rule out marketing of tailored services without

a license. Prospective customers in Italy, for example will therefore lose direct access to client research and business development materials, advertising and promotional materials, from UK-based banks.

- The UK has a comparatively less restrictive regime with respect to both marketing and market access for non-EU wholesale firms that are not operating out of UK-based branches or subsidiaries as a result of the UK's "overseas persons exemption"[9].

EU national regulators tend to take a wide view of what constitutes marketing in the era of digital communication. For example, there was no suggestion in any of the Member States surveyed that marketing material accessed via a UK-based website would not be captured by general marketing rules. In general it is the targeting of the customer – as defined by the national regulator – rather than the physical location of the marketing activity that matters.

The sections that follow set out further details on the extent to which an EU-based customer will be able to access key services provided by a UK-based bank on a cross-border basis.

Corporate Banking

Corporate banking[10] is the provision of banking products and services comprising commercial lending and other credit-related products, finance leasing, trade finance and hedging/risk management (e.g. interest rate and currency swaps) and deposit-taking to large business customers. It is a vital and integral part of the financial management of large companies and often closely linked to their raising of capital for investment, management of risk and access to short term working credit for both operations and trade. This kind of activity is critical to these types of companies that drive the growth of the European economy.

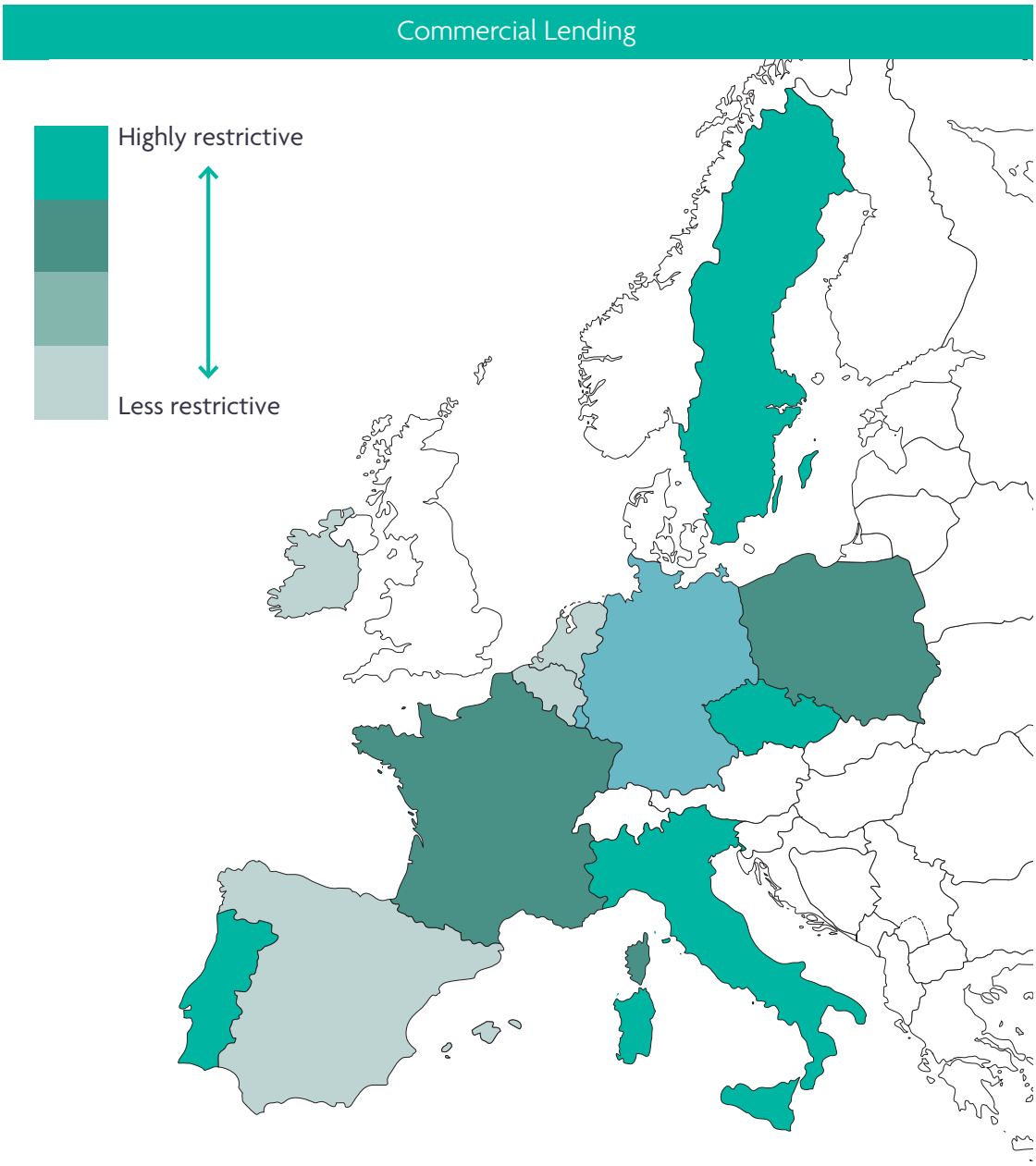
In the absence of a post-withdrawal framework for cross-border UK-EU trade in financial services, there will be significant restrictions on the ability of UK-based banks to continue to serve their EU corporate and business banking customers in the Member States surveyed without a local licence. In some jurisdictions surveyed, including Spain, Luxembourg, Ireland and the Netherlands, the disruption will be more moderate. In others, including Poland, Portugal, Sweden, France, Italy and the Czech Republic, it will be significant.

In certain European countries, as is the case in the UK, commercial lending to large corporate customers is not a regulated activity so there is no requirement to be authorised to carry out this activity. This means that a UK-based bank will be able to support business customers with lending in those Member States. However, this is by no means the case in all jurisdictions. In France, Italy and Sweden for example, there are no generally available exemptions that would allow a customer to access any such services from an UK-based bank without the bank obtaining a local licence. Corporates in jurisdictions where commercial lending is a regulated activity will generally not be able to turn to a UK-based bank for their financing needs unless that bank has a local licence.

[9] The "overseas persons exemption" is an exemption under UK regulation that avoids the need for persons who provide any of a wide range of wholesale financial services activities (and who do not undertake these activities, or offer to do so, from a permanent place of business within the UK such as branch office) to obtain separate UK authorisation.

[10] The term corporate banking describes the provision of banking products and services comprising commercial lending and other credit-related products, finance leasing, trade finance and hedging /risk management (e.g. interest rate and currency swaps) and deposit-taking to corporate customers.

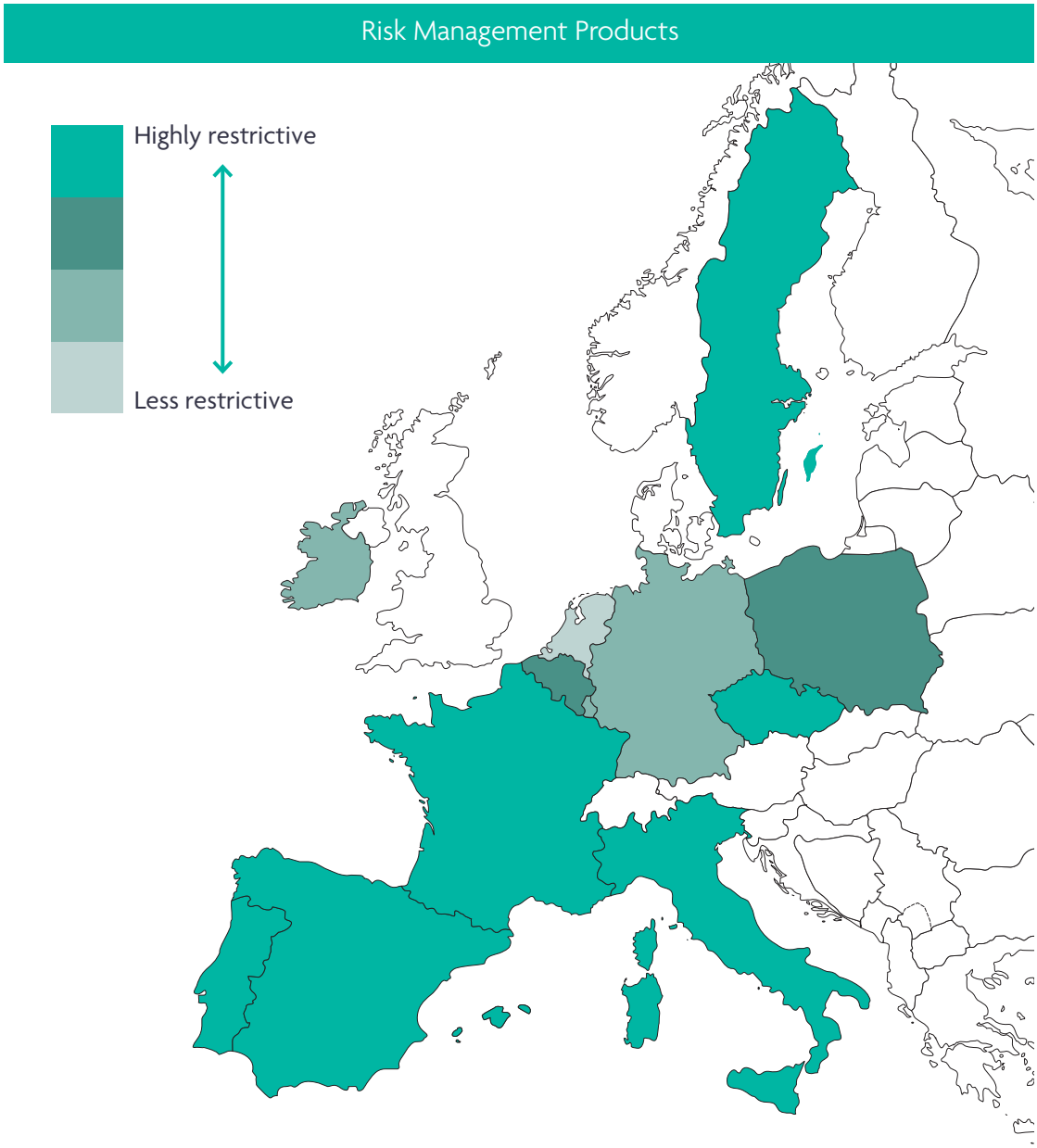
The map below illustrates the position in respect of commercial lending across the EU27 Member States covered by the survey:



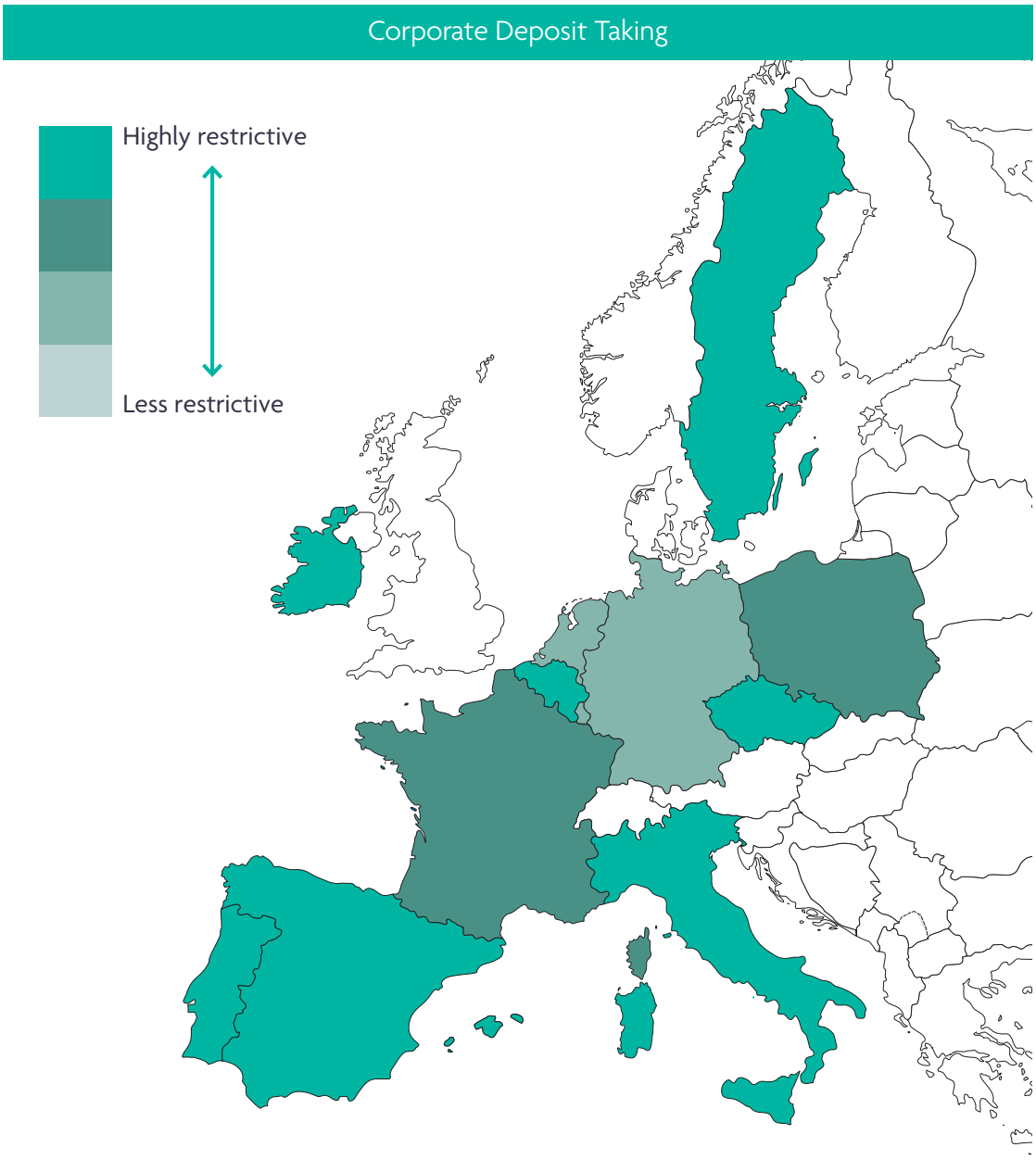
As noted above however, this does not paint the full picture. Lending is of course only one part of the wider services provided to large businesses by banks. Corporates and investors in the EU also turn to UK-based banks to manage their cash and for risk management through foreign exchange and interest rate and currency hedging/risk management products. About 75% of EU foreign exchange and interest rates derivatives trading takes place in the UK[11]. Many loan agreements depend on the ability to manage risk dynamically through the use of such products, and continued access to such products. Therefore, even if lending continues to be available to EU-based customers, the ability of UK-based banks to lend to EU27 customers may in practice be significantly constrained by challenges associated with the provision of flanking risk management products.

[11] European Parliament briefing: *Brexit: the United Kingdom and EU financial services* http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587384/IPOL_BRI(2016)587384_EN.pdf

The map below illustrates the position in respect of risk management products across the EU27 Member States covered by the survey. It generally shows a more restrictive landscape than that for commercial lending:



Like risk management, cash management is also often an integral part of a corporate banking relationship. The majority of Member States surveyed have strict local licensing rules around the provision of deposit-taking services, including to corporate clients, which is an important support function for the EU economy. The map below illustrates the position in respect of corporate deposit-taking across the EU27 Member States covered by the survey:



Belgium

Although there are no specific licensing requirements for commercial lending in Belgium, conduct of business and other rules do apply in relation to the entering into, content, and early termination, of credit agreements with small-and-medium-sized enterprises ('SMEs'). Trade and receivables financing activities (such as factoring) are generally not regulated. An approval from the Belgian Federal Public Service Economy is required for the performance of financial leasing operations in Belgium. This approval is not required for credit institutions from another EU Member State.

Belgian national legislation provides an exemption to third-country banks where investment services – including risk management services involving the use of risk management and hedging products regulated by MiFID – are provided to institutional investors, although a notification must be made in advance to the relevant regulator (the Financial Services and Market Authority or the National Bank of Belgium)[12]. Institutional investors for these purposes include, broadly, MiFID investment firms; Belgian undertakings for collective investment and Belgian insurance and reinsurance companies; and companies whose securities are admitted to trading on a regulated market and whose consolidated own funds amount to at least €25 million. The draft Belgian bill implementing MiFID II will bring the definition of institutional investors in this context into line with the definition of professional clients under MiFID II. In practice, the exemption applies in respect of services provided to a relatively narrow category of corporate.

Firms from Australia, Canada, Hong Kong, Israel, Singapore, Switzerland and the US currently rely on the exemption above and, unless the set of exempt firms expands, there may be incentives for UK-based providers to provide their services through these markets instead of moving them to the EU.

Deposit-taking is a regulated activity in Belgium, but there is a *de minimis* exception. A third country firm will not require a licence for taking deposits if it markets to, or solicits, fewer than 50 people.

Czech Republic

A UK-based bank will not be permitted to conduct any corporate banking activities in the Czech Republic without being licensed to do so. There is no exemption for commercial lending specifically.

Although there is some flexibility in the regime for the provision of receivables factoring services (where provided to a limited number of clients and on an incidental basis), this will be of limited practical use.

Germany

A third-country bank could apply for an exemption in Germany from the licensing requirement for cross-border services (including the suite of corporate banking services referred to above). This exemption may be granted by BaFin in cases where it:

"...deems that no need for supervision exists in connection with the conducting of banking and financial services business generally subject to supervision. In general, this only applies if the company is effectively supervised in its home country by the competent authority/authorities in accordance with internationally recognised standards and the competent home country authority/authorities cooperates/cooperate satisfactorily with BaFin[13]."

In other words, this exemption is available only if BaFin determines that the firm is subject to effective supervision in accordance with international standards in its home state, and if there is sufficient cooperation between BaFin and the firm's home state regulators.

A third-country bank applying for an exemption must provide a certificate issued by its home state regulator that sets out that the firm holds a valid licence for the banking and investment services which it intends to provide on a cross-border basis and that no prudential concerns about the provision of these services in Germany exist.

There are around 70-80 third country firms currently benefiting from this exemption, including banks from Australia, Canada, Singapore, Switzerland and the US, and unless this exemption is extended to UK firms, there may be incentives for UK-based providers to arrange to provide their services through these markets instead of moving them to the EU[14].

Ireland

Commercial lending (including finance leasing and factoring) does not in itself trigger a licence requirement under Irish law. Deposit-taking is, however, a regulated activity in Ireland.

[12] The list of non-EEA firms providing investment services in Belgium is available on the FSMA's website (in French or Dutch): http://www.fsma.be/fr/Site/Repository/lijsten/bo4.aspx.

[13] Section 2(4) of the German Banking Act

[14] A database listing all exempted firms is available on the homepage of BaFin. It is possible to view the relevant database via the following web link: https://portal.mvp.bafin.de/database/InstInfo/ BaFin See also *'Notes regarding the licensing requirements pursuant to Sec. 32 (1) of the German Banking Act (Kreditwesengesetz – KWG) in conjunction with Sec. 1 (1) and (1a) of the KWG for conducting cross-border banking business and/or providing cross-border financial services, dated 5 April 2005'* www.bafin.de

A third country firm may benefit from a 'safe harbour'/exemption which means that it does not need to become licensed in Ireland to offer MiFID investment services. This may assist where corporate clients in Ireland wish to access risk management and hedging services provided directly by UK-based banks. In order to rely on the safe harbour, the firm's head or registered office must be in a non-EEA jurisdiction, it must not have a branch in Ireland and it must provide investment services exclusively to non-individuals i.e. corporate counterparties. The safe harbour/exemption also applies where investment services are provided to individuals who themselves are licensed to provide investment services. It also applies automatically as a matter of law (somewhat similar to the 'overseas persons exclusion' in the UK), so no application is needed.

Luxembourg

There is no generally-available exemption for commercial lending in Luxembourg. There is, however, a 'lighter' licensing regime for third-country banks which looks very similar to a 'passport'. In effect, this lighter licensing regime means that banks that do not have a branch in Luxembourg but which 'occasionally and temporarily' come to Luxembourg in order to conduct regulated banking activities, including taking deposits and lending services, may apply for an exemption. The relevant bank must be subject to equivalent licensing and supervisory rules in its home state. At the time of writing, there are eight banks benefiting from this regime, from Australia, Canada, Switzerland, and the US[15].

The lighter licensing regime described above applies exclusively to banking, including deposit-taking and lending services but will no longer be available under MiFID II for investment services such as receiving or transmitting orders or executing orders in respect of risk management products and services such as interest rate and currency derivative instruments.

Netherlands

Lending, including commercial lending, trade financing, finance leasing, and (in principle) receivables financing, is largely unregulated in the Netherlands. With very limited exceptions (for example, where a UK-based bank provides factoring services to clients that have a nexus with consumers, it will need to obtain a licence), a UK-based bank will be allowed to provide loans to customers based in the Netherlands without obtaining a local licence.

As a general rule, deposit-taking (or the taking of 'repayable funds') from the public requires a banking licence in the Netherlands. No licence is required where the counterparty is a 'professional market party'. This covers circumstances in which the amount of relevant funds exceeds €100,000 (or equivalent) or where the counterparty is a company with a balance sheet exceeding €500 million.

For derivatives and hedging services (such as interest rate swaps), services may be provided on the exclusive initiative of a client based in the Netherlands. In addition, the relevant Dutch regulator may, at its discretion, waive the prohibition on providing banking and investment services in the Netherlands without a licence if the firm in question can demonstrate that the interests which the prohibition aims to protect are sufficiently safeguarded. There are no published statistics, but it appears that the relevant Dutch regulator uses this power in very limited circumstances in practice.

Poland

There is no exemption for commercial lending in Poland. Polish law makes a distinction between a credit facility that is granted for a specified purpose, and a loan, where the funds transferred under the loan to a borrower can be used freely by the borrower for any purpose and the lender has no control over their utilisation. The former constitutes the provision of banking services, for which a banking licence is required. In the context of the latter, lending to corporates – where the funds can be used freely by the borrower – is not regulated in Poland. However, only a locally incorporated entity may provide loans to corporates and retail customers without a banking licence. A third-country bank will require a banking licence to provide loans to corporates and retail customers.

Similarly, a UK-bank wishing to carry on deposit-taking and risk management and hedging activities in Poland will generally need to be licensed to do so.

[15] Search 'Credit institutions and persons originating from third countries exercising financial sector activities by free provision of services' on the public register on the CSSF website: https://supervisedentities.apps.cssf.lu/index.html?language=en#Home

Portugal

There is no generally available exemption for any of the corporate banking services in Portugal: a licence is required. Commercial lending that is structured as a bond issuance may not require the same licence, but this will not be appropriate in all circumstances.

The activities of deposit-taking and risk management and hedging services also require a licence.

Spain

The regulation of commercial lending by non-EU banks in Spain is subject to some uncertainty. There is some scope to conclude that a UK-based bank would be able to serve corporate clients in Spain with commercial lending services on a standalone basis. While there is also some flexibility for the provision of trade finance and finance leasing, this appears to be of limited practical use.

Deposit-taking in Spain requires a licence, as does the provision of risk management and hedging services.

Investment Banking (Primary Markets)

UK-based investment banks[16] play an important role in the EU's financial markets by intermediating between securities issuers and investors, helping raise capital and providing a range of ancillary services in support of EU27 customers. These services are also particularly important for a number of EU27 governments' regular finance raising needs via their appointed primary dealer networks.

London is an important EU centre for EU investment banking: more than 35% of the wholesale financial activities of the EU take place in London[17]. These services include underwriting and placing newly issued securities with investors and helping make secondary markets in these securities after they are listed. UK-based investment banks also provide large corporate, government and institutional clients in the EU with corporate finance and other advisory services. EU governments and other public sector bodies use UK investment banks to place their bonds in the capital markets through a system of appointed primary dealers[18].

Were UK banks to rely on national licensing regimes to provide such services directly from the UK, EU27 customers would face different restrictions depending on what services they sought. There would be less disruption to EU clients who simply receive advice on corporate strategy and M&A from UK-based banks. This is because most national regimes follow the EU MiFID regime in drawing a distinction between investment advice (which is an investment service requiring a licence) and 'advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings', which is an ancillary service which is not of itself regulated. Custody services are generally treated the same way.

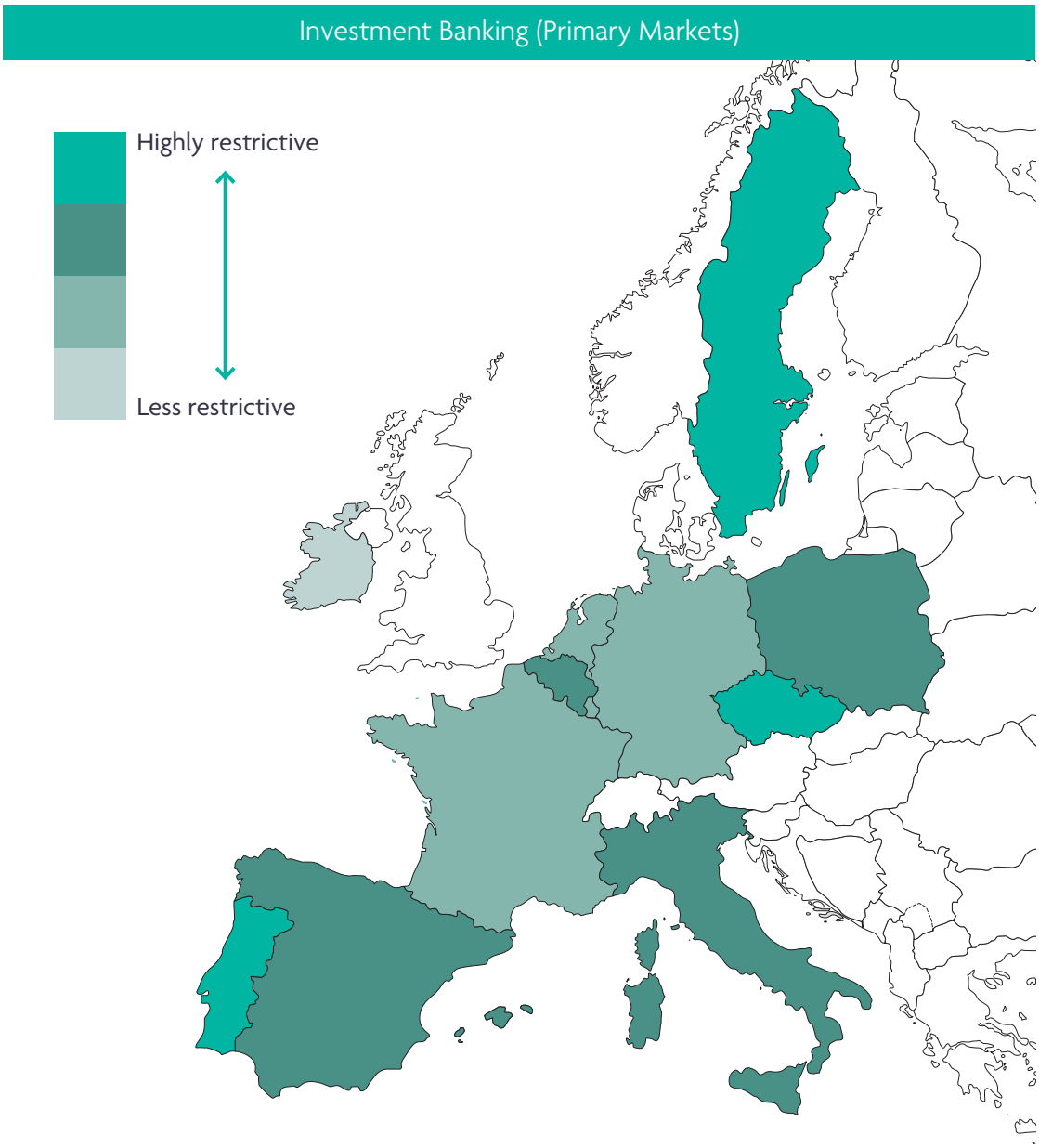
Where the client's primary purpose is 'industrial, strategic or entrepreneurial', the advice provided would generally be treated as ancillary corporate finance advice not of itself triggering a requirement for a regulatory licence. This position is reflected in the national regulatory regimes of many of the Member States surveyed: Belgium, Germany, France, Ireland, Italy, Luxembourg, the Netherlands, Poland, Spain and Sweden. Recipients of corporate finance advice in these jurisdictions – including corporates, private equity or venture capital firms – from UK-based investment banks on a stand-alone basis should not, therefore, be deprived of that access in a post-Brexit environment. Although there is a distinction in Portugal between the provision of corporate finance advice and investment advice, a local licence is required in both cases.

[16] Investment banking describes the provision of both primary market services (advice, corporate finance, structuring, acting as primary dealer, marketing, bookrunning and underwriting services) and sales and trading services on secondary markets (trading in equity and fixed income securities and derivatives, foreign exchange and physical commodities, with or for customers and counterparties, on own account or as agent).

[17] https://www.thecityuk.com/assets/2016/Reports-PDF/The-UK-Europes-financial-centre.pdf

[18] For the EU Member States where a primary dealer (PD) system is in place, the EFC Sub-Committee on EU Sovereign Debt Markets (ESDM) has compiled a list of links to official information on the composition of the PD group per Member State available here: https://europa.eu/efc/node/17_en. There is no PD system in Germany or Luxembourg.

The map below illustrates the position in respect of investment banking (primary markets), across the EU27 Member States covered by the survey:



However, as with corporate banking, these limited exemptions from local authorisation for UK-based banks providing services would be of limited value to EU27 customers who need access to a full suite of services rather than just an advisory service. To preserve such 'package' services, EU27 customers are likely to need to seek these services from an appropriately licensed firm, if one is available.

EU governments and other public sector bodies also currently use UK investment banks to place their bonds in the capital markets through a system of appointed primary dealers (see *Sovereign debt issuance and the use of Primary Dealers to provide value for taxpayers* explanatory box). There will be significant restrictions on the ability of UK-based banks to act as a primary dealer in government securities in all the jurisdictions surveyed where a primary dealer system is in place, other than Ireland. This will affect the development and functioning of primary and secondary markets for relevant government securities. In Belgium, for instance, a UK-based bank will not be able to act as a primary dealer (i.e. subscribing for and making markets) in government securities unless it has a branch in Belgium and that branch has been approved by the NBB. In Italy, only EU resident banks may act as primary dealers in government securities.

Sovereign debt issuance and the use of primary dealers to provide value for taxpayers

Almost all EU27 Member States borrow money from investors via capital markets as part of their ordinary economic activity, using both short-and long-term debt to finance investment or expenditure. This debt is issued in the form of government securities. Government officials use banks to place this debt with interested investors in the EU and around the world and to create a secondary market in that debt by buying and selling it after it has been issued. Banks that perform these services are referred to as primary dealers. EU27 Member States rely on such primary dealers to ensure competitively-priced sovereign debt and the maintenance of a liquid market in their securities. Because the interest on such debt is ultimately paid with taxes, issuing it as cheaply as possible is a vital part of good sovereign economic management.

For this reason, most EU27 Member States as issuers of sovereign debt try to maintain a roster of primary dealers to ensure a wide and competitive market for their debt and for the services associated with issuing it. In the EU27 Member States surveyed in this report the number of identified primary dealers ranges per Member State from 7 to 21. In many cases, UK-based banks are heavily represented on these lists.

These include UK banks, non-EU banks domiciled in London and EU banks passporting into the UK. For example, at the time of writing:

- In Belgium, 6 of its government's 13 primary dealers are UK-based banks.
- In France, 4 of its government's 16 primary dealers are UK-based banks.
- In the Czech Republic, 3 of its government's 10 primary dealers are UK-based banks.

In addition:

- In Italy, 12 of its government's 18 primary dealers as at August 2015 were UK-based banks.
- In Portugal, 11 of its government's 20 primary dealers as at August 2015 were UK-based banks.

However, many EU27 Member States require that their primary dealers be EEA-based banks. This has important implications for EU27 Member States looking to issue sovereign debt once the UK has withdrawn from the EU, as they may find themselves restricted from using UK-based banks to provide this important service and the efforts by many UK-based banks to enhance their capacity to provide a similar level of service from entities located in the EU27 are likely to be incomplete. The sudden and significant reduction of available providers could materially reduce the choice available to EU27 sovereign debt issuers and with it the prospects of a competitive, cost-effective service to EU27 governments and their taxpayers.

There are several other important but limited mitigants available across the EU27 Member States surveyed which may allow EU-based customers to access cross-border investment banking services from UK-based banks in some narrow circumstances. Some of these are described below.

Belgium

Institutional investors may continue to access products and services from UK-based investment banks under the wide-ranging exemption mentioned above (subject to the UK-based bank notifying the relevant regulator in advance).

Germany

German customers will only be able to access investment banking services provided on a cross-border basis if the UK-based bank has secured the exemption referred to above.

Ireland

Irish corporates may benefit from the relatively liberal safe harbour under Irish legislation which permits non-EEA entities to provide investment services on a cross-border basis to non-individuals, i.e. corporate counterparties, in Ireland (e.g. banks, investment firms, SPVs and funds).

Luxembourg

Professional clients in Luxembourg may be able to benefit from the liberal interpretation of the 'characteristic performance' test mentioned above to access investment banking services from UK-based banks. It is often suggested that the Luxembourg regulator, the CSSF, will treat such services as being provided in the location of the service-provider rather than in Luxembourg.

Netherlands

Professional and/or retail clients based in the Netherlands may approach UK-based investment banks for investment services on their exclusive initiative. It will not be possible to rely on the initiative test if the scope of investment services that are provided is extended to services other than those that were initiated by the client.

In theory, the AFM has discretion to waive the licence requirements for providing investment services in the Netherlands if the firm in question can demonstrate that the interests which the prohibition aims to protect are sufficiently safeguarded. As mentioned earlier, there are no published statistics on the use of this discretion and it appears that in practice the AFM uses this power in very limited circumstances.

Investment Banking (Sales and Trading)

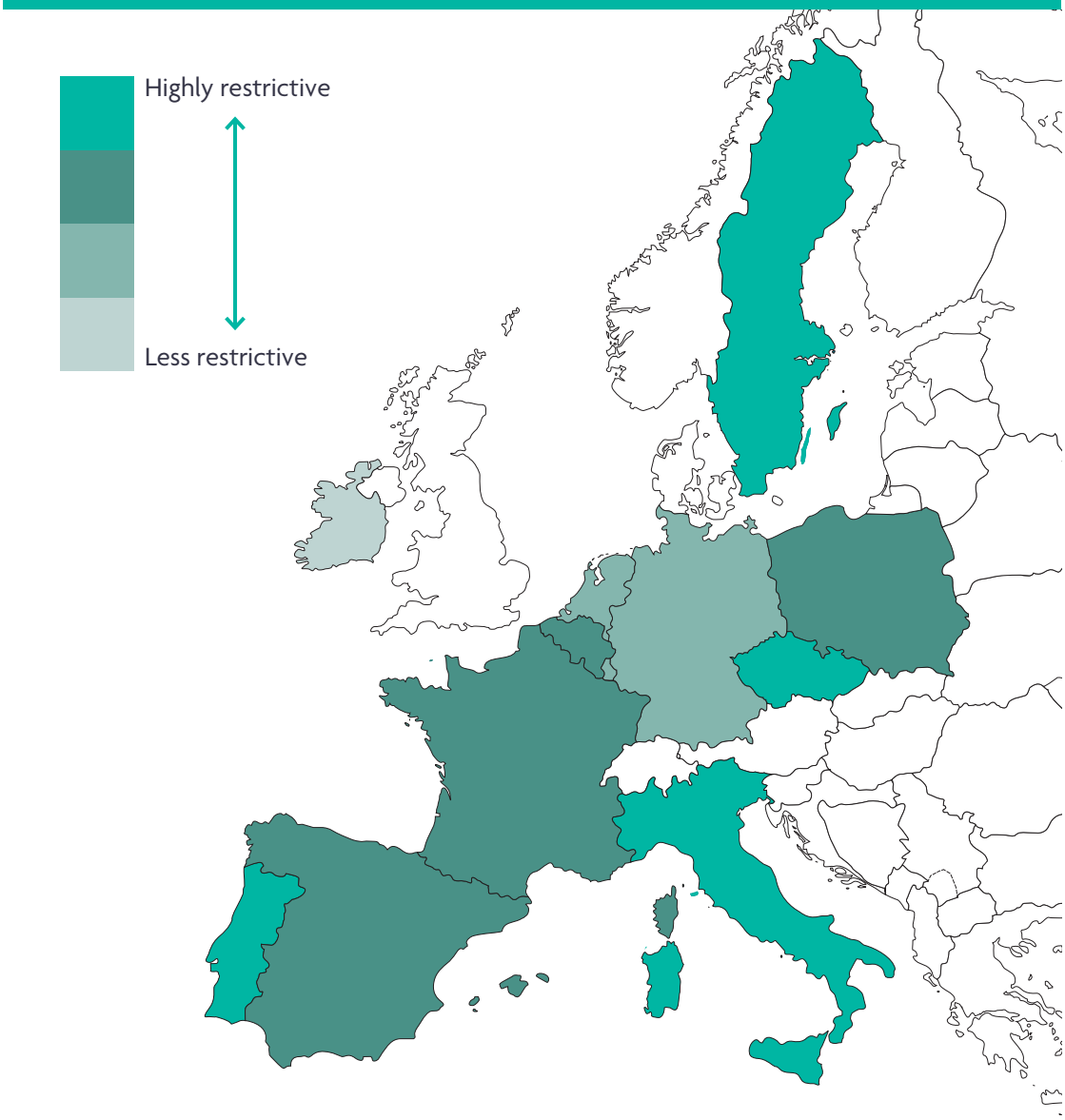
UK-based banks currently carry out a range of cross-border sales and trading[19] and investment activities for customers across the EU. The equities and fixed income sales and trading businesses of investment banks help customers trade equity and fixed income securities and derivatives, foreign exchange and physical commodities. They provide a highly competitive foreign exchange market both in cash and foreign exchange derivatives and a very wide range of risk management services such as interest rate and foreign exchange derivatives. These are vital services that corporates and businesses of all sizes must access as part of their day-to-day activities and if they are to grow.

Customers in many of the EU27 Member States surveyed – notably in the Czech Republic, France, Italy, Portugal and Sweden – will, as a general rule, not be able to receive these services from a UK-based bank following the UK's exit from the EU, as there appears to be no available exemption or other flexibility written into their national legal regimes for the cross-border provision of these services. Although it is a matter of interpretation for each Member State, spot foreign exchange contracts are generally not within the scope of MiFID regulation on the basis that a spot foreign exchange amounts neither to a transferable security nor a derivative contract. This point is recognised explicitly, for example, in Germany and the Netherlands. However, in all other areas, national regimes are generally highly restrictive.

[19] The term 'sales and trading' describes the provision of marketing services relating to new equity and debt issues; block trades of equity and debt securities; equity and fixed income market secondary trading; spot and forward foreign exchange trades; securities financing transactions (including repo and stock lending transactions); commodities trading (spot and derivatives trading); and sales of non-retail structured products.

The map below illustrates the position in respect of investment banking (sales and trading), across the EU27 Member States covered by the survey:

Investment Banking (Sales and Trading)



Customers in Belgium, Germany, Ireland, Luxembourg (professional clients as defined by MiFID II only), and the Netherlands may be able to benefit from the exemptions or safe harbours described elsewhere in this report to continue to access these services.

Retail Banking

Retail banking[20] makes up the services most people generally associate with banking and includes the provision of deposit-taking, payment management and lending services to retail customers. This includes loans; mortgages; credit cards and other credit-related products; payment services, e-money services; and the design and sale of retail structured products such as retail investment products that link returns to an index rather than an underlying interest rate.

Traditional retail banking activities are currently mainly domestic[21]. The share of consumers who purchase banking products from another Member State is around 3% for credit cards, current accounts and mortgages. In consumer credit only

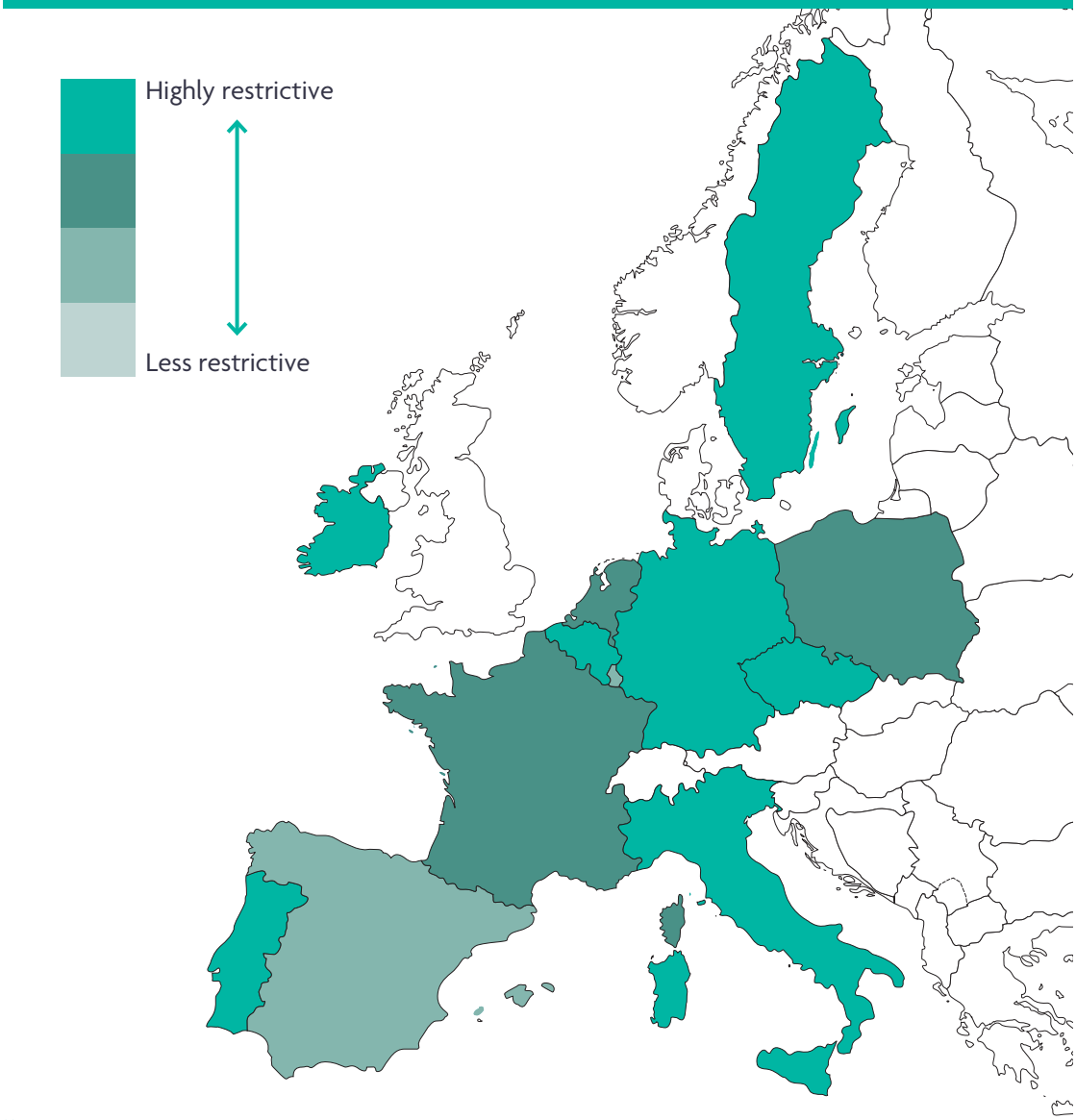
[20] The term retail banking describes the diverse services that banks provide to retail customers, including deposit-taking; loans; mortgages; credit cards and other credit-related products; payment services, e-money services; and the design and sale of retail structured products.

[21] Figures from the European Commission http://ec.europa.eu/finance/consultations/2015/retail-financial-services/docs/green-paper_en.pdf: http://ec.europa.eu/finance/consultations/2015/retail-financial-services/docs/green-paper_en.pdf.

5% of loans are obtained cross-border. Cross-border loans within the euro area account for less than 1% of the total household loans in the area. The main interaction between the UK and the EU in retail services occurs through branches or subsidiaries of UK-based banks. While the scale of such activity is comparatively small, the disruption caused by the UK's exit from the EU may be significant. Consumers could find themselves unable to access existing accounts and/or existing services unless their service providers take mitigating actions. It is worth noting against this background that the European Commission has, following on from its 2015 green paper on Retail Financial Services[22], expressed a commitment to improve choice, transparency and competition in retail financial services to the benefit of EU consumers and to facilitate true cross-border supply of these services, so that financial firms can make the most of the economies of scale in a truly integrated EU market.

However, this commitment to a deeper internal market in the EU for retail banking services does not translate into openness to the provision of retail banking services from outside of the EU. The majority of Member States surveyed have very strict rules that require a firm providing retail banking services from outside the EU to obtain a local licence. They also require local licences for the provision of payment services. Unless they can rely on a reverse solicitation exemption, actual and prospective customers in most Member States surveyed will lose access to retail banking services provided by UK-based banks without a local licence in almost all cases. The map below illustrates the position in respect of retail banking across the EU27 Member States covered by the survey:

Retail Banking



[22] http://ec.europa.eu/finance/consultations/2015/retail-financial-services/index_en.htm

Belgium

As noted above, there is a *de minimis* exception for deposit-taking which applies in relation to both retail and non-retail clients. A non-EU firm will not require a licence for taking deposits if it markets to, or solicits, fewer than 50 people. This exemption does not, however, assist for the issue of credit cards, or payment or e-money services. Consumer and mortgage lending to Belgian nationals is also restricted.

Germany

As noted above, there is an exemption from licensing requirements in Germany for a range of banking and investment services. Banking services to retail clients are potentially eligible for the same exemption if a German credit institution or EEA institution passporting into Germany acts as an introducer or intermediary ('Anbahnungsinstitut').

Interestingly, Swiss banks may offer services directly to retail clients in Germany if they use a 'simplified exemption procedure' – where the requirement to use an intermediary does not apply. This derogation is provided in a so-called 'Memorandum for procedural aspects of cross-border activities in the financial sector' concluded between the Federal Republic of Germany and the Swiss Confederation and a subsequent execution agreement (see *The bilateral agreement for retail banking services between Germany and Switzerland* explanatory box).

Ireland

In Ireland, there is an exemption for consumer lending and mortgage lending if the credit is provided to individuals who meet the criteria for an opted-up 'professional client' under MiFID, i.e. a client possessing the experience, knowledge and expertise to make its own investment decisions. In addition, it may be possible to argue that the regulated activity of deposit-taking from 'members of the public' does not cover deposit-taking from institutional customers (but note this argument has not been tested in court or addressed in guidance from the Central Bank of Ireland).

Luxembourg

A non-EU bank that occasionally and temporarily collects deposits and other repayable funds from the public in Luxembourg may benefit from a lighter licensing regime if it is subject to equivalent licensing and supervisory rules as those in Luxembourg. In principle, this lighter regime may apply to all regulated activities surveyed in Luxembourg other than investment services.

Netherlands

A non-EU firm may be allowed by the relevant Dutch regulator to offer certain banking products and services, such as credit, carry on consumer lending, and conduct mortgage lending in the Netherlands without a licence in certain very limited circumstances. For example, the Dutch regulator has the discretion to waive the prohibition to provide consumer credit without a licence if the applicant can show that the consumer's interests will be sufficiently safeguarded. There are additional exceptions for certain short-term credit agreements where the costs charged are insignificant.

A non-EU firm may also, in theory, avoid the need for a licence for retail deposit-taking if, broadly, the relevant Dutch regulator considers that the firm is subject to adequate supervision in its home state (currently Australia, Canada, Japan, Switzerland, and the US are designated for this purpose).

There is no data available that shows how often the Dutch regulators have made use of this discretion, but it appears that they have done so very rarely in practice. Past examples of discretion being exercised in this context have related to a partial waiver of some prudential requirements for broker-dealers operating from the US in the Netherlands on a cross-border basis.

There is no such discretion for the issue of credit cards and the provision of payment or e-money services.

Spain

Consumer lending is not a regulated activity in Spain. Although this does not seem to have been tested, lending to individuals by a third-country bank may continue. Customers in Spain will not, however, be able to access credit cards and payment or e-money services provided cross-border by a UK-based bank.

The bilateral agreement for retail banking services between Germany and Switzerland

The German-Swiss arrangements for the cross-border provision of retail banking services stand out as one of the few substantive examples of cross-border provision of retail banking services between an EU Member State and a third country, albeit one that is closely integrated with the EU, and with whom German commercial interaction and regulatory cooperation are longstanding and intensive.

Swiss banks that wish to provide retail banking products and services to clients domiciled in Germany can apply to the German regulator (BaFin) for permission to do so through the 'simplified exemption procedure' operated for this purpose. The Swiss bank must submit an application to BaFin along with other relevant information, including a description of its proposed business activities, sample client contracts and a confirmation from the Swiss regulator, FINMA, that it holds the necessary Swiss licences for these activities under Swiss law and operates in good standing in this respect in Switzerland. BaFin examines each application on a case-by-case basis. If the exemption is granted, the Swiss bank is able to provide retail banking products and services to German clients without engaging a German or EEA credit institution as intermediary.

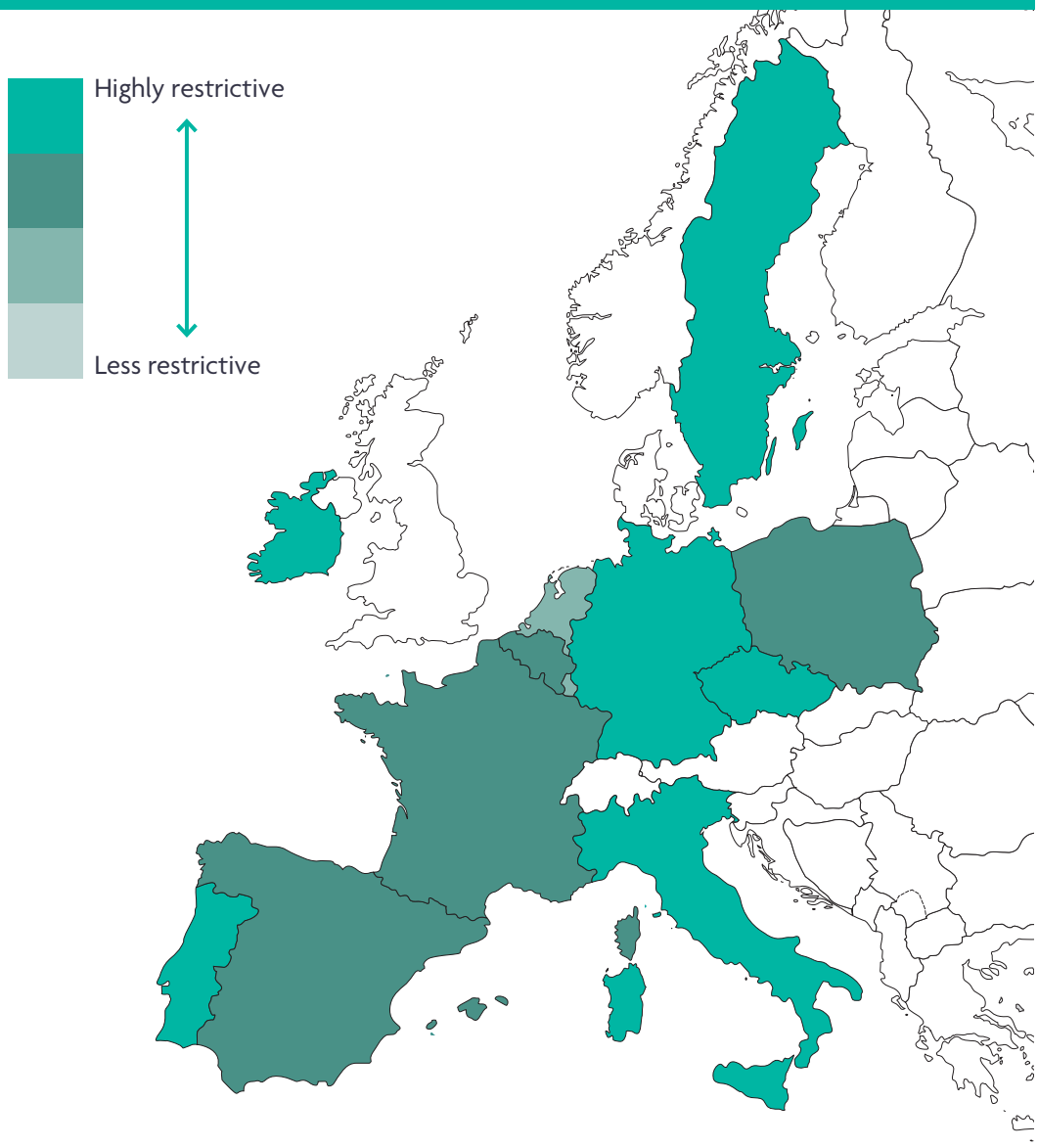
Although this agreement is ultimately designed to make it easier for Swiss banks to gain entry to the German retail banking market, it nevertheless imposes important practical requirements on Swiss banks that wish to do so, including a requirement for Swiss banks to comply with a range of local German rules to secure the exemption.

Private Banking and Wealth Management

The concerns discussed above in relation to EU-based customers' access to UK retail banking services also arise to a similar extent in the context of private banking and wealth management[23]. This is largely because, in the EU27 Member States surveyed, customers of private banks are generally categorised for regulatory purposes as retail customers. This is an area in which the impacts of the loss of passporting rights for UK-based banks may be acutely felt by EU customers, as although they are generally categorised as retail clients for the purposes of regulation, many EU private banking customers are users of specialist investment and banking services provided cross-border from the UK.

High net worth individuals from the Czech Republic, France, Ireland, Italy, Poland, Portugal and Sweden who are customers of private banks based in the UK and do not fall within the scope of any reverse solicitation regime would not be able to access any of these services. The possible exemptions in the markets surveyed are set out below. These are likely to be of limited value as many private banking and wealth management customers seek a suite of related services, only a limited number of which may benefit from the available exemptions. The map below illustrates the position in respect of private banking and wealth management, across the EU27 Member States covered by the survey:

Private Banking and Wealth Management



[23] In this working paper, private banking and wealth management include not only retail banking type products and services (i.e. deposit-taking, credit and payment services) but also other services such as portfolio management, financial advisory services, the provision of risk management services and the sale of structured products (including derivatives), generally provided to high net worth or other affluent customers.

Belgium

As noted above, there is a *de minimis* exception for deposit-taking in Belgium which applies in relation to both retail and non-retail clients. A third country firm will not require a licence for taking deposits if it markets to, or solicits, fewer than 50 people. This will not, however, assist customers who wish to access discretionary or portfolio management or investment advice.

Germany

Customers will only be able to access private banking services provided into Germany on a cross-border basis if the UK-based bank has secured the exemption referred to above (i.e. if the firm is subject to effective supervision in its home state and if there is sufficient cooperation between the German regulators and the firm's home state regulator) and where a German or other EU credit institution acts as an introducer or intermediary.

Ireland

UK-based private banks will, post-Brexit, not be permitted to rely on the wide-ranging safe harbour/exemption for MiFID services described elsewhere in this working paper in Ireland because the exemption does not apply where the client is an individual, unless that person is licensed to provide investment services. This is the case regardless of the individual's wealth.

Retail lending is also restricted in Ireland as the provision of consumer loans triggers a licensing requirement under the 'retail credit firm' regime (a licensing regime for non-bank lenders).

Luxembourg

For investment services for professional clients (as defined by MiFID), a third country bank may act on a free provision of services basis if it is subject to equivalent licencing and supervisory rules. Investment services to retail clients are subject to the reverse solicitation model or to the establishment of a branch. A third-country bank that occasionally and temporarily collects deposits and other repayable funds from the public in Luxembourg may benefit from a lighter licensing regime if it is subject to equivalent licensing and supervisory rules as those in Luxembourg.

Netherlands

Customers in the Netherlands will be able to seek investment advisory and portfolio management services from UK-based banks on their own initiative (in which case UK-based banks will not be considered to be providing services in the Netherlands). In all other cases, and where the required service is consumer lending, customers will not be able to access services from the UK-based bank unless the AFM has used its discretion to waive the licensing requirement, which it does rarely.

The same restrictions described above with respect to deposit-taking apply in relation to high net worth customers in the Netherlands, although there are no restrictions in circumstances where a customer, retail or otherwise, deposits an amount of €100,000 or more (or equivalent).

Spain

Although this does not seem to have been tested, high net worth individuals in Spain should still have access to lending carried out by UK-based banks without a local licence. However, they will not be able to access investment advisory services or portfolio management.

Access to Central Counterparties

Although central counterparties (CCPs) are the infrastructure for a service rather than a service itself, it is important to note the way in which they are implicated in the picture set out above. EU banks and other market participants – for example, EU corporates that use derivatives for hedging purposes – are significant users of UK CCPs and vice-versa. There are a variety of ways in which Brexit will affect EU market participants – both banks and end-users – and their use of UK CCP services, as well as the use by UK market participants of EU market infrastructure. Although this section refers to CCPs in particular, similar issues arise in relation to market access to central securities depositories, trading venues such as UK exchanges, trade repositories and data service providers.

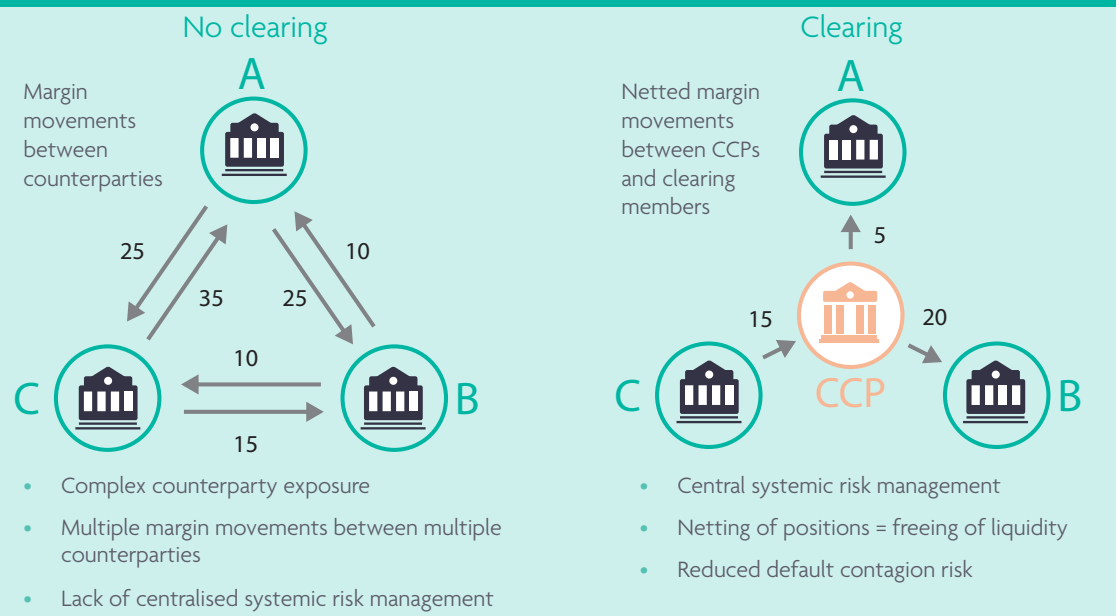
EU access to UK CCPs

In some cases it is difficult to separate the question of whether a service can be provided cross-border by a UK-based bank to a customer in the EU27 from the question of whether the underlying infrastructure on which that service is provided is recognised in certain key respects as adequate by the EU, which has prerogatives in this area which supersede those of Member States. The case of CCPs is a good example.

What is a CCP?

A CCP, or a central counterparty, is a type of market infrastructure vital to the safe and efficient functioning of financial markets. CCPs operate by inserting themselves between the buyer and seller of a financial contract (such as a derivative) after a trade is executed, becoming the buyer to the seller and the seller to the buyer (the 'counterparties'). This is called 'clearing', and it means in the event that one of the counterparties defaults, the CCP will step in and complete the trade. 'Clearing' through a CCP in this way allows businesses to more effectively and efficiently manage their risks, whilst also lowering the wider risk of market disruption in the event of a counterparty default.

Figure 5: The differences between clearing and non-clearing

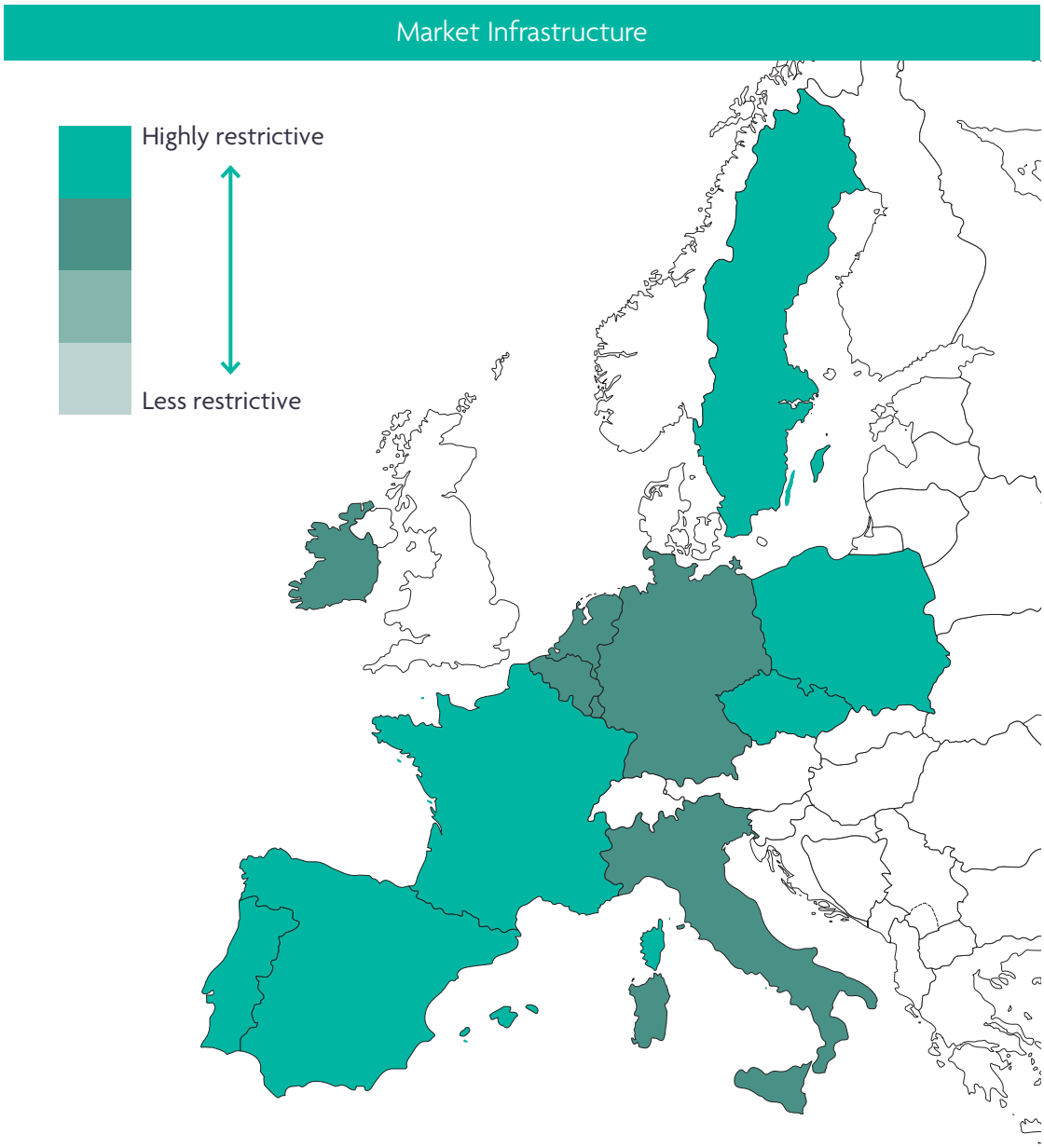


- Complex counterparty exposure
- Multiple margin movements between multiple counterparties
- Lack of centralised systemic risk management

- Central systemic risk management
- Netting of positions = freeing of liquidity
- Reduced default contagion risk

Since 2013 it has become mandatory for many types of derivative to be 'cleared' through suitably EU-authorised CCPs. This has increased the importance of clearing markedly, and in widening the role of CCPs in this way, their own resilience has become of critical importance. For this reason, EU regulatory authorities take a close interest in determining which CCPs can be used by banks in their jurisdiction and on what terms. The European Market Infrastructure Regulation (EMIR), which entered into force in 2012, not only makes clearing mandatory for certain types of EU entities, but also establishes a set of protocols for recognising CCPs from outside the EU, and which can be used by EU banks to meet their EMIR obligations. At present, UK CCPs such as LCH.Clearnet are treated as 'domestic' and recognised under EMIR. When the UK becomes a third country outside the EU they will no longer be part of this system and their subsequent status under EU regulation remains uncertain.

CCPs are used to 'clear' the trade in certain kinds of widely-used derivatives. They act as guarantors of the trades being undertaken by standing between all buyers and sellers – for a fee – and in doing so providing a degree of transparency and stability to the market. As explained in our *What is EMIR and why does it matter to EU customers?* explanatory box, their use has become increasingly mandatory in the EU since 2013. The EU has an established regime for recognising CCPs in third countries in a way that allows EU businesses to meet their EU clearing obligations even when using this market infrastructure outside the EU. The map below illustrates the position in respect of market infrastructure, across the EU27 Member States covered by the survey:



The direct users of CCPs are banks acting on their own behalf or on behalf of clients, who are 'indirect' clearers, and are typically other banks or very large non-financial companies. These direct clearing banks have contractual relationships with the CCPs in question and corresponding back-to-back contracts with their indirect clearing clients. A reversion to a system based on national licensing regimes for cross-border contracting between individual EU Member States and UK-based banks would raise a number of issues for this model.

Whether EU-based clients can contract with UK-based banks for this service will depend on whether the necessary exemptions or reverse solicitation allowances exist in their national licensing regime. As noted above, there would be less impact for a counterparty in Luxembourg,

Ireland, the Netherlands and – assuming the UK-based bank can rely on relevant national exemptions – Belgium and Germany. There could be considerable disruption in jurisdictions where 'reverse solicitation' is construed narrowly and where there are no available exemptions. However, an EU counterparty will not be able to satisfy its clearing obligation for mandated derivative products – products which ESMA have determined meet appropriate liquidity thresholds to warrant mandatory clearing - under EMIR by clearing them at a UK CCP that has not been granted recognition by ESMA under EMIR.

In addition, where that recognition is not in place, EU financial counterparties will be required to apply punitive capital treatment to their direct or indirect exposures to a UK CCP (unless and until that CCP has been granted recognition by ESMA under EMIR). EU banks will thus face increased costs of clearing. Although EU corporates who are direct clearing members of a UK CCP will not be similarly penalised as they are not subject to the Capital Requirements Regulation (the European legislation that establishes prudential requirements for credit institutions and investment firms), they may suffer increased costs if they clear on a CCP via a partner bank which is a clearing member (i.e. 'indirect' clearing). It has been estimated that capital requirements would increase 50 times for direct clearing members, and 25 times for financial counterparties who indirectly clear their trade on UK CCPs[24]. For EU corporates who clear their trades indirectly, it is possible that the increased costs of their direct clearing member will be passed onto them.

A possible response to this scenario would be for an EU bank to move its existing positions from UK CCPs to EU CCPs or to other CCPs recognised by ESMA. This could be achieved by trading out of positions in the UK CCP and opening new trades in the other CCP, or by moving all the positions. There are likely to be significant practical difficulties involved with either of these routes. It is likely to be difficult and costly to move existing positions and users would lose the ability to offset their existing portfolios with new trades opened on other CCPs. These disadvantages are not immaterial for EU based customers and may be particularly problematic for those, such as EU international exporters, that are significant users of risk management products which directly or indirectly involve the use of CCPs.

What is EMIR and why does it matter to EU customers?

As the EU's implementing vehicle for the G20's 2009 commitment to reduce systemic risk in the OTC derivatives markets, EMIR imposes far-reaching obligations on all EU entities that use OTC derivative instruments. These obligations do not fall equally. 'Financial' counterparties (defined as being funds, banks, investment, insurance and reinsurance firms) are generally subject to much more stringent conditions than 'non-financial' counterparties (broadly defined as any undertaking not fitting within the 'financial counterparty' definition, but generally taken to apply to EU corporates), especially where a non-financial counterparty falls beneath certain trading thresholds.

For EU corporates, the obligations EMIR imposes are significant. Not only does EMIR introduce a mandatory clearing requirement where ESMA determines that a class of OTC derivatives contract is sufficiently standardised and liquid to warrant being cleared on an EU-authorised CCP, it also obliges EU corporates (subject to exemptions) to report all their derivative contracts to an EU-authorised trade repository. Where ESMA determines that an OTC derivative contract is not suitable for mandatory central clearing, EMIR still requires EU corporates who trade in OTC derivative contracts to implement risk mitigation measures such as the mandatory exchanging of collateral with their counterparties (again subject to exemptions).

In order to meet these obligations, many EU corporates have come to rely on their partner bank, or have had to themselves establish compliance frameworks involving the creation of systems, policies and procedures. In some instances this has required EU corporates to build extensive reporting and monitoring infrastructure that has connected them to UK-based banks, CCPs, or reporting infrastructures, in the context of Brexit. The suitability of all of these arrangements will need to be revisited to assess whether changes will be required to maintain compliance.

[24] IRSG *CCPs post-Brexit Implications for the users of financial markets in the UK and EU27*, https://www.irsg.co.uk/assets/IRSG-Paper-on-CCPs-Post-Brexit.pdf, pp3-4

UK access to EU CCPs

A separate issue concerns the ability of UK-based banks to maintain direct access to EU market infrastructure post-Brexit. This is partly a question of EU law and partly one of the requirements of the infrastructure operators as set out in their rules.

Access to euro payment clearing systems and certain EU securities clearing and settlement infrastructure is generally limited to regulated firms incorporated in an EU Member State or which have a branch in the EU Member State hosting those systems, although there are some exceptions to this norm. A UK-based bank that currently obtains access from the UK or from a passported branch elsewhere in the EU may, unless it restructures, lose such access post-Brexit.

A UK-based bank may therefore need to consider whether it can obtain access to that market infrastructure indirectly through another firm with the requisite status in the EU and whether that would be consistent with the UK-based bank's contractual obligations to its customers.

Contractual considerations

A further consideration prompted by this uneven national licensing landscape is the irregular implications it will have for bank customers in different Member States with respect to contractual certainty. As different product lines are subject to different licensing regimes across the EU, the UK's withdrawal from the EU will not affect the provision of all products and services equally. The greater the extent to which a national licensing regime renders elements of cross-border services no longer contracted and provided under the EU passporting regime illegal or unenforceable, the greater the scope for contractual uncertainty in that market and the greater likelihood that existing contracts may have to be novated to new licensed entities, restructured or even terminated.

If it becomes illegal for a UK-based bank to continue to perform elements of pre-existing contractual obligations in a Member State, and the continuity of those elements is desired by the customer and the bank, then, depending on the terms of the relevant documents, the contract may need to be closed out, or transferred to another entity, for example an appropriately licensed subsidiary in another Member State.

The legal certainty problem for contract holders

Perhaps one of the clearest examples of where differences in individual EU27 Member States' national licensing regimes may have materially different consequences for EU27-based customers is in relation to the treatment of existing contracts for the delivery of financial services whose duration extends beyond 2019.

The marketplace for the cross-border provision of financial services between the UK and the EU is large and active and reflects over three decades of integration and the implementation of the single market rules. The UK exit from the EU will change this, and will have significant consequences for EU27 customers. A new long-term partnership agreement will need to be negotiated and agreed, and transitional measures defined to help mitigate the impact of a revised market framework for EU27 businesses that source important banking and financial services products from the UK. The same holds true for UK-based customers accessing financial products and services from EU-based banks.

These services include lending and capital markets, risk management and foreign currency products and services that span the entirety of the financial services sector, including banking, insurance and investment management. It is estimated that €1.3 trillion of UK-based bank assets are related to the cross-border provision of financial products and services to a variety of customers ranging from governments and individuals to businesses of all sizes.

The regulatory framework and financial passports that enable EU27-based customers to access this diverse suite of cross-border financial products and services from UK-based banks will cease to apply after the UK exit from the EU. This has important implications for the many customers that hold contracts for the delivery of financial services between the two markets whose duration extends beyond 2019, with a significant proportion of this back-book of contracts extending beyond this

date. Many of these services support EU exporting businesses that are key drivers of the EU and UK's international earnings and strong contributors to economic growth and job creation.

The question of what, if anything, will replace these current rights to contract for such financial products and services between the EU and the UK remains unclear. The UK exit from the EU potentially creates significant uncertainty for EU27 businesses, including with respect to the continuity of the contracts which support their funding, economic activity and risk management. Early action is required to provide the necessary clarity that these contracts will continue after the exit of the UK from the EU.

The contractual uncertainty problem

Typically, a contract for financial products and services will have a number of elements embedded in its performance. Where any of these elements remain to be performed after the date of the UK's exit from the EU each element of continuing performance will need to be analysed to assess whether it remains permissible or whether it is now restricted or otherwise prohibited. Such assessments will require an analysis to be made of the requirements at an EU regulatory level and also at the national regulatory level of the country in which the customer is located. Because of differences across individual EU member states, it is possible that the outcome of the assessment may differ from country to country and customer to customer.

In addition, the commercial or economic environment for a contract that extends for a number of years may evolve or change such that a customer in the normal course of business activity wishes to refine or otherwise 'fine tune' aspects of the contract to respond to the new environment. Where this involves a change to elements of the contract to be performed after the date of the UK's exit, this will similarly need to be assessed.

Uncertainty as to whether elements of continued activity under, or any changes to, contracts are a regulated activity in the respective EU jurisdictions may have a material impact on the commercial outcomes that these contracts are meant to support. As a result, affected contracts may need to be transferred, restructured or potentially terminated with the respective UK-based bank. In addition, businesses may need to look for alternative financing providers to ensure that they can meet their commercial objectives in the lng term and have the appropriate financial flexibility.

If the quantity of requests for alternative service provision is high, then alternative providers may face limitations in their capacity to provide such replacement financial products and services on the same terms and at the same prices, at least in the short to medium term.

For EU27 customers, the implications of such restructuring may involve not only significant demands upon management time and resource but may also result in additional one-off reorganisation costs, the crystallisation of tax liabilities and even ongoing expense where it is not possible to restructure the affected contract on a like-for-like basis.

Case study 2 illustrates how potentially disruptive and damaging this uncertainty can be and how it gives rise to potentially significant economic costs that are both unnecessary and that it should be possible to mitigate by collaborative and coordinated actions by the EU and UK.

For this reason, the treatment of such financial contracts should be addressed as part of the current negotiations between the EU and the UK. Both the EU and the UK have a shared interest in ensuring that this issue is resolved at an early stage as part of the negotiations and avoids any chilling effect for business, additional costs for customers and disruptive economic effects for the EU and UK. Absent some sort of blanket solution, each contract will need to be individually assessed to determine if elements to be performed constitute a regulated activity no longer authorised under EU passports and whether the national laws of the location of the customer nonetheless permit the activity.

Where this point is ignored, the consequences of illegality vary between EU Member States. In some cases there may be criminal and civil penalties and in others such contracts may be treated as unenforceable.

In most EU Member States there are no mechanisms to achieve such a transfer without the consent of the customer. Any assignment of rights and assumption of new obligations would generally require the consent of both contracting parties. Moreover, the tax, accounting and other regulatory consequences for the customer and the bank of transferring a product would require consideration, and in some cases may be significant.

One area where this potential disruption may be felt particularly keenly is for commercial lending, where the UK-based banking sector is a substantial provider to the wider EU economy and where there is significant variation in the extent to which cross-border commercial lending without local authorisation is permitted. In some EU Member States, including France and Poland, for example, a licence is required in respect of ongoing lending under an existing agreement.

The loss of relevant licences may also be felt in the case of more sophisticated products (e.g. hedging or other risk management contracts). As noted by the International Swaps and Derivatives Association (ISDA), the loss of EU passporting rights could lead to a UK party to a transaction being unable to enter into derivative transactions with an EU based counterparty. Whether this will also apply to the performance of pre-existing contractual obligations needs to be clarified on a jurisdiction by jurisdiction basis[25].

Case Study 2: The importance of contractual certainty for European companies

Europa SA is a leading SME manufacturing firm, headquartered in an EU27 Member State, and with operations across the EMEA region and Asia. Like many similar businesses, it is part of the network of EU exporters to the world that have greatly contributed to European economic growth and job creation.

In 2017 Europa SA entered into a five-year U.S. dollar denominated revolving credit agreement with its UK-based bank to fund building a new factory in Asia. Europa SA expects to draw on the credit facility during various stages of building the factory and commissioning the production lines to be installed at the factory. Alongside its revolving credit agreement, Europa SA entered into interest rate swaps and hedged its foreign exchange risk with forward contracts with the same relationship bank, matching the expected payment flows for the building of the factory and the commissioning of the production lines. Like many other similar mid-sized businesses, Europa SA consolidates its banking relationships among a small number of relationship banks to maximise service efficiencies and to reduce management time required to obtain financing for its international business needs.

Once the UK exits from the EU in March 2019, and in the absence of any transitional arrangements, the financial services activity between Europa SA and its UK relationship bank will be governed in relevant part by a combination of EU regulations and the national licensing regime in the country where Europa SA is headquartered. These national licensing regimes differ greatly across EU Member States, with some being more restrictive than others in relation to the provision of wholesale banking services.

Although so far as Europa SA is concerned it has only one commercial objective – the financing of the construction of its factory and production lines – as a legal matter, Europa SA will have to analyse three different financing contracts: the revolving credit agreement; the interest rate hedge agreement; and the currency hedge agreement. Each of these contracts has a series of different elements to be performed after March 2019.

Scenario 1: Europa SA's factory is built and its production lines are installed on schedule

In this scenario, activities under the contracts are performed as agreed at inception. This gives rise to a number of questions, however. Is it the case that if Europa SA draws down additional tranches after March 2019 under the existing revolving credit agreement, that may be a regulated activity carried on by the UK bank? In some EU27 countries the answer will be 'yes', but in others 'no'. In addition, is it the case that if Europa SA is required to post additional collateral to that bank as part of its risk management contracts this may be considered a regulated activity carried on by the bank? In most EU Member States the simple receipt or release of cash collateral as part of the normal performance of a derivative contract agreed before the UK departure from the EU would not be treated as a new regulated activity requiring licensing. The UK-based bank may need to address issues associated with each element of

[25] ISDA Brexit FAQs, December 2016

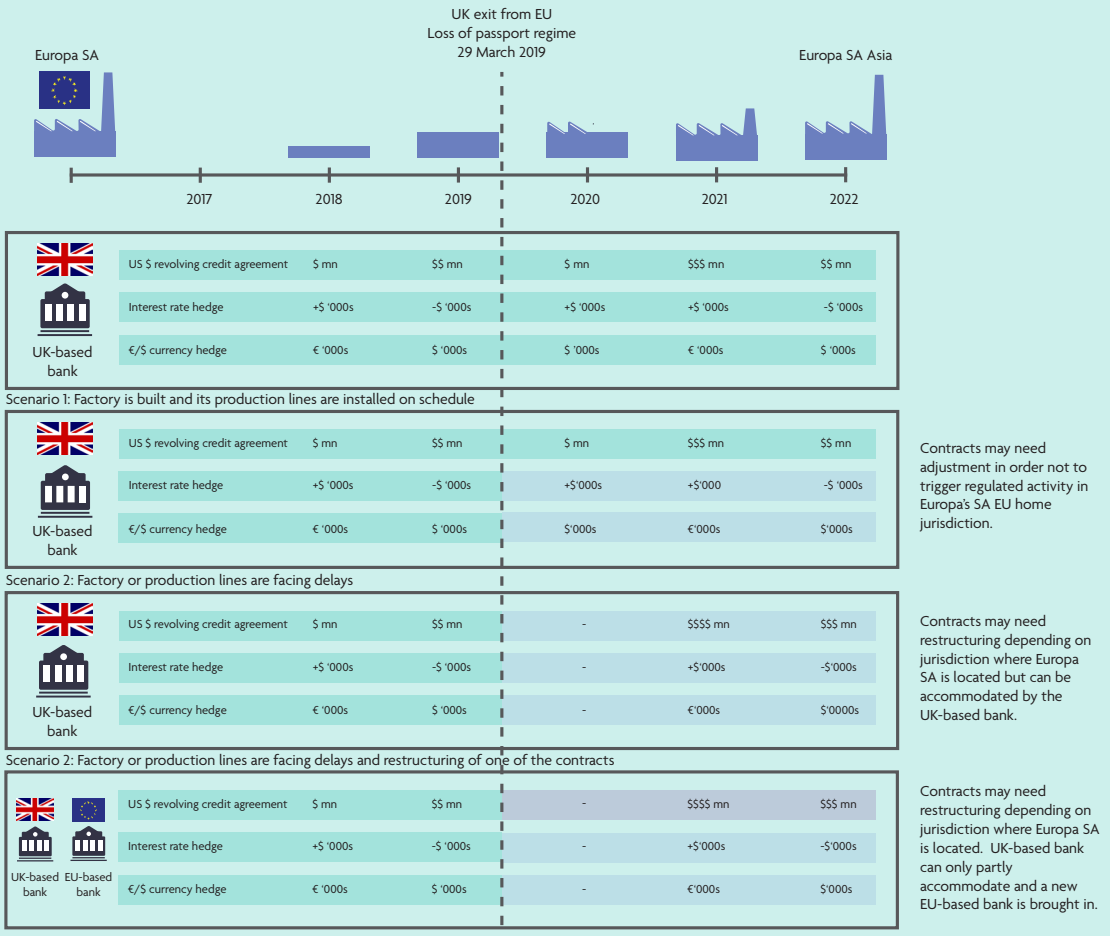
ongoing performance for each contract to ensure that it is not in violation of any regulated activities in the relevant EU jurisdiction.

Scenario 2: Europa SA's factory or production lines is facing delays

As the building process progresses, it transpires that the factory is being built on an archaeological site and local authorities are required to investigate. This is expected to set the construction schedule back by six to twelve months. Europa SA has as a result amended its investment plan and in order to reflect the situation on the ground the revolving credit agreement and the risk management agreements need to be amended. Some elements of the amendment of the financing plans underpinning the construction are likely to trigger the UK-based bank being considered as engaging in regulated activity in some EU27 countries. In some countries, only the amendments to the interest rate and currency hedging agreements will be treated as a regulated activity; in others both the amendments to the hedging agreements and to the revolving credit agreement will be regarded as regulated activities. In some countries it is possible to obtain an exemption to conduct such regulated activities with certain types of customer, but in other countries, no such exemption possibility exists. Under the passporting regime, reflecting the commercial consequences of the construction delay would have been straightforward, but following the UK's exit from the EU, Europa SA and the UK-based bank may need to restructure none, some or all of the contracts depending upon the regulatory position in the country in which Europa SA is located.

To properly assess its situation and determine whether remedial action is required to ensure that its commercial objectives are not adversely affected, Europa SA and its UK-based relationship bank will wish to work together and ascertain what needs to happen under different scenarios with each of the financial contracts it has outstanding and whether they need to be restructured, novated or even terminated. In addition, Europa SA will need to consider how to organise the capacity and capabilities of its own finance function after the UK exit from the EU to ensure that it can cotinue to execute on its financial strategy and can finance its operations and future investments.

Figure 6: Europa SA factory and production line financing



Scenario 3: Europa SA and its UK-based relationship bank conclude that one of the three agreements should be restructured

Following their analysis, Europa SA and its UK relationship bank conclude that the regulations of the country in which Europa SA is located are among the most restrictive in the EU27, and that the drawing down of the next tranche of the loan to pay for the next construction instalment for the factory will be a regulated activity for which no exemption is available for the bank.

To provide Europa SA with its desired commercial outcome – drawing down the next tranche of the dollar denominated credit agreement to make the factory construction payment on time – the UK-based relationship bank proposes to restructure the revolving credit agreement and to move it to a subsidiary it has established in Luxembourg.

Europa SA analyses the implications of this proposal and realises that it will crystallise a tax liability for Europa SA because its domestic tax regulations treat the restructuring of the loan (in US dollars with a UK-based bank) and the establishment of a new loan (in the same currency but with a Luxembourg-based bank) as a repayment. Furthermore, because Europa SA accounts to its tax authorities in euros, and thanks to the euro/US dollar exchange rate changing between the dates when the loan was drawn down and the date when it is to be treated as repaid, the termination of the US dollar denominated loan is treated as giving rise to a taxable gain in euros.

Europa SA wishes to avoid incurring such a significant tax cost merely to ensure that it continues to receive the benefit of the financing arrangements that it put in place in 2017. It seeks an alternative and less costly solution. Europa SA concludes that it will be more economic to leave the existing revolving loan agreement in place with its UK-based bank but make no further drawing under this agreement. Instead it approaches a new bank, an EU bank based in its own country, and asks the EU-based bank to provide a new US dollar loan agreement for the balance of the financing Europa SA requires to complete construction of its factory and production lines. The EU-based bank assesses its interest in the possible new relationship with Europa SA and decides to offer Europa SA the requested loan. However, current market conditions for new loans have changed since 2017, because the amount of business that EU-based bank believes it will obtain from Europa SA at this early phase in the new banking relationship is limited, and the existing interest rate swap and currency agreement to hedge the loan agreement are not with the EU-based bank and so cannot be taken into account by the EU-based bank for its own risk management calculations. As a result of these factors, the EU-based bank offers pricing and other terms for the new US dollar loan that are more expensive and less attractive for Europa SA than its original 2017 agreement.

Europa SA considers the alternatives available to it and decides that the combination of maintaining the arrangements with its UK-based relationship bank for existing drawings and the new arrangements with the EU-based bank for its future drawings are 'the lesser evil'.

Absent any blanket solution, whether via a transition arrangement or a legislative change conceptually similar to that introduced for the establishment of the euro, Europa SA's and its relationship bank's experience described in this case study will need to be mirrored for hundreds of thousands of entities and millions of contracts across the UK and the EU, a hugely wasteful use of resources that would be better applied to support new exports, economic growth and job creation throughout the EU and the UK.

Local establishment as a solution to service disruption

The previous chapter focused on potential disruption to services for EU27 customers where the relevant national licensing regime will determine whether they can or cannot receive services directly from a bank based in the UK. As noted above, their ability to do this is likely to be very limited in most respects, with material variation between EU Member States.

One obvious conclusion that might be drawn from this is that the best way for EU27 customers to preserve some, or all, of their access to the specialist services often provided by UK-based banking groups will be for those groups to establish a base inside the EU, either via a branch or a full subsidiary.

This chapter looks at some of the practical challenges inherent in these options. It assesses the extent to which this process, like the access of non-EU banks to EU customers, is determined by national licensing regimes, and highlights the wide and material variances across EU Member States. Importantly, it also briefly outlines the operational complexities in transposing business lines from a UK-based bank to a EU-based branch or subsidiary, and highlights that even under a best case scenario, this process might not be completed in time before the UK's withdrawal from the EU.

Setting up a fully-licensed branch in an EU Member State

In general, it is underestimated how complex the process for establishing a fully-licensed branch of a non-EU bank in an EU Member State can be. Even the conversion of an existing 'passported' branch of a UK bank (of which there are around 70 in the EU) into a fully-licensed branch of a foreign bank requires substantial changes to its legal structure, and imposes a new regulatory framework and local permissions and conditions that give greater regulatory prerogatives to the host state than for EEA branches. It also requires a complex process of customer novation and, in most cases, consent. A number of useful case studies for bank transformation programmes involving changes to existing legal entities in different jurisdictions and/or setting up a new legal entity have previously been published[26].

It is also often less appreciated that many EU Member States either host few or no foreign bank branches and in many cases their frameworks for the establishment of foreign branches are untested or not subject to clear established protocols. For example:

- There are currently no branches of non-EEA based banks in Sweden and, as a result, some uncertainties on how the Swedish regime might treat questions such as the extent to which a branch in Sweden can rely on intra-entity services from a 'head office' outside of the EEA.
- In Italy, seven branches of non-EU banks are currently licensed to operate, but most obtained their licence several years ago under a different regulatory and macro-economic framework.
- In Belgium, there are currently eight branches of non-EU banks. Two of these are branches of US banks which have been established in Belgium for decades.

[26] See for example *"Planning for Brexit - Operational impacts on wholesale banking and capital markets in Europe"* report commissioned by AFME from PwC, January 2017.

As branches of non-EU banks in the EU (unlike their passported equivalents) have no passporting rights to trade onwards into the rest of the single market, setting up a branch inside the EU also involves important judgements about where to prioritise branch presence. A UK-based bank may only consider this to be an economically worthwhile solution in the 'bigger' EU Member States, i.e. those with larger customer bases.

The practicalities of setting up a fully-licensed branch in an EU Member State

Establishing a fully-licensed branch is in principle a realistic option in all of the 12 EU Member States surveyed. However, there is significant variation across Member States with respect to the speed of the process and the conditions attached to branch establishment.

The formal timelines for the application process range from four to six months (in Luxembourg) to potentially 18 months (in Germany and some other EU Member States). The table below sets out the anticipated time for approval of a properly evidenced and documented local branch licence:

Table 2: Anticipated time for approval of a filed application for a branch licence

Fewer than 6 months	6-12 months	12-18 months
Italy	France	Germany
Luxembourg	Belgium	Ireland
Poland	Czech Republic	
Sweden	Spain	

Governance and the ability to outsource

In all EU Member States, local laws and regulatory practice dictate specific corporate governance requirements that affect how a branch is set up and staffed; some of these are relatively extensive. In Germany, Luxembourg and Spain, for example, the governance requirements are materially the same as for a locally incorporated and licensed bank.

Member States also vary in their treatment of the extent to which services can be delegated from a branch to a head office or another office outside of the EU or the Member State in which the branch is established. For example:

- In Ireland, it is required that the 'mind and management' of the branch is located in Ireland – i.e. so that branch decision-making takes place in Ireland. The branch may rely on intra-entity services from a 'head office' outside Ireland, provided that the extent of any outsourcing does not 'hollow-out' the activities of the branch in a way that would transfer responsibility for management and decision-making out of Ireland.
- In France, a branch may rely on intra-entity services from a head office in the UK post-Brexit as long as the French entity carries on business and has its own management and employees in France. The French regulator may require in particular the branch to keep certain key competences internally.
- In Germany, the provision of intra-entity services from a head office in the UK is subject to scrutiny from BaFin and an expectation that all or significant parts of the material business units and control functions of the German branch would stay in Germany.
- In Luxembourg, a branch can rely on intra-entity services, provided that activities outsourced to the head office are governed by a service level agreement which respects certain conditions laid down for outsourcing (business continuity, confidentiality, quality of service) and that the CSSF is satisfied that the branch holds a satisfactory governance and administrative infrastructure in Luxembourg.
- It is unclear to what extent a fully-licensed branch of a UK-based bank must have 'substance' in the Netherlands post-Brexit. Currently the only substance requirements are that the individuals performing the

daily management of the branch must work from the Netherlands. However, there is a suggestion that this point will be subject to increased scrutiny by the Dutch regulator. Critical activities such as internal audit and control and risk management are likely to be required to be performed in the Netherlands in order for DNB to be able to supervise the requirements regarding sound and prudent business operations.

Branch prudential and other requirements

A key factor in the feasibility of establishing a branch of a UK-based bank in the EU will always be the capitalisation and other prudential requirements it is subject to. In some EU Member States a third country firm that obtains a direct licence for a branch can use capital which it holds in its home jurisdiction to satisfy local capital requirements and, therefore, does not have to hold that capital separately in the relevant EU Member State. Others require much greater ring fencing of capital and liquidity inside a branch. This can be linked to where banks are required to book transactions carried out with customers in that state: In the Czech Republic, France, Germany, Luxembourg, the Netherlands, and Portugal, a fully-licensed local branch is required to book transactions carried out with customers in that jurisdiction on its balance sheet. The position is less clear and subject to regulatory discretion in Italy, Poland, Spain and Sweden. A branch of a UK-based bank, as a third-country entity, would need to contribute to local depositor protection schemes in all the EU Member States surveyed.

EU Member states vary widely in the conditions they prescribe to the establishment of a branch

As with other aspects of branch establishment, EU Member States vary widely in the terms they impose on the establishment of foreign bank branches. So, for example:

- The Czech Republic imposes a minimum capital requirement of CZK 500,000,000. Capital requirements can be higher than this reflecting the scope of, and risks related to, activities of the branch. However, Czech law does not require that the liquidity of the branch be localised in the Czech Republic.
- In Germany, capital requirements for branches are calculated in accordance with the EU Capital Requirements Regulation ('CCR') and liquidity requirements are the same as for a licensed German credit institution.
- In Ireland, while there are no notional capital requirements for the branch, in broad terms the Central Bank expects liquidity to be managed as if the branch were a subsidiary in its own right, with its own liquidity risk management policy, liquidity coverage ratio and maturity mismatch calculations.
- In Luxembourg, a branch must have at its permanent disposal an endowment capital or capital base equivalent to that required of an entity governed by Luxembourg law that carries on the same activity. Branches of non-EU banks are submitted to the same liquidity requirements as Luxembourg banks.
- In the Netherlands, a third-country bank as a whole, and not a branch, must meet requirements regarding own funds and solvency. The branch would, however, be required to hold sufficient liquidity which must be localised in the Netherlands so that DNB can supervise compliance with liquidity requirements. A third-country branch in the Netherlands is also subject to the same Liquidity Coverage Ratio requirements that apply to credit institutions established in the Netherlands, but is subject to fewer reporting requirements.
- In Portugal, third-country branches are subject to prudential supervision by the Bank of Portugal and the legal framework applicable to credit institutions licensed in Portugal applies to those branches, including liquidity requirements, own funds requirements and mandatory reserves. In the case of banks, the minimum share capital currently is €17,500,000.
- In Spain, a branch of a non-EU bank is generally subject to the same solvency requirements (buffers, liquidity, large exposures, risks, leverage) as a Spanish bank. The Bank of Spain is entitled to waive some of these requirements. The liquidity of the branch need not be localised in Spain. However, the geographical localisation of an asset will be relevant to determine the level of liquidity of such asset for the purposes of meeting liquidity requirements.

Subsidiarisation, branching, and the challenge of time

Establishing a subsidiary in an EU27 Member State can be costly, time consuming, and the outcome uncertain. UK-based banks considering this option will inevitably focus on those markets with the largest pool of existing and future customers

The issues that must be navigated in establishing third-country branches in different EU Member States are a reminder that branches are far from a simple solution to the question of how to ensure the continuity of services to EU customers. The authorisation of branches can be costly, the outcome uncertain, and may take as much as a year and a half to secure even under normal circumstances. Importantly, from the point of view of EU customers, UK-based banks considering the feasibility of branching will inevitably choose to establish operations in those markets offering the greatest return on their investment. These will generally be those offering the deepest pool of existing and potential customers, most commonly found in the largest Member States.

Many of the legal challenges inherent in EU branch authorisation also apply to the establishment of an EU27 subsidiary. Authorisation of subsidiaries generally involves more complexity and cost, subject as they are to more demanding regulatory conditions addressing issues such as the adequacy of risk management controls, capital model approval and the suitability of senior management.

The role of the European Central Bank (ECB) in supervising subsidiaries and their branches in EU27 Member States must also be considered. This is pertinent because while the initial authorisation of a financial institution or subsidiary in an EU27 Member State is first decided by the host Member State national competent authority, once it is satisfied that the application complies with national conditions for authorisation, it proposes to the ECB a draft decision containing its assessment and recommendations. The final decision on the authorisation of the subsidiary rests thereafter with the ECB.

Complexities arise not only with respect to the role the ECB plays in authorisation but also supervision. The Single Supervisory Mechanism – a key element of banking union – grants the ECB the right to directly supervise the most 'significant' banks in the eurozone countries, as well as those of any opting-in non-eurozone Member States, although none currently do so. The determination of 'significance' depends on factors such as the bank's economic importance, cross-border activity and whether or not its total assets exceed €30 billion. Importantly, while the ECB becomes the supervisor of an authorised institution in such a situation, it supervises the institution according to EU laws and, where applicable, the national legislation transposing them into Member State law. Where the relevant law grants options for Member States, the ECB also applies the national legislation exercising those options. This could result in 'significant' subsidiaries authorised in different Member States being supervised by the ECB in slightly different ways.

An additional consideration is the treatment of branches. Under the passporting regime, once a subsidiary is authorised in the EU27, it can then establish a branch in another EU27 Member State (called the 'host' state). Where that branch provides critical economic functions in that host state, it may be designated as a 'significant plus' branch, in accordance with EBA guidelines. In this case, home and host supervisors are required to cooperate on supervision and recovery planning of that branch. This supervisory approach stands in contrast with the treatment of branches from non-EU27 institutions, whose operations are supervised exclusively by their host state supervisor.

Beyond barriers such as those to quickly establishing an EU27 subsidiary, the actual operational transfer of a UK-based business to a EU27 branch subsidiary can take considerable time. The transfer of business to a EU27 branch or subsidiary involves multiple elements of planning, with some processes having long lead times that cannot be achieved in parallel. Factors which must be considered include:

- The local statutory framework and regulatory application process;
- Internal and regulatory approval of the preferred booking and netting models;
- The leasing of real estate;
- The establishment and testing of technology and information systems;
- The recruitment and relocation of staff; and
- Client outreach and repapering.

Each transfer will face its own set of challenges, issues and complexities, with no single template for guidance. Further encumbering the processes is the fact that few EU jurisdictions have a banking business transfer mechanism akin that under Part VII of the UK *Financial Services and Markets Act 2000*, so counterparty consents to transfer will often be required. Work will also need to

be undertaken to understand whether the UK group's internal risk and liquidity models can be applied to the EU subsidiary and the availability of a liquidity waiver, enabling it to rely on facilities from its UK bank parent in meeting its liquidity coverage ratio. Finally, the treatment of exposures between the UK bank and the EU subsidiary will need to be taken into account. This will be critical to understanding how much an EU subsidiary may rely on services from the UK (or elsewhere), and will affect where to locate. It will also affect the number and seniority of staff to relocate and/or hire locally.

An additional consideration is whetherthe EU subsidiary has in practice the immediate balance sheet size and capital and liquidity strength to carry anticipated EU27 customer business volumes in the short-to-medium-term. This will be especially so if there were a cliff-edge effect due to a failure by the UK to secure suitable transitional agreements when it leaves the EU. Similarly, inefficiencies associated with subsidiarisation, especially the reduction in economies of scale and centralisation, also mean that banks may consider reducing capacity in, or the closure of, less profitable product lines, or even cease to provide certain cross-border services into the less mature or smaller EU27 markets. This consideration needs to be weighed against the benefit of an EU27 point-of-entry with automatic access to passporting.

Another complicating factor is that due to the uncertainty regarding the timelines and characteristics of any future UK-EU relationship, some UK-based banks are pursuing strategies to continue to serve as many customers in the EU as possible without immediately committing the substantial resource and expense of establishing or expanding a branch or subsidiary. This more cautious approach also seeks to reduce the risk for the bank of finding that it has locked up capital in the medium term that may be harder to release once the position clarifies. As a result, the decision by some banks to move business to an EU27 subsidiary is being deferred for very practical commercial reasons. This increases the risk of temporary customer service disruption and instability in the short-to-medium-term because capacity will not have had time to fully adjust and achieve a new equilibrium.

The process of deciding on the correct approach to take to the transfer of business capacity is all the more challenging when one considers the number of UK-based banks that will have to transfer their services at the same time and prior to the UK's departure from the EU in 2019. For this reason, it remains necessary to understand how the national regulatory regimes of the EU27 Member States will treat the provision of banking and investment services from banks from outside the EU27, as it is likely that these transfers will not all have been completed by the time of the UK's withdrawal from the EU.

Case Study 3: Moving banking business from London to Dublin

International Bank is a large international wholesale bank catering to medium-to-large EU corporates and several institutional clients from a long-standing UK-based subsidiary. It serves these customers via its prime brokerage, prime financing and securities lending services.

Unsure of whether it will be able to serve its EU customers from the UK beyond March 2019, International Bank decides to transfer part of its businesses to an EU subsidiary. As part of this process, it undertakes a number of complex tasks, some of which run in parallel, and others which must be completed sequentially. These include:

- Conducting target jurisdiction and transfer mechanism diligence: International Bank performs structured due diligence over several months to identify a shortlist of potential options. Each is then considered against a defined set of quantifiable and more esoteric criteria, including local availability of real estate; skilled resources; cost of living considerations; the local infrastructure for transferring employees; work place culture; political environment; employee expertise; and the attitude of the local regulator to in-scope businesses.
- Identifying the appropriate legal transfer mechanism under which to affect the transfer: International Bank begins work on arm's length transfer agreements including the arm's length negotiation of a number of commercial issues such as price calculation mechanics, the tax liabilities of the eventual transfer, and method and timing of any associated payments.

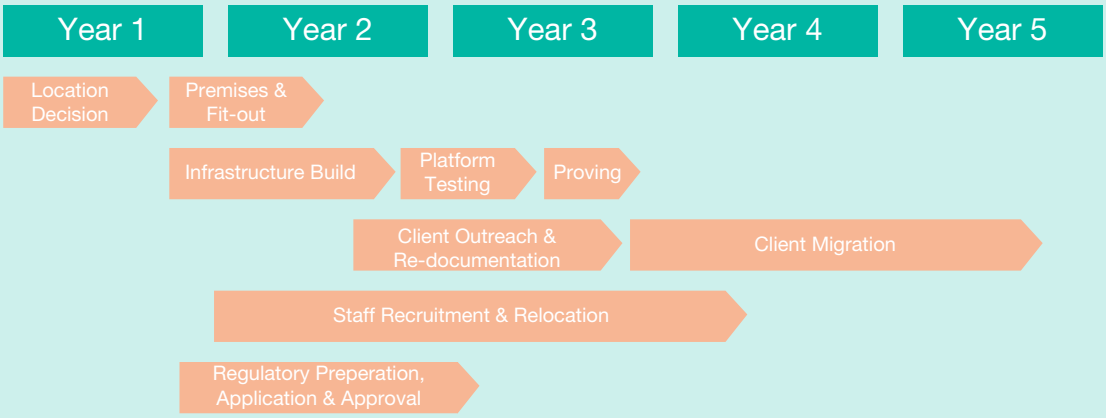
- Initiating the regulatory application processes: International Bank decides to move parts of these businesses to a new Irish subsidiary in order to build on an existing branch in Dublin. It applies for authorisation of the branch from the Irish authorities. At the same time, International Bank starts work on drafting new client templates, and begins a client outreach programme.

At this point, International Bank's regulators request substantial information from International bank in order to meet their statutory requirements. They do this continually throughout the duration of the project, all having a vested interest in understanding the impact of the transfer in the context of the strategy of the group, the nature and risks associated with the transfer including residual liabilities with the transferor, and the shape, make up and risk profile of the entity post transfer. All look to ensure that operational risks and prudential requirements continue to be managed effectively throughout. However, the divergent experience and knowledge of each the regulators results in extended delays.

Meeting each of these requests involves considerable resources from International Bank, and also makes significant demands on the regulators.

- Designing the Target Operating Model ('TOM') and associated Booking Models: The impact of moving a complex business with historically embedded systems and process proves to be very challenging to the development of the workable TOM and Booking Model. Ultimately, International Bank determines that a "plug and play" solution is not appropriate for its needs, so is required to expend considerable effort to implement bespoke front to back processing flows (e.g. capturing a trade, confirming and settling it), plus its capital, liquidity and tax compliance model. Again, these must be considered by the regulators.
- Securing a location for its new subsidiary: International Bank secures real estate for its business. However, the pace of identification and acquisition of appropriate location has proved very sensitive to volatility in demand in small markets. It now engages in lease negotiation and property fit-out which take time to conclude.
- 'Lifting and shifting' its support technology: International Bank begins a 'lift and shift' of relevant technology. This proves by far the largest program spend and, complicated by the need to transpose legacy systems, requires the longest lead time, ultimately setting the critical path timeline for the project.
- Launching a comprehensive testing program: The necessity to test a complete business platform front-to-back does not arise very often and is viewed along similar lines to significant historical industry-wide challenges such as Y2K and Economic and Monetary Union. Challenges include developing the required front-to-back testing environment and/or sequencing of code promotion in multiple systems. At this point, contingencies start to strain timelines across programs due to authorisation delays.
- Recruiting and Relocating People: International Bank's employee strategy and planning is dictated by a key requirement to keep business fully operational and ensure the transfer is seamless for clients. In addition, numerous relocation challenges are supplemented by local hiring limitations, adding to the complexity of delivery.
- Repapering: International Bank begins a client and supplier repapering exercise. High documentation volumes require very significant SME customer resource, which proves to be a key determinant of the ultimate timeline.

Representative timeline for the transferring of business from a UK-based entity to an EU27 entity



International Bank is ultimately successful in transferring its businesses. However, the capital efficiencies of the new entity are reduced. This results in greater costs for EU27 customers facing that entity. In addition, the time taken to deliver this project has meant that during the interim period between the UK's withdrawal from the EU until International Bank's Dublin entity is fully operational, International Bank served its customers using a hybrid model combining the expanding capabilities of its Dublin operation and its existing UK based capacity according to the terms of each of its client's domestic legal framework. This resulted in a significant diminution of service to some of those clients. Some commentators have suggested that the capacity of domestic EU banks to seamlessly fill any resulting service gaps across all customers and products is far from certain.

Conclusions

From the results of the survey presented here, it is possible to draw some general but important conclusions about the consequences of a scenario in which the UK and EU are unable to agree a new framework for cross-border trade in banking services before the UK's departure from the EU.

1. National licensing regimes will be an important but limited tool at the point of Brexit.

National licensing regimes can serve as a possible partial mitigant against some of the risks of system instability and disruption in a 'cliff edge' scenario. They can also assist those customers fortunate enough to be located in more open jurisdictions to access the sophisticated products and services they require and which UK-based banks can provide. As a potential mitigant, the usefulness of national licensing regimes ultimately depends on the policy positions taken by key regulators in the more open jurisdictions.

2. This patchwork of rights is in each case limited, uncertain and poorly suited to the kind of services that EU27 exporting companies need.

Where national licensing regimes do create scope for EU27 customers to contract with UK-based banks after Brexit, they generally do so in a way that is partial, inflexible and uncertain. While all are very restricted in comparison to the status quo, there are also material differences in the degree to which they allow customers in their markets to be served by banks outside the EU.

From the perspective of an EU27 customer currently benefiting from the direct or indirect use of services provided by UK-based banks, reverse solicitation or rapid establishment or expansion of UK and EU27-based branching and subsidiarisation offer inflexible or imperfect solutions. The capacity of existing EU based banks to seamlessly fill any service gaps for all customers across all EU27 Member States in the short-to-medium-term is also uncertain. Consequently, and as a practical matter, the combination of these together with the complementary but only partial solution offered by national licensing regimes would mean new restrictions for customers in sourcing important banking services, and the risk of a large measure of uncertainty and disruption. Far from presenting a single prospect to EU27 customers seeking specialist banking services from the UK after Brexit, the national licence regimes available for banks to serve their customers would present 27 different regimes. This is of particular importance for many EU customers involved in export oriented businesses as these are typically among the largest users of the more sophisticated international banking services for which the UK is a significant provider across the EU.

3. The nature of the risk at the time of the UK's withdrawal from the EU will depend upon the size of the gap between customer need and available banking sector capacity.

Consequently, it seems likely that in the short-to-medium-term, banking service capacity will be provided via a combination of EU-based banks expanding their capacity and capabilities so as to absorb disruption in the most seriously affected product and service areas, and UK-based banks adapting their own existing product and service capabilities to adjust their business models towards a new equilibrium. Effecting these changes will involve considerable complexity and costs for both UK and EU27-based banks.

4. In the short-to-medium-term, the provision of banking services for many EU27 customers could become more costly and constrained.

Until sufficient capacity becomes available in the right locations to fulfil customer needs, it is likely that the cost of banking services will increase while the choice of products and services will decrease due to a reduction in economies of scale and centralisation. EU27 customers in the more restrictive EU national regimes will be proportionately more exposed to disruption and contractual uncertainty in the immediate term and loss of choice and service in the medium term. These implications will not be uniform; they will depend materially on where a customer is based in the EU27 and the banking profile of their local market.

5. The most effective mitigant against the risk of a 'cliff-edge' effect at the point of the UK's withdrawal from the EU is to ensure that comprehensive transitional arrangements are agreed well in advance, ultimately supported by a comprehensive UK-EU cross-border market access agreement on terms that are mutually acceptable to the UK and EU27.

If the UK and EU can commit at an early stage to transitional arrangements, 'cliff-edge' macro and micro risks of Brexit and their likely real-economy consequences on EU economic activity in the short-to-medium-term (and especially on EU exports) can be avoided[27]. A solution guaranteeing continuity of access for EU27 customers to the wide range of financial services provided by UK-based banks in both the period immediately after the UK's withdrawal from the UK, and in the long term is in the interests of all parties.

6. Several provisions found within some EU national licensing regimes warrant consideration as a possible basis for any future UK-EU financial market access agreement. In many instances, these provisions set a more flexible and robust precedent than the relatively inflexible models that currently exist at an EU level.

While the national licensing regimes of EU Member States provide an uneven and limited basis for a long-term framework for trade in banking services between the EU and the UK, they have been a testing ground for a range of approaches to cross-border trade in financial services and for this reason could provide a source of possible ideas for facilitating cross-border services between the two markets. For example, 'Inter-professional' exemptions already effectively exist in the laws of a small number of EU27 Member States, allowing sophisticated counterparties subject to adequate home supervision to contract for services from each other on more permissive terms. The EU and the UK could consider extending these exemptions to all Member States. Some national licensing regimes take a similar approach to specific economically vital services such as commercial lending.

[27] For further information, please refer to *Brexit Quick Brief Time to adapt: the need for transitional arrangements* (https://www.bba.org.uk/wp-content/uploads/2017/03/BQB-6-new-version-online-FINAL.pdf)

Glossary

AFM	The *Autoriteit Financiële Markten*, the Authority for Financial Markets responsible for regulating Dutch financial markets.
AIF	Alternative investment fund.
AIFM	Alternative investment fund manager.
AIFM Directive	EU Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers.
BaFin	The *Bundesanstalt für Finanzdienstleistungsaufsicht*, the Federal Financial Supervisory Authority responsible for regulating German financial markets.
BoE	Bank of England.
Capital Requirements Regulation (CRR)	EU Regulation 575/2013/EU of the European Parliament and of the Council of 23 June 2013 on prudential requirements for credit institutions and investment firms.
CCP	Central counterparty, defined in Art. 2(1) EMIR as a *'legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer'*.
Consob	The *Commissione Nazionale per le Società e la Borsa*, the Italian financial markets regulator.
CRD IV	EU Directive 2013/26/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. Sometimes 'CRD IV' is used to denote both this directive and the CRR.
CSSF	The *Commission de Surveillance du Secteur Financier*, the Luxembourg financial sector regulator
DNB	*DeNederlandsche Bank*, the Dutch central bank.
EBA	European Banking Authority
ECB	European Central Bank.
EEA	European Economic Area.
EMIR	EU Regulation 648/2012/EU of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (the European Market Infrastructure Regulation).
ESMA	The European Securities and Markets Authority.
EU27	The European Union excluding the United Kingdom.
FINMA	The Swiss Financial Market Supervisory Authority.
MiFID II	The new EU legal framework coming into force in January 2018 governing the requirements that apply to investment firms, trading venues, data reporting service providers and non-EU firms providing investment services or activities in the EU; the two principal pieces of EU legislation establishing the MiFID II framework are the MiFID II Directive (Directive 2014/65/EU) and the MiFID II Regulation (Directive 600/2014/EU); the MiFID II framework will replace the existing MiFID framework, which came into force in 2007.
NBB	The National Bank of Belgium, the Belgian central bank.
UCITS	Undertaking for collective investment in transferable securities, a type of fund vehicle established pursuant to EU directives and their national implementing laws in Member States.

Annex 1

Methodology for the Survey

The findings presented in this report are based on information gathered from a survey on the law and regulation of the 12 Member States completed by local lawyers: Belgium, the Czech Republic, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Poland, Spain and Sweden.

The following main topics were explored:

- the ability to conduct various forms of marketing in these jurisdictions;
- the availability of exemptions or cross-border licensing regimes for banking and securities services;
- the governing law of customer contracts and dispute resolution;
- requirements to contribute to local depositor and investor protection schemes; and
- the feasibility of a UK-based bank establishing a fully-licensed local branch.

The jurisdictions were chosen based on a wide range of objective criteria and with a view to achieving even geographic representation across the EU banking sector[28]. Factors that were taken into account include: GDP; size of the banking sector of a Member State relative to GDP; exposure to the UK-based banking sector; statistics from the Global Financial Centres Index; and figures on UK trade surplus in financial services per EU Member State.

The survey was structured around an agreed set of general questions focusing on the regulatory regimes for banking and securities services of Member States to which relatively brief responses were required. The questions were framed around a comprehensive list of banking product and business lines, ranging from corporate banking services to capital markets business, asset management activities to retail deposit-taking.

We are grateful to these law firms who contributed information on their national regulatory regimes to inform this report: NautaDutilh (Belgium); PRK Partners (Czech Republic); Bredin Prat (France); Hengeler Mueller (Germany); Arthur Cox (Ireland); BonelliErede (Italy); Elvinger Hoss Prussen (Luxembourg); De Brauw Blackstone Westbroek N.V. (Netherlands); WKB Wiercinski, Kwiecinski, Baehr Sp. k. (Poland); Uría Menéndez Proença de Carvalho (Portugal); Uría Menéndez (Spain); and Gernandt & Danielsson (Sweden). The opinions and conclusions expressed in this report are not, however, those of the aforementioned firms, and those firms shall have no responsibility or liability for this report or any part of it.

Local lawyers were asked to assume that:

- the UK is no longer a member of the EU, has not become a member of the EEA and has not negotiated any replacement single market access (whether on a transitional or a longer-term basis) in respect of the provision of financial services in the EEA; and
- The UK is considered to be a 'third country' under relevant EU financial services legislation (e.g., MiFID II, MiFIR, CRD IV and EMIR) and has not been deemed 'equivalent' under any such legislation following the UK's withdrawal from the EU.

This report is concerned not only with local law and regulation, but also with the approaches of relevant national supervisors. As a matter of practice rather than law, this is not always a clear-cut matter. For example, we found a range of uncertainties around how the regulators in some Member States would approach an application for a new branch licence following a loss of passporting rights. In addition, there are sometimes discrepancies in the approaches of regulators in a single jurisdiction.

[28] https://www.ecb.europa.eu/pub/pdf/other/reportonfinancialstructures201610.en.pdf?592b728066f71be0788991e606b504bd ; http://ec.europa.eu/eurostat/web/national-accounts/overview ; http://www.zyen.com/research/gfci.html https://www.thecityuk.com/assets/2016/Reports-PDF/The-UK-Europes-financial-centre.pdf

Annex 2

Below is a tabular representation of the relative openness of surveyed product lines. A number of these are important to EU27 exporting businesses.