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C H A N C E

FRANCE GETTING READY FOR A "NO DEAL" BREXIT

The French government is implementing changes to allow UK firms operating in banking and finance to continue their activities in France in the event of a 'no deal' Brexit and to ensure that French firms will still be able to work with UK entities under their new third country firm status.

While negotiations for an orderly withdrawal of the UK from the EU are still ongoing, France is introducing a number of contingency measures. The aim is to secure as far as possible the performance of contracts entered into before Brexit (ongoing contracts) and to allow for continued participation in various inter-bank payment and settlement systems and post-trade infrastructures. The approach is consistent with the European Commission's contingency plan, which underlines the need for preparedness for all possible scenarios. The measures taken by France are described below.

The French Brexit Law

The French government has been authorised to adopt measures for a "no deal" Brexit without going through a lengthy parliamentary process under the French Brexit Law which was published in the *Journal Officiel* on 20 January 2019.

The French Brexit Law covers issues such as the employment of UK nationals in France, the applicability of social benefit schemes to UK nationals residing in France, the transportation of passengers and goods, and the continuity of regulated activities carried out by UK individuals and legal entities. With respect to banking and finance, the French Brexit Law authorises the French government to adopt measures in order to:

- Allow French firms to have access to third country interbank and settlement systems, such as CLS, CHAPS and CREST, by ensuring the finality of payments made through such systems – this measure would allow French market participants to continue to conduct business on those markets post-Brexit. It must be noted that the European Commission has adopted, as part of its contingency plan, with respect specifically to cleared derivatives and CSDs, a decision of equivalence for twelve months, which will allow ESMA, in a "no-deal" scenario, to temporarily recognise central counterparties and central securities depositories currently established in the UK on a pre-application.
- Designate the competent authority for the supervision of securitisation activities.
- Introduce specific rules for the management of collective investments whose assets comply with investment ratio in European entities.
- Ensure continuity of the use of master agreements in financial services.

Key points

- In the next three weeks, the French government will adopt measures required by a "no-deal" Brexit, without going through a lengthy parliamentary process.
- A possible run-off regime for ongoing contracts which have not been transferred to an EU entity will be elaborated and adopted by way of ordinance.
- Clearing houses will be subject to a specific (simplified) clearing house licence instead of the ECB credit institution licence (unless required by the ACPR based on their activities).
- French participants in CLS, CHAPS and CREST will be protected under the SFD regime.
- Mere performance of most ongoing contracts (including derivatives) will remain possible post-Brexit.
- Continuity of account opening services provided by UK firms will not be affected post-Brexit since characteristic performance is in the UK.

The European Commission's contingency plan is available here.

- Secure the performance of ongoing contracts. The French government notes that the loss of the European passport does not raise any legal concerns for most ongoing contracts, since as a matter of practice, those would be generally transferred to duly authorised EU entities. The French government also notes the possibility that such matters may be dealt with at the EU level though, at this stage, the European Commission's contingency plan leaves the issue of contract continuity to private sector action although it appears to envisage some action by Member States in granting authorisations. Nevertheless, in the event where operational difficulties would delay the transfers, the French government considers that it may be necessary to adopt specific measures to secure the transfer or performance of ongoing contracts. Additionally, in respect of ongoing contracts that would present uncertainties, the French government plans to define a run-off regime that would allow the service provider to perform its contractual obligations by carrying out transactions which are strictly necessary in the best interest of its clients. This proposal reflects the suggestions made by the French High Legal Committee for Paris financial markets (*Haut Comité Juridique de la Place financière de Paris*, HCJP) (see below).

Finally, the French government notes the possibility of setting out simplified and determined terms (such as simplified consent terms for the client) for the conclusion of a new market master agreement by an EU based entity.

The French government is currently preparing relevant ordinances in anticipation of Brexit day (29 March 2019), which are scheduled to be adopted by 6 February 2019. The first ordinance was adopted on 23 January 2019 and relates to the implementation of temporary border control infrastructure. A further four ordinances are expected, which will relate to the rights of UK nationals in France; the continuity of road transportation in France by UK companies; the continuity of defence material transfers between France and the UK; and, with respect to banking and finance, the continuity of certain financial activities (including insurance activities) after the loss of European passporting rights by the UK.

Adapting financial market infrastructure – The French legal framework

Another Brexit-related French government initiative is to modernise post-trade market infrastructures, and in particular clearing houses and securities settlement systems. The "Pacte Law", a draft law relating to the growth and transformation of firms, proposes a more flexible licensing regime for clearing houses specifically in the event of a no-deal Brexit. As such, the Pacte Law legally secures the status of French firms by guaranteeing them access to UK market infrastructures post-Brexit.

Replacement of the credit institution licence for clearing houses

French law currently requires clearing houses to obtain a credit institution licence as a pre-requisite. The licence must be obtained from the European Central Bank (ECB), on the proposal of the Prudential and Resolution Supervision Authority (*Autorité de contrôle prudentiel et de résolution* or ACPR) after having consulted the Financial Market Authority (*Autorité des marchés financiers* or AMF) and the French Banque de France.

The Pacte Law would replace the requirement for a credit institution licence with a requirement to obtain a specific clearing house licence from the ACPR. It should be noted however that the ACPR could still require the clearing house to obtain a credit institution licence depending on the nature, volume and complexity of its activity.

Access to third-country interbank and settlement systems (including the UK) by French entities

As from the effective date of Brexit, the UK Continuous Linked Settlement (CLS) payment system will become a third country system. As a result, the Settlement Finality Directive (SFD)[1] regime will no longer apply to CLS, and it will not be regarded as a system under French law post-Brexit.

The purpose of the SFD regime is to remove systemic risk, for example the risk that the default of a counterparty results in the default of other participants in the system or of the system itself. This is achieved through the irrevocable nature of transactions, which cannot be called into question under insolvency laws once they have been introduced into the system. Set-off instructions and operations are legally enforceable, including against third parties, provided that they have been submitted to the system prior to the expiry of the business day (as defined under the rules of the system) on which a court opens insolvency proceedings or prior to proceedings being launched against a participant, notwithstanding any legal provision or court decision to the contrary.

Further, under the SFD regime, in the case of an insolvency proceeding being instituted against a participant to an EEA system, the rights and obligations arising from or in connection with its participation are determined by the law governing the system, to the extent such law is that of an EEA jurisdiction. This does not apply when the system is governed by the laws of a country outside the EEA. Therefore, in this case French insolvency common law would apply to the participant.

As a result, the fact that CLS will no longer be recognised as a system under French law could create a legal uncertainty both on the part of the French firm (which would be prevented from participating in CLS and there would be no existing alternative) but also from the perspective of CLS.

To remedy this issue, the Pacte Law seeks to implement recital No. 7 of the SFD, which allows member states to apply the provisions of the SFD regime to participation in third country systems and to collateral provided thereunder. As a result, the SFD regime (including the protections on the insolvency of a participant) would continue to apply to third country systems included within the SFD regime under the Pacte Law. This would include CLS, CHAPS, the UK interbank payment system for Sterling, and CREST, the UK securities settlement system for debt obligations and listed shares.

With respect to cleared derivatives and CSDs, we must also note the European Commission's decision to grant a temporary equivalence in a "no-deal" scenario (please see above).
Additionally, it should be noted that the Pacte Law incorporates the recommendations made by the HCJP (which worked with ISDA on the drafting of the new master agreement governed by French law) to:

1 Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems (as amended).

- Amend the scope of transactions eligible for set-off and termination under the financial collateral regime to extend it to, among other things, spot FX transactions, buying, selling and settling precious metals or emission allowances transactions.

- Allow compound interest, including interest due for a period of less than one year, contrary to the current condition requiring interest due for at least one year under article 1343-2 of the French civil code (*anatocisme*).

According to recent official sources, the Pacte Law is expected to be adopted and published during Summer 2019, in other words, post-Brexit. As a result, the Brexit measures described above are likely to come too late. The French Brexit Law therefore includes some of the Pacte Law measures so that they will be adopted on Brexit day at the latest.

Mitigating the impact of the loss of the European passport by the UK

In 2017, the HCJP carried out an assessment of the impact of Brexit on the access by UK entities to the EU market and the impact on ongoing contracts (the relevant report is available in French here). More recently, the HCJP carried out further analysis of Brexit's impact on banking and investment services and published a new report in November 2018 (it is available here).[2]

The HCJP group that worked on contract continuity in the banking and investment services sectors was composed of, among others, representatives of:

- The French regulatory authorities (namely, the AMF and the ACPR), the *Banque de France* and the French treasury.
- Major French financial institutions and financial industry associations (FBF, AMAFI).
- Academics, law firms[3] and legal experts.

The HCJP banking and investment services report covers the following services:

- Banking transactions, payment services, issuance and e-money management.
- Investment services, though excluding underwriting and placement services, and operation of an MTF (Multilateral Trading Facility) or an OTF (Organised Trading Facility).

The HCJP banking and financial services report – main findings

In its report on the impact of Brexit on the banking and investment sectors, the HCJP says that in the absence of any French or European law provision related to the consequences of the loss of the European passport, a specific regime should be introduced under French law. This would be similar to the current French law regime relating to the management of ongoing agreements in the event of a licence withdrawal. This is a solution that would be capable of being implemented through the French Brexit Law.

1 Separate reports have been published in relation to, respectively, insurance and asset management, which are available here.

2 Including Clifford Chance.

The HCJP says, as a general rule, the validity of ongoing contracts must be assessed at the time they were entered into (i.e. pre-Brexit, where UK firms were still capable of relying upon the EU passport). The performance of ongoing contracts should not be put into question post-Brexit to the extent that such a performance does not entail the characteristic performance of a regulated service in France. In other words, no new regulated services must be provided in France post-Brexit.

Where applied to various banking and investment services, the outcome of such an approach would be the following:

(1) **Financing contracts***:* to the extent the parties would have been irremediably committed before Brexit, the contract will continue post-Brexit. For example, reimbursement of funds under a loan agreement (that was entered into prior to Brexit) may take place post-Brexit. However, the continuation of a financing contract might be jeopardised if the conditions precedent are not met before Brexit or if an event occurs that substantially amends the characteristics of the contract (e.g. an increase of the facility amount).

(2) **Derivatives and repo contracts**: Brexit should not affect the continuity of derivatives contracts, in particular regarding life cycle events, as long as the contract was validly entered into before Brexit. For example, the exercise of an option or the payment and settlement on the initially agreed date will be viewed as a mere performance of the relevant contract which may take place post-Brexit. Conversely, an event that would substantially amend the contract may qualify as the provision of a new regulated service. This would be, for instance, the case of the extension of a maturity, the increase of the nominal or rolling of a position, the novation or renegotiation of terms and conditions.

(3) **Account opening services:** with respect to deposit accounts and correspondent banking services offered by a UK-based entity to clients located in France on a cross-border basis, the HCJP considers that the characteristic performance of such services would take place outside France. Accordingly, such services should fall outside the territorial scope of application of the French licensing requirements. The HCJP is of the view that ongoing contracts related to such account services should not be affected post-Brexit, insofar as the mere performance of such contracts is concerned. In the absence of any official guidance or position from the French regulatory authorities, the HCJP is of the view that the same approach should apply to payment services.

The HCJP report also analyses the various options that UK firms have to provide banking and financial services within the European market post-Brexit. Among other options, the HCJP considers that outsourcing arrangements may be put in place between the locally licensed branch or subsidiary of the UK firm and its head office in the UK. Such outsourcing is subject to the following limitation: the substance of the activity must, in any event, remain within the locally licensed entity/branch, it being noted that compliance with such a requirement would have to be assessed by the relevant local authorities.

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