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Brexit: Potential regulatory and transactional impacts for financial institutions

Overview

This paper considers the key potential regulatory and transactional consequences for financial institutions of the UK's referendum vote on 23 June 2016 to leave the EU. The future relationship between the UK and the EU is unclear. But financial institutions can put themselves in the best position to react appropriately by understanding the extent to which the UK's current membership of the EU underpins their activities.

The key points are:

Provision of financial services throughout the EU

- The ability to rely on passporting rules to provide financial services from the UK in or to other EU jurisdictions will be in jeopardy if the UK leaves the EEA.

- "Equivalence" rules may eventually provide an alternative means of accessing the EU financial services market from the UK. Unfortunately, this access is neither automatic nor consistent across different EU sectoral regimes for banks, insurers, fund managers and investment firms. As such, they may not give international businesses currently operating in the UK the certainty they need to rely on the UK as an access point.

Transactions and documents

- The referendum result triggers few immediate legal consequences for most finance agreements and derivative contracts. The most obvious immediate transactional impact will be commercial: how does economic uncertainty arising from the result affect a counterparty's business, and therefore its risk of default?

- The referendum result in itself is unlikely to trigger events of default (e.g. "material adverse change") or termination rights. Parties to derivative transactions should consider implications if a change of law results in withholdings being made.

- There is unlikely to be a significant change to parties' approach on choice of governing law and jurisdiction, although the adoption of mutual exclusive jurisdiction clauses may become more common.

Part 1 – Providing financial services throughout the EU

How would Brexit affect the ability of a financial institution based in the UK to provide financial services throughout the EU?

If the UK were to leave the EU but remain a member of the EEA, the direct impact would be minimal. All EU legislation relating to the single market in financial services is integrated into the EEA Agreement so it applies throughout the whole EEA (currently the EU plus Iceland, Liechtenstein and Norway). But it may be difficult to agree this transition to EEA status within the relevant time periods. It may also not be feasible politically for a future UK government to seek this type of relationship, as key EU principles such as free movement of people would continue to apply.

So focus is inevitably shifting to how a withdrawal from both the EU and the EEA would affect the UK financial services industry. Might the UK seek to have an "equivalent" regime to EU legislation in relation to the provision of certain services, and what does this mean?

Background – current ways to market and provide financial services in EU jurisdictions

When considering access to a market, firms should consider not just whether it is possible to provide the services on a cross border basis or from a local branch, but also whether it is possible even to contact possible clients and/or market services in that jurisdiction.

Consistent with the principles of freedom to provide services, firms that have passport rights also have the ability to market services locally. In the absence of EU wide rules, third country firms generally need to consider each EU country's rules to understand whether they are able to market or promote services into that country, and what form of marketing to what type of client might be acceptable. Common restrictions include restrictions on marketing to retail clients and prohibitions on cold calling and other forms of direct marketing.

Any firm carrying on business that requires authorisation under any relevant EU sectoral legislation (including banks, investment firms, fund managers and insurers) may do so in any EU jurisdiction in one of five ways:

- by being authorised in the relevant Member State;
- by providing cross-border services from the Member State in which it is authorised (the "home" Member State) to customers in another Member State (the "host" Member State) – using the "services" passport under the relevant legislation;
- by providing services by setting up a branch in the "host" Member State – using the "branch" passport under the relevant legislation;
- by seeking local agreement from the regulator in the relevant Member State; or
- where equivalence applies (see below), by appropriate registration following an equivalence decision.

Passporting, whether on a services or branch basis, requires notification to the relevant regulators. Except in exceptional circumstances, the "host" state regulators must accept the notification and must not impose any prudential requirements on the passporting business, as these are "host" state responsibilities. However, depending on the sector, the regulatory classification of the customers and whether the passporting occurs by branch or services, the "host" state may apply certain local investor protection rules.

In principle, therefore, if the UK leaves the EEA, none of the existing "passports" that UK firms have will be able to continue to operate. The majority of UK banks, insurers and large investment and asset management firms have several passports to carry on business with customers in many other EU jurisdictions. If they wished to continue doing business with these customers without setting up a regulated entity elsewhere in the EU, they might argue that no services are provided in any other state. For instance, are they only accepting deposits from EU customers in the UK? However, any such argument would need to be assessed on a case-by-case basis. Both the precise nature of the activity in question and any promotion or marketing of that activity would need to be considered. The question would need to be analysed under both

UK law and the law of the relevant EU Member State(s). Otherwise, they might be able to rely on the relevant UK law being deemed "equivalent" to EU law.

Much discussion on "equivalence" focuses on investment firms, but "equivalence" regimes are in place for other areas of the financial market already. Experience to date indicates that equivalence is a long-winded process, and the outcome of any application will not be guaranteed.

We consider equivalence under the main sectoral legislation below, starting with CRD 4 (for banks or credit institutions). We then consider Solvency 2 (for insurers), MiFID 1 and 2 (for investment firms), and AIFMD (for private equity, hedge and other alternative fund managers). We also look at the European Market Infrastructure Regulation (EMIR) which deals with derivatives clearing, reporting and risk management.

Equivalence in relation to deposit-taking business under CRD 4

Article 47 of CRD 4, like its predecessor CRD 3, allows each Member State to authorise a branch of a third country bank, provided that the Member State first notifies the Commission, the European Banking Authority (EBA) and the European Banking Committee. In addition, Article 47(3) allows the EU to treat branches of a particular third country bank identically throughout the EU through agreements with one or more third countries. This power might be invoked for UK based credit institutions; it would be preferable to negotiating with each remaining EU member state individually.

Finally, Article 48 allows for the EU to agree with one or more third countries on how to supervise institutions headquartered in the EU or in a third country on a consolidated basis. In practice, Article 48 has not been invoked. EBA has found the information sharing with third countries adequate and instances where it was not (mainly where the EU country was the host to a third country bank) not yet significant.

Third country regulators take part in colleges of regulators set up under Article 116(6). Third country resolution authorities may also participate in resolution colleges under Article 88(3) of the Bank Recovery and Resolution Directive (BRRD). Participation in these colleges depends on the significance of the third country supervisor for the banking group and confidentiality requirements considered "equivalent" (in accordance with EBA recommendations) being in place. Although equivalence assessments are labour intensive and sensitive, 29 such equivalence determinations have been made. As a third country, the UK would want to ensure that PRA and the Bank of England participate in these colleges with the European Central Bank (the supervisor of significant credit institutions in the eurozone under the single supervisory mechanism). Note though that the UK regulators would only be observers if the UK is not subject to EU law.

CRD 4 does not provide for cross-border services. This is because it is generally considered that deposit-taking, like asset management, is a service which is provided where the account is opened. There may of course be local restrictions on marketing such a cross-border service to clients in an EU member state similar to the UK's financial promotion regime which restricts (but does not ban) the promotion of off-shore deposits into the UK.

CRD 4 also requires that third country regimes be considered equivalent for certain classes of third country exposures to benefit from lighter capital requirements. For example, when calculating capital requirements for credit risk, exposures to third country banks, investment firms, central counterparty (CCPs) and exchanges must be subject to prudential and supervisory requirements at least equivalent to those in the EU (CRR Article 107).

These provisions are likely to matter for EU credit instutions and investment firms with exposures to post-Brexit UK institutions. If the UK regimes were not considered equivalent, and regulatory capital cost were to increase, it is at least conceivable that those EU institutions might prefer dealing with North American or Asian institutions subject to "equivalent" regimes.

Equivalence under Solvency 2

Solvency 2 introduced a different kind of equivalence. There are three ways in which third-country jurisdictions may be considered as equivalent to the EU – in relation to reinsurance, the solvency calculation and group supervision. If an equivalence decision is in place, this can prevent duplication and possible contradiction of requirements for internationally active insurance groups, and therefore make it more attractive for third country insurers to do business in the EU and vice versa. So far, only Switzerland and Bermuda have been granted full equivalence, with a further seven jurisdictions having a provisional or temporary ruling.

Equivalence under the Markets in Financial Instruments Directive (MiFID 1) including the Revised Markets in Financial Instruments Directive and Regulation (MiFID 2 and MiFIR)

Like CRD 4 and its predecessors, MiFID 1 contemplates that third country firms might set up branches or provide services into the EU. However, other than explicit provisions on the exchange of information (which is already subject to equivalence requirements under Article 63), and a provision for EU regulators to complain to the Commission and ESMA if investment firms have difficulty establishing themselves or providing services into a third country (Article 15), there are no EU-wide conditions for establishing such branches or providing such services. These are still matters of local law.

This will change under MiFID 2. The UK will almost certainly not have left the EU by the date MiFID 2 is to take effect, 3 January 2018, given that no Article 50 notification has yet been made. MiFIR and the various implementing regulations will therefore apply directly in the UK and MiFID 2 and the implementing directives will need to be implemented into UK law, by way of changes to the FSMA, PRA or FCA rules. MiFID 2 introduces new options for third country firms.

First, MiFID 2 and MiFIR provides for reverse solicitation. Where a client requests services on their own initiative, there is no requirement for the third-country firm to set up a branch (if the client is a retail or elective professional client) or register with ESMA (if the client is a per se professional client or eligible counterparty) specifically to perform those services. However, if the firm is required to have a branch, it cannot market categories of product or service as well as that sought by the client to that client or others other than through the branch. Similarly, if a client requests a service, the firm may provide that service without a registration but may not market categories of product or service in addition to that requested by the client.

Second, under MiFID 2 Article 39 Member States may (but do not have to) require third-country firms wishing to provide investment services or perform investment activities with or without ancillary activities to retail or elective professional clients to set up a branch in the relevant Member State. Where this is the case, the branch can be authorised in that Member State only if it meets certain conditions:

- the firm requires, and has, authorisation to provide the services in the country of its establishment and is supervised for compliance with the Financial Action Task Force recommendations on the prevention of money laundering and terrorist financing;
- there are appropriate co-operation agreements between the home country regulator and the relevant Member State;
- the branch has sufficient freely available initial capital;
- the branch appoints one or more persons to manage it, and each relevant person complies with the provisions of the fourth Capital Requirements Directive (CRD 4) on governance and the management body in the same way that all firms covered by MiFID 2 must;
- the third-country "home" country has in place an agreement with the relevant EEA Member State that fully complies with the OECD Model Tax Convention on Income and Capital; and
- the firm belongs to a compensation scheme authorised or regulated in accordance with the Investor Compensation Directive.

An Article 39 branch must also provide the relevant Member State regulator with information about itself, its supervisor, its domestic management and compliance arrangements and details of its initial free capital. Once authorised, the firm must comply with the requirements of MiFID 2 on organisation, trading, conflicts of interest, investor protection (including the rules on disclosure, suitability and appropriateness, best execution, client order handling and dealing with eligible counterparties). It must also comply with relevant rules on trading venues, and MiFIR's requirements on transparency and transaction reporting.

Finally, MiFIR Article 46 provides an alternative regime for third-country firms wishing to provide investment services or carry out investment activities with or without ancillary activities to or with per se professional clients and eligible counterparties within the EU with or without setting up a branch. These firms may do so based on registration with ESMA. ESMA will do this based on an application where:

- there is an equivalence decision in place;
- the firm is authorised in the jurisdiction where its head office is established to provide the services and activities it wishes to provide in the EU, and is subject to effective supervision and enforcement; and
- ESMA has established co-operation agreements with the third-country regulator.

A registration with ESMA will cover the entire EU. No Member State can impose any requirements on the third-country firm additional to those set out in MiFID 2 and MiFIR, or treat these firms more favourably than other firms. However, they may at their discretion allow third-country firms to provide services and activities to eligible counterparties and per se professionals if there is no equivalence decision in effect.

Registered third-country firms must tell customers before providing any investment service that they are not allowed to provide services to anyone other than an eligible counterparty or per se professional. They must state that they are not supervised in the EU, and the name of their home country supervisor. They must also offer to submit any disputes to dispute resolution mechanisms before they provide any service.

MiFIR Article 47 provides that the Commission will only make an equivalence decision if the third country requires firms providing the services and activities:

- to be authorised and to be subject to ongoing supervision and enforcement;
- to be subject to sufficient and appropriate capital requirements and requirements on shareholders and members of the management body;
- to have adequate organisational requirements around internal controls;
- to comply with appropriate conduct of business rules; and

has in place rules preventing insider dealing and market manipulation.

If a third-country firm is already authorised under Article 39 of MiFID 2, it can provide services to eligible counterparties and per se professional clients without setting up any more branches. However it must comply with the same information requirements in Article 34 of MiFID 2 as apply to EU firms wishing to passport on a services basis. It will be subject to the supervision of the EU home state of the branch.

ESMA will keep a publicly available register of registered third-country firms, setting out which services the firms can provide and who is responsible for their supervision.

So, following a Brexit that leaves the UK outside the EEA, no UK firm would be able to apply to ESMA for registration until the European Commission had adopted an equivalence decision for the UK. Absent an equivalence decision, individual Member States would have discretion to allow firms to do business with eligible counterparties and professional clients in their jurisdiction.

Equivalence under Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD deals with the management and marketing of alternative investment funds (AIFs) whether set up in the EU or not.

The AIFMD, which Member States had to implement in 2013, required ESMA to review, by July 2015, how the arrangements under it for marketing alternative investment funds (AIFs) had worked. ESMA had to assess the National Private Placement Regimes (NPPR) and advise on whether to introduce a passport for non-EU alternative investment fund managers (AIFMs) to manage EU AIFs and to market EU and non-EU AIFs. Such a third country passport would depend not only on agreements as to the exchange of information but also on an equivalence decision.

ESMA's advice urged the European Commission not to make hasty changes.To date, ESMA has assessed Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the US. It concluded the passport could be extended now to Jersey and Guernsey, and also to Switzerland, where pending legislative change would remove the outstanding hurdles to equivalence. However, it had concerns in relation to the other three jurisdictions. Currently, the process appears to be stalled, as ESMA feels too few countries are equivalent for it to be worth the European Commission initiating its decision-making process. As a result, we are still very far from the ability for any third-country AIFM to have a passport, and it is difficult for non-EU AIFMs to conduct business with EU customers.

Non-EU AIFMs therefore still have to resort to multi-jurisdictional surveys, given the NPPR regime differs for each EU member state. Using a local MiFID-authorised firm for marketing works in certain jurisdictions, but restrictions and conditions, including a requirement to register fund documentation with each EU regulators for the target countries, apply.. Without an equivalence decision, AIFMD is likely to pose a significant hurdle for those UK firms currently able to market funds across the EU based on their AIFM passport.

Equivalence under European Market Infrastructure Regulation (EMIR)

Under EMIR, there are three main obligations:

- reporting of all derivatives to a trade repository;
- clearing of certain derivatives via a central counterparty (CCP); and
- risk mitigation techniques for derivatives not cleared via a CCP.

EMIR caused significant problems not only for third country CCPs and trade repositories wanting to do business in the EU, but also for non-EU counterparties to trades. Non-EU counterparties were required to comply with EMIR reporting requirements, even where they also had to comply with local reporting requirements (for example under Dodd Frank). EMIR allows the European Commission to adopt equivalence decisions in respect of the laws of a third country. The effect is to allow a non-EU counterparty established in a third country benefitting from an equivalence decision to comply with its local regime rather than EMIR. It avoids duplication and conflict.

Particularly problematic under EMIR was the process that eventually led to an equivalence decision in respect of the US. The European Commission finally deemed the US equivalent in March 2016. There are now 10 equivalence decisions in respect of EMIR reporting requirements. 19 third country CCPs have been recognised by ESMA as qualifying CCPs. Equivalence in relation to CCPs was particularly important given the massively increased capital requirements imposed on EU banks and investment firms with exposures to non-qualifying CCPs under CRD 4.

Would the UK meet the equivalence requirements?

Each piece of EU legislation sets its own requirements for an equivalence determination to be made. We have not set these out in detail in this note, as we should at least be able to assume that the EU considers its own laws would meet its standards, and the UK already applies (or, with MiFID 2, will apply) those standards. Clearly, if the UK decided, following a Brexit, to amend its laws so as to diverge from the relevant EU laws in a material way, the equivalence decision might not be granted or withdrawn. But even with laws mirroring those of the EU, the equivalence decision and attendant benefits for firms would not be automatic. That said, if the UK were to adopt the European rules wholesale, it would be strange for the Commission not to regard the UK's laws equivalent.

Part 2 - Debt capital markets

Impact on capital raising in the debt capital markets?

EU legislation currently enables an issuer of debt securities to "passport" its prospectus offering those securities to other EEA member states. This is particularly relevant where debt securities are issued by way of a public offer. If the prospectus complies with the relevant European legislation and has been approved by the competent authority of an EEA member state, the issuer can use it to raise capital across the EEA without requiring further consents or approvals. Moreover, many issues involve activities by investment firms that benefit from the EU single passport under MiFID 1 (or from 3 January 2018, MiFID 2) – without this, their ability to market securities to potential investors elsewhere in the EU is likely to be curtailed.

So, if the UK ceases to be an EEA member state and is unable to agree with the EU any equivalent to the EU Prospectus legislation, a UK issuer wishing to make a pan-European public offering of its debt securities will need to apply for approval of its prospectus by a competent authority in an EU regulated market – just as "third country issuers" currently do – rather than in the UK. This may encourage issuers with programmes that are currently listed in London to move them elsewhere in Europe. At this stage we cannot know whether the UK government might also require additional UK regulatory approval in respect of "EU-approved" prospectuses that are used to market securities in the UK. More generally, given the likely uncertainty of the UK's position for the foreseeable future, it would not be surprising if more issuers chose the Irish Stock Exchange or the Luxembourg Stock exchange as their listing venue for bond issues going forward.

Impact on insider dealing and market abuse laws?

UK laws governing market abuse changed significantly on 3 July 2016, with impact on both issuers and financial advisers. The key changes came with the Market Abuse Regulation, a key example of where EU legislation applies directly to UK businesses. Were that Regulation to cease to apply in the UK, the UK government would need to decide whether to fill that void with legislation equivalent to the Market Abuse Regulation, revert to the laws as they were before it, or take some different stance.

Part 3 – Transactions and documents

Choice of law and jurisdiction

Is the choice of English law and jurisdiction still a good one for international finance transactions?

Many of the factors that have traditionally encouraged parties to international finance transactions to make their contracts subject to English governing law and/or the jurisdiction of the English courts would remain unaffected by Brexit. These include:

- the certainty and commercial focus of English law, primarily developed via a long-standing system of case law and well-established principles of contractual interpretation and party autonomy (meaning that, in most cases, the English court will uphold the bargain agreed by the parties). This in turn provides confidence to both domestic and international parties as to what the law relevant to their dealings means and the predictability in how English courts will apply it;
- the flexibility of the common law system and its ability, when necessary, to adapt to business and other changes: for example, the courts can take developments in the appropriate market or sector into account as part of the factual matrix relevant to what the contract language used by the parties means;
- the reputation of the English courts and in particular the independence and commercial focus of the judiciary, bolstered by specialist lists for many types of business dispute headed by judges with extensive experience in those particular areas of dispute;
- where parties choose English governing law and also provide for the jurisdiction of the English courts there is no need to prove the content of the applicable law through expert evidence and a strong element of procedural certainty as to how the courts will deal with and resolve any dispute.

But to what extent would Brexit affect the recognition of parties' choice of English law and English court jurisdiction, and the enforcement of English court judgments in other courts?

Governing law, jurisdiction and enforcement of judgments – potential impacts

EU legislation currently sets out the rules which a court within the EU would apply to decide what law governs contractual or non-contractual obligations, or which court has jurisdiction to hear a dispute between parties. EU legislation also sets out a framework for mutual recognition of judgments across the courts of the EU. How would these be affected by Brexit?

Choice of law. Parties' ability to choose the governing law of their contracts would be unlikely to change in any significant way on Brexit. EU courts (other than in Denmark) currently apply the Rome I and II Regulations (respectively) to determine which law to apply to contractual and non-contractual obligations. They provide that, subject to some specific exclusions, the parties' choice of law will be upheld regardless of whether the stipulated governing law is that of an EU member state or not. In other words, even if or when the UK exits the EU, the remaining EU courts should respect a choice of English law in the majority of cases, unless one of the exclusions applies. And it must surely be safe to assume that any replacement UK legislation will provide for the courts of the individual UK jurisdictions to uphold a choice of English law.

Jurisdiction and enforcement of judgments. The Recast Brussels Regulation currently comprises the main set of rules concerning which EU member state courts should have jurisdiction to deal with disputes in civil and commercial matters. Subject to certain exceptions, where the parties have agreed that the courts of a member state should have jurisdiction, that court and other EU courts will recognise that choice. The Recast Brussels Regulation also provides a system of reciprocal recognition and enforcement of judgments within the EU. There is some uncertainty about how these arrangements could be affected by Brexit.

The UK and the EU might agree to continue to apply equivalent rules: Switzerland, Norway and Iceland have already agreed similar rules on jurisdiction and recognition of judgments with the EU under the 2007 Lugano Convention. Even if that did not happen, the UK could unilaterally choose to ratify the Hague Convention on Choice of Court Agreements. As the EU has already ratified the Hague Convention, that would automatically create a replacement system for ensuring parties' contractual choice of English jurisdiction is respected by EU courts, and for enforcement of courts' judgments between the UK and the EU. The rules on reciprocity provided under the Hague Convention are though of narrower scope than those that apply under the Brussels Regulation. For example, they broadly only apply to exclusive jurisdiction agreements and judgments arising from them: asymmetric jurisdiction clauses of the type commonly included in facility agreements may not count as exclusive for this purpose.

In light of the Brexit vote, in transaction-specific circumstances, it might be appropriate to make minor changes to jurisdiction clauses to address potential uncertainty over the rules that would apply post-Brexit (for example, choosing a mutual exclusive jurisdiction clause in a facility agreement). But there is unlikely to be a general change of approach, and it is likely to benefit all jurisdictions to agree a sensible way forward.

Facility agreements

These are likely to be the key points for parties to facility agreements (current and future) to consider following the Brexit vote:

- ***Compliance with existing representations, undertakings and covenants*:** Any changes which the Brexit vote (and the uncertainties around it) causes to a borrower's business will bring the package of representations, undertakings and covenants which bind it under scrutiny. Most obviously, a decline in financial performance could affect its compliance with financial covenants. A borrower may also wish to address potential difficulties that would arise as a result of Brexit by making significant changes to its business operations. However, its facility agreement may restrict these. For example, in a facility agreement a borrower may have agreed not to move its "centre of main interests" (a concept derived from the European Insolvency Regulation) away from its jurisdiction of incorporation. This may be a problem if it wished to move its headquarters and operations to another jurisdiction due to actual or potential Brexit.

- ***Increased costs clauses*:** Brexit would almost certainly herald the introduction of new laws or regulations. If these resulted in a lender incurring increased costs in connection with its lending activities, it might seek to recover these costs using the increased costs provisions in its facility agreements.

- ***Events of default*:** Few existing facility agreements contain specific Brexit-related events of default. Those that do should be assessed individually. By contrast, most facility agreements contain a "material adverse change" event of default. Could Brexit, or even the Brexit referendum vote itself, trigger these? Material adverse change events of default in facility agreements usually relate to the position of the borrower and its business, rather than to increased political or economic risk generally. So Brexit of itself would seem unlikely to trigger this type of clause (and the referendum vote on Brexit seems even less likely to). But of course the analysis will always depend on the drafting of the particular clause by reference to the particular circumstances. Whether a Brexit-related event leads to a substantial deterioration in the financial position of the borrower such that a material adverse change occurs is a separate question. However, in those circumstances it would be likely to also cause breach of a financial covenant or a non-payment event of default.

- ***Contractual recognition of bail-in*:** We do not know if the UK would remain within the EEA post-Brexit. If it did not, and no other solution were found (such as recognition at state level) EEA financial institutions would have to start including contractual "bail-in" clauses in certain new English law documents they enter into, or existing English law documents they materially amend, to comply with Article 55 of BRRD. A bail-in clause recognises that the institution's obligations under the relevant document are subject to an EEA regulator's exercise of its write-down and conversion powers under BRRD implementation legislation.

- ***References to EU and EU legislation in contractual terms*:** It is not uncommon for agreements to define "EU" as the members of the European Union from time to time. If the UK was intended to be included in such a definition, parties should check the significance of this potentially not being the case. References in existing finance documents to EU legislation will also need to be considered in light of the Interpretation Act 1978 and other interpretative provisions.

- ***Jurisdiction clauses*:** Many English law facility agreements contain an asymmetric jurisdiction clause. This provides that the borrower may only start proceedings in the English courts, whereas the lender may start proceedings in the English courts or any other court with jurisdiction. As explained above (see Choice of law and jurisdiction), in some new transactions parties may wish to include a mutual exclusive jurisdiction clause instead.

Derivatives transactions[1]

The referendum decision has no doubt already had a commercial impact on existing derivatives transactions. For example it will have led to increased margin calls, changes in the eligibility of collateral under credit support documents, and consideration of certain disruption events – for example under the ISDA Equity Definitions. However, at this stage it is unlikely to have any immediate legal consequences that would require parties to amend their ISDA Master Agreements. Nonetheless, parties to ISDA Master Agreements may wish to consider the following points:

- ***Representations and agreements in the ISDA Master Agreement*:** Parties to the ISDA Master Agreement give certain representations upon entry into the ISDA Master Agreement and each transaction pursuant to it. Whilst there should be no immediate reason preventing parties from continuing to make such representations, if post-Brexit, any future arrangement between the UK and the EU resulted in a party's financial services and products passports being lost, then parties should consider whether they are able to continue to make certain representations – see, for example, Section 3(a)(iii) *(No Violation or Conflict)* and Section 3(a)(iv) *(Consents)*.

  Parties to the ISDA Master Agreement also give certain covenants to each other on an ongoing basis for so long as either party has any obligations to the other under the agreement. As above, in the event that a party loses its passporting rights, it should consider whether it can continue to make certain covenants - see, for example, Section 4(b)(*Maintain Authorisations*) and Section 4(c) (*Comply With Laws*).

- ***Termination Events*:** At the moment, it is unlikely that any Termination Events (e.g. Tax Event, Illegality or Force Majeure) will arise, however, parties should consider any bespoke Additional Termination Events or additional Events of Default. In the event that the terms of the UK's exit from the EU result in a Change in Tax Law and withholding tax becomes payable under the ISDA Master Agreement, then a Tax Event may arise.

- ***Definitions*:** If Scotland declares independence from the UK, then this could potentially constitute wa "Sovereign Succession Event" under the 2014 ISDA Credit Derivatives Definitions in relation to any credit default swaps in which the UK is the designated Reference Entity.

- ***Jurisdiction clauses*:** The 2002 ISDA Master Agreement contains a hybrid exclusive/non-exclusive jurisdiction clause in favour of the English courts where English law is chosen as the governing law. Even before the referendum result, it was not uncommon for parties to change this to a pure exclusive jurisdiction clause. This may become more widespread to ensure that reciprocal enforcement between the courts of the UK and the EU would continue to apply even if that regime were to be based on the Hague Convention (see above).

1 This note does not consider the position under other standard securities financing transaction documents (for example the GMRA or GMSLA); however, we would expect the analysis to be broadly consistent for those documents.

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