COMMERCIAL BAR ASSOCIATION
BREXIT REPORT
BANKING SUB-GROUP

COMBAR Brexit papers

Members of COMBAR are leading specialists in many of the areas of commercial legal practice that will or may be impacted by Brexit. A series of detailed papers explaining the potential effect of Brexit on these areas of practice have been produced by teams of COMBAR members, in some cases working with non-COMBAR specialists including solicitors, academics and retired judges in the following areas:

1. Conflicts of Laws, Jurisdiction, Choice of Court Agreements, Choice of Law, Service of Legal Process and Judicial Assistance in Taking of Evidence.

2. Banking.

3. Financial Services.

4. International Arbitration.

5. Competition.

These papers were recently submitted to the Ministry of Justice following a meeting with the Lord Chancellor in December attended by a number of members of the COMBAR Brexit Committee. They are now being made available on the COMBAR website. Anyone is welcome to read them and to disseminate them on the understanding that, in doing so, the fact that they were produced by COMBAR will be acknowledged.

A second tranche of papers on other areas of legal practice affected by Brexit will be provided in the near future.

Authors / Contributors 5
Introduction 6
Summary of Conclusions 8
Derivatives 14
Introduction 14
Transaction Documentation 15
Clauses affecting the parties' obligations to perform 16
Events of default 16
Termination events and force majeure 21
Frustration 22
Standard form documentation 23
Events of Default 25
Termination events 26
Governing law 27
Jurisdiction clauses 29
Service 32
Definitions 32
Regulation of Derivatives 33
Adapting/protecting jurisdiction clauses in light of Article 46 MiFID II 34
Article 55 Banking Recovery and Resolution Directive 34
Payment Services 36
SEPA 36
The existing framework 36
The impact of Brexit 42
Conclusions / recommendations 45
Payment Services Regulations 45
The existing framework 45
The impact of Brexit 46
Conclusions / recommendations 48
Interchange Fee Regulation 48
The existing framework 48
The impact of Brexit 53
Conclusions / recommendations 56
Set off and Netting 57
Introduction 57
Set-off and Netting 59
The existing framework 62
Domestic law 62

EU law ... 64
European instruments addressing set-off and netting ... 65
The Settlement Finality Directive ... 66
The Financial Collateral Directive ... 69
Conflict of laws rules in relation to set-off and netting ... 74
European rules applicable to clearing houses ... 76
Conclusion ... 80
The impact of Brexit ... 80
Conclusions / recommendations ... 82
Insolvency ... 85
Introduction ... 85
UK Banks ... 85
Legislative framework ... 85
Pre-Brexit: the domestic position ... 88
Post-Brexit: the domestic position ... 90
Pre-Brexit: recognition within the EEA of the Special Resolution Regime applicable to UK banks ... 90
Post-Brexit: recognition within the EEA of the Special Resolution Regime applicable to UK banks ... 92
BRRD: Third Country resolution proceedings ... 93
CIWUD: Third Country winding-up proceedings ... 97
Customers and Counterparties: the Insolvency Regulations 1346/2000 and 2015/848 ... 98
Introduction ... 98
Scope and objectives of the Insolvency Regulations ... 99
Pre-Brexit: the current ... 101
Jurisdiction to open insolvency proceedings ... 101
Recognition and enforcement of judgment orders ... 101
Applicable law ... 102
The Recast Insolvency Regulation ... 104
Communication and co-operation ... 104
The impact of Brexit ... 105
The Alternatives ... 106
Schemes of Arrangement ... 108
Brexit and Financial Collateral Arrangements ... 109
Anti-Money Laundering Regime and Financial Crime ... 111
Summary ... 111
The existing Anti-Money Laundering framework ... 111
Looking ahead to June 2017: the Fourth Money Laundering Directive ... 113

The impact of Brexit on the AML regime ... 114
Immediate gaps in the law ... 114
Future direction of UK AML measures ... 115
Cross-border intelligence sharing and law enforcement ... 117
International co-operation in setting AML standards ... 118
Other aspects of financial crime ... 119
Counter-terrorist financing ... 119
Sanctions regime ... 120
Conclusions ... 122
Consumer Protection: Consumer Credit and Unfair Contract Terms ... 123
Introduction ... 123
Unfair Terms ... 124
The existing unfair contract terms framework and its relationship with EU law ... 124
Issues with the existing framework ... 128
The impact of Brexit ... 129
Consumer Credit ... 130
The existing consumer credit framework and its relationship with EU law ... 130
The impact of Brexit ... 131

AUTHORS / CONTRIBUTORS

Sonia Tolaney QC (chair)

Mark Arnold QC

Richard Salter QC

Daniel Toledano QC

Anthony Zacaroli QC

Natasha Bennett

Adrian De Froment

Laura Feldman

Hannah Glover

Fred Hobson

Anne Jeavons

Emma Jones

James MacDonald

Giles Robertson

Sophie Weber

INTRODUCTION

1. The UK's financial market, centred on the City of London, is one of the largest international financial centres in Europe, attracting a wide range of global banks and other financial services providers.

2. Since the late 1990s, the laws governing the financial services industry have been tied ever closer to European law, with the EU launching a number of regulatory initiatives aimed at ensuring the harmonisation and integration of EU financial markets, and the removal of any legal barriers to the provision of cross-border financial services activity across Europe.

3. This report considers the impact of the UK's impending exit from the EU (**Brexit**), whatever form it takes, on the existing legal framework for each of the following areas of banking and financial services:

   (1) derivatives;

   (2) payments services;

   (3) netting and set-off;

   (4) insolvency;

   (5) anti-money laundering; and

   (6) consumer protection.

4. Each section follows broadly the same format, and considers the existing legal framework, the extent to which it is derived from domestic and/or EU law, and the impact of Brexit on the same.

5. The impact of Brexit on financial services regulation is the subject of a separate report.

SUMMARY OF CONCLUSIONS

6. Below we provide a brief summary of the key conclusions and recommendations in relation to each of the areas covered in the report.

(1) As regards derivatives:

(a) The clauses in derivative agreements that govern the parties' obligations may be affected by events associated with Brexit. For example, as to derivative agreements entered into prior to 23 June 2016, it is at least arguable that a loss of the right to passport into the EU as a result of Brexit may constitute a material adverse change.

(b) Even if Brexit does not directly trigger material adverse change clauses, the volatility that the UK exit may trigger will likely result in increased collateral requirements, changes in collateral under credit support documents, or increased margin calls, which could in turn lead to a default on any failure to satisfy the additional requirements.

(c) Brexit may also have an impact on the choice of law rules applied by the English Courts in determining the governing law of derivative contracts. Post-Brexit, the Rome Regulations, which uphold the parties' express choice of law, will not apply in the UK (unless UK ultimately becomes a member state of EFTA). To avoid any uncertainty, the UK Government may wish to consider legislative guidance to support the English courts continuing to recognise the express choice of law adopted by the parties.

(2) As regards payment services:

(a) Single Euro Payments Area (SEPA): Once the UK leaves the EU, the SEPA Regulations will cease to be directly applicable and the UK will fall outside the geographical scope of SEPA unless it either remains part of the EEA or reaches agreement for the UK's continued participation in the SEPA scheme. If the UK does not remain part of the EEA, its continued participation in SEPA post-Brexit will depend on whether it meets the participation criteria applied by the European Payments Council. If the UK considers continued participation to be desirable then its national law will need to be functionally equivalent with certain EU legislation, including aspects of the SEPA Regulation. The most obvious means of achieving this would be for the UK to enact national law in the same or similar terms to the relevant EU Regulations.

(b) Payment Services Regulations: Unless the UK remains in the EEA on Brexit, the Payment Services Regulations will need amendment to avoid existing payments falling out of their scope. In the longer term, the UK will need to consider what rules to implement in this sphere.

(c) Interchange Fee Regulation: Once the UK leaves the EU, card-based payment transactions within the UK, or between the UK and a Member State, will likely fall outside the scope of the Interchange Fee Regulation, which will cease to be directly applicable. The UK Government will, therefore, need to give consideration to whether to legislate to fill the gap in national law left by the disapplication of the Regulation, and, if so, on what terms.

(3) As regards netting and set-off:

(a) There are two European Directives in relation to netting which the UK has implemented by means of Regulations.

(b) There are also other European instruments relevant to set-off and netting as well as European rules applicable to clearing houses.

(c) Since these European rules are aimed at ensuring the proper functioning of financial markets, if all the rules including the EU Directives and any implementing English law were removed, there would likely be a real adverse effect on the proper functioning of the financial markets and significant prejudice to market participants (both from the United Kingdom and abroad).

(d) The overriding objective should therefore be to preserve the stability of the financial markets by adopting, continuing or making new legislative provisions covering the same areas and broadly to the same effect as the present EU and EU-derived law in this area.

(4) As regards insolvency:

(a) UK Banks: If the UK were no longer to be a member of the EEA, the domestic Special Resolution Regime applicable to a UK bank would no longer be the subject of, nor entitled to, automatic recognition throughout the EEA/EU because Credit Institutions Reorganisation and Winding-up Directive (CIWUD), Arts 3 and 9 would no longer apply. In such circumstances, the UK would instead be a

Third Country for the purposes of the CIWUD and Bank Recovery and Resolution Directive (BRRD).

(b) Customers and counterparties of UK banks: the Insolvency Regulations which govern the insolvency and restructuring of bank customers and counterparties (whether corporate or individual) within the EU will cease to apply in the UK when the UK leaves the EU. What will happen thereafter in respect of recognition of UK insolvency proceedings and the effect of EU insolvency proceedings in the UK will depend on the arrangements that may be negotiated and agreed after notice has been given under Article 50. If the substance of the Insolvency Regulations is to be retained, it would be necessary for the UK to seek to conclude a bilateral or multilateral arrangement (presumably in the form of a treaty) with the EU or with individual Member States.

(c) Financial Collateral Arrangements (No. 2) Regulations 2003 (FCAR): Once de-coupled from its European origin, there will be some uncertainty as to the process for interpreting the FCAR. It would be preferable for the interpretative process to be identified by Parliament, rather than being left to the Judges to work out.

(5) As regards anti-money laundering:

(a) Whilst derived from EU directives, the core pillars of the UK's Anti-Money Laundering regime are contained in UK primary and secondary legislation; as such, the legislative framework will remain substantially unaffected by Brexit in the immediate term. On a longer term horizon, there is the possibility of the UK and the EU developing divergent anti-money laundering standards. Whilst certain

differences can be expected to develop over time, it is highly unlikely that the UK will seek to relax its anti-money laundering standards in any material respects given the UK's long-standing commitment to combating financial crime.

(b) The EU sanctions regime has been a key pillar of the sanctions regime in force in the UK. Brexit will therefore leave a significant gap and the UK will need to decide whether it continues to adopt the EU sanctions measures or chooses to go its own way relying upon autonomous UK sanctions.

(6) As regards consumer protection:

(a) Unfair contract terms: It seems unlikely that the UK Parliament would want to scale back or reduce the level of consumer protection from unfair terms especially as the law has been very recently revised in the form of the Consumer Rights Act 2015. For these reasons, it is to be anticipated that there will be limited appetite in the short term for further revisions to the existing framework of consumer protection from unfair contract terms. In the longer term, the UK Parliament could seek to formulate a framework that is more straightforward to apply, is drafted in clearer terms that makes use of English common law concepts, and which is specifically designed to meet the specific concerns and exigencies of UK consumers.

(b) Consumer credit: Since the current regime provides a high level of consumer protection, there is no short term need for Parliament to turn its attention to consumer credit law. Brexit will provide the UK Parliament with the opportunity to review the regulation of consumer credit and, where appropriate, to re-mould

the current position to better reflect the forms of consumer credit found commonly in England but less commonly in continental European jurisdictions

DERIVATIVES

Introduction

7. Given the importance of London as a centre for derivatives trading worldwide, it is essential that sensible and considered transitional and permanent arrangements are implemented for derivatives trading by the UK and EU as part of the Brexit negotiations. The certainty and commerciality associated with English law underlies London's position as the heart of the financial services sector. To the extent possible, the UK Government, with the support of the judiciary, should attempt to ensure the legal clarity and commercial approach that has allowed English law to underpin financial markets.

8. There is currently significant uncertainty in respect of the shape of Brexit, which makes it impossible to predict all the issues that may arise in relation to derivative transactions. As such, the exact consequences of the vote to leave the EU can only be analysed in the abstract until the specific terms of the UK exiting the EU are known.

9. For example, currently UK banks and financial firms are able to provide a range of financial services anywhere in the EU, and in the wider European Economic Area (EEA), while being based in the UK and regulated by UK authorities, without the need for additional local licences. These rights (referred to as "passporting rights") apply correspondingly to banks and financial firms authorised to do business in other EU/EEA countries and arise as a result of the Markets in Financial Instruments Directive 2004/39/EC (MiFID). If, however, the UK leaves the EU without retaining EEA membership, then unless the UK enters into equivalent bilateral agreements with some/all of the EEA states, or secures an exit deal allowing passporting to continue, it is assumed that Brexit will result in UK firms losing these "passporting rights".

10. Nonetheless, the UK Government should be aware of areas already identified as being potentially adversely affected by Brexit or areas of uncertainty that require clarification. Many of the issues identified could be remedied through a carefully managed Brexit, which has due regard for legal norms that ensure the smooth performance of derivative transactions.

Transaction Documentation

11. The clauses in derivative agreements that govern the parties' obligations may be affected by events associated with Brexit. The following section explores this potentiality in further detail.

12. Outside the regulatory framework applicable to derivatives, the English law governing derivative agreements is largely derived from contractual principles developed independently of EU law. In light of which, Brexit may have a limited effect on English contract law. However, an area of potential uncertainty is the approach that the courts will adopt in relation to contractual construction in light of Brexit. Generally, the parties' intention is addressed having regard to their position at the time of contracting, construed in light of the express words used. Following and during the process of Brexit, it is likely that there will be questions in relation to whether and how to apply EU law that may have existed at the time of contracting but is repealed or altered during the course of Brexit. Similarly, the extent to which English courts should recognise or follow principles of EU case-law established prior to Brexit remains a matter of speculation. The UK Government may wish to consider whether it can give direction in this regard, with the support of the judiciary and the legal sector, to clarify the approach to contractual interpretation under English law.

Clauses affecting the parties' obligations to perform

13. There are various clauses in derivative agreements that may entitle a party no longer to perform its obligations under the contract. These include clauses addressing events of default, representations by the parties, material adverse changes to the parties or circumstances, force majeure events and termination. Contractual doctrines that may have a similar effect on the contract include frustration or illegality.

Events of default

14. Typically, derivative contracts specify the scenarios that will constitute an event of default. Such events may include a material adverse change in circumstances, misrepresentation or a tax event. An event of default may suspend a party's payment or delivery obligations (by preventing the crystallisation of the condition precedents for payment), entitle a party to terminate the agreement (typically following serving notice in accordance with the contractual provisions) and/or result in a payment of an early termination amount (calculated in accordance with set procedure or methodologies). It is not expected that the Brexit vote in itself will trigger an event of default. Nonetheless the events associated with Brexit may trigger such clauses. The events of defaults that may be triggered by Brexit or events associated with Brexit are considered in further detail in the following section.

15. As an introductory note, with any transaction, bespoke events of default or additional termination events agreed by the parties will need to be analysed specifically for any potential difficulties.

Material adverse change clauses

16. Within the context of derivatives, there is limited judicial guidance on the occurrence of a particular event(s) or deterioration of the parties' position that will relieve a party of its obligation(s) due to a material adverse change. Nonetheless, in accordance with accepted tenets of construction, the undoubted starting point for the exercise of interpreting material adverse change provisions will involve assessing the particular words used. In that, the process of construction requires identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision.

17. Mr Justice Blair in *Grupo Hotelero Urvasco SA v Carey Value Added SL* [2013] EWHC 1039 considered the construction of a material adverse change clause in relation to the deterioration of the financial condition of a counterparty to a loan agreement. Within this context, the judgment sets out four principles of construction in relation to material adverse change clauses. We would expect similar principles to apply in relation to derivatives.

18. First, the judgment indicated that an assessment of the financial condition of the company should normally begin with the company's financial information at the relevant time, and a party seeking to rely on such a clause ought to show an adverse change over the period in question by reference to that information. Additional information relevant to the question of whether a material adverse change has occurred in the party's financial condition can also be considered.

19. Secondly, for the change in financial condition to be material, the adverse change must be material in a substantial or significant way to the counterparty's ability to perform the transaction in question.

20. Thirdly, a state of affairs at the time of contracting will not give rise to a material adverse change. In this respect, Professor Hooley's observation (made in light of the 9/11 attacks) were quoted in the judgment as follows:

"*General and/or sectorial economic decline that was known to, or should have been foreseen by, the party relying on the clause when he entered into the contract is unlikely to be held to constitute a material adverse change unless the wording of the clause is particularly clear on the point*".[1]

21. Finally, in order to be material, any change must not merely be temporary.

22. Having regard to the third principle cited by Blair J, it is unlikely that Brexit or reasonably foreseeable events associated with Brexit will trigger a material adverse change provision in derivative agreements entered into after the 23 June 2016 UK referendum decision to leave the EU.

23. As to derivative agreements entered into prior to 23 June 2016, it is at least arguable that a loss of the right to passport into the EU as a result of Brexit may constitute a material adverse change by virtue of substantially affecting the financial condition of certain companies or the circumstances of particular derivative contracts. The economic volatility associated with Brexit may also adversely affect the financial condition of certain companies to such an extent that it provides grounds to rely on material adverse change clauses on the basis of consequential adverse effects on the financial condition of companies. Further, if a party's business is dependent on EU legislation and/or free access to EU markets, a Brexit that repeals relevant EU laws and/or limits access rights could trigger material adverse change clauses. Similarly, a chaotic Brexit, or

---

[1] Material Adverse Change Clauses After 9/11, chapter 11 of Commercial Law & Commercial Practice , ed. Worthington, 2003.

poorly managed Brexit, could potentially result in ratings downgrades for contractual parties, which may in turn trigger material adverse change clauses.

24. We hope that the UK will limit the risk of parties escaping contractual obligations by relying on material adverse change clauses by ensuring in the EU negotiations that an alternative framework is agreed that protects the rights of UK entities to operate under EU regulations. Ideally this protection would arise under a permanent treaty arrangement, or alternatively an interim arrangement that allows contracting parties to address any permanent arrangement that may ultimately be implemented to recognise the exit of the UK from the EU. We would hope and expect that the UK Government, with the support of the Bank of England, will also attempt to limit the economic volatility associated with Brexit.

25. Pending further clarification on the final terms of the UK's exit from the EU, the UK Government should encourage contracting parties to review existing agreements to assess the potential effect of various related events on material adverse change, force majeure and other clauses that may allow a contracting party to evade its obligations under derivative agreements. Contracting parties should also assess ways to ensure the protection of necessary consents to perform existing obligations, in particular protecting financial services passporting rights, which may ultimately necessitate the transfer of rights to an EU entity unaffected by Brexit.

26. Even if Brexit does not directly trigger material adverse change clauses, the volatility that the UK exit may trigger will likely result in increased collateral requirements, changes in collateral under credit support documents, or increased margin calls, which could in turn lead to a default on any failure to satisfy the additional requirements. These risks are heightened where margin calls are met by posting assets that are linked to the UK (for example, UK sterling or UK gilts).

A deterioration in the value of those assets may also result in obligations to post additional margin. Once again, we hope that the UK will carefully navigate the negotiations with the EU to limit the risk of further market volatility.

Misrepresentation

27. Most derivative agreements contain clauses setting out representations relating to the parties' authorisation to transact under the contractual terms. Thus, the commonly used standard representation clauses in derivatives agreements confirm that the contracting parties have the necessary powers to perform their obligations under the agreement and all necessary regulatory approvals to transact with one another. Typically, the representations are repeated on the occurrence of the parties' obligations and failing to be able to make the representations will amount to a material misrepresentation or will be defined as an Event of Default.

28. Following Brexit, entities established in the UK may have a different status and have different rights and obligations under EU regulations. Of particular relevance is the European Market Infrastructure Regulation (the **EMIR**). Contracting parties may cease to hold all necessary regulatory permissions as a result of UK-authorised firms losing rights to passport into Member States. The result of the altered status of UK entities may be that the representation clauses addressing the contracting parties' power to perform their relevant obligations are breached. To address any gaps that may exist in authorisations as a result of Brexit, contracting parties may start to transfer all transactions to, and enter future transactions through, an appropriately authorised entity that will not be affected by the Brexit.

29. Given the recent spate of cases where there have been attempts to avoid payment obligations by arguing a lack of legal capacity to enter into the relevant contracts or relying on prevailing

mandatory national laws, particularly by state owned or related entities,[2] one can foresee attempts to circumvent contractual obligations by claiming a material change in the capacities and powers of a party, or the parties, to execute or perform derivatives agreements such that the representations can no longer be made. Along similar lines, parties may also claim that performance conflicts with prevailing mandatory law. Although generally such arguments have not succeeded, there are cases where they have[3] and appeal court clarity in relation to these decisions is not expected until late 2017 (at the earliest).

Termination events and force majeure

30. At the current time, and absent specific or bespoke wording, it is unlikely that any termination events (such an illegality or force majeure) will be triggered by Brexit itself. Although, termination events that include a material change in tax laws may be triggered depending on the specific terms upon which the UK exits from the EU. We also foresee parties using events associated with Brexit, such as the possible loss of rights to passport into the EU, as an opportunity to rely on termination events to evade their contractual obligations. The UK Government and parties to derivative agreements should be aware of the disruption and possible satellite disputes there may follow as part of their charting of the risks arising from Brexit.

---

2 *Haugesund Kommune v Depfa ACS Bank* [200] EWCA Civ 579; *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103; *Dexia Crediop SpA v Comune di Prato* [2015] EWHC 1746 (Comm); *Banco Santander Totta SA v Companhia De Carris De Ferro De Lisboa SA and others* [2016] EWCA Civ 1267.

3 *Dexia Crediop SpA v Comune di Prato* [2015] EWHC 1746 (Comm), although doubted in *Banco Santander Totta SA v Companhia De Carris De Ferro De Lisboa SA and others* [2016] EWCA Civ 1267 at 54-55.

Frustration

31. Even if an express termination event is not included in a derivative agreement, the common law doctrine of frustration may operate to terminate an agreement automatically (together with the transactions under it). The effect of frustration is generally different from that of a termination event. Instead of the termination payment being designed to preserve the value of the parties' performance obligations, it is designed to restore the parties to the position they would have been in if the transaction had not been entered into.[4]

32. The doctrine of frustration can be relied upon if a contract becomes impossible to perform. The same is true if an event beyond the control of either of the parties occurs which so significantly changes the nature of the outstanding rights and/or obligations from what the parties could reasonably have contemplated at the time of the contract's execution that it would be unjust to hold the parties to the contractual terms in the new circumstances.[5] However, that performance has become more onerous or expensive is not sufficient to justify reliance on the doctrine of frustration.

33. Given the high threshold for reliance on the doctrine of frustration under English law, it is unlikely that Brexit or the events associated with Brexit will provide grounds to terminate on the basis of frustration. Moreover, if specific termination event(s) are included, as is the case for the ISDA Master Agreement or agreements that include a force majeure provision, this will generally

---

[4] Law Reform (Frustrated Contracts) Act 1943.

[5] *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] A.C. 675.

prevent the doctrine of frustration from applying.[6] Events which fall outside the scope of the provision will, therefore, usually have no effect on the parties' obligations.

34. Nonetheless, if a derivatives agreement relies on a party's right to operate under EU regulations or throughout the EU, such as clearing via a UK CCP, then we envisage parties raising arguments that, amongst other legal doctrines excusing performance, the contract has been frustrated. As noted above, we hope that the UK Government will take steps to limit the risk of parties attempting to use Brexit and the events that follow, as an opportunity to evade contractual obligations and spur disputes.

Standard form documentation

35. There is widespread standard form documentation that is frequently used to construct derivative agreements. One of the most popular is the ISDA documentation, especially the 1992 and 2002 ISDA Master Agreement. Standard form documentation ensures the efficient, coherent and effective documentation of derivatives transactions and enables transactions to be confirmed rapidly and cleared through central counterparties. To allow standard form documentation governed by English law to continue to attain these objectives, it will be important to limit the uncertainty surrounding the construction of the provisions arising on Brexit.

36. Although the ISDA Master Agreement may be used for the full range of derivatives transactions, the British Bankers Association has also published standard form documentation that continues

[6] *Joseph Constantine SS Line Ltd v Imperial Smelting Corp. Ltd* [1942] A.C. 154, 163; *Kuwait Supply Co v Oyster Marine Management (The Safeer)* [1994] 1 Lloyd's Rep. 637; *Bangladesh Export Import Co Ltd v Sucden Kerry SA* [1995] 2 Lloyd's Rep. 1. Cf. exceptions to this principle apply: see Chitty on Contracts (31st ed., Sweet & Maxwell, London, 2012), para. 23-058.

to be used occasionally. In 1992 the LICOM Terms and their US equivalent were replaced by a new master agreement for currency options, known as the International Currency Master Agreement. In September 1993, the BBA also published the International Foreign Exchange Master Agreement, for use in documenting spot and forward foreign exchange contracts. The ICOM Agreement and IFEMA were updated in 1997 and, at the same time, an amalgam of the two agreements, the Foreign Exchange and Options Master Agreement, was prepared and published.

37. To address areas of uncertainty in relation to the ISDA Master Agreement, ISDA has a dedicated website on Brexit providing guidance on several issues. These issues have also been discussed in further detail during ISDA conferences and seminars.[7] During similar instances of government, legislative or market change, ISDA has managed industry-wide issues by way of online protocols to which parties can agree to adhere, simply updating all their documentation in accordance with the protocols. ISDA Determination Committee decisions may also be a source for guidance. It is hoped that the BBA will consider publishing guidance on the effect of Brexit on its standard form documentation. Brexit may indeed present an opportunity to address areas of uncertainty that existed in relation to standard form documentation, even prior to Brexit, and/or to publish updated standard form documentation. The UK Government may wish to consult with industry bodies, such as the BBA and ISDA, to assist the provision of guidance to contractual parties that rely on standard form documentation. If following Brexit, issues of interpretation arise, despite such guidance, contractual parties may be best advised to seek clarification from

---

[7] For example, as part of series of webinars and seminars on Brexit, on 13 September 2016, ISDA held a webinar on the legal issues stemming from Brexit focusing on governing law, jurisdiction and arbitration clauses under the ISDA Master Agreement.

the courts via Part 8 proceedings or the Financial List Test Case procedure, particularly where the interpretation of standard form documentation is in issue.

38. The following section sets out areas where there are potential uncertainties in relation to the application of terms of standard form documentation governing derivatives in light of Brexit.

Events of Default

39. The ISDA documentation expressly specifies events of default, including a misrepresentation, illegality and termination events. The parties are free to add to the specified Termination Events to the Agreement by including a suitable provision in a Schedule or a Confirmation (specifying which party or parties should be treated as an Affected Party if the event occurs). An additional Termination Event that is frequently included in the 1992 Master Agreement applies where, due to circumstances beyond a party's control, it becomes impossible for that party to make or receive a payment or delivery under the Agreement (or to comply with any other material provision of it), or for a Credit Support Provider to perform any obligation it has under a Credit Support Document. Wording that could be included for this purpose is contained in the User's Guide to the 1992 ISDA Master Agreements.[8] Such termination provisions could be triggered should Brexit result in the loss of passporting rights or other essential rights under EU law that support performance under derivative agreements.

40. Other additional Termination Events that are sometimes seen are triggered by a change of control of one of the parties, a downgrade in its credit rating below a specified level, a material adverse change in its financial position or a reduction in its net asset value to less than a specified amount.

---

[8] Firth, Derivatives Law and Practice at 11.100.

Should a disorderly Brexit or poorly negotiated Brexit result in ratings downgrades or loss of essential rights under EU law it could result in the triggering of such additional termination rights under certain agreements.

41. Parties to the ISDA Master Agreements give certain representations upon entering into the agreement and upon each transaction under its terms. A failure to satisfy the representations constitutes an event of default. As noted above, the UK's exit from the EU may result in a party losing passporting rights with the result that representation provisions are breached. For example, sections 3(a)(i) and (ii) of the ISDA Master Agreements address the status of the contracting parties, "good standing" under relevant laws and powers to execute and perform the agreement, section 3(a)(iii) of the 2002 ISDA Master Agreement provides that performance of the agreement does not violate or conflict with applicable laws, and section 3(a)(iv) mandates that all governmental and other consents that are required to perform have been obtained with respect to the agreement.

42. Similarly, parties also give covenants to each other throughout the course of performance, which may be triggered as a result of a party losing passport rights (for example, section 4(b) maintain authorisations and section 4(c) comply with laws).

Termination events

43. The ISDA Master Agreements also allow termination on the occurrence of certain specific events; for example, on the occurrence of an "illegality" event. Such an event would occur where it becomes unlawful to perform the parties' obligation(s) under any applicable law due to an event or circumstance occurring after a transaction is entered into. Generally, as indicated above,

Brexit and the events associated with Brexit will not allow a contracting party to terminate its obligations under a derivatives agreement (on grounds of illegality or force majeure).

44. Nonetheless, in the event that the terms of the UK's exit from the EU results in a change in tax law and withholding tax becomes payable[9], then a Tax Event constituting a Termination Event under the ISDA Master Agreement may arise. As such, the UK will need to have regard to the tax obligations that may arise between contracting parties in the financial services industry as part of the exit negotiations. Contracting parties will also have to consider whether any tax may become payable as a result of the UK leaving the EU.

45. It also should be noted that the 1992 and 2002 ISDA Master Agreements differ in relation to the circumstances under which a party can rely on illegality to terminate transactions.

Governing law

46. Section 13(a) of the 1992 and 2002 ISDA Master Agreements states that the Agreement will be governed by and construed in accordance with the law specified in the Schedule. The parties are thereby able to choose the law by which the Agreement will be governed and construed. English law is often chosen as the governing law, both by parties domiciled in the UK and parties in other jurisdictions. The popularity of English law is likely to be due to its content, rather than the UK's membership of the EU. Indeed, English contract law has developed largely independently of EU law, with key concepts such as contractual estoppel and the implication of terms, having been

---

9 Section 2(d) of the 1992 and 2002 ISDA Master Agreements, contains provisions setting out the consequences if a tax is imposed by any applicable law on a payment required to be made by a party under a transaction.

derived from the Common Law. It is therefore hoped that Brexit will not have a marked impact on the numbers of parties choosing English law to govern their contracts.

47. Brexit may however have an impact on the choice of law rules applied by the English Courts in determining the governing law. Currently all EU countries are required to apply the choice of law rules in the Rome I Regulation (EU Reg No. 593/2008) for contractual claims and the Rome II Regulation (EU Reg No. 864/2007) for tort claims. In short, the Rome Regulations provide that the courts will recognise and apply the parties' express choice of law. The English Courts are therefore required to give effect to the parties' choice of law set out in section 13(a) of the ISDA Master Agreement. Post-Brexit, the Rome Regulations will not apply in the UK (unless UK ultimately becomes a European Free Trade Association member state).

48. However it is expected that, under the common law or any replacement regime, the English courts will nevertheless continue to follow the express choice of law in relation to contractual disputes in line with Rome I (contract claims). Perhaps more uncertain is whether the English courts will continue to recognise an express choice of law in relation to tort disputes in circumstances where pre-Rome II (tort claims), English law adopted a different position. Pre-Rome II, English law applied the law of the State in which the tort occurred rather than the express choice of law selected by the parties. However, given that the English courts generally recognise the autonomy of contractual parties, it seems unlikely that the judiciary will depart from the position under the Rome II Regulation.

49. To avoid any uncertainty, the UK Government may wish to consider legislative guidance to support the English courts continuing to recognise the express choice of law adopted by the parties. One option would be to leave the substance of the Rome Regulations in place, but re-

enacted as UK legislation.[10] Another option would be to fall back on the rules in place in the UK immediately before those Regulations. In the case of contractual obligations these were contained in the Rome Convention, which is broadly similar to Rome I, and respects the parties' choice of law. However, as explained above, in the case of non-contractual obligations, the pre-existing legislation, the Private International Law (Miscellaneous Provisions) Act 1995 did not give the parties an express right to choose the law applicable to non-contractual obligations. As such, the first option of re-enacting the Regulations as UK law, is preferred.

50. Following Brexit, Rome I and Rome II will continue to apply in the remaining Member States. Therefore, it is expected that Member State courts would still give effect to an English governing law clause, even if the UK was no longer part of the EU. Although, the approach of Member State courts will need to be assessed in line with any prevailing local laws.

<u>Jurisdiction clauses</u>

51. Pursuant to Section 13(b) of the 2002 ISDA Master Agreement, if the parties have selected English law as the governing law, the parties will be treated as having irrevocably submitted to (a) the non-exclusive jurisdiction of the English courts if the proceedings do not involve a "Convention Court" and (b) the exclusive jurisdiction of the English courts if the proceedings do involve a "Convention Court"[11].

52. A "Convention Court" is defined in the 2002 ISDA Master Agreement as any court which is bound to apply to the Proceedings either Article 17 of the 1968 Brussels Convention on

---

[10] However, over time, the interpretations of such Regulations could diverge between the English courts and the courts of the EU Member States

[11] The 1992 ISDA Master Agreement similarly refers to "Contracting States".

Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters or Article 17 of the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters.[12] Since the publication of the 2002 ISDA Master Agreement, the Brussels Convention has subsequently been amended by the EU Brussels Regulation (now set out in the Recast Brussels Regulation EU 1215/2015 (the "Recast Brussels Regulation")).

53. Therefore the effect of section 13(b) of the 2002 ISDA Master Agreement, is to impose an automatic exclusive jurisdiction clause in favour of the English courts if the contract is entered into between EU-based counterparties and they chose English law as the governing law. The parties are also free to agree for the English courts to have jurisdiction even if the governing law is not English law.

54. Given that section 13(b) of the 2002 ISDA Master Agreement seems to be premised on the assumption that the UK is a signatory to the Recast Brussels Regulation, its status may be unclear following Brexit. In this respect, Peter Werner, Senior Director at ISDA, recently observed that the issues arising under section 13 will be one of the future action points for further discussions to be conducted in the ISDA working groups on Brexit, and that ISDA had already received interesting comments on how to amend section 13. To address these issues, parties to the 2002 ISDA Master Agreement that intend to ensure recognition of the exclusive jurisdiction of the courts of England may wish to specify clearly the parties' choice of forum.

---

[12] Given that the 2002 ISDA Master Agreement defines Convention Court by reference to the 1968 Brussels Convention, rather than the 2001 Brussels Regulation I, which was in force at the time when the Agreement was produced, it is arguable that the exclusive jurisdiction is not conferred on current EU Member States. Nor does the definition recognise the 2007 Lugano Convention or the Recast Brussels Regulation.

55. Currently in determining whether to accept jurisdiction over a dispute, the English Courts apply the Recast Brussels Regulation, which respects parties' choices of forum. The Recast Brussels Regulation also provides for reciprocal recognition across the EU of judgments handed down in all member states, including English court judgments.

56. Following Brexit, the Recast Brussels Regulation will no longer apply. It is therefore important that an equivalent regime is put in place so that parties are not deterred from choosing the English courts as the forum in which disputes are to be settled. The UK Government will need to explore the potential alternative options to the Recast Brussels Regulation to ensure that party autonomy is respected and that English judgments continue to be recognised and enforced across the EU. The 2007 Lugano Convention and the Hague Convention on Choice of Court Agreements are viable alternative options, albeit without a number of the added benefits found in the Recast Brussels Regulation.

57. As arbitration falls outside the Brussels Regulations, arbitration clauses that elect English law, seat and arbitration rules will not be affected by Brexit. The reciprocal recognition of such arbitration clauses across the EU (and worldwide) is subject to the New York Convention on the Recognition of Foreign Arbitral Awards to which the UK is already a signatory in its own right.[13] Although one change is that Brexit may result in the re-emergence of anti-suit injunctions to prevent parallel arbitration or litigation in breach of contractual obligations, which the ECJ has declared to be incompatible with EU law.

[13] See ISDA Brexit website at section 3: http://www2.isda.org/functional-areas/legal-and-documentation/uk-brexit/ (accessed 11 November 2016).

Service

58. There is currently no requirement to serve a claim form or Court documents out of the jurisdiction if service is to be effected in the EU and the English courts have jurisdiction under the Recast Brussels Regulation (see also EU Service Regulation 1392/2007/EC). This in turn allows a clear and predictable basis on which proceedings can be served in the EU. Should the UK no longer be part of the reciprocal arrangement under the Recast Brussels Regulations on Brexit, then the benefit of a straightforward means of service would be lost.

59. A similar exemption to seeking permission for service out of jurisdiction applies under the 2007 Lugano Convention, which presents a further benefit for the UK acceding to the Convention. Pending clarification, if parties have chosen the English courts for jurisdiction and one or more parties is based abroad, then it would be sensible for parties to include an agent for service in England.

Definitions

60. The standard form documentation containing references to EU legislation or the EU itself will have to be updated to reflect any change that may materially affect derivatives agreements. If Scotland or, albeit less likely, Northern Ireland, seek independence from the UK as part of the exit negotiations, then this could potentially constitute a "Sovereign Succession Event" under the 2014 ISDA Credit Derivatives Definitions in relation to any credit default swaps if the UK is the designated Reference Entity. ISDA Determination Committees have previously considered similar issues.

Regulation of Derivatives

61. There is a large body of EU law and regulation governing the derivatives market and its operation. Detailed consideration of the impact of the Brexit on the way in which these markets are regulated falls outside of the scope of this report, and will be addressed by the COMBAR financial regulation sub-committee. However, in summary it is anticipated that the key areas which may be affected by Brexit and will need careful consideration as part of the Brexit transition are as follows:

    (1) Ensuring the continuation of Markets in Financial Instruments Directive (MiFID) "passports" for cross border financial services;

    (2) Ensuring the continuation of safeguards for collateral netting, set-off and financial collateral arrangements (as currently envisaged in the Financial Collateral Directive (2002/47/EC), the Bank Recovery and Resolution Directive (2014/59/EU) and the Credit Institutions Winding Up Directive (2001/24/EC));

    (3) Ensuring the continuation of the cross-border recognition provisions under EMIR;

    (4) Ensuring the continuation of cross-border access to market infrastructure under the Markets in Financial Instruments Directive II (2014/65/EU), the Markets in Financial Instruments Regulation (Regulation (EU) No 600/2014) and EMIR.

62. The impact of Brexit on the following two pieces of EU legislation is also worth considering in the context of derivatives.

Adapting/protecting jurisdiction clauses in light of Article 46 MiFID II

63. A potential risk arising on Brexit in relation to jurisdiction clauses in favour of the English courts arises from UK firms becoming "*third-country firms offering services*" under the recast Markets in Financial Instruments Directive (**MiFID II**). Under Article 46(6) of MIFID II, the third-country firms must offer to submit any disputes to "*the jurisdiction of a court or arbitral tribunal*" in a Member State before they provide any investment service in the EU. The provision may require parties to submit disputes to a Member State court or arbitral tribunal seated in an EU Member States, as opposed to an English court or a London seated arbitration specified in a derivative agreement.

Article 55 Banking Recovery and Resolution Directive

64. The Banking Recovery and Resolution Directive (2014/59/EU) (the **BRRD**), as supplemented by EU Regulation 2016/1075, requires EU Member States to implement legislation that requires EU financial institutions to include in certain agreements a contractual term requiring their counterparties to recognise the power of regulators pursuant to bail-in envisaged under the BRRD. The requirement to include such a clause under Article 55 BRRD applies where the agreement relates to a liability which is not excluded and which is governed by third country law (i.e. non-EU law).

65. The requirement to include such a clause does not currently apply to contracts governed by English law, which recognises the position of the UK as a member of EU (i.e. not currently a third country). However, subject to the outcome of the Brexit negotiations, the UK may become a third party for the purposes of the BRRD. As a result, in accordance with Article 55 of BRRD, financial institutions regulated in the EU which incur liabilities under English law contracts, will

have to recognise in the contract the possibility of a bail-in under the BRRD. ISDA has published a protocol to enable market participants to give contractual recognition of bail-in under the BRRD, which is accompanied by a questions and answers sheet.

66. The above said, it is expected that the UK will maintain legislation in place substantially identical to that required by the BRRD. It is hoped this will place the UK in the position to claim that it operates an equivalent regime to BRRD so that it is not a third-party state for the purposes of the BRRD.

67. The BRRD is considered in more detail below in the section on Insolvency.

PAYMENT SERVICES

68. The European Commission describes payments as the 'oil in the wheels of the internal market'.[14] However, the payment services of Member States have typically been organised along national lines, with little harmonisation at the cross-border level.

69. A key objective of the Commission has been to establish a modern and coherent legal framework for payment services with the objective of creating a single payment area in which citizens and businesses can make cross-border payments as easily, safely and efficiently as they can within their own countries and subject to identical charges.

70. Although the UK is not part of the Eurozone, the UK's payment services at a domestic and cross-border level are governed by a framework of EU regulations and directives. The aim of this section of the report is to consider the potential impact of Brexit on this legal framework, in particular, insofar as it lays down rules relating to credit transfer and direct debit transactions denominated in euro, the rights and obligations of the users and providers of payment services, and the level of interchange fees.

SEPA

The existing framework

71. The Single Euro Payments Area (**SEPA**) is a payment-integration initiative of the European Union for simplification of bank transfers denominated in Euro. SEPA is based on the premise that there should be no distinction between cross-border and domestic electronic retail payments

[14] http://ec.europa.eu/finance/payments/index_en.htm

in Euros. The aim is to create a harmonised, common market for payment processing across Europe comparable to any efficient domestic clearing market and to drive out inefficiencies by promoting competition among payment service providers and clearing mechanisms to the benefit of corporate and consumer end-users. The project covers key retail payment instruments — credit transfers, direct debits and payment cards – and has been realised through a number of Directives and Regulations, notably:

(1) Directive 2007/64/EC of 13 November 2007 on payment services in the internal market (**PSD**). The PSD, which is considered in more detail below, is aimed at enhancing competition and transparency in the payments industry across the EU and ensuring that the level of consumer protection is sufficient and harmonised. It provides a modern legal foundation for the creation of an internal market for payments, of which SEPA is a fundamental element.[15]

(2) Regulation (EC) No 924/2009 of 16 September 2009 on cross-border payments in the Community (the **Cross-Border Payments Regulation**), which also provides a number of facilitating measures for the success of SEPA, such as:[16]

(a) aligning, as of November 2009, the pricing of euro cross-border direct debits with that of local transactions (as was already the case for credit transfers and card transactions);

15 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:0036:en:PDF
16 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:266:0011:0018:en:PDF

(b) setting clear rules for transaction-based multilateral interchange fees until November 2012.

(c) mandating, from November 2010, banks in the euro area offering direct debits in euro to be reachable for cross-border direct debit collections.

(3) Regulation (EU) No 260/2012 of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in Euro an amending Regulation (EC) 924/2009 (the **SEPA Regulation**).[17] The SEPA Regulation lays down rules for credit transfer and direct debit transactions denominated in Euro where both the payer's payment service provider and the payee's payment service provider are located in the Union, or where the sole payment service provider (**PSP**) involved in the payment transaction is located in the Union. The main objective of the SEPA Regulation is the migration from national credit transfer and direct debit schemes to harmonised SEPA credit transfer (**SCT**) and SEPA direct debit (**SDD**) schemes, inter alia, by providing Union citizens with a unique international bank account number (**IBAN**) that can be used for all SEPA credit transfers and direct debit transactions denominated in Euros.

(a) Article 3 sets out the reachability requirements for PSPs with regard to credit transfers and direct debits.

(b) Article 6(1) and (2) mandate that credit transfers and direct debits shall be carried out in accordance with the relevant requirements set out in Article 5 of, and in the

[17] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:094:0022:0037:en:PDF

Annex to, the Regulation by 1 February 2014, subject to certain limited exemptions mentioned in the Regulation.[18]

(c) Article 10 requires Members States to designate as the competent authorities responsible for ensuring compliance with the Regulation public authorities, bodies recognised by national law or public authorities expressly empowered for that purpose by national law, including national central banks, and to ensure that the competent bodies have all the powers necessary for the performance of their duties.

(d) Articles 11 and 12, respectively, require Members States to lay down rules on the penalties applicable to infringements of the Regulation and to establish adequate and effective out-of-court complaint and redress procedures for the settlement of disputes concerning rights and obligations arising from the Regulation between payment service users (**PSU**) and their PSPs.

(e) Article 13 empowers the European Commission to adopt delegated Acts in accordance with Article 14 to amend the Annex setting out the technical requirements applicable to SCT and SDD transactions in order to take account of technical progress.

---

18 Although the SEPA Regulation marked 1 February 2014 as the point at which all credit transfers and direct debits in Euro would be made under the same SEPA format, a transition period was introduced by Regulation (EU) No 248/2014 allowing banks and other PSPs to continue, for a limited period of 6 months, the processing of non-compliant payments through their legacy payments schemes alongside SCT and SDD.

http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0248&from=EN

(f) Article 16 sets out transitional provisions allowing Member States to opt for certain derogations and allowing certain requirements to come into force at a later date. Article 16 (2) and (8) provide that Members States which do not have the Euro as its currency shall comply with the requirements of Articles 3, 4 and 5 by 31 October 2016.

(g) Article 17 amends the Cross-Border Payments Regulation so as to remove (i) the ceiling of EUR 50,000 on the 'principle of same charges' so that it applies to Euro denominated payments of any value, and (ii) settlement-based national reporting obligations on PSPs for balance of payments of any value (not just below EUR 50,000) from 1 February 2016.

72. As a non-Euro Member State, the UK was not required to comply with Articles 3, 4 and 5 until 31 October 2016.

73. All Member States were required to comply with Articles 10, 11 and 12 of the SEPA Regulation by 1 February 2013.

74. The UK laid The Payments in Euro (Credit Transfers and Direct Debits) Regulations 2012 (the **Payments in Euro Regulations**) before Parliament on 18 December 2012. The Payments in Euro Regulations came into force on 15 January 2013 and designated the Financial Conduct Authority (**FCA**) as the competent authority responsible for ensuring compliance with the Cross-Border Payments Regulation and the SEPA Regulation. The Financial Ombudsman Service was designated as the UK's out-of-court redress body for SEPA-related complaints, and for payments-related complaints in general.

(1) Regulations 3 to 17 confer functions on the FCA in relation to the supervision and enforcement of the Cross-Border Payments Regulation and the SEPA Regulation. These include powers to gather information, impose penalties or disciplinary measures, apply to court for an injunction and require restitution. The FCA is also required to maintain arrangements for dealing with complaints and has power to issue guidance and exchange information with other competent authorities in the European Union in order to resolve disputes. Provision is made for the FCA's supervisory costs and its exemption from liability in damages.

(2) Regulation 18 makes provision for civil proceedings to be brought in cases where a person has suffered a loss due to an institution breaching certain articles of the Regulations.

(3) Regulation 19 provides for a derogation under Article 16(3) and (4) of the SEPA Regulation to apply so that the requirements of Articles 8(2) and (3) of that Regulation concerning interchange fees for direct debit transactions do not apply until 1st February 2016.

(4) Regulation 20 makes provision for the application of these Regulations to UK branches of Gibraltar-based firms.

(5) Regulation 21 and the Schedule apply certain provisions of the Financial Services and Markets Act 2000 and secondary legislation (with modifications) in respect of the FCA's functions.

(6) Regulation 22 revokes, with savings, the Cross-Border Payments in Euro Regulations 2010, which were enacted pursuant to the UK's obligations under Articles 9, 10 and 13 of the Cross-Border Payments Regulation.

75. As of 28 April 2016, SEPA consists of the 28 Member States of the EU and the additional 3 European Economic Area (**EEA**) countries. Switzerland, Monaco, and San Marino are also part of the geographical scope of SEPA, so too, with effect from 1 May 2016, are the British Crown Dependencies of Guernsey, Jersey and the Isle of Man.[19]

The impact of Brexit

76. As matters stand, the Cross-Border Payments Regulation and the SEPA Regulation are directly applicable in the UK, without the need for any transposing legislation.

77. The Regulations will continue to have this effect so as long as the UK remains within the EU. Once the UK leaves the EU, the Regulations will cease to be directly applicable and the UK will fall outside the geographical scope of SEPA,[20] unless it either remains part of the EEA or reaches agreement for the UK's continued participation in the SEPA scheme.

78. If the UK does not remain part of the EEA, its continued participation in SEPA post-Brexit will depend on whether it meets the participation criteria applied by the European Payments Council (**EPC**).

---

[19] http://www.europeanpaymentscouncil.eu/index.cfm/knowledge-bank/epc-documents/epc-list-of-sepa-scheme-countries/epc409-09-epc-list-of-sepa-scheme-countries-v2-4-april-2016/

[20] Assuming that to be the case, the Payments in Euro Regulations will no longer be necessary and will need to be repealed by Parliament.

79. The EPC considers whether it is appropriate to expand the geographical scope of the SEPA scheme beyond the EU and the EEA on a case-by-case basis and by reference to a set of conditions that involve the applicant demonstrating that participation of its institutions in SEPA can take place on the basis of a legal and regulatory level playing field with other scheme participants. The following conditions are amongst those regarded as essential for the inclusion of a country or territory as part of the geographical scope of the SEPA scheme:[21]

(1) demonstrating that the provisions of applicable EU/EEA legislation affecting payment services in Euro in the territory or country from which it operates are effectively represented in the laws relevant to the applicant or in equally binding practice applicable to the applicant for payments in Euro;

(2) in particular, demonstrating that provisions substantially equivalent to Titles III and IV of the PSD (as and if amended) as well as to those of Article 5 and the Annex of the SEPA Regulation (as amended by Regulation (EU) 248/2014) are represented in the laws relevant to the applicant or in equally binding practice applicable to the applicant for payments in Euro;

(3) demonstrating that banking or financial regulation in the country or territory from which it operates is functionally equivalent to the Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and the regulation of other payment services providers is functionally equivalent to the Directive 2007/64/EC on payment services in the internal market (as and if amended);

---

[21] http://www.europeanpaymentscouncil.eu/index.cfm/knowledge-bank/epc-documents/criteria-for-participation-in-sepa-schemes/epc061-14-criteria-for-participation-in-sepa-schemes-v20pdf/

(4) demonstrating that anti money laundering processes in the country or territory from which it operates are functionally equivalent to the Directives 2005/60/EC and 2006/70/EC (as amended) on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and that the country or territory from which it operates is not blacklisted by the Financial Action Task Force;

(5) demonstrating that all United Nations Security Council financial sanctions are implemented in the country or territory from which it operates to the same extent as implemented by Regulation in the EU;

(6) demonstrating that the country or territory from which it operates has either ratified the Rome Convention on the Law Applicable to Contractual Obligations of 19 June 1980, as subsequently amended or has provisions in its domestic law that are functionally equivalent to the rule on the "freedom of choice of law" set out in Article 3 of Regulation (EC) No 593/2008.

80. As well as satisfying these conditions, the UK would also need to satisfy other legal and regulatory criteria and market and operational criteria before its institutions could be admitted to participate in the SEPA schemes.

81. The analysis above proceeds on the assumption that the UK remains part of the EEA or applies to the EPC to participate in SEPA as a non-EU/EEA country.

82. If the UK does not remain part of the EEA and does not apply to the EPC to participate in SEPA, then, other than repealing the Payments in Euro Regulation, the UK will not need to take any

legislative action. This may, however, lead to charges being levied on Euro payments in, into or from the UK post-Brexit.

Conclusions / recommendations

83. The impact of Brexit on the UK's participation in SEPA depends on the manner in which the UK exits the EU and its desire to continue participating in the SEPA scheme thereafter.

84. If the UK considers continued participation to be desirable then its national law will need to be functionally equivalent with certain EU legislation, including aspects of the SEPA Regulation. The most obvious means of achieving this would be for the UK to enact national law in the same or similar terms to the relevant EU Regulations.

Payment Services Regulations

The existing framework

85. The first Payment Services Directive (2007/64[22]) establishes a pan-European framework for "payment services"— nearly all methods of making payments other than cheques and cash. In addition to creating a new authorisation regime for "payment service providers" (which is not discussed here) the directive establishes a framework of rights and obligations for the users and providers of payment services. The directive required implementation by 1 November 2009.

86. The directive is implemented into UK law by the Payment Services Regulations 2009, which were made on 9 February 2009 and generally came into force on 15 May 2009.

[22] http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32007L0064&from=EN

87. A further directive (the second Payment Services Directive (2015/2366[23])) was published in November 2015 and must be implemented by 13 January 2018. This will radically reshape the landscape for payment services, including by imposing stricter security requirements on payment systems, enabling consumers to initiate payments in new ways, and requiring banks to make consumers' financial information available online so they can use aggregation services to review their financial position across a number of providers.

<u>The impact of Brexit</u>

88. On the UK's departure from the EU, the Payment Services Regulations will continue in force in UK law, even without a so-called "*Great Repeal Bill*". However, the effective application of the Regulations may depend on the form Brexit takes and the date it occurs:

(1) At present, Parts 5 and 6 of the Regulations (dealing with the position of users of payment services) apply where the payment service concerned is provided from the UK, the payee's payment service provider is in the EEA, and the payment is denominated in Euro or the currency of an EEA state.

(2) If the UK remains in the EEA on Brexit, the Regulations will largely continue to operate as at present. But without a specific transitional provision, if the UK *leaves* the EEA, then payments in sterling, or payments made where the payee is not in the (continuing) EEA, will cease to be within the scope of the Regulation.

(3) However, if Brexit occurs after 13 January 2018, it will occur after the UK will have implemented the second Payment Services Directive. That extends the scope of the

23 http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32015L2366&from=EN

directive to so-called "*one-leg*" payments, where either the payer or the payee is in the EU (but the other is not). If (as may be expected) that directive is implemented by amending the Payment Services Regulations, it is likely that *some* of the payments that would otherwise fall out of the scope of the existing Regulations on Brexit would remain in scope of the revised Regulations. However, UK–UK payments would still fall outside the scope of the Regulations even as revised to implement the second Directive.

89. In the longer term, the UK post-Brexit will need to consider how to structure the law relating to payment services. Despite occasional statutory intervention (most notably in the Bills of Exchange Act 1882) the UK approach to payments has generally been to allow the rights and obligations of the parties to be determined by the common law. Where electronic payments are concerned, this in practice means that the rules have been set by the contract between the payment system operator and the user, which itself is almost invariably on the payment system operators' terms.

90. The Regulations have been a departure from that approach. Their impact has been limited because parties are permitted to disapply them when the payment system user is not a consumer, micro-enterprise or charity, and in our experience banks almost universally seek to disapply them when it is possible to do so. At present, they seem to be being rarely cited in Court. That said, a case could be made for having an over-arching legal code governing the rights of participants in payment systems. Whether or not that should be maintained in its present form will depend in part on the extent to which the UK wishes to maintain parity with the European rules on the point.

Conclusions / recommendations

91. Unless the UK remains in the EEA on Brexit, the Payment Services Regulations will need amendment to avoid existing payments falling out of their scope. In the longer term, the UK will need to consider what rules to implement in this sphere.[24]

Interchange Fee Regulation

The existing framework

92. The UK's law on interchange fees for debit and credit card transactions is derived almost entirely from EU law and, in particular, Regulation (EU) No 2015/751 of 29 April 2015 on interchange fees for card-based payment transactions (the **IFR**).[25]

93. The key objective of the IFR is to cap interchange fees. These fees arise where a customer pays for a purchase using a credit or debit card. The bank that serves the store (the **acquiring bank**) pays a fee to the bank that issued the payment card to the consumer (the **issuing bank**). A so-called interchange fee is then deducted from the final amount that the merchant receives from the acquiring bank for the transaction. The fees form part of the package of fees that acquiring banks charge to merchants. Merchants in turn incorporate these card costs, like all their other costs, in the general prices of goods and serves.[26]

94. The IFR lays down uniform technical and business requirements for card-based payment transactions carried out within the European Union where both the issuer and acquirer are located

[24] See the Financial Services Regulatory Report for further discussion of the Payment Services Directives.
[25] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0751&from=EN
[26] http://europa.eu/rapid/press-release_IP-15-4585_en.htm

therein. The IFR imposes requirements directly on payment card schemes, issuing and acquiring payment service providers (PSPs), processing entities, other technical service providers and, in limited circumstances, merchants.

(1) Articles 3 and 4 impose, respectively, a cap on the interchange fee of 0.2% of the value of the transaction for any debit card transaction and a cap of 0.3% of the value of the transaction for any credit card transaction. These Articles permit Member States to define a lower per transaction percentage interchange fee cap for domestic debit and credit card transactions. Until 9 December 2020, Members States may also, in relation to domestic debit card transactions, allow payment service providers to apply a weighted average interchange fee of no more than the equivalent of 0.2% of the annual average transaction value of all domestic debit card transactions within each payment card scheme. Member States may define a lower weighted average interchange fee applicable to all domestic debit card transactions.

(2) Articles 6 to 12 set out a number of business rule provisions that require payment service providers and payment card schemes to amend their business practices, unless they are already compliant. These rules relate to the separation of payment card scheme and processing entities (Article 7), co-badging and choice of payment brand or payment application (Article 8), unblending merchant service charges (Article 9), the application of the 'Honour All Cards' rule (Article 10) and steering consumers to the use of any payment instrument preferred by the payee (Article 11).

(3) Articles 13 to 15 require Member States, inter alia, to designate competent authorities that are empowered to ensure enforcement of the IFR, lay down rules on penalties applicable

to infringements of the IFR and take all measures necessary to ensure they are applied, and ensure and promote adequate and effective out-of-court complaint and redress procedures or take equivalent measures for the settlement of disputes arising under the IFR between payees and their payment services providers.

95. The IFR was published in the Official Journal of the European Union on 19 May 2015 and entered into force on 8 June 2015, with the exception of certain Articles, which entered into force in phases.

96. The first phase introduced the caps on interchange fees provided for in Articles 3 and 4 which, together with Articles 6 (licensing) and 12 (information to the payee on individual card-based transactions), applied from 9 December 2015.

97. As noted above, Articles 3 and 4 provided Members States with national discretions in three key areas:

(1) Member States could decide to implement lower interchange fee caps for domestic credit card transactions than the caps set out in the IFR;

(2) Member States could decide to implement lower caps on interchange fees for domestic debit card transactions than the caps set out in the IFR. There were also other flexibilities in the way Member States could apply interchange fee caps for domestic debit card transactions, such as applying a weighted average for a period of up to 5 years; and

(3) Member States could exempt three party card schemes from caps to interchange fees for a period of up to three years, provided that the scheme's market share remained below 3% in that Member State.

98. HM Treasury consulted on how the UK should exercise its national discretion and how it should implement the terms of the IFR requiring Member States to designate a competent authority to supervise and enforce the IFR. The response was published by HM Treasury in October 2015,[27] and the Payment Card Interchange Fee Regulations 2015 (the **Interchange Fee Regulations**) were enacted shortly thereafter.[28] The Interchange Fee Regulations came into force on 9 December 2015.

(1) Part 2 designates the Payment Systems Regulator (**PSR**) as the competent authority in the UK for the IFR and sets out the duties and powers of the PSR in that role. The regulatory regime set out in Part 2 is closely aligned to the existing regime overseen by the Payment Systems Regulator under Part 5 of the Financial Services (Banking Reform) Act 2013 (c. 33).

(2) Part 3 designates the Financial Conduct Authority (**FCA**) as a competent authority in the UK for certain provisions of the IFR, and amends the Payment Services Regulations 2009 (S.I. 2009/209) so that the relevant requirements of the IFR are treated as being requirements imposed by those Regulations. The Financial Conduct Authority may act under the Payment Services Regulations 2009 to supervise and enforce compliance with those requirements by firms regulated under those Regulations.

(3) Part 4 adds Article 10(4) of the IFR (requiring payees to inform consumers if they do not accept all cards issued under a payment card scheme) to Schedule 13 of the Enterprise

27 https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/466783/Interchange_fee_regulation_response.pdf

28 http://www.legislation.gov.uk/uksi/2015/1911/pdfs/uksi_20151911_en.pdf

Act 2002 (c. 40) so that the Competition and Markets Authority, local weights and measures authorities in Great Britain and the Department of Enterprise, Trade and Investment in Northern Ireland may enforce a contravention of Article 10(4) which harms the collective interests of consumers under Part 8 of the Enterprise Act 2002.

(4) Part 5 amends provisions in the Financial Services (Banking Reform) Act 2013, which require cooperation between the PSR, FCA, the Bank of England and the Prudential Regulation Authority, such that those co-operation requirements include the functions of the PSR and FCA in relation to the IFR.

(5) Part 6 exercises the option in Article 1(5) of the IFR, exempting from the interchange fee cap until 9th December 2018 domestic transactions under any three party payment card scheme which is considered to be a four party payment card scheme pursuant to Article 1(5) of the IFR and which does not exceed the market share set out in Article 1(5).

(6) Part 6 also exercises the option in Article 3(3) of the IFR allowing payment service providers to apply the interchange fee cap on a weighted average basis for domestic debit card transactions until 9 December 2020.

(7) Part 7 provides for the Treasury to review the Regulations at intervals not exceeding five years.

99. The UK refrained from exercising the option in Article 3(2)(a) and Article 4 to implement lower interchange fee caps for domestic credit and debit card transactions than the caps set out in the IFR.

100. The second phase of IFR introduced the business rules provided for in Articles 7, 8, 9 and 10, which applied from 9 June 2016. The PSR consulted on these wider requirements and published draft guidance in May 2016,[29] with the intention of publishing a complete guidance document later in the year.

The impact of Brexit

101. As matters stand, the IFR is directly applicable in the UK, without the need for any transposing legislation.

102. The IFR will continue to have this effect so as long as the UK remains within the EU. However, once the UK leaves the EU, card-based payment transactions within the UK, or between the UK and a Member State, will fall outside the scope of the IFR, which will cease to be directly applicable.

103. The UK Government will, therefore, need to give consideration to whether to legislate to fill the gap in national law left by the disapplication of the IFR, and, if so, on what terms. This task is likely to be made more difficult by the fact that the UK Government will not have the benefit of the report of the European Commission on the application of the IFR, which is not due to be issued until 2019.

104. The IFR draws a distinction between cross-border transactions and domestic transactions, with Member States having more discretion in relation to the interchange fee caps applicable in the latter context.

[29] https://www.psr.org.uk/sites/default/files/media/PDF/CP163-IFR-Phase-2-draft-guidance-document.pdf

105. As regards domestic card-based payment transactions, post-Brexit, the UK will, in theory, have complete discretion. This could result in the UK setting lower caps, higher caps or no caps at all on interchange fees. There is thus considerable scope for any national legislation to diverge from the IFR, particularly in relation to the following issues:

(1) *The need for, and level of, any cap on interchange fees*: the UK was a key supporter of the IFR during negotiations and supported swift implementation and flexibility on interchange fee caps so that the UK could choose caps to suit its own market.[30] That would tend to suggest that the UK Government will be keen to enact something similar to the IFR as part of national law. The major international card schemes, namely, Visa and MasterCard, are the most likely opponents of continued interchange regulation. MasterCard, for instance, was strongly opposed to the interchange caps in the IFR.[31] Any decision not to regulate interchange fees would need to be considered from a competition law perspective.

(2) *The application to four party and three party schemes*: the IFR only covers four party schemes and three party schemes that operate in a similar way. There may be pressure from the major international card schemes for any national legislation to extend to three party schemes.

(3) *The application of the 'Honour All Cards' rule*: under the IFR, merchants cannot be required to accept two products just because they belong to the same brand and/or category unless the products are subject to the same regulated interchange. Again, there

[30] https://www.gov.uk/Government/consultations/interchange-fee-regulation/interchange-fee-regulation-a-consultation
[31] https://www.parliament.uk/documents/commons-committees/european-scrutiny/Interchange-fees-for-card-based-payment-transactions.pdf

may be pressure from major international card schemes for any national legislation to enforce the 'Honour All Cards' rule, the rationale being to provide certainty to the consumer that any card with a scheme logo on it will be accepted wherever the consumer sees the same logo in a retailer.

(4) *The separation of payment scheme and processing*: the IFR requires payment card schemes and processing entities to be independent in terms of accounting, organisation and decision-making processes. Both the UK Government and MasterCard took the view during the IFR consultation that this proposal was unnecessary and disproportionate. The UK Government may, therefore, decide not to enact this requirement in any national legislation.

(5) *Co-badging*: the IFR prohibits any payment card scheme rules and rules in licensing agreements or measures of equivalent effect that hinder or prevent an issuer from co-badging two or more different payment brands or payment applications on a card-based instrument. The UK Government and MasterCard voiced opposition to this provision of IFR, considering it to be unnecessary, impractical for consumers and unlikely to provide any significant benefit. The UK Government may, therefore, decide not to enact this requirement in any national legislation.

106. As regards cross-border card-based payment transactions, there is the potential post-Brexit for card sales from consumer cards issued in EU countries to be reclassified as inter-regional (i.e. non-EEA, if an EU exit also means an EEA exist) as opposed to intra-regional (i.e. EEA). Interchange fees for inter-regional transactions are around four times higher on average than

intra-regional fees because they are not covered by the EU caps. There would need to be some form of bilateral agreement to change the position at the cross-border level.

Conclusions / recommendations

107. Any regulation of interchange fees for domestic card-based transactions post-Brexit will require the enactment of national legislation.

108. The IFR may provide a useful starting point, but aspects of the regulation were considered to be unnecessary and/or undesirable at the time of its implementation. The UK's exit from the EU provides an opportunity to enact national legislation that more closely reflects the views expressed by the UK Government and relevant stakeholders in consultation.

<u>SET OFF AND NETTING</u>

<u>Introduction</u>

109. This section addresses the related topics of set off and netting. Set-off is the right of a debtor who is owed money by his creditor on another account or dealing to secure payment for what is owed to him by setting this off in reduction of his own liability.[32] Set-off operates both outside and within insolvency.

(1) Outside insolvency, its prime function is to avoid circuity of action, so that instead of the creditor having to sue the debtor for the debt, it can (in certain circumstances) merely cancel its own debt to the debtor. This not only saves litigation and enforcement costs, but can also reduce the creditor's exposure to the debtor's credit risk, which can have an effect on capital adequacy.[33]

(2) Within insolvency, the availability or otherwise of a set-off can be crucial. The creditor, in the absence of a set-off, would be obliged to pay the full amount of its own debt, but would receive only a dividend in respect of the cross-debt. Where a set-off is available, however, the creditor will receive payment in full to the extent of the set-off. Insolvency set-off therefore provides a significant exception to the *pari passu* principle of insolvency law, under which all creditors within a particular class must be treated alike.

110. When combined with netting, set-off is extensively used by those who trade on the financial markets (especially the derivatives markets) to reduce exposure and risk, and also to reduce the

[32] *Goode on Legal Problems of Credit and Security* (5th ed, 2013, ed Gullifer) para 7-01.
[33] Gullifer and Payne, *Corporate Finance Law, Principles and Policy* (2nd ed, 2015), para 6.3.4.

volume of settlements.[34] In dealings on organised markets, the legal protection of set-off and netting has in recent years also been seen as fulfilling the crucial requirement of reducing systemic risk.[35] It is in that area that EU law has intervened, both to require a minimum level of protection for set-off and netting in financial market transactions to be available in Member States, and to require mutual recognition throughout the EEA. It is these systemically vital provisions that will need to be continued or replaced when the UK ceases to be a Member State.

111. This section provides a high-level overview of the current EU law framework in relation to set-off and netting arrangements. Although the effectiveness of such arrangements is commonly tested in the context of insolvency, insolvency law is not considered in detail here since this is a separate topic and will be covered by the Chancery Bar Association in their report. Further, this section does not consider the set-off and netting provisions contained in (i) the Bank Recovery and Resolution Directive[36]; (ii) in the Basel III accords or (iii) the regulatory banking framework (including the Capital Requirements Regulation[37] and CRD IV Directive[38]) which are part of the EU's legislative package implementing the Basel III international regulatory capital framework.

---

34 Ibid.

35 Goode, *op cit*, para 7-01.

36 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending various directives which contains provisions relating to recovery and resolution planning, intragroup financial support, early intervention, resolution tools and powers, cross-border group resolution, relations with third countries and financing arrangements ([2014] OJ L173/190).

37 EU Regulation No 575/213 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 ([2013] OJ L176/1).

38 Directive 2013/36/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, amending various directives ([2013] OJ L176/338).

Set-off and Netting

112. It may be helpful to begin with a brief consideration of what we mean by the expressions 'set-off' and 'netting'. In finance transactions, the terms 'netting' and 'set off' are sometimes used interchangeably even though they are not the same thing. The confusion appears to come from the fact that netting and set-off can result in the same economic outcome for the parties involved.

113. At a general level, set-off can be defined as the settling of money cross-claims against each other to produce a balance. English law provides for a variety of types of set-off:[39]

(1) In the case of parties neither of whom is bankrupt or is a company in liquidation, a set-off may proceed on the basis of a legal or statutory set off if the case is one of mutual debts or in accordance with the principles developed independently by the courts of equity.[40]

(2) If one of the parties to cross-demands is a person who is bankrupt or a company in liquidation or in some circumstances in administration, insolvency set-off may be available.[41]

(3) In addition, there are certain rights which are distinct from set-off but which have an analogous effect:

---

39 See Derham, *The Law of Set-Off* (4th ed, 2010) paras 1.10 to 1.12.

40 The labels usually given to these types of set-off are: (1) 'independent set-off'; and (2) 'transaction set-off'. Features common to all forms of set-off other than contractual set-off are that (a) they are confined to situations in which both the claim and the cross-claim are for money (or one party's claim is to money and the other's is to property which the first party is authorised to dispose of and thus convert into money); and (b) they require mutuality of parties, that is the claim and cross-claim must be due from the same parties in the same right: Goode, *op cit*, at 7-03.

41 The label usually given to this form of set-off is 'insolvency set-off'.

(a) The combination of bank accounts: this refers to a bank's right to look upon various accounts held by a customer as combined to produce a single debt;[42]

(b) The rule in *Cherry v Boultbee*:[43] this applies in the situation in which a person who is entitled to receive a distribution from a fund is also obliged to contribute to the fund. It entitles the administrator of the fund to direct the person to satisfy his or her entitlement to a distribution from a particular asset of the fund, in the form of the person's obligation to contribute.

(4) Parties dealing with each other may enter into a set-off agreement for the satisfaction of their cross-demands. The set-off may be expressed to occur immediately or upon the happening of a specified future event or it may be at the option of one of the parties.[44]

114. Netting comes in various forms, which are closely related to but distinct from set-off. It encompasses various contractual provisions which change the nature of the parties' obligations to each other, either to have the effect of set-off or so that set-off (contractually provided for) can take place.[45] Netting can be either bilateral or multilateral.

(1) Novation netting is an agreement whereby all contracts between the parties are consolidated into one single contract, with one payment obligation. Usually, as each new contract is entered into, it is consolidated with the single contract so that there is only ever one balance payable. The actual time of payment is provided for separately by the

---

42 The label usually given to this form of set-off is 'current account set-off'.

43 (1839) 4 My & Cr 442, 41 ER 171.

44 The label usually given to this form of set-off is 'contractual set-off'.

45 Gullifer and Payne, *op cit*, para 6.3.4.5. The various forms of netting are discussed e.g. by Lightman J in *Enron Europe Ltd v Revenue and Customs Commissioners* [2006] EWHC 824 (Ch), [2006] BCC 953 at [20]-[22].

contract. One use of this technique is where there is a clearing house in a market. The clearing house rules usually provide that each time two members of the market trade with each other, each transaction is novated to the clearing house (so that the clearing house then has two contracts, one with each party) and consolidated with each party's other obligations to and rights against the clearing house, so that only one balance is payable either to or from the clearing house.[46]

(2) Settlement netting relates purely to payment, so that when amounts become due from and to two or more parties, they are netted out so that only one sum is payable.[47] The purpose of settlement netting is to ensure that the creditor's risk of non-payment is limited to the net amount. It is often used in the settlement of payment through a clearing house, although novation netting is a safer method in the event of the insolvency of one of the members.[48]

(3) Close-out netting is the most significant type of netting in terms of protecting against credit risk.[49] Close-out netting provisions are extensively used in the financial markets, and are found in many master agreements governing such transactions. In particular, close-out netting is a vital component of the ISDA Master Agreement[50], which governs most derivatives transactions, as well as of the industry-standard terms for repos and securities lending transactions.[51] Close-out netting is a contractual arrangement whereby all outstanding obligations of the parties under transactions between them are terminated

---

46 Gullifer and Payne, *op cit*, para 6.3.4.5.

47 Thus, it is distinct from novation netting, which can apply to executory contracts.

48 Gullifer and Payne, *op cit*, para 6.3.4.5.

49 Ibid.

50 See e.g. section 6(e)(i) of the 2002 ISDA Master Agreement.

51 See, for example, the ISLA's Global Master Securities Lending Agreement 2011 clause 11 (securities lending); and the ICMA's Global Master Repurchase Agreement 2011 clause 10 (repos).

following the occurrence of a specified event, then valued and set off against each other so that only a balance is owing. The process is intended to reduce exposures on open contracts if one party should become insolvent or a like event occurs before the settlement date and is sometimes referred to as "extended set-off".

115. Accordingly, the distinction between netting and set-off is more a technical one than a practical one. Set-off acknowledges the existence of cross-claims between the parties but effects a discharge of them to the extent that the amounts are equivalent whereas netting involves just one monetary claim being owed by one party to the transaction to the other at any point in time. Close-out netting is similar to insolvency set-off in that it provides protection in the event of one party's bankruptcy or insolvency and thus provides an exception to the *pari passu* principle.

The existing framework

Domestic law

116. In the law of England and Wales, the rules relating to set-off and netting are mostly dealt with by domestic law, either judge-made or by statute. Domestic law provides both for the availability of rights of set-off as well as for limitations on the validity and effectiveness of set-off and close-out netting arrangements. For instance:

(1) Under section 323 of the Insolvency Act 1986 and rules 2.85 and 4.90 of the Insolvency Rules 1986 (soon to be replaced by the Insolvency Rules 2016) where a person goes into bankruptcy or a company goes into liquidation or administration, mutual debts are automatically set-off following the taking of an account of what is due (including future,

contingent and unliquidated sums).[52] Sums due from the bankrupt or insolvent are not taken into account if the other party had notice at any time of the bankruptcy, insolvency or administration. The right to set-off only applies where the cross-claims are mutual and also commensurable. Insolvency set-off is mandatory: it cannot be restricted, excluded or extended by agreement of the parties and takes precedence over any other form of set-off exercised before the bankruptcy, liquidation or administration of the debtor. Detailed rules have been developed in the caselaw to provide for the application of this statutory right to claim a set-off in bankruptcy or liquidation or administration.

117. In English law, a multilateral netting arrangement can be challenged by a liquidator of a member of a clearing house on the ground that it allows a setting off of claims in relation to which there is no mutuality and that such an arrangement accordingly infringes the *pari passu* principle. In *British Eagle International Airlines Ltd v Cie Nationale Air France*[53], the House of Lords refused to uphold agreements whereby more than two parties had agreed to set off any amounts owed between them on a periodical basis by means of a clearing house if one of the parties went into insolvency. The majority held that the clearing house system could not operate after the commencement of the liquidation in respect of debts and credits not cleared at that date, because this would be contrary to the principle that the property of a company is to be applied in its winding up in satisfaction of its liabilities *pari passu*.[54] It made no difference that the parties may

[52] Where a party has gone into administration, the rules are similar to the rules for liquidation, except that insolvency set-off for administration is only triggered if the administrator gives notice that he intends to make a distribution.

[53] [1975] 1 WLR 758, [1975] 2 All ER 390.

[54] As David Richards J observed in *Revenue and Customs Commissioners v Football League Ltd* [2012] EWHC 1372 (Ch) at [66], "*The* pari passu *principle applies only to the distribution of assets belonging to the insolvent estate at the commencement of the insolvency proceedings, and, as it seems to me in the case of a company, any asset coming into its ownership at a later date. It does not apply to assets which either never belonged to the insolvent estate or ceased to belong to it before the commencement of the insolvency proceedings. The issue in British Eagle on which the House of Lords divided was whether there was a debt due to the insolvent company at the commencement of its winding-up, to which the netting-off provisions of the IATA clearing house rules then applied. The majority held that there was*

have had good business reasons for entering into the arrangement or that the arrangement was not designed specifically in order to evade the insolvency legislation.[55]

EU law

118. The existing EU law in this area primarily concerns netting and set-off in financial markets. It sets out rules that are considered necessary for the proper functioning of the financial markets in that the EU legislator has tried to shape national laws so as to avoid inconsistency and impediments in the wholesale financial sector. In essence, the aim of the EU rules is to ensure the effectiveness of set-off and netting arrangements in the financial markets and to ensure their effectiveness and enforceability, in particular by protecting them against national insolvency legislation. The EU law instruments in relation to netting (mostly Directives implemented into English law by means of regulations) have affected the position set out in paragraph 116 above in certain situations.

119. The EU framework in relation to set-off and netting is patchy and scattered across various legal instruments dealing with different matters (e.g. financial collateral arrangements, settlement finality in payment and securities settlement systems and the rules on clearing houses). Whilst most of the rules are substantive law provisions, EU law has also provided for choice of law rules

---

such a debt and hence its distribution among members of IATA under the operation of the clearing house rules offended the pari passu *principle. IATA amended its rules in the light of the decision and the issue whether the amended rules also offended the* pari passu *principle arose in proceedings in Australia. The High Court of Australia held that the amended rules did not do so*: International Air Transport Association v. Ansett Australia Holdings Ltd *[2008] HCA 3, [2008] BPIR 57*".

[55] Because *British Eagle* can present difficulties in structuring clearing houses for electronic payments made by or to member financial institutions, the modern tendency has been to restrict its ambit: see e.g. *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] EWCA Civ 1160 [43]-[58] and *Lomas v JFB Firth Rixson Inc* [2010] WHC 3372 (Ch) [94]-[96]. The Supreme Court declined to reconsider *British Eagle* despite a submission that it should be overruled or declared inapplicable since the coming into force of the Insolvency Act 1986: see *Belmont Park Investments Pty Ltd and others v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383.

to determine the law applicable to the question of which rules of set-off may be applicable and whether netting agreements are enforceable in the context of insolvency. The various rules are considered in turn below.

120. As mentioned above, set-off and netting provisions are also commonly found in industry-standard contracts used in the financial markets. As these are typically governed by English or New York law, they are not really Brexit-related. However, their effective operation may be severely undermined if (for example) reciprocal settlement finality is not preserved.

European instruments addressing set-off and netting

121. There are two European Directives in relation to netting:

(1) The Settlement Finality Directive: Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems ([1998] OJ L166/45) as amended;[56] and

[56] Amended by (i) Directive 2009/44/EC the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims ([2009] OJ L146/37); (ii) Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) ([2010] OJ L331); (iii) Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ([2012] OJ L201/1]; (iv) Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012) ([2014] OJ L257/1).

(2) The Financial Collateral Directive: Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements ([2002] OJ L168/43) as amended.[57]

122. These two directives are considered in turn below.

The Settlement Finality Directive

123. The Settlement Finality Directive was adopted in order to reduce systematic risk associated with participation in payment and securities settlement systems that operate on the basis of payment netting and to minimize the disruption caused by insolvency proceedings against a participant in such a system. It establishes a regime under which the finality of transfer orders and netting, as well as the enforceability of collateral security, are ensured in respect of both domestic and foreign participants in payment and securities settlement systems.

124. Article 2 of the Settlement Finality Directive contains definitions of key terms including "netting", "system", "clearing house", "participant" and "transfer order". The Settlement Finality Directive provides *inter alia* that:

(1) Transfer orders and netting are to be legally enforceable and binding on third parties, even in the event of insolvency proceedings, provided the transfer orders were entered into the system before the moment of the opening of the insolvency (article 3(1) as amended). A

---

[57] Amended by (i) Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims ([2009] OJ L146/37) and (ii) Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council ([2014] L173/190).

transfer order that enters the system after the commencement of insolvency proceedings against a participant may nevertheless be enforceable provided it is executed on the same business day and provided the system operator can demonstrate that it was unaware of the insolvency proceedings at the time that the transfer order became irrevocable.

(2) There is to be no unwinding of a netting because of the operation of national laws or practice that provide for the setting aside of contracts and transactions concluded before the moment of opening of the insolvency proceedings (article 3(2)), which is defined as the moment when the relevant judicial or administrative authority handed down its decision (article 6(1)).

(3) A transfer order is not to be revoked by a participation in a system, nor by a third party, from the moment defined by the rules of that system (article 5 as amended).

(4) Insolvency proceedings are not to have retrospective effect on the rights and obligations of a participant arising from, or in connection with its participation in a system earlier than the moment of the opening of such proceedings i.e. the moment when the relevant judicial or administrative authority handed down its decision (article 7 as amended).

(5) The rights of a participant to collateral security provided to it in connection with a system are not to be affected by insolvency proceedings against such participant. Such collateral security may be realised for the satisfaction of these rights (article 9(1) as amended).

125. The United Kingdom has implemented the Settlement Finality Directive by the Financial Markets and Insolvency (Settlement Finality) Regulation 1999 (SI 1999/2979) as amended (the **Settlement Finality Regulations**).

126. These regulations allow a system which effects securities and payment transfers and which provides for netting and the closing out of open positions to apply to be a 'designated system' and thereby to have the benefit for certain protections against the operation of normal insolvency law insofar as it applies to transfer orders entered into the system. Regulation 2(1) defines 'designated systems' as "*a system which is declared by a designation order for the time being in force to be a designated system for the purposes of these Regulations*" and netting as "*the conversion into one net claim or obligation of different claims or obligations between participants resulting from the issue and receipt of transfer orders between them, whether on a bilateral or multilateral basis and whether through the interposition of a clearing house, central counterparty or settlement agent or otherwise*".[58]

127. By dis-applying insolvency law, the Settlement Finality Regulations protect the finality and irrevocability of the transfer orders and strengthen the enforceability of collateral security. In order to receive those protections, a system must meet the criteria set out in the Settlement Finality Regulations and be designated by the Financial Services Authority or the Bank of England. In its capacity as designating authority, the Bank of England has granted *inter alia* CHAPS Sterling as a clearing "designated" system.

128. Part II of the Settlement Finality Regulations deals with designated systems and the application for designation. Part III of the Regulations deals with transfer orders effected through a designated system and collateral security and largely displaces the rules of insolvency law, giving

---

[58] The designated systems are currently BACS, CHAPS, the Cheque and Credit Clearing Systems, CME Clearing Europe, Continuous Linked Settlement, Euroclear UK and Ireland, Faster Payments, ICE Clear Europe, LCH.Clearnet, LME Clear and SIX x-clear: see http://www.bankofengland.co.uk/financialstability/Pages/fmis/supervised_sys/systems.aspx.

.

precedence to the proceedings of the relevant designed system (see in particular regulation 14 which provides that the rules are not be regarded as invalid on the ground of inconsistency with the law relating to the distribution of the assets or a person or company in insolvency) and regulation 15(2) dealing with section 323 of the Insolvency Act and rule 4.90 of the Insolvency Rules 1986). This effectively reverses the effect of the ruling in *British Eagle* (as to which see paragraph 116(2) above) so far as those designated systems are concerned. The provisions of the Settlement Finality Regulations do not apply to market contracts within the meaning of Part VII of the Companies Act 1989 (see regulation 15(1) and regulation 21).

The Financial Collateral Directive

129. The Financial Collateral Directive created a uniform European legal framework for the cross-border use of financial collateral which greatly simplifies the ease with which certain specified categories of persons may enter into financial collateral arrangements and thus abolished most of the formal requirements traditionally imposed on collateral arrangements.

130. The Financial Collateral Directive protects transactions basically between all types of financial institutions (including public authorities, central banks, credit institutions, financial institutions, investment firms, insurance undertakings, UCITS, a central counterparty, settlement agent or clearing house) and, where it has not been excluded by the implementing State, other types of market participants transacting with a counterparty belonging to some of the aforementioned categories (articles 1(1)-(3)). Most, but not all, financial transactions are covered, as the condition for falling within the scope of the Financial Collateral Directive consists of collateral or security (cash or financial instruments, including shares and debt securities negotiable on the capital

markets) being provided between the parties, a very common characteristic in wholesale transactions (see articles 1(4)(a) and 2(1)(a) to (c)).

131. The effect of the Directive is that collateral transactions falling within its scope are shielded against a number of typical threats to enforceability that can arise in insolvency proceedings, notably recharacterisation by the court, voidance by the insolvency administrator etc. (articles 3 to 8). In particular, under article 4(5), Member States shall ensure that a financial collateral arrangement can take effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker. Under article 8 of the Directive certain insolvency provisions are to be dis-applied.

132. Close-out netting agreements are especially protected by the Financial Collateral Directive. Under article 7(1) Member States shall ensure that a close-out netting provision of a financial collateral arrangement (e.g. a master repurchase or securities lending agreement), or of an arrangement of which a financial collateral arrangement form part (e.g. an ISDA master agreement of which a credit support annex forms part), can take effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker. Under Article 7(2), Member States are to ensure that the operation of a close-out netting is not subject to the requirements for realising financial collateral unless the parties expressly agree otherwise.

Recital 15 of the Financial Collateral Directive appears to allow Member States to maintain certain restrictions in their national laws in relation to netting.[59]

133. The United Kingdom has implemented the Financial Collateral Directive by the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226) as amended (the **Financial Collateral Regulations**). These regulations, unlike the Settlement Finality Regulations, are not confined to 'designated systems' and accordingly have a more general scope of application.

134. Regulation 12 of the Financial Collateral Regulations transposes article 7 of the Financial Collateral Directive. The scope of regulation 12 is limited because it only applies to close-out netting provisions in the case of a financial collateral arrangement or an arrangement of which a financial collateral arrangement forms part. It would thus not extend to ordinary contracts for the sale and purchase of foreign currencies where a financial collateral arrangement does not form part of the arrangement.

(1) Regulation 3 defines "close-out netting provision" as "*a term of a financial collateral arrangement or of an arrangement of which a financial collateral arrangement forms part, or any legislative provision under which on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise (a) the obligations of the parties are accelerated to become immediately due and expressed as an obligation to pay the estimated current value or replacement value of the original obligations, or the obligations are terminated and replaced by an obligation to pay such an amount or (b)*

[59] Recital 15 provides as follows: "*any restrictions or requirements under national law on bringing into account claims, on obligations to set-off, or on netting, for example relating to their reciprocity or the fact that they have been concluded prior to when the collateral taker knew or ought to have known of the commencement (or of any mandatory legal act leading to the commencement) of winding-up proceedings or reorganisation measures in respect of the collateral provider*."

an account is taken of what is due from each party to the other in respect of those obligations and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other."

(2) A "financial collateral arrangement" can be either a "*title transfer financial collateral arrangement*" or a "*security financial collateral arrangement*" (see regulation 3).

(a) Under the former, a collateral-provider transfers legal and beneficial ownership in financial collateral (defined as cash and financial instruments, which in turn is defined in terms of shares, bonds and other securities) to the collateral-taker on terms that, when the relevant financial obligations secured or covered by the arrangement are discharged, the collateral-taker must transfer legal and beneficial ownership of equivalent financial collateral to the collateral-provider.

(b) In the case of the latter, a collateral-provider creates or there arises a security interest in financial collateral to secure the relevant financial obligations owed to the collateral-taker and the financial collateral is delivered, held or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf.

(3) A financial collateral arrangement is defined in terms of an arrangement in which both parties are "non-natural persons". Non-natural person is in turn defined as a corporate body, unincorporated firm, partnership or body with legal personality except an individual. A close-out netting agreement with an individual is therefore not protected by regulation 12.

135. Pursuant to regulation 12(1), close-out netting arrangements take effect in accordance with their terms and are thus enforceable despite the opening of winding-up proceedings or reorganisation measures (which are defined in regulation 3 as including administration and company voluntary arrangement within the meaning of the Insolvency Act 1986). However, regulation 12(1) is subject to regulation 12(2) which qualifies the effectiveness of netting arrangements in situations where at the time of entering into the agreement, a party was aware or should have been aware of the insolvency proceedings or had notice of one of various facts which typically proceed the opening of such proceedings (regulation 12(2)). In other words, a close-out netting agreement can be unenforceable if the solvent party knew or should have known about the imminent insolvency when it entered into the agreement. It should be noted that different EU countries have implemented this rule differently and therefore there are different national criteria for the avoidance of close-out netting. For instance, in some countries it is not possible to challenge close-out netting on the grounds of knowledge.

136. Regulation 12(4) provides that rules 2.85(4)(a) & (c) and 4.90(3)(b) of the Insolvency Rules 1986 do not apply to close-out netting provisions unless regulation 12(2)(a) applies. The purpose of this rule is unclear because it assumes that, in its absence, those rules would have applied. However, regulation 12(1) provides that a close-out netting provision takes effect in accordance with its terms notwithstanding a liquidation or administration subject only to regulation 12(2). On its face, that leaves no room for the application of the Insolvency Rules.

137. Regulation 14 of the Financial Collateral Regulations applies in the situation in which the collateral-provider or the collateral-taker is in liquidation or administration and a close-out netting provision provides for or permits either the debt owed by the party in liquidation or

administration to be assessed or paid in a currency other than sterling, or the debt to be converted into sterling at a rate other than the official exchange rate prevailing on the date when the party went into liquidation or administration. In those situations, regulation 14 dis-applies rule 4.91 or as the case maybe rule 2.86 of the Insolvency Rules 1986 unless the arrangement provides for an unreasonable exchange rate or the collateral-taker uses the mechanism provided under the arrangement to impose an unreasonable exchange rate, in which case the appropriate rule will apply.

Conflict of laws rules in relation to set-off and netting

138. Three other European instruments which are relevant in this context must also briefly be mentioned.

139. The first is Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions ([2001] OJ L125/15) as amended[60] (the **Banks Winding-Up Directive**). It applies to insolvent credit institutions (banks) and all EU-regulated investment firms but no other type of financial institution. It prescribes that only the home Member State's courts (i.e. where the entity has been authorised) are empowered to open insolvency proceedings, including over the bank's or investment firm's foreign branches: the *lex fori concursus* is the law of that State (articles 9 and 10). It provides for differentiated conflict of laws rules to supplement or replace the general *lex fori* rule applicable to certain matters affected by a reorganisation measure or the opening of

[60] Amended by Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council ([2014] L173/190).

winding-up proceedings and there is a special rule on set-off and a special rule on netting in Title IV of the Banks Winding-Up Directive.

(1) In respect of set-off, the law of the home Member State (*lex fori concursus*) governs the conditions under which it may be invoked (article 10(2)(c)). However, creditors can still demand the set-off of their claims against the claims of the credit institution where such set-off is permitted by the law applicable to the credit institution's claim (article 23(1)) although voidness, voidability and unenforceability will still be governed by the *lex fori concursus* (article 23(2)). Thus, depending on the situation the law governing set-off in insolvency may be split between the *lex fori concursus* and the *lex contractus*.

(2) This is different when it comes to close-out netting. Article 25 (as amended) provides that "*netting agreements shall be governed solely by the law of the contract which governs the agreement*" and thus this is to the exclusion of the insolvency law of the forum. However, article 25 is without prejudice to articles 68 to 71 of Directive 2014/59/EU which exclude certain contractual terms in early intervention and resolution and gives Member States the power to suspend certain obligations or restrict the enforcement of security interests.

140. The United Kingdom has implemented the Banks Winding-Up Directive by the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (*SI 2004/1045*). Regulation 34 transposes article 25 of the Banks-Winding Up Directive and provides that "*The effects of a relevant reorganisation or a relevant winding upon a netting agreement shall be determined in accordance with the law applicable to that agreement*". Article 10(2)(c) is transposed in regulation 22(3)(d) which provides that the conditions under which a set-off may be invoked are

to be determined in accordance with the general law of insolvency of the United Kingdom in the case of the winding-up of a UK credit institution. Regulation 28 transposes article 23 of the Banks Winding-Up Directive.

141. Second, the relevant parts of the Insolvency Regulation (Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings ([2000] OJ L 160/1) to be replaced by Regulation E(U) 2015/848 on insolvency proceedings ([2015] OJ L141)) and the Solvency II-recast (Council Directive (EC) 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance ([2009] OJ L335/1)) also contain choice of law rules affecting set-off. The Solvency II-recast applies to the insolvency of insurance undertakings and the Insolvency Regulation applies to insolvency proceedings over debtors other than insurance undertakings, banks, investment firms or collective investment funds. The rules in relation to the law governing set-off in both instruments are almost identical those in the Banking Winding-Up Directive. However, a rule on close-out netting corresponding to article 25 of the Banks Winding-Up Directive is missing from either instrument. In the absence of a specific rule, the general rules apply referring the question of enforceability of close-out netting to the law of the home Member State.

<u>European rules applicable to clearing houses</u>

142. The European Union has also legislated in relation to clearing houses and thus close-out netting arrangements in that context, for instance by Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market ([2007] OJ L319/1) and most recently by Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on over the counter derivatives, central counterparties and trade repositories ([2012]

OJ L201/1) (the European Market Infrastructure Regulation or **EMIR**) and Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 ([2012] OJ L52/11)). The relevant EU Directives were implemented by way of regulations amending Part VII of the Companies Act 1989 (sections 159 to 190 as amended). Further, although European Regulations are directly applicable, domestic law (including Part VII of the Companies Act 1989) had to be amended to ensure that English law was compatible with EMIR and the supplementing Regulation.

143. The objective of EMIR is to reduce systematic counterparty and operational risk and to help prevent future financial system collapses. It establishes common rules for central counterparties (which interpose themselves between involved parties in a contract to serve as the focal point of each trade) and trade repositories (which collect and maintain all records of trades). EMIR requires the reporting of all derivatives, whether OTC or exchange traded, to a trade repository and outlines three sets of obligations, including the clearing, reporting and risk mitigation of applicable products (interest rate, equity, foreign exchange or credit and commodity derivatives).

144. The Financial Services and Markets Act 2000 (Over the counter derivatives, central counterparties and trade repositories) (No 2) Regulations 2013 implement part of EMIR and the Commission delegated Regulation supplementing EMIR by amending Part VII of the Companies Act 1989. These UK regulations relate to the clearing of financial transactions through recognised clearing houses and amend insolvency law to facilitate the segregation and transfer of indirect clients' assets and positions. They impose new requirements on recognised central counterparties and recognised clearing houses which are not central counterparties. The former are required to maintain effective arrangements for the allocation of losses that threaten their

solvency and both categories of clearing houses are required to maintain the continuity of services if that continuity is threatened.

145. Part VII of the Companies Act 1989 introduced provisions designed to overcome the effects of *British Eagle*. The regime in Part VII is designed to safeguard the operation of financial markets and to protect the financial markets from the insolvency of a market participant. It dis-applies certain provisions of insolvency law where those provisions would conflict with the techniques employed by the market of netting out exposures to defaulting counterparties or contractual remedies agreed between market participants and their counterparties.

146. The scope of Part VII is however limited. It applies to rules of certain recognised investment exchange and recognised clearing houses (together **Recognised Bodies**).[61] These institutions must have rules complying with the requirements of Part VII, mainly close-out netting against defaulters.

147. Part VII modifies the application of insolvency law to protect the actions of Recognised Bodies in the event that one of their members defaults on the obligations it has entered into in the course of buying or selling financial instruments (see sections 155 to 172). Part VII is crafted so as to ensure that the operation of the "default rules" of the exchange or clearing house and other rules of the exchange or clearing house relating to the settlement of market contracts take precedence over the general law of insolvency when a member defaults.

---

[61] Within the meaning of section 285 of the Financial Services and Markets Act 2000, the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (SI 2001/995) as amended and section 190 of the Companies Act 1989.

(1) Market contracts are defined in section 155 as a contract connected with a recognised investment exchange or recognised clearing house.

(2) "Default rules" are rules which provide for the taking of action in the event of a person appearing to be unable, or likely to be unable, to meet his or her obligations in respect of a market contract (see section 188(1)). Such default rules allow the Recognised Body to undertake offsetting transactions either individually or to hedge risk across the portfolio while the defaulter's positions are being resolved and contain provisions for the calculation of net sums owing between the Recognised Body and the defaulting member and permit the Recognised Body to realise collateral. The Recognised Body's rules may include offsetting profits and losses on different contracts and setting off assets provided as margin against net losses.

148. The 'safe harbour' created by Part VII enhances legal certainty in the financial markets, prevents trades from being unravelled by an administrator or liquidator, and permits the insolvency of the member to be managed with greater certainty and more effectively. In practice, this means that third parties, including administrators or other insolvency officer-holders, cannot interfere with or disrupt the operation of the default rules or prevent settlement of transactions held at a Recognised Body in the defaulter's name.

149. Part VII also provides that the rules of the exchange or clearing house are not invalid on the ground of inconsistency with insolvency laws relating to the distribution of the assets of a person in bankruptcy, winding up or administration (see in particular section 159 and generally sections 155, 158-165, 188 and 190 of the Companies Act 1989). Section 159(1) provides that neither a market contract nor the default rules of a recognised institution are to be regarded to any extent

invalid on the ground of insolvency laws. Further, sections 159 and 163 of the Companies Act 1989 allow contracting out of the automatic and mandatory insolvency-set off in the context of financial markets. A debt arising from a market contract cannot be set-off until the completion of default proceedings (see sections 159(4) and 163(1)&(2) of the Companies Act 1989). These are proceedings brought pursuant to the relevant investment exchange or clearing house rules where default occurs.

Conclusion

150. As can be seen from this review, national rules still determine the scope of and limits to set-off and netting in relation to all those transactions that do not fall within the ambit of the EU instruments mentioned above. There are thus many situations involving set-off or netting arrangements which are not addressed by EU law.

151. However, in the systemically important transactions of the financial markets, EU law (or Domestic Law, adopted or adapted in order to implement of EU law) now plays a central role. Unless the effectiveness of the market-standard contractual provisions and of the domestic and international market arrangements for set-off and netting is guaranteed, the level of systemic risk in those markets will be significantly increased. The consequent uncertainty seems to us to be likely to have a significantly detrimental effect on the level of economic activity.

The impact of Brexit

152. Given the uncertainty as to what Brexit will actually involve, the impact of Brexit on these matters is difficult to predict.

153. If the United Kingdom leaves the European Union and does not remain a member of the single market or the European Economic Area, then EU Regulations will cease to be directly applicable in the United Kingdom. Unless the proposed "Great Reform Act" or other specific legislation provides to the contrary, English law will therefore probably revert to the common law position in relation to those matters now covered by the relevant EU Regulations, e.g. the rule in *British Eagle* in relation to multilateral netting (as to which see paragraph 116(2) above).

154. EU Directives are not directly applicable but need to be implemented into domestic law. Although it is clear that once the United Kingdom leaves the European Union, there is no longer an obligation for the United Kingdom to implement European Directives into domestic law, it does not necessarily follow that all of the national law which transposes European Directives will automatically be repealed and cease to have effect. Indeed, the relevant provisions – notwithstanding their European origin – would probably continue to apply as a matter of English law. It would probably require specific legislation to repeal them.[62]

155. Given the scope of the European rules, the impact of Brexit on the rules of set-off and netting will in any event be limited to those rules which deal with the proper functioning of the financial markets. However, those particular rules are of vital importance to the UK economy.

---

[62] Though, on Brexit, most of them are likely to require amendment. For example, the Settlement Finality Regulations will require amendment, in particular because: (1) the definition of 'central bank' refers to the central bank of an EEA state (which may, on Brexit, no longer include the Bank of England); (2) the definitions of 'credit institution', 'electronic money institution' and 'investment firm' depend on the relevant European regulations; and (3) under Regulation 4 on granting designation for a system the designating authority must inform the European Securities and Markets Authority.

Conclusions / recommendations

156. Since the European rules discussed above are aimed at ensuring the proper functioning of financial markets, if all the rules including the EU Directives and any implementing English law were removed, there would likely be a real adverse effect on the proper functioning of the financial markets and significant prejudice to market participants (both from the United Kingdom and abroad).

157. Rules for the proper functioning of the financial markets – both substantive rules (e.g. in relation to settlement finality) and choice of law rules (e.g. in relation to the law applicable to set-off and netting in the context of cross-border insolvencies) – will continue to be vital. It will remain important to have a framework to ensure settlement finality in payment and securities systems and to guarantee the enforceability of close-out netting arrangements as well as effective functioning of clearing houses notwithstanding insolvency proceedings. In particular, the majority of designated settlement systems operate on a cross-border basis and are likely to require some form of settlement finality rule to continue operating in the UK. For example, CLS (which is the predominant settlement system for FX transactions) requires a legal opinion from each country in which it operates confirming that the law of that country respects the finality of settlement even if a settlement member is subsequently subject to an insolvency proceeding.

158. There are a variety of different ways to achieve this and to preserve the current status quo (or even to improve on it).

    (1) The easiest way to limit the impact of Brexit and to ensure that settlement finality continues and that close-out netting arrangements remain valid and enforceable despite insolvency proceedings, would be to keep within English law those provisions that are

implementations of EU Directives at least in the first instance. They are now part of English law and would presumably continue to have effect unless specifically repealed. Going forward, these provisions could (where necessary) be updated by the UK legislator independently or in light of future EU developments. It would also be possible to amend or repeal those provisions which may not work satisfactorily or to which the United Kingdom may have objected during the adoption process and to bring in rules that work even more efficiently. Consultation with relevant stakeholders may be appropriate before any amendments are made.

(2) Another way to keep the substantive rules on settlement finality and choice of law would be to adopt English legislation mirroring the current EU framework or to adopt rules that were substantially similar to the EU rules. This would ensure that in effect the current regime continued even if the UK were no longer a member of the European Union and would avoid disruption to the financial markets. This would mean that the rules were English choice of law rules but to the extent that the rest of Europe had the same rules, it would ensure mutuality and reciprocity and avoid irreconcilable results by ensuring that the solution as a matter of the new English law were the same as that to which the Member States of the European Union would come.

(3) It would of course be possible for the UK legislator to adopt entirely new rules on clearing houses, settlement finality and netting arrangements. However, given the substantial volume of legislation which may be required to deal with other key areas, this may not necessarily be a matter of priority, especially where there are currently English law provisions that could continue to apply at least for some time.

159. The financial markets are international. One of the objectives of the EU in legislating in this area has been to achieve a single market in financial products and financial services. If we de-couple our legal system from the EU regime in this area, we will put a practical barrier between our markets and those of the rest of the EU. However, London's principal rival in this field of activity is not Frankfurt, Paris or Rome, but New York: and there are a number of important differences between New York law and the law of England (incorporating, as it presently does, the law of the EU). Many aspects of financial law are also covered by international agreements (e.g. standards promulgated by the Basel Committee on Banking Supervision) which are not specific to the EU.

160. It therefore seems to us that the overriding objective should be to preserve the stability of the financial markets by adopting, continuing or making new legislative provisions covering the same areas and broadly to the same effect as the present EU and EU-derived law in this area.

INSOLVENCY

Introduction

161. With enterprise comes the risk of failure. Just as the one is to be encouraged, so the other must be managed, lest the failure of one should lead to the failure of others. As institutions, banks will inevitably be affected by insolvency at some stage, whether it is their own or, more commonly, that of their customers or counterparties.

162. The aim of this section of the report is to summarise the potential impact of Brexit in the context of the insolvency regime as it relates to (A) UK banks; and (B) their customers or counterparties; as well as (C) its potential impact on the Financial Collateral Arrangements (No. 2)) Regulations 2003. It is intended to be read with the Bar Council's Brexit Paper: The implications of Brexit for insolvency and restructuring, prepared by the Chancery Bar Association, and the further report which we understand is being prepared by the Chancery Bar Association.

UK Banks

Legislative framework

163. The relevant legislative framework comprises:

- Banking Act 2009 (BA 2009), as amended by the Bank Recovery and Resolution Order 2014/3329 and the Bank Resolution and Recovery (No. 2) Order (which implement in part the BRRD)

- Credit Institutions Reorganisation and Winding-up Directive 2001/24/EC (**CIWUD**)

- Credit Institutions (Reorganisation and Winding up) Regulations 2004 (**2004 Regulations**)
- Bank Recovery and Resolution Directive 2014/59/EU (**BRRD**)

164. The purpose of CIWUD is to ensure mutual recognition of measures taken in relation to the reorganisation and winding up of credit institutions by the competent authorities of the Member State by which they are authorised to conduct business (the **home Member State**). With limited exceptions, it requires that measures which may affect third parties' existing rights be given effect by every other Member State regardless of the place in which any individual branch of the institution is located (the **host Member State**) or the law which governs the obligations which it has undertaken. CIWUD ensures that all assets and liabilities of the failing institution are dealt with in a single process in the home Member State. As appears below, CIWUD also applies to a decision involving the use of one of the resolution tools in respect of a failing institution introduced by the BRRD.

165. The BRRD was adopted in the wake of the financial crash of 2008. Its purpose was to provide a minimum degree of harmonisation among Member States of the powers available to enable them to respond quickly and effectively to threats of that kind. The resolution authorities designated by each Member State (Art 3) are to have at their disposal a range of resolution tools and powers, which may adversely affect the rights of third parties, including shareholders and creditors.

166. CIWUD and the BRRD form part of an integrated set of European rules for dealing with failing financial institutions, under which measures taken by the home Member State are to be given

universal effect throughout the Union, even in relation to obligations governed by foreign law.[63] In other words, it is for the home Member State to decide how to deal with a failing institution. Universal effect is achieved by CIWUD Art 3, pursuant to which reorganisation measures implemented in the home Member State are to be fully effective in every host Member State as soon as they become effective in the home Member State. Reorganisation measures for these purposes include the resolution tools and procedures provided for by the BRRD: CIWUD, Art 2. The CJEU has made clear that the definition of "reorganisation measures" is to be interpreted broadly: measures of a kind that do not fall within the scope of the BRRD can nevertheless constitute a reorganisation measure, with the consequences that flow from that.[64]

167. Similarly, recognition of measures taken by the resolution authority of another Member State is expressly provided for in the BRRD, Art 66, which requires each Member State to ensure that the measures taken in the home Member State in respect of assets or liabilities in another Member State have effect in or under the law of the other Member State.

168. Universal effect throughout the EU is similarly achieved in relation to winding up proceedings (broadly defined) by CIWUD, Art 9.

169. The law applicable to the reorganisation measures or winding up proceedings is generally that of the home Member State (CIWUD, Arts 3 and 10), subject to certain exceptions (Arts 20-27, 30-32).

---

63 For an authoritative summary of the relationship between CIWUD and BRRD, see *Guardians of New Zealand Superannuation Fund & others v Novo Banco SA; Goldman Sachs International v Novo Banco SA* [2016] EWCA Civ 1092.

64 *Kotnik & Others v Državni zbor Republike Slovenije* (Case C-526/14).

170. CIWUD (as amended by the BRRD) is incorporated into domestic law in the UK by the 2004 Regulations.

171. Both CIWUD (Arts 8, 19) and the BRRD (Art 67 and Title VI, Arts 93-98) make provision for Third Country credit institutions, which are incorporated into English law by Part 5 of the 2004 Regulations (Regs 36-38). For present purposes, a Third Country credit institution is one which has its head office outside the EU but which has set up a branch in a host Member State: CIWUD, Art 8; BRRD, Art 2(86). As incorporated into domestic UK law, it is a person which has permission under the Financial Services and Markets Act 2000 (**FSMA**) to accept deposits or to issue electronic money as the case may be, whose head office is not in the UK or an EEA State: 2004 Regulations, Reg 36(1)(b).

172. The provisions as they relate to Third Country credit institutions differ from those applicable to EEA institutions. The principal differences are addressed below.

Pre-Brexit: the domestic position

173. UK banks for present purposes are those defined by the Banking Act 2009, s 2, namely UK institutions (with specified exceptions) which are authorised under Part 4A of FSMA to carry on the regulated activity of accepting deposits.

174. The insolvency regime relating to UK banks is the Special Resolution Regime, for which the Banking Act 2009, Parts 1, 2 and 3 provide.

175. The Special Resolution Regime comprises:

(1) certain pre-resolution powers exercisable by the Bank of England: ss 3A and 3B BA 2009;

(2) the five stabilisation procedures (Part I BA 2009, as amended and supplemented by the Bank Recovery and Resolution Order 2014/3329, which implements in part the BRRD), namely:

   (a) Transfer to a private sector purchaser

   (b) Transfer to a bridge bank

   (c) Transfer to an asset management vehicle

   (d) The bail-in option

   (e) Transfer to temporary public ownership;

(3) the bank insolvency procedure, which is based on a modified form of liquidation as it applies to companies: Part II BA 2009; and

(4) the bank administration procedure, which is based on a modified form of administration as it applies to companies: Part III BA 2009.

176. These powers and procedures fall to be exercised and implemented so as to ensure the continuity of banking services in the UK and other critical functions as well as other objectives set out in s 4 BA 2009 (see below).

177. The provisions of BA 2009 are supplemented by the 2004 Regulations, regulations 22 and 23-35. These provide that the general law of the UK will apply to determine certain fundamental matters arising in the insolvency (the phrase used is "relevant winding up", but this extends to a UK CVA, administration, winding up or making of a stabilisation instrument: reg 21(1)(b)),

subject to certain exceptions (Arts 23-35). In substance, these provisions mirror those to be found in the Insolvency Regulation 1346/2000 (Arts 4, 5-15: see section B below).

Post-Brexit: the domestic position

178. As the domestic insolvency regime relating to UK banks is contained within domestic legislation, there is no reason why the domestic position should change post-Brexit, whether or not the UK remains an EEA State, within the single market, or becomes a Third Country (ie a non-EEA State). This will be so unless and until the Banking Act 2009 itself is revised, amended or repealed.

179. Whether recognition will be accorded elsewhere in the EU to the Special Resolution Regime applicable to UK banks, whatever form it may take, however, may depend on the UK's status following Brexit. This is addressed below.

Pre-Brexit: recognition within the EEA of the Special Resolution Regime applicable to UK banks

180. Where the UK is the home Member State, recognition in other Member States will be determined by reference to CIWUD, and the BRRD where applicable, and the domestic legislation by which the host Member State(s) concerned have given effect to the requirements of those directives. In summary:

(1) The UK's administrative or judicial authorities alone are empowered to decide on the implementation of one or more reorganisation measures in a credit institution, including branches in other Member States. Save as otherwise provided by CIWUD, the reorganisation measures will be applied in accordance with the laws, regulations and procedures applicable in the UK: CIWUD, Art 3.

(2) It follows that such reorganisation measures are effective throughout the EU as soon as they become effective in the UK, and will be fully effective in accordance with UK law throughout the EU without further formalities, including as against third parties in other Member States: CIWUD, Art 3.

(3) Reorganisation measures for these purposes mean measures intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, and include the application of the resolution tools and the exercise of resolution powers provided for by the BRRD: CIWUD, Art 2. They would thus include (a) the five stabilisation powers and (b) bank administration, at least in some cases.

(4) The UK's administrative or judicial authorities alone are empowered to decide on the opening of winding-up proceedings concerning a UK credit institution, including branches established in other Member States. A decision to open winding-up proceedings taken by any court in the UK will be recognised without further formality, within the territory of all other Member States, where they will be effective as soon as the decision becomes effective in the UK: CIWUD, Art 9.

(5) In such cases, the UK bank would be wound up in accordance with the laws, regulations and procedures applicable in the UK (CIWUD, Art 10), subject to certain exceptions (CIWUD, Arts 20-27 and 30-32).

(6) Whatever may be the precise nature of the procedure adopted as part of the Special Resolution Regime in respect of a UK bank, therefore, it will be automatically recognised and given effect throughout the EU, including in relation to its branches established in other Member States.

181. For completeness, as regards non-UK EEA credit institutions:

(1) reorganisation measures and winding-up proceedings taken or opened in another Member State as the home Member State of the institution concerned will be recognised and take effect in the UK: Reg 5 of the 2004 Regulations;

(2) since 5 May 2004, such an institution (or any of its branches) cannot be wound up or put into administration or become subject to a company voluntary arrangement in the UK: Reg 3 of the 2004 Regulations; and

(3) schemes of arrangement may not be proposed or sanctioned if the institution (or branch) is already subject to a directive reorganisation measure or directive winding-up proceedings unless the requisite notices have been given and no objections have been received: Reg 4 of the 2004 Regulations. In the absence of any such measure or proceedings, however, it follows that schemes of arrangement may be proposed and sanctioned in respect of EEA institutions, which are to be regarded as companies liable to be wound up under the Insolvency Act 1986 for this purpose: Reg 4(1) of the 2004 Regulations.

Post-Brexit: recognition within the EEA of the Special Resolution Regime applicable to UK banks

182. Much will depend on the UK's status following Brexit. If it were to remain within the EEA with access to the Single Market, CIWUD and BRRD would continue to apply as they do now with the result that the Special Resolution Regime applicable to UK banks would continue to be automatically recognised and given effect throughout the EU/EEA.

183. If the UK were no longer to be a member of the EEA, however, the position would be different: the domestic Special Resolution Regime applicable to a UK bank would no longer be the subject of, nor entitled to, automatic recognition throughout the EEA/EU because CIWUD, Arts 3 and 9 would no longer apply.

184. In such circumstances, the UK would instead be a Third Country for the purposes of CIWUD and BRRD.

BRRD: Third Country resolution proceedings

185. In the context of resolution proceedings relating to a UK institution, the consequences of the UK being a Third Country under the BRRD would include the following:

(1) The Commission may submit proposals for the negotiation of an agreement with the UK as a Third Country regarding the means of cooperation between resolution authorities and the relevant UK authorities for the purpose of information-sharing in connection with recovery and resolution planning in relation to qualifying institutions and cooperation in carrying out tasks and exercising the powers referred to in Art 97 (considered below): BRRD, Art 93(1)-(3).

(2) Unless and until the Commission does so, Member States may enter into bilateral agreements with the UK in relation to such matters, but such arrangements must be consistent with BRRD provisions governing relations with Third Countries: BRRD, Art 93(4).

(3) Unless and until an international agreement is negotiated between the Commission and the UK, or if such an agreement (once concluded) does not extend to recognition and

enforcement of UK resolution proceedings, arrangements relating to the recognition and enforcement of UK resolution proceedings where the UK institution or parent undertaking has subsidiaries or branches in relevant EEA States will be a matter for:

(a) the European resolution college established in accordance with BRRD Art 89 (if there is one), in which case national resolution authorities will be obliged to seek enforcement of the UK resolution proceedings, once they have been recognised by the college, in accordance with their national law;

(b) the same will apply where the UK institution has assets, rights or liabilities which are located in two or more Member States or governed by the law of those Member States;

(c) in the absence of a joint decision by the college, or if there is no college, the resolution authority of the Member State concerned, giving due consideration to the interests of each Member State where the UK institution operates.

(4) The resolution authorities of relevant Member States would have certain minimum powers to (amongst other things) take their own resolution action in relation to:

(a) assets belonging to the UK institution which are located in their Member State or governed by its law; and

(b) rights or liabilities of the UK institution that are booked by the branch of the UK institution in their Member State or governed by its law, or where claims in relation to such rights and liabilities are enforceable in their Member State (BRRD, Art 94(4).

(5) In each such case, recognition and enforcement of UK resolution proceedings would be without prejudice to any normal insolvency proceedings under national law applicable (where appropriate) under the BRRD: Art 94(6).

(6) Recognition or enforcement may be refused in respect of any UK resolution proceedings in the circumstances set out in BRRD, Art 95. These include circumstances where the college or relevant resolution authority considers that the UK resolution proceedings would have an adverse effect on financial stability in the relevant Member State, if they think independent resolution action is necessary, or that the effects of such recognition or enforcement would be contrary to national law.

(7) The resolution authorities of the Member States concerned will have power to take unilateral action in relation to the branch of the UK institution located in those Member States in the event that there are no applicable resolution proceedings in the UK or, if there are resolution proceedings in the UK, grounds to refuse recognition or enforcement have arisen under Art 95, if certain conditions are met: BRRD, Art 96.

(8) Unless and until an international agreement is negotiated between the Commission and the UK, or if such an agreement (once concluded) does not extend to co-operation with the UK in respect of the matters set out in BRRD, Art 97: BRRD, Art 97(1):

    (a) The EBA may conclude general non-binding co-operation arrangements with the relevant UK authorities, but not so as impose any legal obligations on Member States.

(b) The EBA framework cooperation arrangements, if made, would establish processes and arrangements for sharing information necessary for and cooperation in carrying out various tasks and powers, including the development of resolution plans under UK law, and the application of resolution tools and the exercise of resolution powers exercisable under UK law: BRRD, Art 97(3).

(c) It would be for the competent authorities or resolution authorities of individual Member States themselves to conclude non-binding cooperation arrangements with the relevant UK authorities in line with the EBA framework arrangements. However, this would not prevent any Member State from concluding a bilateral or multilateral arrangement with the UK, in accordance with Regulation (EU) No 1093/2010, Art 33: BRRD, Art 97(4), (5).

(9) Member States will be obliged to ensure that the exchange of confidential information with relevant UK authorities will be subject to strict requirements, the object of which will be to ensure that confidentiality is maintained: BRRD, Art 98.

186. It will be apparent from this summary that there can be no assurance that recognition and enforcement of resolution proceedings relating to a UK institution will be subject to the same regime as that which currently applies, nor that recognition and enforcement (if obtained) would have the universal effect currently required in other EEA States. The absence of certainty is likely to have a material impact on the outcome of any UK resolution proceedings in those cases where the UK institution operates (whether through a branch or subsidiary) in another member State, or has assets, rights or liabilities governed by the law of a Member State, or enforceable in a Member State.

CIWUD: Third Country winding-up proceedings

187. CIWUD makes no provision for the recognition and enforcement in a Member State of winding-up proceedings (widely defined) opened in a Third Country, nor for the prevention of the opening of such proceedings in relation to a branch or subsidiary of a Third Country institution by the administrative or judicial authorities of the host Member State. On the contrary, CIWUD, Art 19 specifically contemplates that the relevant authorities of the host Member State may open winding-up proceedings in relation to a branch of a Third Country institution. A similar position prevails in respect of reorganisation measures (CIWUD, Art 8), albeit this would be supplemented by the BRRD Third Country provisions outlined above.

188. In the context of winding-up proceedings (widely defined to include a CVA or administration) in respect of a UK institution, therefore, recognition would depend on the conflict of laws rules prevailing in the relevant Member State unless that Member State has adopted the UNCITRAL Model Law. As matters stand, only four other Member States have done so (Poland, Greece, Romania and Slovenia).[65] Enforcement will also depend on the conflict of laws rules prevailing in the relevant Member State. Even if the Model Law has otherwise been adopted by that Member State, its provisions do not currently extend to enforcement of judgments and orders made in another state.

VI Post-Brexit: Recognition within the UK of the resolution, reorganisation and winding-up proceedings applicable to EEA institutions

189. The position as it relates to UK institutions, in the event the UK becomes a Third Country for the purposes of CIWUD and BRRD, is to be contrasted with the position as it would relate to banks and credit institutions formed and authorised in other Member States. Whether or not the UK

[65] It is worth noting that, when adopting the UNCITRAL Model Law, countries can exclude credit institutions. Thus, for example, as adopted by the UK, the Model Law does not apply to a proceeding concerning a UK, EEA or Third Country credit institution: CBOR Sch 1, Art 1(2)(h) and (i). It is to be expected that other countries will do the same.

remains an EEA State or qualifies as a Third Country, the 2004 Regulations would continue to apply to any non-UK EEA Institution (unless and until revised, amended or repealed as a piece of domestic legislation). That being so, the position in the UK in respect of such institutions would remain as it is at present, as summarised above.[66]

190. In consequence, there would be a structural imbalance and, depending on what (if any) arrangements are put in place between EEA States and the UK as a Third Country, an absence of reciprocity. Recognition and enforcement in an EEA State of resolution, reorganisation and winding-up proceedings applicable to UK institutions will depend on the conflict of laws rules prevailing in that EEA State. These may not always be clear. Certainly the uniformity and predictability characteristic of the regime put in place by CIWUD and BRRD will be lacking, with potentially serious consequences for the UK institution itself, as well as those likely to be affected if it were to fail.

Customers and Counterparties: the Insolvency Regulations 1346/2000 and 2015/848

Introduction

191. With certain exceptions,[67] the principal piece of legislation likely to govern the insolvency and restructuring of bank customers and counterparties (whether corporate or individual) within the EU is EC Regulation 1346/2000 (the **Insolvency Regulation** or **EIR**). The Insolvency Regulation is shortly to be replaced by Regulation No. 2015/848 (the **Recast Insolvency Regulation** or **RIR**), which will come into force on 26th June 2017. Thereafter, the Insolvency

[66] In addition, assistance would (if necessary) be available in the UK in respect of a credit institution from Ireland or Gibraltar, under s. 426 of the Insolvency Act 1986.

[67] The Insolvency Regulations do not apply to insolvency proceedings concerning insurance undertakings, credit institutions (see section A above), investment undertakings which provide services involving the holding of funds or securities for third parties, or to collective investment undertakings.

Regulation will continue to apply to insolvency proceedings opened before 26th June 2017, while the Recast Insolvency Regulation will apply to insolvency proceedings opened afterwards: RIR, Art 84.

192. The Insolvency Regulations constitute EU legislation which has direct effect in each Member State. For as long as the UK remains a Member State, therefore, the Insolvency Regulations will apply to insolvency proceedings opened in the UK ("UK insolvency proceedings") and will also govern the effect in the UK of insolvency proceedings opened in any other Member State ("EU insolvency proceedings"). What will happen thereafter in respect of UK insolvency proceedings and the effect of EU insolvency proceedings in the UK will depend on the arrangements that may be negotiated and agreed after notice has been given under Article 50. Whatever arrangements may be agreed, the Insolvency Regulations will continue to apply to insolvency proceedings opened in every remaining Member State (except Denmark, which has exercised its right to opt out).

Scope and objectives of the Insolvency Regulations

193. The Insolvency Regulation introduced a coherent set of uniform conflict of laws rules across the EU (except Denmark) regarding jurisdiction to open insolvency proceedings, the law applicable to insolvency proceedings, the recognition and enforcement of judgments arising from such proceedings, and communication and co-operation where insolvency proceedings have been opened in two or more Member States. It is reciprocal in nature: insolvency proceedings opened in the UK are accorded exactly the same respect in other Member States as insolvency proceedings opened in those Member States would be accorded in the UK. Save in certain minor respects, which it is unnecessary to consider here, the Insolvency Regulation does not introduce

uniform rules of substantive law. Having direct effect, it takes precedence over any conflicting provisions of Member States' domestic legislation. It is the most ambitious, advanced and sophisticated arrangement of its kind in the global restructuring world.

194. It is to be compared with the UNCITRAL Model Law. This is a different and more limited framework for cooperation in cross-border insolvencies that has so far been adopted by 41 states across the world[68]. The Model Law differs from the Regulation in the following important respects:

(1) As it currently stands, the Model Law contains no provisions for the enforcement of judgments and orders made in the requesting state.

(2) The Model Law does not provide any set of conflict of laws rules equivalent to that which the Insolvency Regulation provides, and which the Recast Insolvency Regulation will provide in due course.

(3) What the Model Law does is to provide a framework by reference to which a foreign officeholder may seek recognition and assistance from the adopting state, to the courts of which the foreign officeholder will have direct access. The effects of recognition are considered further below.

(4) Although the UK has adopted the Model Law (by the Cross Border Insolvency Regulations 2006[69]), only four other Member States have done so (Poland, Greece, Romania and Slovenia). The vast majority of Member States (23/28) have not.

---

68 See: http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html

69 The CBIR does not apply to the insolvency of banks or EEA insurers (SI 2006/1030, Schedule 1, Article 2(h) to (l)).

195. While the Model Law represents a great advance in cross-border co-operation in the field of insolvency and is undoubtedly useful, therefore, it is (currently) altogether more modest in its objectives than either of the Insolvency Regulations.

Pre-Brexit: the current

Jurisdiction to open insolvency proceedings

196. Under the Insolvency Regulation, jurisdiction to open main (primary) insolvency proceedings is given to the courts of the Member State where the debtor's "centre of main interests" (COMI) is situated (EIR Art 3(1)). The courts of other Member States only have jurisdiction to open insolvency proceedings in respect of the same debtor if it has an "establishment" in that other Member State (EIR Art 3(2)). Such proceedings will be "territorial" or "secondary". If the debtor's COMI is not in a Member State, the Insolvency Regulation does not apply.

Recognition and enforcement of judgment orders

197. The Insolvency Regulation contains provisions for the automatic recognition of judgments and orders made in main and secondary proceedings: EIR, Arts 16, 17 and 25. The nature of the proceedings will determine the geographical reach of their governing law. The essential difference between them is that, while a judgment opening insolvency proceedings in a Member State will be automatically recognised in every other Member State, whether they are main proceedings or secondary proceedings (EIR, Art 16):

(1) a judgment opening main proceedings will generally produce exactly the same effects in every other Member State as it would under the law of the Member State where the proceedings are opened, without further formality;

(2) the only qualification to that general rule is that if secondary proceedings are opened in another Member State, the secondary proceedings in that other Member State will be governed by the insolvency law of that Member State and not the insolvency law of the Member State where main proceedings were opened (EIR Art 17);

(3) conversely, the effects of the secondary proceedings, which will be governed by the law of the Member State where they are opened (EIR Arts 4 and 28), will be restricted to the assets of the debtor located within the territory of that Member State (EIR Arts 3(2) and 27).

198. Automatic recognition is accorded not only to judgments opening insolvency proceedings or which concern the course and closure of those proceedings, but also to judgments deriving directly from the insolvency proceedings and which are closely linked with them (even if handed down by another court), or which relate to preservation measures taken after the request for the opening of insolvency proceedings is made: EIR Art 25.

199. Judgments opening insolvency proceedings, or which concern the course and closure of such proceedings, as well as those which derive directly from the insolvency proceedings and which are closely linked with them (even if handed down by a another court) are to be enforced in accordance with the Recast Judgments Regulation (1215/2012), Arts 39-44 and 47-57: EIR Art 25.

Applicable law

200. The general rule is that the law applicable to insolvency proceedings and their effects is the law of the member state in which the proceedings are commenced (EIR Articles 4(1), 28). The

governing law will thus determine the conditions for the opening of insolvency proceedings, their conduct and their closure, including the particular matters set out in EIR Article 4(2).

201. This is subject to various exceptions (EIR Articles 5 to 15). The exceptions most likely to be of particular relevance in relation to a bank customer/counterparty insolvency are the rules which apply to third parties rights *in rem* (EIR, Article 5); set-off (EIR Article 6); payment systems and financial markets (EIR Article 9); rights subject to registration (EIR Article 11); and the effects of insolvency proceedings on lawsuits pending (EIR Article 15). As to these:

(1) *Rights in rem:* EIR Article 5 provides that rights *in rem* in respect of assets situated outside the Member State in which proceedings are commenced are not affected by the opening of those proceedings. This rule applies to security rights of a proprietary nature, and specifically includes floating charges (Article 5(1)). For example, where main insolvency proceedings are commenced in England (the debtor's COMI being in England), rights *in rem* over property belonging to the debtor which is situated in France will be determined under French law, and will not be affected by English insolvency law. On the other hand, the enforceability of rights *in rem* over property belonging to the debtor which is situated in England will be subject to English insolvency law.

(2) *Set off:* EIR Article 6 provides creditors with a useful alternative route to set-off where this would otherwise be limited or prohibited by the law of the insolvency proceedings. Specifically, where an insolvent debtor has a claim against a creditor, that creditor will be able to demand set-off, where set-off is permitted by the law applicable to the insolvent debtor's claim.

(3) *Payment systems:* EIR Article 9 states that, without prejudice to Article 5, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market.

(4) *Effects on rights subject to registration:* Rights in immoveable property, or immoveable property of significant value such as a ship or an aircraft, are commonly required to be recorded in a public register. EIR Article 11 states that the effects of insolvency proceedings on the rights of the debtor in immoveable property shall be determined by the law of the Member State under whose authority the relevant register is kept.

(5) *Effects of insolvency proceedings on lawsuits pending:* EIR Article 15 provides that the effects of insolvency proceedings on a pending lawsuit which concerns an asset or a right of which the debtor has been divested (ie by virtue the opening of insolvency proceedings) shall be governed by the law of the Member State where the lawsuit is pending. The same applies to pending arbitrations.

The Recast Insolvency Regulation

202. While the Recast Insolvency Regulation will expand the exceptions to the general rule as to applicable law in certain respects, the general rule itself (RIR Article 7) and the substance of the exceptions highlighted above will remain unchanged (RIR, Articles 8, 9, 12, 14 and 18).

Communication and co-operation

203. EIR Article 31 imposes a duty to cooperate and communicate as between liquidators (broadly defined) in circumstances where they have been appointed in main and secondary proceedings

opened in respect of the same debtor in different Member States. These duties will be expanded and extended under the Restated Insolvency Regulation: RIR Articles 41-44.

The impact of Brexit

204. As the Insolvency Regulations have (or will have) direct effect in the UK, it must follow that, unless other arrangements are put in place, when the UK ceases to be a Member State and leaves the EU, they will cease to apply in the UK.

205. In that event, insolvency proceedings opened in the UK, which would currently qualify as main or secondary proceedings, would no longer be entitled to automatic recognition, or enforcement, in other Member States. The same would apply to judgments relating to preservation measures or which derive directly from the insolvency proceedings and which are closely linked with them.

206. In such circumstances, recognition of UK insolvency proceedings in the EU would depend on (a) whether the Model Law has been adopted by the Member State where recognition is sought or (b) the private international rules of that Member State. As already stated, only a handful of other Member States have adopted the Model Law, namely: Greece, Poland, Romania and Slovenia. Further, the Model Law (even where it has been adopted) does not currently provide for the enforcement of judgments and orders made in the requesting state.

207. Similarly, insolvency proceedings opened in any remaining Member State and judgments deriving directly out of or connected with them will not be entitled to automatic recognition or enforcement under the Insolvency Regulations, in the UK.

208. Nevertheless, recognition in the UK of insolvency proceedings opened in a Member State of the EU (but not enforcement of associated judgments and orders) would be available under the Cross

Border Insolvency Regulations 2006, which incorporate the Model Law into UK law. Subject to that, the effects of such proceedings will fall to be determined at common law. As matters stand, only the Republic of Ireland could seek co-operation as a relevant country under section 426 of the Insolvency Act 1986.

The Alternatives

209. The essential problem is one of imbalance. The default position (i.e. where no alternative arrangements are put in place following Brexit) will likely result in greater access to the UK courts being afforded to officeholders in insolvency proceedings commenced in other Member States than would be available to UK officeholders seeking recognition and assistance elsewhere in the EU. As already stated, that is because the UK has adopted the Model Law, whereas the vast majority of other Member States (23/27) have not done so. Where a Member State in which recognition and assistance is sought has not adopted the Model Law, the UK officeholder will be dependent upon the domestic law of that Member State, which is likely to differ from case to case. Uncertainty often means inconvenience, delay and expense, none of which is easily affordable in the insolvency context.

210. Even where recognition and assistance would be available under the Model Law, however, its effects would be by no means as extensive as they would be under the Insolvency Regulations. That is because, as already noted, the Model Law contains no equivalent set of the conflict of laws rules currently to be found in the Insolvency Regulation, which (with certain exceptions) give primacy to the law of the state of the opening of insolvency proceedings. What it does instead is provide a framework by reference to which a foreign officeholder may seek recognition and assistance from the adopting State, to the courts of which the foreign officeholder will have

direct access. Recognition depends on satisfaction of a number of specified conditions (Arts 15, 16 and 17), and will result in an automatic moratorium (Art 20); the grant of other relief is discretionary (Art 21), as is the relief which is available as soon as an application for recognition is filed (Art 19). Although undoubtedly useful, the Model Law is altogether more modest in its objectives than the Insolvency Regulations.

211. As an alternative, the UK could seek to preserve the substance of the Insolvency Regulation by incorporating its provisions into domestic law, for instance as part of the so-called "Great Repeal Act". However, taken by itself, this would have an asymmetric effect. It would mean that there would be no change in the effect that insolvency proceedings opened in Member States would have in the UK. While that would give debtors, creditors and officeholders from other Member States certainty as to their position in the UK in respect of insolvency proceedings opened in those Member States (recognition, applicable law etc), however, it would not address issues relating to the recognition and effect in other Member States of insolvency proceedings opened in the UK. In the absence of reciprocity, for which domestic UK legislation could make no provision, the problem of imbalance would, if anything, be exacerbated.

212. If the substance of the Insolvency Regulations is to be retained, therefore, it would be necessary for the UK to seek to conclude a bilateral or multilateral arrangement (presumably in the form of a treaty) with the EU or with individual Member States. However, the agreement of the remaining Member States would be required. Whether the UK would be continue to have influence over any future changes to the EU cross-border insolvency regime as it applies between remaining Member States is, at best, uncertain.

213. A final possible (albeit frankly optimistic) alternative would be for an arrangement to be negotiated and agreed between the UK and remaining Member States which builds on, as well as replaces, the Insolvency Regulations. Whether there is any appetite, even assuming there is capacity, for the adoption of such a course is, at best, uncertain.

Schemes of Arrangement

214. Schemes of Arrangement under the Companies Act 2006 are not within the scope of the EIR. Moreover, the jurisdiction of the English court to sanction a scheme of arrangement for a foreign company is primarily based in the common law. The recast Judgments Regulation (EU 1215/2012) creates a potential hurdle to the English court's jurisdiction to sanction a scheme of arrangement, but (a) it has not so far been definitively decided that it applies to a scheme of arrangement at all, and (b) in any event, on the assumption that it does, the courts have invariably easily concluded that its requirements are met (see, for example, *Re Global Garden Products Italy S.p.A.* [2016] EWHC 1884). Accordingly, even if the UK ceased to be party to the recast Judgments Regulation, it is unlikely to impact negatively on the jurisdiction of the UK court to sanction a scheme of arrangement for a foreign company.

215. It is likely that, if similar arrangements were not put in place following Brexit, however, this would have a serious and potentially negative impact on the ability to persuade the UK court to exercise its *discretion* to sanction a scheme of arrangement for a foreign company either incorporated in or having substantial assets in an EU Member State. This could in turn have serious implications for the restructuring market in London.

216. That is because in order to obtain the English court's sanction of a scheme of arrangement in relation to a foreign company, the court requires evidence of its effectiveness abroad (in the place

of incorporation and/or in the jurisdiction(s) where its assets are located). To date, in relation to EU Member States, this has been achieved by adducing expert evidence from a lawyer from the relevant Member State to the effect that the scheme would be recognised by virtue of the recast Judgments Regulation. If the UK ceased to be party to the recast Judgments Regulation, then this route to recognition would likely be lost. As a result, the question whether a scheme of arrangement would be recognised abroad in a particular Member State would depend upon the conflict of law rules of that Member State. Obtaining convincing evidence of this may be challenging.

Brexit and Financial Collateral Arrangements

217. The Financial Collateral Directive, 2002/47/EC, (**FCD**) and the Financial Collateral Arrangements (No.2) Regulations 2003, SI 2003/3226 (as amended) (**FCAR**) are considered (primarily in relation to their impact on netting arrangements) in the section above on Netting and Set-off. The impact of Brexit on the aspects of the FCD and FCAR of particular relevance to insolvency proceedings is considered briefly in the following paragraphs.

218. The FCAR dis-apply, in relation to certain security arrangements over financial collateral (as defined in the FCAR) aspects of UK Insolvency Law, for example, restrictions on enforcement of security in the context of administration and s.127 of the IA 1986 (avoidance of property dispositions). They also dis-apply requirements as to formalities and registration, and create an additional remedy (appropriation) for enforcement of security over financial collateral.

219. The FCD is part of a wider European initiative with the objectives of creating efficiency and reducing systemic risk in the financial markets. It builds, in particular, on Directive 98/26/EC

on settlement finality in payment and securities settlement systems. Those objectives remain equally important whether or not the UK is part of Europe.

220. The continued application of the FCAR is but one aspect of achieving this wider objective, and needs to be undertaken in conjunction with a wholesale review of European legislation concerning the financial markets.

221. Brexit would not have any immediate impact on the FCAR (assuming that the proposed Great Repeal Act retains statutory instruments that currently derive their authority from the ECA 1972). Once de-coupled from its European origin, there will be some uncertainty as to the process for interpreting the FCAR. At present, its provisions are said to have an autonomous meaning, and thus are to be interpreted by reference to the meaning of the provisions in the FCD, as guided by European legislative and pre-legislative materials. It would be preferable that the required interpretative process going forward is identified by parliament, rather than being left to the Judges to work out.

Anti-Money Laundering Regime and Financial Crime

Summary

222. So far as the anti-money laundering regime is concerned, the overall picture post-Brexit is likely to be one of continuity rather than change. Whilst derived from EU directives, the core pillars of the UK's Anti-Money Laundering regime are contained in UK primary and secondary legislation; as such, the legislative framework will remain substantially unaffected by Brexit in the immediate term. On a longer term horizon, there is the possibility of the UK and the EU developing divergent anti-money laundering standards. Whilst certain differences can be expected to develop over time, it is highly unlikely that the UK will seek to relax its anti-money laundering standards in any material respects given the UK's long-standing commitment to combating financial crime.

223. Greater uncertainty attaches to the financial sanctions regime. The EU sanctions regime has been a key pillar of the sanctions regime in force in the UK. Brexit will therefore leave a significant gap and the UK will need to decide whether it continues to adopt the EU sanctions measures or chooses to go its own way relying upon autonomous UK sanctions.

The existing Anti-Money Laundering framework

224. The principal framework by which the UK's anti-money laundering (**AML**) legislation is currently comprised is essentially as follows:

(1) The *Proceeds of Crime Act 2002* (**POCA**) creates the principal money laundering offences and sets out confiscation powers in respect of criminal proceeds.

(2) The *Money Laundering Regulations 2007* (the **2007 Regulations**) are regulations passed by statutory instrument which impose "know your customer" and various compliance/reporting obligations on financial institutions and other regulated persons.

225. So far as the relationship between that framework and EU law is concerned:

(1) POCA originates from two EU Directives: the First Money Laundering Directive (1991) and the Second Money Laundering Directive (2001).

(2) The 2007 Regulations[70] implement the Third Money Laundering EU Directive (just as the 2003 Regulations had implemented the Second Directive).

(3) Accordingly, the three EU Money Laundering Directives have been enacted into UK law under both primary and secondary legislation. It should be noted that the EU Directives do not have direct effect; they need to be transposed into national law.

(4) An important point to note is that in enacting POCA, Parliament chose to provide for a more stringent regime than that required by the 2001 Directive. Under the 2001 Directive, money laundering was defined *inter alia* as intentional conduct of various types in respect of property *known* to be derived from criminal activity. In contrast, however, POCA gave a significantly more extended definition to money laundering so that it embraced property known *or suspected* to constitute a benefit from criminal activity.[71]

---

70 Together with the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Amendment) Regulations 2007, which amend the Terrorism Act 2000 and the Proceeds of Crime Act 2002 to update the system for members of the regulated financial sector to disclose suspicions of money laundering or terrorist financing to the Serious Organised Crime Agency.

71 POCA section 340(3). See *Bowman v Fels* [2005] 4 All ER 609 at paragraphs 47-51 for fuller consideration of this point.

226. Complementary to the measures set out above is Regulation (EC) 1889/2005 (concerning declaration of sums of cash over €10,000 by persons entering or leaving the EU) and Regulation (EC) 1781/2006, the *Fund Transfer Regulation* (**FTR**, also known as the Wire Transfer Regulation or the Payment Regulation).[72] Unlike the EU directives referred to above, these are EU regulations which have direct effect. However, certain matters require transposition into UK law which is achieved by way of the Transfer of Funds (Information on the Payer) Regulations 2007.[73] The FTR is designed to ensure traceability of payment; the regulation imposes identification and verification requirements on payers and payment service providers.[74]

Looking ahead to June 2017: the Fourth Money Laundering Directive

227. The Fourth EU Money Laundering Directive was published in June 2015. Member states have until June 2017 to transpose its requirements into national law. There is also a new EU Fund Transfer Regulation which comes into force in June 2017 (Regulation 2015/847).

228. The UK will on any view remain within the EU in June 2017. This means that the UK will be required to enact the Fourth Money Laundering Directive into national law by that date. The referendum result will have no impact on that. HM Treasury put out a consultation paper in September 2016 which confirms that the Government proposes to pass Money Laundering and Transfer of Funds (Information on the Payer) Regulations in 2017 in order to transpose both the

---

72 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:345:0001:0009:EN:PDF

73 http://www.legislation.gov.uk/uksi/2007/3298/pdfs/uksi_20073298_en.pdf

74 See the UK National Risk Assessment at para 2.8 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf

Fourth Directive and certain aspects of the new FTR that need to be transposed into national law.[75]

The impact of Brexit on the AML regime

Immediate gaps in the law

229. The main pillars of the AML regime are contained in POCA and the 2007 Regulations; this is self-standing UK primary/secondary legislation. Whilst that legislation is ultimately derived from EU law, Brexit will have no effect on its efficacy. (That said, as with all such legislation, in interpreting POCA and the Regulations, there will be a more general question as to the extent to which that legislation falls to be interpreted in the light of the wording and purpose of the EU directive to which it gives effect.[76])

230. However, one point which needs attention relates to the Fund Transfer Regulation (or FTR). As noted above, there is a new FTR which comes into force in June 2017. Subject to certain points which in any event need to be transposed into national law (as noted above), the FTR (both in its current and new forms) is a directly effective regulation. As such, the FTR will need to be incorporated into national law if it is intended that its provisions should apply post-Brexit.

[75] https://www.gov.uk/government/consultations/transposition-of-the-fourth-money-laundering-directive

[76] See for example *Bowman v Fels* paragraph 44

Future direction of UK AML measures

231. Post-Brexit, there is of course a possibility of the UK and the EU developing divergent AML standards. However, it seems highly improbable that the UK will wish to relax its AML measures in material respects:

(1) The UK legislative framework is currently more stringent than the requirements under the EU directives as mentioned above. Having "gold-plated" the minimum requirements under the EU directives, it is unlikely that the UK will now choose to fall below the EU standards.

(2) The UK published an Action Plan for anti-money laundering and counter-terrorist finance, in April 2016,[77] and, following a consequent consultation on anti-money laundering and counter-terrorist finance,[78] a Criminal Finances Bill 2016-2017[79] has also been presented to the House of Commons,[80] with the stated aim of further improving the AML, corruption and counter terrorist financing regimes.[81]

(3) The UK has introduced the "People with Significant Control" regime and has committed to establishing a public register of company beneficial ownership for foreign companies

---

77 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517992/6-2118-Action_Plan_for_Anti-Money_Laundering__web_.pdf

78 See the response to consultation on legislative proposals, October 2016, at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559957/Action_Plan_for_anti_money-laundering_and_counter-terrorist_finance_-_consultation_on_legislative_proposals.pdf

79 introduced to the House of Commons on 13 October 2016

80 As at the time of writing the Bill is at the Committee Stage.

81 https://www.gov.uk/government/collections/criminal-finances-bill

who own/buy property in the UK.[82] There is a strong political will to combating corruption and financial crime.[83]

232. The UK will also remain a member of or signatory to the following post-Brexit:

(1) The UK will remain a member of the Financial Action Task Force (**FATF**), an inter-governmental organisation under the auspices of the OECD which issues recommendations to governments. Whilst the UK legislation derives from the EU directives referred to above, those EU directives have themselves largely been based on the FATF recommendations (the European Commission is independently a member of FATF). Therefore, the FATF standards will continue to flow through to future UK legislation post-Brexit. There will be an evaluation of UK compliance with FATF recommendations in 2018.

(2) Mention should also be made of Council of Europe Conventions. The UK is a member of the Council of Europe. The UK has been a signatory to many of the Council's Conventions, including the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (1990, ratified by the UK on 28 September 1992), and the more recent Convention on Money Laundering and Terrorist Financing (ratified by the UK on 27 April 2015). The Council of Europe has, due to the overlap in membership between the Council and the EU, a largely diminished role, with overlapping EU legislation (and the domestic implementation thereof) generally fulfilling co-existent obligations under

[82] See consultation paper at para 10.3 https://www.gov.uk/government/consultations/transposition-of-the-fourth-money-laundering-directive

[83] See also the

Council Conventions. Following Brexit the UK will need to ensure that its obligations under Council Conventions are, or will be, met by domestic legislation.

233. Thus, the UK's continued membership of FATF and the Council of Europe are further reasons to suggest that there is unlikely to be substantial divergence between the EU and UK AML regimes post-Brexit.

234. That said, the Government (as part of its 'Cutting Red Tape Programme') is currently undertaking a review to identify any aspects of the AML regime which could be made more efficient.[84] The dual policy aims are to ensure that the AML regime is both effective and proportionate. A Government report following a call for evidence is currently awaited.

Cross-border intelligence sharing and law enforcement

235. At present, intelligence sharing between national financial intelligence units (**FIUs**) is organised by the Egmont Group; this is a worldwide network comprising 151 members. Brexit will have no impact on this network.

236. The UK's Action Plan[85] for anti-money laundering and counter-terrorist finance noted that there is: "*A lack of consistency in the legal and regulatory frameworks that govern information sharing creates vulnerabilities for private sector firms*." The Action Plan sets out that the UK will work with international groups, such as the G20 and FATF to promote better and more effective

[84] https://cutting-red-tape.cabinetoffice.gov.uk/anti-money-laundering/

[85] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517992/6-2118-Action_Plan_for_Anti-Money_Laundering__web_.pdf, para 2.53.

international information sharing on money launderers between Governments. Brexit would not appear to directly impact this work.

237. However, there is also cooperation at the EU level. For example, there is cooperation between the FIUs of EU member states[86] and there also EU-wide measures to facilitate enforcement and confiscation. In December 2014 the UK implemented EU measures (the Criminal Justice and Data Protection Regulations 2014) to enable the mutual recognition of freezing and confiscation orders made by the courts in EU member states. This should enable faster and more effective cooperation on the recovery of proceeds of crime, as the measures significantly reduce the grounds on which requested states can refuse to cooperate, set short time limits for orders to be brought before the courts.[87] The Government will no doubt be keen to ensure that cooperation between the UK and EU member states over intelligence sharing and law enforcement continues post-Brexit.

International co-operation in setting AML standards

238. As noted above, the UK is a member of the FATF. However, there is also cooperation at the EU level:[88]

(1) Expert Group on Money Laundering and Terrorist Financing: meets regularly to share views and help the Commission define policy and draft new legislation.

---

86 See for example: http://ec.europa.eu/justice/criminal/document/files/aml-factsheet_en.pdf

87 National Risk Assessment para 10.15

88 http://ec.europa.eu/justice/civil/financial-crime/index_en.htm

(2) Committee on the Prevention of Money Laundering and Terrorist Financing: may also be convened to give its opinion on implementing measures put forward by the Commission.

(3) The European Commission takes part in the informal network of Financial Intelligence Units (the EU FIUs Platform).

(4) The Joint Committee of European Supervisory Authorities works on measures to combat money laundering.

239. In a post-Brexit world, one can expect that it will be more difficult for the UK to participate in and contribute to policy development and standard setting at a European level.

Other aspects of financial crime

Counter-terrorist financing

240. Counter-terrorist financing measures emanate from a combination of: the EU Money Laundering Directives; UN Sanctions; specific inter-government groups[89]; and national legislation (Terrorism Act 2000 (Part 3) and POCA, in addition to the Action Plan and proposed Criminal Finances Bill 2016-2017). Similar considerations arise in relation to the CTF regime as are addressed above in relation to the AML regime.

241. The EU Commission published a new Terrorist Finance Action Plan on 2 February 2016. In its April 2016 Action Plan,[90] the UK stated that it welcomed the Action Plan and will continue to engage at EU level to help prevent and disrupt terrorist financing in a way that complements the

---

89 For example, the UK is a member of the Counter ISIL Finance Group and works within the group to ensure closer and more effective working with international partners to degrade Daesh finances.

90 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517992/6-2118-Action_Plan_for_Anti-Money_Laundering__web_.pdf, at para 2.56

UK's domestic counter-terrorist finance regime. Whilst one can expect that the manner of engagement with the EU may well change following Brexit, the UK will no doubt look to ensure that it continues engagement all international partners, including the EU, in this area.

Sanctions regime

242. The current sanctions regime implemented by the UK derives from:[91]

(1) UN Sanctions, implemented by way of a Resolution of the UN Security Council. These are directly binding on UN member states.[92]

(2) EU Sanctions. The EU implements financial sanctions imposed by the UN, interposing itself between the UN, and UN members states who are also EU member states. The EU also implements EU autonomous financial sanctions and EU additions to UN sanctions.[93] All sanctions are implemented through EU regulations, having direct legal effect in the UK.

(3) The UK makes statutory instruments to provide for the penalties for any breach of EU sanctions and for the provision and use of information relating to the operation of those sanctions.

---

91 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/513838/OFSI_Financial_Sanctions_-_Guidance_-_April_2016_Final.pdf

92 pursuant to Article 25 of the UN Charter.

93 See https://europeansanctions.files.wordpress.com/2013/03/eu-recommendations-for-working-methods-2011.pdf For an example of EU additions to UN sanctions, see the EU sanctions against Iran (addition of further designated individuals and legal entities to those specified by the UN Security Council Sanctions Committee). For an example of EU autonomous sanctions, see the EU sanctions against Russia relating to Russia's actions in Ukraine.

(4) The UK may also issue its own domestic financial sanctions and restrictions under a number of pieces of domestic legislation (Terrorist Asset Freezing etc. Act 2010, Counter Terrorism Act 2008, Anti-Terrorism, Crime and Security Act 2001).

243. Following Brexit, whilst UN sanctions will continue to be implemented in the UK and whilst the UK will continue to have its own domestic powers under the above mentioned legislation, the UK will of course no longer be bound by the EU sanctions regime. The EU sanctions regime has in recent years supplied the bedrock of the international sanctions regime applicable in the UK, especially in relation to targeted sanctions (e.g. in respect of Iran and Russia). Brexit will therefore leave gaps in the sanctions regime which the UK will need to act on. This will be the case where, for example, the UN sanction does not specify listed individuals,[94] but rather stipulates only the class of persons to whom the sanctions are to be applied and leaves member states to decide which persons and entities fall within the class identified by the sanction.[95] Where this has been the case, EU sanctions have provided the list of designated targets for its member states.[96] The removal of the interposed EU in this scenario will leave the UK to identify and maintain a blacklist. EU sanctions have also extended considerably beyond UN sanctions. In respect of EU additions to UN sanctions and EU autonomous sanctions, post-Brexit, the UK could decide to follow the EU and/or increase its own autonomous sanctions powers.[97] The UK will also need to consider how it manages information sharing about sanctions compliance within the EU, where such information sharing is prescribed within the EU sanctions themselves.

---

94 Such as the 1267/1989/2253 sanctions regime, which stipulates a 'blacklist' of individuals, maintained by the UN 1267/1989/2253 Sanctions Committee.

95 Such as UN Resolution 1373 (2001).

96 In the case of UN Resolution 1373 (2001), see Regulation 2580/2001.

97 See Maya Lester QC's blog post at https://europeansanctions.com/2016/06/24/uk-sanctions-post-brexit/

Conclusions

244. Since the key pillars of the AML regime are contained in UK primary and secondary legislation, there are not expected to be any material "gaps in the law" as a result of Brexit (subject to the point addressed above relating to the Fund Transfer Regulation). On a longer term horizon, whilst there will be scope for a degree of divergence between the UK and EU AML regimes, it is highly unlikely that the UK will wish to relax its AML standards in any material respect. The position as regards cross-border intelligence cooperation and policy development is more uncertain post-Brexit as explained above. The real uncertainty lies in relation to financial sanctions, however. Following Brexit, the UK will need to decide whether it continues to adopt the EU sanctions regime or chooses to develop a different path relying upon autonomous UK measures.

CONSUMER PROTECTION: CONSUMER CREDIT AND UNFAIR CONTRACT TERMS

Introduction

245. Consumer rights are protected, in EU law, by a number of directives (and some regulations)[98]. These include, *inter alia*, directives governing the provision of consumer credit[99], the regulation of unfair terms in consumer contracts[100], distance selling and contract information[101], unfair business practices,[102] and conformity of goods sold with the contract[103]. The EU framework seeks, to different extents, to harmonise consumer protection law across member states.

246. The EU framework has been implemented in UK law, most recently by the Consumer Rights Act 2015 (**CRA**). The CRA introduced following an extensive consultation process and in line with advice to the Department for Business, Innovation and Skills from the Law Commission (the **Advice**)[104]. It was intended to streamline, clarify and modernise consumer protection in the UK[105]. The CRA does not, however, replace all UK consumer protection law, which remains split over a number of primary and secondary legislative enactments[106].

---

98 For a helpful overview, see *Chitty on Contracts*, 32nd ed, chapter 38, paragraphs 001 to 026.

99 Directive 2008/48/EC of 23 April 2008 on credit agreements for consumers

100 Directive 93/13/EEC of 5 April 1999 on unfair terms in consumer contracts

101 Directive 2011/83/EU of 25 October 2011 on consumer rights (the "Consumer Rights Directive")

102 Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market (the "Unfair Commercial Practices Directive").

103 Directive 1994/44/EC of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees.

104 Law Commission Advice to the Department for Business, Innovation and Skills on Unfair Terms in Consumer Contracts, March 2013 ("Advice").

105 See p. 6 of the Consumer Rights Bill: Statement on Policy Reform and Responses to Pre-Legislative Scrutiny, January 2014.

106 For example, the UK implemented the Consumer Rights Directive by way of freestanding secondary legislation, the 2013 (Information, Cancellation and Additional Charges) Regulations 2013. Similarly, the Unfair Commercial Practices directive has been implemented by the freestanding Unfair Trading Regulations 2008 (as amended). Special rules also govern consumer contracts of insurance: see the Consumer Insurance (Disclosure and Representations) Act 2012 and Insurance Act 2015.

247. The discussion in this section does not seek to provide a comprehensive analysis of the potential impact of Brexit on consumer rights protections. Rather, it seeks to focus on two particular areas of consumer rights protection which, in the experience of COMBAR's members, most frequently give rise to banking-related litigation in the Courts. These are the issues of: (i) consumer protection from unfair contract terms and (ii) consumer credit, which are discussed further below.

248. More generally, there may well be scope following Brexit to simplify and consolidate the entire existing framework of consumer protection legislation, so as to build a streamlined, clear and UK-specific consumer protection framework. Consideration of this (important) topic goes beyond COMBAR's scope of expertise and so this is not addressed in this section.

Unfair Terms

The existing unfair contract terms framework and its relationship with EU law

249. Consumers are protected from unfair contract terms by Part 2 of the CRA. The CRA replaced the 1999 Unfair Terms in Consumer Contract Regulations (**UTCCRs**) which implemented EC Directive 93/13/EEC of 5 April 1999 on unfair terms in consumer contracts (the **Directive**).

250. The Directive provides, essentially, that a contractual term which has not been individually negotiated will be unfair if, "*contrary to the requirement of good faith*", it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer (Art 3(1)) (the "test for fairness"). A term which fails the test for fairness will not bind the consumer (Art 6(1)). A term which defines the main subject matter of the contract or relates to the adequacy of the price or remuneration is excluded from the test for fairness (Art 4(2)). The Annex to the Directive contains a non-exhaustive "grey list" of terms which may be unfair.

251. The CJEU has now given detailed (and currently binding) guidance on the interpretation of the test for fairness in the 2013 case of *Aziz v Caixa d'Estalvis de Catalunya* (C-415/11) [2013] 3 CMLR 891[107] at paras [64]-[71]):

(a) The question of whether there is a "significant imbalance" in the parties' rights depends mainly on whether the consumer is being deprived of an advantage he would enjoy under national law in the absence of a contractual provision; and

(b) For the purposes of assessing whether a provision is contrary to the requirements of good faith, the Court must consider objectively whether the seller, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations.

252. The Directive (and the UTCCRs which previously implemented the Directive in the UK) is drafted in wide and general language which has led to many difficulties of interpretation. For example:

(1) The test for fairness itself, as laid down in Art. 3, is formulated in vague terms which have recently described as "*rather opaque*" by Lord Neuberger of Abbotsbury PSC[108]. There have been differences of opinion in the Courts as to how it should be interpreted and

---

[107] This case was recently applied by the UK Supreme Court in a case concerning the UTCCRs and said to be the leading authority: see *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2015] 3 WLR 1373 at [105]. The test for fairness was further considered by the CJEU in *Constructora Principado SA v Menendez Alvarez* (C-226/12) which clarified, essentially, that a "significant imbalance" does not have to mean a significant economic impact, but can mean a serious impairment of his legal rights enjoyed under national law.

[108] *Cavendish v Makdessi*, ibid, at [105]

applied[109]. The test for fairness also imports autonomous European concepts such as "good faith" which are (relatively) unfamiliar to English common law.

(2) The carve-out from the test for fairness of terms which relate to the adequacy of the price and remuneration (Art 4(2) (the "Art 4(2) carve-out")) has proved highly problematic[110]. Differing views have expressed by the UK House of Lords and Supreme Court[111] and by the CJEU, which itself has needed to consider the Art 4(2) carve-out on six different occasions resulting in detailed and complex guidance on the subject[112].

253. Part 2 of the CRA essentially implements the Directive. In particular, section 62 CRA applies the same test for fairness and provides that unfair terms are not binding on the consumer. There are however some important differences:

(1) First, the Directive only applies to contractual terms which have not been individually negotiated (Art. 3(1)). The CRA applies the test for fairness to all "consumer contracts" (as defined in section 61(1)[113]) not merely to terms which have not been individually negotiated[114].

---

109 See footnote [14] below

110 Law Commission, Advice, S.6

111 *Director General of Fair Trading v First National Bank Plc* [2002] 1 AC 481 (HL), *OFT v Abbey National Plc* [2010] 1 AC 696 (SC)

112 *Caja de Ahorros* (C-484/08) [2010] 3 C.M.L.R. 43; *Pohotovost* (C-76/10); Nemzeti (C-472/10); *Kasler* (C-26/13); *Matei* (C-143/13); *Van Hove* (C-96/14)

113 And also, by section 61(4), to a notice which relates to rights and obligations as between a trader and consumer or which purports to exclude or restrict a trader's liability to a consumer.

114 Schedule 4 of the CRA also made amendments to the Unfair Contract Terms Act 1977 ("UCTA") which have the effect that UCTA no longer governs consumer contracts, which are now exclusively governed by the CRA.

(2) Second, the CRA adopts a more expansive definition of consumer than the Directive (contrast CRA section 2(3) with Art. 2(b)[115]).

(3) Third, the Directive excludes contract terms from being assessed for unfairness if they relate to the main subject matter of the contract or the adequacy of the price and remuneration – insofar as such terms are "in plain intelligible language". The CRA, again, is more stringent. Under section 64 CRA, such terms are only excluded from assessment for unfairness if they are both "transparent" and "prominent"[116]. The objective is to stop important terms being buried in small print[117].

(4) Fourth, the "grey list" of indicative unfair terms in the CRA contains a number of additional provisions which do not appear in the Directive[118].

(5) Fifth, some modifications have been made to the language of the Directive in the CRA. This has been done with a view to improving clarity and making the Directive easier to apply and interpret. In particular, the Art 4(2) carve-out, which the Law Commission has described as "*particularly difficult to interpret*"[119] has been reformulated using clearer language, see CRA section 64(1)(b).[120]

---

115 Art 2(b) of the Directive defines consumers as natural persons acting for purposes outside their trade, business or profession, but section 2(3) of the CRA defines consumers as individuals acting for purposes "*wholly or mainly*" outside their trade, business, craft or profession.

116 I.e., it is brought to the consumer's attention in such a way that the "average consumer" would be aware of the term: see CRA section 64(4)-(5).

117 See pp. 59-60 of the Consumer Rights Bill: Statement on Policy Reform and Responses to Pre-Legislative Scrutiny, January 2014.

118 Terms 5, 12 and 15

119 Advice, S.6

120 Whereas Art 4(2) excludes from the test for fairness terms "*which relate to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplies in exchange, on the other*", CRA section 64(1)(a) excludes terms from the test for fairness only where the "*assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it*".

Issues with the existing framework

254. Notwithstanding the work done in the CRA to improve the language of the Directive, there may remain scope for further enhancement, clarification and improvement:

(1) The CRA (necessarily) implements the test for fairness using the language of the Directive. The test for fairness therefore remains somewhat vague and opaque.

(2) It may be questioned whether the CJEU's guidance on the test for fairness in *Aziz*, which focuses principally on whether the consumer would have agreed to the term and whether the term deprives the consumer of an advantage enjoyed under national law, is the most apposite way of approaching the test for fairness. It might be regarded as somewhat formalistic and narrow in its approach[121].

(3) The CRA implements and/or draws on a number of autonomous European law concepts, in particular, good faith (section 62(4)), the concept of the "average consumer" (section 64(4)) and the requirement of "transparency" (section 68(1)). These concepts are somewhat nebulous, unfamiliar to English common law and have required detailed elucidation by the CJEU[122].

---

121 Contrast the inclusive and multi-factorial approach taken by the House of Lords in *Director General of Fair Trading v First National Bank plc* [2002] 1 AC 481 (HL) per Lord Bingham at [17], with the more formalistic approach taken by the CJEU in *Aziz* and *Menendez*.

122 Good faith. The autonomous European law meaning of good faith, as referred to in the existing test for fairness, essentially requires the Court to have regard to all the circumstances: see recital 16 of the Directive; *Chitty* 38-246, 253. This concept is arguably otiose in any event, since, reflecting Art 4(1) of the Directive, section 62(7)(b) CRA requires the Court to have regard to all the circumstances in any event.
Average consumer. As explained in *Chitty* at 38-041, the "average consumer" is a concept derived from EU legislation and case law. Section 64(5) CRA defines the "average consumer", in line with such EU legislation and case-law, as a "*consumer who is reasonably well-informed, observant and circumspect*". However, an "average consumer" may not necessarily have these characteristics. Moreover, the test may not always be an apposite one in any event, since some consumers may be more vulnerable than average and some more sophisticated.

255. Although the Art 4(2) carve-out has been clarified to some extent in the CRA as discussed above, this carve-out may still prove difficult to apply in practice.

The impact of Brexit

256. It seems unlikely that Parliament would want to scale back or reduce the level of consumer protection from unfair terms. Moreover, as noted above, UK law on consumer protection from unfair terms has been very recently revised in the form of the CRA, following extensive consultation and Law Commission advice. For these reasons, it is to be anticipated that there will be limited appetite in the short term for further revisions to the existing framework of consumer protection from unfair contract terms.

257. Having said that, in the longer term, Parliament may take the view that, once it is no longer obliged to implement the Directive, there may be scope for reconsidering the framework for consumer protection from unfair contract terms. Parliament may wish to take a fresh look at the law. It will no longer be obliged to implement the Directive and therefore could seek to formulate a framework that is more straightforward to apply, is drafted in clearer terms that makes use of English common law concepts, and which is specifically designed to meet the specific concerns and exigencies of UK consumers.

Transparency. As regards "transparency", section 68(1) CRA imports the European law requirement that contract terms need to be "transparent", but this is does not mean "transparent" in its ordinary English usage (i.e., see-through). Rather, it has an autonomous European law meaning, essentially, that the term must not only be grammatically intelligible but also that the consumer can understand its practical significance (see *Kasler v OTP Jelzalogbank Zrt* (C-26/13) at [71]-[75]). Section 64(3) CRA explains that the requirement for transparency in a contractual term is met if the notice is "*expressed in plain and intelligible language and (in the case of a written term)… legible*".

Consumer Credit

The existing consumer credit framework and its relationship with EU law

258. The law of consumer credit[123] is regulated primarily through (i) the Consumer Credit Act 1974 (**CCA 1974**); (ii) the Financial Services and Markets Act 2000 and (iii) the Financial Services Act 2012, part 9

259. The consumer credit regime created under the CCA 1974 was subject to significant modification as a result of Directive 2008/48/EC on credit agreements for consumers (the **Directive**). The Directive resulted in the creation of a two-fold consumer credit regime in the UK: agreements with individuals for credit not exceeding £60,260 fall within the scope of the Directive, whereas agreements with individuals for credit exceeding £60,260 remain governed by CCA 1974. The Directive was implemented in the UK by a series of regulations – namely the Consumer Credit (EU Directive) Regulations 2010; Consumer Credit (Total Charge for Credit) Regulations 2010; Consumer Credit (Disclosure of Information) Regulations 2010; Consumer Credit (Agreements) Regulations 2010; Consumer Credit (Advertisements) Regulations 2010; Consumer Credit (Amendment) Regulations 2010; and Consumer Credit (Amendment) Regulations 2011 – each of which came into force on or around 1st February 2011 and which together create a wide-ranging series of consumer protections.

---

[123] This description excludes regulated mortgage contracts, regulated home purchase plans and certain other low cost and exempt transactions: see R Goode *Consumer Credit Law and Practice* (Lexis Nexis Butterworths; looseleaf, updated April 2016).

The impact of Brexit

260. The Directive and the regulations listed above form a large and complex body of law and a detailed summary or analysis of its provisions falls outside of the scope of this report. There are nonetheless two high-level comments to be made about consumer credit law and the possible impact of Brexit.

261. First, the Directive has already been transposed into UK law. As free-standing primary and secondary legislation, the CCA 1974 and associated regulations will remain effective following Brexit.[124] There is therefore no short term need for Parliament to turn its attention to consumer credit law: the current regime provides a high level of consumer protection.

262. Second, Brexit will provide Parliament with the opportunity to review the regulation of consumer credit and, where appropriate, to re-mould the current position to better reflect the forms of consumer credit found commonly in England but less commonly in continental European jurisdictions. By way of example, s66A Consumer Credit Act 1974 (introduced by the Consumer Credit (EU Directive Regulations) 2010, regulation 13) provides a general right of withdrawal from all regulated credit agreements which may be exercised, subject to some exceptions, within 14 days of entry into the agreement. In such cases the agreement shall be treated as if it had never been entered into. This right, however, poses significant difficulties in cases of hire-purchase agreements because the structure of the agreement necessitates that withdrawal operates as a

[124] Although necessarily some questions may arise as to the interpretation of the regulations and relevant provisions of the CCA 1974 if they do not fall to be interpreted in light of the Directive.

forced sale to the creditor.[125] This applies similarly to cases of conditional sale or credit sale agreement.

263. That said, for the reasons given above, this is unlikely to be a priority for legal reform in the immediate aftermath of Brexit.

[125] This is because the creditor has not received a loan of money that can readily be returned, but in has received the goods themselves on credit. On withdrawal, then, that 'credit' is no longer extended and the creditor must pay the balance of the cash price of the goods. Section 66A(11) provides in such circumstances that the creditor will receive title to the goods should he pay the price in full.