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THE IMPLICATION OF BREXIT ON THE FINANCIAL MARKET OF THE EUROPEAN UNION AND ITS REGULATION – LEGAL AND INSTITUTIONAL ASPECTS

Abstract: The article tackles the topic of the impact of *Brexit* on the EU financial market. The most important changes are identified and analyzed. Among the different types of implications, the author discusses those which are important for the shape of the EU financial market. The article identifies all crucial changes in EU law regulating the financial market among all the effects of *Brexit* in EU law. The article contains an analysis of the single passport rule in the context of *Brexit* and the usability of the equivalency mechanism in this context. The changes in BMR and EMIR caused by *Brexit* are also analyzed.

Keywords: *Brexit*, financial markets, EU law, ESMA, equivalency third-country regime

1. Introduction

From 29 March 2017 – the date of the official notification under Article 50 TEU – the process of the United Kingdom (UK) leaving the European Union (EU) began. This process took more than three years, until the end of the transition period on 31 December 2020. The process included long and intensive negotiations between the EU and the UK on the rules of the withdrawal by the UK from the EU, the future relations between the UK and

the EU, the changes in EU law and UK law and also different activities on the EU level and on the level of the Member States to prepare for the withdrawal. In the EU different types of preparations including changes in EU law were made. When analyzing the impact of *Brexit* on the EU, the main attention was paid to the effects of leaving the EU and future relations between the UK and the EU. Simultaneously, there were negotiations on the future relationship between the EU and the UK and preparatory activities within the EU. Preparatory steps were taken to protect the interests of the EU. The main objective of the measures taken was to reduce or completely eliminate the negative effects of UK's withdrawal from the EU in the context of the internal market. Activities by EU institutions were undertaken at different stages of the negotiation process and there was no unified information about them. At the same time, many activities were undertaken in various areas of European policies. The question is if there were changes in EU financial law due to the impact of *Brexit* and what scale those changes were. The identification of the changes on EU financial market law that were made in recent years in connection with *Brexit* required an analysis of all preparatory actions at the EU level and changes in EU financial law. Therefore, a complete list and analysis of the changes of EU financial law due to the influence of *Brexit* was a significant challenge. The analysis of the scope and nature of those changes allowed us to identify the main features of EU legislation on post-*Brexit* situation.

From the perspective of the financial market, the changes in EU law were devoted to aspects of the integrity and stability of the financial markets. This unprecedented process also had a significant impact on the shape of the EU financial market.¹ The UK was one of the key players in the financial services, therefore *Brexit* also impacted the EU financial market. The EU was forced to undertake a series of preparations in the area of financial services to protect the financial stability and the integrity of the internal market. The EU regulations of the financial market mostly include rules dedicated to the third countries, therefore there was no need to change the current shape of EU law but there was a need for some improvements in the area of critical connections of the EU financial market and the UK financial market. The significant role of the UK in the financial market determined the area of financial services as one of the crucial fields of internal market

¹ The EU financial market understood as a part of the EU internal market regulated by the EU law in the area of financial services.

touched by *Brexit*. The article identifies the most important changes in EU law in the area of financial services. The analysis of the law and public statements of EU institutions was the basis for the research and present thesis. The research was undertaken from the perspective of the EU and EU law without a presentation of the perspective of the UK. There were many analyses of the impact of *Brexit* on the UK economy and on the possibility of delivering services by companies based in the UK but there is no complex analysis of the impact of *Brexit* on the change of EU financial market regulation as a reaction of leaving the EU financial market by entities based in the UK.

The UK's withdrawal from the EU threatened serious and negative consequences both for the entities based in one of the 27 EU Member States and for entities based in the UK. A number of functional, institutional and processual links developed between companies and entities operating on the financial markets needed revision after *Brexit*. Therefore, a number of preparatory steps were taken to facilitate the process. Most of the regulations relating to financial institutions and financial markets set the rules of accession to the EU financial market, the requirements for the market participants,² the power of national supervisory authorities and European Supervisory Authorities (ESA). This is why the EU institutions, supervision authorities (both European and domestic) for financial markets and market participants needed to take appropriate steps to prepare for the withdrawal of the UK from the EU. The article tackles the legal preparations and activities of the EU institutions.

2. Losing Access to the EU Internal Market from the Perspective of the Financial Markets

The UK before *Brexit* was perceived as a global financial center and one of the key players on the EU financial market. Moreover, the UK was treated as a hub between non-Member States market participants and the EU single

² The term “financial market participants” was used in the article as a general name for all possible entities which deliver financial services under EU law.

market.³ The UK was also one of the most important actors in the law-making process in the area of financial markets.⁴

A series of assessments of the scale of the participation of the UK on the EU financial market was made. The UK was responsible for over 70 percent of foreign exchange trading and interest rate derivatives and 50 percent of fund management services in Europe.⁵ Even a larger share of entities based in the UK was in hedge fund assets (85 percent).⁶ Financial market participants based in Member States have the opportunity to access the EU internal market. The withdrawal from the EU caused a change in status not only for the UK but also the status of entities based in this country. In the UK in 2016 (before *Brexit*), 5,500 financial market participants were registered (banks, insurers, asset managers and payment firms) and they used the single passport rule as access for the EU internal market (whereas in the other EU Member States there were around 8,000 such financial market participants). More than 2,000 financial market participants (whereas in the rest EU Member States 5,700) based in the UK used the single passport under the MIFID II regime.⁷ The importance of the UK for the EU financial market was also visible in the area of the functioning of the central counterparties (CCP) and the settlement of derivatives transactions. According to data presented by the European Commission at the end of the 2017, the global value of OTC derivatives achieved more than EUR 500 trillion worldwide. Around 1/3 of this global value was denominated in euro and other EU currencies and what is most important – almost 97% of those transactions were cleared by CCP based in the UK.⁸ At the end of 2019, the share of the UK

3 Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank. Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019, COM(2018) 556 final/2, Brussels, 27.8.2018, 14.

4 Howarth, Quaglia, “Brexit and the Single European Financial Market”, 149-153.

5 Peihani, *Brexit and Financial Services: Navigating through the Complexity of Exit Scenarios*, 1.

6 De Vries and others, *Implications of Brexit on EU Financial Services. STUDY*, IP/A/ECON/2016-22, June 2017, 9.

7 Kaya, Schildbach, Lakhani, *Brexit Impact on Investment Banking in Europe*, 7-8.

8 Commission Implementing Decision (EU) 2018/2031 of 19 December 2018 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council, OJ L 325, 20.12.2018, p. 50-52, Motion 4.

CCPs in the clearing services was still over 90% and slightly decreased compared to 2017.⁹ One more important element of the financial market in the context of *Brexit* which ought to be mentioned are benchmarks provided by administrators based in UK, especially LIBOR.¹⁰ LIBOR was widely used as a benchmark in financial agreements and financial instruments, especially in OTC derivatives. The reference to LIBOR was made in OTC derivatives and valued at USD 156.8 trillion.¹¹ The abovementioned scale of the participation of the UK in the EU financial market proved the significant role of the UK and the scale of the challenge caused by *Brexit*.

The general implication of the UK leaving the EU was losing the status of a Member State which meant that various Treaties ceased to apply to the UK and the full secondary EU law as well.¹² From the perspective of financial market participants, this meant that all financial market participants based in UK started to be treated as companies from a third country (non-Member State) and lost their previous legal basis to access the EU financial market. The redefinition of the status of every financial market participant based in the UK was a challenge not only for those companies but also for their counterparties in the EU, their clients in the EU and also for the supervision authorities in the EU. This challenge, especially in the context of the possibility of the continuation of ongoing relations required legal analysis and in some particular areas also required the change of the EU law.

The financial market in the EU is strongly regulated by the variety of regulations and directives and every act has set particular rules for access to the activity, special requirements and supervision rules under the public authorities. There is no one general regulation for the whole financial market but every market participant (e.g. bank, investment firm, CCP, trade repository,

9 Commission Implementing Decision (EU) 2020/1308 of 21 September 2020 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council (notified under document C(2020) 6539), OJ L 306, 21.9.2020, p. 1-5, Motion 5.

10 LIBOR – The London Interbank Offered Rate.

11 Commission Implementing Regulation (EU) 2017/2446 of 19 December 2017 amending Implementing Regulation (EU) 2016/1368 establishing a list of critical benchmarks used in financial markets pursuant to Regulation (EU) 2016/1011 of the European Parliament and of the Council, OJ L 346, 28.12.2017, p. 1-3, Motion 6.

12 Radwan, “Brexit – prawne następstwa i prawnicze spekulacje”. [Brexit – Legal Consequences and Jurists’ Speculations. Remarks on the Book by M. Kramme, Ch. Baldus, M. Schmidt-Kessel], 93.

benchmark administrator, credit rating agency) had their own rules and possibilities to access the EU financial market. To make the situation even more complex, the law created on the EU level is supplemented by domestic law. Therefore, such rules could be even different in particular Member States. To realize the idea of the internal market in the area of the financial services, a special solution on the EU level was created and called the “single passport” or “EU passport”. In EU law the difference between entities from Member States and non-Member States was created, therefore, a change in status of every entity based in the UK also implied a lack of possibility to access the EU financial market on the previous legal basis.

In general, the single passport rule means that if a financial market participant received legally binding permission for delivering particular financial services or activities in one Member States the same permission is recognized in other Member States. The idea of the single passport was a practical implementation of the freedom of services and entrepreneurship within the EU.¹³ The single passport rule in the area of financial services is a special solution which allows the authorization of entities from other Member States and the division of powers and competences between supervision authorities within the EU. A general rule is that in the case of using the single passport rule, the supervision authority is one from a Member States headquarters of a financial market participant.¹⁴ Such an assumption enables the elimination of the duplication of control and supervisory activities. The single passport, derived from Treaty freedoms, was gradually introduced into particular acts of secondary EU law. At the level of secondary law, the rules were defined under which entities established in one of the Member States may use the single passport rule. Currently, most legal acts relating to financial services provide for the right to use the single passport rule: banking services, investment services, settlement and clearing services, insurance and reinsurance, pension funds, investment funds, alternative investment funds, securities and derivative market, credit rating agencies.¹⁵ Bearing in mind that this solution is dedicated only for entities established and operating in Member States, the most significant implication of *Brexit* for the financial market is the loss of the possibility of access

13 Bąk, *Europejskie Prawo Finansowe*, 2013.

14 Górka, *Zasada Wzajemnego Uznawania w Prawie Unii Europejskiej*, 169-171.

15 Lannoo, “EU Financial Market Access after Brexit”, 2-5, on-line access: [www.ceps.eu / ceeps-publications/eu-financial-market-access-after-brexit/](http://www.ceps.eu/ceps-publications/eu-financial-market-access-after-brexit/)

to the EU internal market on the current legal basis and all rules dedicated to third country financial market participants started to be applicable.¹⁶

In the area of the financial market, the abovementioned implication was the greatest change and a huge risk from the perspective of ongoing business relations. This was also spotted by the Commission. In 2018, before *Brexit*, the European Commission issued a series of preparatory notes. From a legal perspective these documents were not legally binding acts, they were rather public statements of the Commission and information for all interested stakeholders. The Commission created preparatory notes for all crucial EU policies and internal market aspects.

Nine of those preparatory notices were devoted to the issue of financial markets for: statutory audit, credit rating agencies, asset management, post trade services, financial instrument, banking services, insurance and occupational retirement institutions.¹⁷ Most of these notices were updated in 2020, after the Withdrawal Agreement was made.¹⁸ These notices were types of guidelines and information for stakeholders regarding the consequences of *Brexit*. The Commission took these steps to support stakeholders in their preparations for *Brexit*. Each enterprise and individual who had relations with entities from the UK had to be prepared for the consequences of *Brexit* and the reclassification of the UK's status as a third country. In the notices devoted to the financial markets, the Commission highlighted the consequences of losing the "EU passport" by UK entities.¹⁹ The aim of the Commission communication was to encourage all stakeholders

16 Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions: Getting ready for changes Communication on readiness at the end of the transition period between the European Union and the United Kingdom, COM/2020/324 final, 13-14.

17 The Webpage of the European Commission, *Preparedness notices*, https://ec.europa.eu/info/brexit/brexit-preparedness/preparedness-notices_en.

18 The Webpage of the European Commission, *Consequences of Brexit*, https://ec.europa.eu/info/strategy/relations-non-eu-countries/relations-united-kingdom/new-normal/consequences-brexit_en.

19 See more: Notice to Stakeholders – Withdrawal of the United Kingdom and EU rules in the field of banking and Payment Services, Brussels, 7 July 2020, REV2 – replaces the notice (REV1) dated 8 February 2018, 3-6; Notice to stakeholders – Withdrawal of the United Kingdom and EU rules in the field of asset management, Brussels, 7 July 2020, REV2 – replaces the notice (REV1) dated, 8 February 2018, 2-3; Notice to Stakeholders – Withdrawal of The United Kingdom and EU Rules in the Field of Insurance/Reinsurance, Brussels, 13 July 2020.

REV1 – replaces the notice dated 8 February 2018, 2; Notice to Stakeholders – Withdrawal of the United Kingdom and EU Rules in the Field of Markets in Financial Instruments, Brussels, 13 July 2020 REV1 – Replaces the notice dated 8 February 2018, 2-3.

to undertake the needed measures to mitigate the negative consequences of *Brexit* for them. The stakeholders needed to take appropriate measures and conduct preparatory action because there was not a general legal solution which allowed the continuation of previous activity after *Brexit* on the previous legal basis. Moreover, a number of UK-based entities lost their right to deliver services within the EU financial market after *Brexit*. The practical implication was the withdrawal of registration from ESMA's registered UK-based entities. On 4. January 2021 ESMA announced that it withdrew the registrations of six UK-based credit rating agencies and four trade repositories.²⁰

The UK's loss of status as a Member States caused significant changes for financial market participants and forced them to change their ongoing relations and model of cooperation. Every financial market participant based in the UK was no longer able to get access to the EU financial market by using the single passport rule. This consequence forced them to use other possibilities to continue business relations with entities and clients based in the EU. The change of legal status of every entity based in the UK induced an actual change in the structure of the EU financial market: some financial market participants were no longer a part of the EU financial market, some of them changed their headquarters to be based in one of the EU states and others applied for access to the EU financial markets as third country entities. The approach presented by the Commission could be interpreted as a conviction that there was no strong and wide need to change EU law but there was a need to take actions by market participants because there were already legal solutions and rules for cooperation with third country entities. The greatest challenge was to adjust to the new situation and to guarantee the maintenance of current relationships in the new reality.

3. Central Counterparties Based in UK after Brexit and their Role in the EU Financial Market

Despite the change in the structure of the EU financial market, there were also changes made in EU law. Those changes were forced by the need to mitigate the risk in the stability of the EU financial market as a negative

²⁰ ESMA Press Release, *Brexit: ESMA withdraws the Registrations of Six UK-based Credit Rating Agencies and Four Trade Repositories*, 4 January 2021, ESMA71-99-1498.

outcome of *Brexit*. The changes were made only in those areas which were identified as vulnerable on the withdrawal of UK based entities from the EU internal market. One of the most exposed areas of the financial market were the clearing of OTC derivative transactions. As mentioned above, the UK CCPs played a dominant role in the clearing of these transactions.

The obligation to clear OTC transactions by CCP was introduced into EU law under EMIR.²¹ The creation of the CCP transaction clearing mechanism contributed significantly to reducing the risk of such transactions. The main task of CCP is to estimate the level of risk present in the system and to adjust the required margins in such a way as to reduce this risk. As a result, CCPs gained a systemically important role in reducing the risk of a crisis on the OTC financial instruments market which may affect the stability of the entire financial market.²² Under EU law, OTC derivatives must be cleared through the authorized CCP established in the EU or the recognized CCP established in a third country. In the context of *Brexit* all CCPs based in the UK became CCPs from a third country, they lost their existing powers to clear transactions, while their further provision of services required recognition in accordance with Article 25 EMIR.

According to an assessment made by the Commission, the lack of possibility of using services of CCPs from the UK may have done the disturbance to the EU financial stability and monetary policies of EU and Member States.²³ Moreover, there was no simple solution for replacing current contracts and relations for others after *Brexit* and to replace the role of UK entities for EU market OTC derivatives. The systemic role of CCPs located in the UK for the EU financial market forced the Commission to take appropriate steps, including a change in current EU law.

The first act was the recognition of the regulatory framework of the UK as equivalent to the EU regulations in this area. According to Article 25 EMIR only the third country's CCP recognized by ESMA may provide clearing

21 EMIR – 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, OJ L 201, 27.7.2012, p. 1-59, (as amended).

22 Pyka, Muszyński, “Nowe regulacje bezpiecznego obrotu instrumentami pochodnymi na rynku pozagiełdowym w Polsce”, 127-128.

23 Commission Implementing Decision (EU) 2018/2031 of 19 December 2018 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council, OJ L 325, 20.12.2018, p. 50-52, Motion 5.

services. ESMA could not recognize any third country CCP if the Commission assessed that regulatory and legal framework in the non-Member State for operating CCP and the supervision of CCP are not equivalent. The Commission did this by adopting an implementing act in the meaning of Article 291 TFEU. The first implementing act in the area of clearing services was adopted on 19 December 2018. The decision was adopted only for a limited period of time until 30 March 2020.²⁴ So, the decision was made before *Brexit* to provide legal certainty for market participants in an ongoing relationship but not for a guarantee for a long period of time to give access to the EU financial market for UK CCPs. Unfortunately, the process of the negotiation of the rules of the UK withdrawal from the EU took more time than anyone (including the Commission) expected. Due to this fact, the Commission changed the initial text of the act. The change aimed at allowing the use of CCPs based in UK for a year after the final *Brexit* date.²⁵ This act was replaced by another decision which recognized the equivalence of the UK legal and supervisory framework for CCPs for an even longer period, until 30 June 2022 because the interconnections and scale of the UK based CCP on the EU financial market was still high.²⁶

Following the implementing act issued by the Commission, ESMA (due to applications submitted by CCPs from the UK) recognized three British CCPs: LME Clear Limited has, ICE Clear Limited, and LCH Limited.²⁷ These legal actions made by the EU institutions mitigated the risk of a lack of continuity of ongoing relations in the area of OTC derivatives. The equivalence decision regarding CCPs was issued for a limited period in order to reduce the risk

24 Commission Implementing Decision (EU) 2018/2031 of 19 December 2018 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council, OJ L 325, 20.12.2018, p. 50-52.

25 Commission Implementing Decision (EU) 2019/2211 of 19 December 2019 amending Implementing Decision (EU) 2018/2031 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council, OJ L 332, 23.12.2019, p. 157-158.

26 Commission Implementing Decision (EU) 2020/1308 of 21 September 2020 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council (notified under document C(2020) 6539), OJ L 306, 21.9.2020, p. 1-5.

27 ESMA Public Statement, *ESMA to recognise three UK CCPS from 1 January 2021*, 28 September 2020, ESMA77-99-1403.

of *Brexit* only to help financial market participants gradually reduce dependence from UK based CCPs and to give them more time to choose CCPs based in the EU to give the opportunity to mature ongoing contracts. All of these decisions were made for a limited period of time and did not have the intention of sustaining the dominant role of UK's CCPs on the EU financial market. The limited period for which the decisions were issued introduced a long-term legal uncertainty and did not encourage EU financial market participants to create new relationships with UK CCPs, but only allowed the performance of ongoing contracts. However, after *Brexit*, the dependence on CCPs based in UK declined at an unsatisfactory pace so the Commission once again extended the period for which it recognized equivalence of UK's regime in this area until 30 June 2025.²⁸

Implementing acts under Article 25 EMIR were not only changes in the legal framework in this area. Bearing in the mind the systemic and important role of CCPs and the above-mentioned share of UK CCPs in the European OTC derivatives market, the Commission decided to change EMIR. On 23 October 2019, Regulation (EU) 2019/2099 was adopted.²⁹ The change in EMIR was needed due to the growing cross-border interconnections in capital markets and the participation of third country CCPs in the OTC derivative market. The Commission indicated that this high share of third country CCPs in the European financial market was significant, while the current competences of ESMA were not sufficient to fully effectively monitor the operating conditions of third-country CCPs and, consequently, to react quickly to possible events affecting the stability of EU financial market institutions. Finally, the Commission referred to the UK and the situation after *Brexit*.³⁰ Bearing in the mind the outstanding role of UK CCPs in the EU

28 Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council, OJ L 28, 9.2.2022, p. 40-44.

29 Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, OJ L 322, 12.12.2019, p. 1-44.

30 Proposal for a Regulation of the European Parliament and Of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, Strasbourg, 13.6.2017, COM(2017) 331 final.

financial market, one can state that *Brexit* directly affected the need to make changes in EMIR.

Pursuant to Regulation (EU) 2019/2099, third country CCPs were divided into Tier I and Tier II CCPs. According to the amended Article 25(2) (e), a Tier I CCP is one that is not considered systemically important for the EU financial market. In turn, according to the added Article 25(2a), a Tier II CCP is one that may be of systemic importance for the financial stability of EU or at least one of its Member States. This division into two types of CCP is directly connected with the systemic risk and stems from the need to protect EU interests. After those changes, ESMA had stronger supervision competences in relation to Tier II CCPs (under Article 25b EMIR) no matter whether the CCP was based in the EU or not. Moreover, higher requirements were set for Tier II CCPs under Article 25(2b) EMIR. Based on the changes made to EMIR, two delegated regulations were issued by supplementing and further specifying the criteria for assessing third country CCPs in the context of assessing the degree of systemic risk that the third country CCPs posed to the financial stability of the EU.³¹

Changes in EMIR were a practical example of the implication of *Brexit* on the EU financial market, its structure and also the shape of the EU regulations in this area. Two UK-based CCPs were recognized as Tier II CCPs: ICE Clear Limited and LCH Limited.³²

The changes imposed in EMIR allowed European institutions to have a stronger impact and greater competences in contacts with CCP from the UK, even if the UK was no longer a Member State and EU law was no longer applicable in the UK. Without the significant outstanding share of UK CCPs on the EU financial market those changes would not have been undertaken. These changes were intended to guarantee certain competences to the EU institutions for entities that are not based in the EU. It was a significant

31 Commission Delegated Regulation (EU) 2020/1303 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the criteria that ESMA should take into account to determine whether a central counterparty established in a third country is systemically important or likely to become systemically important for the financial stability of the Union or of one or more of its Member States, OJ L 305, 21.9.2020, p. 7–12 and Commission Delegated Regulation (EU) 2020/1304 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the minimum elements to be assessed by ESMA when assessing third-country CCPs' requests for comparable compliance and the modalities and conditions of that assessment, OJ L 305, 21.9.2020, p. 13-26.

32 Public Statement, *ESMA to recognise three UK CCPS from 1 January 2021*, 28 September 2020, ESMA77-99-1403.

change in the way of constructing and regulating the scope of supervisory competences. The general rule was to supervise those entities that have their location in a given territory. In this case, there is a creation of cross-border supervisory powers in relation to entities from third countries due to reasons of financial stability and security of financial markets. The need to have a real possibility to monitor and in some contexts supervise entities located in a third country was the background for this change and it would not be even considered without the large number of OTC derivatives contracts cleared and settled by UK based entities. This change was meaningful especially for professional market participants, not for retail and was implemented in order to safeguard EU financial stability as a whole.

4. Benchmarks Provided by Administrators based in UK and their Role for EU Financial Market

The UK as one of the key players in financial markets also played a crucial role as a place of origin of one of the most used benchmarks on the financial market. The history of LIBOR is more complex and has been developed and researched in numbers of articles and books. The manipulation of LIBOR was the reason for establishing a new legal framework for creating and using benchmarks within the EU.³³ In 2016 BMR³⁴ was published in the Official Journal of the European Union. BMR also created special rules for using benchmarks delivered by the third country-based administrators.

BMR created a legal framework under which benchmarks from third countries were allowed to be used within the EU. According to Article 29 BMR benchmarks provided by administrators located in non-Member States need to be in a register governed by ESMA to be used within the EU. Several models for access to the EU financial market were envisaged, one of which was based on the recognition of the equivalence of the legal and supervisory framework. Additionally, Article 51(5) introduced a transitional period allowing the use

33 Proposal for a regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contract, Brussels, 18.9.2013, COM(2013) 641 final, p. 2.

34 BMR – Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014, OJ L 171, 29.6.2016, p. 1–65 (as amended).

of benchmarks from third countries even without being entered in the ESMA register. Originally, the transition period was to last until 1 January 2020, then it was extended twice until the end of 2023.³⁵ By extending the transitional period, *Brexit* should in principle not affect the benchmark market and not interfere with the possibility of the further use of the LIBOR benchmark in financial contracts and financial instruments.

Regardless, there were certain circumstances which forced the EU legislators to change EU law. The transitional provisions did not eliminate all the difficulties arising from the change of the UK status to a third country in this context. Before the UK's withdrawal from the EU, LIBOR had the status of a critical benchmark (under Article 20 BMR). The status of critical benchmark means that the disappearance of it could cause disturbances to the stability of the EU financial market. LIBOR was recognized as a critical benchmark in December 2017 by an implementing act of the Commission.³⁶ The status of a critical benchmark can be only given to a benchmark provided by the administrator located within the EU. Therefore, the first implication of *Brexit* was the loss of the status of the critical benchmark by LIBOR.³⁷

The second, even more significant implication was the possible risk of cessation of LIBOR which was no longer a benchmark supervised by a supervision authority based in the EU and operating under EU law. The representatives of the British supervisory authority announced the possibility of the cessation of LIBOR before *Brexit*.³⁸ Due to the key importance of LIBOR for global financial markets, including the EU financial market, regulators considered the negative effects of LIBOR cessation. Such work was also carried out at the EU level. The Commission presented a draft

35 Regulation (EU) 2021/168 of the European Parliament and of the Council of 10 February 2021 amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation, and amending Regulation (EU) No 648/2012, OJ L 49, 12.2.2021, p. 6–17.

36 Commission Implementing Regulation (EU) 2017/2446 of 19 December 2017 amending Implementing Regulation (EU) 2016/1368 establishing a list of critical benchmarks used in financial markets pursuant to Regulation (EU) 2016/1011 of the European Parliament and of the Council, OJ L 346, 28.12.2017, p. 1–3.

37 Commission Implementing Regulation (EU) 2021/1122 of 8 July 2021 amending Implementing Regulation (EU) 2016/1368 adding the Norwegian Interbank Offered Rate to and removing the London Interbank Offered Rate from the list of critical benchmarks used in financial markets established pursuant to Regulation (EU) 2016/1011 of the European Parliament and of the Council, OJ L 243, 9.7.2021, p. 39–42.

38 The Webpage of the Financial Conduct Authority, *The Future of LIBOR*, <https://www.fca.org.uk/news/speeches/the-future-of-libor>.

of changes to BMR on 24 July 2020. These changes assumed the introduction of a mechanism of statutory replacement in case of the cessation of this benchmark which played a systemic role on the EU financial market. The explanatory memorandum for the project explicitly indicated that one of the reasons for introducing changes to BMR was the announcement of the cessation of LIBOR. It was emphasized that the cessation of LIBOR could have a significant impact on the European economy.³⁹

The changes were introduced by adding Article 23a-23c BMR. According to the adopted solutions, if the conditions described in the BMR were met, it was possible for the public authority (European Commission or national public authority) to designate the statutory replacement which by law replaced all references to the benchmark under cessation in all contracts and financial instruments. BMR was a part of secondary EU law. Due to the announced withdrawal of the UK from the EU, the BMR had to be constructed in such a way to cover not only benchmarks from the EU but also those from the third countries that are important for the financial stability of the EU, therefore those solutions could not be dedicated only for critical benchmarks in the meaning of BMR. To cover the challenges caused by the cessation of LIBOR (which after *Brexit* lost the status of a critical benchmark under BMR and started to be treated as a third country benchmark) in the new Article 23b, a statutory replacement mechanism applied not only for critical benchmarks (in the meaning of BMR) but also for third country benchmarks with a strong impact on the stability of the EU financial markets. The power to designate a statutory replacement for a third country benchmark was given to the Commission.⁴⁰

The changes in BMR were not directly motivated by *Brexit* but the change of the status of the UK and LIBOR forced the Commission to change EU law and to empower the Commission to also react in the context of third country benchmarks. This indirect impact of *Brexit* had a significant influence on the shape of the current EU financial market and its regulations. Finally, the Commission adopted an implementing regulation with a designation for

39 Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation, COM/2020/337 final, Brussels, 24.7.2020, p. 1-13.

40 Regulation (EU) 2021/168 of the European Parliament and of the Council of 10 February 2021 amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements of certain benchmarks in cessation, and amending Regulation (EU) No 648/2012, OJ L 49, 12.2.2021, p. 6-17.

the statutory replacement of LIBOR CHF.⁴¹ This is the proof that the imposed mechanism was needed for stability reasons. The changes in this area once again showed that the strong and historical interconnectedness with financial markets and entities based in the UK could not be broken off in one day, and that more time and systemic solutions needed to govern all possible connections. Moreover, the changes in EU law show that the shape of the financial markets forced EU institutions and lawmakers to adjust the law to reality.

5. Equivalency Decisions

Several acts of EU law in the area of financial markets had particular solutions dedicated to third country entities which wanted to obtain access to the EU financial market. Partially, the mechanism of access to the EU financial market was based on equivalency decisions delivered by the Commission.⁴² The equivalency mechanism allows the Commission to assess the comparability regulatory regime of the third country in the context of a particular part of EU financial market regulation. In certain situations, positive assessment of the third country regime allows entities from this country to deliver services on the EU financial market.⁴³ After the announcement of the UK's wish to leave the EU, the discussion on the usability of this mechanism as a substitute for the 'EU passport' after *Brexit* was raised.⁴⁴ Nevertheless, the equivalency regime cannot be treated as a substitute for the EU passport, it does not duplicate the rights of Member States and it is limited only to dedicated aspects of the financial market and particular type of services, not all of them.⁴⁵

The Commission in its communication also highlighted that equivalency cannot be treated as a substitute of rights of Member States. Moreover, the Commission highlighted that the equivalency mechanism is a type of unilateral decision of the EU and there is no space for negotiations

41 Commission Implementing Regulation (EU) 2021/1847 of 14 October 2021 on the designation of a statutory replacement for certain settings of CHF LIBOR, OJ L 374, 22.10.2021, p. 1-5.

42 Višekruna, "The Access to the EU Financial Market for the Companies from non-Member States", 659-662.

43 Pennesi, "The EU Equivalence Regime in Financial Services: an Effective Instrument to Preserve Financial Stability after Brexit?", 2-3.

44 Moloney, "Financial Services, the EU, and Brexit: An Uncertain Future for the City?", 77-79.

45 Pennesi, *ibidem*.

or discussions between the EU and third country assess. That is why the guarantee equivalency assessment was not part of negotiations on the future relations between the UK and the EU but in the Political Declaration both sides committed to carrying out equivalence assessment.⁴⁶ Bearing in the mind that until 1 February 2020 the UK was a Member State, one can assume that the all UK law was similar to EU law in the area of financial market and should be recognized as equivalent in all areas. However, the Commission did not have the willingness to recognize equivalence in all possible areas but only in those which were assessed as crucial for EU financial market.⁴⁷

The Commission decided to recognize equivalency in the above-mentioned regulatory framework applicable to central counterparties. Additionally, the Commission issued the implementing decision in the area of regulatory framework applicable to central securities depositories in UK. It was an implementing act under Article 25 Regulation (EU) No 909/2014 (CSDR)⁴⁸ and allowed to deliver services by central securities depositories based in UK. Recognition was given by a limited period of time, until 30 June 2021.⁴⁹ The Commission also adopted a series of delegated acts in which the Central Bank of England and the UK public authorities were recognized as equivalent to European public institutions under EU law.⁵⁰ Those deci-

46 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Getting ready for changes Communication on readiness at the end of the transition period between the European Union and the United Kingdom, COM/2020/324 final, p. 12-13.

47 Communication From the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Getting ready for changes Communication on readiness at the end of the transition period between the European Union and the United Kingdom, COM/2020/324 final, p. 13-15.

48 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, OJ L 257, 28.8.2014, p. 1-72, (as amended).

49 Commission Implementing Decision (EU) 2020/1766 of 25 November 2020 determining, for a limited period of time, that the regulatory framework applicable to central securities depositories of the United Kingdom of Great Britain and Northern Ireland is equivalent in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council, OJ L 397, 26.11.2020, p. 26-28.

50 Commission Delegated Regulation (EU) 2019/463 of 30 January 2019 amending Regulation (EU) 2015/2365 of the European Parliament and of the Council with regard to the list of exempted entities, OJ L 80, 22.3.2019, p. 16-17; Commission Delegated Regulation (EU) 2019/461 of 30 January 2019 amending Delegated Regulation (EU) 2016/522 as regards the exemption of the Bank of England and the United Kingdom Debt Management Office from the scope of Regulation

sions were important from the perspective of public debt management and monetary policies. On other fields of financial market equivalency decisions were not taken, despite the fact that according to the Commission there were around 40 different legal bases upon which to assess the equivalency of the third country regime.⁵¹

New delegated and implementing acts with the recognition of third country regimes and public institutions as equivalent became a part of the EU legal system. The decision held by the Commission impacted on the shape of the current EU financial system by giving the opportunity of access to the EU financial system by financial market participants from the UK and giving legal basis for new decisions of ESMA and domestic supervision authorities. The amount of decisions and also the limited time of recognition suggests that these measures were taken only for protection of EU interests and to reduce the shock for financial markets upon *Brexit* but the equivalency decisions were not a systemic and long-term planned approach to UK. Those measures had a character of temporary measures and emergency and preventive measures only for a particular purpose to minimize EU losses as a consequence of *Brexit*.

6. Final Conclusions

The change of the status of the UK implied changes in the shape of the EU financial market. Mostly, there were changes in the structure of the financial market and its economic dimension but also there were changes in the law regulating the financial market. Among a raft of different activities and steps undertaken by the EU, identified and chosen were the most important legal implications for the EU financial market. Taking into account the fact that the UK after *Brexit* was no longer a Member State, financial market

(EU) No 596/2014 of the European Parliament and of the Council, OJ L 80, 22.3.2019, p. 10-12; Commission Delegated Regulation (EU) 2019/462 of 30 January 2019 amending Delegated Regulation (EU) 2017/1799 as regards the exemption of the Bank of England from the pre- and post-trade transparency requirements in Regulation (EU) No 600/2014 of the European Parliament and of the Council, OJ L 80, 22.3.2019, p. 13-15; Commission Delegated Regulation (EU) 2019/460 of 30 January 2019 amending Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the list of exempted entities, OJ L 80, 22.3.2019, p. 8-9.

⁵¹ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of The Regions Equivalence in the area of financial services, COM/2019/349 final, p. 2.

participants based in the UK lost their status and the possibility of using passport rights and access to the single market. Financial market participants based in the UK after *Brexit* were classified as legal entities from a third country without the possibility of using the fundamental right of the internal market: free movement of goods, persons, services and capital.

The abovementioned facts and strong interconnections between the EU and UK financial market implied the need to change EU law in some areas. The author has divided those changes into two types:

- changes in existing EU legal acts regulating the financial market to prepare for *Brexit* implications (changes in EMIR and BMR) and to protect financial stability;
- creating new legal acts as a reaction to the change of the status of the UK to a non-Member State (acts recognized the UK law equivalency in particular areas of financial market regulation) to sustain ongoing relations between financial market participants.

Moreover, EU institutions issued a series of communication and public statements as preparatory notes for market participants. These documents were not binding acts but they affected the behavior and expectations of financial market participants within the EU. The important activities which affected the current shape of the EU financial market were the administrative decision made by ESA in consequence of the change of the status of financial institutions based in the UK after *Brexit*. Finally, the last activity which affected the current shape of the financial market in its legal dimension was the change of the headquarters of European Banking Authority from London to Paris.⁵²

The analysis of the changes in EU law leads to several conclusions. Only a few pieces of EU law had to be changed and adjusted to life after *Brexit*. EU law has already an established and functioning legal framework regulating the rules of access by third country entities to the EU financial market. Both BMR and EMIR were adopted under Article 114 TFEU, therefore the changes made under the influence of *Brexit* were made in the context of functioning and establishing the internal market and aimed at reducing obstacles within the internal market. The introduced changes were aimed at strengthening the position of EU institutions (ESMA and the Commission) in selected areas of operation of UK entities on the EU financial market. These changes

52 Regulation (EU) 2018/1717 of the European Parliament and of the Council of 14 November 2018 amending Regulation (EU) No 1093/2010 as regards the location of the seat of the European Banking Authority, OJ L 291, 16.11.2018, p. 1-2.

were dictated by the concern for the stability of the EU financial market and the cohesion of the internal market. No facilities have been introduced for UK entities, nor has there been a universal and general consent for access of UK entities to the EU financial market under special rules. UK entities must apply for access on the same terms as entities from other third countries. On the other hand, in two areas, CCP and benchmarks, the position of European institutions in relation to entities located in the UK was strengthened.

The equivalence decisions were also not aimed at general admission to the market of all UK entities, but were issued in key areas due to the stability of the EU financial market. Wherever there was no risk of threat to stability, entities could in a simple way recreate relations or gain access to the financial market on the basis of general market access rules for entities from third countries, decisions on equivalence were not issued.

Finally, it should be noted that the areas of legislative interference focused on professional financial trading and related to highly specialized functions. *Brexit* in no way affected the rules of retail customer service or the ability to provide financial services by UK (as the third country) entities to retail customers. The actions taken related to the sphere of professional investment services and resulted from high financial exposure, which could not be replaced at a short time by the use of services provided by entities located in the EU.

All activities undertaken by the EU focused on the regulation of the capital market and trading in financial instruments. There were no changes in the area of banking or insurance. This fact highlighted the existing interconnections in the area of capital markets and movement of capital in a global context.

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