DILLON EUSTACE

Ireland: Your Post-Brexit Passport to Europe

Brexit will fundamentally alter the UK's relationship with the EU and will have a profound effect on the landscape of financial services in Europe. Ireland is the logical relocation choice.

This paper considers the potential impact that Brexit may have on the main UK financial services sectors and explains why Ireland should be a logical relocation choice for those firms who may decide to transfer part (or all) of their business from the UK to an EU hub post-Brexit.

Accepting that real negotiations can only begin once the UK election is over, it seems likely that those negotiations are going to be tough, hard fought and also complicated by conflicting or competing interests both within the UK and within the EU 27. In addition, hard positions adopted publicly now may be difficult to back down from or to compromise on down the line.

The UK Prime Minister has already indicated that the UK intends to exit the single market and to negotiate an extensive free trade agreement with the EU. Such an approach seems to rule out European Economic Area ("**EEA**") membership; that will mean that UK regulated financial services firms and credit institutions will lose the ability to passport their services into EU Member States without the need either for local branch or local subsidiary authorisation.

This position will present a major difficulty for those UK financial services providers that actively target EU customers, as well as for those non-EU entities that passport into Europe using an authorised UK subsidiary. To put the scale of the issue in context, according to figures from the Financial Conduct Authority, published by the House of Commons Treasury Select Committee[1], close to 5,500 UK-registered entities rely on passporting to do business in other EU countries.

While it is extremely difficult to predict exactly where we will be in two years from now, it does seem likely that the outcome of the negotiations will be a UK outside the EU Single Market and Customs Union. For this reason, we have based this paper on the assumption of a "hard" Brexit.

EQUIVALENCE - EQUIVOCAL AT BEST

Certain commentators have suggested that, with the loss of passporting, access for UK financial services firms to the EU market could readily continue under "equivalence"; a system whereby the EU grants access to the Single Market to non-EU (or "third country") financial services firms that have legislation deemed equivalent to that in force in the EU.

However, this would seem a less than ideal proposition, as it is for the EU to decide whether equivalence has been met by any third country, including the UK. Even if some bespoke alternative to the current equivalence regime were put in place specifically to accommodate the UK, it is likely that the EU would retain a veto on approval, which leads to uncertainty as to timing and potentially as to outcome.

To facilitate equivalence, the EU would most

likely require that the UK retain equivalent legislation to that already in place and also to replicate future EU legislation in the relevant area. These requirements may not be particularly palatable to the UK.

The International Regulatory Strategy Group has carried out a detailed analysis[2] of the EU's existing third country equivalence regime to ascertain if it provides a possible solution to allow the UK-based financial services industry cross-border access to EU-markets following Brexit. Their report found that equivalence measures are not sufficiently robust and that, in any event, only a limited number of financial services sectors that are currently able to avail of the passporting regime can seek to utilise equivalence provisions, with several areas currently covered by passporting having no equivalence regime at all. These include banking (deposit taking), lending, payment services, mortgage lending, insurance mediation and distribution; and activities relating to the management of UCITS.

Given the unpredictability and limited availability of equivalence regimes, UK financial services providers cannot simply hope for the best.

THE EXPIRED PASSPORT

The impact of a loss of passporting rights will be felt across a wide spectrum of financial services activities.

Banking, Debt Capital Markets and Securitisation: For UK regulated banks, including the thousands of third country banks who use the City of London as their EU hub, a hard Brexit may mean that they will no longer be able to offer regulated services on a cross border basis into an EU Member State in the absence of becoming authorised in such Member State. The passporting regime contained in the Capital Requirements Directive[3] allows deposit taking institutions to carry out services such as lending and deposit taking throughout the EU on the basis of their home state authorisation. It appears likely that this will be lost by the UK post-Brexit, which we have already seen is leading to many UK institutions moving some operations to an EU Member State to ensure that they can continue to access the EU markets efficiently. Ireland is a well-established location for international banks, some of whom have already announced plans to significantly expand their Irish operations in light of Brexit. Interestingly, the Bruegel Institute, a Brussels based think tank, estimates that almost a fifth of wholesale finance activity within the EU could shift to Ireland as a result of Brexit[4].

On the capital markets side, the likely result of Brexit is that the ability for the UK to passport prospectuses throughout the EU will be lost. This means that any prospectus issued by a UK issuer would require approval from each individual EU Member State in which it is proposed securities will be offered or listed. For wholesale debt offerings, which – if not listed – generally benefit from an exemption under the Prospective Directive[5] , this may not be all that notable, but it could have a significant impact on retail offerings. The Irish Stock Exchange (the "**ISE**") is one of the leading exchanges in the world for listing by special purpose vehicles ("**SPVs**"), providing a sophisticated listing service for debt securities.

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We anticipate more issuers seeking to migrate from the London Stock Exchange to the ISE in circumstances where they have up to now listed in London for the purposes of availing of EU wide passporting.

Brexit also creates issues for the UK in the area of securitisation, particularly in the context of the proposed new Capital Markets Union ("**CMU**")[6]. One of the key tenets of the CMU is the concept of simple standard and transparent securitisation ("**STS**"). There is much uncertainty post-Brexit as to whether a UK securitisation would be able to

satisfy the proposed STS criteria, in circumstances where a UK firm would not be eligible to be an investor, sponsor, originator or original lender (and consequently a risk-retainer) in an STS if it is not regulated in the EU.

Ireland is the leading European jurisdiction for the establishment and servicing of securitisation structures. As of March 2016, some 1,400 SPVs were established in Ireland, representing almost a quarter (24% of financial vehicle corporation assets) of the European industry. Securitisation in Ireland is predominantly international, with 86 per cent of Irish SPVs set up on behalf of non-Irish sponsors[7].

Ireland already has a significant cross-border industry in the areas of banking, (re)/insurance, payment services, e-money, AIFs, UCITS and asset management/investment services.

Insurance: The UK insurance sector also faces difficulties. According to a LSE Study[8], approximately £4 billion of UK insurance and reinsurance sector revenues, or 10% of the total, are from EU-related business. However, because 75% of insurance and reinsurance services are provided through subsidiaries, about a quarter of these revenues, or £1 billion, may be lost to EU competitors due to Brexit. According to the Intelligent Insurer, Ireland is a very attractive location for insurers seeking to create a unit within the EU to retain access to the common market post-Brexit, owing to its cultural and geographical proximity to the UK, its existing regulatory framework, infrastructure, qualified workforce and favourable corporate tax rate. Many international insurers, such as Allianz, AXA, Standard Life and Zurich, are already located here.

Asset management - UCITS, AIFMD and MiFID: The impact of the loss of passporting on the area of asset management may also be significant, given the scale of regulation in this area. The main regulatory regimes affecting this industry, each of which currently has the benefit of passporting are the Undertakings for Collective Investment in Transferable Securities Directive ("**UCITS**"[9]), the Alternative Investment Fund Managers Directive ("**AIFMD**"[10]) and the Markets in Financial Instruments Directive II ("**MiFID II**"[11]). The exact impact for participants in this area of the loss of passporting in any particular case depends on a number of factors, such as where the fund or the client is located, the location of the asset manager and the types of investor. At one level, the impact may not be too great. The fact that UK domiciled UCITS will cease to benefit from the UCITS passport to distribute throughout the EU, for example, is of little relevance as most UK managers have domiciled their UCITS in Ireland or Luxembourg (if targeting more than the UK).

Of more relevance is the fact that a UK ManCo will not be able to act as management company to a UCITS and it is not entirely clear that the current capacity of an EU domiciled UCITS ManCo to delegate asset management functions to a post-Brexit UK asset manager will remain as it is. The working assumption – which we shared – was that a UK asset manager would be no worse off than, for example, a US or Japanese asset manager. Rumours – and they may prove to be no more than that – indicate that we should not automatically make that assumption.

The position may be less problematic on the AIFM side, at least in the short term, as non-EU AIFMs are possible. However, their rights are limited and the obligations and requirements that they are subject to will only increase. That is on top of competitive pressures in circumstances where EU domiciled AIFs with EU domiciled AIFMs will have the greatest EU market access for the foreseeable future.

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The impact of Brexit on the ability to passport MiFID services does not, at first glance, seem as profound, as MiFID does enable non-EU investment firms to provide investment services to eligible counterparties and certain professional clients based in the EU. However, in order to do so, such firms will be required to register with the European Securities and Markets Authority ("**ESMA**") and the UK will need to apply conduct of business and prudential requirements equivalent to those applicable in the EU. Where UK investment firms seek to offer services to retail clients, it is likely, in the absence of some negotiated bespoke equivalence regime, that EU Member States will require that such firms obtain authorisation and establish a branch in the relevant jurisdiction, prior to the provision of such services.

Ireland offers a real opportunity to address these challenges. UK asset managers can set up their own UCITS ManCo or a MiFID firm in Ireland. The opportunity also exists for the establishment of a so-called "Super ManCo" – dual UCITS and AIFMD authorised, with the added AIFMD Article 6(4) individual portfolio management capacity – in Ireland.

Payment Services and E-Money: Post-Brexit, it is also likely that payment services and electronic money providers will need to become regulated in an EU country in order to continue providing services on foot of a passport. Given that the implementation date for Payment Services Directive II[12] will be upon us in January 2018, coupled with the relatively short period that the UK has before Brexit happens, UK payment institutions now need to examine alternative models for EU cross-border financial services activity.

Ireland is a popular location for many payment services and e-money firms. Facebook's establishment of an e-money firm in Dublin in late 2016 attracted quite a bit of publicity, as did the more recent announcement by Prepaid Financial Services (one of the largest Mastercard issuers in Europe) that they plan to re-locate their operations from London to Ireland, a move that is estimated to create up to 800 jobs.

EMIR: European Market Infrastructure Regulation ("**EMIR**")[13] related activity will too be affected by Brexit – the likelihood is that UK central counterparties will need to demonstrate to ESMA that the regime in the UK is equivalent to that in the EU. Experience has shown that this has proven difficult in the past for credit counterparties in other third country jurisdictions, such as the USA.

BREXIT AND THE ECONOMIC, GEOGRAPHIC AND POLITICAL ADVANTAGES OF IRELAND

It is clear that many UK financial and credit services firms that wish to continue to avail of passporting will be required to seek an alternative EEA base for their operations as a result of Brexit. This is where Ireland presents a solution.

A Reputation for Excellence in Financial Services: Ireland is an obvious choice for many firms seeking out an alternative EU base post-Brexit. It already has a significant cross-border industry in the areas of banking, (re)/insurance, payment services, e-money, AIFs, UCITS and asset management/investment services. Indeed, many of the firms now looking to relocate parts of their business from London to an alternate EU hub may already have a presence in Ireland.

Our financial services sector is well-established; it is supported by a multitude of experienced and well-resourced professional services firms offering cost efficient services of an exceptional standard. Ireland has a highly educated (over 50% of Irish 30 to 34 year olds have a third level degree; the highest rate in the EU), skilled workforce, with a wealth of experience to draw on in the area of financial services.

A Good Cultural Fit with Close Ties to the UK: Ireland has very similar legislative, cultural and economic landscapes to the UK and ties between the two jurisdictions are close.

A Favourable Regulatory Environment: The Central Bank of Ireland (the "**CBI**"), the country's financial regulator, is *"engaged, efficient and open"*[14]. It is well embedded in the EU's regulatory regime, with vast experience in dealing with international institutions setting up in Ireland and its overall approach to authorisation is comparable to that in the UK. The CBI is committed to ensure that it has the resources to accommodate the anticipated Brexit-related influx of authorisation applications and has announced that it is increasing its headcount substantially to deal with this.

Bottom Line: Ireland is an onshore EU jurisdiction and has a sophisticated taxation regime, with a corporation tax rate of 12.5% for most trading income. It has an extensive double taxation treaty network (including a double tax treaty with the UK) which operates to significantly reduce or eliminate the application of withholding tax on non-Irish source income.

In addition, Section 110 of Ireland's Taxes Consolidation Act 1997 (as amended) provides for particular tax treatment for qualifying SPVs who satisfy certain criteria; it is widely used in securitisation and structured finance transactions. Section 110 provides that the calculation of the profits of a qualifying company for tax purposes effectively mirror its commercial accounting profit and that, subject to compliance with relevant anti-avoidance legislation, a deduction is available for profit dependent interest. These provisions, when taken together, typically result in the tax neutrality of these vehicles.

A Vision for Success: Ireland is committed to the growth of its financial services industry. In 2015 the Irish Government launched its five year strategy in this area, with the aim of increasing employment by 30%. In addition, the latest six year Dublin development plan has just been completed and it provides for the likelihood of an influx of Brexit related business to the capital. This will see thousands more houses and apartments being built to accommodate an increased workforce. Similarly, development is well underway to ensure that adequate commercial office space is available to cater for this anticipated growth. According to Savills, approximately 136 new office buildings, totaling over 12 million square feet are being planned for Dublin over the next five years - enough to facilitate 100,000 new employees.

TIME TO GET MOVING

Brexit will fundamentally alter the UK's relationship with the EU and will have a profound effect on the landscape of financial services in Europe. The anticipated loss of the UK's financial services passport and the significant limitations inherent in reliance on the equivalence regime has capacity to cause serious issues for the UK financial services sector. Ireland offers available and effective solutions.

ABOUT DILLON EUSTACE

Dillon Eustace is a market leader in Ireland in the areas of banking and financial services. We have established a dedicated, cross-sectoral Brexit advisory team to provide our domestic and international clients with strategic advice on the legal, tax and regulatory implications of Brexit.

Please do not hesitate to contact us if we can be

of any assistance to your business or if you have any Brexit related queries.

NOTES

1 https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/financial-conduct-authority-correspondence-16-17/

2 The International Regulatory Strategy Group "The EU's Third Country Regimes and Alternatives to Passporting" – January 2017

3 Directive 2013/36/EU

4 André Sapir, Dirk Schoenmaker and Nicolas Véron "Making the best of Brexit for the EU27 financial system" – 8th February, 2017

5 Directive 2003/71/EC

6 https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union_en

7 The Irish Debt Securities Association "Special Purpose Vehicles and the Securitisation Industry in Ireland – Q&A" - December 2016

8 Simeon Djankov "The City of London after Brexit" – February 2017
http://www.lse.ac.uk/fmg/dp/discussionPapers/fmgdps/DP762.pdf

9 Directive 2009/65/EC

10 Directive 2011/61/EU

11 Directive 2014/65/EU

12 Directive 2015/2366/EU

13 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

14 Gerry Cross, CBI Director of Policy and Risk – speech dated 23rd January, 2017 "Brexit and Asia: Implications for Financial Services in Ireland"

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Andrew is the author of several publications, including detailed guides on UCITS, AIFMD, QIAIFs, MiFID and on insurance regulation. He is a former council member of the Irish Funds Industry Association and is a regular speaker on financial services topics at domestic and international conferences and industry events. He has been recognised as a leading lawyer in these practice areas by *Chambers and Partners, The Legal 500, IFLR* and others.

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Kate has spoken at industry events and is regularly published and quoted in media publications and local and international industry journals, including The Financial Times, Finance Dublin, The Airfinance Journal, Alternative Credit Intelligence and HFM Week, covering topics such as: SME and consumer lending, enforcement of security, credit servicing, capital markets, aircraft finance and leasing and Brexit.

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