

Client Update

UK and EU Agree in Principle to 21-Month Brexit Transition Period

INTRODUCTION

On 19 March 2018, the United Kingdom and the European Union announced an agreement in principle on a transition period for the UK's exit from the EU. Under the draft agreement,¹ the transition period will come into effect on 29 March 2019 and end on 31 December 2020.

During the transition period, the UK will remain a member of the EU single market and customs union. This provides businesses with an additional 21 months to prepare and, if necessary, launch contingency plans to move operations from the UK to the EU. Although the transition period is shorter than the 24-month period proposed by Prime Minister Theresa May in her September 2017 speech in Florence,² the UK government has been given welcome additional time to determine whether its regulatory framework will remain aligned with that of the EU or deviate, at least partially, from it.

Since the UK triggered Article 50 on 29 March 2017, the business community has been uncertain whether a transition period would be put in place to avoid a “cliff edge” exit from the EU at midnight on 29 March 2019 if a deal is not reached between the UK and the EU. The draft agreement provides a partial answer. While David Davis, the UK Brexit Secretary, has claimed that Brexit talks with the EU have moved “another significant step” forward, much remains unresolved and the coming months are likely to contain significant ongoing negotiations.

The draft agreement is subject to endorsement by the EU Council at its summit later today, and will also not be legally binding until (and unless) the entire Brexit deal is agreed and ratified by each of the 27 Member States of the EU.

¹ https://ec.europa.eu/commission/sites/beta-political/files/draft_agreement_coloured.pdf.

² <https://www.gov.uk/government/speeches/pms-florence-speech-a-new-era-of-cooperation-and-partnership-between-the-uk-and-the-eu>.

APPLICABILITY OF EU LAWS

The UK conceded in the draft agreement that EU rules will continue to have effect on the UK during the transition period, with strict sanctions imposed to the extent the UK fails to comply with its EU obligations. This allows free movement of goods, capital, services and people to continue during the transition period. It also permits the ongoing application of the Common Fisheries Policy until 31 December 2020.³

UK-based investment firms will be able to continue benefitting from AIFMD,⁴ MiFID II⁵ and UCITs⁶ passporting rights during the transition period. Until the agreement is ratified and becomes legally binding, however, it is unclear whether regulators will require banks and other financial services firms to obtain EU licences by the March 2019 official Brexit date or by the end of the transition period in December 2020. Notably, the Single Supervisory Mechanism, the European Central Bank's supervisory wing, has imposed a June 2019 deadline for banks to obtain an EU banking licence. In contrast, the Bank of England has taken a more lenient approach and is prepared to give a "regulatory underpinning" to any transition period to help investment firms prepare for Brexit. Although it is possible that the financial regulators of individual EU Member States may relax the June 2019 deadline, it would be prudent for banks and insurers to continue to implement their relocation plans in the next 12 months, notwithstanding the transition period.

ABILITY TO SIGN TRADE DEALS

Under the draft agreement, the UK will be able to negotiate, sign and ratify international agreements, including new free trade deals, with non-EU countries during the transition period, provided that such agreements do not become effective until after the transition period has ended. This marks a positive development for the UK, which had previously been told by the EU that the UK would not be able to negotiate any trade deals with non-EU countries until after the UK's departure from the EU. While this has been welcomed by the business community, the complexities of any trade deal make it unclear how many, if any, the UK will be able to put in place by the end of the transition period.

JURISDICTION OF THE EUROPEAN COURT OF JUSTICE

The UK will remain subject to the jurisdiction of the European Court of Justice (the "ECJ") during the transition period, including for appeal proceedings. The ECJ's jurisdiction will also extend to any disputes between the UK and the EU in relation to the transition agreement. In

³ The UK has been granted consultation rights during the transition period and an undertaking from the EU not to reduce the UK's current allocation when fishing quotas are set in 2020.

⁴ Alternative Investment Fund Managers Directive 2011/61/EU.

⁵ The Markets in Financial Instruments Directive 2014/65/EU.

⁶ Undertakings for the Collective Investment in Transferable Securities Directive 2009/65/EC.

addition, the final EU (Withdrawal) Bill is expected to import significant aspects of EU law and jurisprudence into UK law, which would mean that the UK courts would continue to look to ECJ judgments for guidance. Businesses should carefully consider how future business relationships could be affected by EU law during the transition period and thereafter.

DATA SHARING

Under the draft agreement, current EU law as to personal data protection will continue to apply in the UK during the transition period. The UK and the EU, however, remain in disagreement over the data sharing regime that will be implemented post-transition. While the EU may grant the UK data adequacy status so as to retain the status quo for data sharing, it is also possible that no deal will be reached and businesses will thus be subject to increased costs and burdensome requirements in order to transfer data between the UK and the EU from 2021 onwards.

IRISH BORDER

The issue of the Irish border is a key matter marked in the draft transition agreement as subject to further negotiation. In the draft agreement, the UK consented, despite earlier protestations, to a “backstop solution”, which avoids a hard border between Northern Ireland and the Republic of Ireland by keeping Northern Ireland in the EU single market and customs union and fully aligned with the EU’s regulatory framework post-Brexit. While talks will continue in the coming weeks about the Irish border problem, the onus is now on the UK government to find a workable alternative to the “backstop” that promotes businesses’ interests.

RECOMMENDATIONS FOR BUSINESS

The agreement to the UK-EU transition period is a significant breakthrough for business in many respects. The 21-month period now agreed still leaves, however, very little time for putting plans into practice. It is crucial that businesses consider their Brexit-readiness at this stage, including what is likely to occur at the end of the transition period in relation to market authorisations, regulatory approvals, product standards and consequential changes in contracts entered into pre-Brexit.

Until there is a legally binding agreement between the UK and the EU, we recommend that businesses continue to implement contingency plans to ensure continued access to EU markets, including obtaining EU licences to the extent necessary. In addition, so long as the transition agreement is in draft form, businesses should factor in the possibility that, despite the agreement, there may be a sudden ‘hard Brexit’ on 29 March 2019.

If the transition agreement becomes legally binding, however, businesses should use the transition period to implement any restructuring and reorganisation plans, adjust their operating models and engage with regulators and government authorities, as appropriate.

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Please do not hesitate to contact us with any questions.

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