

EBA/Op/2018/05

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25 June 2018

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# Opinion of the European Banking Authority on preparations for the withdrawal of the United Kingdom from the European Union

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## Introduction and legal basis

1. The European Banking Authority's (EBA's) competence to deliver an opinion to competent authorities is based on Article 29(1)(a) of Regulation (EU) No 1093/2010<sup>1</sup> (the EBA Regulation). Article 29(1)(a) mandates the EBA to play an active role in building a common Union supervisory culture and consistent supervisory practices and approaches throughout the Union including by providing opinions to competent authorities.
2. In accordance with Article 14(5) on the Rules of Procedure of the Board of Supervisors<sup>2</sup>, the Board of Supervisors has adopted this opinion.
3. This opinion is addressed to competent authorities as defined in point (2) of Article 4(2) of the EBA Regulation, including the European Central Bank with regard to matters relating to the tasks conferred on it by Regulation (EU) No 1024/2013 and the Single Resolution Board, established by Regulation (EU) No 806/2014. The opinion is also addressed to the national competent authorities of the EEA EFTA States Norway, Liechtenstein and Iceland as per the European Economic Area Agreement. This opinion concerns the activities of credit institutions<sup>3</sup>, investment firms<sup>4</sup>, payment service providers<sup>5</sup>, electronic money institutions<sup>6</sup>, and creditors and credit intermediaries<sup>7</sup> (financial institutions).

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<sup>1</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

<sup>2</sup> Decision adopting the Rules of Procedure of the EBA Board of Supervisors of 27 November 2014 (EBA/DC/2011/01 Rev4).

<sup>3</sup> As defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013.

<sup>4</sup> As defined in point (2) of Article 4(1) of Regulation (EU) No 575/2013.

<sup>5</sup> As defined in point (11) of Article 4 of Directive (EU) 2015/2366.

<sup>6</sup> As defined in point (1) of Article 2 of Directive 2009/110/EC.

<sup>7</sup> As defined in points (2) [and (5)] of Article 4 of Directive 2014/17/EU.

## Background

4. On 29 March 2017, the United Kingdom (UK) notified the European Council of its intention to withdraw from the European Union (EU) pursuant to Article 50 of the Treaty on European Union (TEU). The withdrawal will take place on the date of entry into force of a withdrawal agreement or, failing that, 2 years after the notification, on 30 March 2019. The UK's decision to withdraw from the EU includes the UK leaving the European Single Market<sup>9</sup>.
5. The EBA is issuing this opinion in response to this unprecedented situation, considering that the potential for disruption to financial institutions and their customers if financial institutions are not adequately prepared poses serious risks to the objectives given to the EBA<sup>10</sup>. This opinion therefore highlights the EBA's expectations relating to the engagement of competent authorities to ensure that financial institutions are preparing adequately for this situation, as well as meeting their obligations to their customers in these circumstances. The aims of this opinion are to ensure that competent authorities:
  - a) ensure that financial institutions are adequately considering the risks entailed by the possible departure of the UK from the EU without a ratified withdrawal agreement, and that they are putting in place appropriate plans to mitigate any risks in an appropriate timeframe; and
  - b) draw attention to the customer protection obligations of financial institutions in these circumstances.
6. This opinion is addressed to the competent authorities of the financial institutions that are currently present in the UK and that provide services to the EU27 (whether directly or by establishment), as well as financial institutions that are currently present in the EU27 and that interact with counterparties, clients or customers based in the UK (whether directly or by establishment). This opinion is in line with the European Council guidelines<sup>11</sup> and the European

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<sup>8</sup> Article 50 also allows the European Council, in agreement with the Member States, to extend this period.

<sup>9</sup> See: HM Government, The United Kingdom's exit from and new partnership with the European Union, February 2017.

<sup>10</sup> The EBA's overall objective is to protect the public interest by contributing to the short-, medium- and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses. Market disruption arising from the UK's departure from the EU in particular poses serious risks to the EBA's objectives relating to ensuring the integrity, transparency, efficiency and orderly functioning of financial markets; international supervisory coordination; preventing regulatory arbitrage and promoting equal conditions of competition; ensuring the taking of credit and other risks are appropriately regulated and supervised; and customer protection.

<sup>11</sup> European Council guidelines of 29 April 2017 following the United Kingdom's notification under Article 50 TEU (EUCO XT 20004/17); European Council guidelines of 15 December 2017 following the United Kingdom's notification under Article 50 TEU (EUCO XT 20011/17); and European Council guidelines of 23 March on the framework for the future EU-UK relationship (EUCO XT 20001/18).

Parliament resolution<sup>12</sup>, as well as the EBA opinion of 12 October 2017<sup>13</sup>. Where relevant, this opinion takes into account and complements any communications issued by the European Securities and Markets Authority (ESMA)<sup>14</sup> and the European Insurance and Occupational Pensions Authority (EIOPA)<sup>15</sup>. This opinion does not prejudice any future opinions or other convergence tools issued by the EBA.

7. Through its engagement with competent authorities, the EBA has been monitoring the level of contingency planning and other preparations undertaken by financial institutions, and is of the opinion that this planning should advance more rapidly in a number of areas. Where planning is taking place, some financial institutions appear to be delaying triggering the necessary actions. The time for the required actions to be taken is reducing. Financial institutions should not rely on public sector solutions, as they may not be proposed and/or agreed.
8. As a result of these observations, the EBA has decided to issue this opinion at this time because:
  - a) progress in the preparations of financial institutions for the potential departure of the UK from the EU without a ratified withdrawal agreement in March 2019 is inadequate;
  - b) the recent political agreement on a transition period, while welcome, does not provide any legal certainty until a withdrawal agreement is ratified at the end of the process for the departure of the UK from the EU;
  - c) there remains a material possibility that, despite the best efforts of both sides to conclude a ratified withdrawal agreement, this may not be possible, in which case the UK would leave the EU on 30 March 2019 by operation of law without a transition period; and
  - d) the necessary mitigating actions take time, and should be pursued without further delay.
9. The EBA is cognisant that the necessary actions will entail costs; this is, however, an inevitable consequence of the departure of the UK from the EU. Financial stability should not be put at risk because financial institutions are trying to avoid costs. A ratified withdrawal agreement may provide all stakeholders with more time to implement the necessary changes, but, given the lack of certainty, mitigating actions need to start now if they have not already done so. Financial

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<sup>12</sup> European Parliament resolution of 5 April 2017 on negotiations with the United Kingdom following its notification that it intends to withdraw from the European Union (2017/2593(RSP)); European Parliament resolution of 3 October 2017 on the state of play of negotiations with the United Kingdom (2017/2847(RSP)); European Parliament resolution of 13 December 2017 on the state of play of negotiations with the United Kingdom (2017/2964(RSP)); and European Parliament resolution of 14 March 2018 on the framework of the future EU-UK relationship (2018/2573(RSP)).

<sup>13</sup> See Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union (EBA/Op/2017/12), and in particular paragraphs 16, 23, 102 and 114-119: EBA opinion on Brexit.

<sup>14</sup> See, for instance: <https://www.esma.europa.eu/press-news/esma-news/esma-issues-principles-supervisory-approach-relocations-uk> and <https://www.esma.europa.eu/press-news/esma-news/esma-issues-sector-specific-principles-relocations-uk-eu27>

<sup>15</sup> See, for instance: <https://eiopa.europa.eu/Pages/News/EIOPA-issues-principles-on-supervisory-approach-to-the-relocations-from-the-United-Kingdom-.aspx>, <https://eiopa.europa.eu/Pages/News/Insurance-companies-urged-to-make-sufficient-and-timely-preparation-to-ensure-service-continuity-upon-the-United-Kingdom%E2%80%99s-.aspx> and <https://eiopa.europa.eu/Pages/News/EIOPA-CALLS-UPON-NATIONAL-SUPERVISORY-AUTHORITIES-TO-ENSURE-THAT-INSURERS-PROPERLY-ADDRESS-ALL-RISKS-TO-THEIR-SOLVENCY-POSITIVE.aspx>

institutions, and their boards, have obligations to their shareholders and to their customers to take action in a timely manner.

10. This opinion, while addressed to competent authorities, contains matters of importance for financial institutions. Competent authorities should therefore convey the messages in this opinion to financial institutions in their jurisdiction in a timely, clear and understandable manner. Competent authorities should ensure that smaller financial institutions that are subject to less intensive supervisory engagement are nevertheless aware of the messages set out in this opinion.

## Risk assessment and preparedness

11. In March 2019, the UK will become a third country for the purposes of the EU's legal framework and, in the event of the departure of the UK from the EU without a ratified withdrawal agreement, the UK will not benefit from rights under Union law, or be subject to its obligations. This has a number of implications for EU27 financial institutions interacting with UK-based counterparties, clients or customers, as well as for UK financial institutions interacting with EU27-based counterparties, clients or customers. Competent authorities should engage with financial institutions to ensure that they follow the sequence set out below in assessing the implications for themselves, and responding to these implications where relevant.

- a) To be adequately prepared, financial institutions should identify the risk channels (beyond the general risk of market turmoil) arising from the possible departure of the UK from the EU without a ratified withdrawal agreement in March 2019. In doing so, they should take into account the European Commission's notices to stakeholders<sup>16</sup>. This process should include, but not be limited to, identifying:
  - i. direct financial exposures to UK (for EU27 financial institutions) or EU27 (for UK financial institutions) counterparties;
  - ii. existing contracts with UK (for EU27 financial institutions) or EU27 (for UK financial institutions) counterparties;
  - iii. reliance on UK (for EU27 financial institutions) or EU27 (for UK financial institutions) financial market infrastructures (FMIs), including central counterparties (CCPs) and related ancillary services;
  - iv. the storage of data in, and transfer of data to, the UK (for EU27 financial institutions) or the EU27 (for UK financial institutions); and
  - v. reliance on funding markets in the UK (for EU27 financial institutions) – including for issuances of instruments eligible for minimum requirement for own funds and

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<sup>16</sup> See: Notices to stakeholders published on 8 February 2018, in particular relating to the 'Withdrawal of the United Kingdom and EU rules in the field of banking and payment services', available at: [https://ec.europa.eu/info/brexit/brexit-preparedness\\_en?field\\_core\\_tags\\_tid\\_i18n=22848&page=3](https://ec.europa.eu/info/brexit/brexit-preparedness_en?field_core_tags_tid_i18n=22848&page=3)

eligible liabilities (MREL) under UK law – or in the EU27 (for UK financial institutions).

- b) If financial institutions identify relevant risks, they should consider the implications in the event that the risks materialise. This assessment should include consideration of the implications with respect to their solvency and liquidity positions, as well as their business models. In particular, financial institutions should take the risks identified (including, for example, those arising from the application of increased risk weights for certain UK exposures, or higher capital requirements for derivatives cleared through non-qualifying CCPs) into account in their capital planning, and this should be shared with the relevant competent authorities. This assessment should take into account the financial institution's business plan and strategy, including whether continued market access to the UK or the EU27 (respectively) is necessary or desirable. If financial institutions conclude that withdrawing from the relevant market is the appropriate action, they should consider how to deal with existing business and contracts, and in particular they should consider their obligations to their customers (see 'Customer communication' below).
- c) Where appropriate, in view of their business models, financial institutions should ensure that they have the necessary regulatory permissions in place both in the UK and in the EU27 to conduct new business and support existing business. If new or expanded regulatory permissions are needed, these applications should be submitted, and/or other relevant steps taken, as soon as possible, to allow sufficient time for them to be processed and to be in place by March 2019. Credit institutions should ensure that they fully adhere to the requirements of the Deposit Guarantee Scheme Directive<sup>17</sup> (DGSD), including with respect to the membership in the deposit guarantee schemes (DGS) of any new or expanded credit institutions.
- d) Careful consideration should be given to how any new or expanded entity fits into a financial institution's existing organisational structure. The booking model<sup>18</sup> of the financial institution should clearly articulate how and where risk, including market risk (to include both pricing and hedging), will be managed. The booking model should also take into account considerations related to recovery and resolution arrangements, and the resilience of the new or expanded entity. Financial institutions should not outsource activities to such an extent that they operate as 'empty shell' companies, and all institutions should have the substance to identify the capability to manage the risks they generate from the first day after the withdrawal of the UK, as the EBA made clear in its Opinion on Brexit of 12 October 2017<sup>19</sup>. Where relevant or required (see, for instance,

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<sup>17</sup> Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

<sup>18</sup> This refers to the policies and procedures in which the institution sets out the jurisdictions and entities in which that institution concludes, records and risk manages its transactions with its counterparties.

<sup>19</sup> See in particular paragraphs 16, 23, 102 and 114-119.

Article 28(4) of the Payment Services Directive 2<sup>20</sup> (PSD2) in that regard), financial institutions should inform their competent authorities of any changes with regard to their activities, outsourcing arrangements, etc.

- e) Financial institutions should identify which existing or future contracts will be potentially affected (including derivative contracts). Issues with such contracts may in particular include the those related to the performance of ancillary services or actions that require particular regulatory permissions. For contracts governed by master agreements, financial institutions should have regard to the relevant documentation. Once the relevant contracts are identified, financial institutions should consider their options with respect to mitigating possible risks to these contracts, including making the necessary changes to those contracts (amendment, novation, transfer, etc.). Where amending or replacing contracts is identified as a mitigant, financial institutions should engage with the affected clients as soon as possible to clarify their proposed approach and aim, as well as the identity of any proposed new counterparty. Given the length of time that it may take, financial institutions should commence making the necessary changes to those contracts as soon as possible.
- f) With respect to data transfer and storage, financial institutions should identify where their data, and those of their clients, are stored (whether in the EU27, the UK or elsewhere) and whether or not these data need to be transmitted across borders between the EU27, the UK and/or another third country. Financial institutions should have regard to the provisions of the EU's General Data Protection Regulation<sup>21</sup> (GDPR) when assessing their options. Where relevant, financial institutions should consider mitigating actions such as transferring the location of the storage of that data and including data-processing clauses in new and existing contracts.
- g) With respect to access to FMIs, including CCPs, financial institutions should identify the FMIs to which they need access that are based in the UK (for EU27 institutions) or the EU27 (for UK institutions). They should consider which alternative FMIs are available in the event that their access to existing FMIs is lost or curtailed or the finality of their instruments/settlements is no longer guaranteed. They should ensure that they have the ability to transfer to those alternative FMIs in an appropriate timeframe, considering that many other financial institutions might do the same simultaneously. They should take into account that the FMIs themselves may also be taking contingency actions<sup>22</sup> to deal with the risks caused by the departure of the UK from the EU, and they should engage with the

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<sup>20</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

<sup>21</sup> Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (GDPR).

<sup>22</sup> Although legislative changes are currently under discussion to ensure an enhanced supervision of third country CCPs by the EU, uncertainties on scope and timing remain. Therefore, financial institutions should develop contingency plans that do not assume these are in place by March 2019.

relevant FMIs as a client to ensure that they are aware of these actions and that they are taken into account in their own planning.

- h) Financial institutions should assess their reliance on wholesale funding (either in the UK or in the EU27) and their ability to continue accessing this funding in the event of the departure of the UK from the EU without a ratified withdrawal agreement with a loss of market access. In carrying out this assessment, they should take into account the maturity profile of the relevant funding and their potential roll-over needs, in particular around the date of the departure of the UK from the EU on 30 March 2019. Financial institutions should consider other sources of funding, and, in the event that such funding would be unavailable, consider the implications for their liquidity positions and business activities.
- i) For financial institutions that are subject to the Bank Recovery and Resolution Directive<sup>23</sup> (BRRD), much of the analytical work referred to above should already be carried out by these financial institutions in the context of recovery and resolution planning. To the extent that this is the case, financial institutions should leverage from this work to expedite the relevant contingency planning as much as possible.
- j) Financial institutions that are subject to the BRRD should assess the extent to which their MREL-eligible liabilities are issued under UK law (for EU27 institutions) or under EU27 law (for UK institutions), having regard to the fact that such issuances may cease to be eligible for MREL following the UK's departure from the EU<sup>24</sup>.
- k) Financial institutions that are subject to the BRRD should ensure that their MREL-eligible instruments issued under UK law (for EU27 institutions) or EU27 law (for UK institutions) will remain eligible for MREL after the departure of the UK from the EU. In this regard, financial institutions that choose to include contractual clauses<sup>25,26</sup> recognising the eligibility of those instruments to be subject to the write-down and conversion powers of EU resolution authorities (for EU27 institutions) or UK resolution authorities (for UK institutions) in newly issued instruments should be prepared to demonstrate that any decision of a relevant resolution authority would be effective in the UK (for EU27

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<sup>23</sup> 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.

<sup>24</sup> Articles 45(5) and 55 BRRD.

<sup>25</sup> A failure to include such clauses could result in the de-recognition of instruments issued under English law for MREL purposes once the UK becomes a third country. This could result in a breach by institutions of their MREL requirements, or a longer time horizon before they meet their MREL requirements, with either instance threatening the resolvability of those institutions.

<sup>26</sup> Articles 45(5) and 55 of the BRRD. See also Articles 42-44 of Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges.

institutions) or in the EU27 (for UK institutions) after the departure of the UK from the EU27. Financial institutions should engage with relevant resolution authorities as to the requirements of those resolution authorities in this regard. In any case, financial institutions should note that the issuance of liabilities under EU27 law (for EU27 institutions) or UK law (for UK institutions) would achieve legal certainty for these financial institutions in terms of MREL eligibility.

- l) Financial institutions that are subject to the BRRD should ensure that, where they choose to issue new non-MREL liabilities under UK law (for EU27 institutions) or EU27 law (for UK institutions) that might be subject to bail-in as part of a resolution action, these can credibly be written down or converted through the inclusion of bail-in recognition clauses.
  
- m) Financial institutions should inform their competent and resolution authorities, as appropriate, of the results of their assessment of the risks to them, as well as the details of any plans they are putting in place to address these risks, and the timelines for the implementation of any actions envisaged.

## Customer communication

12. Competent authorities should engage with financial institutions to ensure that they have carefully assessed their obligations to (existing and prospective) customers, and taken any necessary actions to ensure the continuity of services in the light of their continuing contractual commitments<sup>28</sup>.

13. To minimise any potential disruption arising from customer confusion, competent authorities should engage with financial institutions to ensure that they provide clear information to customers whose contracts or services may be affected, as soon as that information becomes available to them, and in any event no later than the end of 2018. The information should cover at least the following areas:

- a) The specific implications of the departure of the UK from the EU for those customers, based on the circumstances of those customers (depositors, debtors, etc.), should be covered. Messages should focus on the impact of the departure of the UK from the EU for the given institution and its business, and the particular implications this has for the relationship between the customer and the institution.
  
- b) There should be information on the actions that the institution is taking to prevent any detriment to the customers.

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<sup>27</sup> Article 45(5) BRRD.

<sup>28</sup> Legal obligations are to be assessed having regard to the activities that the financial institution carries out in accordance with the EU passport regime that can possibly be affected by the departure of the UK from the EU. These obligations include – but are not limited to – obligations under PSD2 (including the requirements for providers in relation to changes to or termination of a contract), the Mortgage Credit Directive and the Deposit Guarantee Scheme Directive (including the requirement to disclose to depositors their level of protection).

- c) The implications for the customers from any corporate restructuring and preparedness activities should be covered. In particular, any relevant changes to contractual terms should be clearly communicated and explained, taking into account relevant national provisions, where appropriate. Financial institutions should also explain any circumstances where there is a change to the DGS coverage of that customer, for instance arising from the change in the DGS membership of the financial institution with which the customer holds their account.
- d) There should be information on any contractual and statutory rights of the customers in these circumstances, including the right to cancel the contract and any right of recourse, where applicable.

14. Any communication to the customers should be clear and in plain language, with next steps that are expressed in a simple way, actions to take where applicable and realistic timelines. The communication should be in the language originally chosen by the customer in the contract, or, where not applicable, the language in which the contract with the customer was drafted. Any communication should not cause undue concern. Customers should be informed of whom they can contact for further information.

15. Competent authorities should ensure that financial institutions inform them of their communication with customers, including providing those authorities with the text of the messages that they are conveying where requested.

## Monitoring by the EBA

16. The EBA will continue to monitor developments, including by engaging with competent authorities to assess the aggregate level of contingency planning being carried out by financial institutions. The EBA will assess the extent to which the EBA's opinion is effective in mitigating the risks identified. In addition, the EBA will conduct its analysis and make use of its powers and oversight tools to support supervisory convergence through bilateral engagements with the supervisory and resolution authorities, providing further communications as the need arises.

This opinion will be published on the EBA's website.

Done at London, 25 June 2018

[signed]

Andrea Enria

Chairperson

For the Board of Supervisors