

CLIENT MEMORANDUM

Brexit – UK Votes to Leave the European Union UK Remains in the European Union – For Now Key Legal Implications for Business

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On 23 June the British electorate voted on the question of whether or not to remain a member of the European Union (the “EU”). The result of the vote was for the United Kingdom to leave the EU, the so-called “Brexit”. At present the result of the vote has more political significance than direct legal significance – with the Prime Minister’s resignation being the most prominent political fall-out to date.

For the time being, the UK remains in the EU and enjoys all the benefits and is subject to all the obligations of membership.

The immediate next steps are also going to be driven largely by politics and economics rather than by any defined legal road map. They will be subject to a number of key dependencies, including the reaction of the other leaders of the larger EU Member States and, closer to home, the Scottish government. However, the process of withdrawal will begin, and businesses will want to start understanding the process and how they can manage the risks and challenges that this presents. But what “withdrawal” actually means has yet to be determined. It was a feature of the referendum campaign that advocates of “leave” did not spell out a particular model for a post-Brexit relationship with the EU, and it is not possible to predict what kind of agreement will be reached between the UK and the EU.

**Brexit – UK Votes to Leave the European Union
UK Remains in the European Union – For Now
Key Legal Implications for Business**

Continued

This client memorandum will briefly consider some key legal implications for businesses. The vote to leave doesn't have an immediate effect under either UK or EU law; consequently all current laws applying to businesses operating or providing services in the UK will continue until the process of withdrawal is complete.

How will Brexit occur?

Domestically, the move to exit the EU will require primary legislation to be passed in the UK in the usual way by both houses of the UK Parliament, including the amendment or repeal of the original legislation that paved the way to membership, the European Communities Act 1972.

With regard to the EU, Article 50 of the Treaty on European Union (the "Treaty") requires any Member State to notify the European Council of its intention to leave. The Treaty is not prescriptive about how and when such a notice is to be given.

The Prime Minister, David Cameron, has indicated that the Article 50 notice should be a matter for his successor and the timetable for the election of a new leader of the Conservative Party – and hence Prime Minister – means that notice is unlikely to be given before October 2016. In contrast, many EU leaders, including the President of the Commission and the European Parliament, have urged the UK to give notice sooner rather than later to reduce the period of uncertainty. Nonetheless, the UK cannot be forced to give an Article 50 notice and legally the timing is entirely at the discretion of the UK government. Despite public statements to the contrary from the German Chancellor, it is difficult not to believe that informal discussions between the UK and key EU Member States will commence to scope out the parameters of a new arrangement before the Article 50 notice is formally given.

In any case, provision of a notice under Article 50 will not give rise to an immediate exit, but is merely the start of a two-year negotiation period. During this period the Member States of the EU are required to "negotiate and conclude an agreement with [the UK], setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union". The agreement would require a qualified majority of Member States (excluding the UK itself) on the European Council to vote in favour, after obtaining the consent of the European Parliament.

The agreement would come into force on the date contemplated by the agreement or, failing any such agreement, exit would occur two years from the date the formal notice to withdraw was given by the UK. Given the complexity of the exit negotiations, it is fair to say that the UK would remain in the EU for a bare minimum period of two years. During this period, the laws and other aspects of the UK's membership of the EU would continue unchanged.

Relationship between UK and EU post Brexit

The form of agreement that might be entered into as part of the exit negotiations is subject to intense speculation. There are a number of potential alternative models, including membership of the EEA (a model adopted by Norway, Iceland and Lichtenstein), membership of the European Free Trade Area (which adds Switzerland to the EEA), the European Free Trade Association, the Customs Union (as agreed between the EU and Turkey) and the fall-back position of trading under WTO rules. Each of these will have different implications, determining whether (for example) the UK will continue to

Brexit – UK Votes to Leave the European Union
UK Remains in the European Union – For Now
Key Legal Implications for Business

Continued

benefit from the EU Single Market, allowing free movement of goods, services, people and capital (the EEA model), or something else.

UK legislative change

The UK will also need to make changes to its domestic legislation to reflect its withdrawal from the EU and its future relationship with the EU and other countries.

There will be a process of disentangling UK legislation from EU laws, and filling in the gaps in terms of both legislation and supervisory capability will be a complex and substantial task.

New laws will need to be enacted if the UK wishes to replace any EU laws, such as EU Regulations which have direct effect in the UK, such as EMIR and MAR or Directives that have been implemented such as Solvency II, MiFID and AIFMD.

Regulations such as those supporting Solvency II and EMIR currently have direct effect in the UK without the need for legislation from the UK Parliament. Depending on the exit “model”, the UK Parliament may decide on a wholesale replacement of existing EU Regulations with domestic laws. However, some gaps are inevitable, and it is unclear how the regulations will operate during the transition.

Outside of the European directives and regulations, amendments will still be required to take account of the new relationship between the EU and the UK, such as regarding the appointment and oversight of the UK regulators in place of EU organisations such as the European Insurance and Occupational Pensions Authority, the European Banking Authority and ESMA.

Impact for financial services, investment business and insurance

The loss of access to the Single Market, and therefore the “passporting” regime, would be the major impact for the financial services industry. Currently UK-based (re)insurers, banks and investment firms are not required to obtain parallel authorisations in any other Member State in which they offer their services and (re)insurers, banks and investment firms incorporated in one EEA Member State can establish a branch or provide services in another Member State on the basis of their authorisation and supervision by their state of incorporation. Passporting also applies to the marketing of collective investment schemes and alternative investment funds such as hedge funds and private equity funds.

Financial services firms such as banks, investment firms and (re)insurers that currently make use of “passporting” rights should consider their structures and whether they should reorganise their groups so as to ensure that they have continued access to the Single Market. We could see a period of group restructurings, reorganisations, subsidiarisation in EU Member States, acquisitions, or perhaps the establishment of a *Societas Europaea* (SE) (a form of company regulated by EU law). A feature of an SE company is that it can move its place of domicile from one EU Member State to another. During the two-year exit negotiation period, UK companies could convert to SE status, move their place of domicile to an EU Member State and thereby maintain access to the EU Single Market.

**Brexit – UK Votes to Leave the European Union
UK Remains in the European Union – For Now
Key Legal Implications for Business**

Continued

Fund managers in the UK who rely on the passport to market their products across the EU would either have to move their operations to an EU country, or rely on the national private placement regime in the same way non-EU managers currently do.

EU financial services firms currently relying on the passport to provide services in the UK will, of course, also need to consider their position.

Other areas of law

There are numerous other aspects of law that will be affected and that businesses will need to factor into their planning, depending upon the nature of their business and their group operating model. They include:

- tax and VAT
- capital markets
- competition law
- intellectual property
- data protection
- court judgements, disputes and arbitration

We would be happy to advise clients on their options at this time of uncertainty.

**Brexit – UK Votes to Leave the European Union
UK Remains in the European Union – For Now
Key Legal Implications for Business**

Continued

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**Brexit – UK Votes to Leave the European Union
UK Remains in the European Union – For Now
Key Legal Implications for Business**

Continued

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