



The business of relationships.™

FIA Webinar

Brexit Impact on Power, Gas and Commodity Markets

8 March 2017

Chris Borg, Partner

+ 44 (0) 203 116 3650

cborg@reedsmith.com

Brett Hillis, Partner

+44(0) 203116 2992

bhillis@reedsmith.com

Today's talk

- Overview of withdrawal
- Some financial regulatory effects
- Other matters affecting commodity markets
- Market structure for energy, emissions and related products



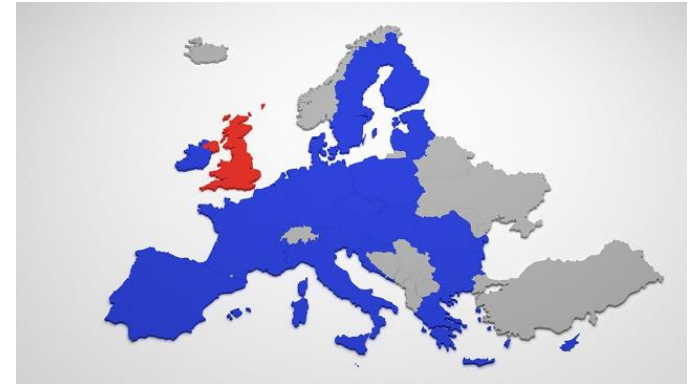
Current position

- **Today:**

- UK remains EU Member State
- Rights and obligations of EU membership continue to apply to the UK
- No Article 50 notification given but expected shortly
- No changes so far to UK law to reflect the Referendum result

- **Consequences of withdrawal under Article 50:**

- Depends of agreements reached with EU
- Agreements between EU and third countries (e.g. as to trade) would cease to apply to the UK
- Phasing-out of EU financial programmes
- Treatment of acquired rights of EU citizens living in UK and UK citizens living in EU



Possible Models for Post-Brexit EU Market Access

- **EEA Membership**

- Ready-made package
- Gives EEA-wide Single Passport rights, without EU membership
- Ruled out by UK government under “hard Brexit” approach

- **Equivalence (e.g. under MiFIR)**

- Could underpin *some* rights of access.
- Dependent on EU Commission’s discretion (for grant & maintenance)
- EU Commission working paper
- Timing issues, if equivalence decision not available in time.

- **Territorial Scope Argument**

- Ad hoc analysis: not a comprehensive solution.
- Subject to ongoing political risk.

- **Something new...**

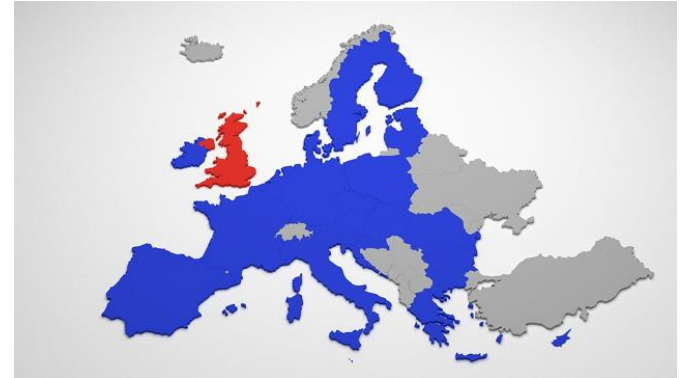
- Would take time to negotiate.
- Likely need for transitional arrangement in the meantime



Equivalence under MiFID2/MiFIR – a Closer Look

Cross-border Access Regime for TC firms

- For business with ECPs/Per Se Professionals only.
- EU Commission *may* determine a TC is “equivalent”:
 - TC firms may provide services cross-border into EU Member States with no branch establishment requirement, where:
 - authorised at home (for all relevant business); **and**
 - registered with ESMA (180 days to process an application).
 - (For first 3 years after equivalence determination firms may continue to access MS on basis of national policies)
- NB EU Commission has no obligation to make equivalence determination and may revoke it on short notice.
- Member States may impose branch registration requirements for business with retail clients/elective professional clients.



Other MiFID2/MiFIR implications – when UK is not “in the Union”

Ancillary Business Exemption

- How could TC firms claim the exemption?
 - **Level 1 (Condition for exemption):**
 - “...annually notify the relevant competent authority...”.
 - Which NCA is the relevant one? Is there one?
 - **Level 2 (ESMA: DP Dec 2014 & FR Sep 2015):**
 - “...firms ... in a third country should make the notification to the competent authority *of the Member State where their branch is situated...*”.
 - No provision for TC firms without a branch in an EU Member State.
 - Comes down to Member State implementation?



Other MiFID2/MiFIR implications – when UK is not “in the Union”

Ancillary Business Exemption

- If thresholds are calculated by reference to GNV or capital “in the Union” :
 - Trading activity & overall market size – excludes UK ...
 - Main business & capital employed – excludes UK ...
 - Retrospective effect or not?
 - Possible long-term incentive for EU firms to trade FIs on UK trading venues through UK/Non-EU affiliates?



REMIT implications – when UK is not “in the Union”

REMIT definition of “wholesale energy product”:

- Contracts for the supply of electricity or natural gas where delivery is *in the Union*
- Derivatives relating to electricity or natural gas, produced, traded or delivered *in the Union*
- Contracts relating the transportation of electricity or natural gas *in the Union*
- Derivatives relating to the transportation of electricity or natural gas produced, traded or delivered *in the Union*



MiFID2 & REMIT – Scope Impact

ANNEX I, SECTION C

C(5): Cash-settled commodity derivatives

C(6): Physically-settled commodity derivatives on a RM, MTF or OTF

C(7): Other physically-settled commodity derivatives

C(10): Exotics Derivatives

C(11): Emission allowances



MiFID2: Delegated Act - C(6) & C(7)

“REMIT” EXEMPTION

- “Wholesale energy products”
- Traded on an “OTF”
- “Must be physically settled”
- Carved out of C(6) and C(7) categories

Post-Brexit

- NBP/GTMA forwards (and LNG for delivery in UK) are not WEPs
- So not eligible for “REMIT exemption”
- Volume in these would be included in ancillary threshold calculation – where traded by EU entities/on EU TVs
- Position limits etc. would apply if traded on EU TVs
- Would be “financial instruments” for all other purposes, including EMIR and MAR



MiFID2/R: Position Limits Impact

- **Net position**
- **Person**
- **Commodity derivatives on trading venues (CDTV)**
- **Economically equivalent OTC contracts (EEOTC)**

“...position limits on the size of a net position which a person can hold at all times in commodity derivatives traded on trading venues and economically equivalent OTC contracts...”

MiFID2, art 57(1)



MiFID2/R: Position Limits – Scope

“Commodity derivatives on trading venues”

- “Trading Venues” defined as regulated markets (RMs), multilateral trading facilities (MTFs) and organised trading facilities (OTFs)
- EU entities by definition

“EEOTC”:

- Very narrow scope intended.
- MiFID2 Position Limits would **not** apply to Commodity Derivatives on UK TVs – but “equivalence” ruling may require corresponding UK regime.
- Would UK withdraw from MiFID2 architecture for position limits governance?



And so much more ...

- Third country firm treatment for EMIR purposes
- Revisit transaction reporting under REMIT, EMIR and MiFID2
- UK CCPs to be “recognised” instead of “authorised” under EMIR
- UK-based benchmark administrators to revisit basis for EU access (recognition/endorsement)
- Liquidity assessments for transparency purposes under MiFID2/MiFIR



UK domestic law consequences

- Under UK domestic law, primacy of EU law based on European Communities Act 1972
 - Section 2(1) – gives effect to the Treaties under UK law
 - Section 2(2) – gives authority to Government to make regulations implementing EU obligations (e.g. Directives)
- Some EU obligations implemented under Acts of Parliament
- Repeal of ECA 1972 provisions (“The Great Repeal Bill”)
- Will place law made under ECA 1972 on new legal footing by way of new Act(s) of Parliament, probably giving UK government broad powers to make law by way of statutory instrument.
- Need to review existing legislation
- These will be massive tasks!



Tax

- **Issues for companies trading in goods between UK and EU/ Rest of World – loss of access to EU Customs Union (power and gas = goods)**
 - Imposition of customs and import tariffs on goods traded between the UK and the EU.
 - Trade in goods between the UK and the RoW may also be subject to higher customs and import tariffs, because the UK will lose access to the EU's free trade agreements with other countries/regions.
 - The precise outcome will depend on what alternative arrangements are negotiated.
- **Group structures with UK and EU entities in direct relationships**
 - Tax efficiency of profit extraction under their structures
 - UK holding companies
 - UK operating subsidiaries



English jurisdiction and enforcement of judgments

- Legal basis supporting English jurisdiction clauses will change.
- Specific issues:
 - Revisit jurisdiction clauses drafted by reference to EU legislation e.g. ISDA Master Agreements
 - Service of process – inclusion of a process agent clause
- Potential enforcement issues in certain Member States – local law advice may be helpful to assess any risk
- UK courts would no longer automatically recognise and enforce judgments of courts of EU Member States
- Arbitration may become more attractive option – ability to obtain anti-suit injunctions, enforcement through NY Convention



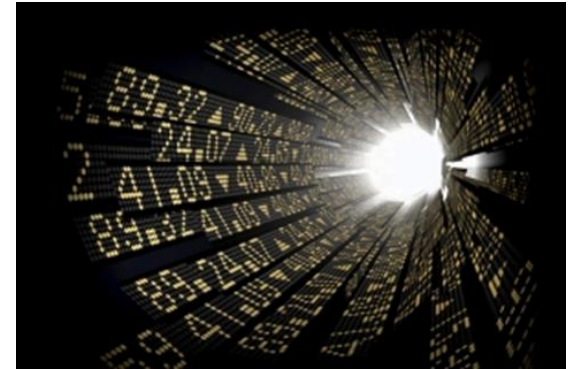
Netting, collateral and insolvency

- UK has had statutory regime for set-off on insolvency supporting close-out netting of mutual dealings since at least 1869
 - Do not expect any change in this
- Cross-border recognition of proceedings
 - The EU Regulation on Insolvency (EUIR)
- Financial collateral arrangements
 - Important particularly for IM under new margining regime for FCs and NFCs+



Data

- UK Data Protection Act implements existing EU data protection laws
- General Data Protection Regulation = a seismic change to the existing laws and is due to come into force on 25 May 2018
 - Depending on timing of exit, GDPR could come into force in the UK prior to withdrawal;
 - Thereafter the UK may decide to enact laws to keep it (or could remain bound, e.g. under an EEA-type arrangement)
 - In any event, even if the GDPR itself did not form part of UK law, the UK is likely to enact domestic legislation tracking GDPR requirements in order to achieve “adequacy” status from the EU
- EU Cyber Security (NIS) Directive due to come into force in mid 2018 (concerns security of national infrastructure, compulsory breach reporting and cooperation on threat intelligence): would require implementation by the UK in order to apply



EU Sanctions

- Sanctions require EU unanimity
- Traditionally the UK has been a sanctions “hawk” in the EU:
 - Nothing will change until the UK formally leaves the EU
 - Consideration will need to be given to existing EU sanctions regimes and their being carried forward on a new legal basis
- Possible the UK will adopt a “policy mirroring approach” to align itself to EU sanctions when it withdraws from the EU

Cf so many more areas...





The business of relationships.™

FIA Webinar

Brexit Impact on Power, Gas and Commodity Markets

8 March 2017

Chris Borg, Partner

+ 44 (0) 203 116 3650

cborg@reedsmith.com

Brett Hillis, Partner

+44(0) 203116 2992

bhillis@reedsmith.com