31 January 2017

Written evidence submitted by FIA to the UK Parliament's Treasury Select Committee in relation to its consultation on Brexit transitional arrangements

Dear Sirs,

FIA is the leading global trade organisation for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C.

FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; to protect and enhance the integrity of the financial system; and to promote high standards of professional conduct.

FIA is concerned that significant market disruption, financial instability and regulatory uncertainty may result from a failure by the UK and the EU to deliver a smooth transition through the Brexit process.

Given the complexity of the global financial markets and the regulations applicable thereto, FIA believes that transitional arrangements are a necessity in order to provide end-users, brokers and market infrastructure with sufficient time to implement the new legal requirements resulting from the Brexit negotiations.

Executive summary

- The need for a transitional period is already recognised by the European Commission[1] and the UK government.[2]

- A "cliff-edge" effect caused by a failure to agree and implement transitional arrangements by the end of the Article 50 process should be avoided. Such a failure would have a particularly negative effect on the end-users whom use cleared derivatives markets to manage their risk.

- The need for, and details of, such transitional arrangements should be agreed upon in the first few weeks of negotiation following the trigger of Article 50. Such arrangements should last for a finite period that is sufficiently long so as to provide industry with a realistic and achievable timeframe in which to achieve full and scalable compliance with the new regime. The precise period required will be driven by the complexity of the changes that result from the political agreement reached between the UK and the EU through the negotiations. Such initial finite period should be capable of *further extension* in the event that more time is required in order to facilitate the smooth transfer by the global derivatives industry to their post-Brexit operating models.

- Transitional arrangements serve two very different purposes:

[1] *"Cecilia Malmström, who is in charge of Europe's trade negotiations, said that Michel Barnier, the EU's chief negotiator, was insistent that a transitional arrangement was needed to bridge the gap while a new permanent relationship was hammered out."* – The Times, 20 January 2017 - http://www.thetimes.co.uk/article/divorce-must-come-before-trade-talks-start-zb2839p0s

[2] *"…I want us to have reached an agreement about our future partnership by the time the 2-year Article 50 process has concluded. From that point onwards, we believe a phased process of implementation, in which both Britain and the EU institutions and member states prepare for the new arrangements that will exist between us will be in our mutual self-interest. This will give businesses enough time to plan and prepare for those new arrangements."* – UK Prime Minister, Theresa May, Lancester House, London, 17 January 2017 - https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech?dm_i=J8I,4PSK3,NLEYLS,HNY4O,1

- To avoid the cliff edge of (i) EU entities being excluded from UK markets and (ii) UK businesses being unable to supply services into the EU; and

- To allow (i) businesses with activities that are currently carried out in the UK under the existing regime to adapt their business model and make any necessary reorganisations to permit them to provide services to EU customers once the post-Brexit regulatory regime is known and (ii) EU customers to choose how they wish to receive services in the post-Brexit regulatory regime once they know what is on offer.

- Noting the key role of cross-border service providers and market makers/liquidity providers, FIA encourages policymakers to adopt transitional and final arrangements between the EU27 and the UK that achieve the following outcomes:

  - Continued access to UK market infrastructure, service providers and end users by EU27 firms;

  - Continued access to EU27 market infrastructure, service providers and end users by UK firms;

  - Minimising disruption to protect the integrity of global markets and mitigate systemic risk; and

  - Avoiding policy determinations that fragment markets, collateral and liquidity, which would lead to increased costs, increased operational risk and more complex risk management for both EU and UK end users and clearing firms.

- While transitional arrangements are put into place, the UK and EU should agree to grandfather the existing authorisations and registrations of such UK market infrastructure by way of a standstill arrangement until such time as the European Commission has been able to make a decision whether to recognise such market infrastructure under applicable European law.

- "Equivalence" under EMIR and MiFID II/MiFIR by the European Commission with respect to the UK regulatory regime, the determination of UK supervisory arrangements as being equivalent to EU requirements and the "recognition" of UK market infrastructure should be sought and attained as soon as possible during the Article 50 period. FIA encourage the European Commission and the UK to allocate their respective resources in a manner that procures the delivery of this outcome, to mitigate the various risks identified below.

- Such equivalence determinations can be achieved in several ways, including:

  - Adopting third country equivalence and trading venue/CCP/trade repository recognition that are set out in EMIR and MiFIR;

  - Following the provisions of Article 46 of MiFIR regarding the ability of third country firms to provide investment services to EU27 eligible counterparties and per se professional clients without the need to establish a branch or a subsidiary in an EU member state, provided certain equivalence and ESMA registration requirements are met; and/or

  - Enacting a bilateral, reciprocal, free trade deal between the UK and the EU.

- During such standstill period, UK market infrastructure could continue to be subject to EMIR, MiFIR and all other EU laws and EU regulatory oversight, together with their National Competent Authorities.

1. The desirability of transitional arrangements

1. *The desirability in principle of transitional arrangements and the reasons they might be necessary*

1.1.1	The need for a transitional period is already recognised by the European Commission and the UK government. A "cliff-edge" effect caused by a failure to agree and implement transitional arrangements by the end of the Article 50 process should be avoided. Transitional arrangements are *desirable in principle* in order to promote financial stability and to afford all affected industry participants sufficient time to take the necessary strategic decisions related to their business and to implement them in compliance with applicable laws. Transitional arrangements serve two very different purposes: • To avoid the cliff edge of (i) EU entities being excluded from UK markets and (ii) UK businesses being unable to supply services into the EU; and • To allow (i) businesses with activities that are currently carried out in the UK under the existing regime to adapt their business model and make any necessary reorganisations to permit them to provide services to EU customers once the post-Brexit regulatory regime is known and (ii) EU customers to choose how they wish to receive services in the post-Brexit regulatory regime once they know what is on offer.
1.1.2	In the context of the cleared derivatives market, given that so much liquidity is currently concentrated in UK trading venues and CCPs, transitional arrangements are *necessary* so as to ensure that EU27 users of derivatives (including corporates, pension funds, financial institutions, market makers, insurance companies and others, whether they be MiFID-authorised or exempt firms): • Are not cut-off from being able to access UK trading venues, clearing houses or trade repositories; • Are able to unwind or hedge existing positions cleared on UK clearing houses; and • Do not suffer costs so great as to render such unwinds or hedges becoming uneconomic.
1.1.3	These outcomes could occur due to denial of access to markets because of regulation, excessive capital costs and/or lack of access to the most liquid markets.
1.1.4	FIA emphasises the key role of cross-border liquidity providers and market makers in reducing the spreads of products traded on UK and EU27 trading venues, thereby bringing down the costs of trading for end investors.
1.1.5	Whilst FIA members' primary focus relates to derivatives markets, the cash equity and derivatives markets are strongly interlinked, especially from a systemic risk perspective. Accordingly, the transitional arrangements should apply to all aspects of the UK trading venues' and CCPs' activity, not just their derivatives activity.
1.1.6	Under the Markets in Financial Instruments Directive (MiFID), some EU firms with branches in London currently report all their trades (including those executed on UK trading venues) to their home state regulator in the EU27. Such EU27 firms should continue to be able to do so, post-Brexit.

	<u>Transitional arrangements for UK market infrastructure: Trading Venues, CCPs and Trade Repositories</u>
1.1.7	Cleared derivatives (comprising swaps, options, futures and forward contracts) are traded on execution venues, cleared through clearing houses (CCPs) and reported to trade repositories (TRs).
1.1.8	By way of illustration of the importance of the UK's market infrastructure: • 4 of the 17 EMIR-authorised EU CCPs are located in the UK; • The UK handles 75 per cent. of euro-denominated derivatives transactions, according to data from the Bank for International Settlements; • By volume and market share, the UK hosts the world's leading trading venue for metals and some of the world's leading clearing houses for metals, energy, OTC interest rate derivatives and OTC credit default swaps, among other asset classes; and • 4 of the 6 EMIR-registered TRs are located in the UK. Approximately 75-80% of all trades reported to TRs since the commencement of the EMIR mandatory trade reporting obligation are reported to just 1 UK-located TR.
1.1.9	Once the UK ceases to be a member of the European Union, should a European user of cleared derivatives be required to comply with: • the *mandatory trading obligation* under MiFIR, it can do so by executing such derivatives on a trading venue located in the UK only if such trading venue has been assessed as "equivalent" by the European Commission for such purpose; • the *mandatory clearing obligation* under EMIR, it can do so by clearing such derivatives through a CCP located in the UK only if (i) English law relating to the clearing of derivatives has been determined by the European Commission to equivalent to EMIR and (ii) such CCP has been "recognised" by the European Commission for such purpose; and/or • the *trade reporting obligation* under EMIR, it can do so by reporting such derivatives to a TR located in the UK only if (i) English law relating to the reporting of derivatives has been determined by the European Commission to equivalent to EMIR and (ii) such CCP has been "recognised" by the European Commission for such purpose, and, in each case, cooperation agreements between the UK and EU regulators are adopted.
1.1.10	EMIR does not state what that the impact is on OTC derivative contracts that are cleared on a CCP that loses its EMIR authorisation / recognition, i.e. whether such trade have to be transferred to another CCP that is authorised or recognised. Transitional arrangements are needed to avoid the cliff edge risk of needing to transfer (as a market) a very large number of positions across CCPs, clearing members and jurisdictions, upon the expiry of the 2 year Article 50 process.
1.1.11	As such, there are two key regulatory steps that are required in order to ensure that UK trading venues, CCPs and TRs can continue to service EU clients:

	• English laws that govern their operations and the services that they provide must be deemed by the European Commission to be "equivalent" to the related European laws; and • Co-operation agreements must be put in place between the relevant UK and EU regulators.
1.1.12	This process of re-authorisation and entry into of co-operation agreements takes more time than is afforded by the Article 50 process. The applicable European regulations do not currently provide for any transitional arrangements with respect to the switch from being an EU market infrastructure firm to being a third country infrastructure firm, as a result of the country in which you are located leaving the EU.
1.1.13	Even if the UK simply "copy and pastes" applicable EU laws into English law without material amendment, the European Commission has expressed reservations about its operational human resource capacity, before the expiry of the Article 50 process, to verify that such amendments result in English laws that are "equivalent" to applicable European legislation.
1.1.14	Transitional arrangements therefore either need to grandfather existing arrangements or provide clarity and certain on the process for ensuring continuity.
1.1.15	FIA notes that there are certain statuses afforded by EU legislation for which there are no third country equivalence provisions – for example, even if the UK adopted MiFID II and MiFIR word-for-word, it is not possible for a UK-located Systematic Internaliser to exist under MiFID II. Other regulations such as the Settlement Finality Directive and the Central Securities Depositories Regulation (CSDR) also lack such third country equivalence mechanics.
	Transitional arrangements relating to execution brokers and clearing brokers located in the UK
1.1.16	See paragraph 1.5.8 below regarding the options available to such brokers when servicing EU clients.
1.1.17	It takes time to move capital, obtain all necessary licences from regulators, move people and systems, update the legal documentation between brokers and their clients and to connect to new trading venues, CCPs and trade repositories. This process will take significantly more time than the two years permitted via the Article 50 process.
1.1.18	In any event, businesses will also need to understand the new legal and regulatory environment post-Brexit before they can make long term plans.
1.1.19	Firms will be forced to move unless there is clarity on whether transitional arrangements will be forthcoming.
1.1.20	Transitional arrangements are therefore absolutely essential, otherwise EU businesses risk being put in a position whereby they are unable to manage their risks using cleared derivatives in the UK and businesses operating in the UK will be unable to offer certain services to EU customers.

2. *The pre-emptive action that might be taken by the private sector in the absence of a credible commitment to transitional arrangements during the Article 50 negotiations*

1.2.1	Execution and clearing brokers may need to change the geography from which they service their clients – see paragraph 1.5.8 below regarding the options available to them.
1.2.2	Firms need to ***plan for the worst case scenario***. That means they need to assume that: • No deal will be struck between the UK and the EU by the end of the Article 50 process; • The EU will not agree to even discuss the terms of the future EU/UK relationship until after the Article 50 process has been concluded; • UK market infrastructures will lose all of their regulatory approvals from Europe with the result that they can no longer service European derivatives users nor have European members; • EU clients and end users are forced en masse to transfer their positions to an EMIR authorised/recognised CCP; and • UK firms will lose the ability to service EU27 clients from outside the EU.
1.2.3	On the basis of these assumptions, firms: • May start to move business, operations and staff into EU locations[3] as soon as (or even before) Art 50 triggered; • Will need to consider whether to move only their front office staff, or whether to also move middle and back office functions; • Will need to apply for licences and trading venue/CCP memberships where they don't have them already; • Will nonetheless likely look to make these changes reversible, in case a more positive outcome that such worst case scenario comes to pass; • Will likely prioritise key business lines and clients, with the risk that smaller clients and some business lines may have no adequate contingency, and trades may be priced based on a risk of their clearing location having to change over the life of the trade, adding to the costs for end users.

3. *The timetable over which such pre-emptive action might be taken*

1.3.1	Some banks are already in the process of taking such action. The process may accelerate once further details of the UK and EU positions are known and once Article 50 has been triggered. Even if firms execute their contingency plans immediately upon the triggering of Article 50, they will not be able to complete the transition to the new operational and legal environment for all house and client business in the timeframe available.
1.3.2	It is estimated by some that it takes 18-24 months to move the operations of a major financial institution from one jurisdiction to another, so such institutions will need to give thought as to whether they should be executing their contingency plans immediately, so as to ensure that they can service their clients without interruption at the end of the Article 50 process. As noted above, there is also a material risk that smaller clients risk being excluded or deprioritised.

[3] https://www.bloomberg.com/politics/articles/2017-01-31/what-the-world-s-biggest-banks-say-about-fleeing-brexit-britain?cmpid=BBBXT013117

1.3.3	From a commercial viewpoint, the point of no return is triggered when clients are notified, a process that could take 12 to 18 months due to constraints in firms' ability to re-document their relationship with all affected clients.

4. *The extent to which a political commitment to transitional arrangements might reduce the likelihood of pre-emptive action and the form in which such a commitment in principle would need to be made*

1.4.1	To be clear, any such commitment would be need to be a bilateral commitment on the part of both the EU27 and the UK. Such a commitment may reduce the need for market participants in the UK and EU to execute their contingency plans if it allows them more time to consider their strategic options, but only if such political commitment is forthcoming in the first few weeks of negotiations – announcing transitional arrangements at the end of 2017 would likely be too late. Firms would not be able to wait so long before taking pre-emptive action, because it takes time for them to address physical relocation issues (staff, premises, IT etc.) and to obtain all necessary regulatory approvals from the relevant EU27 national competent authorities.
1.4.2	We understand that upon the triggering of Article 50, Didier Seeuws' team at the European Council anticipates taking around six weeks to discuss, agree and set the parameters for the European Commission to negotiate on behalf of the EU27. The best possible outcome, for EU27 and UK firms alike, would be for the European Council and European Commission at that stage to express a firm political agreement to adopt transitional arrangements with respect to cleared derivatives to address the various issues set out in this response.
1.4.3	FIA has no strong view on the form of such commitment in principle, but there must be no doubt that the issue is politically settled. Only then may industry participants seek to postpone the execution of their contingency plans.
1.4.4	Even in that scenario, there are still risks being taken by industry participants by not executing their contingency plans at that early stage in the Article 50 process.

5. *The likely consequences of not having negotiated transitional arrangements, assuming the UK's final, settled relationship with the EU has not been agreed at the end of the Article 50 process*

1.5.1	The industry's primary goal has to be to ensure that users of derivatives can continue to access the markets and their clients with minimal/no disruption. To achieve that goal, users and service providers may need to take their business elsewhere and/or to re-locate some of their business to the EU. This would only partially address the issues of (i) UK-based access to clients in EU27 member states and (ii) firms' ability to access UK trading venues, CCPs and TRs from EU27 member states.
1.5.2	On the assumption that UK trading venues, CCPs and TRs will need to follow the approval processes set out in EMIR and MiFIR, rather than the UK and EU agreeing in a bilateral trade deal to override such requirements, then the following issues demonstrate the manifest need for transitional arrangement in relation to the regulatory approvals of such UK market infrastructure.

1.5.3	Impact on users of UK trading venues: If no transitional arrangements are agreed for UK trading venues, then European users of derivatives will not be able to meet their mandatory trading obligation under MiFIR by executing such derivatives on UK markets. They will therefore be cut-off from the wholesale market liquidity that exists in London. For a very large number of asset classes, London is the/one of the pre-eminent global pools of liquidity.
1.5.4	As an aside, if UK liquidity is removed from EMIR and MiFIR calculations, query how many mandatory clearing and trading obligations would remain under those EU regulations. Given the UK is a key market for such activity, the EMIR and MiFIR calculations would likely need to be reviewed. By way of example of the importance of UK trading venues: • the majority of non-ferrous on-exchange business is conducted on the London Metal Exchange, equating to USD10.3 *trillion* notional in 2016; and • Up to two thirds of the world's oil is priced relative to the ICE Brent complex. ICE's primary European trading venue and clearing house are both located in London.
1.5.5	Impact on users of UK CCPs: If no transitional arrangements are agreed for UK CCPs, then various consequences arise - in short, EU end users will be cut-off from UK CCPs: • EMIR prohibits those UK CCPs from having EU clearing members; • EU end users will no longer be able to use UK CCPs to meet their mandatory clearing obligations under EMIR; • EU end users will lose the ability to clear even risk-reducing trades on such CCPs, leaving the positions trapped there unless an industry migration of such positions to another authorised or recognised CCP is achieved via a hugely complex and potentially costly operation; • UK CCPs will each become a "non-QCCP" under CRR, such that it will become uneconomic for EU banks to clear on such CCPs because capital requirements would increase 50 times for direct clearing members and 25 times for non-direct clearing members; and • Business may migrate to US, EU and/or Asia.
1.5.6	UK-located trading venues and CCPs may not wish to relocate to an EU27 country for a variety of reasons: • From a product perspective, the contracts traded/cleared on the relevant market may only be denominated in USD and/or GBP; and/or • There may be an insufficient number of EU27-located members of such trading venue/CCP.
1.5.7	Impact on users of UK Trade Repositories: If no transitional arrangements are agreed for UK TRs, then European users of derivatives will not be able to meet their EMIR reporting obligation by reporting their transactions to TRs in the UK. There are only two TRs in the EU27 that have been authorised to date, so there is very limited choice available as regards replacement TRs. EMIR is unclear as to whether trades that are reported to a TR that loses its registration status and does not become "recognised" under EMIR have to be re-reported to another registered/recognised TR.

1.5.8	**Impact on clearing brokers and their clients:** It remains far from certain that the provision of clearing broking services is an investment service under MiFID II. Taking the worst case scenario and assuming that MiFID II applies, then in order to continue servicing their EU client base, UK-located clearing brokers have the following options under MIFID II / MiFIR: • **Clients whom are Eligible Counterparties or Per Se Professional Clients – rely on MiFIR with equivalence:** Rely on equivalence under Article 46 of MiFIR in order to service their European Eligible Counterparty/Per Se Professional Clients from the UK, without establishing a branch or subsidiary in the EU – English law would apply to the provision of such services to such European clients. This option is not possible without, *inter alia*, the European Commission having deemed applicable English laws as "equivalent" by the end of the Article 50 process; • **Clients whom are Eligible Counterparties or Per Se Professional Clients – MiFIR without equivalence:** If that equivalence is not forthcoming, rely on Article 46(4) of MiFIR in order to service their European Eligible Counterparty/Per Se Professional Clients from the UK, without establishing a branch or subsidiary in the EU – the laws of the EU Member State in which the client is located would apply to the provision of services to such European client. This option is only possible if the applicable EU member state allows the broker to service the EU client out of London; • **Retail/Opted-Up Professional Clients – MiFID II:** Rely on MiFID II Article 39 to service those clients. The broker can potentially do so from London, unless the local EU regulator exercises its right to require the broker to establish a branch in its Member State. The broker would only be able to service clients in that one Member State from that branch; • **Rely on "reverse enquiry":** The UK broker could in theory seek to Rely on its European clients approaching it on a reverse enquiry basis under Article 42 of MiFID II, but this is unreliable for all the reasons mentioned by Dame Corley in her oral testimony to the Treasury Select Committee; or • **Move the relevant business to the EU and obtain a passport:** Move the business to a subsidiary in an EU member state, obtain local authorisation in that EU Member State and then passport its services to all EU 27 member states without having to seek additional approvals from each of those other EU 27 member states – the relevant European laws (EMIR, MiFID II etc.) would apply to the provision of such services to such European clients.
1.5.9	There will likely be a divergence of approaches between firms that currently service their EU clients from their London office. Some will wish to transfer the minimum possible business into the EU. Others may be willing to transfer more – for all sorts of reasons. Some already have large footprints in the EU. Other have far less of a footprint. There will also likely be some arbitrage between EU Member States. For example, some countries may offer a solution in which the firms only need to transfer a small proportion to the country and permit back to back arrangements and outsourcing. Regulatory capital requirements may also heavily influence decisions.
1.5.10	So, teams of staff whom are currently in London may need to move or be replaced by teams locally in the EU27. If firms don't have the relevant licences already, they will need to obtain them from the relevant NCAs in the applicable EU27 Member States.
1.5.11	As a result of all of these changes, there is a risk that such firms suffer significantly increased capital requirements, trapped liquidity and trapped balance sheet, with the costs and impact of those issues being suffered by their clients in the real economy.

1.5.12	Notwithstanding the systemic importance of the services provided by clearing members, the number of firms actually providing clearing services to clients is in significant decline. This decline results from such firms being under unprecedented cost pressures throughout this decade due to increased regulatory capital requirements; new balance sheet leverage constraints; a low interest rate environment; and a record amount and pace of global regulatory change that applies to their business, both locally and internationally.
1.5.13	The uncertainty caused by Brexit adds significantly to those cost pressures and risks more clearing firms withdrawing from the market, thereby further restricting access to CCPs by users of derivatives.
1.5.14	To mitigate that additive Brexit-specific risk, it is important to provide as much certainty to clearing firms as possible. In particular, if the clearing firms have no alternative but to trigger their contingency plans shortly after Article 50 is triggered, the resulting costs of seeking to "hedge" the outcome of the Brexit negotiations will likely lead to significant additional costs being borne by such clearing brokers and/or passed on by such clearing firms to their clients, including but not limited to their EU27 and UK clients.

6. *The particular risks that might not be readily manageable in absence of transitional arrangements*

1.6.1	None of the above risks are readily manageable without transitional arrangements unless, on or prior to the end of the Article 50 process: • the European Commission confirms, for the purposes of all articles of EMIR and MiFIR that require a positive equivalence assessment, that English law is equivalent and "recognises" all UK market infrastructure that is then authorised/registered • ESMA and the applicable UK competent authorities enter into the cooperation agreements required by EMIR and MiFIR with respect to such market infrastructure • Each EU27 Member State confirms whether, with respect to third country firms located in the UK whom wish to provide investment services or perform investment activities to clients in that Member State: o They require such third country firms to establish a branch when servicing Retail Clients or Opted-Up Professional Clients; and/or o Such firms can provide or perform the same in accordance with national regimes in the absence of an equivalence assessment from the European Commission.

7. *The extent to which the Great Repeal Bill might provide all the legal certainty and continuity required to render the need for transitional arrangements unnecessary*

1.7.1	The relevant powers are not in the gift of the UK Parliament and so no legal certainty can be provided through the Great Repeal Bill alone. The relevant laws that are applicable to the derivatives industry in the UK and Europe alike are almost entirely regulations created by the European Union (e.g. EMIR, MiFID II, CRD IV, Market Abuse Regulation, Benchmarks Regulation, BRRD, CCP Resilience Recovery and Resolution Regulation, PRIIPS, REMIT, SFTR, AIFMD) rather than national Member State laws. For the most part, if EU market users want to continue using UK market infrastructure and if UK firms wish

	to continue servicing the clients from the UK, then equivalence and recognition needs to be granted *by the European Commission* to the UK and firms in the UK or some other solution (e.g. a bilateral trade deal) must be found.

2. The design of transitional arrangements

1. *The period of notice that would be required of the UK's final, settled relationship with the EU to enable the private sector to make necessary preparations*

2.1.1	The answer to this question depends upon the amount and complexity of any changes required as a result of the Brexit negotiations.
2.1.2	Further, it will also depend upon whether the UK and the EU agree the terms of their future relationship on or prior to the expiry of the Article 50 process. If they do not, then FIA foresee a four-stage process (Stages 3 and 4 comprising the equivalence period in this scenario): • Stage 1 - Between now and the triggering of Article 50 (assumed to be by the end of Q1 2017): EU27 and UK firms prepare their contingency plans; • Stage 2 - During the Article 50 process: firms execute their (reversible) contingency plans, whilst the UK and EU agree the terms of the UK's withdrawal from the EU; • Stage 3 - A given period of time (which could last several years) after the expiry of the Article 50 process: The UK and the EU agree the terms of their future relationship; and • Stage 4 - A given period of time (uncertain in duration): the private sector prepare for implementation, in phases. We note the comments of David Davis MP that the UK proposes a two year implementation period, but consider that period too short in practice to implement changes of such complex cross-border changes.
2.1.3	If Stages 2 and 3 are completed concurrently, then the transitional period only needs to allow sufficient time for implementation by the industry (Stage 4). Transitional arrangements need to extend to the end of Stage 4.
2.1.4	The transitional arrangements need to be sufficient both in terms of length and scope, so that firms are not forced to implement their contingency plans. Accordingly, the industry needs (i) early clarity and (ii) assurance that there will be transitional arrangements that mean the status quo is maintained until the future relationship is established and there has been sufficient time for the industry to implement changes to their business model within the parameters of that future relationship. We would recommend that any transitional arrangements are expressed to last a specified number of years, but that such transitional period may be extended further if it is apparent that the industry will not be able to fully implement the necessary changes to their business without such extension(s).
2.1.5	As the Treasury Select Committee is well aware, the Article 50 process only applies to the UK's withdrawal from the European Union. It does *not* govern the process for determining the terms of the UK's future relationship with the European Union. That will be the subject of separate negotiations, which may or may not run, in whole or in part, concurrently with the withdrawal process under Article 50. At this stage, one should not assume that the EU shares the UK Government's enthusiasm to complete Stages 2 and 3 concurrently.

2. *The form that transitional arrangements would need to take in order to prevent pre-emptive action by the private sector, and minimise the risk of sudden and disruptive changes to the operating environment*

2.2.1	Whilst form is important, it is the substance that is critical: the transitional arrangements must be capable of being reasonably relied upon by the global industry.
2.2.2	Given (i) the absence of transitional arrangements in the applicable EU regulations, (ii) that there may be operational reasons why the European Commission is unable to transition the regulatory approvals of UK market infrastructure firms within the required timeframes, (iii) EU market participants risk being completely cut off from UK market infrastructure and (iv) the very limited choice of alternative TRs, the UK and the EU should seek to agree to grandfather the existing authorisations and registrations of such UK market infrastructure by way of a standstill arrangement, with the effect that the provisions of key European regulations such as EMIR, MiFIR and all other EU laws with application to trading, clearing, reporting and the provision services related thereto would *continue to apply* during such standstill period. Those UK market infrastructure firms would also continue to be subject to regulatory supervision by their existing college of regulators (where applicable), by the European Securities and Markets Authority (ESMA) and by their national UK competent authorities.

3. *The desirability or otherwise of a temporary period during which the UK's economic and legal relationship with the EU does not change ("standstill"), and the length of time that this would need to last in order for necessary preparations to be made*

2.3.1	This is critical. UK market infrastructure that is currently authorised or registered under EMIR or MiFID II/MiFIR will need to have those authorisations/registrations grandfathered, otherwise EU users of the derivatives markets will be cut off from accessing that infrastructure from the date of the end of the Article 50 process.
2.3.2	Even if the UK "copy and pastes" applicable EU laws into English law without material amendment, the European Commission has expressed reservations about its operational human resource capacity, before the expiry of the Article 50 process, to verify that such amendments result in laws that are "equivalent" to applicable European legislation. Accordingly, the grandfathering provisions need to last sufficiently long for the European Commission to make such determinations and, further, to consider the applications made by UK market infrastructure for their recognition by the European Commission. Article 89 of EMIR provides a template for the sort of language that could be used.
2.3.3	The standstill arrangement should last until such time as: • The European Commission has made a decision whether to recognise such market infrastructure under applicable European law; or • The EU is otherwise satisfied that arrangements are in place for EU customers to have access to services equivalent to those provided in the UK.

3. The negotiation of transitional arrangements

1. *The interests of other EU Member States in transitional arrangements*

3.1.1	The UK and the EU share a common priority in needing to promote stability, investor confidence and investor protection. Financial and regulatory instability is in no-one's best interests.

2. *The interests of other EU businesses in transitional arrangements*

3.2.1	The ability of EU governments and EU manufacturers, producers, asset managers, insurance companies, pension funds and others to manage their risk and raise financing by connecting to the pools of liquidity that are located in the UK, without disruption, is self-evident.

3. *The likely timetable for securing a political agreement to transitional arrangements during the Article 50 negotiations*

3.3.1	This is a political question on which FIA is not best placed to comment, but would emphasise the need for agreement to be reached quickly to minimise disruption to EU27 end users.

4. *The compatibility of transitional arrangements with the Government's intention to leave the EU two years after the triggering of Article 50*

3.4.1	Whatever the political issues, FIA considers it unrealistic for anyone to expect an entire global industry to be able to transition in a fully legally compliant way to a new status quo in the two years afforded by Article 50. We re-iterate the points made above in paragraphs 1.1.2, 1.5.3, 1.5.5, 1.5.7 and 2.2.2.

5. *The compatibility of transitional arrangements with the Government's intention to end free movement and the jurisdiction of the European Court of Justice*

3.5.1	Whatever the political issues, FIA considers it unrealistic for anyone to expect an entire global industry to be able to transition in a fully legally compliant way to a new status quo in the two years afforded by Article 50.

6. *The practicalities of negotiating transitional arrangements before agreement has been reached about the shape of the UK's final relationship with the EU*

3.6.1	Transitional arrangements are manifestly in the best interests of all parties. Whilst the precise terms of such arrangements should reasonably be expected to be subject to detailed negotiation, the need for both parties to agree on the principle of a transitional arrangement at the start of negotiations is indisputable. It could take 18 months or more simply to agree the terms of the transitional arrangements, but agreement in principle that there will be transitional arrangements should be an urgent priority and announced at the first available opportunity in 2017. As noted above, transitional arrangements serve two

	purposes: (i) to avoid a cliff edge effect and (ii) to provide time to transition to, and implement, the post-Brexit regulatory regime in both the UK and the EU27. Transitional arrangements that do not address both purposes are not fully effective.