

# "Brexit and Financial Services"

Nicholas Sowels

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**Building Research Synergies in Global Governance**

(amendments and comments to slides introduced 21 September 2021)

# Passports – August 2016

	<b>Total</b>	<b>Inbound<sup>3</sup></b>	<b>Outbound<sup>4</sup></b>
Number of passports in total <sup>5, 6</sup>	359,953	23,532	336,421
Number of firms using passporting	13,484	8,008	5,476

Source: Andrew Bailey (FCA), *Letter to Andrew Tyrie MP*, Chairman of the Treasury Committee, House of Commons, 17 August 2016.

Under the Single Market principle of “mutual recognition”, the UK and the City in particular had become a base for foreign (and British) financial service institutions, servicing the EU market. This is shown by the number of firms, many holding multiple passports. “Outbound” is for UK-based financial services selling products to the rest of Europe.

# “Brexit means Brexit”

## January 2017



**OUT of the Single Market**

**OUT of the Customs Union**

In his diaries, *The Grand Illusion: A Secret Diary of Brexit*, (2021), Michel Barnier recalls being “stupefied” by the “number of doors Theresa May shut, one after the other” in her Lancaster House speech in January 2017 (reviewed by Jim Brunsten and Sam Fleming, “Boris Johnson’s ‘madman’ dumbfounded Brussels’ Brexit chief”, *The Financial Times*, May 6, 2021).

By coming out of the Single Market (to take back control of immigration, budget contributions and primacy of domestic laws), Theresa May inevitably set the UK on a hard Brexit path, with no real hope for “mutual recognition” and passporting.

# Mutual recognition > Equivalence?

Equivalence: unilateral, revocable

Not all activities

Equivalence is a far weaker regime than having passporting rights. First, it applies to far less services, and in particular excludes banking and insurance services for retail clients (see next slide). Second, equivalence is unilateral, and can be withdrawn by the European Commission at short notice. This constitutes a poor regime for investors who prefer stable legal conditions.

**Table 1: The potential availability of equivalence for UK financial services products**

Product-type	EU law	Importance of EU Passport to UK financial services	Is Equivalence Available	Does equivalence permit passporting?
Banking	Market in Financial Instruments Directive II/ Regulation	High: portfolio management, investment advice	Yes	Yes
Banking	Capital Requirements Directive (CRD IV)	High: wholesale and retail banking services such as deposit taking, commercial lending and payment services	No	No
Asset management	Alternative Investment Fund Managers Directive (professional clients)	Medium: marketing and management of investment funds across borders to professional clients	No, but there is trade precedent for indirect portfolio management	No, but absent a deal, individual Member States may permit
Asset management	Undertakings for Collective Investment in Transferable Securities Directive	Medium: as above but to retail clients	No	No
Insurance	Solvency II Directive	Low: cross-border reinsurance	Yes (reinsurance)	Yes
Insurance	Solvency II Directive	Low: cross border direct insurance; most insurers which operate cross-border have established independent subsidiaries in other Member States	No (direct insurance)	No

# Political positions harden... over time

**For the EU, financial autonomy and regulatory authority became important.**

(This is a practical and quasi-sovereignty issue. During the Eurozone sovereign debt crisis, the ECB suspected financial markets in London betting against bonds of southern Member State governments, aggravating the crisis. Also, the ECB needs to have regulatory authority over EU financial activities on the one hand, and does not want to be liable for business outside its jurisdiction on the other hand.)

**With Davis, Johnson & Frost politics and sovereignty triumph!**



David Davis and his team (right) arrive in Brussels empty-handed to start negotiations in June 2017



Johnson lambasts EU rules for shipping kippers, ignoring that these rules were adopted at Britain's request (Conservative Party conference, July 2019.)

# Financial Services $\neq$ Goods

## Not in EU-UK Trade and Cooperation Agreement (30 Dec 2020)

(WTO GATS is thus essentially the trade framework, though Britain has granted equivalence unilaterally.)

## Hard to track

(But, financial service trade does not cross physical borders. It relies on digital technology and so is hard to track. The EU is especially worried about “shell companies and “fly-and-drive” services. Financial institutions must be capitalised in the EU and have management responsibilities in the EU, etc.)



Separation > Divergence > Separation > Divergence

**BUT FINANCIAL  
INSTABILITY  
AVOIDED! ... SO FAR 😊**

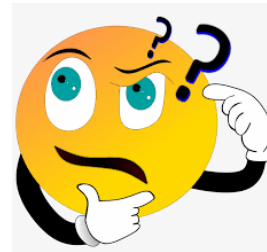
***GHOST OF  
THE GFC***



During the various hard-Brexit deadlines (end March 2019, mid-April 2019, end October, and December 2020), there were numerous worries about market cut-offs, contract breakdowns, cliff-edge failures. These concerns led to repeated preparations by UK and EU regulatory authorities. Shocks (like the Lehman bankruptcy (in 2008)) were avoided.



# Now What



**Good News** 😊 - G20 / Basel III framework

(The UK took part in the re-regulation of financial services after the global financial crisis. It supports the guidelines set out by the G20, and the Basel committee.)



No “Singapore-upon-Thames” ... YET  
Bonus cap remains!



“Stringent but **Stylish**” – “agile”  
Sam Woods (2019)

## Competition through better regulation

(Strong capital ratios, “ring-fencing”, senior managers and certification regime, “sandbox” for fintech, etc.)

# Central Counter Parties: The Big Battle



- Exchanges of standardized derivatives – very important since GFC
- €100 trillion market (Reuters 27/5/21)
- LCH (London Clearing House) 90% of clearing in euro interest rate swaps
- EMIR 2.2 – tier 2 CCPs of systemic importance

The UK wants to preserve this business. The EU would like to bring it into the Eurozone. But economies of scale are important, and there are some risks to financial stability involved. Large EU operators are also likely wanting cheaper services that come from the large London market.

The Commission has granted access to the London CCPs (for EU based companies) until the end of June 2022.

# The Future – *la vie n'est pas en rose*

The City “will survive” but...

could be less competitive with NY

More “agile” regulatory divergence

Possible recruitment problems

EU fragmented finance

Dublin, Paris, Amsterdam,  
Luxembourg, Frankfurt

**The cost of finance will be higher**

But maybe more balanced  
regional/sectoral growth as financial  
services are dispersed across the EU?

# New Challenges



Libor is ending at end of 2021, maybe there will be opportunities for Euribor?



The UK authorities will seek to encourage fintech. As UK regulation involves less parties, it may well be more efficient in nurturing fintech.



Bitcoin, cryptocurrencies, rising inflation and possible economic/monetary competition from China could present major future challenges, beyond Brexit.

# Oliver Wyman Study: Costs of Brexit in Financial Services (October 2016)

UK leaves but retains passporting and equivalence

WTO terms

Fall in EU-related activity -£2bn (2% of int'l business)

40-50% of EU-related activity at risk (£18-20 billion)

3,000 to 4,000 job losses

31,000 to 35,000 job losses

£500 million less tax

£5 billion less tax

# New Financial estimates: April 2021

Little equivalence

Trading of EU listed firms must occur in Eurozone – shifted to Amsterdam (nearly £6 bn in share dealing – first trading day of 2021).

- **New Financial survey:**

- 440 firms have located so far;
- £900 bn in bank assets (about 10% of UK banking system);
- 7,400 staff moves identified;
- Main moves to Dublin 25% of moves (a 1/3 of all asset management movers); Paris, Luxembourg, Frankfurt (banks' main base); Amsterdam (trading platforms)

Service Sector Trade by the UK, in £ millions

	2015	2019
Exports to the EU 28		
Financial services (a)	22,424	23,928
Insurance & pensions (b)	3,627	3,205
Imports from the EU 28		
Financial services (c)	3,291	5,720
Insurance & pensions (d)	–	1,406
Balance of trade with the EU in financial services and insurance & pensions (a+b)-c	22,760	21,410
		Incl.(d):20,004
Total service exports to EU	88,909	123,667
Total service imports from EU	67,977	106,147
Balance on total service trade with EU	20,932	17,520
TOTAL exports of services to world		
Financial services (e)	50,769	59,210
Insurance & pensions (f)	12,907	19,943
TOTAL imports of services from world		
Financial services (g)	8,695	18,072
Insurance & pensions h)	151	2,551
TOTAL balance (e+f) – (g+h)	54,830	58,530
TOTAL balance of UK trade in services	87,763	100,378
Share of financial services' surplus in total services surplus, in percent	25.9%	21.3%
TOTAL UK current account balance	-100,261	-130,880

The UK trade surplus in financial Services appears already to have Fallen between 2016 and 2019.

But these are early times still.