

Course 8

- 1. The Road to Brexit**
- 2. Some words on EU regulation**
- 3. The quest for Mutual Recognition, then Equivalence**
- 4. Worries about financial instability**
- 5. The long road to divergence with EU**

The UK Referendum to Leave the EU, 23/6/2016

“Take Back Control”

52% of votes for “Leave” (74% turnout)

No planning and no ideas for what Brexit actually means.



“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.

Passports – August 2016

	Total	Inbound³	Outbound⁴
Number of passports in total ^{5, 6}	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.

A short history of EU Financial Policy

- The Treaty of Rome 1957 sets out principle of free movement of persons, services, capital and goods.
- 1973-1983 – harmonization policies: 1973 First Non-Life Insurance Directive; 1977 First Banking Directive; and 1979 First Life Insurance Directive
- June 1985 White Paper on internal market – proposed harmonisation via a single bank licence (1987 Single European Act)

GFC and post-crisis reform

- Increasing integration and interdependence of financial markets halted by GFC
- Between October 2008 and Oct 2011, the European Commission approved €4.5 trillion of State measures
- Flagship initiatives: Banking Union and Capital Markets Union (which remain to be achieved)
- Widespread agreement internationally on reform (G20, Basel, FSB, etc.)
- Stronger prudential requirements for banks; enhanced supervision and resolution; managing failing banks; improved protection for depositors => the “single rule book”

Key EU financial services legislation

- Banking: Capital Requirements Directive (CRDIV) access to activity, and the Capital Requirements Regulation (CCR) – minimum standards
- Single Supervisory Mechanism (SSM) Regulation > the ECB is central prudential supervisor. Supplemented by Single Resolution Mechanism Regulation (2014)
- Bank Recovery and Resolution Directive (2014)
- Deposit Guarantee Schemes Directive (2014)
- Markets in Financial Instruments (MiFID II, 2014) – consumer protection and market transparency
- Solvency II Directive (2009) harmonized rules on insurance

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

The “Bonus cap” remained in place for a while!



“Stringent but **Stylish**” – “agile”

Sam Woods, CEO Prudential Regulation Authority (2019)

Competition through better regulation

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

The Future – *ce n'est pas la vie 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?

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:**

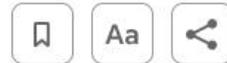
- 440 firms have located so far;
- £900 bn in bank assets (about 10% of UK banking system);
- 7,400 staff moves identified;
- Main moves to Dublin 25% of moves (a 1/3 of all asset management movers); Paris, Luxembourg, Frankfurt (banks' main base); Amsterdam (trading platforms)

October 2024: the Lord Mayor of the City of London says...

Brexit 'disaster' cost London 40,000 finance jobs, City chief says

By John O'Donnell, Elisa Martinuzzi and Andy Bruce

October 16, 2024 5:02 PM GMT+2 · Updated October 16, 2024



[1/3] People walk through the Canary Wharf financial district of London, Britain, December 7, 2018. REUTERS/Simon Dawson/File Photo [Purchase Licensing Rights](#)



Lord Mayor Michael Mainelli:

"We had 525,000 workers in 2016. My estimate is that we lost just short of 40,000."

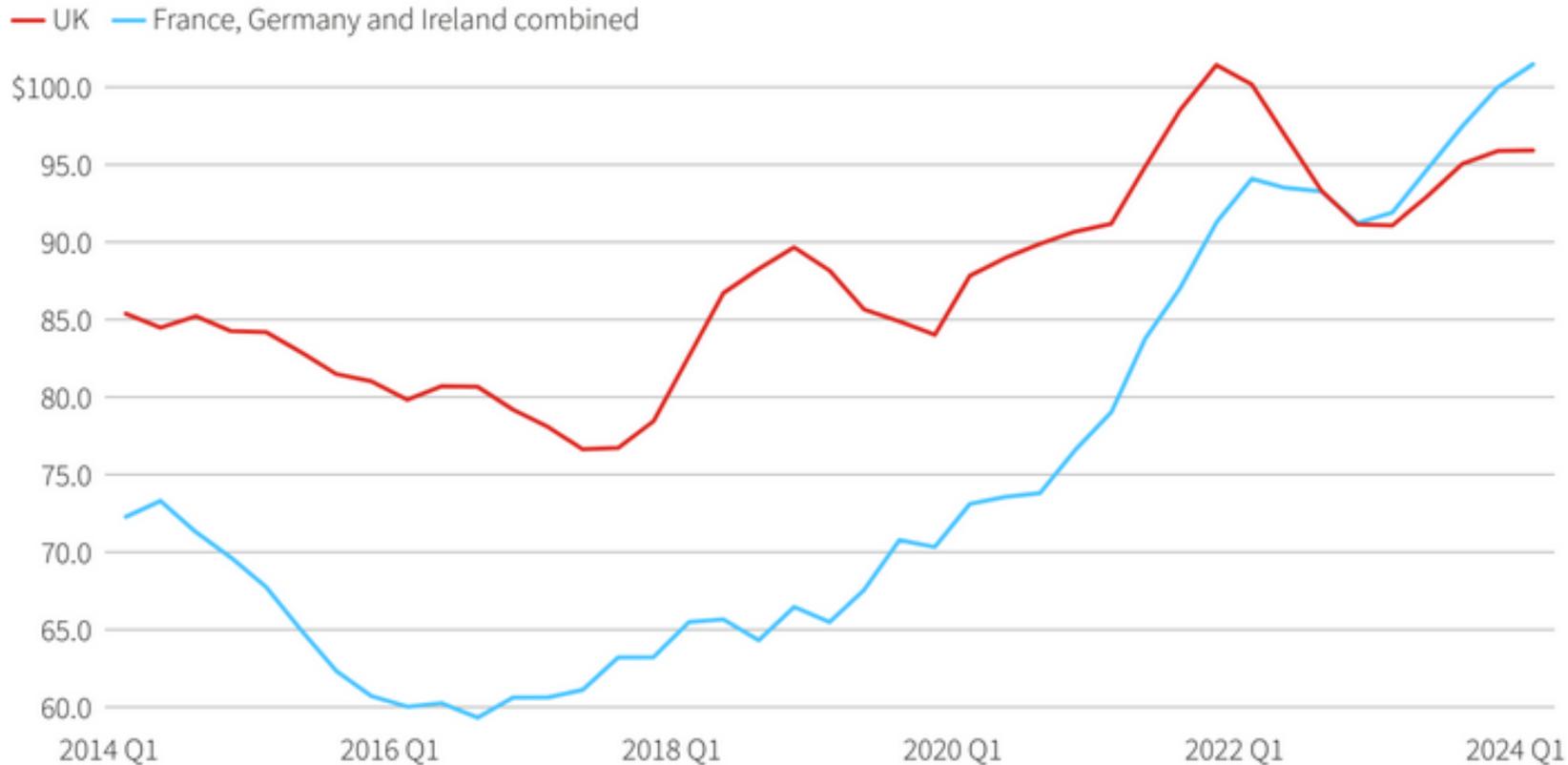
Dublin gained most, 10,000 positions

"The City voted 70-30 to remain"

Ibid, [Reuters “Brexit 'disaster' cost London 40,000 finance jobs, City chief says”, by John O'Donnell, Elisa Martinuzzi and Andy Bruce, October 16, 2024.](#)

UK finance exports overtaken by Germany, France and Ireland

Since late 2022, Germany, France and Ireland have exported more financial services than post-Brexit Britain.

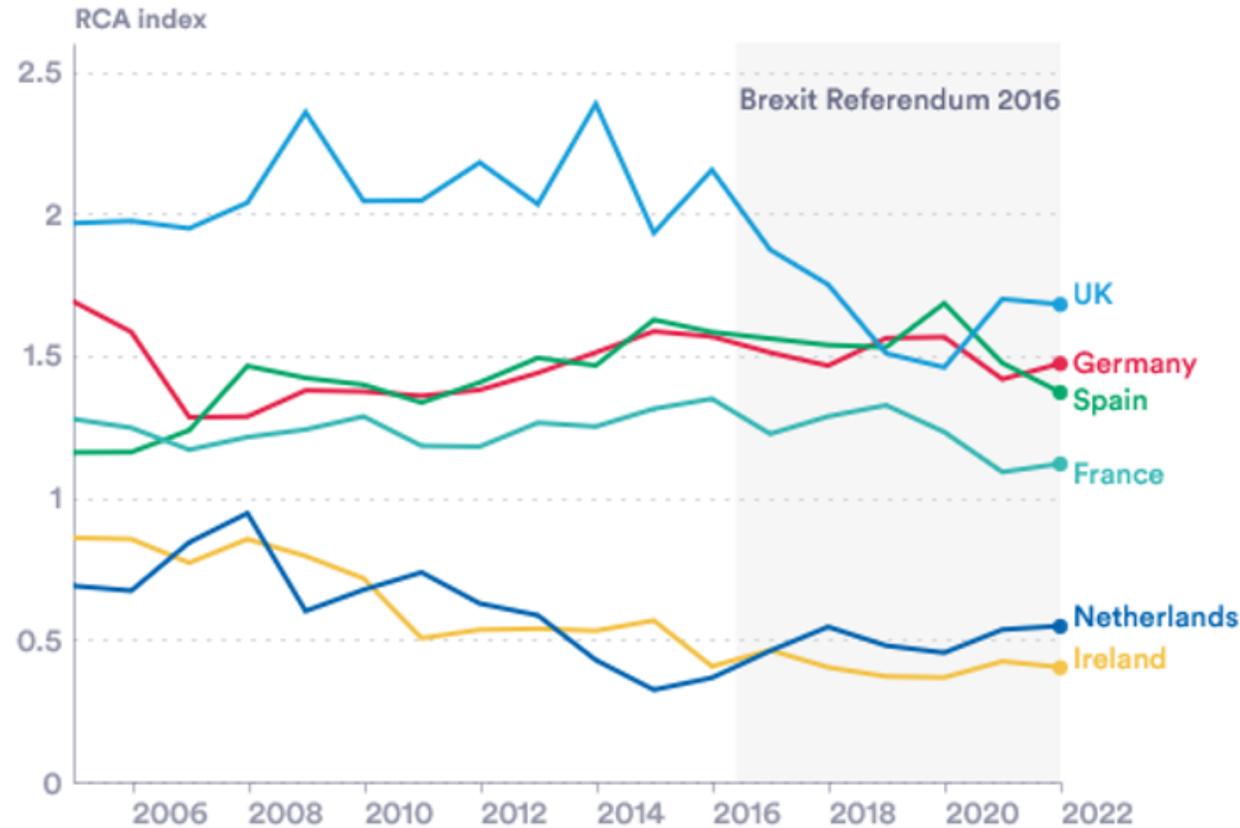


Note: Billions of U.S. dollars, current prices, 1-year rolling sum

Source: International Monetary Fund Balance of Payments Data | Reuters calculations | Andy Bruce

Since late 2022, Germany, France and Ireland have together exported more in financial services than post-Brexit Britain.

Revealed comparative advantage* of financial services in the UK and major EU countries



* In simple terms, revealed comparative advantage (RCA) shows whether a country exports more (or less) of a product than would be expected from the country's overall share in world trade. When $RCA > 1$, the sector (in this case financial services) has a revealed comparative advantage. When $RCA < 1$, it has a revealed comparative disadvantage.

Source: Calculations by Douch, M., Wu, Y. and Gao, B. based on the Trade in Services dataset from the World Trade Organisation (WTO).

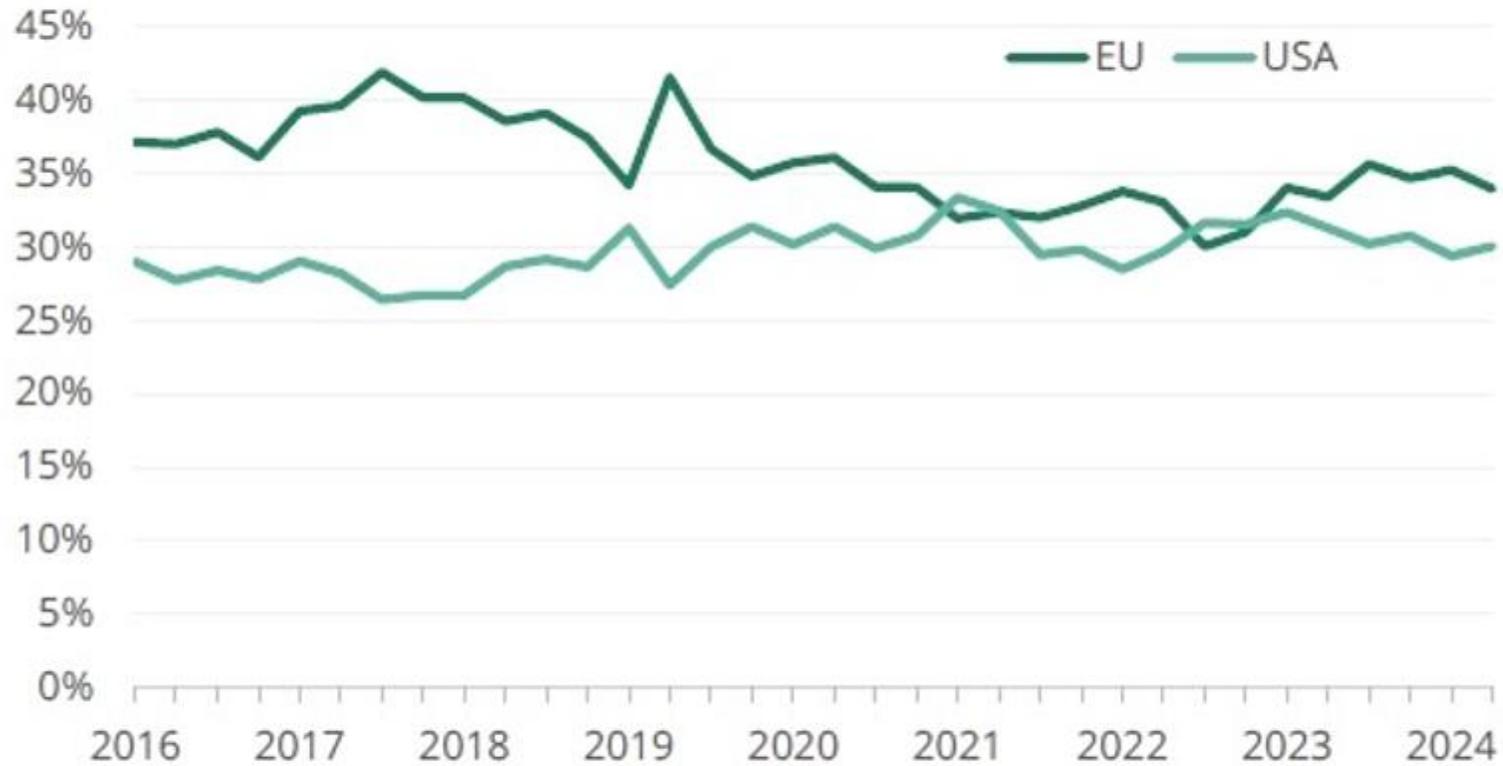
Trade in Financial Services between the UK and the EU

	2015	2019	2020	2024
Exports to the EU				
-Financial	22,424	23,928	21,409	33,682
-Insurance & pension	3,627	3,205	3,311	4,539
Imports from the EU				
-Financial	3,291	5,720	4,887	4,596
-Insurance & pension	--	1,406	1,381	5,087
Balance				
-Financial	19,133	18,208	16,522	29 086
-Insurance & pension	--	1,799	1,930	-548

Source: ONS, Pink Book, 2016 (Table 9.11), and Table 9.13 for all other years.

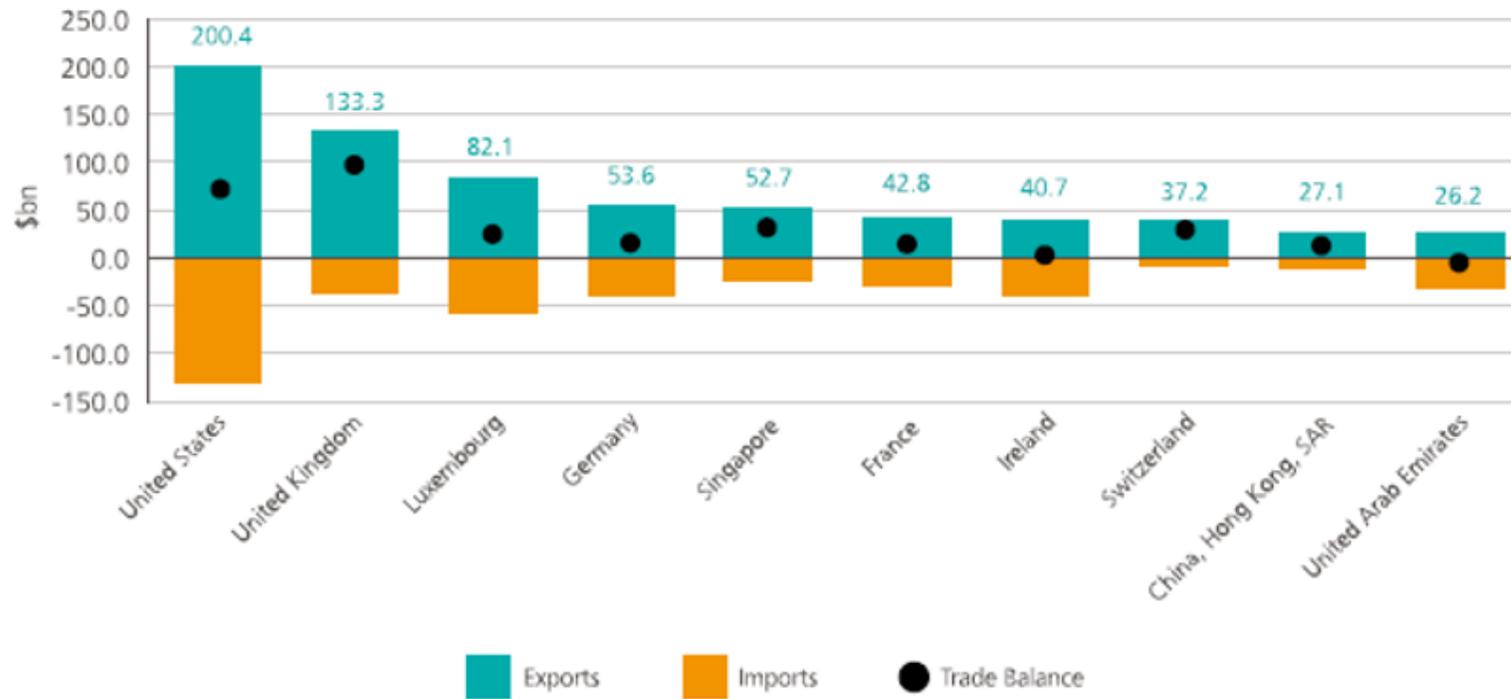
UK financial services exports to the EU and USA

% total, Q1 2016–Q2 2024



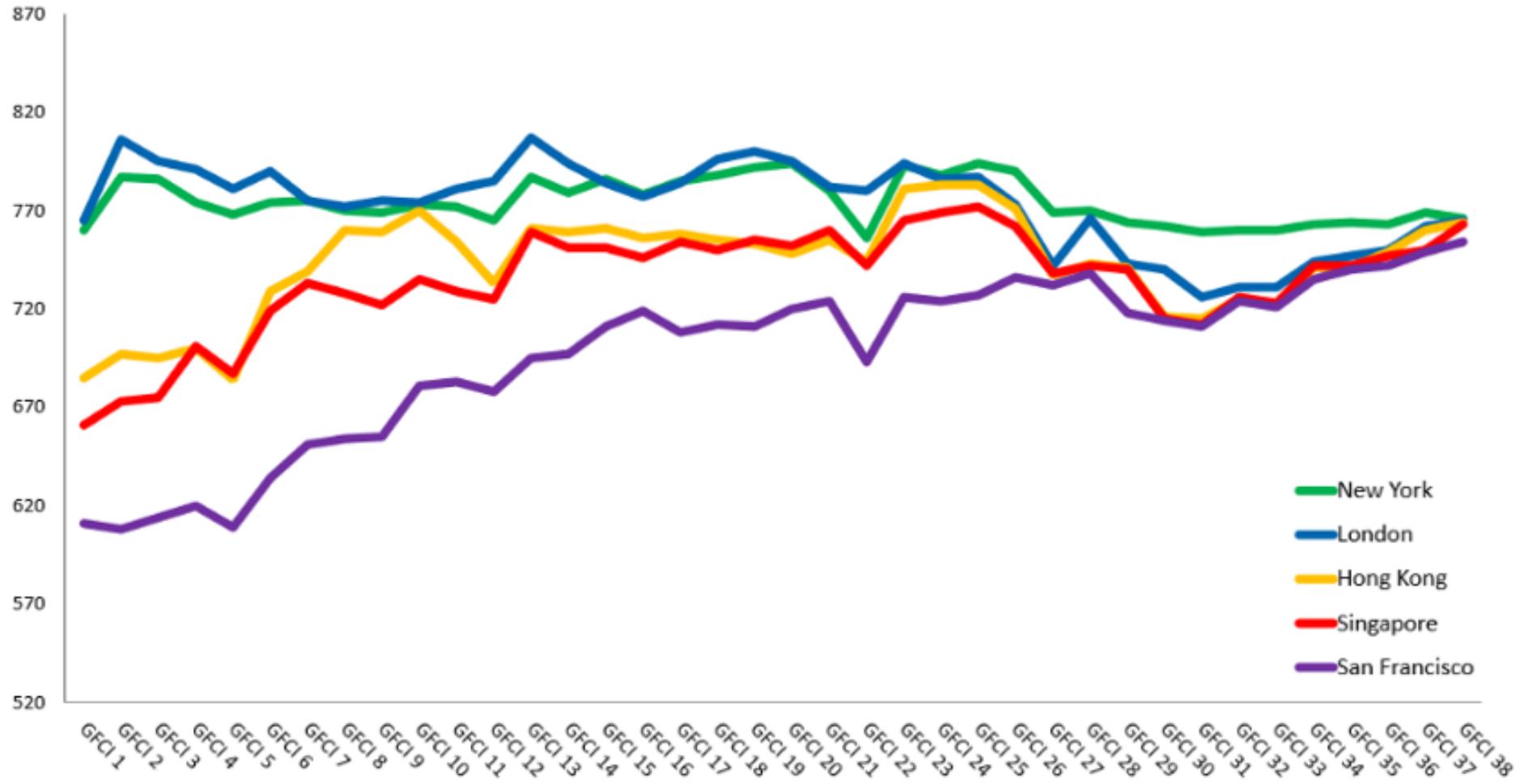
Source: Hutton, G., Panjwani, A. and Ward, M, "Financial services in the UK", *House of Commons Library Briefing*, No 6193, 18 November 2024, based on ONS, *UK trade in services: service type by partner country*, quarterly series.

Trade balance of the largest global exporters of financial services, \$ billion 2023



Source: TheCityUK, TheCityUK, *Key facts: about the UK as an international financial centre 2024*, January 2025, p 6, calculations based on UNCTAD data.

The Top Five Financial Centres – GFCI Ratings over time



Source: Z/Yen and China Development Institute, *The Global Financial Centres Index 38*, September 2025, p7.

Financial centre indicators, share by country (%)

	UK	US	Canada	France	Germany	Switzerland	Singapore	Japan	China	Hong Kong	Others
Cross-border bank lending (Q2 2024)	14.6%	9.6%	3.8%	13.3%	9.1%	2.4%	2.0%	11.6%	3.9%	4.9%	24.8%
Foreign exchange turnover* (Apr 2022)	38.1%	19.4%	1.7%	2.2%	1.9%	3.6%	9.4%	4.4%	1.6%	7.0%	10.7%
Interest rates OTC derivatives turnover* (Apr 2022)	45.5%	29.3%	1.2%	3.5%	4.7%	0.3%	2.7%	0.9%	0.2%	5.6%	6.1%
Insurance premiums (end-2023)	5.2%	44.9%	2.4%	3.9%	3.4%	0.9%	0.6%	5.0%	10.1%	0.9%	22.7%
International debt securities outstanding (Q1 2024)	12.0%	8.4%	4.5%	4.6%	4.6%	0.5%	0.9%	1.8%	0.8%	1.1%	60.8%

*Figures for foreign-exchange turnover and interest rate derivatives turnover are for April 2022 because the Bank for International Settlements' survey from where the data are sourced is triennial.

Source: *ibid*, with TheCityUK calculations based on data from the Bank of International Settlements (BIS) and Swiss Re Institute.

Scott James and Lucia Quaglia, “Three challenges the UK faces in de-Europeanising financial sector policies after Brexit”, LSE Blog 9 May 2023

Domestic institutional framework:

Government & Parliament set framework

Prudential Regulatory Authority (part of Bank of England) and Financial Conduct Authority > issue regulations

UK tradition of strong “arms-length”, independent institutions

December 2022: HMG announces Edinburgh Reforms

- 1.Reforms to Ring-Fencing Regime
- 2.Implementation of Post-Brexit Financial Regulatory Framework
- 3.Growth and Competitiveness Remit for U.K. Regulators
- 4.Reforms to Wholesale Markets
- 5.Faster Settlement
- 6.Senior Manager's and Certification Regime
- 7.Changes to Promote Investment and Growth in Financial Services
- 8.Sustainable Finance
- 9.FinTech and Digital Assets
- 10.Consumer Credit

Source: Shearman & Sterling, [“UK Government Publishes Edinburgh Reforms for Financial Services”](#), December 20, 2022.

Scott James and Lucia Quaglia... continued

DE-EUROPEANISATION	OUTCOME	EXAMPLES
Intentional	UK divergence	Capital markets, fintech (less stringent) Bank capital (more stringent)
Passive	EU divergence	Crypto assets (more stringent)
Failed	Limited divergence	Solvency 2, Listings regime
None	Alignment	Derivatives clearing

Central Counterparties: Resolving 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.

An official deadline of June 2025 to bring business to the Eurozone.

In early 2024, the EU effectively decided to allow most trading to remain in London, by only requiring participants to open “active accounts” in the Eurozone, to deal with “systemic” derivatives. (Source: Huw Jones, “EU agrees new rules to move derivatives clearing from London”, *Reuters*, February 7, 2024)

Financial Services and Markets Act 2023

Broad ranging – framework for revoking retained EU law (REUL)

Also provisions covering a large range of activities, including:

- UK MiFID;
- critical third parties;
- the financial promotions regime;
- a new Designated Activities Regime;
and the regulation of crypto-assets and stablecoins used as payments

A “the secondary objective for the FCA and the PRA to facilitate the international competitiveness of the UK economy”

(Source: Ashurst, [“Financial Services and Markets Act 2023: Setting out the post Brexit framework for financial services”](#), 2 August 2023)