Brexit: Will it really have an enduring impact on the EU and US financial services markets'

April 19, 2017 Bradley Richards

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Article 50 has been triggered and, after 44 years as a member, the UK is now officially leaving the EU.

Prior to the 23 June 2016 referendum there was much "Project Fear" hype within the global financial services camp. The overwhelming feeling was that Brexit would have a significant negative impact, largely because leaving the EU brings the right to "passport" between the UK and the EEA into question.

Passporting rights enable an EEA member state to carry on business in another EEA member state without having to seek a separate license for each EEA country in which that EEA member wants to do business. These are important rights for banks, asset managers, insurers, brokers and custodians and are entrenched in a number of EU laws including the CRD IV, MiFID, Solvency II, AIFMD and UCITS directives. Given Theresa May's announcement that the UK will leave the single market and her objective to control immigration, which is contrary to the EEA’s freedom of movement criteria, there is a risk that passporting rights will be lost on both sides of the English Channel.

It remains to be seen whether "equivalence" will get the UK its European business passport through the back door. Certain EU financial regulations permit entities that are established in non-EEA countries to conduct business within the EEA, in the same way as EEA member states, so long as their legal and regulatory requirements are as good as the EU's. Following the recent Great Repeal Bill EU law will be incorporated into UK law on Brexit Day. How hard can it therefore be to be granted equivalence? That depends on how many political and administrative hurdles the UK will be forced to jump. Equivalence, albeit a technical assessment, is assessed by the European Commission at its discretion. It is under no obligation to act and can wait as long as it wishes before providing its decision.

Even if the UK were in pole position for its two year negotiation race, equivalence is not a one-size-fits-all solution. It is more limited than passporting rights and some EU regulations offer no equivalence at all. Equivalence recognition does not extend to CRD IV which covers deposit-taking and lending or to UCITS V which covers investment funds targeted at retail clients. Similarly, Solvency II does not provide equivalence for direct insurers.

At the end of the two year race, the UK could find that it has withdrawn from the EU, lost its passport rights and does not benefit from any equivalence regime. But the EU would find itself in similar shoes with respect to doing business in the UK — will it cut off its nose to spite its face?

There are uncertainties for banks, asset managers, insurers and other financial service providers headquartered in the EEA or the UK Businesses will need to assess their exposure to the potential loss of passporting and consider whether they have fallback options or how risks can be mitigated, whether that is by ceasing to provide certain services, using other group entities or establishing subsidiaries in the UK or EEA to conduct business.

Prior to Brexit, the UK participated with the EU in Transatlantic Trade and Investment Partnership (TTIP) discussions and benefited from the EU trade relationship with the US. The TTIP concerns reducing regulatory barriers to trade, including banking regulations. Post-Brexit, the UK and the US will need to negotiate a free trade agreement so that they can access each other's markets. Trump states that the UK's exit from the EU will be good for both the UK and the US and that his administration will prioritise a new trade agreement with the UK. One should expect however that the President will want to drive an agreement that is favourable to the US.

When negotiating a trade agreement with the US, the UK is likely to push for the removal of some of the stricter US banking restrictions brought in after the financial crisis. Trump has stated that he plans "a very major haircut on Dodd-Frank" although his ability to deliver this quickly is uncertain.

Historically the UK has helped the US communicate and address its economic and political interests in the EU. However the triggering of Article 50 looks set to change the game. The outcome of upcoming general elections in various EU countries will also play a role in the US' and the UK's future relationship with the EU post-Brexit.

Uncertainty abounds, and there will be bumps in the road ahead, but we must consider the long view. There can be little doubt that these nations will continue to trade successfully as we have done for centuries.

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