Written evidence for The House of Lords EU Sub-Committee on Financial Affairs chaired by Baroness Falkner of Margravine on the future of Financial Services in the UK following the vote to leave the European Union.

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A. Key interests for the UK and EU in financial services

- How important is maintaining the financial services 'passport' for the health and growth of both the UK and EU financial services sector?

London is a global and regional financial centre that provides wholesale services to the European financial sector and wider economy. A prime example is a competitive forex market (both cash and derivatives), which makes forex trading (including hedging positions) possible at low costs for financial firms and corporates.

The main wholesale financial markets in London cover:

a) Derivatives
b) Foreign exchange trading
c) Private and public bond trading
d) Equity trading
e) Commodities trading

Deep and liquid wholesale markets are important for both the UK and EU financial services sector. Fragmentation of financial markets may raise the cost of finance and thus harm corporates in the UK and the EU.

- What key arrangements need to be preserved so that market infrastructure providers in the UK can continue to provide their services to EU clients and vice versa?

Two arrangements are very important (Schoenmaker, 2016b):

1) The passport for the single market
2) Clearing and settlement in the euro

- How important is the principle of free movement of people for the UK and EU financial services sector?

For the financial services sector, free movement of people is helpful but not key. Both in the UK and the rest of the EU, the financial services sector employs non-EU individuals. This shows that the financial services sector is able to attract and employ talent from inside and outside the EU alike. However, the free movement of people will be part of the overall negotiations on the internal market, which has the so-called 'four freedoms' in goods, services, capital and people (Pisani-Ferry et al, 2016).

- What transitional arrangements would provide certainty to financial services and markets in the period between the UK's withdrawal terms and its future relationship with the EU?

A key element in the transition is grandfather clauses and a sufficiently long grace period. Grandfathering allows a smooth transition from the old to the new regime. It means that a licence received under the old regime remains valid under the new regime (i.e. is grandfathered).

Another element is the legal form of the partnership between the EU and the UK. The more this relationship is hard-wired in a Treaty, the less scope there is for changing parts of the relationship in the future. This provides more certainty for financial services providers.

Nevertheless, it will be difficult to address the uncertainty on the outcome during the negotiations. A clear and joint vision on the desired outcome from the outset and a relatively speedily negotiation are helpful to keep this uncertainty to a minimum.

B. Constraints and opportunities for a future relationship with the EU in financial services

- Can you describe in detail the degree of market access provided by the EU to financial sectors in non-EU member states (i.e. Norway model, Switzerland model, Turkey model, Canada model, the WTO model)? What do these models tell us about how the UK may be able to negotiate a bespoke relationship?

The details of the different models are provided in some background papers (Pisani-Ferry et al, 2016; Schoenmaker, 2016a, b). A key issue is whether the UK wants to remain in the single market. An important requirement for staying within the internal market is the acceptance of the supranational institutions (the European Commission and the European Court of Justice) which uphold the appropriate functioning of the internal market. Pisani-Ferry et al (2016) have made a proposal for a continental partnership, whereby the UK would have a say on EU policies but ultimate formal authority would remain with the EU.

- Referring to the aforementioned models, which financial activities would be most ‘at risk’ from Brexit?

First, the activities that need a passport are most at risk. Examples are (retail) banking (CRD IV), insurance (Solvency II), and investment services (MIFID). Second, the financial activities that rely on euro clearing and settlement are at risk, as the ECB might want to limit euro clearing and settlement to the EU/EEA under the so-called location requirement (Schoenmaker, 2016b).

- What are the shortcomings or issues associated with the EU’s equivalence regime?

The equivalence regime allows access to an EU country from third countries if the EU (the European Commission and/or relevant supervisors) deem the supervision of the third country equivalent (Goodhart and Schoenmaker, 2016). Nevertheless, the relevant supervisor(s) in the EU country can still impose regulatory and supervisory requirements. Moreover, the third country licence does not provide the passport to do business across the EU.

C. Means by which the key interests could be realised

- Which arrangements for UK access to EU financial markets are most likely to be acceptable to EU negotiators?

An important element is the continuing acceptance of the supranational institutions of the EU that guard the single market (i.e. the European Commission and the European Court of Justice).

- What steps are financial market sectors most likely to take preserve their position in the absence of full market access?

Financial services providers will seek a licence in one of the EU countries and will use that licence as passport for market access to the EU/EEA markets.

- How could the UK financial services sector thrive outside of the EU?

The UK financial services sector faces a fundamental choice between global and EU business. On the one hand, London can position itself as an international financial centre with light-touch regulation and supervision to try to gain extra global business. But under that model, the equivalence of UK regulation and supervision will come under pressure, which makes access to the EU more difficult and cumbersome (extra regulatory and supervisory requirements from the EU). On the other hand, the UK can choose to remain close (i.e. equivalent) to EU legislation and thus favour its regional business in the EU. Under this model, London can still attract global business, as it does currently.

References

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