Impact of Brexit on financial institutions
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What would happen to the passport under the EU single market Directives?

London is seen as an entry point to the EU’s single market in financial services. A complete exit from the EU would mean that the UK would not be party to EU single market Directives and therefore lose the ability to passport under them. There could possibly be a period of significant confusion as overseas financial services firms which use a London subsidiary would need to decide how to restructure themselves and decide how much of their operation to transfer elsewhere in the EU. However, like non-EU member Norway, the UK could apply to join the European Economic Area (EEA) whereby its members are granted access to the EU’s single market subject to compliance with the relevant EU legislation. Alternatively the UK could seek to follow the Swiss model and obtain access to the EU single market through bilateral treaties, without being a member of either the EU or EEA.

What impact would Brexit have on the way in which banks are regulated in the UK?

The regulation of banks in the UK rests on three pillars – the capital requirements contained in Capital Requirements Directive IV and the Capital Requirements Regulation2 (together CRD IV), the stabilisation, recovery and resolution provisions contained in the Banking Act 2009 and the Bank Resolution and Recovery Directive3 (BRRD) and the structural reforms in the Financial Services (Banking Reform) Act 2013 (BRA). The BRRD and CRD IV are the consequence of EU legislation. Parliament will need to consider how much of the legislation to retain. The CRD IV largely implements the requirements of Basel III, which the UK would still be committed to. However, there are provisions within the CRD IV (such as the limits on the payment of bankers’ bonuses) which are not Basel III related and could be abolished or amended. Assuming that Parliament decides it wishes to maintain the current regulatory structure and achieve mutual recognition between the British and European regulatory authorities, it will be necessary to consider how much the BRRD, the BRA and the PRA Rulebook need to be amended to maintain equivalence. Parliament will also have an opportunity to reconsider the burden of the regulatory compliance matrices imposed on banks by the CRD IV and BRRD. The larger retail banks are subject to the ring fencing of the BRA. Whilst this is an entirely UK regime, Brexit will impact the legislation application of the EEA branches and subsidiaries. With regard to the application of the Regulation on Banking Structural Reform (the BSR Regulation) the latest Council text already contemplated recognition for national legislation requiring core retail activities to be ring-fenced. However, the importance of recognition of the UK’s own ring-fencing legislation may become moot if the BSR Regulation has not been implemented at the time of Brexit.

What impact would Brexit have on the UK insurance industry?

A substantial amount of insurance and reinsurance is distributed and underwritten both into and out of the UK. The London market currently has access to 500 million customers through the EU (estimated to represent £6bn in premium income). There are likely to be lengthy negotiations on the UK’s ongoing access to EU member state markets, potentially resulting in a series of bilateral treaties to enable UK firms to passport into the EU (and allowing the same privileges to EU insurers and brokers wanting to operate in the UK).

The approach to the regulation of UK insurers is also unlikely to change. The Prudential Regulation Authority (PRA) has been heavily involved in the negotiation of the Solvency II Directive4 which was based on UK’s own ‘risk-based’ regime. Should the UK leave or change its relationship with Europe by becoming an EEA member, we can expect the PRA to continue its commitment to a Solvency II-based regime for insurance companies. Commission Delegated Regulation5 will have to be transposed into UK law.

What impact would Brexit have on the UK funds industry?

Since many UK based fund managers already use Irish or Luxembourg UCITS6 and alternative investment fund (AIF) platforms for pan-European distribution, the effect on the UK as a fund domicile is likely to be limited. The big issue for the UK asset management industry will be the risks of changes to delegation rules enabling MiFID investment firms, alternative investment fund managers (AIFMs) and UCITS management firms to delegate to a UK based investment manager. As matters stand at present, it seems likely that a post-Brexit UK regime would be deemed sufficiently equivalent to enable delegation by EU firms to UK investment managers. There may also be a risk of obstacles being put in place under the tax regimes of different EU member states which would make delegation to the UK less attractive than it is now. If the third country regimes contemplated in the Alternative Investment Fund Managers

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6 UCITS (Undertakings for Collective Investment in Transferable Securities) are European harmonized regulated fund products which can be sold on a cross border basis within the EU.
The Capital Markets Union (CMU) package of reforms under development by the EU aims to unify capital markets across Europe in order to promote investment and growth. Between now and 2019, a wide range of reforms will be proposed under the CMU umbrella. The UK government has said that it is fully committed to, which it regards as being of critical importance to building a stronger and more competitive European economy. At the same time, the UK government has expressed concerns that will involve the transfer of direct supervision of UK market infrastructures or firms to European level. However, it is difficult to conceive an effective comprehensive architecture for that would not involve such centralisation.

Exactly what the consequences of Brexit would be on the UK’s involvement of would depend on the terms of the exit agreement reached between the UK and the EU. In the meantime, however, the resignation of Jonathan Hill as Commissioner for Financial Stability, Financial Services and Capital Markets Union means that the UK has lost a strong voice in the shaping of the CMU project. His portfolio has been transferred to Latvia’s Commissioner, Valdis Dombrovskis. At this stage, Mr. Dombrovskis has not indicated any intention to change direction with respect to the liberalisation of European capital markets. Diminished influence from the UK may, however, tip the balance towards greater centralisation of supervision and regulation.

Will UK financial institutions be part of the new Capital Markets Union?

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Will financial services regulation radically change under Brexit?

At the moment the UK is still a full member of the EU and bound by EU legislation. This position continues should it issue a notification under Article 50 of the Treaty on European Union. The position only changes once the UK formally exits the EU. The Treaty provides for a Member State’s exit once a withdrawal agreement has been concluded or, failing that, two years after the notification unless the European Council, in agreement with the 27 remaining EU Member States, agrees to an extension. It is most likely that the UK will still be negotiating its exit when MiFID II / MiFIR apply on 3 January 2018 so one assumes that there will be no cherry picking of this legislation. It is also worth noting that even in the highly unlikely event that the UK withdraws from the EU before 3 January 2018 with no access to the Single Market, the third country provisions in MiFIR will be important and the equivalence of the UK regime will be a crucial factor. It is also important to note that many EU initiatives stem from international commitments coming from the G20 (for example OTC derivatives reform) and the Basel Committee on Banking Supervision (capital requirements) which the UK remains a party to. Therefore it is highly unlikely that financial services regulation with radically change under Brexit. It is worth noting the UK Financial Conduct Authority’s press statement on the day the referendum result was announced advising that “firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect.”

What impact would Brexit have in the financial investors space?

We suspect that Brexit may have limited impact, similar to asset and wealth management. European investors are not a large contributor of funding to UK private equity managers. Also, UK hedge funds and private equity companies may face a relatively easier test than others should they wish to continue providing services to customers in the EU. The key test is the “equivalence” of UK regulation compared with international standards, such as those set by the Financial Stability Board. Other financial institutions, like banks may face a more difficult hurdle with the key test being the equivalence of UK regulation with those in the EU. One would hope that any exit arrangements would deal with any adverse tax consequences relating to where funds are established, assets held or beneficiaries reside.

If UK financial institutions were to participate in EU capital markets, how would it work?

While scenarios that involve re-applying for EEA and EFTA membership or agreeing bilateral agreements with EU member states would mean that UK firms might retain a degree of access to EU capital markets, they would differ in one aspect. So long as the UK is a member of the EEA, could provide a comprehensive market architecture and regulatory framework. A bilateral scenario would require the UK to voluntarily apply rules to UK firms. This would likely need to be complemented by ‘indigenous’ UK-specific market architecture and regulation for those firms not operating in Europe. As a result, a bilateral scenario (and to some extent where UK firms fall outside the framework) would likely result in UK firms needing to comply with overlapping UK and EU requirements. Such requirements might not always be consistent.

If UK firms were excluded from , they would likely seek to participate as third country participants (similar to the access by US firms). This would require compliance with both EU and UK rules. In such a scenario, the UK will be unable to prevent the adoption by the EU of rules that are adverse to the interests of UK firms.
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