HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

Number 07628, 6 July 2017

Brexit & financial services

By Tim Edmonds

Contents:

Contents

Summary

Financial Services are of especial importance to the UK economy. The vote to leave the EU has significant implications for the financial services sector. The degree of inter-linkage between the 'City' and the EU economies is substantial, economically speaking, and intricate in terms of the legislative interface.

There is little certainty over what will happen next.

With respect to the regulatory framework, the new chief Executive of the FCA, Andrew Bailey, confirmed that whilst the FCA had set up an internal Brexit unit to deal with Brexit specific activity, its main work remained unchanged. Many of the FCA rules were derived from the EU and the FCA would continue to enforce existing rules and work to implement ones that had been agreed, but which were not yet in place. For the Regulator therefore it was 'business as usual'.

Along with most other industrial and commercial sectors the more considered reaction of the industry to any question is "it all depends".

In the absence of any clear guidance on what the EU negotiations will lead to in terms of the treatment of services, commentators have largely been reduced to guessing what large institutions intend to do from their pre vote statements and matching these to the permutations of different possible negotiation outcomes.

In a sector with different interests and priorities and with a wide range of possible outcomes, the possible permutations of outcomes is very high.

The debate and commentary has been largely framed around whether banks and other would stay (in London) or go. Informing this choice has have been two issues: timing and the likelihood of continued 'passporting or equivalence.

Despite one banking commentator saying that most banks had their "hands are quivering over the relocate button" currently, only one bank and the European Banking Authority have said that they are leaving.

1. Introduction

Financial services are of especial importance to the UK economy. A 'Key Facts' report by CityUK (a representative body of the industry) states that:

> London and the wider UK is the leading global international financial and related professional services centre. Britain's trade surplus in financial services of £63bn in 2015, was more than the combined surpluses of the next three leading countries (US, Switzerland and Luxembourg).
>
> The UK has the leading share of trading in many international financial markets such as cross border bank lending (16%), international insurance premium income (29%) and foreign exchange trading (37%). It is also a global leader in providing professional services.
>
> Britain is the heart of Europe's financial system with London being its pre-eminent financial capital. London's major competitors include New York, Hong Kong, Tokyo and Singapore, with Asian centres gaining advantage in recent years from the shifting global trade patterns. At the next level Shanghai and Toronto are being joined by the likes of Istanbul and Dubai as they seek to develop their offerings. This is not a zero sum game. And greater competition is a challenge to companies to innovate and improve services – areas of traditional strength for the UK.[1]

The government's Brexit White Paper in February 2017 states:

> 8.22 The financial services sector is an important part of our economy. It is not just a London-based sector; for example, two thirds of financial and related professional services jobs are based outside the capital, including 156,700 in Scotland, 54,300 in Wales and 32,000 in Northern Ireland. The UK is a global leader in a range of activities, including complex insurance, wholesale markets and investment banking, the provision of market infrastructure, asset management and FinTech.[2]

The vote to leave the EU at an as yet unspecified date has immense implications for the financial services sector, an economic sector which is critical to the UK economy. The degree of inter-linkage between the 'City' and the EU economies is substantial, economically speaking, and intricate in terms of the legislative interface. Some groups see the opportunity to be rid of EU regulation as an opportunity and point to the warnings (unfulfilled) about the UK not adopting the Euro as a precedent. Most of the industry, however, have concerns about how best to respond to the new conditions.

This note brings together some immediate responses from relevant organisations and outlines some of the emerging issues four months on from the referendum vote.

A Backbench Business debate on this subject was held on 3 November 2016.

1 CityUK *Key Facts about the UK as an international financial centre 2016*; 1 November 2016
2 The United Kingdom's exit from, and new partnership with, the European Union

2. Immediate reactions

This section brings together some immediate responses from relevant organisations. There is no intention to analyse the comments, merely to present what is available as it is published. The choice of material reflects what there was. Other material and commentaries can be found. All entries are dated 24 June unless otherwise stated.

2.1 Official bodies

The Bank of England

The Bank of England (through the Prudential Regulation Authority) is responsible for financial stability in the United Kingdom.

> The people of the United Kingdom have voted to leave the European Union.
>
> Inevitably, there will be a period of uncertainty and adjustment following this result. […]
>
> Some market and economic volatility can be expected as this process unfolds.
>
> But we are well prepared for this. The Treasury and the Bank of England have engaged in extensive contingency planning and the Chancellor and I have been in close contact, including through the night and this morning.
>
> The Bank will not hesitate to take additional measures as required as those markets adjust and the UK economy moves forward.
>
> These adjustments will be supported by a resilient UK financial system – one that the Bank of England has consistently strengthened over the last seven years.
>
> The capital requirements of our largest banks are now ten times higher than before the crisis. The Bank of England has stress tested them against scenarios more severe than the country currently faces. As a result of these actions, UK banks have raised over £130bn of capital, and now have more than £600bn of high quality liquid assets.
>
> Why does this matter?
>
> This substantial capital and huge liquidity gives banks the flexibility they need to continue to lend to UK businesses and households, even during challenging times.
>
> Moreover, as a backstop, and to support the functioning of markets, the Bank of England stands ready to provide more than £250bn of additional funds through its normal facilities.
>
> The Bank of England is also able to provide substantial liquidity in foreign currency, if required.
>
> We expect institutions to draw on this funding if and when appropriate, just as we expect them to draw on their own

> resources as needed in order to provide credit, to support markets and to supply other financial services to the real economy.
>
> In the coming weeks, the Bank will assess economic conditions and will consider any additional policy responses.
>
> Conclusion
>
> A few months ago, the Bank judged that the risks around the referendum were the most significant, near-term domestic risks to financial stability. To mitigate them, the Bank of England has put in place extensive contingency plans.
>
> These begin with ensuring that the core of our financial system is well-capitalised, liquid and strong. This resilience is backed up by the Bank of England's liquidity facilities in sterling and foreign currencies. All these resources will support orderly market functioning in the face of any short-term volatility.
>
> The Bank will continue to consult and cooperate with all relevant domestic and international authorities to ensure that the UK financial system can absorb any stresses and can concentrate on serving the real economy.
>
> That economy will adjust to new trading relationships that will be put in place over time. It is these public and private decisions that will determine the UK's long-term economic prospects. The best contribution of the Bank of England to this process is to continue to pursue relentlessly our responsibilities for monetary and financial stability. These are unchanged. We have taken all the necessary steps to prepare for today's events.
>
> In the future we will not hesitate to take any additional measures required to meet our responsibilities as the United Kingdom moves forward

Bank of England website

Financial Conduct Authority (FCA)

The FCA is the main regulator of financial conduct in the United Kingdom.

> The FCA is in very close contact with the firms we supervise as well as the Treasury, the Bank of England and other UK authorities, and we are monitoring developments in the financial markets.
>
> Much financial regulation currently applicable in the UK derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for Government and Parliament.
>
> 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.

> Consumers' rights and protections, including any derived from EU legislation, are unaffected by the result of the referendum and will remain unchanged unless and until the Government changes the applicable legislation.
>
> The longer term impacts of the decision to leave the EU on the overall regulatory framework for the UK will depend, in part, on the relationship that the UK seeks with the EU in the future. We will work closely with the Government as it confirms the arrangements for the UK's future relationship with the EU.

FCA website

2.2 UK financial institutions

Barclays

> Barclays Group Chief Executive Officer Jes Staley said: 'The United Kingdom has voted to leave the European Union. This is a significant decision and there will be many questions asked in the coming days and weeks about what happens next. The answers are complex but our position is not: we will not break our stride in delivering the Barclays of the future.
>
> 'Barclays has stood in service of our customers and clients for over 325 years. We have been here for them through equally profound changes before. And no matter what has been laid before us, we have been here to help them achieve their ambitions.
>
> 'That does not change today. And through the uncertainty of the months ahead, be in no doubt that we are ready to do whatever it takes to uphold that promise.
>
> 'The strategy we announced on 1 March was not conditional on the UK remaining in the EU. We are a transatlantic consumer, corporate and investment bank, anchored in the UK and the US. That remains the core of our strength and the Barclays of the future.'

RBS

> The result of the referendum has been announced. The UK has voted to leave the European Union.
>
> We would like to reassure our customers that the outcome of this referendum should have no immediate impact on their everyday banking services.
>
> We are operating business as usual, please find further information on our FAQs [here].

Santander

> Nothing has changed for Santander UK. There are no changes to the way we serve you and we won't make any changes to our products and services as a result of the referendum without notifying you first.

> Your eligible deposits are still protected by the Financial Services Compensation Scheme (FSCS) up to a limit of £75,000. This won't change now that the UK has voted to leave the EU.

Lloyds of London

> Commenting on the vote, Chairman John Nelson, said:
>
> "I am confident that Lloyd's will stay at the centre of the global specialist insurance and reinsurance sector, and I look forward to continuing our valuable relationship with our European partners.
>
> "For the next two years our business is unchanged. Lloyd's has a well prepared contingency plan in place and Lloyd's will be fully equipped to operate in the new environment."

2.3 Other organisations

TheCityUK

TheCityUK is a trade body representing the interests of the City of London. It said:

> The people of the UK have decided that the future of the UK is a new one outside of the European Union. There will be challenges ahead and it will be important for Government and business to work together to address them. Our immediate focus is on stability – in the markets, for investors, and for our industry's customers.
>
> Clear agreement is now needed on the way forward for the forthcoming negotiations as Government shapes a new relationship for the UK with the EU and retains the jobs and investment that the UK has seen to date. For financial and related professional services, the focus is on securing continuing access to the Single Market.
>
> It is vital that action is taken to reinforce the global competitiveness of the UK as a place in which and from which to do business. This will help to mitigate the risk of prolonged uncertainty while a new relationship with the EU is negotiated. We look forward to working with Government on forward-looking policies to help achieve this and to advancing the attractiveness of UK-based financial and related professional services.

Prior to the referendum it had produced *A practitioner's guide to Brexit* which:

> addresses the practical questions businesses need to be aware of in the event of a Brexit and looks more widely at the EU referendum debate. It also considers the UK's post-Brexit trading arrangements with other countries and three alternatives to our current EU membership from the perspective of the financial and related professional services industry.

Travers Smith

Travers Smith is a London law firm with significant experience in the development of European financial services law. It has produced a summary – *Brexit: What is the short term legal impact on UK financial services?* . It begins:

> The UK electorate has voted in support of the UK leaving the European Union. We now expect the UK Government to initiate the process for the UK's departure. This is likely to be complex and there will be a protracted period of negotiations before the long-term position is settled. What are the immediate impacts on the law and regulation applicable to UK financial services firms in the meantime? In short: very little.

And ends:

> Will there be a significant impact in the future?
>
> This will depend in part on the terms of exit which are unlikely to be known for some time. If the UK remained part of the European Economic Area, it would retain access to the single market for financial services and operate within broadly the same regulatory framework. That outcome seems unlikely because the UK would also be subject to EU obligations on the free movement of persons, which was a key theme in the leave campaign. If the UK does not negotiate a trade deal with remaining EU members requiring it to comply with all EU financial services law and regulation, there will be an intense debate about how much of that law and regulation is retained and for how long.

It has produced a longer Brexit document written pre referendum.

New Capital

A pro-market think tank, New Capital, set out the implications (from its pessimistic viewpoint) that City firms will generally be considering in the aftermath in a report - *Beyond Brexit: what happens next for European capital markets?* In summary they include:

1) Pulling the trigger: The decision by David Cameron not to pull the trigger on Article 50 means that capital markets will be in limbo for at least the next few months until a new government or Parliament start the clock on the formal two year process of leaving the EU.

2) First mover advantage: Banks and asset management firms cannot afford to wait. They have to assume the worst case scenario of complete separation with no access to the single market and start the process of relocating legal entities, operations and staff immediately.

3) Relocation, relocation, relocation: In order to future proof their business, banks, asset managers and other market participants will need to have a separately authorised subsidiary with a sufficient management presence inside the EU. Dublin, Frankfurt, Paris and other cities will be vying for that business.

4) An acrimonious divorce (and a protracted custody battle): Most firms seem to be planning for an acrimonious divorce. While the divorce process itself may be reasonably swift, the separate negotiations to establish the terms of the future relationship between the UK and the EU will be slowed down by the competing domestic political imperatives in all 28 member states and could take years.

[…]

6) A regulatory backlash?: Brexit could trigger a concerted regulatory backlash in the rest of the EU against elements of the single market and capital markets union that are seen to play to the UK's advantage, such as the location of euro-denominated clearing.

7) A loss of influence: Whatever the outcome, the UK will lose influence over the future direction and nature of EU regulation that it may have to implement. The departure of Lord Hill will significantly change the tone of the future regulatory dialogue.

8) Equivalence vs divergence: In order to retain access to the single market from outside the EU, the UK would have to retain an 'equivalent' regulatory framework. While it would be equivalent on day one, over time changes to EU legislation may lead to costly regulatory divergence.

9) The future of EU citizens: In some sectors of the capital markets EU27 citizens account for as much as a quarter of all staff in the UK. Assurances over their future legal status have so far been too vague to instil confidence [Note there have been several statements subsequent to this publication which have addressed this question].

3. Subsequent reaction and emerging issues.

3.1 Introduction

There is precious little certainty in the debate currently. There is some, however, on the legal status of EU legislation which is deeply embedded in the sector.

With respect to the regulatory framework, the new chief Executive of the FCA, Andrew Bailey, confirmed at the 2016 Annual Public Meeting of the FCA, that whilst the FCA had set up an internal Brexit unit to deal with Brexit specific activity, its main work remained unchanged. Many of the FCA rules were derived from the EU and the FCA would continue to enforce existing rules and work to implement ones that had been agreed, but which were not yet in place. For the Regulator therefore it was 'business as usual'.

Along with most other industrial and commercial sectors the more considered reaction of the industry to any question is "it all depends".

In the absence of any clear guidance on what the EU negotiations will lead to in terms of the treatment of services, commentators have largely been reduced to guessing what large institutions intend to do from their pre vote statements and matching these to the permutations of different possible negotiation outcomes.

The Brexit White Paper sets out the Government's ambitions for negotiations:

> 8.25 In our new strategic partnership agreement we will be aiming for the freest possible trade in financial services between the UK and EU Member States.
>
> 8.26 […] As the UK leaves the EU, we will seek to establish strong cooperative oversight arrangements with the EU and will continue to support and implement international standards to continue to safely serve the UK, European and global economy.
>
> The financial services sector is an important part of the European economy, contributing significantly to the funding and growth of European business. It is in the interests of the UK and the EU that this should continue in order to avoid market fragmentation and the possible disruption or withdrawal of services.
>
> […]
>
> The fundamental strengths that underpin the UK financial services sector, such as our legal system, language and our world-class infrastructure will help to ensure that the UK remains a pre-eminent global financial centre.[3]

In a sector with different interests and priorities and with a wide range of possible outcomes, the possible permutations of outcomes is very high. Whilst most 'City' commentary and opinion has been negative

[3] The United Kingdom's exit from, and new partnership with, the European Union

towards the Brexit decision some commentators see it is a positive opportunity and even advocate the things that most of the sector is most concerned about. One example of this, is the Report by the Leave Means Leave Group ***Why our financial services need a clean Brexit***, published in October 2016.

The FCA Chief Executive, Andrew Bailey, made a keynote speech in July 2017 in which he outlined the work that the FCA had done and the key issues that they had identified. The speech can be found here: Why free trade and open markets in financial services matter. It ended with:

> My view is that if there is a commitment on all sides that the UK and the EU maintain substantially equivalent regulatory arrangements in future, that it will not be necessary to restrict open markets and free trade in financial services and therefore not necessary to limit the freedom of firms on location. And therefore, I see no reason why we should sacrifice open financial markets and free trade, as an inevitable response to Brexit.

However a number of key issues are emerging which may determine whether the City sees a large number of banks, insurance companies and investment funds leave or downgrade their London operations or whether, the natural advantages of London prevail and it simply adapts to new conditions. The first is timing and the second is the 'passporting/equivalence' debate. It is worth looking first though, at who is saying what, and who has done what in regards to the 'will they stay or will they go' question.

3.2 Issues

Will they stay or will they go?

Generally, post-vote comments have been a shade more positive than those made before but this may be because companies (especially publicly listed ones) have to be careful about giving out market sensitive data, so their public statements have been guarded.

An article in the Financial Times though implied that there had been a Treasury led attempt to co-ordinate a post Brexit response "Officials asked international banks to sign a "more optimistic" joint statement than the one that was eventually published".

The article noted that some banks had refused to go along with this arguing that they were not "cheerleaders". But, even within the banking community there were divisions. Some banks are annoyed at JP Morgan's decision to issue strident public warnings about job cuts.[4]

The most recent comments on the banking industry made by the Chief Executive of the British Banking Association reflect the hesitancy and uncertainty that banks now face. Writing in the Observer, Anthony Browne wrote:

> "Most international banks now have project teams working out which operations they need to move to ensure they can continue

4 Financial Times 14 July 2016

> serving customers, the date by which this must happen, and how best to do it," he says.
>
> "Their hands are quivering over the relocate button. Many smaller banks plan to start relocations before Christmas; bigger banks are expected to start in the first quarter of next year."[5]

Currently, as at the time of writing, the only bank that has indicated that it will leave is the Russian investment bank VTB which announced that it will move HQ from London. According to Herbert Moos, deputy Chair VTB "We did have bigger plans for the London office but, after Brexit, we are scaling them down and building them up elsewhere".[6] In a separate announcement the European Banking Authority which is the regulator for the euro-zone area, announced that it will move from its current London headquarters within the next two years.[7]

What there has been is a lot of talk about what the intentions might be.

A BBC article 30 June 2016 quotes Barclays as saying that it "has no plans to move jobs out of the UK". On the other hand the same article quotes HSBC as saying that 1,000 jobs may go to Paris and JP Morgan saying 4,000 might be relocated.

Timing

A thing which overhangs a lot of current decision making discussions is the timing issue. The best time for a bank or insurer to decide whether London still held comparative advantages over other locations would be when the outcome of the negotiations are known. Given that the UK government is likely to trigger these negotiations in the early part of 2017, and that they will then be concluded within two years, that optimum decision point is about two years away.

But. The time it takes to move a bank or other institutions to an alternative location – assessing where to go, arranging premises, gaining regulatory permissions and staffing etc cannot be much less than about two years. So if any bank wants to be certain that it is not, after Brexit, left in a London that does not have what it wants mainly the ability to offer services freely across Europe, the time to start thinking about moving is now – or very soon.

Access to markets: staff

For many years, continued access to overseas staff has been a key concern of many financial institutions in the City. Brexit has sharpened this concern. It is reported that UK asset managers have begun plans to secure visas for their EU staff, and pay the associated costs, if they become necessary.[8] For some companies, about half their staff are non UK residents, and even if visas were free or easy to acquire, recent examples of hostility to racial abuse have made some staff reconsider their UK futures.

---

5 Reported Guardian 22 October 2016
6 Financial Times 12 October 2016.
7 Financial Times 30 June 2016
8 FTfm 1 August 2016, p1.

Access to markets: Passporting/equivalence

Along with staffing, the main pre-occupation of financial firms has been the potential loss of 'passporting' rights. In the EU, financial authorisation in one Member State means that in many markets and activities, the firm can operate and sell in all EU countries because it now has an (authorisation) passport. In the UK context, financial firms like to set up in London – which is seen to have advantages over other European cities – get authorisation from the UK authorities and then they can operate across the EU freely. The Bank of England described passporting in its booklet about EU membership: *EU Membership and the Bank of England*

According to a news article the Bank of England has confidentially told EU banks that they won't have to "establish a separately capitalised UK subsidiary" to operate in the UK post exit.[9] No details are publicly available to date.

Alongside the passport, it has been suggested that if the UK does not secure this, it would at least be able to show that it was compliant with EU requirements and hence could operate across several markets under the equivalence rules which gives the same level of access.

Although 'it all depends' applies here with full force there are some things we do know and can say:

- that the UK financial sector is compliant with all EU financial directives – it has written lots of them and has been instrumental in setting all of them
- the directives will continue to be enforced and applied until the point of departure
- some directives have equivalence built in, others do not
- at the point of departure the UK will be fully compliant with EU regulations
- with respect to UK law now set by an EU directive, the most likely starting point is everything continues as was and then the UK can alter the law in all areas as and when we want. This makes the promised Great Repeal Bill likely to be a much shorter document.

From the City's point of view a negotiated agreement to continue with existing passports would be the ideal position. But if that failed, would equivalence be just as good?

An interesting Bloomberg article on the issue of equivalence and the comments on negotiating it from (ex) Commissioner Hill are revealing:

> **What's involved in an equivalence decision?**
>
> Equivalence refers to the European Commission's recognition that a country's rules and oversight of specific business lines are as tough as its own. This allows the EU to rely on firms' compliance with those frameworks, reducing overlaps on both sides as well as

9 Financial Times 1 August 2016

reducing capital costs for EU companies exposed to equivalent third countries.

Most EU financial-services acts contain provisions for equivalence, including the updated markets rules known as MiFID II, which come into effect in 2018. Equivalence is also possible for some purposes in the EU's bank capital rules and in Solvency II, which governs the insurance industry.

How does it work?

To see how equivalence works, take the recent agreement the commission struck with the U.S. Commodity Futures Trading Commission on central counterparties.

EU law, in this case the European Market Infrastructure Regulation, allows companies based outside the bloc to "provide clearing services to clearing members or trading venues" set up in the EU on two main conditions. First, the commission has to determine that the country's legal and supervisory systems are an "effective equivalent" to those in the EU; second, the company must be recognized by the bloc's markets regulator.

The deal with the CFTC, announced in February, enabled companies such as Chicago-based CME Group Inc. to continue providing services to EU firms. Without it, traders would have faced higher EU capital requirements to clear swaps, futures and other derivatives in the U.S.

How long can equivalence talks take?

While the EU's equivalence talks with the CFTC were successful, they dragged on for nearly four years even though at issue was "one tiny subset of the whole financial services sector landscape," as Jonathan Hill, the EU's former financial-services chief, said in June. What's more, this was a case in which both sides "wanted to conclude it quickly," he said.

"The bureaucratic process of gaining equivalence is complex," said Edward Chan, banking partner at Linklaters LLP in London. The process is "likely to take a minimum of six months upon exit," he said. The European Commission is under "no obligation" to grant equivalence, and "the decision can be time-bound and reversed, so, although it is not meant to be a political process, it is likely that political considerations will influence this decision." [10]

Another report on this from Open Europe puts more detail on the political process underlying the granting of equivalence:

In theory, having been a member of the EU, the UK would have no problem obtaining equivalence on day one after Brexit. However, if EU regulations change over time the UK would have to adapt its own legislation to maintain continued market access for its financial services sector. This could become increasingly challenging if in future, with the UK no longer involved in the law-making process, the EU takes a more protectionist approach to financial regulation. Although in that scenario being able to diverge from onerous regulations may in fact prove a competitive advantage for the UK, even if access is lost.

That said, it is worth noting that the European Commission has never actually withdrawn an equivalence decision due to

1. [10] Bloombergs; Banks in U.K. Eyeing EU Market May Find Equivalence Cold Comfort

> divergence of regulation. While it is a relatively new concept, this is still important. It has, however, withheld the granting of equivalence for both technical and political reasons. Overall, equivalence is therefore a far more piecemeal approach than the passport:
>
> - Equivalence does not currently cover the whole range of EU financial regulation, particularly when it comes to retail financial services;
> - The level of market access third-country firms can obtain via equivalence varies depending on the relevant piece of EU legislation. While equivalence under MiFIR essentially offers passport-like rights to third country firms providing investment services to professional clients, equivalence under Solvency II does so only for re-insurance services;
> - Equivalence is granted at the behest of the Commission, and is therefore part of a political process.

Bearing in mind the timing issue the Report continues:

> The case for 'pre-emptive' equivalence
>
> One option the UK should consider is to seek 'pre-emptive' equivalence on financial services regulation as part of the upcoming exit talks with the EU. This means the EU would treat the UK's regulatory and supervisory framework as equivalent from the moment the withdrawal agreement concluded under Article 50 TEU enters into force – that is, from day one of Brexit. This would help minimise uncertainty, at least with regard to those pieces of EU law that make provisions for third-country access.
>
> Admittedly, such an arrangement would likely involve a liberal interpretation of the existing equivalence process. The UK will not become a 'third country' until the entry into force of its withdrawal agreement with the EU – or until the two-year deadline set out by Article 50 TEU expires. Therefore, in principle the UK should not be able to apply for equivalence until then.
>
> However, there is a precedent for this kind of 'pre-emptive' equivalence – albeit in slightly different circumstances. The European Commission adopted a first package of positive equivalence decisions under Solvency II in June 2015, with the new rules due to come into effect six months later.69 There will remain a question around whether ESMA can begin assessing a state before it is fully a third country and the UK will likely have to lay out its regulatory regime in detail so that it can be assessed (or just promise to keep things as they are). However, if the decision is forward-looking and does not come into force until after the UK leaves, this is less of an issue.
>
> Alternatively, the UK could seek interim equivalence – broadly mirroring what happens in some cases with the provisional application of free trade deals between the EU and third countries. Essentially, the EU would grant the UK provisional equivalence on day one of Brexit – pending confirmation from the European Commission and the relevant pan-EU financial watchdog (ESMA, EIOPA or EBA). By logic, such an arrangement should be fully possible given that the UK has so far been applying EU financial services regulation as a member of the bloc.[11]

---

[11] Open Europe; *How the UK's financial services sector can continue thriving after Brexit*, October 2016

Sentiment appears to be moving away from the view that an unadjusted 'equivalence' will work as a stand-alone alternative to passporting. The clearest indication of this was in evidence given by the Bank's Governor, Mark Carney, to the Treasury Committee in January 2017. Asked whether 'equivalence' mitigated the risks of Brexit the Governor replied that it would need to be further augmented by other bodies:

> We do not want to be a rule-taker as an authority. Right now, we are not a rule-taker; we come to a consensus within the EU, and we might not always like the end result, but in general we feel that the regulatory construct in the EU is broadly as we would have it with respect to safety and soundness.
>
> […]
>
> In general, we like it, but the rules in the EU are influenced by international standards and by the presence of UK officials in their development. Once we are not there, one would expect increasingly rules with which we do not agree and which may cause risks to financial stability. That goes to the equivalence point, which is: on what grounds is equivalence granted, and is equivalence granted in a way such that we are a rule-taker? In other words, we have to basically cut, copy and paste any change that is made in Europe, in order to maintain equivalence.
>
> Alternatively, if I can wear my chair of the FSB hat for a moment, is equivalence viewed as it should be cross-border, with rules that achieve equivalent outcomes in terms of safety, soundness, consumer protection etc.? You can have slightly different approaches but achieve roughly the same outcome that recognises different institutional structures and other aspects. We should very much want the latter, because that allows us to tailor our system to the fact that we have the world's leading global financial system and to the nature of UK law and other peculiarities. We should want that.
>
> If we were going to have equivalence, we would want that recognised up front. That then requires some way for the two sides to make continuous judgments about whether or not they are equivalent. As you will have heard and as you know, you do not want equivalence that is there on day 1 and is taken away the next year. Again, we want stable access. There are various ways to determine how you would maintain equivalence, if that is the route that the Government and the country go down.
>
> One of them is with reference to international standards. You are equivalent if you broadly meet international standards. They are high, and, whether it is the IMF or the FSB itself through peer review, countries are judged on whether or not they meet international standards. If you meet international standards in slightly different ways—sometimes you are super-equivalent—then you are still equivalent. If that is what is agreed, that is very sensible and, as a financial stability authority, we would look at that and say it is broadly okay.
>
> The second thing, though, that is likely to be necessary, if we were in a trade deal-type arrangement, and I am not going to prejudge that—otherwise, we would be relying directly on the MiFID II equivalence as written, I would suggest—is some form of dispute resolution authority, which is not a UK one or an EU one but, as in a trade deal, is a separate panel of experts and is able to

> make judgments only in those cases where it is a matter of dispute, as opposed to generally meeting equivalence.
>
> On top of that, we should want domestic protection to have some sort of institutionalisation of regulatory co-operation between ourselves and Europeans, and they will want the converse, because if we are going to have free and seamless access in wholesale markets, we want some comfort that the rules are being applied and supervision is robust on the counterparties for your major financial institutions. One could start from equivalence, but I would suggest from a financial stability perspective that one would want to build on that equivalence with other institutional structures.[12]

The issue of passporting rights and equivalence continues to be key to the industry. A Daily Telegraph article reported comments made at a recent conference:

> Speaking at a conference in London on Tuesday, Robert Rooney, the head of Morgan Stanley's business in Europe, said that despite all the noise about Brexit, the issue "really isn't terribly complicated".
>
> If the UK stays in the single market (which, for want of a better phrase, we'll call "soft" Brexit) then the banks will likely be able to carry on much as before, if not (the "hard" Brexit scenario) then there's stuff that they used to do out of London that they will legally have to do somewhere else. It really is as simple as that.[13]

[12] Evidence from Dr Mark Carney, Treasury Select Committee 11 January 2017; Q137

[13] Daily Telegraph*, The City Exodus is already happening. It just doesn't look like you expect it to*; 12 October 2016