**EPFSF** Briefing

# “BREXIT: WHAT DOES THE UK’S DEPARTURE MEAN FOR EU FINANCIAL REGULATION?”

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## INTRODUCTION

This briefing paper provides a high-level overview of the status of the Brexit negotiations and discusses a number of key issues which arise in relation to financial services.

## STATUS OF THE POLITICAL NEGOTIATIONS

At the time of writing, negotiations on the Withdrawal Agreement are continuing following the European Council summit 17-18 October. Agreement on the backstop for the Irish border is the main outstanding issue since the meeting of the European Council on 22-23 March, where EU and UK negotiations reached an agreement on the legal text of the Withdrawal Agreement on citizens’ rights, financial settlement, and a time-limited transition period until 31 December 2020. A preliminarily scheduled additional Council summit for November has been put on hold by the EU27 until “decisive progress” is made . It is therefore unclear whether an agreement on the backstop arrangements for the Irish border can be finalised in November, and it seems more likely that negotiations could continue until the Council summit in December. If a deal is reached, it will have to be ratified by the UK and European parliaments. With just five months until Brexit, market participants have highlighted the urgent need to conclude the negotiations on the Withdrawal Agreement and provide certainty on the agreed transition period to 31 December 2020. Industry participants and businesses have emphasised that a transitional period remains the key priority.A general framework for the future economic relationship between the EU and the UK is expected to be set out in the political declaration accompanying the Withdrawal Agreement. The economic relationship is expected to only be negotiated in detail once the UK has ceased to be a Member State.

In its White Paper from 12 July, the UK government proposed a model for continued market access and supervisory cooperation based upon an expanded and amended version of the EU’s existing equivalence frameworks. The White Paper outlines a number of areas where the UK would seek to build upon the existing equivalence framework, while accepting that each party would retain ultimate autonomy over decision-making and legislation. The key changes proposed include:

a) an expanded scope of equivalence;
b) reciprocal recognition of equivalence under all existing third country regimes; and
c) an economic and regulatory framework with common governance principles, supervisory and regulatory cooperation, and streamlined processes.

In the meantime, the European co-legislators are discussing certain changes to the existing third country equivalence frameworks including to EMIR equivalence for CCPs and MIFID II/MiFIR equivalence for investment firms, but there remains significant uncertainty with important implications for the future of Europe’s financial markets.

# IMPACT ON THE FINANCIAL MARKETS

The UK is the EU's largest financial centre with the City of London providing access to global markets for businesses and banks across Europe. Many financial services firms have used the UK as a hub to service European markets, relying on single market passports to do so. This has led to a very high degree of interconnectivity between the UK and EU27 markets, with for example 46% of the EU's equity capital raised through UK capital markets, 49% of global OTC interest rate derivatives trading executed in the UK and over one-third of EU assets under management being managed in the UK.

However, in light of the current discussions on the future economic relationship between the EU and the UK, it seems very likely that the existing single market passports for financial services will end.
In May, a joint technical working group of the ECB and Bank of England was established to assess risks of a 'no deal' Brexit taking place on 30 March 2019. The UK government and regulators have announced a Temporary Permissions Regime to provide firms and regulators with additional time to adapt. Some EU27 regulators and Member States have also indicated the need to consider actions in the interests of maintaining financial stability and minimising disruption, but at the time of writing there is a lack of clarity on actions that would need to be taken if the UK left without an agreed transition period.
The European Commission, ESAs and regulators have made clear that the primary responsibility for preparing to adapt, to a 'no deal' Brexit, is for market participants. The industry has conducted extensive planning, and in the absence of certainty that there will be a transition period, it is now implementing contingency plans for a 'no deal' scenario to minimise disruption to clients, including adapting their business structures and licenses to ensure that they can continue to service clients and consumers.

However, a number of significant operational and practical challenges and risks remain. With just five months until the UK leaves the European Union, financial services firms across Europe continue to face significant political and regulatory uncertainty. Market participants have raised the concern that a number of cliff edge risks remain in a possible no-deal scenario, that cannot be adequately addressed by firms' contingency plans alone, and that solutions need to be put in place as a matter of urgency .

In particular, market participants have highlighted the need for urgent clarity on the legislative or regulatory steps that will be taken to address cliff-edge risks in the event that the UK exits the EU without a transition period. This is likely to be required to ensure an orderly withdrawal and maintaining financial stability. Areas of uncertainty include the ability, post-Brexit, for:

- EU27-based firms to access UK financial market infrastructure including CCPs (and vice-versa);
- clients and policyholders to continue to rely on services under existing cross-border contracts;
- EU-27 firms to rely for regulatory purposes (i.e. MREL) on instruments already issued under English law, and
- firms to continue to transfer personal data between the EU and the UK.

It is also important to consider how potential barriers to cross-border activities and trading for financial services in a 'no deal' scenario could impact European capital markets, for example whether this could lead to a split in liquidity and greater fragmentation, and to consider any consequential impacts for consumers and clients.

The future economic relationship between the EU and the UK will be very important for European markets. It is likely that concepts and questions linked to the existing framework of equivalence will be key to determine this relationship. It will be important to provide a stable and robust framework for market participants going forward, to ensure market efficiency and access to liquidity pools with the aim of minimising fragmentation and supporting growth across Europe, while at the same ensuring a level playing field and protecting the integrity of the single market. It will also be essential to put in place mechanisms for close supervisory cooperation and regulatory dialogue between the EU and UK, to support financial stability and market integrity and ensure the coherent alignment of regulation.

# CONCLUSION

With little time until the UK leaves the European Union, significant outstanding questions remain that need to be urgently addressed. Whilst market participants are implementing their contingency plans to mitigate potential impacts of different Brexit scenarios, a number of cliff edge risks still have to be addressed to minimise the impact on consumers, clients and financial stability. It will also be important to consider the future framework for market access, supervisory cooperation and regulatory dialogue between the EU and the UK.

This event provides an important opportunity to discuss these issues at a critical time for the future of Europe's financial markets.

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