

Brexit: Implications for Financial Services (“FS”)

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Issues to Consider

1. Downturn in UK Economy and Market Volatility

- Impact on all Irish firms
- Particular impact on Irish FS entities exposed to the UK

2. Changes in FS Regulatory Regime (actual or anticipated)

- Loss by the UK of Single Market in FS
- Impact on Irish firms
- Potential for UK FS firms to relocate to Ireland

1.1 General Spill-over effects of a UK downturn

- FS and related services contributes 12% UK GDP
- The UK is the world’s largest exporter of FS
- Just under half total stock of FDI in UK is concentrated in FS



- 1 million people work in FS
- Another 1.2 million people work in FS related industry in UK
- 2/3 of these work outside London
- 22% City employees are non-nationals (about ½ from EU)
- Largest employers (in order) are Banking, Insurance, Securities Markets and Fund management.

* Source: TheCity UK, FT and HM Treasury (2016)

#Brexocalypse

- Significant economic costs to UK (2.7-7.5% reduction in GDP (OECD))
- Likely effects include sterling depreciation, stock market volatility, reduction in cost and availability of bank credit, postponement of investment decisions, drop in property prices and a dip into recession
- Shock transmitted to other countries especially in EU
- More than half of Irish trade is with the UK
- Permanent loss to Irish GDP of 1.1%-3.1% (Open Europe, 2016) or 0.9%-1.6% (ESRI, 2015)

1.2 Effect on Irish FS entities exposed to UK

- Impact of a Brexit on the Irish financial sector could be **“significant if it occurred in a disorderly manner and/or had a large negative impact on the UK economy”**.
- Irish **banks** have **sizeable, largely property-related exposures to the UK economy**. The 5 retail banks have a total loan exposure of approx €64bn (21% of their total assets) in the UK. **“Any shock to the UK economy could cause issues for future growth, profitability and loan performance. Financial market effects could also impact on banks’ profitability.”**
- Outward **sales of insurance** to UK amounted to €8.6bn in 2014. Financial markets volatility could also cause losses within Irish insurers’ **investment portfolios**.

Source: Central Bank Macro-Prudential Review (November 2015)

2.1. Loss by the UK of Single Market in FS

- EU FS passport allows FS firms to provide cross-border services or to establish branches in other member states without further authorisations
- Single European Rulebook
- **No Free Trade Agreement offers the same market access for FS**



UK as a Gateway to Accessing EU 

- Banks, capital market firms and investment management firms benefit significantly
- More than half world's largest FS firms have their European headquarters in UK

**Option for
UK Firms and other Non-EEA firms
= Establish subsidiaries
in EU**

Third Country "Equivalence"

- Certain services/products/activities may be allowed by Commission if regulatory and supervisory regime is recognised as equivalent in managing risk
- UK currently "equivalent" and likely to retain most of the EU FS regulatory framework
- Not applicable in certain areas or to certain investors eg management company of a UCITS must be an EEA firm
- Barriers to reaching agreement include scope of task, complexity and political willingness
- A finding of equivalence is subject to change

Loss of Influence on FS Regulation

- Voting Power in **Council of Ministers** and Parliament
- **Commissioner** for Financial Stability, FS and Capital Markets Union
- Membership of **influential committees**
- **Impact on policy** included proposal to introduce EU Financial Transaction Tax, requirement that clearing of euro-denominated transactions take place in euro area countries (cf remuneration)




Options Following a No Vote

	Arrangement/ Membership	FS Inclusion
Norway	European Economic Area & European Free Trade Association	Access to single market Limited impact on regulation
Switzerland	European Free Trade Association & Bilateral Trade Agreements with EU	Individual trade agreement required Some single market access (FS excluded) Limited impact on regulation
Turkey	Customs Union	Some single market access (FS excluded)
Canada	Free Trade Agreement with the EU	Market Access negotiated sector by sector
[Default Option]	World Trade Organisation (MFN)	No single market access for FS Firms

Switzerland – a Unique case?

- “I’m sure we could get a better deal than Switzerland when it comes to financial services [partly because of] the sheer weight of the City of London.”- Matthew Elliott, Vote Leave, April 2016
- Very lengthy negotiations in a different political environment
- 20 Principal Accords and >100 Supplemental Accords
- “The U.K. would need to dismantle and then reconstruct, but it would be like building a new house in Chernobyl!” Rene Schwok, University of Geneva



War Games on Post Brexit Negotiations OpenEurope (January 2016)

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“Europe would never agree to open pass-porting for British financial institutions unless you would also agree to the supervisory powers of the ECB...because if not, that would break up the whole monetary union. You cannot have a free-rider.” - *Karel de Gucht, EU Institutions*

“I’m not sure that I can impress my Frankfurt electorate, that the one and only chance after your Brexit to compete with London as the leading financial centre...[I end up making an agreement with the UK Government] that gives you a free entry to the European Financial market...This cannot be a serious option in our renegotiation.” *Steffen Kampeter, Germany*

“We will also be looking to see, that as much as possible of the FS market in the EU, that is currently in London, is relocated in Ireland” – *John Bruton, Ireland*

Banks

- UK is largest centre for foreign branches in the EU
- Consensus in favour of Remaining In
- Ernst Young European Banking Barometer 2016 reported 70% of European Banks said Brexit would impact their business and 29%/19% of UK/Irish banks anticipated “significant impact”.
- Complications in obtaining debt and equity finance from UK investment banks and investors
- “Problems are already beginning to arise in respect of financing documentation and terms that contemplate Brexit.” (McCann FitzGerald, 2016)



Asset Management

- There will **not be a single “impact”** on the UK investment management industry – rather it will affect individual firms in different ways, depending on the extent to which they are UK or EU focused, the type of products they offer investors, and can be mitigated by the amount of business they are able or willing to do outside Europe.” – Clifford Chance (2015)
- Many UCITS with many UCITS and management companies would re-domicile . Effect of this on investors is unclear.
- Some UK alternative investment funds (AIFs) and their managers would re-domicile or use national private placement regimes.
- “Investors assume ...a deal would be struck allowing investment management to be delegated back to the UK” (Morgan Stanley, 2016)



2.2 Impact on Irish Non-bank Financial Intermediaries

- For non-bank financial intermediaries, a loss of access to a UK client base could have a negative impact on business although the exit of UK competitors from the market might benefit other firms. Brexit could also be disruptive in the short term for funds and “a large degree of legal/contract novation and repapering might be required”.

Source: Central Bank Macro-Prudential Review (November 2015)

Effect on All Firms (including FS Firms)

- “There would be merit in Irish companies and businesses which **trade and engage with the UK, depend upon UK-based entities** and/or which do business under English Law **reviewing their own business model and arrangements to identify weaknesses or possible concerns** that could arise if there is a vote in the UK to leave the EU.”

Source: McCann FitzGerald, *Brexit: A Legal Perspective*, 2016

2.3 Relocation of FS Entities or Expansion of Operations

- “If we can’t passport out of London, we’ll have to set up different operations in Europe.” Jamie Dimon, JPMorgan

- “A significant amount of financial trade currently booked in London would leave if the UK left the EU...It wouldn’t happen overnight but, steadily, it would fragment throughout the EU.” Alex Wilmot-Sitwell BAML (Europe)

Relocation to Ireland - Pull Factors

- In EU (and Eurosystem)
- English Speaking
- Skilled labour force
- Similar Legal System to UK
- Infrastructure?
- Openness to foreign firms

Central Bank Macro-Prudential Review (November 2015)

A disorderly Brexit could be associated with a loss of access to European markets for UK-based financial services firms...[In the event of relocations here] the impact on the financial sector here might be significant, with **positive and negative consequences** from an economic perspective and a direct impact on the scale of Central Bank's mandate, for example arising from increased numbers of authorisations, changes in type and complexity of business models including the possible establishment of financial market infrastructures etc."

Competition

Fragmentation



Time for Prudent Risk Management

- Only a Vote to Remain will bring any certainty in the Short to Medium Term


