Brexit: what impact might leaving the EU have on the UK's financial services industry?

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Following the UK's vote to leave the European Union in a so-called Brexit referendum, we consider the potential implications for the financial services industry.

1. Passporting

At the moment a range of authorised businesses, such as banks, insurance companies and asset managers, are able to operate across the EU as long as they have a base in the UK. This is called "passporting".

Passporting means that a British bank can provide services across the EU from its UK home. Importantly, it also means that a Swiss or an American bank can do the same from a subsidiary established in the UK. Goldman Sachs and JPMorgan both gave evidence to the Parliamentary Commission on Banking Standards before the referendum, flagging up the importance of the UK's EU membership in providing a base from which non-EU businesses can passport across the EU.

Passporting into the EU from the UK will not be possible following a Brexit unless a special arrangement can be negotiated. Financial services businesses wanting to continue to provide services across the EU may well have to establish subsidiaries in mainland Europe (to the extent that they do not already have them).

2. Red tape

Financial services is a highly regulated industry. Although much of this regulation emanates from Brussels, it is unlikely that regulation is going to lessen following a Brexit. While there are some examples of financial regulatory requirements which have been resisted by the UK (e.g. the bonus tax) much of the EU-derived requirements reflect the perceived need in the UK. It is therefore unlikely that the UK will repeal or amend significant parts of the financial regulatory law. Where the requirements have had direct effect in the UK, through Regulations, then the UK would need to decide whether to adopt these requirements or allow them to lapse on a Brexit.

If the UK wants to continue to do business with the remaining EU Member States following a Brexit, it will almost certainly need to comply with EU regulations in order to meet an equivalence assessment - but unfortunately without the ability that it previously had to negotiate, influence or challenge those regulations. Banks may also be faced with having to comply with UK as well as EU legislation, which may well diverge over time or at minimum be applied inconsistently.

3. Continuing the UK's relationship with the EU

Various models have been proposed for how the UK and the remaining Member States of the EU might manage their relationship following a Brexit. Could the UK be the new Norway (by becoming a member of the EEA and EFTA)? Or Switzerland (accessing the EU by way of bilateral agreements)? Or Turkey (which has a customs union with the EU)?

No doubt plenty will be said about the advantages and disadvantages of these and other options in coming weeks and months as the alternatives are assessed in more detail. Focussing solely on the financial services perspective, however, it is only the Norway model which is appealing for the sector, but it is unlikely to be politically appealing.

Switzerland's 120+ bilateral agreements with the EU require constant renegotiation. None of these agreements allows Switzerland full access to the EU's internal market for financial services. As a result, Switzerland tends to do banking business by passporting - often from the UK.

Turkey's customs union is limited to trade in goods. It does not extend to trade in services (financial or otherwise) and is intended as a pre-cursor to EU membership, not an alternative to it.

It is likely therefore that the UK will now be looking to set up a bespoke arrangement going forward.

4. Legal framework

The UK's legal system has become tightly enmeshed with that of the EU over a period of forty years. The unravelling process is likely to be a long and expensive one. Which European legislation and regulation does the UK like or need and therefore want to keep? What should be replaced? Where are the gaps? New UK legislation might also be incompatible with EU legislation. Over time, it is almost inevitable that the two banking environments would drift apart.

There may also be an impact on contracts as time goes by. For example, contractual parties will be asking:

- Will a contractual requirement to comply with a particular piece of EU legislation still be binding following a Brexit?
- What principles of EU law will still influence English courts?
- How will a judgment from an EU Member State now be enforced in the UK?
- How will a choice of English law be interpreted if EU law was part of English law at the time the contract was made but not by the time of performance?

5. Comment

The UK's decision to leave the EU raises significant uncertainty for the financial services sector. For this sector, continued access to the single market is a priority. On the one hand, UK institutions, which are heavily reliant on the EU as the destination for UK exports of financial services, will be seeking to support and influence the UK Government in the important exit negotiations. On the other hand, these institutions will be seeking to implement their contingency plans to achieve continuity of access to the single market.

For more information on any of the issues, facts and figures in this piece, please contact the authors.

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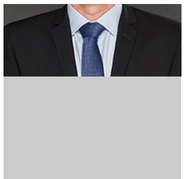

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