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The Irrelevance of Brexit for the European financial market

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(1) Introduction

Starting point: Brexit referendum

- end of EU membership
- different scenarios discussed (Norway model, Swiss model, New York, Singapore, etc.)
- hard Brexit versus soft Brexit
- in any case, City access to EU financial market under threat

(1) Introduction

My claim:

- Brexit will be irrelevant in practice, at least for financial services
- Very strong economic and political case for staying in the single market for financial services
- “politics will find a way”
- Broader point: politics (and economics) trump law

(2) The doom scenario

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No more passporting post Brexit?

Passporting – principle of home state control in EU financial markets regulation

- Once authorised, no further scrutiny elsewhere (allows branch or CB service provision)
- Reduces costs of CB business within the EU
- Enshrined in all relevant laws, eg MiFID II, CRD IV, UCITS, AIFMD, PSD, IMD/IDD

(2) The doom scenario

‘Norway’ as the alternative?

- EEA membership largely seen as unattractive in the UK
- Single market access, but subject to rules without seat at the table
- Norway critical of UK membership

(2) The doom scenario

A tailor-made agreement?

- Wide divergence in standpoints
- UK seeks to restrict free movement of persons
- EU27 see this as an integral part of single market access

Conclusion:

- no deal?
- End of passporting

(3) A more realistic view

(3) A more realistic scenario

Economic case for single market access for financial services – for the UK

- Financial services = UK's biggest industry, worth as much as 10 per cent of GDP
- nearly 5,500 UK firms use passports to access the EU market (FCA 2016)
- Clearing of Euro securities under threat
- Leaving Single Market could cost 35,000 jobs in finance (Oliver Wyman); up to 285,000 financial sector jobs at risk (Treasury)
- When the banks leave, the professional services firms who work with them would follow over time
- Third country banks (US, Japan) most likely to move

(3) A more realistic scenario

Economic case for single market access for financial services – **for the EU27**

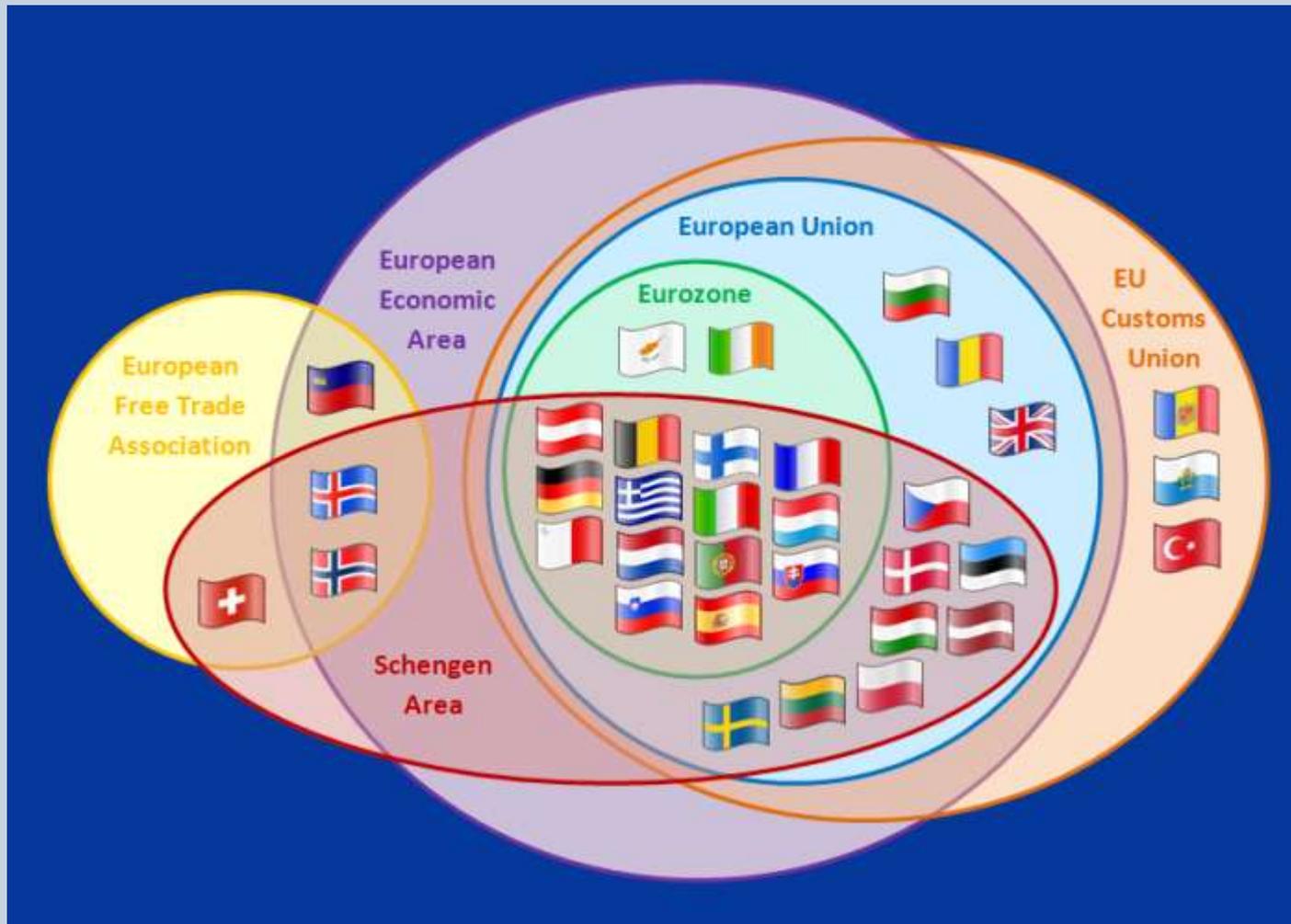
- About 8,000 EU firms use passports to access the UK market (FCA 2016)
- ‘passporting is a two-way street’
- Common interest – City weakness would hit German and French exports to the UK (Fuest 2016) – close relationship of mutual economic dependency between UK and Eurozone
- Threat of arbitrage and competition with an independent City of London (eg bonus caps)

(3) A more realistic scenario

But – what about the risk of setting a precedent / inviting copycats?

- Size of the UK and its financial market
- historical examples:
the UK rebate – reduces the UK's contribution to EU budget since 1985 (Thatcher)
- Multi-layer EU already a reality: Eurozone, Banking Union, Schengen etc

(3) A more realistic scenario



(3) A more realistic scenario

Politics – intra-UK

- Majority of MPs are pro-remain
- Currently: Parliament rebellion
 - consequences for UK trade
 - Fear of being sidelined
 - New trade deals mandated by government action
- Scotland is pro-remain

(3) A more realistic scenario

Politics – preparation of Article 50 negotiations

- currently hardening positions: pre-bargaining rhetoric
- Theresa May's dilemma
 - domestically, she needs to speak tough to honour referendum outcome -> tough talk on immigration, sovereignty and ECJ jurisdiction
 - in Europe: this rhetoric will prevent her from getting a good deal
- creates counter-reactions and tough rhetoric from the EU's side!
- negotiations will show common ground

(4) But how does this square with Brexit?

(4) Politics & economics trump law

Key lesson from EU financial integration:

Politics and economics frequently trump formal legal rules

- EU legal system has proven to be malleable
- Creativity in particular during the 2008/09 Financial Crisis and 2010-12 Sovereign Debt Crisis
- “Given a choice between financial stability and the rule book, ditch the rule book” (The Economist)
- Expect the same in the Brexit crisis

(4) Politics & economics trump law

Examples

- Euro convergence criteria (in particular 3 % budget deficit)
- Global financial crisis (bank bailouts) vs. state aid rules
- Creation of ESAs & independent decision-making
- Fiscal discipline: Sixpack 2011 and Fiscal Compact 2013
- ESM, Greece rescue vs. ‘no bail-out’ clause (*Pringle case*)
- Creation of Banking Union – legal basis unclear
- ECB: “Whatever it takes”, OMT and QE (*Gauweiler case*)
- Italian banking crisis 2016 and bail-in

(4) Politics & economics trump law

Should we worry?

- Pistor: genius of law is its flexibility in crisis situations
- German government – establishment of a rules-based Europe

What does it mean for Brexit?

- Legal rules a malleable: in crisis times, they become unimportant
- ‘Brexit’ will formally be implemented, but politics will find a solution for financial services

(5) How could a solution look like?

(5) Solutions

Most likely outcome

- 'Special deal' with the UK, Switzerland-style
 - UK is out of the EU
 - Single market access, at least for financial services
- May to give in on immigration
 - Actually to the benefit of the UK!
 - Wide carve-outs likely
- Bespoke agreement with the EU
- ~ Continental partnership (Bruegel)

(5) Solutions

Alternative?

Third country status – relying on ‘equivalence’ (eg Art 46 MiFID II)

- (P) typically restricted to wholesale financial services, not retail
- Shouldn't matter, UK financial industry mostly focused on wholesale
- Patchy, eg doesn't apply to UCITS
- Still risk of political exploitation, agreement preferable

(5) Solutions

Transition?

- Temporary EEA membership will give time and breathing space
- Continue single market access for a while and allow for individual treaty negotiations
- Or third country status with guaranteed equivalence as interim and negotiate agreement

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