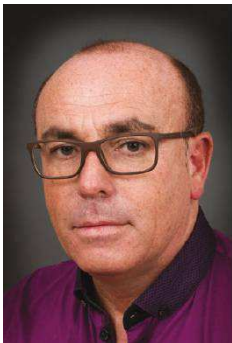


What will Brexit mean for the financial services industry?

In this article, **David Bowden** examines the likely impacts of the UK leaving the EU on the country's financial services industry.



About the author
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On 23 June 2016, the UK electorate voted to leave the EU. Since then, there has been a government restructure which has included the setting up of the Department for exiting the European Union (DExEU). In this piece, the author will look at the implications of Brexit for the financial services industry within the UK, and what the future shape of financial regulation could look like.

What are the UK's constitutional requirements?

Article 50(1) of the Lisbon Treaty says that a member state may decide to withdraw from the EU 'in accordance with its own constitutional requirements'. The UK government initially maintained that this could be done by the exercise of a prerogative power. However, by an 8–3 majority the Supreme Court, in *R (Miller and another v Secretary of State for Exiting the European Union* [2017] UKSC 5, ruled that the UK's constitutional requirements needed the approval of parliament by means of a bill. The European Union (Notification of Withdrawal) Act 2017 received royal assent on 16 March.

What will happen when the UK leaves the EU?

The Treaty says that the EU shall negotiate with the UK, so the option of delaying or obstructing negotiations is not available.¹

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- While the language of the Treaty is 'withdraw', it qualifies this by referring to 'arrangements for its withdrawal' and 'framework for its future relationship' with the EU. Clearly this contemplates that the UK could keep some existing EU rules such as those on the internal market.
- Although the Treaty says that after two years the existing EU treaties will cease to apply to the UK, this period can be extended; however, this would require complete unanimity within the Council of Ministers (and not just a qualified majority vote), but a member state can abstain from voting.

The UK's options post-Brexit

In theory, the options are limitless, but in relation to financial services they seem to fall into the following groups:

- join Norway in the EEA, which would represent no change for financial services;
- negotiate a free trade agreement between the UK and the EU similar to the one Canada has negotiated;
- have a customs union with the EU (similar to Turkey's);
- negotiate a number of bilateral trade agreements (similar to Switzerland's); or
- rely on agreements negotiated by the World Trade Organisation.

EU directives versus EU regulations

The EU has two legislative tools available to it: directives and regulations, but it can also issue decisions. Where a directive is issued, it is then left to the government of an EU member state to transpose it into national law and report back to the relevant directorate of the European Commission on what has been done. Where directives are not transposed properly or at all, the commission can bring proceedings for infraction before the Court of Justice of the European Union to ensure that they are transposed. Within the UK, the most usual tool for implementing EU directives has been by issuing a statutory instrument under section 2(2) of the European Communities Act (ECA)1972.

On the other hand, EU regulations have direct effect throughout the EU; member states do not need to pass any further domestic legislation to bring them into force. This has the advantage that regulations are the same throughout the EU.

Would repeal of the ECA solve everything?

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At first blush, simply repealing the ECA would mean that all the transposed directives would also disappear too, because the Act which gave power to make the implementing regulations had gone. However, within financial services, the issue is more complex. Many of the substantial number of directives that the EU has issued in the field of company law were consolidated within the Companies Act 2006. This covers a wide field, including themes such as formation of public limited companies, annual accounts, statutory audits and mergers. Similarly, while the Consumer Rights Act 2015 implemented the Consumer Rights Directive (2011/83/EU), it also consolidated the legislation which had applied other earlier EU directives, such as those on unfair contract terms.

The UK government is proposing what it terms a Great Repeal Bill. While a draft bill has not yet appeared, it seems that this will be a measure to try and keep all the EU rules, at the same time as giving powers to individual government departments to change or repeal them in the future. This seems an odd way to go about things because the bill would not repeal anything, but rather could contain Henry VIII clauses, which are usually not permitted.² If the UK decides that it wants to keep a directive, then parliament is likely to need to underpin any implementing regulations by statute if it does decide to repeal the ECA. So, simply repealing the ECA will not be enough.

How large is the *acquis communautaire*?

During the EU referendum campaign, it was claimed that the *acquis communautaire* (or the accumulated body of EU law) was 130 miles long. Internal market legislation accounted for just under 10% of EU law, but when all legislation in the 'four freedoms' (ie, free movement of goods, capital, services and persons) is included this rises to 20%.

Open Europe (which describes itself as a non-partisan and independent policy think tank ...' for thinking about Britain's new relationship with the European Union and its role in the world') counted the pages in the Official Journal L (legislation) series up to 2005, and found that the EU had passed 'a staggering 666,879 pages of law since its inception in 1957'.¹ The authors calculated that, by 2005, the EU's *acquis communautaire* consisted of around 170,000 pages of active legislation.³ The European Commission's 26th annual report on monitoring the application of community law (2008) said that: 'At the end of 2008, the rules of the Treaty were supplemented by some 8,200 regulations and just under 1,900 directives in force throughout the 27 member states'.⁴ Although the commission continues to publish an annual report, it has stopped updating the EU law size statistics.

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How much of this relates to financial services? In relation to financial services, the list of EU regulations and directives is at least 20 pages long. In reality, the list is longer as many earlier EU rules have been consolidated (or recast) in later legislation. There is also other legislation that impacts financial services, such as that relating to copyright and databases (which underpin computer software), the environment (some financiers have co-liability with manufacturers), and tax (especially VAT and its legion exemptions).

What has the Financial Conduct Authority said?

At the Financial Conduct Authority's (FCA's) annual public meeting (APM), in July 2016, chairman John Griffith-Jones stressed that London was a global financial centre and that there would be ramifications for the City because of the referendum outcome. John Griffith-Jones said that the FCA was focused on its overriding objective that markets work well. However, the authority would not speculate on what the outcome of the UK government's negotiations would be. Domestic financial regulation derived from EU law would remain applicable until changes were made either by the UK government or parliament.

He stated that the FCA would continue to plan for EU legislation already in the pipeline, such as the Markets in Financial Instruments Directive II, and that consumer rights and remedies were unaffected by the referendum outcome. The FCA was supplying 'technical advice' to the UK government and would discuss, with firms and consumers, what rights are important to them and why.

At the APM, the FCA's chief executive, Andrew Bailey, said that the authority wanted to see both UK firms continuing to have access to Europe's internal market and 'healthy competition ... supported by cross-border trade ... in services [with] robust global standards and regulation'.

Passporting and its significance

Where a UK-based financial services firm has obtained authorisation from either the FCA (or its predecessor, the Financial Services Authority) this permission is sufficient for the firm to carry on those authorised activities throughout the rest of the EU without the need to obtain further permissions from financial regulators in other EU member states.

The passporting of FCA authorisation is important for wholesale banks as this enables them to trade throughout the EU, without the need to obtain further authorisations. The passport is less valuable or useful for retail banks. By 2019,

Brexit and financial services UK-based banks will need to have split their retail operations from their wholesale ones.

EU law not yet implemented

As negotiating the terms of the UK's departure could take some time, the majority view seems to be that the UK will continue to implement EU directives. There may be some resistance to this approach from hard Brexiteers; however, it should be noted that the terms of the UK's withdrawal could include provision for the UK to retain some EU rules anyway, so there is little reason yet to depart from a business-as-usual approach.

EU law likely to be retained

Within financial services, the UK is likely to want to keep all EU legislation. While the EEC was set up (without the UK being a member) in 1957, nearly all the rules relating to financial services have been agreed or finalised since the UK joined in 1973. The rules on financial services all mesh together, so it will not be feasible to try and get rid of directives on one theme without considering others. For example, there are EU regulations on accounting standards, but these complement EU directives on company law, solvency and shares and securities.

EU law likely to be scrapped

In many ways, there is little appetite for repeal of EU rules relating to financial services. There are two main reasons for this. First, if any legislation is repealed, this will generate work for firms in seeking to implement the changes, with the corresponding cost: leaving the existing rules in place does not generate any further cost. Second, by keeping the EU rules, UK-based firms will know that the level playing field throughout the EU will be maintained.

Roll back of UK: when to?

This is a question that those campaigning to vote leave did not answer. There are, however, the following key dates:

- 1 January 1973 (the date the UK joined the EEC).
- 11 May 1999 (the date the European Commission issued its financial services action plan).
- 2008–2009 (the start of the financial crisis, and when emergency legislation was issued to strengthen financial markets).
- 23 June 2016 (the date of the referendum).

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An attempt to try and roll back the position in the UK to an early date or milestone is likely to cause more problems than it solves; however, we await the official view on this from DExEU.

What does the white paper say?

DExEU issued a white paper, *The United Kingdom's exit from and new partnership with the European Union*, on 2 February 2017.⁴ Sections 8.22 to 8.26 deal specifically with financial services, although the paper is quite vague and thin on detail. It makes encouraging noises that: 'The financial services sector is an important part of our economy', with two-thirds of the jobs based outside London. It notes that: '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.' On passporting, the paper notes: 'there are over 5,000 UK firms that utilise passports to provide services across the rest of the EU, but around 8,000 European firms that use passports to provide services into the UK'.

As to what the future deal with the EU will look like after Brexit, DExEU limply refers to: 'our new strategic partnership agreement' in which it hopes will aim for 'the freest possible trade in financial services between the UK and EU member states'. The paper does not address which of the five choices is the UK's preferred option. Instead, it leaves this wide open: 'In highly integrated sectors such as financial services there will be a legitimate interest in mutual co-operation arrangements that recognise the interconnectedness of markets, as so clearly demonstrated by the financial crisis.' All DExEU will commit to is to 'seek to establish strong cooperative oversight arrangements with the EU' as well as continuing 'to support and implement international standards to continue to safely serve the UK, European and global economy'.

What is the timetable for the next steps?

On 29 March 2017, the UK's permanent representative to the EU, Sir Tim Barrow, informed the office of European Council president, Donald Tusk, of the UK's intention to invoke article 50. This means that the UK will leave the EU by 29 March 2019 unless the European Council, in agreement with the UK, unanimously decides to extend this period.

1 At the time of going to press, negotiations were scheduled to begin on 19 June

2 Henry VIII clauses enable primary legislation to be amended or repealed by subordinate legislation with or without further parliamentary scrutiny

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³ Vaughne Miller, How much legislation comes from Europe? Research paper 10/62, 13 October 2010, HC Library, available at: <http://tinyurl.com/k8vz7k>

⁴ Available at: <http://tinyurl.com/k6nthv>

⁵ Available at: <http://tinyurl.com/zjk2ozz>. See also Neil Parpworth, 'Constitutional law update: The Great Repeal Bill and the government's thinking', (2017) May CILExJ pp24–25