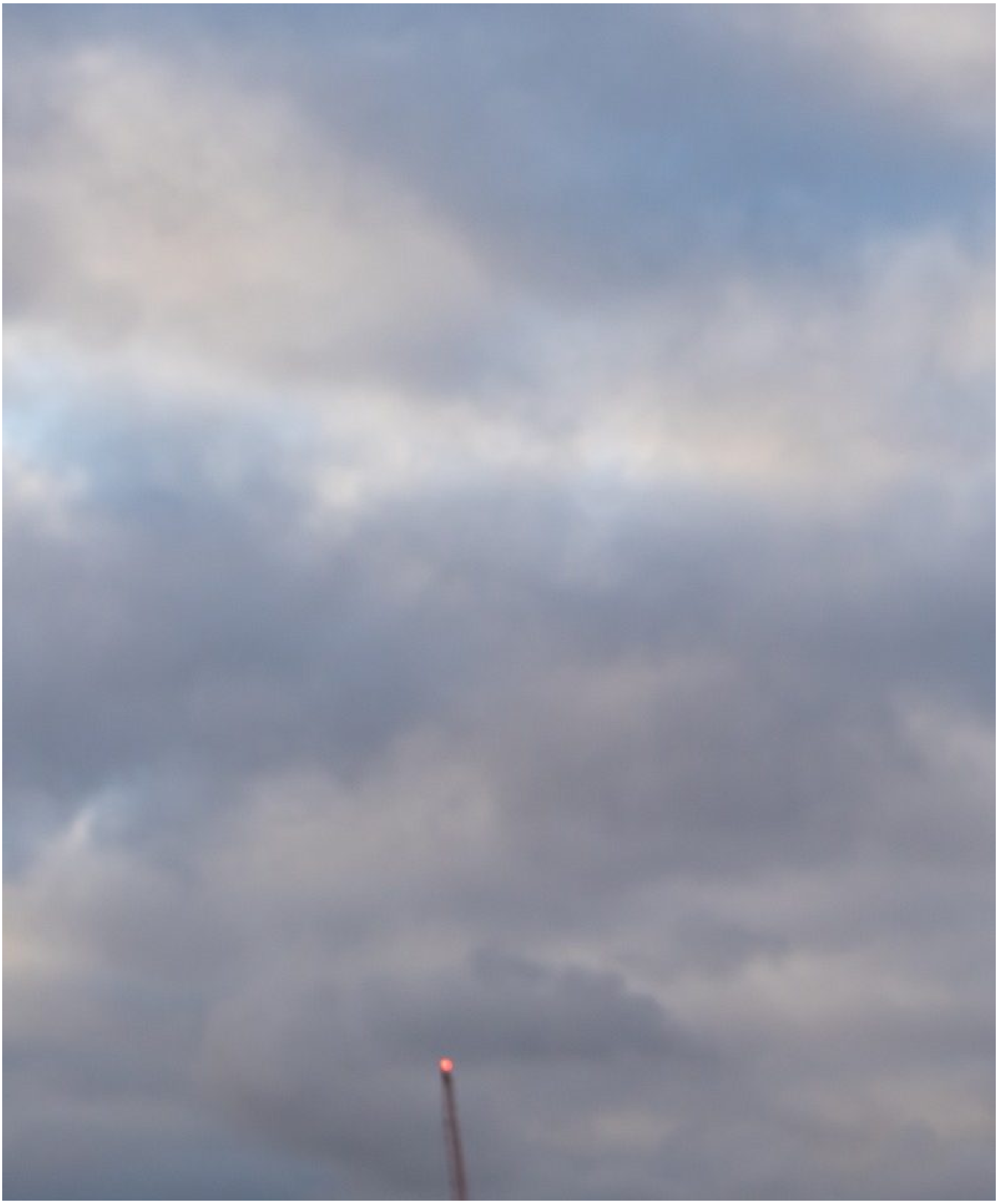
Brexit means Brexit for the City of London

*As of 2021 UK financial firms lost access to the EU single market and now need regulatory equivalence to do business on the continent. Brexit really does mean Brexit for the City of London, writes **John Ryan** (LSE).*

Prime minister Boris Johnson spoke about the new trade deal struck between the UK and EU on December 24, telling the news conference after his prepared statement that "there's some good language about equivalence for financial services". "Above all, it means certainty for businesses from financial services to… (other industries)," he maintained.

At the same time, "[t]he Agreement does not include any elements pertaining to equivalence frameworks for financial services," said the European Commission's corresponding assessment. It added that the EU will seek clarification on the UK's plans, particularly over divergence, and "will consider equivalence (decisions) when they are in the EU's interest".

On 1 January 2021, UK financial firms lost blanket access to the EU under the single market passporting regime and are now reliant on Brussels granting regulatory equivalence to its financial services sector.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'Equivalence' is a system that can be used to grant 'domestic market access' to 'foreign' firms in certain areas of financial services. It is based on the principle that the countries where the firm is based has regimes which are 'equivalent' in control, behaviour, and outcomes. 'Equivalence' does not carry anywhere near the same rights as passporting and either side can unilaterally terminate it, which in EU legislation can be with just 30 days' notice.

So far, Brussels has only given temporary equivalence in two areas, for derivatives clearinghouses and to settle Irish securities transactions. The Political Declaration – part of the UK-EU 'Withdrawal Treaty' – had aimed to conclude 'equivalence' assessments before the end of June 2020. This deadline was missed, limiting the European Commission to grant temporary equivalence to UK central counterparties. This decision allows European customers to continue to have access to Euro clearing houses located in the UK until mid-2022.

The EU has agreed to roll over current arrangements for clearing Euro-denominated derivatives, a business dominated by London-based clearinghouses. For the EU, demanding that Euroclearing be relocated or at least EU regulated is a reasonable stance because it will be the ECB that would have to bear the bailout risk of a failure of any Euroclearing bank. German, French, and ECB policymakers have all been fearful of a disorderly Brexit. Most London-based financial firms have made contingency plans since the 2016 Brexit vote.

Financial services generate 7.2 per cent of the UK's economic output and bring in 11 per cent of total government tax revenue. The sector employs more than one million people and only a small proportion of these jobs have moved to other locations so far. This process is likely to accelerate now that Brexit has happened.

EU Financial Services Commissioner, Mairead McGuinness, said on 19 January 2021 that Brussels would not grant Britain's financiers access to the bloc before assessing the risks to financial stability – and that to do otherwise would be an "experiment". McGuinness said it was likely that more financial jobs would leave London for the EU, and that assessing UK access would be a "big body of work" through 2021 and beyond. "It's not a question of Europe trying to bring everything back home, not at all. It is a question of Europe ensuring that at home Europe is strong, and can be strong globally," she said.

The City UK, the industry group for UK financial services, published a paper outlining the "key outstanding issues" facing Britain's financial and professional services industry. Their appeal for greater access to the European Union single market comes amid fears of the deteriorating relations of the UK government with the EU which could leave large parts of the City of London at a distinct disadvantage in the next years to come. UK financial firms are far from reaching certainty in the post-Brexit world. The Governor of the Bank of England has made clear that the UK should not be a rule-taker. In his view, the UK can make the most of its opportunity to diverge, if needed. At the same time, the UK will continue to help set the agenda at the global level, vital for the raft of firms in the City.

The political imperatives of Brexit have made the negotiations exceedingly difficult. There have been three Brexit drivers which have been largely detrimental to City interests: First, getting Brexit done by concluding a boilerplate agreement on goods, while neglecting financial services; second, leaving the single market and ending freedom of movement making a deal on financial services impossible; and third, the false and arrogant mantra that 'the EU needs the City more than the City needs the EU'.

The EU is, in fact, keen to repatriate financial business and to build its own capacity: it sees Brexit as a once in a generation opportunity to rewind the clock 20 years. If the UK had got a more comprehensive deal or a higher degree of equivalence, fewer firms would have moved jobs and activities to the EU or will do so in the coming months. The EU's approach appears to be working so far. Amsterdam has overtaken London as Europe's largest share trading centre in January 2021. The UK's share of the Euro-denominated swaps market decreased from 40 per cent in July 2020 to 10 per cent in January 2021 with mainly New York, Paris, and Amsterdam benefiting. The City of London and the UK government cannot afford to be complacent. Brexit will over the next few years have a negative impact on jobs, activity, and tax receipts.

After the recent tensions regarding the Northern Ireland Protocol, the deeply eroded level of trust between the EU and UK is making a memorandum of understanding on equivalence probably untenable in the foreseeable future. For the City of London, this means that it will have to adapt to the harsh realities of a hard Brexit, perennial tensions with Brussels, and growing competition from continental financial centres and New York.

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