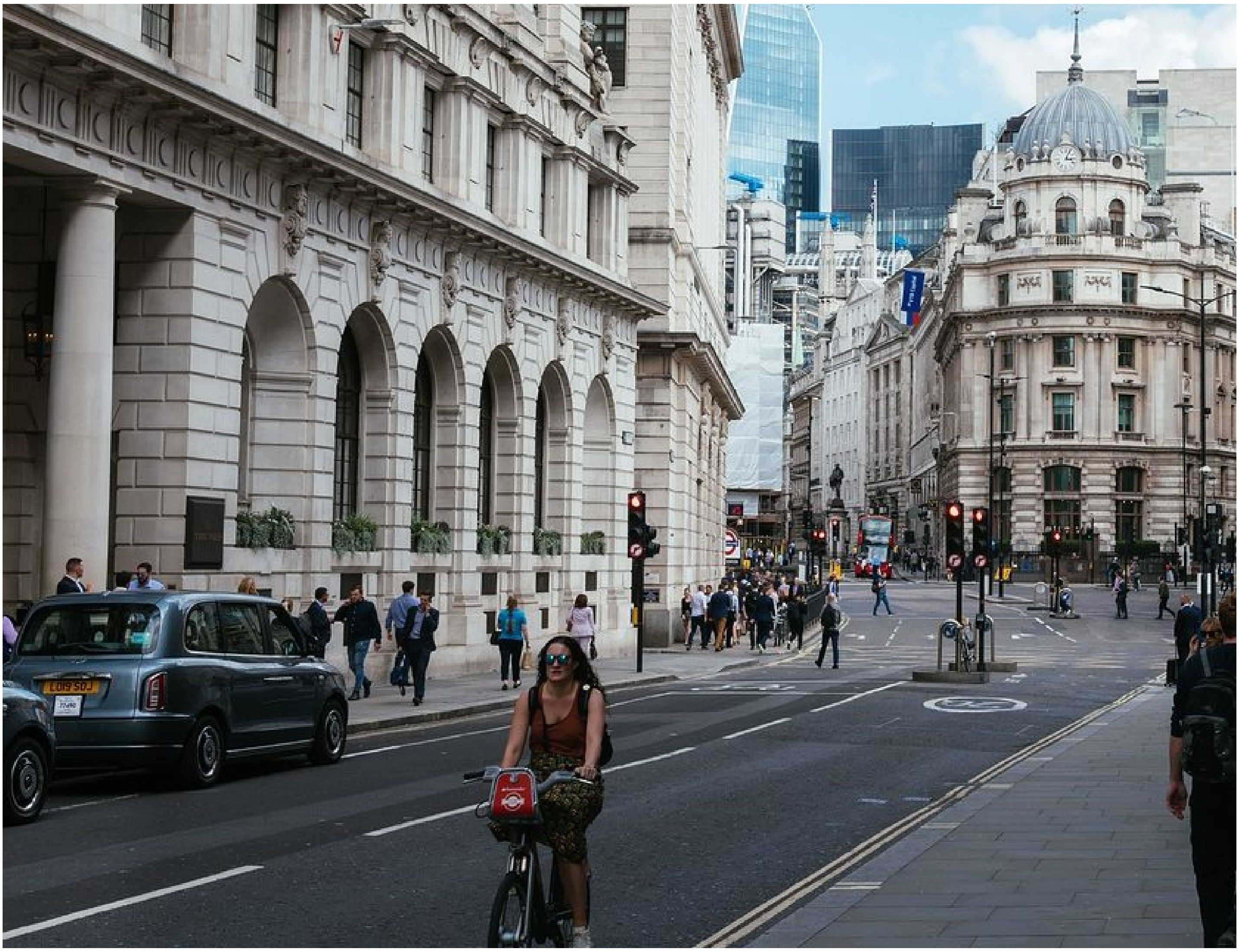
Brexit heralds a bleak future for the City of London

Brexit heralds a bleak future for the City of London writes ***Sven Van Kerckhoven*** *(Brussels School of Governance). He argues that the temporary equivalence frameworks that have been put into place recently buy the EU time to strengthen its financial governance system in preparation for the exodus of the City's financial industry.*

The City of London finds itself in a precarious situation. With the Brexit trade deal barely mentioning financial services, the flight of the United Kingdom's financial industry to the European Union will be difficult to avoid. With temporary equivalence frameworks currently obscuring the underlying harsh reality for the City of London, the EU might just have bought some time to strengthen its financial governance system in preparation for the relocation of the City's financial industry.

London grew over the last decades to become the premier financial hub in the European Union. In particular, London was the first European stock exchange working with a clearinghouse, giving it a significant first-mover advantage. The result is that London far outsizes other European financial centres in terms of foreign-registered monetary financial institutions, making it the international finance hub in the EU. The City's role has been further strengthened with the creation of the European Union and the euro, whereby over time, a growing number of transactions were being conducted in London.

European institutions, such as the European Central Bank, have already long advocated that euro-denominated transactions should be dealt with within the Eurozone. In 2011, the European Central Bank (ECB) already specified that large-scale clearing houses dealing with euro-denominated trades should be fully incorporated in the euro area, where the full operational and managerial control should be located.



For now, as John Ryan argues, equivalence still allows UK clearinghouses access to the EU's single market. However, in due time, it is far from unimaginable that the City's financial infrastructure will move to the remaining EU member states, either by choice or as a necessity. Early post-Brexit reports have already indicated that several financial powerhouses have already started moving a substantial part of their business to EU member states.

In the meantime, the potential (and ongoing) relocation of the UK's financial industry to the EU creates some interesting dynamics. Several EU member states have been actively promoting their national finance centres as alternative locations. In particular, Germany and France have been putting forward respectively Frankfurt and Paris as excellent alternative locations.

As the jury is still out on whether these attempts would be successful, it suffices to state that such relocation would also empower the EU in terms of financial policies. After the Brexit, the UK no longer holds direct influence over EU policy decision-making. The power it currently continues to have relates to the presence of the financial industry in London, but this is set to wane.

The UK (supported by some EU member states) has traditionally always had a large influence on financial governance as the promoter of a market-friendly environment for the financial industry and as the biggest non-eurozone country. Ideationally, the UK has always been a proponent of a more market-friendly approach towards the regulation of (financial) markets.

With the exit of the UK, the proponents of more strict financial regulation still have the upper hand in EU policy-making. Yet, in a recent study, I argue that supported by other EU member states, France and Germany will actively seek to steer towards more oversight over the EU's financial markets even at the risk of alienating those member states more positively inclined towards a more market-friendly approach towards the management of the EU's single financial market.

The EU's current financial regulatory framework still demonstrates certain weaknesses and needs to be further developed to be able to fully replace English courts, which currently govern the master agreements of the ISDA (International Swaps and Derivatives Association). As argued in another recent study, the usage of temporary equivalence might thus just allow the EU to move forward, address the gaps in its oversight, and allow to conduct relocation in a managed and controlled way.

With the potential for a relocation of the UK's financial industry and a move towards more strict oversight of the European single financial market, the City of London might find itself to be a regional financial hub rather than an international financial centre. However, a City of London that does not need to abide by stringent EU rules could become an important competitor to the European financial centre(s) that are to emerge.

Freed from EU regulatory requirements, the UK financial regulator might, in the short run, pursue more deregulation attempting to attract EU business to the City, in turn weakening the European (and global) financial system. The residual power of the City could then also place pressure on EU27 financial centres to compete on market-friendly terms.

However, in the grand scheme of the impact of Brexit on European finance, it seems that this might only play out in the short run. In the medium run, with the relocation of financial services to the EU, the City of London might find itself to be a reminiscence of a once-powerful international financial centre.

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