

Passporting remains the best option for UK financial services industry post-Brexit – or New York may have the last laugh



*After Brexit, UK banks will lose their passporting rights — which allow financial companies authorised in the UK to sell their products across the European Union. This would damage the reputation and status of the City of London as Europe’s leading financial centre, writes **John Ryan (LSE)**.*

Cities in the EU such as Frankfurt, Dublin or Paris are attracting some business from London over the short run. However, it is unlikely that there is a single city in the EU with the physical infrastructure or regulatory infrastructure to take the role London has. Instead, we will see regionalisation and fragmentation in services. The most significant winner is probably going to be New York, as the only global financial centre that could absorb migration of jobs and services from London on a large scale.

Restrictions on EU migration could further impact the competitiveness and attractiveness of the City of London after Brexit. The impact on the EU, in turn, would create uncertainty for the future and a weakening of Europe’s major financial centre.

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Remaining a member of the EEA — and accepting the conditions of the EU that go with it — is likely to be politically unfeasible for the UK government. This means that viable alternatives to passporting will be needed, although the options available are expected to provide little comfort for the City’s long-term planning outside the single market.

Staying within the EEA would require the UK to allow free movement of workers, make contributions to the EU budget and accept the jurisdiction of the European Court of Justice in some areas without being able to influence the EU’s decision-making.



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An alternative system known as ‘equivalence’, whereby financial institutions can continue to operate in the European single market as long as UK and EU regulations are compatible, has frequently been cited as an alternative. However, it is, at best, a partial solution. If the negotiations between the EU and the UK turn hostile, the European Commission may be unwilling to grant equivalence. Even if the negotiations were benign, it could take many years to be granted.

The fact that the City of London and the government could make regulatory changes that take the EU and the UK in different directions would complicate any deal. However, the UK starts from the basis of having the exact same regulation as the EU — something no other country has done — which should make equivalence easier to achieve.

The problem from the UK negotiators’ perspective is that equivalence standards are weighted towards to the EU, and the City of London would be operating with a distinct disadvantage, with each kind of market access requiring different EU approval processes. The UK has a legal system and supervision regime that is ‘equivalent’ to the EU regime at the moment. But regulatory changes may affect the provision so that that determination would be made by the relevant European Supervisory Authority providing technical advice to the European Commission on how the UK’s laws and regulations compare to the corresponding EU requirements.

There is a large degree of scepticism of the suitability of such an outcome, with the main political problem being the EU’s preparedness to accept such an arrangement in the first place. The process is fraught with difficulties and uncertainty since equivalence standards can be withdrawn at short notice which would make long-term planning impossible or at best difficult for the UK’s financial services industry.

Passporting, therefore, principally remains the best option for financial services groups. Alternative solutions could lead to higher costs for clients and lower operating efficiency.

The banking passport relies on two key pieces of EU legislation: the Capital Requirement Directive (CRD) IV and the Markets in Financial Instruments Directive (MiFID). CRD IV allows banks to provide deposit-taking, lending and payment services, while MiFID allows them to provide advisory services, investment services and portfolio management across the EEA from a base in London.

Essentially, wholesale banking is done via CRD IV and investment banking via MiFID.

As it stands, the CRD IV legislation does not allow for equivalence, or meaningful third-party access. Therefore, without a bespoke agreement allowing passport-like access, UK banks and London-based US investment banks could see significant disruption to their business lines across the EEA.

The UK may prioritise negotiating a new deal for the sectors that depend on passport access and where the alternatives are limited. This approach could look to a mixture of government-negotiated specific bilateral agreements and equivalence, as well as individual firms establishing local branches and subsidiaries across the EU where necessary.

Scenarios that have been put forward thus far include ideas around a bespoke CRD IV passporting deal under the Brexit scenario that could take the form of a specific bilateral agreement similar to the EU-Swiss deal on insurance.

As is evident from the scenarios that are being drawn up, reaching an agreement on a bespoke passporting arrangement or an equivalence agreement could take a long time. The current situation does not bode well for an agreement, and the UK may have to revert to WTO arrangements with no deal on passporting or equivalence.

Moreover, it appears highly unlikely that any early talks for pre-emptive action could take place. Much will depend on whether there will be a softening of negotiation positions and coming together of interests once trade talks begin in March 2018.

This post represents the views of the author and not those of the Brexit blog, nor the LSE.

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