Will the United Kingdom's vote to leave the European Union impact the provision of financial services in the United Kingdom?

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Executive Summary

The UK financial services industry contributes more to the economy than any other sector, employing over two million people,[1] and creating 11% of Gross Value Added in 2015.[2] Its value to the overall UK economy is therefore sacred.

Membership to the EU via the European Communities Act 1972 helped the sector grow significantly through the advent of cross-border financial activity in the EU single market. In the present day, 25% of the sector's services are exported to the EU[3] and 6% of its total workforce is EU-born, which demonstrates the mutual benefit of the UK/EU trading relationship.[4]

The question to be considered is whether firms within the UK financial sector can react appropriately to the recent decision by the UK to leave the European Union (also known as 'Brexit'), so as to mitigate potential losses to the economy.

Given the importance of the UK financial services industry to both the UK and EU economies, it is paramount that on leaving the EU, the UK is able to negotiate a trade agreement that is as close as possible to the one it had as a Member State. The financial benefits to the sector of EU membership were arguably a direct consequence of 1) access to the single market, and 2) EU regulatory rules.

EU Directives such as the Markets in Financial Instruments Directive ('MiFID') presented the opportunity for UK firms 'passport' their services cross-border without the need to apply to Member States for individual licences. Article 45

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[1] TheCityUK, *UK-based financial and related professional services: Enabling growth across the UK*, February 2017, p5
[2] TheCityUK, *UK-based financial and related professional services,* p9
[3] Office for National Statistics, *Who does the UK trade with?*, February 2017
[4] The UK in a Changing Europe*,* *Where EU migrants in the EU work?,* June 2016

of the Treaty on the Functioning of the European Union ('TFEU') allowed firms to build on this freedom via cross-border hiring of EU citizens.

A 'soft' Brexit, whereby the UK retains some form of access to the EU single market in return for the free movement of persons, as in the cases of Norway and Switzerland, would have been the best post-Brexit model for the UK financial services sector to retain stability. However, the UK will instead be pursuing a 'hard' Brexit in which it will no longer have access to the EU single market, and thereby removing the passporting provision. It will implement its own Immigration Bill alongside.

As 20% financial activity within the UK banking sector relies on the functionality of passporting, firms such as HSBC Group, Lloyd's of London, and Barclays, would look to implement alternatives to the provision.[5] The closest replication to passporting is the principle of 'equivalence,' whereby the UK will become a 'third country' to the EU and will be eligible to apply for a licence to have its financial services legislation considered equivalent to that of the EU's.

Equivalence has its drawbacks however, as does the UK's intention to strike a bespoke deal with the EU on the basis of a Free Trade Agreement ('FTA'), which could fall back on unfavourable World Trade Organisation ('WTO') terms if the parties cannot agree.

Firms are therefore already engaging contingency plans to set up EU subsidiaries in order to continue having access to the EU single market. This is a pre-emptive measure, however, and firms will be in consultation with the UK Government to discuss how Brexit amplifies new and existing challenges faced by the sector, as well as presents fresh opportunities to establish new FTAs with non-EU countries.

[5] Stephen Booth, 'How to ensure UK and European financial services continue to thrive after Brexit,' 17 October 2016

In summary, Brexit will no doubt impact the provision of financial services in the UK, but it remains to be seen exactly how. A range of flexible options is available to firms to mitigate a negative impact, but viewed in the context of increasing trade and market competition, Brexit could be viewed as an exciting opportunity for the sector.

Introduction

On 29th March 2017, Prime Minister Theresa May triggered Article 50 of the Lisbon Treaty ('Article 50') by giving written notice of the United Kingdom's ('UK') departure from the European Union ('EU') (a process also known as 'Brexit') in the form of a letter addressed to European Council President, Donald Tusk.[6]

Now that Article 50 has been triggered, the UK will have a two-year window (unless the other twenty-seven EU Member States all agree to extend it) within which it can negotiate the terms of its departure from the EU, under Section 3 of the Article.[7] Substantial talks have yet to begin, but the Prime Minister has already clarified the UK's terms going forward. Firstly, the UK will no longer seek membership of the EU single market.[8] Secondly, a UK Immigration Bill will replace Article 45 of the Treaty on the Functioning of the European Union ('TFEU') in which the free movement of persons is enshrined.[9]

This has potentially very damaging effects on the provision of financial services in the UK because, through 'passporting' and the contribution of EU employees to the sector, the industry depends heavily on the two very aspects the UK Government is intending to disrupt on leaving the EU.

As will be seen, the extent to which the UK's decision to leave the EU affects the UK financial service sector specifically depends on the type of trade deals the UK can negotiate, within and without the EU. With regards to the EU, firms accept that, as it stands, the current options available to them to mitigate the effects of a 'hard' Brexit do not provide a silver bullet to the loss of passporting rights, although some have already engaged their contingency plans. Outside

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[6] This paper was partly researched using sources published up to and including the date of 31st March 2017. Any news published after this date has been deliberately omitted for the purposes of writing the paper.
[7] Article 50 of the Lisbon Treaty 2009 s.3
[8] Prime Minister Theresa May, 'Article 50 Letter,' *Gov.uk,* 29 March 2017, p4
[9] Gov.uk, *The Great Repeal Bill: White Paper*, March 2017, p11

the EU, the UK may be able to strike new Free Trade Agreements ('FTA') that could contribute to growth within the sector.

This paper will focus on the actions particular banking firms have already taken in response to Brexit. Banking is a financial services sector that relies heavily on the EU 'passporting' system,[10] is the largest UK employer in financial services,[11] and is regulated considerably by EU legislation.[12]

The Financial Services Sector in the UK

Getting the right deal

The decision to leave the EU raises many questions as to the provision of financial services in the UK, the continued success of which largely depends on the type of post-Brexit deal the UK Government is able to strike with the EU, whilst maintaining the wishes of the 51.9% of the UK population that voted to leave the bloc.[13] It is a tricky balance to achieve, and one that the Government must get right if it is to "minimise disruption" amongst businesses, which the Prime Minister has highlighted as one of her "proposed principles" for discussions with the EU in the recent Article 50 letter.[14]

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[10] Stephen Booth, 'How to ensure UK and European financial services continue to thrive after Brexit' 17 October 2016

[11] London First & PwC, *Facing Facts: The Impact of Migrants on London, its workforce and its economy*, March 2017, p64

[12] Under EU legislation, banks are regulated by the Capital Requirements Directive IV, Capital Requirements Regulation (together 'CRV IV'), and the Bank Resolution and Recovery Directive ('BRRD') alongside UK legislation under the Banking Act 2009 and the Financial Services (Banking Reform) Act 2013 ('BRA')

[13] BBC News, *EU Referendum Results*, http://www.bbc.co.uk/news/politics/eu_referendum/results

[14] Prime Minister May, 'Article 50 Letter', p4

The scale of financial services in the UK

The UK financial services sector includes derivatives and fund management, for which it is the world's leading centre; and banking and insurance, both of which are the world's third largest respective sectors,[15] whilst within cross-border banking the UK is the largest centre in the world.[16]

This paper will focus on the banking sector, and will therefore use as case studies the top three financial services firms that had the largest market value in the FTSE UK 500 during the 2014/15 financial year: HSBC Group, Lloyd's of London, and Barclays Bank PLC.[17] This paper will refer to these firms as the Big Three.

Getting the right Brexit deal is particularly prudent with regards to the financial services sector in the UK because it is astronomically important to the UK economy[18]. The Prime Minister Theresa May makes special mention of the industry in her Article 50 letter because overall, the sector contributes more to the UK economy than any other sector, adding £176 billion in 2015, and amounting to almost 11% of Gross Value Added.[19] This contribution is almost 3% higher than the next highest contribution of financial services to a national economy.[20]

Outside of the scale of revenue the sector generates, it employs over two million people and accounts for around 7% of the working population, making it a leading national employer. The UK financial services sector has, through

[15] TheCityUK, *UK-based financial and related professional services: Enabling growth across the UK*, February 2017, p8
[16] TheCityUK, *Key facts about the UK as an international finance centre, November 2016*, p15
[17] UK 500 companies ranked by sector, UK 500 2015, https://www.ft.com/ft500
[18] Harriet Agnew and Patrick Jenkins, 'Big Bang II: After Brexit, what's next for the City of London?' *Financial Times,* September 2016
[19] TheCityUK, *UK-based financial and related professional services,* p5
[20] Ben Lobel, *How EU membership affects financial services,* 29 July 2016

these means, helped raise national and regional living standards by spreading highly productive and value-added employment.[21]

Whilst the activity that takes place in the City of London is a core strength of the industry, growth in regional areas of the UK consolidates the nation's status as a global heavyweight, and is a key factor in encouraging Foreign Direct Investment ('FDI'). In total, the UK financial services sector has attracted £10.2 billion in FDI[22] and exports the most financial services by economy, beating the US.[23] All this consolidates the UK's status as world's top financial centre for the second year running.[24]

EU membership; a factor of growth in the UK financial services sector?

These are undeniable statistics that demonstrate the very sensitive nature of any Brexit deal going forward with regards to the UK economy and the financial services sector within it. However, the UK financial market would not have been able get to the leading position it is in today without EU membership, which introduced two key factors into the fold: 1) access to the single market, and 2) EU regulatory rules. Economists generally agree that these introductions forced the UK industry to become more competitive, innovative and specialised, alongside the deregulation of the UK's financial markets throughout the 1980s (discussion of the latter lies outside the scope of this paper).

- The EU Single Market

When first implemented in 1972, the European Communities Act gave effect to EU law in the UK. EU Directives put in place since 1999 created a single market by allowing firms authorised in one Member State (home), to carry out

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21 TheCityUK, *UK-based financial and related professional services,* p9
22 TheCityUK, *UK-based financial and related professional services,* p5
23 TheCityUK, *UK-based financial and related professional services,* p13
24 Rebecca Smith, 'London holds off New York to keep its title as the world's number one financial centre despite Brexit uncertainty,' *City A.M*, 27 March 2017

business in other Member States (hosts) without the need to apply for separate licences each time.

Regulated by the Markets in Financial Instruments Directive ('MiFID') and known as 'passporting,' this was especially important to the success of the financial services sector in raising capital because it allowed firms to seamlessly provide cross-border services and establish branches across the EU in order to service new and existing clients. In the case of the Big Three, this means they are able to provide their services across the EU from their UK base.

- EU Financial Regulation

The EU Directives confer respective responsibilities on home and host Member States for business with a cross-border element. This set up a framework within which the UK financial services sector was able to cooperate with its EU equivalents so as to expand business. Title III of MiFID, for example, sets out the regulatory aspects of EU membership specific to financial services, as either a regulated market or multi-lateral trading facility ('MTF'), therefore ensuring that all firms are able to compete on a level playing field.[25]

The nature of Directives means that decisions made in Europe have the power to influence financial policy decisions in the UK, such as the Capital Requirements Directive IV ('CRD IV') which informs UK banks on financial stability and openness, as the Bank of England's 2015 document shows, and has therefore further positively impacted the financial services sector in the UK.[26]

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[25] Financial Conduct Authority, *A brief guide to the European Union and its legislative process*, June 2011, p39
[26] Bank of England, *EU membership and the Bank of England*, October 2015, p49

- The Treaty on the Functioning of the European Union ('TFEU')

Membership to the EU also requires that the UK comply with the free movement of persons as part of the four economic freedoms of the Treaty on the Functioning of the European Union (TFEU') under Article 45.

To remain competitive globally, the UK financial services sector needs to retain access to a global pool of talent. The industry built its success with the help of the 6% of EU-born financial services employees and will want to ensure that any Brexit negotiations going forward do not deter current and future potential employees from providing their services in the UK.[27]

Importance of the UK financial services sector to the EU

The UK operates as the EU's financial services capital, contributing 25% to the total amount of services exported to the EU in 2015; a total of £24 billion.[28] The bloc relies heavily on the UK as regards the cost of borrowing across Europe, and is, in the words of the Governor of the Bank of England, Mark Carney, "the investment banker for Europe".[29]

As seen in this section, the scale of financial services offered by the UK internationally is second to none. This means that striking a minimal-impact trade agreement with the EU, which retains equivalent access to the EU single market to enable continued passporting and free movement of persons, would be in the best interests of the financial services sector, and the UK and EU economies going forward.

[27] The UK in a Changing Europe*, Where EU migrants in the EU work?,* June 2016
[28] Office for National Statistics, *Who does the UK trade with?,* February 2017
[29] Nils Pratley, 'Business and parliament must work together to avoid a 'cliff edge' Brexit,' *The Guardian,* December 2016

2016- Brexit Options

In the immediate aftermath of the EU referendum, it was unclear as to whether the UK would continue to have membership of the EU single market. It was hoped that the UK Government would adopt a 'soft' Brexit in order to maintain some form of access to the single market in return for the free movement of persons. This would have been the prime outcome for the UK financial services sector considering the importance of passporting and EU employees to the industry.

The UK could have based its future relationship with the EU on one of the two models outlined below:

1) Membership of the European Economic Area ('EEA') + European Free Trade Association ('EFTA')= The Norwegian Model

The UK could have become a member of ETFA and had access to the EEA, as in Norway, and thereby continue to enjoy membership of the EU single market without being a Member State. However, a condition of EEA membership is the continued adoption of EU regulation and standards, including the free movement of persons, which the UK wanted to be free of.

2) Negotiation of bilateral accords + EFTA= The Swiss Model

The UK may have sought a number of bilateral agreements with Member States as well as becoming an EFTA member, as in the case of Switzerland. However, there would have been limited access to the single market here, and as recent events have revealed, free movement of persons would still have been enforced.[30]

[30] Eric Maurice, 'EU and Switzerland agree on free movement,' *EU Observer,* December 2016

2017- Brexit Reality

Since January 2017, following Prime Minister Theresa May's Lancaster House speech[31] and as confirmed in the Article 50 letter, the Government has made three things clear.

The first is that at the end of the two-year negotiation period (likely to be March 2019 as negotiations are unlikely to conclude before then), there will be a transitional agreement as outlined in the Great Repeal Bill White Paper ('Great Repeal Bill'), published by the UK Government in March 2017.[32] The legislation will repeal the European Communities Act 1972 and transfer all EU laws into UK equivalents in order to avoid a legal "black hole" after Brexit.

This follows the successful lobbying of groups such as TheCityUK[33], CBI, and the City of London Corporation, who argued the need for a transitional agreement after making their concerns of the uncertainty around the 'cliff edge' effect heard to the Government throughout much of November and December 2016.[34] Much of this concern centred around the "regulatory no-man's land" that firms would experience as a result of a 'cliff edge', disrupting business.[35] The Great Repeal Bill will meet these concerns by ensuring that the process of leaving the EU is a "smooth and orderly exit".[36]

Therefore, the Great Repeal Bill will retain more or less the current EU structure, which means that after leaving the EU in March 2019, financial services firms will continue to have access to European markets and its EU employees will be able to continue working in the UK.[37]

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[31] BBC News, *Brexit: UK to leave single market, says Theresa May,* January 2017
[32] 'The Great Repeal Bill,' p10
[33] The chairman of HSBC Group, Lloyd's of London, and Barclays PLC, each sit on the group's Advisory Council
[34] The Guardian, *May hints at transition deal on Brexit to avoid 'cliff edge' for business,* January 2017
[35] CBI, *Firms 100% committed to making best of Brexit - CBI President*, November 2018
[36] 'The Great Repeal Bill,' p7
[37] *GOV.uk, Guidance for businesses on the Great Repeal Bill*, March 2017

However when the UK diverges from this, there will be more difficulty, as will be seen below.

The second and third, and arguably the most important talking points of the Great Repeal Bill are 1) that the UK no longer intends to have access to the EU single market, and 2) that the UK will implement its own Immigration Bill and detail its position with regards to the rights of EU citizens.

It is clear from these declarations that the UK Government will pursue a 'hard' Brexit, discarding both the Norwegian and Swiss models from the negotiating table, and potentially endangering firms' passporting rights to provide cross-border services from their UK base, as well as limiting the pool of talent from the EU.

Open Europe, a think-tank influential in Downing Street, has rated the importance of passporting as 'high' within the banking industry due to the fact that it is regulated so heavily by EU law. Deposit-taking, lending, payment services, and other such services are governed by the Markets in Financial Instruments Directive (MiFID), whilst portfolio management and investment advice are overseen by the Capital Requirements Directive (CRD IV), culminating in around a fifth of the sector's annual revenue being tied to the passport.[38]

It is clear the industry must retain the benefits associated with passporting if it is to maintain its status as the world's top financial centre.[39] The section below outlines the alternatives for UK firms to gain cross border access to the EU.

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38 Booth, 'How to ensure UK and European financial services continue to thrive after Brexit'

39 Whilst the resilience of the financial services sector in the UK has braved the Brexit effect for the time being, showing overall increased growth within the sector during the first quarter of 2017, this trend is predicted to be only temporary. PwC, *CBI PwC Financial Services Survey: Q1 2017*

Alternatives to Passporting

The alternatives to passporting outlined below have been advised by a range of law firms in the top tiers of the Legal 500 Finance sector, along with concerned lobby groups.

Third Country Regimes

This option is based on the principle of 'equivalence' and works on the basis that once the UK leaves the EU, it will become a 'third country' in the context of latter's financial services legislation. The UK can apply for a licence to the EU, where if granted, its legal and regulatory system would be considered equivalent to that of the EU's, and would apply to all Member States.

This could be a viable option for the UK financial services sector, particularly for MiFID where equivalence is available and provides passport-like rights.[40]

No equivalence determinations have been made under MiFID as yet however, and there are a number of drawbacks to the system.[41] It also places power back in the hands of the EU,[42] and does not cover CRD IV as regards wholesale banking, which Open Europe believes should be the UK Government's primary objective.[43] Most importantly, in its draft staff working document, the European Commission made clear that equivalence does not guarantee third countries a right to a positive determination, further drawing into question the suitability of this option for firms.[44]

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[40] See also equivalence under EMIR. Norton Rose Fulbright LLP, *Brexit and financial services: 10 things you should know (Part III)*, November 2016

[41] TheCityUK, *The EU's third country regimes and alternatives to passporting*, March 2017, p12

[42] TheCityUK, *The EU's third country regimes,* p13

[43] Booth, 'How to ensure UK and European financial services continue to thrive after Brexit,' *Open Europe*

[44] Ashurst LLP, *European equivalence framework is in the Brexit spotlight; European Commission sets out its view*, March 2017

Reliance on Local Laws

Some commentators have suggested that the importance of passporting is inflated, and UK firms may be able to conduct their activities in the EU in line with national laws instead, without having to apply for a licence and therefore avoiding the time-consuming equivalence process.[45] This option would also provide an alternative to equivalence where it is not available, for example in the activities regulated by CRD IV.

Additionally, it would avoid EU bureaucracy by dealing directly with Member States, who tend to take a liberal approach to the provision of services in this capacity.[46] However, there are no universal exemptions to particular financial services activities within Member States; exemptions can be piecemeal and unpredictable. As such, UK firms' ability to provide EU cross border services would be at the behest of Member States: not exactly a satisfactory option.[47]

Contingency plan

The above alternatives to passporting are merely speculations as to future negotiations; nothing can be known for certain until talks commence. However, to avoid the complications already thrown up by these alternatives and to address the unknown future status of EU workers in the UK, some firms have already activated their contingency plans, as in the cases of the Big Three, who have vocalised their intention to set up EU subsidiaries.[48]

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[45] Vincenzo Scarpetta and Stephen Booth, 'How the UK's financial services sector can continue thriving after Brexit,' *Open Europe,* October 2016, p34

[46] Addleshaw Goddard LLP, *Brexit: A changing legal landscape?,* June 2016, p4

[47] Rachel Kent and Dominic Hill, 'Financial services after Brexit: possible cross-border models,' *Hogan Lovells LLP,* March 2017

[48] HSBC Group expects to shift around 1,000 jobs to Paris, HSBC Group, *Annual Report and Accounts 2016*, p5
Lloyd's of London confirms Brussels as its EU subsidiary, Lloyd's of London, *Annual Report 2016,* p4
Barclays Bank PLC has yet to confirm in its Annual Report that its EU subsidiary will be in Dublin, Caitlin Morrison, 'Barclays is reportedly preparing to move its EU headquarters to Dublin,' *City A.M,* January 2017

This is an onerous and large-scale operation that a report by the Association for Financial Markets in Europe and PwC predict would take four years to complete, by which time, the UK will have left the EU, rendering this exercise pointless if a mutually beneficial trade agreement ends up being successful.[49]

There is also the capability element that, notwithstanding shows of strength from cities around the world,[50] it is unlikely these cities would have the capacity to absorb the whole UK financial services ecosystem.[51]

So, although this option is expensive and will add complexity to clients' activities, it is currently the only viable and wholesale option to mitigate the Brexit effect on firms, unless the below model is successfully applied.[52]

3) A bespoke deal as per the Canadian Free Trade Agreement ('FTA') Model

Despite confirming cessation of access to the EU single market which will hit the UK financial services sector hard, the UK Government are calling for a "bold and ambitious" FTA to replace it.[53]

In light of the above drawbacks to 'alternatives to passporting,' UK financial services firms will want to get as close as possible to the current deal in the EU single market. According to Professor Van Reenan, if the sector is to continue providing financial services successfully and remain competitive, it

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[49] PwC, *Planning for Brexit: Operational impacts on wholesale banking and capital markets in Europe*, January 2017, p35
[50] Including Paris and New York
Michael Stothard, 'Paris attempts to lure business from London with new skyscrapers,' *Financial Times*, February 2017
Caroline Binham, 'Financial executives sceptical on London's future,' *Financial Times*, February 2017
[51] TheCityUK , *The EU's third country regimes,* p9
[52] William Wright, 'Analysis of the central roles of investment banks and asset managers in driving growth,' *Barclays Bank PLC*, February 2017, p23
[53] Prime Minister May, *Article 50 Letter*, p5

must retain its current level of Foreign Direct Investment ('FDI'),[54] the main motivator for which is access to the EU single market.[55]

The UK Government will therefore seek to strike a bespoke deal with the EU, as per the (albeit delayed) Canadian model, allowing mutuality of access to reflect market interdependency. As suggested by the International Regulatory Strategy Group (IRSG) report, this could be based on mutual recognition of the pair's financial regulatory systems, as opposed to engaging the equivalence test.[56] This would be a more favourable outcome for the UK financial services sector.

The issue that remains, however, is one of timing; striking a deal will take time, and the 'phased approach' propositioned by the European Council will add to that. There is also always the possibility that despite promises to "work hard" to achieve an agreement, one will never manifest.[57] Then firms must look to prepare for the final model.

4) World Trade Organisation ('WTO') Model

This is the situation whereby UK/EU trade relations would fall back on the largely unfavourable WTO terms if negotiations between now and March 2019 are inconclusive. There would be no further negotiations between the UK and the EU, and the UK would have self-determination of its own free trade policy.

Although, some argue that trading on WTO rules would not be disastrous, under this model there would be no leverage for the EU to negotiate free

[54] John Van Reenen, 'How Brexit would reduce foreign investment in the UK – and why that matters,' *The Conversation*, April 2016
[55] Professor Lucia Quaglia, 'How Brexit would affect UK financial services,' *The Conversation,* August 2016
[56] TheCityUK, *The EU's third country regimes,* p8
[57] Alex Barker and Martin Stabe, 'The EU's Brexit negotiation guidance decoded,' *Financial Times,* March 2017

movement of persons and firms in Member States would lose the right to provide services in the UK, which is the worst scenario so far for firms.[58]

Contingency plan

An option for firms to get around the implications of the WTO model would be to establish an EU subsidiary, as discussed above. Engaging this contingency plan before the WTO model is triggered comes with its risks (see above 'alternatives to passporting' section), but arrangements have already been made by the Big Three to set up subsidiaries before the UK leaves the EU in two years. This prepares the firms threefold: 1) it gets around the issues posed by the 'alternatives to passporting' in the lead up to trade negotiations, i.e. it is in the banks' self-interested spirit to set up EU subsidiaries,[59] and 2) firms will be two years ahead of the curve in setting up EU subsidiaries if WTO rules are triggered on a 'no deal,' according to the data.[60] Thirdly, and most importantly, the firms will maintain access to the EU single market, which means that business can continue without interruption when the UK leaves the EU, providing clients with much needed certainty.

Outside of this, there is not much else firms can do to prepare until negotiations get underway, apart from adapt their contingency plans in response to the trade negotiations. Legal advice and legislation trackers are poised to help firms navigate through the process.[61] But it must be remembered that post-Brexit, EU Member States will also lose the right to passport into the UK, and seeing as 35% of EU financial services activity takes place in London, it is of mutual interest to negotiate a bespoke deal.[62]

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[58] Chris Giles, 'What are the economic consequences of Brexit?,' *Financial Times,* February 2017
[59] Financial Times, *Equivalence makes sense for the City and Europe,* February 2017
[60] PwC, *Planning for Brexit*, p35
[61] Bird & Bird LLP, *Banking and Financial Services*, March 2017
[62] TheCityUK*, The EU's third country regimes*, p10

UK Government and Firms Working Together

The interests of UK Government and UK financial services firms are intertwined with regards to the continued success of the sector post-Brexit, and so the Big Three will continue to be in consultation with the Government during negotiations with the EU.[63]

Yet the challenges put forward by Brexit do not exclusively embody all the hurdles the UK financial services sector is forced to jump over. In a recent report, TheCityUK has identified what it calls the 'five priorities' going forward to tackle new and existing challenges faced by the industry.[64] Already taken into account by the Big Three in their 2016 Annual Reports, these focus on connecting globally; driving national growth; expanding services; innovating, disrupting, and scaling; and building skills.

The report concludes that a considerable revamp of the industry is needed in order to keep the sector ahead of the curve globally, and maintains that the 'five priorities' were ones that needed to be set in motion notwithstanding Brexit, albeit considerably amplified by it.[65]

Big Bang II?

That said, turned on its head, Brexit could be seen as an opportunity, as opposed to a threat to the report's first 'priority' for the sector to connect globally. For many in the industry, Brexit is an exciting business opportunity that frees the UK from the regulatory shackles of a bureaucratic EU and presents the UK with the fresh reality of being able to position itself on the world stage as a less-regulated, offshore, European version of Singapore.[66] Brexit could be a Big Bang II for firms, which opens up scope for establishing

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[63] As per the 2016 Annual Reports of HSBC, Barclays and Lloyd's, in which the latter has incurred costs of £1 million to this effect

[64] TheCityUK, *UK-based financial and related professional services*

[65] TheCityUK, *UK-based financial and related professional services,* p15

[66] William Shaw, 'Bank Clients Risk Brexit Upheaval, Consumer Panel Warns,' *Law360*

new FTAs with non-EU third countries, such as the United States and Japan.[67]

The Prime Minister recently vocalised this opportunity but only time will tell which form these FTAs will take.[68] It is expected they will replicate the fifty FTAs the UK already has as a Member State, and will most likely be based on WTO rules.[69] However, Open Europe questions whether the UK stands to gain anything beneficial from non-EU FTAs based on WTO rules.[70] A Senior Trade Economist at HSBC recommends striking smaller bilateral agreements instead, to bypass the restrictive nature of the WTO and bring trade relations more in line with the current global trend of protectionism.[71]

Conclusion

The UK's decision to leave the EU will certainly impact the provision of financial services in the UK, particularly banking, but it remains to be seen exactly how. Whilst the sector has ridden the wave of Brexit unexpectedly well in the first financial quarter of 2017, it is predicted that this will falter. Yet it would be too simplistic, and would be a disservice to the overall strength of the industry, to argue that just because EU membership helped it to grow through passporting and free movement of persons, that a divorce would automatically stifle it.

It is in the mutual interests of the UK and the EU to offset any potentially permanent damage to the sector but the UK financial services sector is large enough and well enough established to be sufficiently resilient to emerge from Brexit relatively unscathed, with arguably new horizons for trade. The Big

[67] Agnew and Jenkins, 'Big Bang II,' *Financial Times*
[68] "Opportunities to get out into the world and do new business with old allies and new partners," Theresa May, 'CBI annual conference 2016: Prime Minister's speech,' GOV.uk, November 2016
[69] Allen & Overy LLP, *Brexit – the UK and free trade*, January 2017, p1
[70] Giles, 'What are the economic consequences of Brexit?,' *Financial Times*
[71] Douglas Lippoldt, 'Trade agreements: think smaller, for now,' *HSBC Group,* March 2017

Three have already established EU subsidiaries, displaying their innovation and drive to remain competitive within the market.

Nevertheless, as imaginative contingency plans adapt to incorporate evolving trade negotiations between the UK and the EU, the parties would do well to remember that if they leave the negotiating table in two years time with no deal, UK firms will find some way to make it work on their terms. As the Financial Times aptly puts it: “Both sides should remember that markets find a way to subvert governments that fiddle the rules too much. And the markets are right to resist: it is not governments’ money”.[72]

[72] Financial Times, *Equivalence makes sense for the City*

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