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Brexit: Financial Services

City will endure but Europe risks losing out

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At a glance:

- Irrespective of Brexit, London will remain at centre of global finance
- 78 percent of Europe's forex activity and half its fund management takes place in the UK
- Asia and US could strengthen position as banking centres at Europe's expense

For almost three months, debate about the future of Britain's finance sector has centred on 'passporting' — the question of whether banks in the UK can sell services into Europe after Brexit. This is as much an issue for foreign banks using London as their European gateway as British institutions.

So what would happen if the UK did lose its passporting rights and how would that affect banks and businesses outside Europe?

Right now, the message to Europe's political leaders from the UK's finance sector and its customers across Europe seems to be unanimous: 'no change please'. The City of London is the lynchpin in Europe's financial system. Whether a Spanish corporate is looking to issue bonds or an Italian manufacturer wants to insure operations around the world, London is where that tends to happen. Seventy eight percent of Europe's foreign exchange activity and half its fund management takes place in the UK for example.

Europe needs the City

The City is an ecosystem that is impossible to replicate: a place where bankers, brokers, lawyers, accountants, advisers, fintechs, funds and intermediaries meet, speak a common language and operate

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under a trusted legal and regulatory framework. Europe needs the City just as much as the City needs Europe.

Despite that, political considerations on the Continent and the ambition of some to develop their own finance sectors at the expense of London may thwart access from the UK. Axel Weber, UBS Chairman and former head of the Bundesbank, has cautioned against such an approach, saying competition between Rome, Paris, Madrid and Frankfurt may simply push global players to set up elsewhere.

This is the danger for Europe — and the opportunity for Asia — especially for cities like Singapore. Big global banks are not making huge profits in Europe in the first place. While Europe's top banks struggle to meet targeted return on equity (ROE) and are working hard to meet higher capital requirements and trim back, well-capitalised Asian banks are surging ahead. Global players may be tempted to skip Europe altogether and relocate capital eastwards.

Prepare for the worst

So even if logic dictates the continuation of a free and open system with London at its centre, companies need to prepare for the worst. That is why financial services institutions are already making contingency plans based on the full gamut of possibilities from negotiations. Banks and other players in the sector are looking at their options and when they might need to trigger those plans. That includes how they might need to relocate some staff to Dublin, Paris and other EU cities rather than wait for a deal to emerge.

There is time — at least two years — however. Gaining the necessary regulatory approvals in other jurisdictions is a lengthy process and no institution should risk finding itself without a licence to trade.

There may yet be a way that firms in the UK can sell into Europe without the passport. Europe's MIFID II regulations, which take effect in January 2018 (before the UK is due to leave the EU), grant financial institutions outside the European Economic Area the right to sell financial services inside it — as long as that country's regulations are deemed as 'equivalent' to its own. As the UK's rules will be the same as the EU's when it exits, it would be difficult to argue the UK does not qualify, at least initially.

Kept calm. Carried on

Whether or not that happens and irrespective of Brexit, London will remain at the centre of the global financial system. Yes, the referendum is a major challenge to the UK's financial sector, but we should not forget that most of its business - domestic, European and global — will continue to course through the City unaffected.

This fact was perhaps reflected the day after the Brexit vote and the story that didn't break on 24 June: there was no market dislocation or a repeat of the chaos we saw in 2008. The Bank of England's steady hand, and a similarly mature response from authorities across Europe and the Federal Reserve, maintained stability.

In the next few years, Britain's finance sector will need that solidity as it faces a challenge of extraordinary complexity in untangling itself from Europe's financial system. Nevertheless, its primary domestic and global role remains undimmed: to serve as an vital source of credit to facilitate the functioning of the wider economy. I have no doubt it will meet that challenge and continue to be a dependable centre of trade finance and foreign direct investment for both Europe and the wider world.

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