

Brexit and UK financial services

March 2016

All financial institutions are coping with a seemingly never ending deluge of regulation, most of which is driven from the European Commission. Not surprisingly, one reaction from those engaged in the financial industry in the UK to the question "Would we like a regulatory brake?" is likely "yes" and an intuitive consequential reaction may then be to support an "out" vote. It is unlikely however to be that simple. An "out" vote is unlikely to be a solution for those who perceive an over regulation - or complication of regulation - of financial services in the UK.

To identify some of the relevant issues:

What happens if there is an "out" vote?

- **In the immediate future, nothing would happen whilst negotiations for the exit were conducted.**

We would inevitably though be looking at some sort of "quick fix" to keep and/or replace implemented and in some cases directly applicable European provisions.

- **There would certainly no longer be an obligation to follow the inexorable drive towards the EU Single Market for financial services and full harmonisation of regulation.**

The UK would not necessarily need to follow the EU approach. Depending on what deal we do with Europe (see further below) there may however be a need to demonstrate "equivalence" in particular areas to keep the European market open to us.

- **The UK could rely on its own decisions which it will determine regarding comprehensive regulation.**

The FCA and PRA indeed have in any event a history of driving forward regulation in anticipation or in isolation – take RDR, senior managers regime, benchmark regulation.

- **But, although we might know what we would miss, we would not know what would be replacing it. Coming out has its own uncertainties.**

It is not possible to provide a lucid answer on the consequent regulation of authorised firms post a potential "out" vote until we know the status which the UK would have out of the EU.

Potential options include:

- would it be equivalent to Switzerland. It is out of the EU but still, in its own way, replicating many EU laws, for example on AIFMD.
- would it be equivalent to Norway. It still has to implement much EU legislation if it wishes to benefit from the consequential of it.
- would it be truly independent and have to rely on third country arrangements as any other non European country would do.

- **Inevitably, coming out would be disruptive and create much uncertainty. A difficult transition period will be likely.**

Any form of exit will require detailed negotiation post the vote. It would take a long time to negotiate the selected

Brexit and UK financial services

status which the UK would have on coming out and so determine the details of how matters would work going forwards for financial services businesses.

It is not just a case of switching to a different system. It is a case of devising a new system.

What if we vote to stay in?

- **Of course there are uncertainties if we stay in.**

The EU has developed into something which is quite unlike what we expected it to be when the UK joined. Although it can influence it, the UK has lost control over how much of its regulation in the financial services sector develops.

ESMA's work programme is itself causing much work for UK authorised firms - just take a look at its recently published comments in its 2016 work programme. Take for example:

- the prospective implementation of MiFID II. Although the deadline has now moved out to 3 January 2018, that is only to allow the data problems to be resolved recognising that considerable change is required in order to ensure compliance with the new data systems for improving operation of the markets;
- IDD has recently been settled; and
- PRIIPs is at long last settled for initial point of sale documentation for retail insurance and investment products.

These are just to take a few examples as can be seen from ESMA's 2016 published Work Programme. Although there was a claim that there was a move towards bedding in existing regulation, in fact there was much new regulation coming through. We can only influence all this, rather than determine it all.

- **Is it, on balance, better to have the advantages which flow from the Single Market in Financial Services, which is nearing completion?**

If the UK can effectively stay out of the single currency and other elements of centralisation of the economy and financing, might this "semi-detached" membership of the EU be preferable to the complete detachment resulting from an out vote?

- **For certain types of financial businesses, there is considerable benefit from the single market measures which**

have been implemented already for their European business:

- **banks** benefit from passports for their banking businesses and are able to operate on either the basis of the "freedom of establishment" and the "freedom of services". These freedoms would no longer be available.
- **long term and general insurers** benefit from passports for long term and general insurance business respectively on a branch or services basis.

The established arrangements between EU member states involving passporting of insurance business in to, or out of, the UK would no longer be available.

- **investment managers** benefit from MiFID I (and prospectively MiFID II) passports, which would no longer be available.

This enables a wide range of businesses already to passport on a branch or services basis throughout the EU for investment management and advisory services, and the scope of MiFID is to be widened with effect from 3 January 2018.

- For **fund managers**, there are now two established types of funds:

The long established **UCITS** brand – a specific product directive designed to set parameters for funds which can be made available to retail investors. These can be sold cross border in the EU – with UCITS IV endeavouring to get some of the passporting arrangements to work better (although not brilliantly).

Should the UK vote to come out, this would have more serious consequences than might at first be technically apparent:

- UK UCITS would lose the benefit of the **UCITS product passport** and this would affect the few groups who do use their UK fund range for cross border marketing. Admittedly though many now use Luxembourg and Dublin fund ranges even if management is from the UK, third country investment management would still be practicable.
- UK UCITS management companies could not use the UCITS management company passport to manage UCITS funds established in other jurisdictions such as Luxembourg and Dublin. If

the UK exits the UK, UK fund managers could not utilise a **UCITS Man Co passport** for their UK management companies. They could not take the UK based ManCo option.

- There is **also a much wider marketing issue**. UCITS have become a global brand and currently, notably in the Asian markets and South American markets, the UCITS label is valuable. If UK authorised funds lost their UCITS label, this may prejudice business wider than just selling in Europe.
- **for alternative (i.e. non UCITS) investment managers**, the Alternative Investment Fund Managers Directive (AIFMD), implemented relatively recently and still subject to some teething problems which relates to authorisation of the manager, the AIFM, and providing passports both for the manager and also a marketing passport for alternative investment funds cross border.

Should the UK exit the EU, it would become a third country and be facing the same problem as the offshore jurisdictions currently face in selling funds into the EU.

- Offshore fund managers based in London, notably UK based hedge fund managers, might welcome this - as it would take them out of a regime from which essentially they do not benefit.
- For most mainstream managers with a variety of non UCITS funds though, an exit would likely cause more serious restructuring problems – how they arrange their only recently rearranged AIF and AIF management matters.

UK fund managers may be faced with the prospect of restructuring their groups (having only recently completed a restructuring for all their non UCITS fund business with the implementation of AIFMD). In order to maintain their business activities in Europe – and potentially wider, this would be likely result in a focus of even more of their business in non UK firms within their groups - likely those established in other EU member states.

- **payment services firms and e-money issuers** would also lose the benefit of EU passporting regimes.

Financial services firms will also potentially be caught by wider issues affecting business generally. In particular it will become less easy to move staff around between the UK and European offices or recruit talent from Europe. There will also be changes to how VAT operates.

Also most financial groups will have operations in a number of jurisdictions, including other EU member states, and so will in any event continue to have operations in Europe and so need systems capable of dealing with compliance with EU rules.

Whilst therefore on a first glance, an "out" vote might be attractive for financial institutions because they might think they can avoid complying with the deluge of European driven regulation, this need not necessarily be the case. Each type of financial business will need to assess its own position before taking a view as to which option it would indeed prefer.

A lively debate is in prospect running up to 23 June.

Contacts

**Kirstene Baillie**

Partner - London

E: kirstene.baillie@fieldfisher.com

T: +44 (0)20 7861 4000

**Nicholas Thompsell**

Partner - London

E: nicholas.thompsell@fieldfisher.com

T: +44 (0)20 7861 4292

This publication is not a substitute for detailed advice on specific transactions and should not be taken as providing legal advice on any of the topics discussed.

© Copyright Fieldfisher LLP 2016. All rights reserved.

Fieldfisher LLP is a limited liability partnership registered in England and Wales with registered number OC318472, which is regulated by the Solicitors Regulation Authority. A list of members and their professional qualifications is available for inspection at its registered office, Riverbank House, 2 Swan Lane, London, EC4R 3TT. We use the word “partner” to refer to a member of Fieldfisher LLP, or an employee or consultant with equivalent standing and qualifications.