Information Sheet

Following the excellent presentation by Andrew Hilton at the RBS Auditorium for members, the SIMA board thought it would be useful to distribute the transcript. This makes for interesting reading and we very much hope you find the contents useful.

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Financial Services Post-Brexit

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There's a title for a talk... Actually, I think it is not entirely accurate.

"Financial Services post-referendum" would be better – because even at this stage, it is not absolutely clear to me that we will leave the EU. PM May says 'Brexit is Brexit' – without defining Brexit. One reason BoJo may have been stopped in his tracks was a Telegraph article suggesting "Brexit-lite" (though it may have been sex).
We don't know.

Theresa May, Prime Minister

Plus:

- the FT, Economist and Evening Standard still haven't given up;
- Hugo Dixon has set up a paramilitary group, E Fact, to overturn the referendum – which he insists is only 'advisory' (true);
- a thousand barristers have argued that any deal to quit needs Parliamentary approval (untrue);
- Mishcon de Reya has been instructed to find some way/any way to overcome the settled will of the British people; and
- the next issue of Prospect is running a cover story on how to undo the referendum.

In other words, Notting Hill and Islington haven't given up.

Oh, and there are semi-serious suggestions that London should negotiate its own European status.

And then there's Scotland and Ireland – and May's bizarre suggestion that the SNP should somehow have a veto on whether we do leave or not. So, even at this late state, I really think there is only a 70% chance that we will leave.

Of course, I also think that there is a chance – admittedly a small chance, say 5% - that the UK's example will provoke a wholesale disintegration of the EU before we actually wave "Goodbye". There's a constitutional vote coming up in Italy this year, and major elections in France and Germany next year; who knows what might happen?

But let's park the delicious prospect of the EU unravelling, and concentrate on the UK's relationship with Our Friends Across the Water.

First, let's look at what has actually been achieved, in terms of process – and how that affects the City, and the broader FS sector.

Here in the UK, we have a new PM. More important, we have 3 new senior Cabinet :

- BoJo for FCO;
- DD for Brexit; and
- Fox for International trade.

I think BoJo is a good choice. Only one who can schmooze – which is crucial… Merkel. Jokes etc etc. But I accept that he is controversial – cannot keep his mouth shut or his pants up (if his former editor at the Telegraph is to be believed).

I think DD is an even better choice. Ex-Europe Minister. Very tough negotiator. Territorial SAS – only kills at weekends.

Fox – who knows? But it is good that May obviously realises that we need to initiate talks with 3rd countries ASAP. As even George Osborne discovered, they are willing to talk:

- Michael Froman – no nonsense about "back of the queue"; and
- Malcolm Turnbull, even post his own election.

Also New Zealand (which has offered us its entire trade negotiating team), South Korea, even China…

Britain is a major market, and (when things calm down) everyone will want to talk.

What, of course, is an outrage is just how little pre-planning the Treasury and the BofE did ahead of the vote. When they said they had done nothing, I assumed they were lying; apparently they weren't, for which dereliction someone should pay. But won't.

Even worse, perhaps, is the cavalier way our sole Commissioner in Brussels, Jonathan Hill, quit – saying he felt he couldn't do his job. That was unnecessary, stupid and (IMHO) a gross dereliction of duty. As a result, the FS portfolio has gone to an amiable Latvian Valdis Dombrovskis – who knows little about FS. He has said generally positive things about the City, and about Hill's CMU agenda. (Note his interview in yesterday's WSJ, in which he emphasises growth and a continuation of Hill's push for CMU.) But Dombrovskis is very much in thrall to the French Commissioner, Pierre Moscovici, and it is unclear whether he will (for instance) argue against moves to relocate euro-clearing to within the eurozone.

I know we have (belatedly) appointed Ambassador Julian King to replace Hill, but:

- he won't be given a serious portfolio, certainly not FS; and
- he may not even be confirmed by the EP.

Boris Johnson

Still there is now a "Brexit Unit" in London under DD, run by the rather mysterious Olly Robbins – 40 years old, yet another PPE graduate, who is (or was) spooked up to the eyeballs. So, if Juncker gives him grief, he's a dead man. This Unit (apparently) had the power to pull fast-track talent from other departments, and (I guess) is where the action is going to be.

Nigel Farage and Jean Claude Juncker

And, um… That's it.

On the other side, Juncker (at the Commission) and the odious Schulz (at the EP) continue to insist that there can be no talks, even informal talks, until Britain has pressed the Art. 50 button – which is, of course, nonsense. Fortunately, (for us), Merkel doesn't like J or S any more than we do, and I guess she will bash their heads together pretty smartly.

Perhaps more important than the Commission or the EP is the Council, run by the relatively sane Tusk. He has already set up his own 'Brexit taskforce', led by Didier Seeuws – 50, ex-chief of staff to van Rompuy. "keen cyclist"; "a fine intellectual machine". Belgian – I assume, Flemish.

So, we have made some progress on the process side. And, of course, we still have 1,200 Brits working in the Commission – although many of them are said to be applying for Irish or Belgian passports, and most are hopping mad at the sheer effrontery of the UK electorate.

There are also the UK MEPs – though Cameron's decision to pull the Tories out of the EPP a few years ago has meant they tended not to pull their weight. Fortunately, we still have Kay Swinburne on the FS side – at least for now. But, I imagine her attention will be inclined to wander. We certainly won't get any rapporteur (or shadow rapporteur positions) on new FS legislation, of which there is plenty coming down the pike – or Level 2 rules and regs of which there are truckloads. Not good – even to one of a mildly pro-Brexit persuasion.

Whatever, there also remain some really fundamental questions to be answered, in particular:

- when (or even whether) we should activate Article 50; and
- how hard we should push to retain access to the Single Market.

This is where it gets tricky.

If you believe the papers (FT, Economist) there is no alternative to Article 50 if we want to leave the EU. In fact, that is not true: we could simply leave – unilaterally – by repealing the 1972 European Communities Act. But that would piss our Continental friends off, and probably isn't worth it.

So, Article 50… There are two equally plausible views on this:

- the first is that we should press the button ASAP, like Now. This is (for very different reasons) the view endorsed by Redwood and Juncker – the former because he wants to make the decision to leave irreversible, and the latter because he hates Britain, eats children and is an all-round Bad Guy.
- the second (which has basically been my position, though I may be shifting a bit) is that when we press the button is up to us. And – given that the TEU says that, once the button has been pressed, there is no provision for stopping the clock and that, willy-nilly, you are out 2 years from the date you apply to leave – that means we should delay as long as possible. Plus, negotiations are likely to be complicated, so the more time the better.

So far, that seems to be May's position. It may even mean delaying until the second half of next year – when we are scheduled to hold the Presidency of the Council, which could mean that we have a bigger say in how negotiations are conducted. (I note that Cameron said he would give up the UK's turn, in favour of Estonia; I hope he didn't put that in writing.) It might even mean waiting until after the French and German elections, when new (and probably more sympathetic) governments will be in place.

On balance, that would seem to suggest the second option would make more sense. However, as I said, I am slightly shifting my view on this.

One reason is that there are conflicting legal opinions on just how absolute the 2-year time limit is. One (which will piss Redwood off) suggests that, even if Britain presses the button, it can still change its mind, and withdraw its application to leave. Another (which may please him) is there may be ways of 'stopping the clock' if it appears a deal cannot be negotiated in the two-year time frame.

A third reason for pressing ahead fairly rapidly is one that I was rather taken with, when Redwood outlined it to a group we convened just after the referendum. He said (and this was to a City audience):

- that we (ie Brexiteers) won the referendum on the budget and immigration, and those are the only two areas we have to deliver on; which means
- that we don't really care about, say, trade and financial services regulation – they are not a core priority for us.

This was rather a shock to us, but I think Redwood's view is quite widely shared. I would point you to Patrick Jenkins's column in today's FT, and to DD's long article on the Conservative Home blog. Finance and trade are not big priorities.

Should we worry?

Yes and No. On trade, for instance, Redwood suggested that the conventional wisdom is wrong. He says trade is complicated, because the EU has 60 agreements with 130 countries, and because we have had no national competence in this area for more than a decade. He says Not So: we will simply rely on the well-established principle of "novation".

EXPLAIN NOVATION.

On financial regulation, he was equally radical, telling us that his approach would simply be a single piece of UK Parliamentary legislation adopting in toto all the EU Directives, Regulations, rules whatever that are currently on the books without any change.

On both trade and FS, he argued, we could change, amend, relax, abolish, whatever over time. But – he emphasised – the City is simply not a priority for the new government. It is my understanding that DD shares the view – even if he hasn't said so explicitly.

Since then, Gerard Lyons (ex-BoJo) has explained to me that (at least in the eyes of many Brexiteers) we don't need to worry about "passporting" anyway because, when MIFID2 comes into force, the operative criterion will be "equivalence" – and who can say we are not "equivalent" if our own Parliament has just passed a law saying that every rule that was on the books pre-Brexit is still in force post-Brexit?

Now, I know not everyone agrees with these interpretations. My friends in the Commission's legal service, for instance, are adamant that Redwood et al are wrong on 'novation'. And that may be true – though I think it is an interesting place to start. On FS regulation, I have also read anti-Brexit screeds which insist that, regardless of the facts of 'equivalence', the decision to grant or deny it remains political – and, given the mood in the Commission, there is little chance that the UK would be deemed "equivalent" even if the rules were identical.

But that brings up another point.

"Equivalence" is only important as a way of ensuring access to the Single Market as an alternative to the current "passporting" regime – which (it is argued) we would be unlikely to continue to benefit from unless we accepted full labour mobility from the EU. And that, as Redwood explained, is a No No. But do we need access to the Single Market?

Patrick Minford and the guys'n'gals at Economists for Brexit are (apparently) not so sure – though, in this case, I worry that what works for most tradeables may not work so well for FS.

They argue (rightly) that the EU is not an FTA; it is a customs union with a common external tariff. And, if we insist on maintaining access to the single market, part of the price (aside from immigration) is that we are bound by that external tariff when we negotiate agreements with third countries. Better (they say) to accept that we won't have access to the Single Market – and, therefore, that we will be subject to the WTO tariff structure, which would hit us with duties of 3-4%. After all, the US and China don't have any problems trading on this basis. Then, we could more than make up the difference by negotiating FTAs with third countries.

But what, you may say, does that have to do with FS?

Not much, in that WTO rules largely exclude services – particularly FS. But it does suggest to me that, when all the kerfuffle dies down, we may discover:

- that the government (in particular, DD and Olly Robbins) is less than exercised about access to the Single Market than presently appears; and
- that it is gong to rely primarily on equivalence, to the extent it can, as an alternative to "passporting".

So, how will the EU respond?

Well, if J & Schulz and Sylvie Goulard and Elmar Brok etc are to be believed, we will be crushed – if only to send a signal to the AfD, to Podemos, to Le Pen, to Wilders etc that you can check in but you can't check out. But what can they do?

I suppose the biggest stick that they carry is to force the clearing of euro-denominated instruments into the eurozone. The ECB tried this a couple of yeas ago, and was thwarted by the ECJ; but the Court's ruling was not absolute. It only found that the ECB had no supervisory power over CCPs; it did not rule on the substantive merits of relocation.

Under these circumstances, it is quite likely that another attempt will be made. There are ways the UK (which will be backed by the US) can fight back, but it is worth noting that there are plenty of observers here in the UK who believe that the risks of CCP failure in the next crisis that everyone claims to see coming down the pike are so great that we would be well shot of them.

I am certainly not advocating that. And it is true that "equivalence" may help here as well. ESMA already recognises 19 CCPs from 10 countries as 'equivalent' – and if anti-bank forces in the rump EU decide they don't want to carry the risk of failure, they may be more than happy to leave the UK with a disproportionate share of euro-clearing business. But it could well happen – and, if it did, quite a lot of ancillary business will go with it.

SOCIETE GENERALE

What of other areas?

Well, there has been a fair old how-de-do about investment and retail/commercial banks pulling out of London – led (no surprise) by the Americans.

But this is disingenuous. All big banks are downsizing as a result of the Great Reregulation and the fact that higher capital ratios and restrictions on leverage are making many lines of business unprofitable. If Jamie Dimon can blame Brexit for laying off a few thousand workers in the UK (out of a global labour force of around 300,000) he will do it. Just don't forget a few things:

- Moving a bank is no small matter. Leases, contracts, IT systems – even school fees – all make it tough to pack up sticks.
- At my age Paris and Frankfurt would be great. A (relatively) quiet life , lots of sport on TV and (in Paris at least) good food. But if you are under 40, London is where it's at.
(Don't even think about Dublin.)
- And then, of course, there is the Jerome Kerviel effect. He cost SocGen €4.6 billion. Now, a French labour tribunal has ordered that the bank should pay him €450,000 for unfair dismissal. What constitutes "fair" dismissal in France? Do you have to shoot the boss?
(or his mistress?)

Much better, I think, to rely (to the extent that you need to) on the EU passport that a subsidiary within the eurozone will have automatically, and through which (if you need to) you can book business.

And, on this score, it is worth emphasising that, although the 'passport' theoretically enables institutions to sell cross-border and/or to operate through branches (rather than separately capitalised subsidiaries), there has been a strong tendency over the last few years for regulators to force banks to capitalise separately wherever they are operating – regardless of the rules. And I see no sign that that will change. So, when Remainers talk fondly of the Single Market, they need to be reminded (a) that it never worked very well; and (b) that, post-crisis, the trend was actually away from cross-border provision of services towards stand-alone separately capitalised institutions.

The same is probably true of the big fund management firms. Smaller fund managers may, however, face a problem – though I heard a senior partner at a 'magic circle' law firm suggest that it would not be too difficult to envisage a new king of umbrella company being established in (say) Dublin to exploit the single passport for other asset management companies.

In other words, where there is a will there's a way.

However, I don't want to suggest that everything is going to be tickety-boo.
In particular, I want to emphasise:

- the (surprisingly) low priority being given to FS when it comes to negotiating our exit;

- the fairly strong feeling (which I haven't really gone into, but which clearly exists in both Westminster and Fleet St) that it would not be a disaster if Brexit meant a somewhat smaller UK FS sector – both as a percentage of GDP and in absolute terms; and
- the fact that, in certain areas, the rump EU can (and probably will) try to repatriate certain types of euro business back within the eurozone.

What I haven't even really touched on (though we can discuss it) is the rather limited list of areas where (even assuming we do not adopt EU legislation directly as part of our bid for 'equivalence') we can actually roll back legislation to enhance London's role. The bonus cap perhaps; part of the AIMD. The FTT if it ever came to pass. But rally not much more in the short term. In the longer term, however, it is not unreasonable to hope for more RMB business, for a euro-euro market etc, etc.

But it is not going to be easy – and an awful lot still to be worked out.

However, as it has done many times before, I am sure the City will reinvent itself – in this case, as an offshore/onshore market.

Andrew Hilton
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