# All change: Brexit and the City

***David Green** outlines some of the questions facing the financial sector, with much of the outcome depending on just how close the UK wishes to be to the rest of the EU*

It is far too early to say what impact Brexit will ultimately have on the City, assuming it ever happens, but there have already been far-reaching consequences. Some are practical. Because of the failure to reach agreement on an adequate transition period in advance of the original end-March leaving date – and the resulting high risk of a "no deal" – more than a trillion euros of assets had to be transferred into new financial entities in the eurozone. Other financial assets and liabilities also had to be shifted. Thousands of customers have been obliged to take part in these transfers, some under legal constraint. Capital has had to be invested in the new entities. Thousands of jobs have been transferred. Immediate economic consequences have already crystallised, therefore, even before the UK begins to leave.

More fundamental has been the discovery that the UK political establishment no longer attaches importance to what brought many companies from all industries to invest in the UK: the idea that the UK is the springboard for trade within the single market. This has forced a fundamental reappraisal of business models in financial services. Over recent decades it had become conventional corporate wisdom to concentrate assets and roles in the UK. This default is now gone and companies in the UK are having to plan for a range of possible legal frameworks in which to operate, many of the features of which will not be known for years. Head offices are asking whether it makes sense to put all their eggs in one basket, and assumptions about the regulatory environment, cost and social attractiveness of locations outside of the UK are being questioned.

The likelihood of the UK leaving the single market has exposed fault lines in supervision that were always present to a degree, but now are widening cracks. Without a single set of rules, and the European Court of Justice to enforce them, how comfortable can a supervisor be with large parts of its market infrastructure outside its legal reach? And how acceptable is it to have significant aspects of a banking system supervised by an authority in a different jurisdiction, as is the position under passporting? Also, how sensible is it to have the vast bulk of the capital market financing of an economy provided externally?

This last question has given renewed impetus to the debate about the (misleadingly named) Capital Markets Union. There are many elements required to expand capital market finance to supplement, or in part replace, bank financing in Europe, including insolvency reform and capacity building by individual member states. But there is also a question about what happens to financial flows to and from the UK if Brexit puts up barriers, an outcome not to be ruled out. Is the current dependency on the London market a damaging problem or are there ways in which funds can flow through different channels? This is being urgently examined, not least by the EU27 jurisdictions that expect to draw employment and tax revenue from the UK to undertake this intermediation.

> *"Westminster no longer thinks it important that the UK is the springboard for trade within the single market*

Repositioning financial flows, and the staff to manage them, may not be as challenging as some suppose. Most of the firms that arrange market finance in London are present in the EU27, often with recently enlarged capacity because of the need to pre-empt the risk of no deal and no transition.

The prospect of Brexit has already prompted fresh thinking in London about how freedom from EU rules might enable rationalisation of the regulations put in place so quickly after the financial crisis. But whether, and to what extent, this is possible depends on a fundamental political question: "Just how close does the UK wish to be to the EU27?" Does it wish to remain fully aligned to retain market access, does it wish to have the freedom to adopt some changes at the price of some loss of market access, or does it want major divergence to embrace supposed opportunities in the rest of the world?

Different financial sectors and different firms have different preferred solutions depending on their business model. But, even when these questions are resolved, which may take a long time, and even if the ultimate conclusion is to remain after all, nothing will be the same. ■

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