



CoStar Column: Brexit does not mean exit for financial services firms

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The outcome of the Brexit referendum caused uncertainty for lots of different sectors, but few were the subject of more speculation than the financial services industry, says John Ahern and Anna Cartwright, partners at law firm Jones Day.

London's status as the premier global financial centre has come under huge scrutiny because EU law currently allows financial institutions to trade freely across the 27-member bloc. While the nature of the UK's future trading relationship with the EU remains unclear, speculation is rife as to whether other European cities might use the legal uncertainty to entice away London-based talent and businesses. Frankfurt, Paris and Dublin have long coveted greater investment and more jobs from financial services.

For property landlords, the prospect of an exodus of financial services tenants is understandably a concern. However, the legal reality offers reassurance; the detail of existing EU financial services regulation means that the mass departure of financial institutions to the continent is highly unlikely.

Until now, many financial services firms have done business in the EU by setting up regulated businesses in the UK and using their right to "passport" into the rest of the bloc. Since the referendum, financial services executives have been rushing to understand the potential implications of losing these passporting rights following Brexit.

The best-case scenario is that the UK retains access to the EU Single Market (through admission to the EEA or otherwise). If that happens, it would be business-as-usual for authorised firms that operate from the UK. However not many commentators are predicting this form of soft landing.

That means institutions are rightly planning for the scenario where the UK becomes a so-called "third country" for the purposes of EU financial services regulation.

Third country status means that the UK would lose automatic passporting rights. However, under current EU legislation, non-EU businesses may have access to institutional clients in the EU, via a "third-country passport".

The legal test for gaining a third-country passport centres on whether the non-EU country's regulatory regime is regarded as *equivalent*.

Over the past month there has been debate among commentators over the ease with which the UK will achieve an agreement on equivalence. Some European politicians have taken to sabre-rattling, claiming that Brexit Britain cannot take for granted much goodwill from the EU.

However, to reiterate, the decision on third-country passports is based on a legal test. It will be a regulatory matter, not a political decision, as to whether the relevant UK law remains equivalent.

We consider that the European Commission would have almost no choice but to determine the UK's regulatory regime to be equivalent to EU standards. At the point of exit, the UK's financial services legislative framework would undoubtedly reflect the EU law which applied in full the previous day.

That is not to be complacent about the impact of Brexit.

Firstly, it is worth remembering that businesses operating in a third-country will not be able to access retail clients (as opposed to institutional clients), unless they do so on a reverse solicitation basis. This means that the client would need to engage with the business on its own initiative and not have been solicited by the business. If the UK becomes a third-country, on current legislation, this limitation will present a significant challenge to private wealth firms and similar businesses engaging with EU retail clients. However, this position may be softened depending on withdrawal negotiations.

Secondly, the prospect of financial services firms even considering relocating significant parts of their businesses to other cities in Europe has wide-ranging implications. Uncertainty weighs on everyone, not just the thousands of employees and their families that work in the industry directly, but also the service sectors that support them, from restaurants to cleaning firms, even lawyers and landlords.

It is appropriate that authorised firms give significant consideration to their contingency planning. Landlords and property owners in turn will inevitably be considering the possible scenarios and undertaking their own analysis of the risks.

Legally, however, the facts are that the UK will either maintain Single Market access, or that it can reasonably expect to obtain the third country passporting rights required to allow regulated firms access to EU institutional investors under the equivalence principle. As such, from a regulatory perspective, it is hard to see a compelling reason for an exodus of financial services occupiers from the UK.

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