148

# REVUE D'ÉCONOMIE FINANCIÈRE

REVUE TRIMESTRIELLE
DE L'ASSOCIATION EUROPE
FINANCES RÉGULATIONS N° 148
4e TRIMESTRE 2022

# AFTER BREXIT

## *ASSOCIATION EUROPE-FINANCES-RÉGULATIONS*

Association régie par la loi du 1er juillet 1901, déclarée le 11 septembre 2008 (J.O. du 11 octobre 2008)
Siège social : 28 place de la Bourse, 75002 Paris

## MEMBRES

*Membres :* Agence française de développement, Akeance Consulting, Amundi, Autorité des marchés financiers, Autorité des normes comptables, Autorité marocaine du marché des capitaux, Axa, Banque de France - ACPR, Banque Delubac & Cie, Banque européenne d'investissement, BlackRock France, BNP Paribas, Bredin Prat, Caisse des dépôts et consignations, CCR, Citigroup, CNP Assurances, Covéa, Crédit mutuel alliance fédérale, Crédit mutuel Arkea, Direction générale du Trésor, EDF, Engie, Euronext, Gide Loyrette Nouel, Gimar&Co, Goldman Sachs Paris, HSBC, KPMG, Kramer Levin, La Banque Postale, Mazars, Moody's, Morgan Stanley, Natixis-BPCE, Paris Europlace, Scor, Société Générale, Sopra Steria Next, Tikehau Capital.

## CONSEIL D'ADMINISTRATION

*Présidente :* Pervenche Berès
*Conseiller spécial de la Présidente :* Édouard-François de Lencquesaing
*Personnalités qualifiées :* Benoît Coeuré et Didier Valet

*Membres de droit :* Autorité des marchés financiers, Banque de France - ACPR, Paris Europlace

*Membres administrateurs :* Amundi, Axa, BNP Paribas, Bredin Prat,
Caisse des dépôts et consignations, Covéa, EDF, Engie, Euronext, Mazars,
Morgan Stanley, Natixis-BPCE, Société Générale

*En qualité de censeur :* Direction générale du Trésor
*Délégués généraux de l'Association :* Michel Cojean et Sylvain de Forges
*Trésorier de l'Association :* Olivier Bailly

## CONSEIL D'ORIENTATION

*Présidents d'honneur*
Jean-Claude Trichet, Christian Noyer

*Président :* François Villeroy de Galhau, *Gouverneur, Banque de France*

Jean-Pascal Beaufret, *Managing director, Goldman Sachs Paris*
Pervenche Berès, *Présidente, AEFR*
Afif Chelbi, *Président, Comité des Risques, Banque internationale arabe de Tunisie*
Jean Cheval, *Senior Advisor, Natixis*
Benoît Cœuré, *Président, Autorité de la concurrence*
Ambroise Fayolle, *Vice-Président, Banque européenne d'investissement*
Bernard Gainnier, *Président, Finance Innovation*
Antoine Gosset-Grainville, *Avocat à la Cour, BDGS Associés*
Olivier Guersent, *Directeur général, COMP-Commission européenne*
Nezha Hayat, *Présidente, Autorité marocaine du marché des capitaux*
Elyès Jouini, *Professeur, Université Paris-Dauphine*
Hans-Helmut Kotz, *Senior Fellow, Leibniz Institute for Financial Research SAFE,*
*Center for Financial Studies, Université de Harvard*
Eric Lombard, *Directeur général, Groupe Caisse des Dépôts*
Emmanuel Moulin, *Directeur général, Direction générale du Trésor*
Robert Ophèle, *Ancien Président, Autorité des marchés financiers*
Alain Papiasse, *Chairman CIB, BNP Paribas*
Olivier Pastré, *Conseiller scientifique REF ; Professeur émérite, Paris 8*
Patricia Plas, *Directrice des Affaires publiques et des Relations institutionnelles, Axa*
Odile Renaud-Basso, *Présidente, BERD*
Rémy Rioux, *Directeur général, Agence française de développement*
Augustin de Romanet, *Président, Paris Europlace*
Jean-Luc Tavernier, *Directeur général, Insee*
Didier Valet, *Vice-Président Industrie, Institut Louis Bachelier*
Claire Waysand, *Directrice générale adjointe, Engie*

# Introduction

Pervenche BERÈS*
Sylvie MATHERAT**

This issue of the *Revue d'économie financière* (REF) aims to take stock, six years after the referendum that formalised the British people's decision to leave the European Union, and two years after the signing of the agreement formalising this departure, of the consequences of this historic decision from both the European Union's and the United Kingdom's perspective.

This period of time seemed sufficient to us to try to take a dispassionate and prospective look at the respective futures of these two "blocs". We would like to thank all the contributors who agreed to take part in this exercise and to share their thoughts with us.



This issue is organised as follows: an article by *David Wright*, President of EUROFI, first discusses the historical and political aspects that led to this situation; several articles then focus on the consequences as they are currently manifesting themselves on the economy, the banking and financial world and trade in general; finally, some contributors consider the possible developments and opportunities offered by this situation. Some articles were written before Rishi Sunak came to power without detracting from the relevance of the proposed analyses.

## *HOW AND WHY DID WE GET HERE?*

The article by *David Wright* explains, sometimes with great emotion, the chain of mutual misunderstandings that led to the current situation. These misunderstandings are the result, on the British side, of nostalgia for the British Empire and the desire to build, eventually, a Europe in which the United Kingdom would have been at the center, of a lack of knowledge of the functioning and realities of the European

* President, AEFR. Contact: pervenche.beres@aefr.eu.
** Non-Executive Director; Senior Global Advisor, Mazars. Contact: sma@lugny.com.

Union and of a disastrous communication based on unverified fantasies. This is particularly true of the debate, which counted for a great deal before the referendum, on the role of the European Commission in accepting uncontrolled immigration, as well as of all the discussions on the budget, which were also underpinned by a political argument that was more incantation than truth.

The slogan "take back control", which summarised the mood of the press and public opinion in favour of withdrawal, very effectively, according to the author, aggregated and synthesised all the resentments and other frustrations and directed them against the European Union, which then represented the symbol of the difficulties encountered by the United Kingdom and its inhabitants. It was quite easy, and quite effective from a political point of view, to point to the European institutions as scapegoats for the difficulties of all kinds encountered by the United Kingdom at that time.

On the European side, there was also a vague resentment towards the British, who had not stopped behaving like a separate member since their country joined the European Union, often contesting decisions and not giving, in the eyes of Europeans, all the attention that European debates would have deserved.



In fact, the author also points out, albeit with regret, that the Brexit has favoured and probably accelerated European integration. For him, the NextGenerationEU initiative, which established the development of common debt issues in the sole name of Europe and not in the name of the different countries of the Union, would probably not have been possible without the departure of the United Kingdom.

Today, six years after the vote and two years after the signing of the withdrawal agreement, where do we stand?

## *STATE OF PLAY: TWO YEARS AFTER THE FORMALISATION OF THE BREAK-UP, WHERE DO WE STAND?*

Several articles contribute to this reflection on the current situation. In this respect, if it appears that the factors of rupture are indeed there in areas as diverse as trade, competition, immigration, financial aspects with the immediate loss of the European passport, etc., it is clear that the current situation has in fact, to date, little changed.

There are many reasons for this state of affairs: first of all, and completely unrelated to this debate, the health crisis linked to Covid has "frozen" all economic, commercial and financial developments for nearly eighteen months; secondly, the very slow implementation of certain changes and thirdly, particularly in financial matters, the absence of a viable alternative have contributed to an extremely gradual awareness, on both sides of the Channel, of the changes to come.

*The disruptive factors are present in many areas of the economy*

Since December 31, 2020, the United Kingdom has left the single market and the customs union and has thus become, in the language of Europe, a third country. While the entire evolution of relations between Europe and the United Kingdom over the last forty years or so has been aimed at removing barriers of all kinds, this Trade and Cooperation Agreement has consisted of erecting new barriers in complete contradiction with the efforts and progress made in recent years.

As a result, there are now barriers to the free movement of people, goods and services between the European Union and the United Kingdom.

This situation has of course an impact on all economic sectors. The article by *John Berrigan and Olivier Guersent*, both Directors General at the European Commission, looks at the impacts on competition policy and financial sector regulation, while the article by *Xavier Musca*, Deputy Chief Executive Officer of Crédit Agricole S.A., details the economic impacts of the Brexit and points out that the United Kingdom has become less open and less competitive overall since that date. He also notes that the uncertainty about the evolution of the United Kingdom has weighed on investments in this country, which have slowed down considerably since the Brexit.



The situation of the financial sector is particular. Indeed, financial services are not part of the agreement signed in December 2020 and the withdrawal of the United Kingdom means that the institutions of this country have lost the possibility of offering, without having a physical presence on site, financial services in the European Union. This situation, more generally known as the loss of the "European passport", is potentially fraught with consequences, not only for British financial institutions, but more significantly for the London financial center as a whole, insofar as institutions from third countries, and for example, American or Asian institutions that used London as a "bridgehead" to offer financial services in Europe, will no longer be able to do so and will therefore have to opt for a physical presence in Europe. Many of the articles in the magazine comment in detail on this point, notably those of *José Manuel Campa*, Chairperson of the European Banking Authority (EBA), *Andrea Enria*, Chair of the Single Supervisory Mechanism (SSM) and *Christian Noyer*, former Governor of the Banque de France.

However, to date, even if these factors represent a significant break with the previous situation, the evolutions observed still appear timid in relation to the scope of these changes.

## *To date, the current situation shows that the changes are still timid*

How can this situation be explained? First of all, the health crisis has brought all economic activities to a halt for a period of about eighteen months. Thus, any difficulties that may have been encountered at the end of this period on the British side were attributed to post-Covid bottlenecks and not to the consequences of Brexit. Moreover, even if the European workforce has dried up in the UK because of the Brexit, it has been replaced by non-European workers, thereby masking the impact of the break on the movement of people (see article by Xavier Musca).

But above all, as far as banking and financial activities are concerned, the absence, even today, of a viable alternative has weighed on the developments that will nevertheless naturally have to take place.

In fact, before the Brexit, Europe had a very successful financial center, located outside the euro area, but with all the aspects necessary for the dynamism and attractiveness of a European financial center.

To date, even if a wave of relocation to Europe has begun, driven in particular by European regulators and the European Central Bank (ECB) (see in particular the articles by José Manuel Campa and Andrea Enria), which has theorised on numerous occasions its policy of no empty shells, with definite success in terms of asset transfers (the assets recorded on the balance sheet of the European establishments of the nine largest international banks have risen from € 275 bn to more than € 1.3 tn by the end of the first quarter of 2022 (article by Andréa Enria), staff transfers are less significant (around 7,000 employees, i.e. less than 4% of the City's workforce – see article by Xavier Musca) and, above all, no place has established itself as an alternative to London. Several European cities have benefited from these transfers, including Frankfurt and Paris for credit institutions and Dublin and Luxembourg for asset management and insurance companies (articles by Xavier Musca and Christian Noyer).



Even more significantly, all activity related to central clearing counterparties (CCP) and central securities depositories has remained globally unchanged and concentrated in London. This is the only area in which Europe has granted an equivalence decision, renewed until 2025. To date, therefore, European dependence on the London market remains in the very specific area of derivatives clearing, where London-based CCPs concentrate the vast majority of transactions.

There are many arguments in favour of this *status quo*, in particular economies of scale and the need to benefit from abundant liquidity in order to clear efficiently and limit counterparty risks. In this area, concentration is synonymous with financial efficiency (see José Manuel Campa). This is the reason why private European players themselves are not in favour of transferring these activities within the European

Union insofar as "the obligation that could be imposed on European banks to resort to continental players could increase their operational and compliance costs" (Xavier Musca). As *Denis Beau*, Deputy Governor of the Banque de France, points out in his article, the "necessary rebalancing towards continental Europe of the clearing of euro derivatives" requires "the emergence of European market infrastructures that are currently lacking".

Another very important area for the proper development of financial activities concerns regulation. Until its departure from the European Union, the United Kingdom was a major player in the design of the regulatory *corpus*, and in fact, all British regulation was not only equivalent but identical, by definition, to European regulation on the day of Brexit. This point has been and still is the subject of discussions and concerns, particularly among European players who fear the development of a less regulated area, which could be perceived as more "competitive", on their doorsteps and which could, in the event of a financial incident, provoke contagion phenomena that could potentially carry risks for financial stability.

However, in this area too, there has been very little development beyond political posturing and discussions on insurance regulation (Solvency II). The United Kingdom is now faced with a dilemma: either to keep similar rules and hope to benefit from equivalence from the European Union, or to opt for different, more flexible rules and thus take the risk of attracting players and operations that could not be handled on the European continent, with all the risks, particularly financial, that this could cause. At this stage, it is clear, with David Wright quoting Philip Stephens, that the United Kingdom has moved from a position of "rule maker" to a position of "rule taker".



However, this situation seems likely to change. Indeed, the factors of integration are by definition no longer there and there is a marked political will on both sides of the Channel to bring this agreement to life in order to make the most of it. Once the emotion has passed, each of the two actors must be able to envisage the future of these relations in the most constructive way possible for the various economic and financial sectors. Many of the contributors to this issue look at the opportunities offered by this situation and consider different developments for companies, financial services and markets or, more generally, envisage possible future cooperation.

## *WHAT NEXT? WHAT SHOULD THE EUROPEAN UNION DO?*

What should the European Union do? How can we project the evolution of the relationship with the United Kingdom when the Brexiters' slogan, "take back control", is clearly a failure on the internal level, where the referendum did not put an end to the clan struggles within the Conservative Party – even if the purpose of this issue of the REF is not to analyse the purely political aspects of the Brexit – and where power has been exercised for the past two terms by Prime Ministers who did not come from the elections.

Externally, as noted above, the financial legislation developed by the European Union is still effectively binding on the United Kingdom given the continued importance of the activity of British financial institutions in the European Union. Paradoxically, these institutions are obliged to apply regulations over which the United Kingdom no longer has the capacity to intervene, even though, particularly in the area of financial markets, it was in a prime position to influence, orient and define them until Brexit.

From an economic point of view, the impact of the Brexit on the United Kingdom is being assessed, although it is not always possible to distinguish between the Brexit itself and the two crises, the Covid and the war in Ukraine, which followed it (Financial Times, 2022) and whose consequences could be cumulative. At this stage, however, as *Hervé Hélias*, CEO of Mazars, points out, contrary to certain predictions, it is more a question of "disruption without dislocation". Correlatively, as *Robert Ophèle*, former Chairman of the Autorité des marchés financiers (AMF), summarises it very well, "the United Kingdom's ambition to benefit from the best of both worlds... access to the single market as a member of the Union and the freedom to adapt its regulations and supervision as a third country, has not been satisfied".



The situation in the European Union is no less delicate. Indeed, particularly in the financial field, the Union's dependence on the ecosystem successfully developed over many years by the City remains and the prospects for development and attractiveness in Europe require resolute but difficult actions, as explained in numerous articles in this review (see Robert Ophèle, Denis Beau, Stéphane Boujnah).

*The divergences, is it now?*

In this context, what are the respective options of the "two blocs"?

Economist *Catherine Mathieu* considers that the implementation of Brexit on the British side will result in a desire for divergence of the United Kingdom from the European Union on the taxation and regulatory front. The first signs are already visible, aimed at increasing the attractiveness of the United Kingdom in order to maintain its leading role. Thus, for example, the announcement of the abolition of the bonus cap marks the desire to use the tool of regulatory competition (Robert Ophèle, Hervé Hélias). This fear is all the more present as even if its financial actors have lost the "European passport" – which could have an impact on their competitiveness *vis-à-vis* the rest of the world –, the United Kingdom retains considerable assets linked to its know-how, its regulatory agility and its capacity for innovation (Hervé Hélias, Philippe Aghion).

Similarly, *Stéphane Boujnah*, CEO and Chairman of the Managing Board of Euronext, reminds us that the announcement in 2021 of the Wholesale Markets Review opens the door to a reduction in constraints, notably administrative, under pressure from the major investment banks. It is in the area of rules relating to the listing of companies that this author fears rapid and significant changes. He observes that the revision of British legislation on the professional market could lead to more internalisation and less transparency.

After having repatriated the *acquis communautaire*, the United Kingdom is in fact undertaking to adapt it to the new context (see Berrigan and Guersent). It is doing so in parallel with the revision of most of these texts by the European Union itself (MiFID, Solvency II, implementation of Basel III).

As *Robert Ophèle* points out, the current balance is likely to shift, with, no doubt, more rapid revisions on the British side insofar as a single country is by definition more "agile" than the Union, where negotiations are carried out between 27 member states. We can also anticipate how, within the European Union, financial market players could use this situation to advocate a business-friendly approach and seek to reduce certain existing requirements.



*Srobona Mitra and Mahmood Pradhan*, from the International Monetary Fund, believe that the European Union can be concerned about possible divergences in competitiveness, but also that the United Kingdom should not jeopardise financial stability and ignore international best practices, including in the fight against money laundering.

The UK should nevertheless continue to use international bodies to maintain its influence on financial regulations (Basel Committee, for example).

### *Why and how should the European Union take the initiative?*

*Denis Beau* and other authors of this review (notably Philippe Aghion) argue for the development of new frameworks for cooperation.

In particular, it would be a matter of avoiding divergences that produce systemic risks, but also of dealing together with common challenges such as climate change – in this sense, the United Kingdom is now saying that it wants to adopt the European taxonomy –, the development of digital finance or cyber security.

The challenge for the European Union is now to be consistent with the hard line it took during the Brexit and to draw all the consequences for the functioning of the internal market and in particular for financial services. However, "the Union has never considered that the emergence of a powerful European financial system was a priority", *Robert Ophèle* reminds us, even though progress is essential today, whether on the Banking Union or on the Capital Markets Union (CMU). European countries must now work to improve the fluidity between their different financial markets in order to increase liquidity and transparency, two essential aspects of competitiveness. Generally speaking, the European Union must work to improve its attractiveness for financial operations and players.

In this context, many authors argue that the CMU project is urgent. First of all, to optimise the sources and conditions of financing for the real economy of the European Union, which implies thinking of it as an element of sovereignty or strategic autonomy by avoiding measures that would excessively favour actors outside the European Union. In this spirit, Stéphane Boujnah is concerned about the proposals relating to what he considers to be non-strategic aspects (such as the establishment of a consolidated tape) and which do not fill the main gaps of the CMU as they exist. According to him, the European Union needs real bankruptcy legislation (see also Mitra and Pradhan), a review of the effectiveness of existing legislation, a single prospectus and a strengthening of the European market supervisor to promote convergence (see also Robert Ophèle).



*Denis Beau* argues in the same direction because if the absence of equivalence leads to a necessary relocation of financial operations, it also presents a risk of fragmentation between European players. For him, if the Brexit has favoured the emergence of a polycentric network between the financial centers of the European Union based on the successful model of Euronext, this implies more integration around the Banking Union and the CMU, but also the relocation within the European Union of systemic activities such as clearing.

However, for *Srobona Mitra and Mahmood Pradhan*, the repatriation of central clearing activities to Europe presupposes the development of a degree of integration of financial markets equivalent to the existing one for the single market in goods and services, i.e. a true CMU and pan-European banks. In this respect, there is significant room for progress.

### *What cooperation tomorrow?*

*Robert Ophèle* recalls that the agreement that the United Kingdom had concluded with the European Union before the referendum could have been detrimental to the European Union, but that in the end the United Kingdom, the Union's leading financial center, became a third country. So far, cooperation on financial markets seems to have been guided by mutual understanding and a desire to control systemic risks and issues.

For its part, the United Kingdom initially envisaged open cooperation with the European Union while showing a real nostalgia for the Commonwealth (May, 2017) – something to which some within the European Union wanted to open the door (Pisani *et al.*, 2016). This state of mind was initially met with a harsh interpretation by the European Union of its interests, "Brexit is Brexit", as *Stéphane Boujnah* recalls. "The EU is clearly acting according to its interests: maintaining equivalence for only those activities that cannot be carried out today in the euro area, no decisions for the others.", writes *Catherine Mathieu*.

However, the scenarios are not written. They depend on the evolution of the situation in the United Kingdom, where *Roger Liddle*, Labour member of the House of Lords, believes that only Labour could "make Brexit work". They depend on the appeasement of political disputes, starting with the Northern Ireland question (see David Wright, Roger Liddle, Catherine Mathieu). They also depend on the continuation of the "technical" cooperation that has developed between supervisors, the ECB, the Bank of England and the European Commission to ensure a smooth transition away from the difficulties encountered on other aspects of the Brexit (Denis Beau, Mitra and Pradhan, Enria).



While the December 24, 2020, agreement for the UK's exit from the EU did not include specific provisions on financial markets and the planned protocol on these issues is still not signed, there is a certain confidence among the authors of this issue of the REF. This confidence seems to be based on the good cooperation to date between regulators and on the well understood interest of the different market participants to continue to benefit from the mutual advantages built up over the course of history.

This spirit of cooperation is all the more necessary, according to *Srobona Mitra and Mahmood Pradhan*, since the "financial maturity" of the Union's markets will take time and there is a need for short-term cooperation to ensure the continuity of certain operations.

The United Kingdom, for its part, is trying to implement its proposal for a "global Britain" (see the articles by Roger Liddle and Catherine Mathieu), but its effects do not seem very convincing in view of the relative impact of the trade agreements concluded so far.

But the evolution of the relationship will also necessarily take place in a political environment whose elements are not determined solely or directly by the Brexit, as evidenced by the proposal for a European Political Community, born in the context of the war in Ukraine and the dialogue with all the candidate countries, but also with Turkey or Azerbaijan. The United Kingdom, which took part in the first meeting in Prague in October 2022 and should host a future meeting on its territory, could find a place in this initiative that would allow it to reconnect with its particular history (see Catherine Mathieu, Roger Liddle), even if for the moment many questions remain open as to the chances of success of this initiative, including on the institutional level.

To conclude, *Philippe Aghion*, Collège de France, proposes a resolutely pragmatic approach by calling for "coalitions of the willing" on the model of the American Advanced Research Project Agencies (ARPA), allowing each party to make the most of the situation in a context of strong international competition between geostrategic groups.

The European Union, which feared that the Brexit would encourage other countries to follow the same path, is now being approached by new candidates.



Recent macro-economic indicators seem to be favourable to the European Union, including in view of the critical size of its internal market. However, optimising the financial assets of this market is still a test of its ability to mobilise around regulatory and supervisory issues that require real political leadership including by integrating new environmental or digital issues. This is the condition for the European Union to remain a pole of attractiveness.

The Brexit has been long and well prepared, the nature of future relations between the United Kingdom and the European Union remains to be defined. The European Union has a card to play, provided that it does not forget any of its priorities. This is the spirit of this issue of the REF.

*(November 8, 2022)*

## *BIBLIOGRAPHIE*


FINANCIAL TIMES (2022), « The Brexit Effect: How Leaving the EU Hit the UK », October 18, https://www.ft.com/video/91b8a350-5817-4b40-a5ea-c62ec832aa9c.

MAY T. (2017), « Lettre à Donald Tusk », March 29, https://www.consilium.europa.eu/media/24079/070329_uk_letter_tusk_art50.pdf.

PISANI-FERRY J., SAPIR A., WOLFF G., RÖTTGEN N. et TUCKER P. (2016), *Europe after Brexit: a Proposal for a Continental Partnership*, Bruegel, August 28, https://www.bruegel.org/report/europe-after-brexit-proposal-continental-partnership.

REVUE D'ECONOMIE FINANCIERE



58 rue de Lisbonne – 75008 Paris
Site Internet : www.aefr.eu

ISBN 978-2-37647-078-6
ISSN 0987-3368
Prix : **32,00 €**