

Brexit: Issues for European Capital Markets

Prepared for ECB BMCG Meeting,
Frankfurt, 9 October 2018

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October 2018

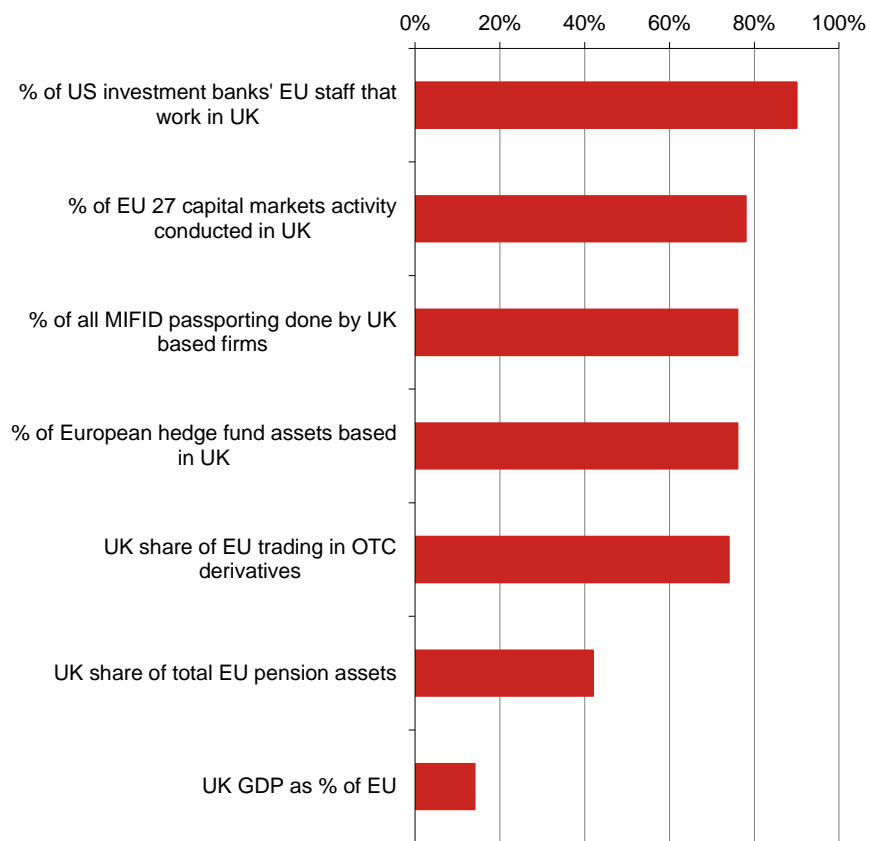
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Context

“The report shows that in some areas the UK has delayed or blocked European integration, making it more of an awkward partner in European integration than most other Member States have been. The UK’s opposition to European integration stems from the UK’s domestic politics, where, in contrast with the situation in other Member States, British politicians have rarely if ever pursued anything more than a transactional approach to EU membership.”(1)

Some comparative data on importance of UK (2)



Measures of EU Economic Integration

EU-25-Index 2012		
Rank	Country	Rank-Points
1	Belgium	75.30
2	Ireland	70.45
3	Austria	69.64
4	Germany	66.06
5	France	65.98
6	Netherlands	65.51
7	Slovakia	65.49
8	Finland	65.11
9	Spain	64.25
10	Slovenia	63.33
11	Malta	62.54
12	Czech Republic	61.33
13	Cyprus	60.81
14	Italy	60.43
15	Portugal	59.57
16	Denmark	57.29
17	United Kingdom	56.75
18	Estonia	56.30
19	Sweden	55.25
20	Lithuania	53.45
21	Hungary	51.85
22	Latvia	51.65
23	Poland	50.68
24	Greece	46.80

Sources: (1) “The Impact of the UK’s Withdrawal on EU Integration”, DG for Internal Policies of the Union, European Parliament, June 2917. (2) The Potential Impact of BREXIT on European Capital Markets, Newfinancial, April 2016. (3) EU-Index.org Jörg König and Renate Ohr

Scenario Variations

Scenario	Key features	Governance Framework	Rule Divergence	Certainty	Access	Consequences
Mutual Recognition	Bilaterally agreed access levels in financial services	Y	Y	Y	Y	Continuity of mutual access. Rule divergence may exist managed through boundaries and governance structure
Reciprocal Equivalence	Agreement between UK and EU to apply Equivalence to each other	N	?	Y	Y	Basic Equivalence model with increased certainty of continuity
Enhanced Equivalence	Stronger EU framework on Equivalence that may give more robust outcomes	N	?	?	Y	Basic Equivalence model with increased certainty of continuity
Basic Equivalence	Wholesale access maintained via Third Country Equivalence	N	N	N	Y	Short term access provided but with a risk of removal with one month notice

Conceded by UK

Dismissed by EU

“Harder” Brexit for financial services likely

“Soft Brexit”

“Hard Brexit”

The Chequers agreement abandoned the previously preferred UK model of Mutual Recognition, in favour of “reciprocal recognition of equivalence”. This sought an outcome somewhere between the basic existing EU Equivalence framework and the full MR model. The EU has since said that access rights “are a gift from Brussels that can be freely withdrawn.”

Basic Equivalence Outcomes

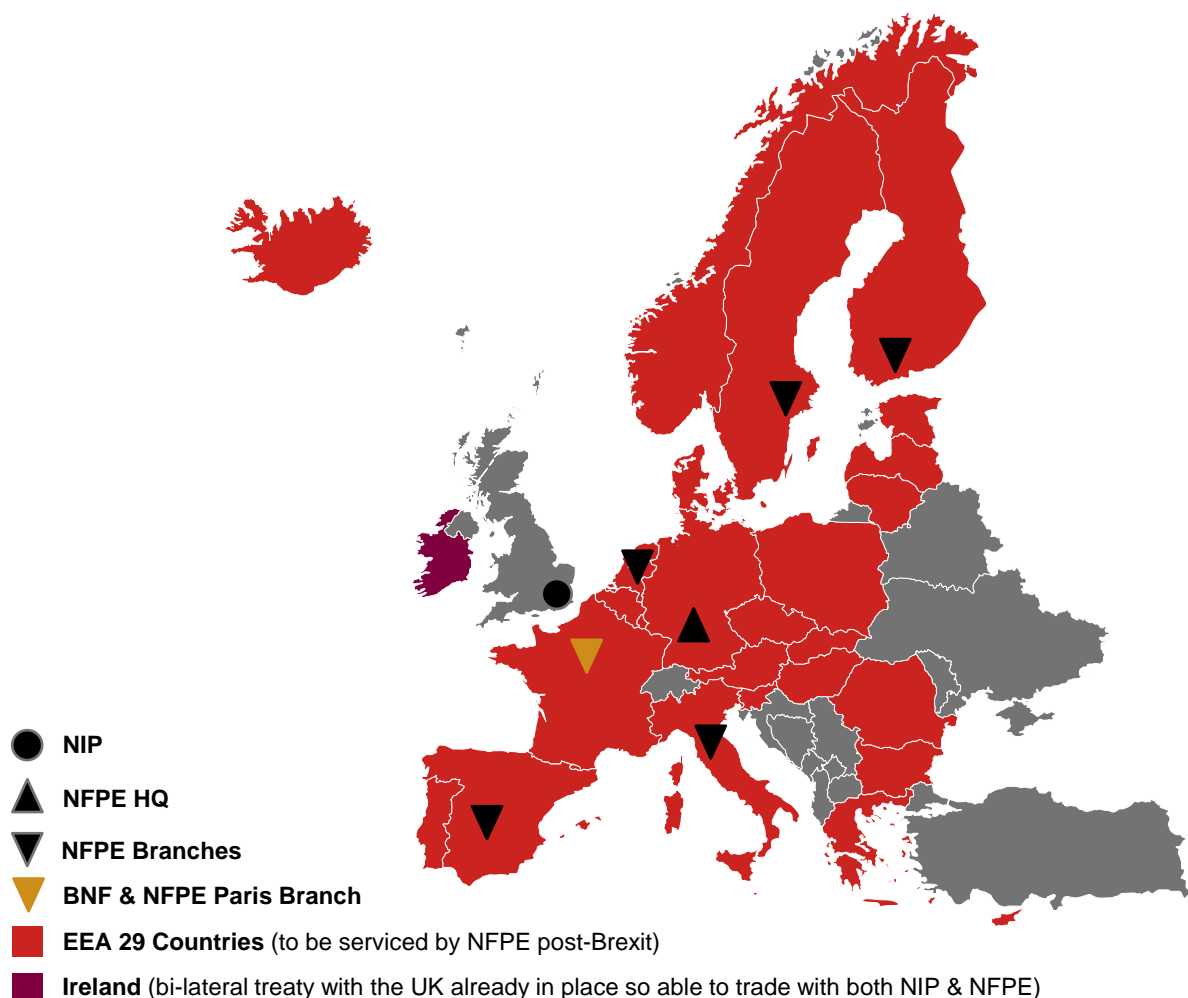
Regulation	Element	Precedents	Likely consequences (No deal / Basic Equivalence)
EMIR	Clearing – Countries	15 countries have been deemed Equivalent for CCP oversight	Based on intended oversight of LCH by the EU under the EMIR refit, LCH as a CCP / UK as a country likely to have interim relief given to allow continuity.
	Clearing – CCPs	A broad set of CCPs across these 15 countries have been deemed Equivalent for mandatory clearing purposes.	
	Margin – Intragroup exemptions	Japan is currently deemed Equivalent for the intra group exemption, though at risk of not being renewed.	Not clear whether Japan Equivalence will continue, and if UK would be added.
MiFID II	Overall – Countries	No countries have been deemed Equivalent to the EU	Very unlikely in a no deal scenario that the EU will pre-emptively deem UK as Equivalent for 1 April 2019 – this key gap is expected.
	Trading Obligation – DTO	US SEFs have been deemed Equivalent for the derivatives trading obligation.	SEFs will remain Equivalent and usable. UK venues may be added, but politically driven. UK venues registering in Holland in preparation.
	Trading Obligation – STO	For shares, HK, Singapore, Australia are already deemed Equivalent. Temporary Equivalence (to Dec 18) awarded to Swiss Stock Exchange.	Likely relief for UK (unlikely that EU would prevent EU firms from trading stocks on the London Stock Exchange)
	Reporting	Broad relief given the EC for temporarily treating all global venues as Equivalent for the purposes of reporting – to avoid double reporting.	Likely that the same relief would continue and implicitly include UK after Brexit.
CRD	Capital	None	Market assumption that UK will be deemed Equivalent for capital computation purposes
Other	<i>A patchwork of Equivalence structures exist across many regulations – eg BRRD, MAR, CSDR, SFTR, Short Selling, EBR...</i>		

Issues and Open questions

- Clearing
- Venues
- Passporting
- UK/EU divergence: risk weightings, MIFID liquidity definitions
- Legal aspects: jurisdiction and continuity
- Multiple markets vs status quo: what are the risks to liquidity
- Costs, benefits, covering scenarios

Nomura's approach

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Issues for discussion

- How do members expect the euro area bond market landscape to evolve after Brexit?
- How advanced are members in their Brexit preparations?
- What are the main pressure points for BMCG members?

Appendix A-1

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