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ISSUES ON FINANCIAL MARKET REGULATION, BUSINESS DEVELOPMENT AND GOVERNMENT'S POLICIES ON GLOBALIZATION

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DOS AND DON'TS OF BREXIT:
THE FUTURE OF THE UK FINANCIAL SERVICES SECTOR *

Andreas Kokkinis** - Andrea Miglionico***

ABSTRACT: *This article examines the various possible scenarios for the UK financial services sector post-Brexit, and explores in more detail the case of credit rating agencies (CRAs) and the relationship with the Banking Union. The first part of this article sets out the stark choice the UK faces between EEA membership and third country status in the context of financial services and discusses the complex notion of equivalence under current EU financial legislation and the challenges equivalence presents, as the legal basis for the future relationship between the UK and EU financial sectors. The second part of the article focuses on the impact of Brexit on CRAs highlighting the possible dismantlement of EU legislation that could leave CRAs completely unregulated, which would exacerbate the problems with the liability of rating agencies and the governance of the ratings industry. The second part also analyses the consequences of Brexit in relation to the Banking Union and, in particular, to the banking recovery and resolution framework. It is argued that the UK may adopt different regulatory regimes for restructuring banks in crises generating risks of inconsistency in the implementation of resolving tools.*

SUMMARY: 1. Introduction. – 2. The possible scenarios of the relationship between the UK and EU financial sectors post-Brexit. – 3. Equivalence in the context of access to EU financial markets. – 4. The impact of Brexit on the regulation of CRAs. – 5. The post-Brexit scenario of special resolution regimes for failing banks. – 6. Conclusion.

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*This article is a result of joint research. Sections 1, 2 and 3 have been written by A. Kokkinis. Sections 4, 5 and 6 have been written by A. Miglionico. Sections 1 and 6 present joint reflections on the subject matter.

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1. At the aftermath of the referendum held on 23 June 2016, the UK is due to leave the European Union (EU) on 29 March 2019. Brexit raises several causes of concern in the financial sector, such as the ability of UK firms to offer financial services in the EU, whether UK-based central clearing counterparties (CCPs) will continue to satisfy the obligation to use a CCP, and whether the London Stock Exchange (LSE) will continue to satisfy the obligations of investment funds in connection to shares with a dual listing.[1] The impact of Brexit on financial services and markets is still difficult to foresee with any satisfactory degree of accuracy, as the future relationship between the UK and the EU will be largely determined by the political situation in the UK.[2]

Many commentators have assumed that the UK will leave the Single Market because the Prime Minister[3] and Government[4] have insisted on multiple occasions that this is the only way to give substantive effect to the decision of the British people to leave the EU. On the other hand, joining the European Economic Area (EEA)[5] and thus remaining part of the Single Market appears to be favoured by parts of the Conservative Party as an alternative plan in case it is not possible to reach a satisfactory withdrawal agreement or parliament rejects the withdrawal

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[1]The Commission has highlighted these issues, which will be explored in detail below, in notices it published in early 2018. See Commission, 'Notice to stakeholders: Withdrawal of the United Kingdom and EU rules in the field of markets in financial instruments' (Brussels, 8 February 2018) and 'Notice to stakeholders: Withdrawal of the United Kingdom and EU rules in the field of post-trade financial services' (Brussels, 8 February 2018), available at https://ec.europa.eu/info/publications/180208-notices-stakeholders-withdrawal-uk-banking-and-finance_en, accessed 6 August 2018.

[2]For an overview of the areas of agreement and disagreement between the two sides and of the available models for the new relationship between the UK and the EU, see European Union Committee, *UK-EU relations after Brexit* (HL 2017-19, 149).

[3]Theresa May, Prime Minister, 'Mansion House Speech' (Speech at Mansion House, London, 2 March 2018), available at https://www.bbc.co.uk/news/uk-politics-43256183, accessed 6 August 2018.

[4]HM Government, 'The future relationship between the United Kingdom and Europe' (Cm 9593, 2018) 1.

[5]The European Economic Area was created by the Agreement on the European Economic Area [1994] OJ L1/3. It is an international treaty originally between the 12 EU Member States and the European Free Trade Association States. These were at the time the following: Norway, Lichtenstein and Iceland (which are still members of EFTA and the EEA), Austria, Sweden and Finland (which joined the EU in 1995) and Switzerland, which never ratified the Agreement due to its rejection by a referendum in December 1992.

agreement.[6] Support for a second referendum, which might even reverse Brexit altogether, is also growing amongst civil society organisations and at Westminster, although currently the only significant nation-wide party that supports this idea is the Liberal Democrats.

This article, therefore, canvasses the various possible scenarios for the UK financial services sector post-Brexit, before exploring in more detail the case of credit rating agencies (CRAs) and the relationship with the Banking Union. Section two sets out the stark choice the UK faces between EEA membership and third country status in the context of financial services. Section three examines the complex notion of equivalence under current EU financial legislation and the challenges equivalence presents, as the legal basis for the future relationship between the UK and EU financial sectors. Section four focuses on the impact of Brexit on CRAs. Section five explores the consequences of Brexit in relation to the Banking Union and, in particular, to the banking recovery and resolution framework. The last section provides concluding observations.

2. This section will briefly explain the EEA option, and will then focus on the more likely scenario where the UK leaves the Single Market.[7] The Single Market's territorial extent is broader than the EU, as it also encompasses three of the European Free Trade Association (EFTA) Member States,[8] and – to a limited extent – Switzerland through bilateral treaties.[9] Those areas of EU law that derive from

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[6]See PARKER, 'Michael Gove discusses backstop UK plan to stay in single market' *Financial Times* (London 2 August 2018), available at https://www.ft.com/content/722039cc-9579-11e8-b67b-b8205561c3fe, accessed 6 August 2018.

[7]The following part of the discussion draws on KOKKINIS, 'The impact of Brexit on the legal framework for cross-border corporate activity' (2016) 27(7) *European Business Law Review*, 963-966.

[8]The European Free Trade Association is an intergovernmental organisation established by a Convention on 4 January 1960. Its original signatories were the United Kingdom, Austria, Denmark, Norway, Portugal, Sweden and Switzerland. Iceland joined in 1970, Finland in 1986 and Lichtenstein in 1991. However, the importance of EFTA gradually declined. Indeed, the UK and Denmark left in 1973, Portugal in 1986 and Austria, Finland and Sweden in 1995. As a result, EFTA currently has four members: Iceland, Lichtenstein, Norway and Switzerland.

[9]The ten bilateral treaties granting Switzerland partial membership of the Single Market were signed in two phases, the first seven in 1999 and the last three in 2004. They cover areas such as the free movement of persons, technical trade barriers, public procurement, agriculture, air and land

the fundamental Treaty[10] freedoms of movement of: goods, services, capital, and persons are equally applicable to countries that are not part of the EU but are part of the Single Market. All the EU acquis that is relevant to financial services and markets falls in that category. The EEA Agreement covers in particular: (1) the free movement of workers; (2) recognition of professional qualifications; (3) the right of establishment; (4) financial services; (5) services in general; (6) the free movement of capital; and (7) EU company law rules. It follows that, if the UK joins the EEA, nothing will change for the UK financial markets and firms and all the economic benefits that UK firms currently enjoy, including passporting rights, would continue as they stand.[11]

This would come at the cost of the UK having to follow any new EU rules in these areas, without having anymore any official voice and power to shape such rules. Indeed, EEA countries are legally obliged to implement all new EU law rules that fall within the scope of the EEA Agreement subject to their approval by special joint committees that include representatives from the EU and EEA. New EU legislation is incorporated into the EEA Agreement by consensus of all EEA states. The process is facilitated by a number of institutions, including the EFTA Standing Committee (of ambassadors to the EU), the EFTA Surveillance Authority, and the EFTA Court.[12] The process is led politically by the EEA Council (foreign ministers of the EEA States and of the EU Member State which holds the presidency). The actual decision to incorporate applicable EU legislation has to be taken unanimously by the EEA Joint Committee, which consists of the EFTA Standing Committee and

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transport, and Switzerland's participation in the Schengen and Dublin agreements. For a discussion of the position of Switzerland in the Single Market, see Stephan Breitenmoser, 'Sectoral Agreements between the EC and Switzerland: Contents and Context' (2003) 40(5) *Common Market Law Review*, 1137.

[10]Consolidated Version of the Treaty for the Functioning of the European Union (TFEU) [2012] OJ C236/47, Art 26(2).

[11]See ALEXANDER, 'The UK's Third-Country Status Following Brexit: Post-Brexit Models, Third-Country Equivalence and Switzerland' in Kern Alexander and others (eds), *Brexit and Financial Services: Law and Policy* (Oxford: Hart Publishing 2018) 118-121. Armour has also argued that a 'soft' Brexit is the safest option for the City. John Armour, 'Brexit and Financial Services' (2017) 33 *Oxford Review of Economic Policy* (suppl. 1) 54.

[12]An analysis of the jurisprudence of the EFTA Court can be found in EFTA Court (ed), *The EEA and the EFTA Court* (Hart Publishing 2015).

the European External Action Service.[13] The Joint Committee scrutinises each piece of legislation to ensure it falls within the scope of the EEA Agreement. EEA countries have the theoretical right to refuse the application of new EU law, but such right has never been exercised since doing so would give the EU the right to terminate the whole EEA Agreement. This explains the strong resistance of many UK politicians to EEA membership as it would effectively bind the UK to follow EU rules without being represented on the EU institutions and fora. Of course, in such a scenario the UK, given its technical expertise and the size of its financial market, would retain the possibility of influencing the direction of EU law in soft ways through lobbying Member States' governments, providing technical assistance to EU authorities and contributing to the development of international financial regulation international financial regulation such as the Basel Committee and IOSCO.

From the perspective of the financial services, it is worth noting that there are effectively two models of the future relationship between the UK and the EU: either full EEA membership or ordinary third country status, which may benefit from equivalence. Regarding the Swiss model, although it is a distinct blueprint for an institutional arrangement with the EU, from the perspective of the financial markets and services, it would amount to little more than ordinary third country status. This is because much of the Single Market acquis does not apply to Switzerland. Although EU law that is based on the free movement of persons (natural and legal) applies, most EU law on financial services and financial markets does not apply.[14] Moreover, the bilateral treaties between the EU and Switzerland do not provide for the incorporation of new pieces of EU legislation.[15] This has led the EU

[13]This is an Agency established for this purpose in 2010. Until then the Commission represented the EU on the EEA Joint Committee.

[14]However, note that a special bilateral agreement allows Swiss general insurance firms to set up agencies and branches in EEA States and vice versa: Agreement between the European Economic Community and the Swiss Confederation of 26 July 1989 on direct insurance other than life insurance [1991] OJ L205/3.

[15]Indeed, any expansion of Switzerland's participation in the Single Market can only achieved by concluding additional bilateral treaties, which has led to a proliferation of treaties, exceeding now 120.

Council to state that no further bilateral treaties will be concluded and to request Switzerland to agree an appropriate institutional framework to ensure the coherence of the Single Market.[16] In any case, in the area of financial services, Swiss policy in recent years has focused on making Swiss law mirror EU law, so that Swiss firms can benefit from equivalence determinations and gain some access to the Single Market, rather than on new bilateral treaties.[17]

It is now pertinent to examine the possibility of financial services to be included in a future free trade agreement between the UK and the EU. Of course, it is theoretically possible for the UK and EU to conclude a free trade agreement with a chapter on financial services that would grant access to each other's markets and provide for mutual recognition of each other's regulatory frameworks or parts thereof. Such an agreement would grant UK financial firms passporting rights (probably using different terminology) to operate in the EU and vice versa, and would include institutional arrangements to ensure that the regulatory frameworks of the UK and EU do not diverge in the future within the scope of such rights of access. Indeed, the Chancellor has consistently advocated this option as it would provide UK financial firms with the necessary legal certainty and clarity. He canvassed this scenario as follows:

'[T]he principle of mutual recognition and reciprocal regulatory equivalence, provided it is objectively assessed, with proper governance structures, dispute resolution mechanisms, and sensible notice periods to market participants clearly could provide an effective basis for such a partnership. And although we will be separate jurisdictions, we would need to maintain a structured regulatory dialogue to discuss new rules proposed by either side building on our current unparalleled regulatory relationships to ensure we deliver equivalent regulatory out-

[16]See AYDAN, BAHADIR and FERNANDO, GARCÉS DE LOS FAYOS, The European Economic Area (EEA), Switzerland and the North (2016), available at http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_6.5.3.html, accessed 6 August 2018.
[17]See ALEXANDER (n 11) 143-145.

comes agreeing mutually acceptable rule-changes where possible. ' [18]

Tempting as this scenario may be for UK financial firms and their management, the prospect of including the financial services within a future free trade agreement between the UK and EU looks dim due to the firm position taken by the Commission and Michel Barnier. Their position is that the UK will face a stark choice between: EEA membership and a Canada-style free trade agreement covering (most) goods, but not services.[19] This appears to have been reluctantly accepted by the UK Government, which in its much discussed Chequers white paper concedes that access to financial markets will be a matter of equivalence rather than mutual recognition:

'This new economic and regulatory arrangement would be based on the principle of autonomy for each party over decisions regarding access to its market, with a bilateral framework of treaty-based commitments to underpin the operation of the relationship, ensure transparency and stability, and promote cooperation. [...] As part of this, the existing autonomous frameworks for equivalence would need to be expanded, to reflect the fact that equivalence as it exists today is not sufficient in scope for the breadth of the interconnectedness of UK-EU financial services provision.' [20]

Evidently, the Government is still hoping for a governance framework that would be enshrined in a legally binding treaty but does not seek automatic mutual recognition, but rather unilateral equivalence granted autonomously, in line with current practice. So, it appears that, barring a major U-turn leading to the UK joining the EEA, the future relationship between the UK and EU in the area of financial services and markets will be based on autonomous and unilateral determinations

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[18]See HAMMOND, Chancellor of the Exchequer, 'Speech on Financial Services at HSBC' (Speech at HSBC Headquarters, London, 7 March 2018), available at https://www.gov.uk/government/speeches/chancellors-hsbc-speech-financial-services, accessed 6 August 2018.

[19]See BRUNSDEN, 'EU rejects Brexit trade deal for UK financial services sector' *Financial Times* (London, 31 January 2018), available at https://www.ft.com/content/7f7669a4-067f-11e8-9650-9c0ad2d7c5b5, accessed 6 August 2018. See also BRUNSDEN, 'Brexit Britain faces services squeeze with Canada-style deal' *Financial Times* (London, 12 December 2017), available at https://www.ft.com/content/30a358ac-dda6-11e7-8f9f-de1c2175f5ce, accessed 6 August 2018.

[20]See 'The future relationship between the United Kingdom and Europe' (n 4) 30.

of regulatory equivalence. In the worst case, from the UK's perspective, this will operate exactly as the current EU framework on equivalence. In the best case scenario, there will be a binding treaty providing for an institutional framework for the making of such determinations on the basis of the following principles: regulatory dialogue, supervisory cooperation, transparent and objective assessment methodology and a presumption against unilateral changes that narrow the terms of existing market access regimes.[21] The next section, therefore, analyses the current way in which equivalence operates in EU financial legislation before exploring potential ways to shape the institutional framework governing equivalence in the future.

3. Several pieces of EU financial legislation include equivalence clauses which effectively allow some degree of market access to the Single Market for firms that are governed by the law of third countries, provided that the legal and regulatory framework of these countries is deemed to be equivalent to the European framework.[22] In these cases, the determination of equivalence is made for the whole of the EU by the Commission and is liable to be withdrawn at any time. However, the notion of equivalence is also used more broadly to determine compliance with EU rules for non-EU firms. In that sense, equivalence is not about market access but rather about allowing a third country firm to demonstrate compliance with any EU law provision which applies to it due to its operations in the EU. An example of that, is the ability to treat certain exposures in a beneficial way in the context of capital adequacy regulation under CRR.[23] Furthermore, other

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[21]Ibid 31-32.

[22]For an overview of various types of equivalence provisions in EU financial legislation and of the distinction between equivalence and passporting, see Directorate-General for Internal Policies (IPOL), 'Third-country equivalence in EU banking legislation' (Briefing Paper of the European Parliament PE 587.369, 12 July 2017), at http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf, accessed 6 August 2018. See also European Union Committee, *Brexit: financial services* (HL 2016-17, 81) 47-49. From the post-Brexit UK perspective, see FERRAN, 'The UK as a Third Country Actor in EU Financial Services Regulation' (2017) 3(1) *Journal of Financial Regulation*, 40.

[23]Capital Requirements Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and

pieces of EU legislation – especially in the areas of prospectuses, transparency, investment funds and alternative investment funds – empower the competent authority of each Member State to determine whether a firm from a third country is subject to equivalent legal requirements on a particular issue, in order to determine the firm's compliance with the requirements of EU law.[24] In the latter cases, the decision lies within the competent authority of the Member State where the third country firm seeks to obtain authorisation or undertake activities.[25] For the purposes of the present discussion it is necessary to explore in more detail the instances where passport-like equivalence is granted centrally by the Commission.

This occurs in three areas, all of them belonging to the wholesale markets: (1) offering investments services to professional clients; (2) reinsurance activities[26]; and (3) the operation of central clearing counterparties.[27] The former of these regimes is the most comprehensive and thus warrants further examination. Indeed, in the area of investment services, the relevant framework is prescribed

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amending Regulation (EU) No 648/2012 [2013] OJ L176/1, arts 107(3)-(4), 114(7), 115(4), 116(5), and 132(3).

[24]See Directive 2009/65/EC of The European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) [2009] OJ L302/32, art 50(f). Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64, art 20. Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] OJ L390/38, art 23. Directive 2011/61/EU of the European Parliament and of The Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L174/1, art 37.

[25]The UK Financial Conduct Authority, for instance, has made equivalence decisions regarding disclosure rules for Switzerland, the United States, Canada and Japan. See FCA, Equivalence of Non-EEA regimes (2016), available at https://www.fca.org.uk/markets/ukla/regulatory-disclosures/equivalence-non-eea-regimes, accessed 6 August 2018.

[26]See Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) [2009] OJ L335/1, art 172 and 227. For a concise discussion, see Alexander (n 11) 142.

[27]See Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1, Art 25(6). In brief, the Regulation stipulates that a third country CCP may provide clearing services to clearing members or trading venues established in the EU only if the CCP in question has been recognised by ESMA, which can only happen if an equivalence determination has been previously made by the Commission.

by articles 39-43 MiFID[28] and 46-49 MiFIR.[29] Briefly speaking, a firm from a third country is allowed to provide investment services to professional clients in the EU without the need to set up a subsidiary or even a branch insofar as it is registered with the European Securities and Markets Authority (ESMA).[30] ESMA will only register a firm, if there has been prior adoption by the Commission of an equivalency decision regarding the legal and regulatory framework of the relevant third country. Notably, cooperation arrangements must be established between ESMA and the competent authorities of the third country. On the contrary, the provision of investment services to retail customers by third country firms remains within the discretion of Member States, which may impose a requirement that the firm sets up a branch or subsidiary in their territory.

Turning to the decision-making process regarding equivalence under MiFID II/MiFIR, the Commission has to certify that the prudential and conduct of business framework of the third country is equivalent to the EU framework. This evidently entails a broad appraisal of the foreign framework. In particular, the Commission must be satisfied that the firm is subject to an authorisation requirement and ongoing supervision; sufficient capital requirements; sufficient organisational requirements; appropriate conduct of business rules; and that there are rules preventing market abuse.[31] In any case, the Commission's decision is discretionary. This process has not yet been tested as there has not been any determination of equivalence under the aforementioned rules at the time of writing, which is unsurprising given the short time that has lapsed since the implementation date for MiFID II/MiFIR.

However, there have already been determinations of equivalence under another provision of MiFIR which is not one granting market access, but rather

[28]See Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) [2014] OJ L173/349.
[29]See Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 [2014] OJ L173/84. From now on to be abbreviated as MiFIR.
[30]For a detailed discussion, see Alexander (n 11) 134-142.
[31]See MiFIR, art 47 (1) (a) – (e).

falls in the category of determining compliance with substantive rules of EU law. Indeed, article 23 MiFIR requires investment firms to ensure that any trade they undertake in shares which are admitted to trading on a regulated market, or are traded on a trading venue only takes place on regulated markets or third-country trading venues assessed by the Commission as equivalent. This means that if an investment firm wants to trade in a share which is listed on one of the EU stock exchanges it has to trade on this share only on an EU stock exchange or on an exchange of a country whose regime has been deemed to be equivalent. Apparently, this is practically significant in the case of dually listed shares which are listed on an EU exchange and a non-EU exchange. To date the Commission has determined that the legal and supervisory framework for national securities exchanges and alternative trading systems of the following countries is equivalent to the EU framework: Australia,[32] Hong Kong,[33] Switzerland[34] and the USA.[35] These decisions need to be complemented by cooperation arrangements. The UK will be highly likely to achieve a similar determination in due course.

Regarding the policy of the Commission on its exercise of discretion under equivalence provisions in general, it recently described the criteria that guide its discretion as follows:

'[The Commission] takes into account objectives stemming from the empowering legislation and from the Treaty. These objectives may include in particular promoting the internal market for financial services and protecting financial

[32]See Commission Implementing Decision (EU) 2017/2318 of 13 December 2017 on the equivalence of the legal and supervisory framework in Australia applicable to financial markets in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L331/81.

[33]See Commission Implementing Decision (EU) 2017/2319 of 13 December 2017 on the equivalence of the legal and supervisory framework applicable to recognised exchange companies in Hong Kong Special Administrative Region in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L331/87.

[34]See Commission Implementing Decision (EU) 2017/2441 of 21 December 2017 on the equivalence of the legal and supervisory framework applicable to stock exchanges in Switzerland in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L344/52.

[35]See Commission Implementing Decision (EU) 2017/2320 of 13 December 2017 on the equivalence of the legal and supervisory framework of the United States of America for national securities exchanges and alternative trading systems in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L331/94.

stability or market integrity within the internal market. […] In this context, factors such as the size of the relevant market, the importance for the functioning of the internal market, the interconnectedness between the markets of the third country and the EU, or the risks of circumvention of EU rules may play a role. The Commission also needs to factor in wider external policy priorities and concerns in particular with respect to the promotion of common values and shared regulatory objectives at international level. All these factors are indicative of the amount of risk to the financial stability or the need for adequate protection of financial market participants and other persons in the EU.' [36]

It also emphasised that 'it follows a risk-based approach and the principle of proportionality'.[37] These statements indicate that fears that the Commission may refuse to grant equivalence to UK firms post-Brexit or withdraw such equivalence in a totally arbitrary manner are exaggerated.

However, references to the size of the relevant market, the interconnectedness between the third country and the EU and the risk posed to financial stability in the EU suggest that there may be some unpleasant surprises for the UK. The UK's financial market is huge by EU standards, highly interconnected to the EU market and a systemic crisis in the UK would significantly reduce financial stability in the EU. These factors weigh negatively in the context of equivalence decisions which means that the Commission is likely to scrutinise the UK regime most carefully before making any equivalence determination. Even if the UK maintains full alignment with relevant substantive EU rules, this does not mean that the Commission will be automatically satisfied, as the ambit of its scrutiny also includes robust supervision and related enforcement. It is worth noting that a refusal to grant equivalence or a revocation of equivalence on ostensible grounds of protecting financial stability is very difficult to be challenged successfully at the fora of the

[36]See Commission, 'EU equivalence decisions in financial services policy: an assessment' (Staff Working Document) SWD (2017) 102 final, 9-10.
[37]Ibid, 8.

World Trade Organisation as contrary to GATS.[38] This means that WTO law offers little effective protection for the UK in this area. Furthermore, there is currently pressure from the French Financial Markets Authority for the EU to tighten its MiFID equivalence regime in view of Brexit.[39] In particular, the French Authority emphasised the need for EU law to require firms from third countries which have achieved equivalent status to apply the MiFID rules on investor protection and market integrity, and the need to give ESMA a power to supervise third country firms that benefit from equivalence.

The preceding analysis suggests that the current regime on equivalence may well provide market access for UK financial firms in several areas, but will not attain the level of legal certainty that firms require.[40] This can only be achieved if an appropriate governance framework is put in place in the lines proposed by the UK Government. However, for the time being at least, the EU appears unlikely to consider entering into such an agreement with the UK as it views such a prospect as undermining the Single Market. This is not to say that in the long-term some institutional framework may not arise, especially one based on informal cooperation rather than hard law.[41]

In the meantime, however, the UK financial services sector will continue to

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[38]See LANG, 'The 'Default Option'? The WTO and Cross-Border Financial Services Trade after Brexit' in Kern Alexander and others (eds), *Brexit and Financial Services: Law and Policy* (Oxford: Hart Publishing 2018) 211-215.

[39]See OPHÈLE, Chairman of the French Financial Markets Authority , 'From Brexit to financial innovations: new challenges for financial regulation' (Speech at the Official Monetary and Financial Institutions Forum, London, 15 March 2018), available at https://www.amf-france .org/en_US/Actualites/Prises-deparoles/Archives/Annee2016?docId=workspace%3A%2F%2FSpa cesStore%2F02d32070-8a04-434a-a237-5b402bbf7139, accessed 6 August 2018.

[40]For instance, a recent House of Lords report concludes that the equivalence framework on its own would not provide a reliable foundation for the relationship between the UK and EU financial markets in for the long-term. See European Union Committee, *Brexit: the future of financial regulation and supervision* (HL 2017-19, 66).

[41]An in-depth exploration of potential models can be found in Eilis Ferran, 'Regulatory Parity in Post-Brexit UK–EU Financial Regulation: EU Norms, International Financial Standards or a Hybrid Model?' in Kern Alexander and others (eds), *Brexit and Financial Services: Law and Policy* (Hart Publishing 2018) 15-28. Regarding the feasibility of reaching a workable solution Ringe has optimistically asserted that a workable solution is highly likely to be found despite prevailing rhetorics on both sides as it is in the economic interest of both. See RINGE, 'The Irrelevance of Brexit for the European Financial Market' (2018) 19(1) *European Business Organization Law Review*, 1.

face the threat of losing business and jobs to the rest of the EU. To be sure, only very few jobs have been already lost to the City,[42] as most firms have established branches or subsidiaries with minimal staff. This, however, could easily change in the near future.[43] At the same time, investment in the sector in 2017 fell in the UK, while it rose in the EU and particularly in France.[44]

4. From the above analysis it is evident that the Brexit referendum has revealed an important question, namely, how far is the current relationship between the UK and EU financial sectors from achieving fairness and equal access.[45] It is worth noting that Brexit has raised several questions such as how to regulate a single banking licence,[46] mutual recognition[47] and home country control. It also raised the question: how to regulate the EU requirements for equivalence determinations in the financial sector. On this point, it is important to understand the current developments of the Brexit negotiations and possible outcomes in the banking and financial transactions. As Moloney noted, 'the rise of technocracy is

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[42]Estimates of the total number of jobs that will have been lost by 29 March 2019, the day of Brexit, put the figure at around 10,500. See Ben Chapman, 'Brexit: UK to lose 10,500 City jobs as 30 per cent of firms flag plans to move staff' *Independent* (London 11 December 2017), available at https://www.independent.co.uk/news/business/news/brexit-latest-news-uk-city-job-losses-move-eu-frankfurt-paris-luxembourg-banks-europe-sam-woods-a8104176.html, accessed 6 August 2016.

[43]Senior officers in the Bank of England have been reported to have estimate that in the long-term 75,000 jobs could be lost. See Kamal Ahmed, 'Bank of England believes Brexit could cost 75,000 finance jobs' *BBC News* (London 31 October 2017), available at https://www.bbc.co.uk/news/business-41803604, accessed 6 August 2016.

[44]According to EY research foreign direct investment in the UK financial services sector reduced by 26% in 2017 while it grew by 13% in the EU as a whole. See ALI, 'We now need decisive action to prevent Brexit uncertainty from damaging the UK's status as Europe's leading financial services hub' (EY Report, June 2018), available at https://www.ey.com/uk/en/issues/business-environment/ey-attractiveness-survey-2018-uk-fs, accessed 6 August 2018. In addition, London has for the first time being surpassed by Paris as the most attractive city for foreign direct investment in the sector. See EY, 'Game changers EY's Attractiveness Survey Europe June 2018' (2018), available at https://www.ey.com/gl/en/issues/business-environment/ey-attractiveness-survey-europe-june-2018, accessed 6 August 2018.

[45]See REYNOLDS and DONEGAN, 'Brexit—Opportunity for a Reboot of Financial Regulation' (2016) 31(12) *Journal of International Banking Law and Regulation*, 613.

[46]The single banking license was introduced by the Second Banking Directive (89/646/EEC) to provide access to EU financial institutions to do business with each other. In this way, credit institutions which are authorized to operate in any Member State are allowed to establish branches and to provide cross-border services throughout the community on the basis of the principle of home country supervision.

[47]Mutual recognition means harmonization of a managed regulatory system. It implies mutual trust and adoption of common rules.

therefore likely to be the most significant influence on how EU financial governance develops over the period when the UK leaves the EU'.[48] In this context, the impact of Brexit would affect certain pieces of EU legislation such as the regulation of credit rating agencies (CRAs) and the special resolution regimes for failing banks.

This section focuses on the withdrawal of the UK from EU rules in the field of CRAs, as the UK leaves the Union according to Article 50 of the Treaty on EU. As the Commission recently warned, 'subject to any transitional arrangement that may be contained in a possible withdrawal agreement, as of the withdrawal date, the EU rules in the field of the Credit Ratings Agencies (CRAs) and in particular Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies ("CRA Regulation") no longer apply to the United Kingdom'.[49]

CRAs are financial intermediaries whose role is to promote market efficiency and efficient resource allocation. Their essential function is to address information asymmetries and assist investors in assessing the risk of default of financial products and issuers. A credit rating is a form of disclosure in which the financial conditions of companies are evaluated through opinions or forecasts about their relative stability.[50] The information provided represents a value for investors who rely on the credibility, transparency and independence of rating reports, although the certification and verification roles of CRAs leave doubts on the accountability regime in case of inaccurate assessments.[51]

CRAs have become major players in the financial markets yet their rep-

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[48]See MOLONEY, 'EU Financial Governance after Brexit: The Rise of Technocracy and the Absorption of the UK's Withdrawal' in Kern Alexander, Catherine Barnard, Eilís Ferran, Andrew Lang and Niamh Moloney (eds.), *Brexit and Financial Services. Law and Policy* (Oxford: Hart Publishing 2018) 113.

[49]See European Commission, 'Notice to Stakeholders Withdrawal of the United Kingdom and EU Rules in the Field of Credit Rating Agencies', 8 February 2018, available at https://ec.europa.eu/info/sites/info/files/180208-notice-withdrawal-uk-credit-rating-agencies_en.pdf.

[50]See MACNEIL, 'Credit rating agencies: regulation and financial stability' in Thomas Cottier, Rosa M. Lastra and Christian Tietje (eds), *The Rule of Law in Monetary Affairs* (Cambridge: CUP 2014) 189.

[51]See COFFEE JR., 'Ratings Reform: The Good, The Bad, and The Ugly' (2010) European Corporate Governance Institute, Law Working Paper No 145, 29.

utations have been tarnished by certain assessments made during the 2007-09 financial crisis.[52] CRAs are capable of bringing about potential distortions in the financial sector, thereby resulting in a reduction in market confidence which, in turn, influences transactions and expectations.[53] Although several legislative reforms have been adopted globally[54] it can be argued that lack of rules of the game is the major factor in the accountability regime of CRAs. The problem is made worse by the fact that investors find it difficult to choose the right financial product because there is no appropriate system of disclosure and the internal control rules are inadequate. Market participants tend to mechanistically rely on ratings, thus causing hazardous behaviour such as sell-offs of securities when they are downgraded, the so-called 'cliff effects', that can contribute to procyclicality and systemic risk.

The regulatory framework of CRAs with regard to the reforms adopted in the UK and the EU highlighted a persistent gap in the supervision and enforcement of CRAs' activities.[55] Although the legislators have improved the monitoring system and increased the disclosure regime, particularly as a result of the direct and intrusive supervisory actions of ESMA in the EU,[56] the business conduct of CRAs has remained unaltered.[57] In this context, it has been noted that 'the current system for disclosing initial approaches by issuers of structured bonds is poorly

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[52]See PAYNE, 'The Role of Gatekeepers' (April 2014) University of Oxford Legal Research Paper Series No 22/2014, 2, available at http://ssrn.com/abstract=2428121.

[53]See HISS and NAGEL, 'Credit Rating Agencies' in Daniel Mügge (ed.), *Europe and the Governance of Global Finance* (Oxford: OUP 2014) 140.

[54]See IOSCO Technical Committee, 'Code of Conduct Fundamentals for Credit Rating Agencies' (December 2004) 3; IOSCO, 'Code of Conduct Fundamentals for Credit Rating Agencies. Revised', May 2008; IOSCO, 'Code of Conduct Fundamentals for Credit Rating Agencies' (Revised March 2015) 3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf.

[55]See Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ 2009 L 302, p. 1); see also Regulation (EU) No 462/2013 (OJ 2013 L 146 p. 1).

[56]See European Securities and Markets Authority, 'ESMA's supervision of credit rating agencies, trade repositories and monitoring of third country central counterparties. 2017 Annual Report and 2018 Work Programme' (ESMA80-199-153), 8 February 2018, available at https://www.esma.europa.eu/sites/default/files/library/esma80-199-153_supervision_ar2017_and_wp2018.pdf.

[57]See DEIPENBROCK, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies – Some Critical Observations in a Broader Context' (2018) 29(2) *European Business Law Review*, 202-203.

designed to constrain ratings shopping'.[58] This means that investors find difficulties in accessing information about the relationships between CRAs and issuers.

The regulatory tools and oversight mechanisms over CRAs did not change the rating market, the conflicts of interest between raters and issuers or the limited competition creating barriers to entry for smaller rating agencies. This scenario could worsen in the aftermath of the Brexit referendum and the UK's withdrawal from the European Union: the possible dismantlement of EU legislation could leave CRAs activity in the UK completely unregulated, which would exacerbate the problems with the liability of rating agencies and the governance of the ratings industry.[59] In the post-Brexit scenario, the UK government might be moved to implement a new regulatory regime for CRAs, which could result in non-convergent rules for users of ratings and absence of adequate protection. The result of post-Brexit changes could be to undermine oversight over CRAs' activities and weaken supervisory practices: this in turn could lead to disruptive consequences, such as the deregulation of rating services and regulatory arbitrage.[60]

From a practical perspective, the Brexit implications on CRAs can affect the following aspects of rating governance: (1) deregistration; (2) use of ratings for regulatory purposes; (3) endorsement in a third country; and (4) prospectus disclosure.[61] In terms of deregistration, CRAs established in the UK will no longer be considered established in the EU. ESMA will therefore withdraw their registrations with effect on the withdrawal date according to Articles 14 and 20 of the CRA Regulation. This can have a major impact on the liability regime for CRAs since there can be a risk of regulatory arbitrage and an unequal playing field for the

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[58]See POZEN, 'EU's attempt to tackle 'ratings shopping' is falling short' *Financial Times* (London, 14 June 2018). The author suggests that 'Esma should establish a central and accessible system of public disclosures on both initial approaches and final ratings by each EU issuer of a structured bond'.

[59]See BINHAM, 'Brexit casts doubt over rating agencies' future in London' *Financial Times* (London, 22 February 2017).

[60]See CASH, 'Credit Rating Agency Regulation in the UK If and When Article 50 is Invoked: Round Holes for a Square Peg?' (2018) 29(1) *European Business Law Review*, 71, where it is observed that Brexit in the ratings industry can spread the risk of regulatory arbitrage with the 'knock-on effect for the UK to weaken [the regulation] towards the CRAs in order to keep them operating, and contributing, within the UK'.

[61]See European Commission (n 49).

ratings industry.[62]

In relation to the use of ratings, if UK-based CRAs are deregistered by ESMA, EU investment firms will no longer be able to use ratings issued by these CRAs for regulatory purposes, such as Solvency II for insurance undertakings,[63] and CRR for credit institutions. This means that compliance with different regulatory regimes can create additional costs for investment firms, which are likely to be passed on to customers and retail investors. With regard to the endorsement question, ratings issued by a CRA established in a third country – which is part of a group to which a CRA established in the EU and registered by ESMA belongs – can be “endorsed” provided that certain conditions are met according to Article 4(3) of the CRA Regulation.[64] Under the prospectus head, according to Article 4(1) of the CRA Regulation any reference to a credit rating or credit ratings issued by a CRA established in the UK will need to include clear and prominent information stating that those credit ratings are not issued by a credit rating agency established in the EU and registered under the CRA Regulation. This is another example of regulatory uncertainty that will be manifested when the UK becomes a third country.

The material impact of Brexit on the regulation of CRAs will be made evident by the reshaping of competent supervisory authorities as ESMA will no longer have the responsibility for monitoring credit rating agencies in the UK and the Financial Conduct Authority will assume this role. In addition, the Brexit-era will be liable to exacerbate the heterogeneity of available remedies for investors seeking to hold CRAs liable as between the UK and the EU. Brexit may also have the effect

[62]On the liability regime for CRAs see PARTNOY, ‘What’s (Still) Wrong with Credit Ratings’ (2017) 92(3) *Washington Law Review*, 1433; see also Matthias Lehmann, ‘Civil liability of rating agencies—an insipid sprout from Brussels’ (2016) 11(1) *Capital Markets Law Journal*, 61-62.

[63]See Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ 2015 L 12, p. 1).

[64]See Article 4(3) of the CRA Regulation provides that CRAs are endorsed if the conduct of the credit ratings activities by CRA established in a third country fulfils requirements which are at least as stringent as the EU specific framework, there is an objective reason for the rating to be elaborated in the third country and there is an appropriate cooperation arrangement between ESMA and the relevant supervisory authority.

of starting a debate about the importance of relying exclusively on market incentives for CRAs: in the event of a new UK regulatory framework, this may well provide for a higher level of immunity for rating agencies.

The uncertainties of Brexit may change the regulatory approach towards CRAs, entailing a risk of disruption in the ratings market. To the extent that Brexit will have an impact on CRAs, this can be seen as a missed opportunity to complete the process of harmonising the rules to which financial gatekeepers are subject. The next section discusses the potential implications of Brexit in the banking sector, namely the effects on the regulation of special resolution regimes for failing banks.

5. As previously discussed, after Brexit the UK will become a 'third country' within the current EU financial regulatory structure. This implies that future access to the EU's Single Market for UK-based financial institutions could be very limited. The uncertainty created in the aftermath of the Brexit vote is likely to affect the banking sector, particularly any plans among international banking groups to expand their UK-based operations. Most interestingly, there will be costs associated with the Brexit transition and 'most banks will be facing similar cost shocks, a large proportion of the additional costs are likely to be passed on to customers, rather than having a long-term impact on profitability'.[65] In this context, the post-Brexit scenario will determine the re-arrangement of special resolution regimes for failing banks regulated by the Bank Recovery and Resolution Directive (BRRD).[66] This section considers the implications of Brexit in dealing with failing banks and highlights the potential outcomes of implementing domestic regulatory tools to re-

[65]See DA SILVA, 'Leaving the EU: impact on bank customers', Oxford Law Faculty, Blog Series, 7 April 2017, 3, available at: https://www.law.ox.ac.uk/businesslawblog/ blog/2017/04/ brexitnego tiationsseriesleavingeuimpactbankcustomers.

[66]EU Bank Recovery and Resolution Directive (BRRD), Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014. These resolution tools require the establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173 of 12 June 2014, p. 190.

solve fragile credit institutions.

It is worth noting that the BRRD and the Single Resolution Mechanism (SRM) form the new European regulatory framework of the bank insolvency regime.[67] The SRM introduced a centralised resolution in a single authority (Single Resolution Board) and a single set of resolution powers for failing banks. In the context of BRRD rules, bail-in is a key resolution instrument: the main rationale is to provide a mechanism to return an insufficiently solvent bank to 'balance sheet stability' at the expense of some of its creditors without the necessity of an external capital injection. Bail-in should have put an end to taxpayer-funded bank bailouts. However, the conditionality attached to the precautionary recapitalisation represents one of the major concerns in the current regulatory framework because of its interconnection with the provisions on State aid.[68] Recapitalisation could preserve financial stability—as a remedy to cover losses for failing banks—in the case of a rescue plan with strict conditionality guaranteed by a pool of investment banks.

The BRRD and SRM for Eurozone banks provide a framework for the resolution of banks that requires senior creditors to participate in losses, if necessary, instead of or ahead of a bank receiving sovereign support.[69] As a rule, group resolution efforts are to be coordinated by the consolidated group-level resolution authority, with only limited scope for independent resolution action by national

[67]The Single Supervisory Mechanism (SSM) has been established by Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287 of 29 October 2013, p. 63. The Single Resolution Mechanism (SRM) has been introduced by Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225 of 30 July 2014, p. 1.

[68]See GORTSOS, 'A Poisonous (?) Mix: Bail-Out of Credit Institutions Combined with Bail-In of Their Liabilities Under the BRRD – The Use of 'Government Financial Stabilisation Tools' (GFSTs)', paper presented at the Workshop of the Financial and Monetary Law Working Group of the European University Institute (EUI, Florence, 12 October 2016) on "Suitability of the new resolution regime for tackling systemic and structural crises in the banking sector – fine-tuning rules in transition", 6, available at https://ssrn.com/abstract=2876508.

[69]It is important to note that covered bonds are exempt from bail-in under BRRD and may benefit from resolution tools.

resolution authorities for individual group companies.[70] The BRRD contains strict legal provisions on loss absorbency in the form of bail-in of shareholders, creditors and depositors not protected by law (deposits exceeding €100,000) up to a maximum of eight percent of the institution's total assets, which in the past would have covered all eventualities.[71] The resolution authorities can decide to sell the bank as a going concern, create a bridge institution, hive off assets, and bail-in creditors. In addition, all Member States must set up national resolution funds with resources which after ten years must amount to one percent of insured deposits.[72] A similar fund accruing total resources of €55 billion will be set up for those banks in the Eurozone countries that are subject to the ECB's Single Supervisory Mechanism (SSM).[73]

The BRRD regulates recovery planning: institutions need to draw up and update recovery plans to (1) assess potential vulnerabilities; and (2) prepare measures to restore their financial position in case of "significant deterioration" of financial position. Recovery plans are based on various scenarios, including both idiosyncratic problems and market-wide stress, and are assessed by competent supervisory authorities, which may require amendments to remedy "material deficiencies". Articles 10-14 of the BRRD and Articles 8-9 of the SRM Regulation regulate resolution planning. In this context, resolution authorities need to draw up and update "resolution plans" to prepare swift and effective resolution action in case "conditions for resolution" under BRRD are met. In addition, resolution authorities of home and host countries need to develop "group resolution plans" to

[70]See BINDER, 'To Ring-Fence or Not, and How? Strategic Questions for Post-Crisis Banking Reform in Europe' (December 2014), available at: http://ssrn.com/abstract=2543860. See generally BRRD, articles 87 (general principles), 88 (resolution colleges), 91 and 92 (procedural and substantive requirements for resolution action in relation to groups). On the conditions for independent action by host authorities in this context, see articles 91(8) and 92(4).

[71]See KOKKORIS and OLIVARES-CAMINAL, 'Resolution of Banks and the State Aid Regime' in Jens-Hinrich Binder and Dalvinder Singh (eds.), *Bank Resolution: The European Regime* (OUP: Oxford University Press 2016) 304-305.

[72]See RAYMOND LABROSSE, OLIVARES-CAMINAL and SINGH, 'The EU bank recovery and resolution directive—Some observations on the financing arrangements' (2014) 15(3/4) *Journal of Banking Regulation*, 218-226.

[73]Specifically, 60 per cent of the fund's total resources will be paid in within the first two years; the fund is also authorized to borrow.

facilitate consistent approaches in the case of corporate groups.[74] Both the SSM and the SRM, within their respective mandates should be able to deal efficiently with the proliferation of cross-border banking and any possible negative implications. However, the EU mechanism for resolving failing banks is still a work in progress and needs to be fully tested. State level deposit insurers are not viable inside a monetary union because the liquidation of small banks could overwhelm the capacity of national deposit insurance. The full mutualisation of deposit insurance across the Eurozone requires full harmonisation of insolvency laws, because the effectiveness of the bank liquidation process will have an impact on the financial situation of each national deposit insurance authority, against which insured depositors have a legal claim.[75]

Converging towards a harmonised approach on recovery and resolution plans is the key issue at stake. As has been observed, 'given that the barriers to cross-border banking are likely to fall, the EU should consider what sort of banking structure would provide the best combination of an integrated financial system and a financial system in which the banks are neither too large to supervise nor too large to safely fail'.[76] This means that rules will have an impact on where banks locate operations due to cost factors and that as a result risk will likely migrate to less regulated local subsidiaries. The rules contained in the BRRD are largely flexible to allow Member States to adopt the policy measures necessary to protect the public interest, even if the Directive does not define the boundaries of 'public interest' as a condition to provide public support.[77]

Withdrawal from the EU will allow the UK to adopt domestic policy measures to rescue distressed institutions. This will leave broad discretion to national competent authorities to provide public financial support and to implement

[74]Articles 15-16 of the BRRD introduce the "assessment of resolvability" with comprehensive powers to remedy impediments to resolvability under Articles 17-18 of the BRRD and Article 10 of the SRM Regulation.
[75]See NIETO and D. WALL, 'Cross-Border Banking on the Two Sides of the Atlantic: Does it Have an Impact on Bank Crisis Management?', FRB Atlanta Working Paper No. 2015-11, 19.
[76]Ibid., 21.
[77]See MICOSSI, Ginevra Bruzzone and Miriam Cassella, 'Fine-tuning the use of bail-in to promote a stronger EU financial system', CEPS Special Report No. 136, April 2016, 16-17.

restructuring tools, namely bail-in, precautionary recapitalisation and resolving plans. Brexit can compound the risk of deregulation for restructuring troubled banks: this complicates meaningful cross-border recognition when it comes to resolution or consolidated supervision.[78] It is instructive that the European Banking Authority (EBA) has warned that 'institutions and authorities need to assess their stock and issuance plans for instruments used to meet the minimum requirement for own funds and eligible liabilities (MREL) in the light of Brexit, and in particular their reliance on instruments issued under English law'.[79] This means that EU banks in the Eurozone will not be able to utilise any of their English law bail-inable debt toward their pending regulatory requirements if no Brexit agreement is reached.[80] In addition, as the EBA has pointed out, the Deposit Guarantee Scheme (DGS) shall ensure the adequate protection of Member States 'by assessing (where relevant) the equivalence of the UK's deposit protection regime at the date of Brexit, and should consider putting in place cooperation arrangements with the UK DGS after Brexit'.[81]

In the short term, the UK regime will continue applying existing domestic legislation for bank insolvency (e.g. the Banking Act 2009 that substantially anticipated the BRRD with respect to recovery and resolution plans).[82] As Mayes claimed, 'the resolution of the UK's banks will remain the responsibility of the Bank of England and purely national concerns will come first'.[83] Specifically, in terms of investment bank insolvency rules, Section 233 of the Banking Act 2009

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[78]See CAPRIGLIONE, 'UK Referendum and Brexit Hypothesis: The Way Out Perspective and the Convenience to 'Remain United' (2016) 27(7) *European Business Law Review*, 893-895.

[79]See EBA, Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union (EBA/OP/2017/12), Part IV Resolution and deposit guarantee schemes, 12 October 2017, 16.

[80]See BIPPART, 'English-law bonds could be excluded from MREL post-Brexit', Euromoney, 24 November 2017, available at https://www.euromoney.com/article/b15rkx7999nk36/regulation-english-law-bonds-could-be-excluded-from-mrel-post-brexit.

[81]See EBA (n 79) 16. In terms of recovery and resolution plans, the EBA clarified that 'once the UK leaves the EU, arrangements for resolution planning for entities based in the UK should be subject to the same standard as for any other third country, in the absence of an agreement to the contrary'.

[82]See Part II ('Bank Insolvency') of the Banking Act 2009.

[83]See MAYES, 'Banking union: the disadvantages of opportunism' (2018) 21(2) *Journal of Economic Policy Reform*, 136-137.

provides that 'in making investment bank insolvency regulations the Treasury shall have regard to the desirability of—(a) identifying, protecting, and facilitating the return of, client assets; (b) protecting creditors' rights, (c) ensuring certainty for investment banks, creditors, clients, liquidators and administrators, (d) minimising the disruption of business and markets, and (e) maximising the efficiency and effectiveness of the financial services industry in the United Kingdom'.[84]

Over time divergences may appear and in fact new rules may be introduced to exploit new markets. As observed, 'a clear danger with adopting an early intervention model is still the timing issue, so whether a rules-based or a discretion-based approach is taken, its success will depend on its use and the timing, and not necessarily what shape it takes'.[85] However, the Banking Act 2009 faced criticism on the fact that it has the potential to cause significant interference with the rights of third parties, both by prohibiting the exercise of termination rights under a contract and, more generally, through the way that the assets and liabilities of an ailing bank are split.[86] One can argue that Brexit could determine the increase in the complexities of resolution for groups that operate in the UK and rest of the EU, particularly if rules diverge. This could lead to conflicting resolving decisions on the applicable restructuring tool for failing banks: the application of the Banking Act 2009 can create inconsistency with other jurisdictions making these divergences challenging to resolve, particularly in the post-Brexit scenario.

6. By way of conclusion it is worth reflecting on the likely future directions of UK financial regulation. The preceding analysis highlights the vital importance for UK firms of retaining alignment with EU financial legislation in order to maximise the chances of equivalence determinations. After Brexit, the UK will become a 'third country' within the current EU financial regulatory structure, which implies

[84]Section 233 ('Insolvency regulations') of the Banking Act 2009.
[85]See SINGH, 'The UK Banking Act 2009, pre-insolvency and early intervention: policy and practice' (2011) 1, *Journal of Business Law*, 42.
[86]See HEARNDEN and WHITFIELD, 'The Banking Act 2009' (2009) 3 *Corporate Rescue and Insolvency*, 96.

that future access to the EU's Single Market for UK-based financial institutions may be very limited. The uncertainty created in the aftermath of this controversial vote is likely to affect any plans among international financial institutions to expand their UK-based operations. In addition, the impact of Brexit would affect transaction costs as financial regulation can diverge from the EU legislative framework. There is little doubt that the UK will continue to comply with MiFID/MiFIR and all other market infrastructure directives and with Directives on banking and insurance prudential regulation. However, this is not to say that there will not be areas where the UK approach may diverge from EU law post-Brexit. The regulation of CRAs and bank resolution are two such areas in which, as explained in this article, possible divergence of the UK from the EU framework and lack of cooperation post-Brexit pose serious risks for regulatory effectiveness and may create additional costs for financial institutions, which are likely to be passed on to retail investors and customers.