

## British Clout Over EU Banking Rules Already Fading

By **Melissa Lipman**

*Law360, London (September 19, 2016, 7:15 PM BST)* -- The U.K.'s influence over European Union banking regulation is starting to wane after its June vote to pull out of the bloc, leaving the country's vast financial services sector without a voice on future rulemaking and a choice between compliance or exclusion from the big EU market.

The nation's historic decision to leave the EU has cast uncertainty across London's most prominent sector, which has long benefited from the ability to passport into markets across the EU from the U.K. as well as from the nation's voice in policymaking. With the official beginning of Brexit talks still months off, banks and law firms advising them can only speculate on how market access and regulation will rebalance.

"There's a broad concern that the expertise of the U.K. has been very positive to the EU's financial rulemaking in general," said Covington & Burling LLP's Carlo Kostka. "So to the extent that that's taken away by definition because the U.K. isn't sitting at the table, there's uncertainty about the future of rulemaking more broadly."

There were plenty of warning signs over the summer.

First, the U.K.'s former representative to the European Commission, Jonathan Hill, the commissioner for financial stability, financial services and capital markets, resigned within days of the June 23 EU referendum. U.K. Prime Minister David Cameron was then excluded from a June 29 EU summit meeting called to discuss a post-Brexit Europe.

Andrew Bailey, the head of the U.K.'s Financial Conduct Authority, told U.K. lawmakers in July that even though the nation's watchdogs still had a seat on the boards of EU regulatory agencies, the country had "to recognize that our ability to advance U.K. agendas has diminished materially."

The European Banking Authority, based in London since its creation in 2011, will almost certainly be moved elsewhere in the EU given the political value member nations place on housing prominent EU agencies.

"For a number of reasons, whether it's language, whether it's tradition, whether it's history, the U.K. has punched above its weight in the EU and especially in the financial services area," Kostka said. "If you're not at the table, that's going to change the dynamic. I don't think that the EU will sort of backchannel phone calls to the U.K. to ask, 'Do you think this is the right thing to do?'"

The result could be changes large and small to financial services legislation and oversight in the EU — rules that the U.K. may ultimately still have to abide by even after it leaves the bloc to secure access to the EU's single market. Banks and the U.K. government will almost certainly try to negotiate a deal that would allow British financial institutions and foreign banks using London as their European headquarters to benefit from passporting provisions that allow firms approved to operate in one EU member to skip any red tape to setting up shop in the rest of the bloc.

And even though the U.K. still has representatives in the European Parliament, including four lawmakers on the key European Parliament committee charged with overseeing financial services, they won't be able to stave off indefinitely proposals the U.K. doesn't like.

"It's inevitable that if the U.K. is not in the EU ... U.K. policymakers such as the [Prudential Regulatory Authority] will have less influence," said DLA Piper partner Michael McKee. "U.K. influence in that area is bound to wane and probably wane quite quickly within both the EBA's drafting of [regulatory technical standards] and working groups, but also more generally in the development of banking and banking supervision within the EU."

On the regulatory side, the loss of U.K. influence may see the EBA becoming more closely aligned with the ECB and eurozone countries once the largest economy outside the shared currency leaves the EU, according to McKee. While a handful of EU nations remain outside the eurozone, most are on a track to join the currency. And without the U.K., only a few fairly small economies like Denmark and Sweden have either tacit or explicit approval to maintain their own national currencies indefinitely.

"You will get a greater congruence and a greater similarity of approach [between the ECB, the EBA and the eurozone countries]," McKee said. "U.K. influence in that area is bound to wane and probably wane quite quickly within both the EBA's drafting of [regulatory technical standards] and working groups, but also more generally in the development of banking and banking supervision within the EU."

Though the U.K. has generally backed high standards for the banking industry in the past — often gaining a reputation for "gold-plating" EU rules to make them tougher — it has taken a "less bureaucratic, more practical" approach, according to Kostka.

The Brexit effects could be even more pronounced when it comes to policymaking. For example, some of the measures that the U.K. has long opposed, such as proposed rules on securitized structured finance transactions, could end up moving forward with the loss of the U.K.'s voice on policy, says Kaye Scholer LLP's Stuart Axford.

"We've seen some things going on within the EU ... suggesting some really strong measures that would have significant deleterious effects on securitized structured finance transactions and clearly historically one of the countries that fought hardest against its proposed implementation is the U.K.," Axford said. "If that voice is removed, it's easy to see there might well be more policies implemented that are adverse to the freedom and efficiency of the markets."

The EU's financial services rules won't change overnight, of course, but some movement is inevitable, attorneys say. And given that the best the U.K. can hope for is an arrangement like what Norway has now where it gets some access to the EU market by adhering to the bloc's rules, the U.K. could find itself being pulled in a direction it would not have gone on its own, Axford says.

"That potentially becomes very interesting ... because up until now [EU banking regulation] has been based on the U.K. model," Axford said. "Would that change with the U.K. no longer in the EU? It's difficult to imagine that it wouldn't."

That would "almost certainly" yield more of the kind of rules favored by other major EU nations but opposed by the U.K., like the recent caps on banker bonuses that have proved controversial in the U.K., Axford says.

Indeed, the FCA and the PRA already said in February that they would not apply EBA rules on bonus caps to smaller financial institutions covered by EU capital requirements rules.

At the same time, there is a limit to how far the U.K.'s influence over some banking standards can erode as long as it continues to participate in some of the international organizations that drive financial policymaking, like the Basel Committee on Banking Supervision.

"The U.K., even if it left the [European Economic Area], would still participate in the Basel process, which was the source of most modern banking regulations even before the financial crisis," said Kaye Scholer special counsel George Williams Jr. "So to that extent they can contribute to the gradual adaption of the focus and emphasis of the basic structure of banking regulation even without having any influence at all in the legislative process."

Likewise, the EU will need to maintain a good relationship with the U.K. That is because even if banks move some of their operations to other European cities to secure continued access to the EU's single market for financial services, London will remain an industry powerhouse, McKee says.

"It will be important in terms of the EU's relationship with the U.K. and with the banks that EU authorities are supervising for there to be continuing and strong dialogue with both the Bank of England and the PRA because even though there may be some changes, shall we say, to the geography of banks within Europe, most banks will need to have a strong London presence come what may," McKee said.

--Editing by Rebecca Flanagan and Emily Kokoll.