

Einstein's advice for Brexit negotiators: relative urgency depends on regulators as much as on politics

Blog post by Head of Europe Tom White, 19 June 2017

Much has been written at the launch of Brexit negotiations today about the time remaining for negotiators. Michel Barnier has set a deadline of October 2018 for agreeing a withdrawal treaty, which may or may not include an outline of the future UK-EU trading relationship. This is to allow ratification by the European Council, European Parliament and - where necessary - national parliaments in the EU27. The UK parliament also plans to vote on the deal before the legal deadline of 31 March 2019, and the current balance of power in Westminster makes that far from a formality.

Away from the main action in Brussels, guidance issued by the UK's Financial Conduct Authority today indicated a six month 'processing time' for one of the main regulatory requirements of asset managers and other investment firms to provide licenced services. This is for both domestic and cross-border business, but it has an important read-across to Brexit planning and indicates a considerably tighter practical deadline. Specifically, the FCA announced in its guidelines for the new Market in Financial Instruments Directive that "to be sure that we can determine an application in time for January 3, 2018, it needs to be complete by July 3, 2017". For a number of financial institutions planning to move operations inside the EU single market by April 2019, securing a MIFID II licence in their chosen new home to provide cross-border services inside the single market forms an important part of their planning. The FCA is one of the best resourced regulators in the EU28, so a six month processing time is a reasonable benchmark for this aspect of relocation plans.

In practical terms, we can therefore infer that investment firms in the broad MIFID definition need to submit applications by October 2018 in the EU27, to be certain of offering their clients continuity of service inside the EU27. Allowing a few months to prepare the necessary paperwork, this means firms will need to finalise Brexit adaptation plans before the summer break next year. However, brinkmanship on future trading terms mean any decision is unlikely before the later October deadline. This mismatch will also be true for many banks and market infrastructure providers that need to maintain or secure other licences. For example, the proposal last week from the European Commission on supervision of central counterparties suggested that continued clearing of euro-denominated securities and derivatives outside the EU27 will be subject to approval by the European Securities Markets Authority. This itself will require significant paperwork and inspections, if UK-based CCPs are not to face a forced relocation of activity to other financial centres.

Ministers and officials argue such licensing requirements will be unnecessary, as negotiations will secure many of the same benefits for the future that firms currently enjoy. They add (to some audiences) that there will also be interests on all sides in agreeing an orderly transition period. However, without some clarity on the form of future legal rights by next spring, institutions will have to plan for a more disruptive outcome, and begin the process of securing authorisations in order to reassure their clients and their investors. This in turn will require the transfer of activities and jobs to overcome suspicions among regulators that they are creating “letter box entities”. In practical terms, it means significant economic disruption could already be hardwired into firms’ planning several months before the deadlines set by politicians.

In explaining his theory of relativity, Albert Einstein once said “holding your hand on a hot stove for a minute feels like an hour, while talking to a pretty girl for an hour feels like a minute”. This comment has not aged well in its appropriateness, but it makes an important point: the hours in Brussels today may be dragging for the two negotiating teams but they are flying past for the businesses whose future they will determine.