Locke Lord LLP (UK)

Don't expect a Brexit bonfire of regulation

It is tempting for the UK to try to overhaul EU rules, but swift changes to regulation would be premature

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Once again, powerful regulatory forces are ready to shake up the rules EU financial markets operate under.

The second iteration of the EU's Markets in Financial Instruments Directive - Mifid II, implemented last January - is still bedding down, but rumbles can already be heard about Mifid III. Mifid II embraced several compromises, which has left few people happy with its impact. Mifid III would attempt to address some of these compromises.

But does any of it matter for the UK, which is set to leave the EU in a few months' time? If no financial services deal is negotiated - which seems a probable outcome since financial services are excluded from Prime Minister Theresa May's Chequers proposal - would the introduction of new rules be a boon or a disaster for the UK?

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The answer to the question is partly political and partly practical. Any regulation should be outcomes based. This is not a new concept. The Financial Services Authority, predecessor to the current UK regulator, the Financial Conduct Authority, adopted this approach to the areas of regulation over which it had control. Before the Treaty of Lisbon, the fundamental EU constitutional agreement implemented in December 2009, the UK effectively had total control over its financial services regulation. No Brexit deal for financial services would return the UK to that state of affairs.

Financial services companies would clearly benefit from the repeal of some regulation introduced since Lisbon, since they do not achieve the desired outcome (and, in some cases, achieve no beneficial outcome at all). However, in others a strong case can be made for new regulation that targets positive outcomes, and introduces a framework to realise them without creating undue burden.

In short, the UK should seek to create a balanced, outcomes-based approach that supports the sector, achieves public policy objectives and makes clear that the country is the preeminent jurisdiction for financial services companies.

Speaking at the Bloomberg Global Business Forum in New York in late September, the prime minister described an unequivocally pro-business Britain that will "deliver an economy that is knowledge rich, highly innovative, highly skilled and high quality, but with low tax and smart regulation". This is very encouraging; smarter, more intelligent regulation is outcomes based by definition.

But swift changes to regulation would be premature. At a recent roundtable Locke Lord hosted, representatives of City financial services and government felt that a probable near-term Brexit outcome was recognition of a form of equivalence. While, ultimately, the participants favoured a return to the old regime of mutual recognition, equivalence has been favoured since the financial crisis (particularly by the US).

Concluding co-operation agreements is an important precursor to establishing any equivalence regime, and should have initial priority. Once implemented, maintaining equivalence will be the goal, but maintenance is not conducive to significant regulatory change. The temptation to implement post-Brexit revisions to Mifid II could crash equivalence on to the rocks.

That said, there is a very real possibility that the EU27 will introduce further regulations that are not compatible with an Anglo-American style of financial services, which could derail equivalence.

Ultimately, for those that carry out activities outside the EU, changes may be on the horizon. But UK financial services companies that operate in the EU are likely to continue to see EU regulation lead UK regulatory initiatives in the post-Brexit environment, and not the bonfire of regulation that some may desire.

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