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# Brexit Fallout Hits EU Financial Regulation Drive

By **Mark Taylor**

*Law360, London (June 27, 2016, 1:51 PM ET)* -- The British vote to leave the European Union last week has already disrupted Europe's push to finalize new financial regulations as policy makers in the U.K. and the EU struggled Monday to agree on the timing of negotiations on the U.K.'s departure.

The EU Commission's' top financial services regulator, Jonathan Hill, resigned over the weekend, saying his British nationality prevented him from staying on. Then EU officials on Monday confirmed plans to transfer the European Banking Authority, which drafts and enforcing banking rules across the EU, out of London to another EU country.

The two steps marked the early beginnings of the U.K.'s pull out of Europe's common regulatory framework. The EBA's presence in London is largely symbolic. But Hill's departure cost the EU its principal driver for a common rulebook for European banking and capital markets, and British banks lost their place at the European financial policy table.

"The new EU balance of power will affect traditionally strong areas for the U.K., including financial services and sanctions," said Miriam Gonzalez, trade law policy partner in Dechert LLP's London office. "The decision is irreversible, and businesses must deal quickly with risks and priorities."

U.K. treasury chief George Osborne on Monday tried to reassure investors, promising at an early morning news conference that the government would work to get the best exit deal with the EU.

The assurance didn't stop U.K. bank stocks from extending their declines in later trading amid concerns that post-exit arrangement with the EU could fail to preserve their freedom to do business with the 27 remaining countries in the bloc.

The next blow could come on Tuesday, when European governments meeting in an emergency session are expected to demand that Prime Minister David Cameron immediately begin the process of withdrawing from the bloc by invoking Article 50 of the EU Treaty. Cameron said when announcing his plans to resign in October he would let his successor initiate official exit talks, repeating the message to politicians throughout Monday's session in Parliament.

Cameron also announced Monday that his cabinet has adopted the outcome of the Brexit vote and will form a special EU Unit that will pool staff and resources from key departments to prepare the way for leaving the EU.

But that's not fast enough for other governments. The European Parliament on Tuesday will vote on a resolution to pressure the U.K. into beginning talks immediately. The resolution also is a reminder that the European Parliament has power to veto any new deal between the U.K. and EU.

"The consent of the European Parliament is required under the treaties. The European Parliament must be fully involved at all stages of the various procedures concerning the withdrawal agreement and any future relationship," the draft resolution said.

Although a minimum two-year negotiation period will begin to determine the future relationship between the U.K and the EU, London risks losing its status as a central hub by which financials can become regulated and freely passport services to the single market's 500 million inhabitants unless it finds a compromise with the EU.

Simon Gleeson, regulatory partner at Clifford Chance LLP, said banks would be under pressure from clients to demonstrate they are restructuring in order to continue to be able to provide services.

"That probably doesn't allow them to maintain a wait-and-see posture for any extended period," Gleeson said. "Thus we expect banks to execute restructuring a fairly soon based on 'worst case' analysis of the possible outcomes of the exit negotiations."

Gleeson said "there is no prospect of UK banks maintaining a passport unless the U.K. agrees to, among other things, freedom of movement and full adoption of all present and forthcoming EU laws." He said this is exactly the discussion which has been being played out with Switzerland, which has gone on for decades.

Passporting is central to the Markets in Financial Instruments Directive, a crucial piece of European law allowing banks and investment firms to conduct investment business across the EU.

"A plausible outcome of Brexit would be that U.K.-based firms lose their MiFID passports and therefore cannot deal with EU-based clients (at least in the short term, as it is unlikely the U.K. would receive a MiFID equivalence assessment in time)," said Rob Moulton, partner in financial services regulatory at London office of law firm Ashurst LLP.

"To continue to do business, they would need to set up an EU subsidiary and transfer the EU business and staff to that EU location. They would need to start this process shortly after the referendum, and long before the outcome of the exit negotiations became clear."

A worst-case scenario, according to the Ashurst team, is banks exiting Britain entirely, and the uncertain future has set back confidence in London as a financial center. Many major banks have announced plans to transfer some operations to countries remaining in the EU as bank share prices fell almost across the board. Shares in Barclays PLC and The Royal Bank of Scotland Group PLC were suspended from trading on the London Stock Exchange on Monday after steep declines.

The city will also lose the European Banking Authority, which moved into London in December 2014 and now set to be relocated "sooner rather than later", according to a spokeswoman for the regulator. Frankfurt and Paris, two heavyweight financial centers, jostle to become the new location for the Bloc's banking watchdog.

In an effort to restore calm, Britain's top financial watchdog the Financial Conduct Authority stressed

Friday that the referendum result had “significant implications” for the U.K., but that there would be no immediate upheaval to current directives.

“Much financial regulation currently applicable in the U.K. derives from EU legislation,” it said. “This regulation will remain applicable until any changes are made, which will be a matter for government and parliament.”

Firms must continue with their regulatory obligations under U.K. law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect.

EU legislators are pushing new capital rules aimed at reviving securitization, or the process where a lender bundles a set of loans, such as mortgages, auto leases and credit card loans, and converts them into investable securities. Securitization suffered a tarnished reputation after abuses during the financial crisis, but advocates say it can play a constructive role in diversifying business funding sources if regulated properly.

Confusion already abounds the banking regulatory space as waves of incoming EU rules, some delayed, others incredibly complex, are causing headaches on bank compliance desks. Research by released by Linklaters LLP last week showed just 5 percent of listed companies felt ready for the incoming EU Market Abuse Regulation, which kicks in July 3, relating to disclosure of inside information.

The EU officially delayed the start date of MiFID II by a year following concerns no-one, including regulators themselves, would be ready to cope with the demands. Hill's successor will also be charged with picking up the European Deposit Insurance Scheme rules, first put forward by the commission in November last year but not yet approved.

The EU launched a wide-ranging review into the whole financial services regulatory framework in September last year, driven by Hill's desire to see the amount of incoming regulation slow and growth boost as a result. Without him at the helm it remains to be seen how this review will pan out, say regulatory experts

“At the beginning of this commission's mandate, I wanted the British commissioner to be in charge of financial services, as a sign of my confidence in the United Kingdom’s membership of the European Union. To my great regret, this situation is now changing,” said European Commission President Jean-Claude Juncker, who said he tried to convince Hill to stay on.

Hill is to be replaced by Valdis Dombrovskis, a former prime minister of Latvia. EU officials close to the matter said the plan is to press ahead.

“There has been very wide support for the project, and we are committed to continue working on it, like any other project under this portfolio,” one official said. “A single capital market for the EU is a shared objective for all Member States, the European Parliament and stakeholders all across the EU.”

It isn’t clear how much of future EU regulation will still find its way into British law as the country renegotiates its legal relationship with the EU in areas ranging from trade and patents to finance and freedom of movement.

Former Prime Minister Tony Blair, speaking to the BBC on Sunday, predicted Britain’s severing legal and financial links with the EU will become “an agonizing and complicated process.”

--Additional reporting by Tom Zanki and Alex Davis. Editing by Rebecca Flanagan.

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