X. Brexit: Passport Rights & Equivalence

A. Introduction

On June 23, 2016, the United Kingdom (the UK) held a referendum vote[1] to exit European Union (the EU). This vote, known colloquially as Brexit, leaves uncertain implications for the UK's access to the European Single Market.[2] Based on Article 50 of the Lisbon Treaty, the UK could exit the EU if the UK notifies the European Council of its intention to withdraw.[3] On March 29, 2017, Prime Minister Theresa May sent the UK's letter of intention to the European Council.[4] Due to procedural requirements in the Lisbon Treaty, the UK and EU must negotiate the terms of their future relations by April 2019.[5] The UK and EU have thus far negotiated on the status of British expats, financial and budgetary liabilities, and EU citizen's rights within the UK.[6] While the EU and UK have discussed

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[1] *See generally EU Referendum: Results*, BBC NEWS, http://www.bbc.com/news/politics/eu_referendum/results [https://perma.cc/DX6C-32E2] (last visited Nov. 18, 2017) (listing the referendum results in full).

[2] *See generally* Alex Hunt & Brian Wheeler, *Brexit: All You Need to Know About the UK Leaving the EU*, BBC NEWS (Dec. 12, 2016), http://www.rexsresources.com/uploads/6/5/2/1/6521405/brexit__all_you_need_to_know_about_the_uk_leaving_the_eu_-_bbc_news.pdf [http://perma.cc/56KS-XSMP] ("A referendum . . . was held on Thursday 23 June, 2016, to decide whether the U.K. should leave or remain in the European Union. Leave won by 51.9% to 48.1%.").

[3] *See* Michael Wilkinson, *What is Article 50? The Only Explanation You Need to Read*, THE TELEGRAPH (Mar. 31, 2017), http://www.telegraph.co.uk/news/0/what-is-article-50-the-only-explanation-you-need-to-read/ [http://perma.cc/F8TV-TWUY] ("[T]he referendum in which British voters opted to leave the bloc does not automatically signal the country's exit. . . . Article 50 of the Treaty of Lisbon gives any member the right to quit unilaterally, and outlines the procedure for doing so.").

[4] *Id.* ("Prime Minister Theresa May triggered Article 50 shortly before 12:30 pm on March 29, 2017.").

[5] *See id.*

[6] Silvia Amaro & Willem Marx, *It's Time to 'Really Start Negotiating,' Says European Parliament Chief for Brexit*, CNBC (Aug. 30, 2017), https://www.cnbc.com/2017/08/30/its-time-to-really-start-negotiating-says-european-parliament-chief-for-brexit.html [http://perma.cc/7RJ5-FYCQ] ("The EU wants to agree first on the U.K.'s financial and budgetary liabilities . . . as well as finding a mutually agreeable resolution to the issue of

market access and free trade agreements, the form Brexit will take remains uncertain. The form of Brexit will impact UK banking strategies for EU clients.[7]

This article seeks to describe and explain the impact Brexit negotiations have had on banking since the referendum vote. Section B provides a brief overview of recent banking activity in the UK and EU. Section C discusses the different forms Brexit may take by the April 2019 deadline. Section D highlights the impact each Brexit form may have after the UK's exit from the EU. Finally, Section E discusses the EU's concerns as banks and national competent authorities prepare for Brexit.

B. Background

Many banks that use their UK offices to support EU clients (UK-based banks) have announced plans to relocate across the EU.[8] Such banks may require $50 billion in additional capital to expand their operations in the EU.[9] Further, approximately 40,000 jobs will relocate from the UK to EU member countries.[10] Such relocations may have a negative impact on the UK, as 22 percent of London's GDP

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the Irish border, and some concrete confirmation of the future rights for EU citizens' living in the U.K.").

[7] Silvia Amaro, *Bank Jobs Are Bleeding Out of London—and Brexit Hasn't Even Kicked in Yet*, CNBC (Aug. 29, 2017), https://www.cnbc.com/2017/08/29/bank-jobs-are-bleeding-out-of-london--and-brexit-hasnt-even-kicked-in-yet.html [http://perma.cc/6YW7-GZLT] ("The financial services industry has been quietly preparing for Brexit given that it's likely to lose its EU passporting rights . . . .").

[8] *See* Jill Treanor, *ECB Critices Banks' Relocation Plans After Brexit*, THE GUARDIAN (Nov. 16, 2017), theguardian.com/business/2017/nov/15/ecb-criticises-banks-relocation-plans-brexit-euro-area [http://perma.cc/LCZ5-PDWL] (stating banks use the UK "as their gateway to the EU"); *see generally* Gavin Finch et al., *Frankfurt is the Big Winner in Battle for Brexit Bankers*, BLOOMBERG (Sept. 28, 2017), https://www.bloomberg.com/graphics/2017-brexit-bankers/ [http://perma.cc/H8LD-WT3Y] (listing number of jobs moving from different banks in the UK to cities in the EU).

[9] Ben Moshinsky, *A Brexit Exodus May Cost London 40,000 Investment Banking Jobs*, BUS. INSIDER (Aug. 1, 2017), http://www.businessinsider.com/oliver-wyman-banks-capital-hole-after-brexit-2017-8.

[10] *Id.* ("International lenders may need to shift as many as 40,000 investment banking jobs to the European Union to maintain activities on the continent after Brexit . . . .").

relies on the financial services industry.[11] Observers believe banking operations in the EU will duplicate financial services currently offered in the UK.[12] As a result, these observers believe the industry will incur an additional $1 billion in operation costs.[13]

Goldman Sachs, Morgan Stanley, Citigroup Inc., Standard Chartered Plc, Nomura Holdings Inc., and other banks may relocate to Frankfurt.[14] Some observers believe that UK-based banks favor Frankfurt due to: (1) Germany's national regulatory agency, Bafin, and its fluency in English, (2) Frankfurt's economic success and geographic proximity to many EU clients, and (3) Germany's GDP share in the EU.[15] Other banks like Bank of America and Merrill Lynch may relocate to existing infrastructure and licensed operations in Dublin.[16] Dublin offers better tax advantages, such as a low corporate tax rate of 12.7 percent and a special assignee program that exempts 30 percent of tax for individuals earning over €75,000.[17] However, wholesale banks already maintain a presence in both Paris

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[11] *See* Karen Gilchrist, *Britain Could Lose 40,000 Investment Banking Jobs in Brexit Exodus*, CNBC (Aug. 1, 2017), www.cnbc.com/2017/08/01/britain-could-lose-40000-investment-banking-jobs-in-brexit-exodus.html [http://perma.cc/LMC5-7BV9] ("The financial services industry is one of the largest contributors to U.K. gross domestic product (GDP), accounting for 22% of London's GDP alone.").

[12] Matt Austen et al., *One Year on From the Brexit Vote*, OLIVER WYMAN, http://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2017/aug/OW-Wholesale-Banking-Brexit-Briefing.pdf [https://perma.cc/M3JJ-SG2J] (last visited Sept. 23, 2017) (indicating UK banks will likely duplicate risk, compliance, and finance operations in their EU subsidiaries).

[13] *Id.* ("We estimate that such changes could add 2–4 percent to the annual cost base, equivalent to around USD 1 billion across the industry.").

[14] Finch et al., *supra* note 8 (listing UK banks moving jobs to EU countries).

[15] Johanna Trick, *Frankfurt Touts Expertise, Not Pomp, in Battle for Brexiting Banks*, POLITICO (July 23, 2017), http://www.politico.eu/article/brexit-banks-frankfurt-touts-expertise-not-pomp-in-battle/ [http://perma.cc/D5PK-WKPY] (mentioning benefits investment bankers see in relocating).

[16] Amaro, *supra* note 7 ("'We already have a fully licensed and operation Irish-domiciled bank . . . .'").

[17] *See* Henry McDonald, *Irish Tax Break Scheme 'Will Attract Top Talent From Britain After Brexit,'* (Oct. 9, 2017), www.theguardian.com/world/2017/oct/09/irish-tax-break-scheme-will-attract-top-talent-from-britain-after-brexit [http://perma.cc/S7TN-6F4D].

and Amsterdam.[18] France has attempted to persuade UK-based banks to relocate to Paris by passing new tax legislation that would eliminate the top bracket of a payroll tax.[19] Germany currently provides a lower corporate tax rate—29.7 percent—compared to that of France.[20] Further, government officials in Frankfurt have announced plans to loosen labor laws for financial service workers.[21] Such reforms would make it easier for investment banks to lay off its employees.[22]

C. Brexit

The future of banking in the UK will depend on the form of Brexit and the resulting availability of passport and equivalence regimes.[23] Specifically, UK-based banks must decide whether to establish a physical presence in at least one EU member country or retain their UK presence to provide EU clients banking services.[24] The UK's exit from the EU could take one of two forms: a soft Brexit or hard Brexit.[25] Under a soft Brexit, the UK would leave the EU and

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[18] *Id.* ("Paris and Amsterdam are considered attractive and convenient locations and are already home to several major wholesale banks.")
[19] *See* Trick, *supra* note 15.
[20] *Id.* ("But for now, corporate taxes are lower in Germany (29.7 percent) than in France (33.3 percent), although above that of Ireland (21.5 percent).").
[21] *See* Will Martin, *Frankfurt is Upping the Stakes in the Battle for Brexit Banking Jobs*, BUS. INSIDER (July 3, 2017), http://www.businessinsider.com/frankfurt-to-exempt-risk-taking-bankers-from-certain-labour-laws-2017-7 [http://perma.cc/4RXY-5NZD] (explaining that Frankfurt announced plans to impose a low, upper salary limit on employee protections of 150,000 Euros).
[22] *Id.*
[23] *See* Amaro, *supra* note 7 ("The financial services industry has been quietly preparing for Brexit given that it's likely to lose its EU passporting rights . . . .").
[24] *See Brexit: Passporting, Third-Country Status and Equivalence*, THOMSON REUTERS: PRACTICAL LAW, https://uk.practicallaw.thomsonreuters.com/w-003-1244?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1&OWSessionId=7b71ebf49b9a44f9947f0e699d8c45ae&skipAnonymous=true (last visited Oct. 1, 2017) ("A U.K. financial institution could establish a separate group company (the EU company) in an EU member state and obtain appropriate authorization to carry out relevant financial services from the local regulator. The EU company could then use passport rights to provide cross-border services . . . .").
[25] *See* Reis Smith, *What is a Hard Brexit and Soft Brexit? Will Theresa May Change Her Strategy on EU Exit?*, SUNDAY EXPRESS (June 13, 2017),

retain access to the European Single Market.[26] Banks and other financial firms would retain passport rights,[27] which enables any EU member based-bank to offer cross border services to another EU member country without requiring a branch in that EU member country.[28] As a member of the EU, any UK-based bank may operate and provide defined services in another EU member country based on passport rights.[29]

Under a hard Brexit, the UK would exit both the EU and the European Single Market.[30] As a result, the UK would receive a "third country" status.[31] If the EU and UK do not reach an agreement by the end of negotiations, the EU may no longer bind the UK to any existing EU treaties.[32] More importantly, UK-based banks will not receive passport rights.[33] In other words, a UK-based bank may need to

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http://www.express.co.uk/news/politics/816451/hard-brexit-soft-brexit-meaning-difference-theresa-may-change-strategy-eu [http://perma.cc/3VKW-7XQF] (explaining the different forms of Brexit).

[26] *Id.* ("Most definitions of a soft Brexit envision the UK retaining single market membership and access to the EU customs union.").

[27] *Id.* ("It would also enabling financial firms to keep their 'passporting' rights to sell services in the EU.").

[28] *See* Ben Moshinsky, *Article 50 Will Be Triggered Today—This is What Brexit Means for London's Financial Centre*, BUS. INSIDER (Mar. 29, 2017), http://www.businessinsider.com/article-50-brexit-financial-passporting-and-banks-city-explainer-2017-3 [http://perma.cc/PU7F-BCFL] ("It is an agreement that allows banks with a base in the UK to access customers and financial markets in the (currently) 28-nation EU trading bloc.").

[29] *Id*.

[30] Smith, *supra* note 25 ("In contrast, a hard Brexit would pull the UK out of the single market in order to regain control over Britain's borders and reduce immigration.").

[31] *See* Jonathan Ford, *UK Must Accept Its Post-Brexit Status as a Third Country*, FIN. TIMES (July 16, 2017), https://www.ft.com/content/3f88d134-6a20-11e7-bfeb-33fe0c5b7eaa?mhq5j=e5 ("For all its geographical propinquity, it will be a "third country" just the same.").

[32] Alex Barker & Chris Giles, *Hard or Soft Brexit? The Six Scenarios for Britain*, FIN. TIMES (June 23, 2017), https://www.ft.com/content/52fb4998-573f-11e7-9fed-c19e2700005f ("The UK would no longer be bound by the EU treaties and there would be nothing to replace the thousands of international agreements that stem from them.").

[33] *Brexit Quick Brief #3: What is 'Passporting' and Why Does it Matter?*, BBA, www.bba.org.uk/wp-content/uploads/2016/12/webversion-BQB-3-1.pdf [https://perma.cc/R394-5YHP] (last visited Sept. 23, 2017) ("These passports are not available to . . . firms incorporated outside the EU.").

establish a physical presence within the EU depending on the rationale.[34]

To operate in the European Single Market after a hard Brexit, UK-based banks may need to apply for licenses in each individual EU member country or rely on the principle of equivalence.[35] Equivalence enables third country banks to offer cross border services without establishing a physical presence in the EU member country, depending on the member country's approval.[36] A third country bank may receive limited access in an individual EU member country if the third country bank's jurisdiction has similar regulatory standards to that of the EU member country.[37] The EU may deem regulatory standards similar if each country's regulatory standards bear the same intent and outcome.[38] By relying on equivalence, a UK-based bank's rights will vary depending on services such banks offer.[39]

D. Impact on UK-Based Financial Services

1. Investments

The Markets in Financial Instruments Directive (MiFID) regulates investment services in the EU.[40] MiFID provides a regulatory

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[34] *See generally id.*

[35] Jonathan Ford, *Financial Future After Brexit: Passporting v. Equivalence*, FIN. TIMES (Jan. 12, 2017), https://www.ft.com/content/61221dd4-d8c4-11e6-944b-e7eb37a6aa8e (mentioning alternative options for non-EEA states to conduct banking services in the EU based on availability).

[36] *Id.* ("Equivalence is a legal concept that has emerged over the past 30 years to facilitate cross border trading between markets that choose to recognize one another's standards.")

[37] *Brexit Quick Brief #4: What is 'Equivalence' and How Does It Work?*, BBA, https://www.bba.org.uk/wp-content/uploads/2016/12/webversion-BQB-4-1.pdf (last visited Oct. 1, 2017) ("When assessing the operational rights or treatment of foreign banks in the EU[,] the EU assesses whether the standards of regulation and supervision in a bank's home market are 'equivalent' to those of the EU.").

[38] *See id.* at 4 ("It is not based on a direct or exact transposition of EU laws into another country's rulebook but a close comparison of the intent and outcomes of the EU system and that of the other country.").

[39] *See* Ford, *supra* note 35 ("Some but not all EU financial legislation accepts the principle of equivalence. There is, for instance, no such provision for commercial banking or primary insurance.").

[40] *Investment Services and Regulated—Markets in Financial Instruments Directive (MiFID),* EUROPEAN COMMISSION, https://ec.europa.eu/info/

regime for investment banks and other investment services firms in the EU.[41] MiFID imposes on investment banks certain obligations relating to equity market transparency, business conduct, and organization.[42] In 2014, the European Parliament adopted a modified version of MiFID known as MiFID II.[43] Under this new piece of legislation, the European Securities and Markets Authority (ESMA) possesses the authority to draft and implement regulatory technical standards across the EU.[44] Although ESMA has exercised these powers, ESMA will not enforce MiFID II until January 2018.[45]

MiFID and MiFID II differ in their stance on passport rights and equivalence. Under MiFID, authorized investment firms from any EU member country could carry on investment services in another EU member country.[46] However, MiFID does not allow third country firms to exercise passport rights or offer cross border investment

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business-economy-euro/banking-and-finance/financial-markets/securities-markets/investment-services-and-regulated-markets-markets-financial-instruments-directive-mifid_en [http://perma.cc/QEG6-V3EE] (last visited Oct. 22, 2017) ("In force since November 2007, [MiFID] is a cornerstone of the EU's regulation of financial markets. It governs provision of investment services in financial instruments by banks and investment firms . . . .").

[41] *MiFID: Overview and Summary of Key Requirements*, JPMORGAN, https://www.jpmorgan.com/jpmpdf/1158459698031.pdf (last visited Sept. 23, 2017) ("MiFID is a comprehensive regulatory regime which will affect how firms carrying on investment business and ancillary activities will organize their international systems and control and how they will conduct business with their customers across Europe.").

[42] *See generally id.*

[43] *MIFID (II) and MIFIR*, ESMA, https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir [http://perma.cc/7PQ3-UYJN] (last visited Sept. 23, 2017) (summarizing the timeline of MiFID II drafting and implementation).

[44] *Id.* ("MiFID II and MiFIR empower ESMA to develop numerous draft regulatory technical standards (RTS) and draft implementing technical standards (ITS) . . . .").

[45] Paige Long, *Don't Expect Leeway on MiFID II Deadline, ESMA Warns Firms*, LAW360 (Sept. 20, 2017), https://www.law360.com/articles/965832/don-t-expect-leeway-on-mifid-ii-deadline-esma-warns-firms ("But the scale of the changes to the original 2007 directive . . . overwhelmed firms and even regulators, resulting in a postponement of the introduction by 12 months to January 2018.").

[46] *Brexit: Passporting, Third-Country Status and Equivalence*, *supra* note 24 (listing which financial institutions are entitled to passport rights to the EU under their respective governing directives).

services across the EU.[47] MiFID permits third country investment firm branches to operate only in EU member countries where they are located.[48] Therefore, third country investment firms require direct authorization from EU member countries to conduct business.[49] Per Articles 46 and 47 of MiFIR under MiFID II, third country investment firms may retain access to the European Single Market by relying on equivalence.[50] To receive equivalence under MiFID II, a third country investment firm must request approval from the ESMA. [51] Moreover, the third country must submit any disputes to a court or arbitral tribunal in the EU.[52]

Investment firm rights under MiFID II also vary depending on the firm's targeted audience.[53] A third country investment bank may provide cross-border investment services to professional clients if: (1) ESMA has deemed regulatory standards between the country the bank

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[47] *Id.* ("MiFID does not contain any mechanisms allowing passport rights to investment firms located in third countries.").

[48] *Passporting Under MiFID*, THOMSON REUTERS: PRACTICAL LAW, uk.practicallaw.thomsonreuters.com/7-214-7011?originationContext=document&transitionType=DocumentItem&contextData=(sc.Default) (last visited Sept. 23, 2017) ("Recital 28 of MiFID emphasizes that branches of non-EEA firms do not benefit from the freedom to provide services or the right to provide services under the Treaty for the Functioning of the European Union (TFEU) other than those member states in which they are established.").

[49] *Id.* ("These firms may need to obtain direct authorisation from the relevant EEA member states that they want to carry on business in.").

[50] *See Brexit: Passporting, Third-Country Status and Equivalence*, *supra* note 24 ("Firms will not be eligible for registration unless (among other things) the Commission has determined that the relevant third country has rules that are equivalent to key EU regulations and has an effective equivalent system for recognition of investment firms authorized under third-country laws[.]").

[51] *See MiFID II: Regulation of Third-Country Firms,* THOMSON REUTERS, https://uk.practicallaw.thomsonreuters.com/5-616-5054?originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)&comp=pluk (last visited Oct. 1, 2017) ("The third-country firm must also offer to submit any disputes relating to its provision of services or performance of activities under Article 46 to the jurisdiction of a court or arbitral tribunal in the EU.").

[52] *Id.*

[53] *See generally* Freshfields Brukhaus Deringer LLP, *The Legal Impact of Brexit on the UK-Based Financial Services Sector*, THE CITY UK (May 2017), https://www.thecityuk.com/assets/2017/Reports-PDF/The-legal-impact-of-Brexit-on-the-UK-based-financial-services-sector.pdf.

is based in and the EU member country equivalent, (2) the EU has authorized the firm's head office to provide investment services in the EU, (3) the firm's head office is subject to supervision and enforcement, and (4) ESMA and the national competent authority overseeing the third country firm's base cooperate.[54] Per Article 47(3) of MiFIR, a non-EU based bank complying with these standards is not required to establish branches in foreign states.[55] However, equivalence does not allow third country banks to provide cross-border investment services to retail clients.[56] Such investment banks can offer services within the local EU member country if they comply with that jurisdiction's regulatory standards.[57] Third country banks must establish branches in each EU member country in which the banks seek to operate and conform to MiFID II-specific requirements.[58]

2. *Impact on UK-Based Investment Services Firms*

Some observers believe that MiFID II will require UK-based banks to establish a branch or subsidiary in the EU to deal with professional or retail clients.[59] As stated above, the deadline for implementing MiFID II is approaching sooner than the UK's scheduled exit from the EU.[60] The UK and EU are still negotiating future financial market access, which has caused banks to operate

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[54] *Id*. at 8 (listing criteria for equivalence under MiFID II).
[55] *See Brexit: Passporting, Third-Country Status and Equivalence*, *supra* note 24.
[56] *See* Freshfields, *supra* note 53, at 9 ("An equivalence determination would not however permit a third-country firm to provide services on a cross-border basis to retail clients or elective professional clients based in the EU.").
[57] *See id.* ("Instead, the ability to provide services to these categories of client would depend on member state local law . . . .").
[58] *See generally, MiFID II: Time to Take Action*, ERNST & YOUNG, http://www.ey.com/Publication/vwLUAssets/EY-time-to-take-action-on-mifid-II/$FILE/EY-time-to-take-action-on-mifid-II.pdf (last visited Sept. 23, 2017).
[59] *See Brexit: Passporting, Third-Country Status and Equivalence*, *supra* note 24 ("The effect of these provisions is that, while a passport may be available to a third-country investment firm dealing with sophisticated (typically wholesale) clients, it may be required to establish a branch or a subsidiary in the EU if it wishes to deal with retail clients or elective professional clients.").
[60] Long, *supra* note 45.

under the assumption that there will be a hard Brexit.[61] Prime Minister Theresa May recently announced that the UK will not have single market access, which makes a hard Brexit appear more likely.[62] Without passport rights, UK-based banks may need to rely on equivalence if they seek to provide investment services in the EU without establishing physical presence in the EU. However, the EU has not deemed a single country's regulatory standards equivalent.[63] Lead negotiators for the EU recently stated, "[I]f Britain maintained the same regulatory framework for financial services as the EU in the long term—without having any influence over its composition—this would erode any competitive advantage the U.K.-based industry would gain from being outside the bloc."[64]

UK-based banks may not want to rely on equivalence because EU member countries can deny a third country bank's services and force UK-based banks to accept alternative terms.[65] Further, UK-based banks would retain only restricted market access rights if they rely on equivalence.[66] While MiFID II will require UK-based banks to retain

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[61] Phillip Stafford, *Mifid Vies With Brexit as City Traders' Main Problem*, FIN. TIMES (Aug. 10, 2017), https://www.ft.com/content/f18bd4a4-7b4a-11e7-ab01-a13271d1ee9c?mhq5j=e5 ("Most City institutions are continuing to work on the worst-case scenario that the UK leaves the EU in March 2019 without a deal, or transitional arrangements that some UK ministers had talked about.").

[62] *See* Theresa May, Prime Minister, U.K., The Government's Negotiating Objectives for Exiting the EU (Jan. 17, 2017) (transcript available at https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech) [http://perma.cc/W7DL-G7UC] ("But I want to be clear. What I am proposing cannot mean membership of the single market.").

[63] Stafford, *supra* note 61 ("In the meantime the EU's equivalence regime for Mifid II is new—no country has been yet judged equivalent—and the UK's departure represents a unique event.").

[64] Sarah Gordon et al., *UK to Diverge From EU on Financial Services Rules After Brexit*, FIN. TIMES (Sept. 21, 2017), https://www.ft.com/content/582ca822-9e06-11e7-8cd4-932067fbf946.

[65] *See* Ford, *supra* note 35 (mentioning how the absence of an agreed definition of equivalence "[L]eaves open the possibility of the EU forcing the UK to implement rules it does not like, in order to remain equivalent").

[66] *Id.* ("Some but not all EU financial legislation accepts the principle of equivalence . . . . Some argue these gaps would need to be filled for the mechanism to be a credible option for the UK."); *Brexit Quick Brief #3: What is 'Passporting' and Why Does it Matter?*, *supra* note 33 ("The EU market access rights available under equivalence assessments are narrower, more

more minimum capital on hand, independent EU member countries may provide exemptions to locally based institutions.[67] Finally, the UK intends to adopt a different regulatory framework, making an equivalence determination by an EU member country less likely.[68]

3. *Other Services*

The Capital Requirements Directive IV (CRD IV) covers other banking functions in the EU, such as deposit-taking and lending.[69] Under CRD IV, third country banks may not rely on equivalence to offer cross border services.[70] However, third country banks may create branches and operate with limited rights in an EU member country subject to the member country's approval.[71]

However, third country banks can expect different obligations under the recently drafted Capital Requirements Directive V (CRD

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onerous and more unstable, and many banking services or other financial services cannot be provided at all via equivalence.").

[67] *See* Stafford, *supra* note 61 ("Tougher capital rules for Mifid investment firms across the EU next year will force institutions to hold more capital on their balance sheets to guard against systemic risk that could spark a financial crisis… But under Mifid, national regulators can grant exemptions for locally-registered investment firms.").

[68] *See* Gordon et al., *supra* note 64.

[69] *Brexit Quick Brief #4: What is 'Equivalence' and How Does It Work?*, *supra* note 37 ("CRD IV applies to core bank services such as lending and deposit taking.").

[70] *Id*. ("While the EU recognizes third countries as equivalent with CRD IV for certain reasons, this confers no market access rights to non-EU banks."); Practical Law Financial Series, *supra* note 22 ("The CRD IV Directive does not contain any mechanisms allowing passporting rights to credit institutions located in third countries. Recital 23 of the CRD IV Directive states that a branch of a third-country credit institution should not benefit from any passporting rights . . . .").

[71] ISSUES OF LEGAL UNCERTAINTY ARISING IN THE CONTEXT OF WITHDRAWAL OF THE U.K. FROM THE E.U.—THE PROVISION AND APPLICATION OF THIRD COUNTRY REGIMES IN E.U. LEGISLATION, FIN. MKTS. LAW COMM. (July 2017), http://www.fmlc.org/uploads/2/6/5/8/26584807/fmlc_paper_on_brexit_and_third_country_regimes.pdf ("Article 47 of the Capital Requirements Directive, however, recognises that a Member State can, at its discretion, permit Third Country banks to establish branches in its territory . . . .").

V).[72] Under Article 21b of CRD V, third country banks must create an EU investment holding company if such third country banks have entities in the EU with €30 billion or have a non-EU global systematically important institution designation.[73]

4. *Impact on Other UK Firms*

Some observers believe that the requirement for third country firms to set up EU investment holding companies is similar to U.S. and Federal Reserve requirements for foreign banking organizations under Article 21b.[74] Due to this obligation to create a U.S. investment holding company, foreign banks reduced their assets to avoid a Foreign Bank Organization status.[75] These observers believe it would be more efficient for banks to establish its main banking presence in the EU and create a UK authorized branch if UK-based banks wish to operate in the UK.[76] By establishing a main banking presence in the EU, UK-based banks may avoid coordinating with EU regulatory authorities to disclose their total value of assets to the European Banking Authority (EBA).[77] Further, banks may only have one EU

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[72] *See generally* Thomas Reid, *The Law and Brexit IX: The Cliff Edge and New Proposals for EU Intermediate Holding Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Dec. 15, 2016), https://corpgov.law.harvard.edu/2016/12/15/the-law-and-brexit-ix-the-cliff-edge-and-new-proposals-for-eu-intermediate-holding-companies/ [http://perma.cc/LY49-4G48].

[73] *Id.* ("The requirement to establish an EU [investment holding company] would apply only to third-country groups (i) that are identified as non-EU global systematically important institutions . . . or (ii) that have entities in the EU with total assets of at least EUR 30 billion").

[74] *Id.* ("No mention is made of the roughly analogous U.S. requirements for IHCs . . . .").

[75] *Id.*

[76] *Id.* ("Rather than use EU branches of a UK bank to run a European business, these proposals mean that it may be more efficient from a capital perspective for an international bank to establish its main banking presence in the EU and then run the UK business through a UK-authorized branch . . . .").

[77] *See id.* ("[R]egulators in the EU member states would be under an obligation to notify the EBA of total assets and liabilities of third-country group authorized branches in their territory.").

investment holding company.[78] More importantly, UK-based banks would not require additional capital to create a new entity in the EU.[79]

E. EU's Concerns

With much of future banking in the UK depending on equivalence, ESMA provided EU member national regulators nine general principles to support supervisory convergence.[80] European Commissioner for Financial Stability, Financial Services and Capital Markets Union Valdis Dombrovskis emphasized relying on equivalence is not a general solution.[81] In Dombrovskis' opinion, equivalence does not grant a "blank check whereby the EU will give up control over key systemic risks to its financial stability."[82] ESMA fears banks will attempt to set up shell companies in the EU and continually rely on their UK offices in an effort to gain access to the European Single Market.[83] In other words, third country banks will keep their central decision-making process in the UK while escaping

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[78] *Id.* ("[M]ultiple EU IHCs would not be permitted: Article 21b provides that there must be a single IHC for all EU banking institutions that are part of the same third-country group.").

[79] *Id.* ("The proposal for an EU IHC could force UK-based credit institutions and investment firms wanting to continue to operate in the EU to establish a separate pool of capital in the EU after Brexit.").

[80] *Opinion of the European Securities and Markets Authority on the General Principles to Support Supervisory Convergence in the Context of the United Kingdom Withdrawing from the European Union*, 2017 (ESMA42-110-433), www.esma.europa.eu/sites/default/files/library/esma42-110-433_general_principles_to_support_supervisory_convergence_in_the_context_of_the_uk_withdrawing_from_the_eu.pdf [https://perma.cc/CL6M-LJSA].

[81] *See* Nathaniel Lalone, *European Commission Publishes Speech on Equivalence and Supervisory Convergence*, CORP. & FIN. WKLY. DIG. (Apr. 28, 2017), http://www.corporatefinancialweeklydigest.com/2017/04/articles/brexit/european-commission-publishes-speech-on-equivalence-and-supervisory-convergence/ [http://perma.cc/MLP5-BYH3] ("[T]he EU must consider every case on its own merits, based on the principle of proportionality, and decide if and under which conditions equivalence can be granted . . . .").

[82] *Id.*

[83] *See* Richard Crump, *EU Gets Tough on Investment Firm Relocation,* LAW360 (July 13, 2017), https://www.law360.com/articles/943828?scroll=1 ("The [ESMA] told EU national regulators to watch out for firms trying to secure access to the single market by setting up shell companies in the EU while discreetly keeping their main operations in London . . . .").

regulation.[84] Additionally, the European Central Bank fears EU member country authorities will loosen regulations in an effort to win UK-based banks over to their jurisdiction.[85] If firms do not abide by the currently-issued guiding principles or EU member countries abuse the situation to win over third country firms, the European Central Bank will likely impose new equivalence rules.[86] While the EU has not envisioned the process to revoke equivalence, the EBA has urged the European Commission to revise equivalence standards.[87]

F. Conclusion

While the final outcome of negotiations between the UK and EU are uncertain, UK-based banks are operating under the assumption of a hard Brexit.[88] A hard Brexit would cause UK-based banks to lose

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[84] Mark Taylor, *Brexit Politics Muddy MiFID Regulations as Overhaul Nears*, LAW360 (June 22, 2017), https://www.law360.com/articles/936148?scroll=1 ("ESMA . . . wants to clamp down on so-called letterbox entities, which would allow a firm to set up a small arm inside a willing EU state but divert the decision-making process back to the post-Brexit London.").

[85] *See* Mark Taylor, *EU Regulator Warns on Brexit Loopholes as Firms Plot Moves*, LAW360 (June 5, 2017), https://www.law360.com/articles/931080 ("The European Central Bank has repeatedly raised concerns . . . that while some institutions could use Brexit as a way of evading regulation, some states may be willing to bend rules to fill their coffers.").

[86] *Id.* ("ECB officials have said they will be forced to rewrite equivalence rules to stop financial services firms from exploiting the fallout over Britain's exit from the bloc to secure looser regulatory obligations from countries eager to accommodate them.").

[87] *See* Caroline Binham, *EU Banking Watchdog Warns Against 'Empty Shell' Brexit Movers*, FIN. TIMES (Oct. 12, 2017), https://www.ft.com/content/4d74f9f0-3d25-36ab-b07f-e6a2b94b2ea0 (stating the European Banking Authority is encouraging the European Commission to redraft legislation out of concern that UK-headquartered firms will set up "shells" in the EU).

[88] Anjuli Davies, *Brexit: U.K. Warned It Could Lose 40,000 Investment Banking Jobs*, INDEPENDENT (Aug. 1, 2017), http://www.independent.co.uk/news/business/news/brexit-latest-news-uk-finances-investment-banking-jobs-lose-40000-city-london-eu-european-union-a7870206.html [http://perma.cc/XTR5-SPNP] ("Banks are currently planning for a worst-case scenario in which they lose access to the European single market once Britain leaves the bloc in 2019 . . . .").

passport rights.[89] If UK-based banks want to continue providing financial and investment services to their EU clients following a hard Brexit, these banks may need to set up entities in the EU.[90] Relocating UK-based banks to EU member countries will likely duplicate banking services and increase costs for the industry.[91] Alternatively, UK-based banks could rely on the legal concept of equivalence.[92] However, UK-based banks offering services to the EU would receive limited market access rights. [93]

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[89] *See* Ford, *supra* note 33 ("[I]f [the UK] wants to retain passporting after Brexit . . . it could remain within the single market, presumably by joining the EEA . . . [b]ut that seems unlikely . . . .").
[90] *Id.* ("London based business could individually establish subsidiaries within the EU that would have passport rights.").
[91] *See* Davies, *supra* note 87 ("[D]uplication of services as they build up new European entities in areas such as risk and compliance could add between 2 and 4 per cent to the annual cost base or around $1bn.").
[92] *See* Ford, *supra* note 35.
[93] *See id*.
[94] Student, Boston University School of Law (J.D. 2019).