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LIKE RUNNING WATER

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The 2nd January 2021 will go down in history as the date that marked a major backlash on the path to European integration. Four and a half years after negotiations that followed a referendum of people in Britain to leave the European Union (EU) and that nearly ended without any agreement, a Trade And Cooperation Agreement[1] could be reached in a last-minute deal.

Including annexes, the document spans 1,276 pages and includes bilateral regulations on almost every area of interaction, covering aspects of trade, travel, transport, intellectual property, energy and social security. It contains clear arrangements on law enforcement and judicial cooperation, sovereign rights in the symbolic field of fisheries and even cooperation commitments in health insurance and cyber security. One area of service – even though it makes up for 21% of Britain's service exports – hardly receives any mention in the agreement: Financial Services.

The limited prospects for any progress in this area may have incited negotiators to leave this topic aside entirely rather than putting the whole agreement at risk. Given the looming hard-Brexit scenario with food or medicinal product shortages that seems a reasonable approach, retrospectively. However, there's no doubt, that the equivalence[2] decision practice isn't making things any easier; on the one hand, because the EU may take back any recognition of a British regulation as equivalent within one-month notice – providing little legal certainty, on the other hand, because the concept of equivalence doesn't cover the services of taking deposits or granting loans. Effectively, where there is no equivalence decision available by the EU, British companies must transfer the relevant client-facing units to the EU in case they want to continue business with EU clients. The European Central Bank prompting international banks to transfer assets worth EUR 1.2 trillion from Britain to their EU units is adding to the pressure.

British banks and market operators have tried to prepare for that scenario by setting up relevant EU affiliates. However, while it has been comparably easy to decentralise banking services with main infrastructures remaining in their British headquarters, trading indicates a different trend. On the 4th January, trading day No.1 of 2021, a share trading volume of around EUR 6 billion has shifted from London to venues within the EU. Since then, a similar trend could be observed for the trading volumes of interest-rate derivatives with the only difference being that this market has migrated to US venues rather than to EU entities.

Some raise the question of how big a hit these trading shifts towards the EU really are to the City of London given that a significant share of these volumes is now being executed outside Britain but has remained with London headquartered entities economically – as it is just being facilitated via their EU subsidiaries.

That view, however, is falling short of the deeper problems the trading shifts may constitute. London had traditionally been the centre of European capital markets. Much of the technology, underlying trading infrastructures, trading itself as well as much of the relevant regulation in Europe is built upon on the knowledge and experience that developed there; and an entire industry of suppliers, subcontractors and vendors in the areas of technology, law and other services rise and fall by the weal and woe of the City. So, the question of where the business is concluded physically has other implications than just where the tax on these transactions will become due.

Experts would agree that markets have become extremely agile in the recent past and that liquidity, like running water, always finds its ways to flood the deepest channels first. Experts also agree that the trading flow, once having left London, won't return to London anytime soon: "I would suspect that this is going to be a permanent change [...]", commented Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA).

If it has been in the mutual interest of the EU and Britain to reach agreements on financial services for the longest time, the pressure is shifting more and more towards Britain as the incentives for the EU to make concessions is fading proportionally with markets getting used to the status quo. And while losing the business of trading EU-listed shares with clients in Europe may be financially bearable for London, the potential loss of its euro-derivatives clearing business would mean a much harder hit.

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1 *"Trade And Cooperation Agreement Between The European Union And The European Atomic Energy Community, Of The One Part, And The United Kingdom Of Great Britain And Northern Ireland, Of The Other Part"*, as signed on 30.12.2020 between the EU, the European Atomic Energy Community (Euratom) and the United Kingdom

2 The EU recognising and acknowledging the regulation another jurisdiction "equivalent" to their own

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