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"Brexit: a challenge for many"

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When reflecting on financial services and Brexit, it is useful to remind ourselves that we are currently living moments when European Union has to continue to reform itself. There are reforms we need independently of whether the Brits are in or out.

2018 will be a key year for EU reform.

Brexit but also a renewal of the Franco-German grand coalition have given fresh momentum to the reforms in the EU, in particular regarding EMU. Unfortunately, different priorities in the Brexit negotiations of the future agreement can threaten EU unity later this year. Let me also say that approaching 2019 elections to EU and the perspective of a new Commission act as a mobiliser, add a sense of urgency to move forward with reforms.

Many of these reforms have been on the table for a while.
Actually, on some of them, in particular regarding the EMU, there has already been for a while an exciting debate.

Regarding Brexit, allow me to say a few words on the process as such.

Withdrawal of the UK from the European Union, based on article 50 of the TEU is not a one-off event. It is a process driven by EU law rather than by international law. It triggers a complex, multidimensional process based on both legal and political grounds. It is about disentangling interdependencies built over more than forty years.

Adjustments are of political, economic, social, institutional and legal nature. It creates far-reaching consequences in short and long term. Unlike in trade negotiations lack of final agreement, called no deal scenario, does not mean status quo ante but a new situation of a serious legal gap. It is also a process which, in spite of the fact that the notification is addressed to the European Council, involves practically all European institutions, as well as many stakeholders on both sides that have strong vested interests. It is also worth mentioning that while notification and the article 50, itself refer to the withdrawal from the Union, the real challenge behind the whole process is - rather than the fact of leaving - the future relationship, the final destination of the leaving member state which in reality is not even covered by article 50.

Where are we now in the Brexit process?

On December 15, the European Council has decided about moving forward to the second phase of the Brexit negotiations. There is now a new calendar for actions at all levels: technical, political, institutional. It is clear, however, that taking into account the much higher - compared with what is behind us - complexity of the challenge ahead and the limited time available, different Brexit related actions must be carried on in parallel and with a high intensity. Serious cooperation between the two parties is a must. We have to move rather fast toward providing legal text of withdrawal agreement. On EU side, this document must be consulted with member states and the European Parliament. New negotiating directives or, if you wish, the new mandate must be prepared. We have to reach agreement with UK on the format for further negotiations taking into account lessons learnt so far and the need to agree on the timeline for those negotiations.

On the EU side, we must spare no efforts to ensure the continuation of unity among institutions and member states in discussions on transition solutions and future framework. The hitherto transparency and multidimensional effort at technical and political level, seminars, technical meetings proved to be an excellent approach.

It would be easier if we could have certainty at this stage about the future scenario, unfortunately, in particular in the context of political situation in UK, we cannot abandon preparation for a no deal scenario. Even if such a scenario is in nobody's interests. The certainty will come probably just a couple of weeks before the planned withdrawal, after the vote in the British Parliament.

Even though sufficient progress has been declared, we know that on many separation related issues there has been no agreement reached yet. Additionally, some of the issues have not been discussed yet. It will be important for the British side to give a high priority treatment to those issues. There is no more time for continuing the listening mode during the UK - EU talks.

A truly grand issue that remains and is seen as of great relevance by the EP is the governance of the whole withdrawal process and of its parts. This will be a crucial part of the withdrawal agreement and is fundamental on many accounts. Also, in the context of the acquis prolongation based approach to transition and the specificities of the British withdrawal bill. Should the governance mechanism be different for the transition and for the future is a big open question.

Of course the negotiations and the Brexit as such have impact on the situation of the EFTA countries, and in more general terms on the functioning of the EEA. This has been in particular relevant regarding the citizens' rights issues. In particular, the transition arrangements will impact EFTA countries and EEA functioning.

A mission impossible open issue is the lack of legal certainty before the formal adoption of the withdrawal agreement. This is painful for citizens, businesses and some sectors in particular.

But one can look at Brexit as an opportunity for the EU 27 to speed up the development of its financial markets and also improve its resilience to shocks. Losing access to the ecosystem of the London financial centre might lead to certain losses of efficiency of the continental markets. But, as I said, with or without the Brits, we will have to upgrade our capacity to ensure market integrity and financial stability.

Some loss of the integration with the UK is obvious and reducing the fragmentation is a challenge. We have to accelerate the investment in financial markets integrity, harmonization of rules, enforcement of rules and consistent supervision. Without, at the same time, increasing too much bureaucratic requirements that might have devastating impact on capital markets. Fragmentation of trading activities might increase costs and reduce access to capital for companies. Among the twenty-seven there might be as well a regulatory race to the bottom and regulatory arbitrage. This would reduce access to capital and increase instability.

The twenty-seven will have in this context to adopt clear policies on many issues.
They still can create a vibrant capital market, improve risk sharing and make EU an attractive global financial centre.

But of course, the reform of the financial sector has many aspects.

Of course, some challenges, such as expanding access to non-bank financing for SMEs or diversifying the sources of funding away from a disproportionately bank-based model have been with us for some time. We have for instance been speaking about the creation of a capital markets Union for a number of years now. Timid steps have been taken in order to build it, for instance with the adoption of the regulation on simple, transparent and standardised securitisation, with a lighter regime for prospectus issuance and with a new regulation on venture capital funds.

Brexit will make the CMU project even more important in the future and we look forward to further work on the areas where the Commission had launched the reflection within the context of the CMU, such as Fintechs, removal of barriers to cross border investment or covered bonds. We also face another challenge, which is completing the Banking Union, following the principle that risk-reduction and risk-sharing have to go hand in hand.

On the issue of further reduction of risks within the banking sector, we will be starting to negotiate the banking package that amends all the main pieces of legislation that regulate banking, and will use it to make our financial system more stable. As regards risk sharing, we have the EDIS file on the table and the Commission has now tabled a proposal to transform the ESM into a European Monetary Fund.

But Brexit is also confronting us with wholly new challenges. As you can imagine, financial sector will not feature in the withdrawal arrangement. But it will be in transition agreement treated like the rest of acquis, everything will remain as it is. Cliff edge will move to the end of transition. Transition period will be used to negotiate future relationship agreement.

I believe, there are three types of challenges related to Brexit that financial sectors has to cope with.
One relates to the clarification of existing legislation and of how it will be applied in the context of Brexit.
The Commission and all European supervisory authorities have been doing a lot of work on this topic. ESMA and EBA have been issuing guidance on the application of legislation relating to banking and asset management. EIOPA is examining the issue of long-term insurance contracts that have been concluded under the passporting regime and the Commission will shortly be issuing a series of notices on the application of rules concerning bankers, insurers, asset managers and credit rating agencies.

The second issue or challenge relates to the adaptation of our regulation and of our supervisory architecture to the new environment that the departure of the UK is creating.

A large part of this work will relate to making the equivalence provisions in relevant legislation better suited to the new situation. Those provisions have never been drafted with the aim of applying them to a jurisdiction as large and, at the point of departure, with as close a regulatory framework to the EU one, as the UK. Therefore, they need to be reviewed and both sides, the UK and the EU, are currently reflecting on their future approach to equivalence in financial services.
The Commission is specifically looking at the pieces of legislation where equivalence has to be strengthened.
One of those pieces of legislation is EMIR, the text governing the supervision of CCP, given the high level of risk that those institutions take on and pass onto the financial system. Another area where the Commission is currently proposing to review the third country framework is this of investment firms, since these firms are mostly based in the UK and, without being regulated like banks in the EU-27, are conducting bank-like activities and taking risks similar to banks.

We also need good supervisory authorities in order to apply legislation and grant equivalence and recognition. This is why, also in the spirit of avoiding a regulatory race to the bottom after Brexit, we are currently reviewing our European system for financial supervision in order to have strong and internationally respected supervisors.

Third, the last area of work concerns contingency planning and preparedness to a no-deal scenario. There is a lot of work to be done there, and emergency crisis powers for supervisors might be considered in order to deal with a disruptive situation. It might be the case that we will be preparing tools and instruments that will never be used but, as the saying goes, we should plan for the worse but hope for the best.