Could Brexit Hasten Europe's CMU Project?

UK Prime Minister Theresa May's Brexit deal was overwhelmingly defeated in parliament yet she survived a no-confidence vote, setting the stage for a no-deal Brexit to take effect on March 29. In a new web series, Global Finance examines the impact of the Brexit vote and a no-deal scenario on M&A, corporate taxes, the Capital Markets Union (CMU), and foreign exchange.

JANUARY 31, 2019, Global Finance (gfmag.com)

Author: **ANDREW WOODMAN**

When the European Commission first announced its Capital Markets Union (CMU) Action Plan in late 2015, Brexit was more of a theoretical question of "what if?" than a practical question of "what now?" With a disorderly UK exit from the European Union (EU) more likely than ever, the CMU project faces its biggest challenge yet.

The CMU initiative was set up in a bid to integrate the capital markets of the 28 EU member states to reduce the cost of raising capital for businesses— specifically small and medium-sized enterprises—and facilitate greater cross-border investment.

The Brexit vote has now potentially stripped the bloc of one of its largest economies and a key financial center in London. This has at best altered the shape of any future union, and at worst, thrown the entire CMU project into question. Europe's response to this unexpected challenge has been to prepare the CMU for Brexit.

Miranda Xafa, a senior fellow for the Centre For International Governance Innovation think tank who recently authored a paper on the future of the CMU, believes Brexit will be less of a problem for UK companies accessing finance than for EU companies.

“EU officials are concerned that the departure of Europe’s largest financial center from the EU could have adverse consequences on continental European companies that rely on London for their capital-raising needs, “ says Xafa. “This concern makes it all the more urgent to build a CMU among the remaining EU27 members, irrespective of whether we have a no-deal, hard- or soft-Brexit.”

Xafa adds that a particular concern will be ensuring stronger central oversight to avoid regulatory arbitrage from the continuing influx of businesses from the City of London to continental Europe. Similar concerns were expressed by Simon Lewis, chief executive of the Association for Financial Markets in Europe (AFME), in a recent report. He said, “The prospect of the EU’s largest financial centre leaving the EU demonstrates the clear need for the EU27 to enhance and integrate its capital-markets capacity and boost its infrastructure.”

In the near term, Xafa points to the outstanding items of the CMU Action Plan post-Brexit that can be completed quickly such as efforts to “improve data comparability, increase legal certainty, and harmonize rules for marketing investment products.”

There is also a question of how the UK will interact with the CMU post-Brexit. So far, the EU has made clear that the best the UK can hope for is an equivalence regime in lieu of the existing unfettered access for UK financial firms to the EU single market. Xafa explains that this would need to be unilaterally granted by the EU, provided it recognizes the UK regulation and supervision regime as equivalent to its own.

“The drawback of this approach is that equivalence can be withdrawn or altered at short notice, making the UK an unattractive place to do business with the EU,” says Xafa. “The EU’s insistence on equivalence partly reflects the desire of some member countries—notably France—to lure financial services away from the City of London and help the EU build its own capital market.”

The only way the UK can participate fully in CMU would be if it retained better market access than the current equivalence framework provides. This could only be achieved if Brexit was somehow stalled or stopped, or a third Brexit-in-name-only arrangement was found where the UK remained part of the European Economic Area (EEA)—along with Norway, Iceland and Liechtenstein—and maintained passporting rights as part of the single market.

However, Xafa explains, leaders of both major political parties in the UK have already ruled out any option that would mean accepting all relevant EU rules as well as the jurisdiction of the European Court of Justice.