Brexit

What now for the cleared derivatives markets?

Simon Puleston Jones, Head of Europe
The markets’ reaction
Reactions to Brexit

Pounded by Brexit
Sterling's fall against the dollar since referendum

Parity Beckons?
Pound falls to 3-year low against the euro

Source: Bloomberg
Reactions to Brexit

**Exceeding Expectations**
U.K. economic data is beating forecasts by the most in three years

- Citi U.K. Economic Surprise Index

**Divergent Paths**
The correlation between U.K. and European stocks is the lowest in more than a year

- FTSE 100 (R1)
- Euro Stoxx 50 (€1)

Source: Bloomberg, Citi

Source: Bloomberg
Stressful Swings
After years of calm, a measure of bank funding stress spiked after the Brexit vote

Libor vs swap rate

Bloomberg
Reactions to Brexit

**London Staffing**
International banks have thousands of employees in the U.K. and may move some abroad.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Staffing</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPMorgan</td>
<td>16,000</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>14,000</td>
</tr>
<tr>
<td>Citigroup</td>
<td>12,000</td>
</tr>
<tr>
<td>BNP</td>
<td>10,000</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>8,000</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>6,000</td>
</tr>
<tr>
<td>Bank of America</td>
<td>4,000</td>
</tr>
<tr>
<td>UBS</td>
<td>4,000</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>4,000</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>2,000</td>
</tr>
</tbody>
</table>

Sources: JPMorgan and KBW research, Bloomberg data

**Brexit Concern**
Goldman has about one in six workers in Britain, the highest share among foreign banks.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Percent of Total Employees in U.K.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goldman Sachs</td>
<td>18</td>
</tr>
<tr>
<td>Banco Santander</td>
<td>16</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>14</td>
</tr>
<tr>
<td>UBS</td>
<td>12</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>10</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>8</td>
</tr>
<tr>
<td>JPMorgan</td>
<td>6</td>
</tr>
<tr>
<td>BNP</td>
<td>4</td>
</tr>
<tr>
<td>Citigroup</td>
<td>2</td>
</tr>
<tr>
<td>Bank of America</td>
<td>2</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>2</td>
</tr>
</tbody>
</table>

Sources: JPMorgan and KBW research, Bloomberg data
The political reaction
Reactions to Brexit
Reactions to Brexit
Reactions to Brexit
Reactions to Brexit
Reactions to Brexit
If "Brexit means Brexit", what does Brexit mean? (and don't say Brexit)
Brexit means Brexit
Brexit means Brexit

Brexit negotiation details will be kept secret from Parliament, David Davis says

The minister for leaving the EU said MPs would not be told about things in advance

David Davis is in charge of leaving the European Union House of Lords
Brexit means Brexit

So what is Brexit?!
Brexit means Brexit

David Davis says process for leaving the EU will be the most 'complicated negotiation of all time'
Can an Article 50 notice be withdrawn?

• There is no provision in the Treaties for withdrawal. However, an agreement to that effect could nonetheless be reached, if there was sufficient political will on all sides
• If no agreement reached, the UK could reapply for EU membership at a later date, but the UK would have to establish its eligibility criteria, which currently includes joining the Eurozone

Can the two year timeframe be extended?
Yes, but only with unanimous consent of the European Council (excluding the UK), in accordance with Article 50(3) of the TEU

Are there any alternatives available to the UK other than the Article 50 route?
The UK could conceivably withdraw from the EU in breach of the TEU, perhaps citing the supremacy of Parliament

When will we know the UK’s proposed post-Brexit model and what the EU’s proposal is?
This is unclear. The Treaties provide very little guidance about the legal consequences of withdrawing from the EU or what the post-exit world would look like for the UK (and remaining Member States)
What is Brexit?

Is that it?
The UK’s current relationships

Box 2: Europe and the European Union

Norway, Iceland, Liechtenstein and the 28 EU Member States comprise the European Economic Area. Switzerland, Norway, Iceland and Liechtenstein are members of the European Free Trade Association (EFTA).
The U.K.'s plan to leave the European Union has focused attention on long-standing pacts that govern trade, immigration and the common currency.

**European Union**
28-nation single market of free trade and shared regulation; includes "free movement" of goods, services, capital and people

**Euro Zone**
19 countries using the euro currency

**European Economic Area** provides access to single market in exchange for payments; has "emergency brake" on free movement of people

**European Free Trade Association**
Free-trade zone and network of agreements with other countries

**Customs Union**
Circulates goods without duties, has uniform system for handling imports

**Schengen Area**
26-country passport-free travel zone

Sources: EU, ETRA, IMF
The UK’s on-going relationship with the EU

When will we know the UK’s proposed post-Brexit model and what the EU’s proposal is?

This is unclear. The Treaties provide very little guidance about the legal consequences of withdrawing from the EU or what the post-exit world would look like for the UK (and remaining Member States). There is a complex trade-off between market access and sharing of sovereignty.

What are the principal models available to the UK?

- The Norway model: European Economic Area / EFTA membership
- The Swiss model: Bilateral agreements with Member States and limited access to the single market in specifically defined areas
- The Turkish model: A customs union
- The Canadian model: A deep free trade agreement
- The WTO model: The U.K. becomes a member of the World Trade Organisation
- The UK model: a bespoke solution that differs from all previous models
What are the key negotiating issues

The UK wants:

- the ability to control immigration from the EU; and

- passporting rights with respect to the EU Single Market

Will it have to pick one over the other?
What is FIA’s position on Brexit?
Overview of FIA members’ position

• **Minimise disruption**

• **Avoid fragmentation of liquidity** by regulatory fiat

• **Maintain UK / EU access** to markets, counterparties and talent

• The UK still has a key role to play in **delivering jobs and growth in Europe**, even from outside the EU
Minimise disruption

• **No rush** to trigger Article 50

• Agree the terms of withdrawal and the UK/EU future relationship **in tandem**

• Procure a **smooth transition** from today’s state into the new relationship

• **Ensure continuity and no adverse impact** of the rules relating to financial collateral arrangements, netting, set-off and settlement finality rules
Avoid fragmentation of liquidity

• Euro should be **freely tradeable and clearable**

• The **market should determine** where liquidity is located

• Forcibly moving trading/clearing into eurozone:
  • **would fragment liquidity** across Frankfurt, Paris, Amsterdam, Luxembourg, Dublin, Madrid and Milan etc., with detrimental effect to EU end users and counterparties
  • **cannot be achieved by regulatory fiat**: if the US responds in kind with respect to USD trading and clearing, it will become impossible to trade and clear a EUR/USD swap or a Eurodollar future
Maintain UK / EU access

• Ensure **continuity of regulatory approvals and EU access** for trading venues, CCPs and Trade Repositories:
  • EU firms should be able to meet the MiFIR trading obligation by using UK trading venues.
  • UK CCPs may require “recognition” instead of “authorisation”
  • UK trade repositories may require “recognition” instead of “registration”

• **Minimise barriers to the provision of services** by:
  • EU-based trading and clearing members to UK clients
  • UK-based trading and clearing members to EU clients

• There should be **no material change to UK legislation** relating to cleared derivatives or commodities in the short-term: equivalence/recognition of the UK at point of exit is imperative

• **Minimise barriers to employment** of:
  • EU nationals by UK companies
  • UK nationals by EU companies
The UK’s ongoing importance for CMU

- FIA members do not believe that fragmentation across the Eurozone of the existing London-based liquidity for trading/clearing of euro denominated derivatives delivers a better outcome for EU end users than the status quo.

- Accordingly, FIA members consider that the way to most successfully deliver jobs and growth in Europe is to **ensure that the EU retains full access** to the liquidity that resides in London.

- Derivatives markets are global, so the choice is not London or Paris or Frankfurt - liquidity for euro denominated derivatives is equally capable of moving to New York, Chicago, Singapore and other non-EU jurisdictions.
I’ve still got lots of questions!
Brexit

Katie Fisher, HM Treasury

Jeremy Brown, City of London Corporation

Mark Hoban, International Regulatory Strategy Group

Richard Tredgett, Allen & Overy
Questions or feedback on Brexit?

To contact FIA’s London office, please call our switchboard on +44 (0)207 929 0081 or email:

spulestonjones@fia.org

cschempp@fia.org

msiraj@fia.org

brexit@fia.org