The Economic Impact of "Brexit"

This is a translation of an article written by Nick Pawson and Sam Tetlow which was published in Expansión, a daily Spanish business newspaper, on 4 March 2016

Following the announcement that there will be a UK referendum on 23 June 2016, "Brexit", referring to the British exit from the EU, has become the word on everyone's lips. Until now much of the focus has been on the prime minister David Cameron's ability to negotiate with the other Member States to agree an improved deal for Britain to remain as part of the EU. Following his return from the negotiating table, the emphasis has now shifted to speculate over which of his cabinet will remain loyal to the Conservative party and support the campaign to remain as part of the EU and those who will support the campaign to leave the EU. As the "in/out" debate gathers momentum ahead of the referendum in June, an analysis of the potential impact Brexit would have on Britain, the rest of Europe and even the global economy has taken centre stage.

No one can know precisely what impact leaving the EU may have on the UK. Early debate has focused on the wider macro-economic issues that may arise, with the finance ministers of the G20 Group listing a potential UK exit from the EU as one of the biggest risks to the world economy in 2016. Different sectors are now quickly carrying out studies and analyses on how a vote to leave the EU on 23 June would impact their business with a view to having contingency plans in place in order to be able to react as quickly as possible once the results of the referendum are known. One sector that is of particular importance is the financial services sector which accounts for approximately 10% of the UK's GDP. There are concerns that Brexit may have a disproportionate effect on providers of financial services, something that may put at risk the UK's dominant position as the world leader in wholesale financial services. In particular, the UK holds approximately 17% of the cross-border bank lending market.

London is one of the world's largest financial centres and home to over 250 foreign banks who gain access to Europe, the world's largest single market with a GDP estimated at €13 trillion and 500 million people, by virtue of the UK's membership of the EU. They are able to do this by using the European passporting regime, a key aspect of EU financial services law which allows any firm in a member state to carry on business in another EU/EEA country. The impact of Brexit on this would depend on whether the UK opted to join the EEA (which would allow it to maintain its passporting authorisation) and the result of negotiations with the EU during the two year negotiation period following a vote for Brexit. If the UK ceases to be part of the EU/EEA, this in turn means that a UK incorporated bank (or a US bank with a UK PRA authorised subsidiary) which does not have a suitably capitalised subsidiary incorporated and authorised elsewhere within the EU, will cease to have the benefit of the passporting regime following Britain's exit from the EU. The concern is that, even if the UK was able to negotiate a special third-country status which would allow London to retain its access to the EU market, this would be a time consuming process particularly as there would be little political impetus from the other EU Member States. Rival European financial centres would also seek to take advantage of such uncertainty, with Dublin and Frankfurt both in prime position to offer a home to some of the world's largest financial services firms.

It is not only the cross-border lending market that may be impacted by Brexit. Over the past decade London has become the restructuring capital of Europe with many international companies (including a significant number incorporated in Spain) relying on the courts of England and Wales for their financial restructurings. In particular, investors of distressed debt typically see the UK as an English speaking gateway to the EU. Following a Brexit, it may become increasingly difficult for a company from an EU Member State to take advantage of the UK's sophisticated and well-established insolvency proceedings, in particular the English law scheme of arrangement. The UK's current status as a Member State allows English law cross-border insolvency proceedings to be particularly effective and an attractive solution. Following a Brexit, the other Member States may see the opportunity to "level the playing field" and make it more difficult for the UK to maintain a disproportionate share of the restructuring market. The legal developments made with regards to Spanish insolvency law, including the development of the process of "homologation" as a viable alternative to the English law scheme of arrangement, suggests that this process is already under way.

The impact on Britain's financial services sector is only one aspect of many that will need to be considered over the weeks leading to the referendum in June. Other key aspects will be the potential impact on the value of Sterling, the negotiation of individual trade agreements with individual Member States and any other trade restrictions that may arise as a result of a Brexit. A clearer understanding of these issues and an open debate as to the impact of a Brexit will be key to the result of the referendum as the UK prepares to go to the polls in June.

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