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MPs Rule Out No-Deal Brexit Too Late For Corporate Britain

By **William Shaw**

Law360, London (March 13, 2019, 9:29 PM GMT) -- The U.K. Parliament's vote against a disruptive no-deal Brexit on Wednesday is unlikely to reverse corporate contingency plans that have already sent operations and jobs across the border to protect companies from regulatory upheaval.

The government has held on to the no-deal option for negotiating leverage with the European Union. Now, with the March 29 Brexit date looming, Parliament's intervention comes too late to make a difference, according to attorneys.

Legal experts say there are too many open questions, running from whether the government can still get a deal that guarantees a transition period to what kind of new trading relationship will follow when the grace period expires at the end of 2020.

Companies across the services and manufacturing industries have already invested enormous sums to prepare for the unknown, said Carlo Kostka, senior counsel at Covington & Burling LLP. Not enough has changed to convince firms that they won't be caught out by a bad Brexit.

"They have investment plans and, with some exceptions and caveats, the trigger has been pulled on many of those," Koska said.

At many companies, preparations for the worst went live months ago. Financial services firms have transferred an estimated $1 trillion out of U.K. operations since the June 2016 Brexit referendum result, according to estimates by consulting firm EY. Prudential, the U.K.'s biggest insurer, announced Wednesday it is transferring £36 billion($47.5 billion) in customer assets to its new hub in Luxembourg.

Retail investors have also turned skittish. Net sales of all types of investment funds to domestic retail investors plummeted 85 percent in 2018 to £7.2 billion in 2018 from £48.5 billion in the previous year.

Prolonged legal uncertainty about Britain's future will deter business capital investment for years, analysts predict. Led by automakers, major manufacturers are canceling spending plans or even shutting plants. Confusion over future EU market access, revised regulatory controls, new tariffs and rewritten tax regimes have kept away foreign investors while encouraging an exodus of capital out of London.

U.K. foreign direct investment in the EU was up by £8.3 billion since the referendum, a 12 percent increase, with incoming investment from the EU falling by £3.5 billion, or by 11 percent, from pre-

referendum levels, according to a February study by the London School of Economics and think tank The Center for Economic Performance.

In the short term, the risk of a no-deal Brexit is still part of corporate planning, despite Wednesday's nonbinding vote in Parliament. Brexit extensions can't go on indefinitely, EU officials warned this week. And, according to EU Council President Donald Tusk, there is no guarantee that the 27 EU governments will agree to grant one at all.

“The problem with a vote against a hard Brexit is that it does not provide any clarity as to what the alternative might be," said James Norris-Jones, partner at Cleary Gottlieb Steen & Hamilton LLP. "Financial institutions undertaking contingency planning may therefore take little comfort … particularly until the terms of any delay to Brexit have been agreed.”

Without some form of withdrawal deal finally passing in Parliament, or Brexit being called off altogether, a no-deal Brexit still remains a threat. That prospect is the immediate concern of financial services companies worrying about the regulatory rupture between London, Europe's largest financial center, and the EU single market for goods and services.

Simon Lewis, chief executive of the Association for Financial Markets in Europe, said that financial companies will continue to prepare for a no-deal Brexit to minimize the hit to their operations and customers.

"A no-deal scenario continues to be a very real concern,” Lewis said after the latest defeat of the government's Brexit bill late Tuesday.

Regulators still haven't fully clarified how a no-deal will impact securities trading, clearing and data transfers, he noted.

And businesses are also still unclear over what kind of trading relationship the U.K. will negotiate with the EU for the future more broadly.

Prime Minister Theresa May’s deal, which she insists could still be resuscitated despite its rejection by MPs on Tuesday, had been cautiously welcomed by businesses because it would have provided a transition period until the end of 2020.

Financial firms also hoped it would help Britain achieve equivalence deals with the EU under its securities rulebook, the Markets in Financial Instruments Directive. Equivalence enables the EU to grant market access to countries outside the bloc if their regulatory regimes are close enough to its own. These possibilities are now receding, and equivalence has its own problems.

“Until the U.K. leaves, the European Securities and Markets Authority is unable to rule on ‘equivalence’ of the U.K. regulation, a key means by which, under MIFID II and other regulation, the U.K.’s financial services businesses can continue to do business in the EU,” said Howard Morris, head of the London business restructuring and insolvency group at Morrison & Foerster LLP. “European institutions are pressing for early resolution of these important questions.”

Europe and Britain have already made key moves to protect the trade in financial services that centers around London.

The European Commission adopted new laws in December to enable Europe's banks to continue using London's clearinghouses for 12 months if Britain crashes out of the bloc, a major step toward protecting the multitrillion-dollar market in over-the-counter derivatives. And last year the Bank of England said that financial firms using passporting rights to carry out regulated activities in the U.K. will be able to continue doing so until the end of 2020, even if no transition deal for Brexit is secured.

Attorneys say that while these measures are temporary, if they prove popular they may survive beyond the transition and become the new status quo.

Wednesday's vote also raises the prospect that MPs, having denied themselves both a deal and no-deal Brexit, will vote on Thursday to seek a delay in the departure date.

If the U.K. now requests an extension and the remaining 27 EU members agree, Britain will then remain in the bloc and the same rules will apply to financial services, said Maziar Peihani, a research fellow at the Center for International Governance Innovation think tank.

"However, that does not address the significant uncertainty about the U.K.-EU relationship, which will continue to make London a less favorable place to do business, prompting foreign banks to look to other European financial capitals to access the EU market," Peihani said.

Many pro-EU campaigners are hoping that amid the deepening political crisis around Brexit, the likelihood of a second referendum may now be growing. Some see this as a chance to reverse the Brexit vote of June 2016. But lawyers say the irresistible momentum of companies moving out of London is unlikely to be checked by a possible u-turn nearly three years later.

"There is so much uncertainty about the question that would be asked: is it two choices or three choices [on the ballot]?" said Covington's Kostka. "The outcome is completely uncertain — that is the killer in everything that is going on."

--Additional reporting by Paige Long. Editing by Melissa Lipman and Pamela Wilkinson.