



ACCA

Brexit impact on financial services

Second edition

Think Ahead

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About this report

This report describes the impact of Brexit, as perceived by professional accountants working in financial services globally.



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Introduction: Uncertainty and opportunity

Just a year before the UK exits the European Union, the financial services (FS) industry is working hard to assess the potential impacts of Brexit – and to plan accordingly. It is hampered, however, by continuing uncertainty: what exactly will the UK’s relationship with the EU be like after Brexit?

This report builds on a similar study ACCA published a year ago and explores the current state of thinking among those in FS: the risks and opportunities that preoccupy them, their hopes and concerns about the shape of the final Brexit deal, and the extent to which they are ready for that new world.

The report draws on a survey of 245 ACCA members working in the FS sector around the world (three-quarters of them outside the UK). In addition to factors affecting the sector as a whole, it incorporates

perspectives specific to five sub-sectors, namely: retail banking, corporate banking, investment banking, asset management and fintech. It is further informed by the following individuals, who kindly provided views specifically for this report:

- Lindsey Naylor, partner, Oliver Wyman
- Michael Taylor, economics research fellow, Policy Exchange
- Gillian Lofts, leader of the UK Wealth & Asset Management Business, EY

- Philippe Morel, senior partner and managing director, and worldwide leader for capital markets, Boston Consulting Group
- Lawrence Wintermeyer, former CEO of Innovate Finance.

By charting the views of professional accountants working within the sector – many of whom will play a crucial role in the practical implementation of post-Brexit policies – the report provides policymakers and advisers with important insights as Brexit negotiations continue.

UK FS and the shape of the deal

The FS industry is vital to the UK economy. In the year to March 2017, UK FS contributed an estimated £72.1bn to the Exchequer – 11% of UK tax receipts. And it provides over 3% of jobs (for 1.1 million people across the country), 7% of output, and 11% of taxes (City of London Corporation 2017).

By some estimates, business related to the EU accounts for as much as one-quarter of the industry’s annual revenues, which underlines the importance of agreeing a post-Brexit deal for FS. There are four possible models for such a deal.

- **Passporting.** Firms based in EU member states and non-EU states that are members of the European Economic Area (EEA) can sell their services freely within the bloc under a system known as ‘passporting’. This is the arrangement under which UK firms currently trade.
- **World Trade Organization (WTO) terms.** States outside the EEA typically do business with the EU on the terms outlined in the WTO’s General Agreement on Trade in Services.
- **Equivalence.** Some non-EEA countries receive preferable market-access rights for certain services, on the basis that their laws and supervisory frameworks are deemed by the European Commission to be ‘equivalent’ to the EU’s.
- **Bespoke free-trade agreement.** Other non-EEA countries have to cover FS as part of a broader free-trade agreement with the EU.



Executive summary

- **Risks outweigh opportunities.** Respondents who see the risks of Brexit as greater than the opportunities currently outnumber those in the opposite camp by more than three to one – an increase from a year ago. This imbalance is expected to ease in the years ahead, but about twice as many respondents still expect risks to outweigh opportunities at the date of Brexit. Only when they predict the probable situation in five years' time do these numbers finally level out.
- **Key risks dominate.** The potential devaluation of the pound weighs heavily on respondents, with the additional costs of having to set up subsidiaries in the UK or EU being another key one to be flagged. Insufficient or unclear communication from government and regulators is also widely seen as a threat.
- **Opportunities do exist.** Some FS firms look forward to potential efficiency savings from streamlining operations, and to an improved regulatory environment, given the possibility that the UK will set its own rules once outside the EU. Nonetheless, significantly fewer companies are excited about these opportunities than are concerned about the risks.
- **The FS industry wants a transition agreement.** Three-quarters of respondents (77%) say that the UK's exit from the EU without a transition agreement would damage their businesses. That includes 6% who are concerned that their business model would no longer be viable.
- **No deal is a bad deal.** More than 7 in 10 FS firms (77%) say that 'no deal' would damage their business, including 6% who say that their business model would no longer be viable.
- **Readiness levels have not improved.** FS firms do not appear to be any further advanced, in aggregate, than they were a year ago. Almost one-quarter (23%) have not even started to make plans (this is even more pronounced among SMEs: 31%), while about one-third (32%) say they are at an early stage.
 - *Firms are not confident of accelerating their progress:* only 15% expect to have completed planning by March 2019; and just 12% expect to be executing their plans by then.
 - *Planning resource is limited.* Just over one-third of FS firms (38%) have no one currently working on strategic Brexit planning. A similar number (37%) have deployed fewer than 10 people on Brexit planning.
- *Skills are at a premium.* While resource capacity may be limited, many FS firms are content with their Brexit-planning capabilities, with just over half rating themselves either 'good' or 'very good'. Nevertheless, a significant minority say their capabilities in meeting the risks and opportunities ahead are limited, suggesting a lack of strategic change management expertise.
- **Recommendations for the months ahead.** The FS sector has clear priorities in the run-up to Brexit:
 - *a favourable deal for FS:* a bespoke free-trade agreement for FS is the most attractive option
 - *visibility and transparency:* communications between government and the FS industry on positioning for Brexit needs to become more open
 - *focus on the long term:* more work is required on how to capitalise on the long-term opportunities Brexit may present.

TABLE ES1: The view from FS sub-sectors

TOP PERCEIVED RISKS AND OPPORTUNITIES BY SUB-SECTOR	
RISKS	
Retail banking	<ol style="list-style-type: none"> 1. Devaluation of the pound 2. Difficulty in transferring funds in and out of the UK or the EU 3. Insufficient or unclear communication by government/regulators on their proposed approach
Corporate banking	<ol style="list-style-type: none"> 1. Insufficient or unclear communication by government/regulators on their proposed approach 2. Devaluation of the pound 3. Increased costs of setting up new subsidiaries/offices within the EU or the UK
Investment banking	<ol style="list-style-type: none"> 1. Difficulty in transferring funds in and out of the UK or the EU 2. Increased costs of setting up new subsidiaries/offices within the EU or the UK 3. Devaluation of the pound
Asset management	<ol style="list-style-type: none"> 1. Insufficient or unclear communication by government/regulators on their proposed approach 2. Loss of passporting 3. Devaluation of the pound
Fintech	<ol style="list-style-type: none"> 1. Increased costs of setting up new subsidiaries/offices within the EU or the UK 2. Devaluation of the pound 3. Increase in UK inflation
OPPORTUNITIES	
Retail banking	<ol style="list-style-type: none"> =1. Improved regulatory environment =1. Improved trade links/opportunities with non-EU countries 3. Streamlining of operations to drive efficiencies
Corporate banking	<ol style="list-style-type: none"> 1. Improved trade links/opportunities with non-EU countries 2. Improved regulatory environment 3. Ability to develop certain product lines more quickly
Investment banking	<ol style="list-style-type: none"> 1. Streamlining of operations to drive efficiencies 2. Improved regulatory environment 3. Move to lower-cost locations will reduce costs in the long term
Asset management	<ol style="list-style-type: none"> 1. Streamlining of operations will drive efficiencies 2. Improved regulatory environment 3. Move to lower-cost locations will reduce costs in the long term
Fintech	<ol style="list-style-type: none"> 1. Move to lower-cost locations will reduce costs in the long term 2. Streamlining of operations will drive efficiencies =3. Improved regulatory environment =3. Selling non-core assets/businesses

1. Establishing the baseline



ACCA has been tracking the views of its members within the financial services (FS) sector, through global surveys, for several years.

The views expressed are updated on a quarterly basis, and therefore take into account changes in the operating environment as they occur. This provides a historical baseline and some context against which to view the current developments in relation to Brexit. It also places the views of FS respondents against the wider background of all respondents. There were approximately 250 FS respondents on average for each quarter.

CONFIDENCE INDEX

ACCA tracks the level of confidence in the economic prospects for the organisations that employ its members through its quarterly global economic conditions survey (GECS). A negative score indicates that respondents who were less confident than in the previous quarter about the prospects facing their organisation, outnumbered those who were more confident.

Confidence in the FS sector was below the overall level for all respondents in the immediate aftermath of the Brexit vote. It later picked up and rose to a high at the beginning of 2017 but dropped back in line with other sectors during that year – as the year closed and uncertainty over the potential impact for the sector continued, confidence fell again but, at the time of the survey, remains above the level for all respondents (Figure 1.1).

INVESTMENT IN STAFF

Across the sector, for several years now, those seeing reduced investments in staff (training and development) have outnumbered those seeing increases, as reflected in the firmly negative index results.

FS recruitment and training levels suffered particularly around the time of the Brexit vote but, in line with the sector’s improving confidence levels, have risen since, and grown steadily over the course of 2017 despite the much-publicised potential for job losses across the sector (Figure 1.2).

FIGURE 1.1: Economic confidence within FS and all sectors

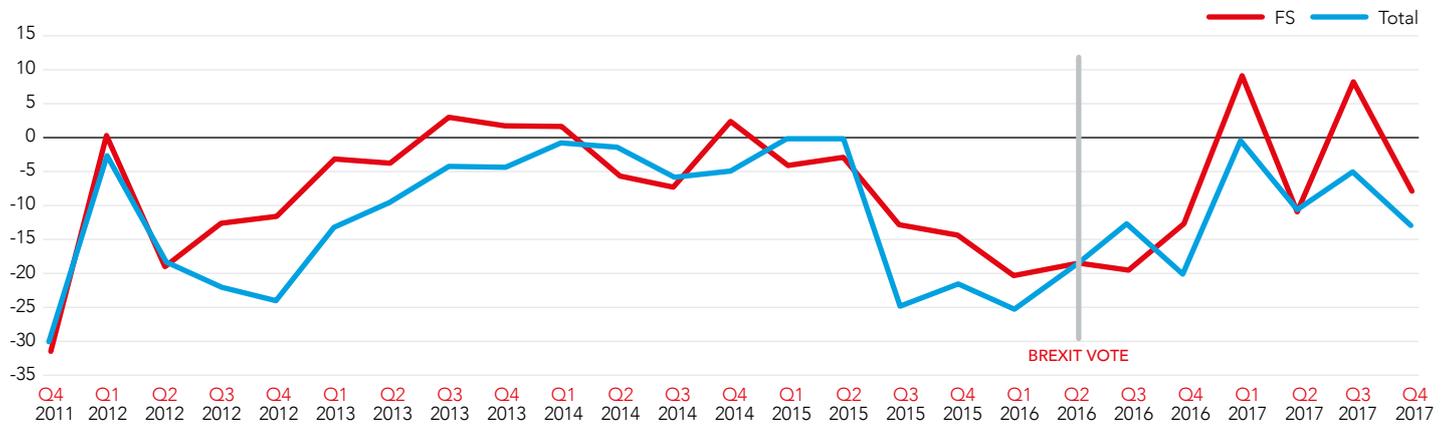
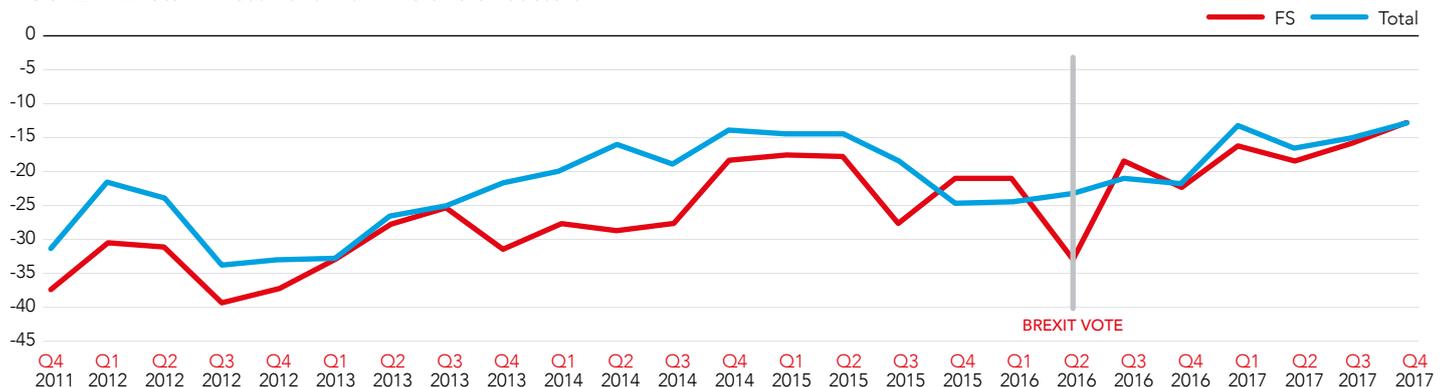


FIGURE 1.2: Staff investment within FS and all sectors





2. Brexit in focus

The difficult and protracted nature of the Brexit negotiations has taken its toll on the FS sector: firms are more concerned now than they were for last year's analysis of risk perceptions.

RISKS OR OPPORTUNITIES?

Almost half (49%) the representatives of the FS firms surveyed for this report stated that the risks posed by Brexit today are greater than the opportunities; just 14% believe the opposite. That negative imbalance has increased markedly since last year, when it was 40% to 16%.

The amount of time it took to reach agreement on the first part of the Brexit negotiations – the terms of the UK's departure – may be one explanation for this decline in sentiment, particularly since there is no clarity on whether this deal is legally binding. Officials are only just starting talks about the terms under which the FS sector will engage with the EU, and time is running out for securing a deal. Moreover, while the sector was at one stage promised it would be given a detailed position paper setting out the UK government's negotiating priorities for finance services, ministers have more recently indicated this may never be published (Parker 2018).¹

Many FS firms are not expecting the trade-off between risks and opportunities to improve in the years ahead. In March 2019, as the UK leaves the EU, the outcome of negotiations should be much clearer, yet 42% of firms still expect the risks posed by Brexit to outweigh the opportunities; only 23% take the opposite view.

Nonetheless, some firms seem to view Brexit as a short-term headwind instead of a long-term, systemic threat. One-third (33%) expect that in five years' time the opportunities presented by Brexit will be greater than the risks – finally outnumbering the 32% that expect the opposite.

Certainly, some of the most dramatic predicted impacts on the City have yet to materialise. While early analysis of Brexit suggested it could cause up to 75,000 job losses in the UK's FS industry (Ahmed 2017), the City itself now predicts a figure between 5,000 and

13,000, and the Bank of England's estimate is 10,000, though the outlook for the years following Brexit is mired in uncertainty. (Jones 2018a).

'In my view, the FS sector is more optimistic now than 12 months ago, particularly since the chances of a "no-deal" Brexit seem to be receding', says Michael Taylor, an economics research fellow at Policy Exchange, a think tank.

'I get the sense that there is now a focus on the potential opportunities of Brexit', he says. 'In particular, for the UK to have a sensible regulatory approach designed to address information asymmetries and systemic risk, rather than to proceed with the European approach, which has been to prevent firms doing anything other than what has specifically been designated as permitted'.

Taylor's view is supported by this report: one of the opportunities strongly

¹ Parker (2018), 'UK Shelves Financial Services Brexit Position Paper', [online article], *Financial Times*, 22 January <<https://www.ft.com/content/783a0840-ff71-11e7-9650-9c0ad2d7c5b5>>, accessed 12 March 2018.



of respondents say that leaving without a transitional agreement would have a significant impact on their businesses.

highlighted by a significant minority of respondents is the potential for developing a different regulatory environment for the UK outside that of the EU. In a market environment where margins are under pressure, firms also see the potential for cost advantages. A year ago, many firms picked out the possibility of moving to lower-cost locations to reduce long-term costs; this year, the priority for firms is more likely to be streamlining their operations during the Brexit adjustment.

But securing these gains means overcoming a broad range of risks, with market access continuing to dominate firms' concerns. In three out of five sub-sectors, firms highlight the costs of having to set up new subsidiaries in the EU or the UK, and retail banking and investment banking flag up the difficulty of transferring funds across the new border (see Figure ES1 above).

Away from market access, the inadequate quality and quantity of communication from the government and regulators, along with the falling value of sterling, are widespread concerns.

NO DEAL IS A BAD DEAL

With no final Brexit settlement likely to be in place by March 2019 when the UK leaves the EU, FS firms' immediate priority is for a transition deal to be agreed. The sector does not want to be confronted with the prospect of 'No deal'.

A so-called 'cliff-edge' Brexit would see UK FS firms losing their passporting rights of access to EU markets, with no agreement on how to ensure continuing trade and smooth financial flows. Almost one-quarter (23%) of the respondents to this report say that leaving without a transitional agreement would have a significant impact on their businesses; 48% expect at least some such impact; and 6% are concerned that it would threaten their very viability.

Similarly, one-quarter (25%) of the firms surveyed warn that if the UK were to leave the EU with no deal and revert to WTO tariffs, there would be significant impact to their businesses, and 46% predict at least some impact. As for the 'cliff edge' scenario, a further 6% warn that a no-deal Brexit could threaten the viability of their businesses.

Recent analysis commissioned by the Mayor of London's office underlines what is at stake (GLA and Cambridge Econometrics 2018). It suggests this worst-case scenario could mean that by 2030 there will be 500,000 fewer jobs in the UK than would otherwise be the case, with the financial and professional services sector hit hardest, down by 119,000 jobs.

So the pressure is on to secure a good deal for the UK's FS industry. But the headwinds are inescapable: the lack of a single EU market for services, for instance, will make the negotiations more challenging. And Michel Barnier, the EU's chief Brexit negotiator, has publicly insisted that the UK will not be able to secure a bespoke deal on FS (Rankin 2017).

Not every FS business is concerned, however: 23% of the respondents for this report expect no impact if there is no transitional period, and 22% say the same of a 'no-deal' Brexit.



of respondents say they have made advanced plans (rising to 28% in larger firms) and put in place contingency measures.

AN UNREADY INDUSTRY

In last year's report, significant numbers of FS firms said they were some way off being ready for Brexit. That picture has not improved.

Just a year away from the UK's exit from the EU, 23% of firms (and 31% of SMEs) either have not made plans or are unclear about what to do – barely changed from 24% last year (and 30% of SMEs). Almost one-third (32%) say they are only at the stage where they are assessing the high-level impacts, which is exactly the same proportion as last year (for SMEs this is 29% this year, versus 30% last year).

Overall, some firms have done better, but the numbers are small: 18% say they have made advanced plans (rising to 28% in larger firms) and put in place contingency measures (up from 13% last year), and only 8% say their planning is now complete and initial work has begun on executing the strategy (up from 5% a year ago). Only 2% say the execution of their strategy is fully under way.

Given how little clarity there is about the eventual outcome of the negotiations, this lack of readiness may

be understandable. But many firms are not expecting to have made a great deal of progress even at the point at which the UK leaves the EU.

By March 2019, 18% expect either that they will still be unclear about what to do or will not have made plans, and the same proportion expect that they will be in only the early stages of planning. At the other end of the scale, the number of firms that expect to have made advanced plans by then has increased only very marginally, to 19%, while 27% expect either to have begun work on execution or to have execution fully under way.

This lack of progress on planning and execution is another reason why a transition deal is so important to the FS industry. Some forward planning is possible, but until a Brexit settlement is agreed it will not be possible to finalise those plans – let alone implement them.

'There's been a mad scramble of contingency planning since day one after the referendum', says Policy Exchange's Michael Taylor, 'but there's a limit to how much you can do while you're basing your planning on a range of hypothetical scenarios'.

RESOURCING FOR RESILIENCE

The lack of clarity about the outlook is part of the reason for many firms' lack of readiness, but there is another problem: FS businesses have not been putting resource into preparing for Brexit.

More than one-third of respondents (38%) say they do not currently have anyone working specifically on strategic planning for Brexit. A further 22% have only one to four people doing this work, and 15% have between five and nine.

In a minority of cases, FS firms have formed bigger teams to work on Brexit: 16% of respondents have 20 or more people in their teams.

Nonetheless, quality is as important as quantity. Despite their lack of workforce preparation, many firms are surprisingly sanguine about their capabilities. Over one-quarter (28%) give themselves 'five out of five' when asked to rate their organisations' capabilities for meeting the risks and opportunities of Brexit, and another 28% give themselves 'four out of five'. Just 14% see themselves as poor: 5% gave themselves 'one out of five', and 9% 'two out of five'.



3. The sub-sectors: a closer look

FS is a diverse industry, comprising businesses with very different characteristics and considerations. This chapter looks at the implications of Brexit for five specific sub-sectors: retail banking, corporate banking, investment banking, asset management, and fintech.

RETAIL BANKING

In line with last year's report, many retail banks are still concerned that communication from government and regulators about their proposed approach to Brexit is insufficient or unclear. These banks are wondering whether and how they will be able to continue operating throughout the EU in less than a year's time. This communication issue presents significant problems.

'Most firms at this point are planning for a hard Brexit, because while there's talk of a soft Brexit and of transition periods, the reality is that nothing is certain until it's agreed', says Lindsey Naylor, a partner at the consultant Oliver Wyman. 'In any case, while a soft Brexit, with customs union membership, say, works well for manufacturers, it doesn't cover financial services'.

The focus now for the leading British banks is to make sure they are not locked out of key European markets if there is no deal securing their passporting rights.

Barclays Bank, for instance, has already signed a lease for more office space in Dublin, and HSBC is considering moving jobs to Paris. Even those banks with more limited operations in the EU are making plans. Lloyds Bank is reportedly close to choosing Berlin as its European base for securing EU access, and Royal Bank of Scotland has signalled that it may move staff to Amsterdam (Reuters 2017).

This manoeuvring could create new opportunities for banks, according to Naylor. 'For firms restating their commitment to Europe and putting people on the ground, this will get them closer to their clients', she says. 'Also, some firms will retrench, because the economics don't work for them, so that creates opportunities to gain market share'.

That could be important for profitability. The UK is now moving back towards a tighter monetary policy – with sterling devaluation and higher inflation supporting the case for higher interest rates – but there is no guarantee that this will boost banks' margins in the traditional way.

In any case, in the fiercely competitive retail banking sector, spreads may not widen so significantly as rates rise – and, given the UK's high levels of indebtedness, the potential losses on non-performing loans may negate any improvements in margins.

Against this backdrop, and despite the current level of uncertainty, retail banks need to step up their Brexit preparations. This report shows that significant numbers are either still at an early stage of planning or have not even begun to prepare, and there is little expectation of any improvement on that, even by the time of the UK's exit from the EU.

CORPORATE BANKING

Corporate banks are equally concerned that poor communication by government and regulators in the UK and Europe is forcing them to plan for the worst. They are particularly concerned that a no-deal Brexit or leaving the EU without a transition agreement would damage their businesses.

In the short term, investment banks are pinning their hopes on a transition deal. Nearly three-quarters (71%) warn that a UK exit from the EU without such an agreement would damage their business.

That concern has prompted many corporate banks to invest significantly in Brexit preparations. But that readiness does not diminish the significant challenges ahead, warns Lindsey Naylor. 'In a very hard Brexit, we risk going from a position of being one of the most connected economies in the world to one of the least', she says. Oliver Wyman's own research suggests that of the 35,000 jobs that could be lost from FS as a result of Brexit, as many as 17,000 could come from wholesale banking.²

Some analysts expect Brexit to shake up European corporate banking. More than half the corporate customers surveyed by Saxo Payments last year said they were reconsidering their banking partnerships in the run-up to Brexit, and one-third said they would move their business away from the UK (Finextra 2017).

So the stakes are high, and get higher still when considering the attendant risks to the broader economy: the problems faced by corporate banks are likely to have a knock-on effect on the customers they serve. A retrenchment in the sub-sector, for example, if banks are locked out of certain markets or are put off by the costs of entry, could limit the supply of credit to small and medium-sized enterprises.

The banks that are now planning for a 'hard' Brexit are focusing on a day-one operating model that enables them to offer continuity of service to key clients by increasing their footprint in EU markets. Yet that may not be sustainable in the medium to long term as the European Central Bank continues to seek tougher banking supervision across the bloc.

There are, however, glimmers of positivity in the study: corporate banks are more likely than the other sub-sectors to see Brexit as an opportunity for improving trade with non-EU countries. Some multinational banks may now choose to reallocate resources from less-profitable EU markets to more potentially lucrative areas, such as the US and Asia.

INVESTMENT BANKING

Investment banks' biggest concerns about Brexit centre on market access: how will they be able to make cross-border transfers once the UK has left the EU? And to what extent will they be forced to set up new subsidiaries in key markets, or at least increase their presence on the ground?

'Operationally, it's more difficult and costly to operate through subsidiaries or to ensure your local activities have more

substance on the ground, which is what European regulators are looking for', warns Philippe Morel, worldwide leader for capital markets at the Boston Consulting Group (BCG). 'And that fragmentation is coming at a time when these industries face increasing capital demands through standards such as Basel III and Solvency II'.

BCG's research suggests that the greatest scope for disruption lies in securities and derivatives trading, which is highly concentrated in London. Trades with other EU clients now booked in the UK are estimated to be worth €380bn in risk-weighted assets, or €1,100bn in trading assets, which suggests that about 68% of all trading between EU clients is currently booked in the UK (BCG 2017).

In the short term, investment banks are pinning their hopes on a transition deal. Nearly three-quarters (71%) warn that a UK exit from the EU without such an agreement would damage their business. Under an interim agreement, banks may be able to use remote booking and back-to-back risk-management models that satisfy European regulators while allowing them to maintain operations in the UK. Nonetheless, in the longer term this compromise is unlikely to be

2 <www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2017/aug/OW-Wholesale-Banking-Brexit-Briefing.pdf>.

Many asset managers have built significant retail and institutional funds businesses throughout the EU, so they do not want any Brexit outcome that makes it more difficult to operate and develop these businesses.

sustainable, and initial optimism that a deal on cross-border recognition might be secured is now fading.

In January 2018, the Bank of England warned that its EU counterparts do not share its view that investment banking regulation should continue to operate across borders after Brexit (unlike the more localised approach that is likely for retail banking) (Binham 2018).³ If negotiations reach an impasse, the Bank of England is likely to reconsider allowing EU-headquartered investment banks that access the City through their branches under an EU passport to apply for new regulatory licences – an offer that would depend on reciprocity for UK-based banks.

Meanwhile, a separate issue is the future of euro clearing, which London dominates through LCH, the London Stock Exchange's clearing house subsidiary. Draft reforms that give the EU powers to force the relocation of the clearing of euro-denominated assets from overseas markets to within the EU are widely seen as an attack on London, though in recent months there have been suggestions that the reforms may be softened (Jones 2018b).

ASSET MANAGEMENT

Many asset managers have built significant retail and institutional funds businesses throughout the EU, so they do not want any Brexit outcome that makes it more difficult to operate and develop these businesses. In this context, 80% of asset managers (including 7% who say it may make their business model unviable) are concerned about the impact of leaving the EU without a transitional deal in place, and similar numbers warn that a 'no-deal' Brexit would be damaging.

'The current passporting of funds and services is seen as highly desirable as it delivers both efficiency and lower costs to end investors. The industry is clear that it needs an appropriate transitional and end solution that works for investors', says Gillian Lofts, leader of the UK Wealth & Asset Management Business at EY.

Lofts does not think that asset managers see no way round this issue, but rather that they are concerned about the navigational costs and impact on consumers. 'Most asset managers have fairly optimised operating models, with limited duplication of activities in different locations', she says. 'They are often passionate about a

global model where asset management or distribution or product location is centred in one single global hub'.

It is in this context that asset managers cite the increased costs of setting up new subsidiaries in overseas markets as one of the four Brexit risks of greatest concern. A retreat from the 'central hub' operating model, or even simply moving the hub to a new location inside the EU, threatens their operational efficiency.

Increasing numbers of asset managers now favour the management company – or 'ManCo' – model, with Luxembourg and Dublin the most favoured EU locations (Ali 2017). But they need to accelerate their preparations: about half warn that they are either still at the earliest stage of planning for Brexit or have not yet started to plan. With quite long lead times in Luxembourg and Dublin, time is running out to get applications filed for the moment of the UK's exit.

Despite these uncertainties, however, asset managers are generally upbeat, possibly since many already have bases in other EU countries. Research conducted by PwC and the CBI found that while the sub-sector shared other FS firms' concerns

³ Binham (2018), 'Investment Bank Regulation Flagged as Next Brexit Flashpoint' [online article], *Financial Times*, 16 January <<https://www.ft.com/content/a1acb7fc-fab9-11e7-9b32-d7d59aace167>>, accessed 12 March 2018.

Compared with their peers in the other sub-sectors covered in this report, the fintech respondents are consistently more conscious of Brexit risks and less confident about their ability to cope.

about the uncertain outlook, asset managers' optimism has improved since last year, and is now ahead of the rest of the FS industry (PwC/CBI 2018).

Preparations for the revised Markets in Financial Instruments Directive (MiFID II), which came into force in January 2018, may be one factor underpinning this improving confidence. MiFID II compliance forced many asset managers to consider Brexit issues because they had to decide where to locate their MiFID-licensed entity. This has given those firms a head start.

FINTECH

Compared with their peers in the other sub-sectors covered in this report, the fintech respondents are consistently more conscious of Brexit risks and less confident about their ability to cope. Significantly more fintech companies than those in other sectors say that Brexit will present more risks than opportunities than vice versa, even in five years' time.

This may in part reflect their relative size and therefore their lack of resources for preparing for Brexit: many fintech companies report that they currently have no one working on strategic planning for the UK's exit from the EU. But it also underlines the problems for fintech companies of two risks in particular.

'The two big problem areas are talent and investment', says Lawrence Wintermeyer, who until last year was CEO of Innovate Finance, the body that represents the UK's fintech community. 'More than 30% of our start-up founders come from overseas, and from Europe in particular. On the capital front, more than half the venture funds coming into UK fintech companies are from foreign investors – many of those investors don't know the environment and they're going to sit on the sidelines until there's a greater degree of certainty'.

Innovate Finance continues to warn that these issues must be addressed for the UK to retain its status as Europe's most important centre of fintech activity. In evidence to the House of Lords EU Financial Affairs Committee in November 2017, it called for a package of measures to support fintech companies post-Brexit, including a progressive immigration policy and work to replace the funding that is currently provided by the European Investment Fund, which is worth about £2.7bn a year (innovate Finance 2017).

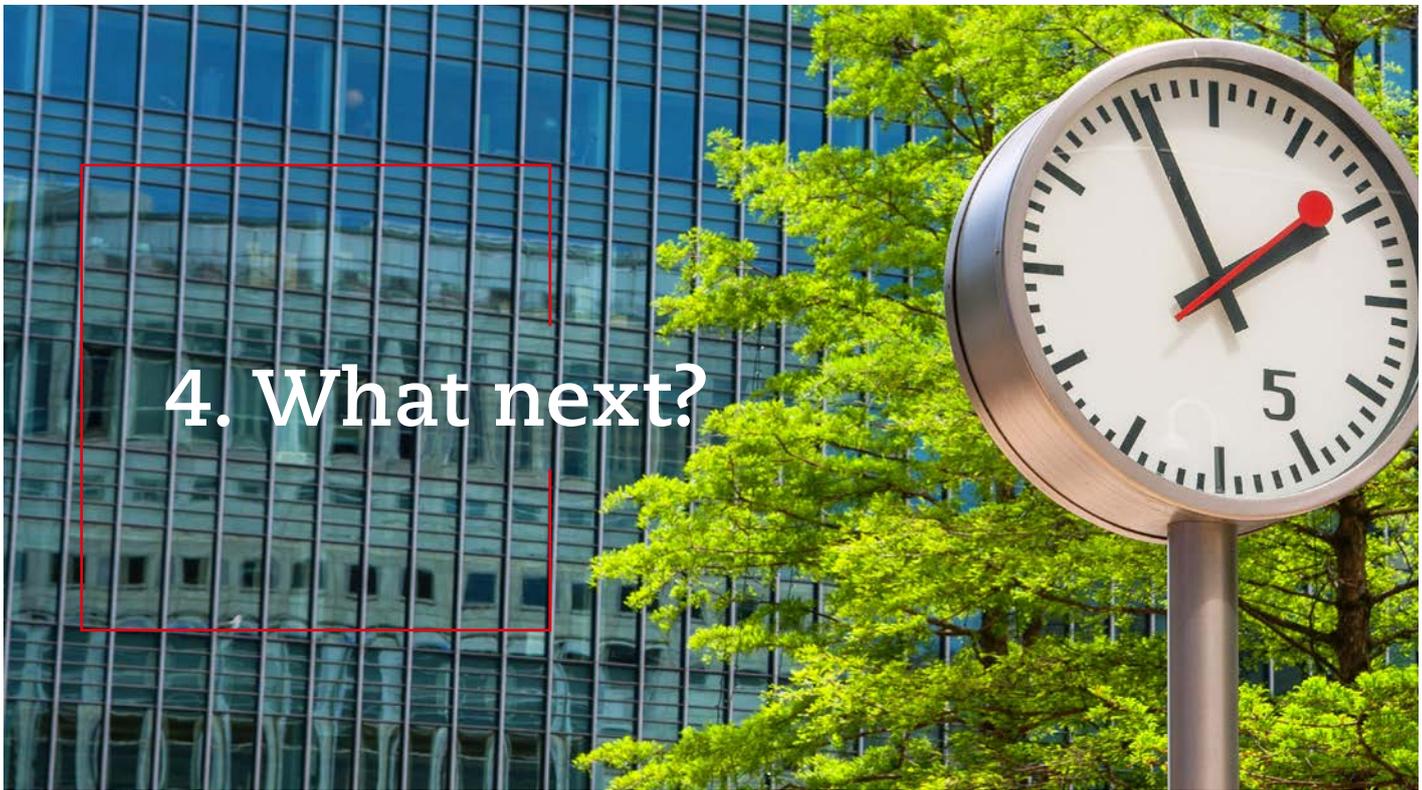
The way the UK leaves the EU is also a huge concern for this sub-sector. About one-quarter of the fintech companies consulted for this report see their business model as potentially unviable without a transitional agreement in place

when the UK exits the EU. The same number warn that they could fail in the event of a 'no-deal' departure.

But it would be wrong to be entirely gloomy. The UK's fintech sector has continued to progress since the referendum, in particular reaching an agreement with China that allows UK fintech companies easier access to one of the world's largest consumer markets. New ties have also been made with South Korea, Singapore, India and Australia, as well as significant investments – such as Japanese firm Softbank's announcement that the headquarters for its £80bn technology investment fund will be located in London.

And while more mature fintech segments, such as payments firms, derive significant revenues from operations in other EU states, they also focus on the Americas and Asia as key markets. For example, mobile money transfer app Azimo raised more than £10m from Japanese e-commerce giant Rakuten in its bid to expand operations in Asia.

Wintermeyer is upbeat. 'Given the world in which we now live, where digital is breaking down borders', he says, 'there will be opportunities and freedoms to do things outside of the EU that we haven't even focused on yet'.



4. What next?

With one year to go until Brexit, policymakers and advisers now negotiating the terms of post-Brexit trade need to secure a deal that will alleviate the concerns of FS firms and help them to exploit the opportunities they have identified.

Last year's study focused on three areas where there was considerable scope for improvement. Since then, however, progress has been patchy.

- **Reducing policy-level uncertainty.** Last year, ACCA made the case for a much clearer articulation of the approach to the Brexit negotiations and a vision for a preferred final outcome. Discussions between the FS industry and ministers have continued, but this year's report again identifies this as a major area of concern. There is still no certainty that the industry will ever be provided with the government's position paper on FS.
- **A bespoke mutual-recognition agreement.** Working out how to maximise two-way access between the UK and the EU is still as pressing as it was a year ago. A bespoke deal for FS seems no longer under discussion, so significant work is required in this area.
- **Segment-level considerations.** Last year, ACCA urged policymakers to inform their negotiating stance through close engagement with every part of the industry. They have made some effort here, with members of the government holding face-to-face talks with the banks, and this work will continue to underpin the UK's approach to Brexit negotiations.

PRIORITIES FOR THE NEXT 12 MONTHS

Time is short, and there is considerable work to do to minimise the potentially adverse impacts of Brexit on UK FS.

1. A favourable deal for FS

It is important that the UK now moves quickly towards securing a transitional agreement. With a significant majority of FS firms looking for reassurance that there will be no 'cliff-edge' Brexit, such an agreement should prolong the passporing regime at least until a new arrangement for FS trade has been agreed, along with a timetable for its implementation.

Large sections of the FS sector cannot countenance a 'no-deal' Brexit. Even a move to an equivalence-based system, though less satisfactory than the status quo (given its limits and the right of the EU to revoke equivalence unilaterally in the future), would be better than a WTO-style default option.

A bespoke free-trade agreement for FS, based on the unique needs of each of the sub-sectors, is a more attractive option. The settlement will also need to address labour-mobility: freedom of movement principles are important to the sector, and crucial to investment banking and fintech.

2. Visibility and transparency

As both reports have highlighted, communication is a problem. Many of the risks perceived by FS firms stem as much from a lack of clarity about the UK government's approach to the Brexit negotiations and its aims as the impact of Brexit itself. In the next stage of discussions, it is vital that the negotiating team and FS leaders establish a more open relationship.

Improved communication would give the government a clearer mandate for negotiating a successful Brexit deal for FS, but it would also help the industry to plan with greater certainty. This is important: this report shows just how much more planning the sector has to do.

3. Focus on the long term

While the priority will naturally be to conclude the negotiations about the terms of a transition deal and the final Brexit settlement, it is important not to lose sight of the long-term opportunities of Brexit.

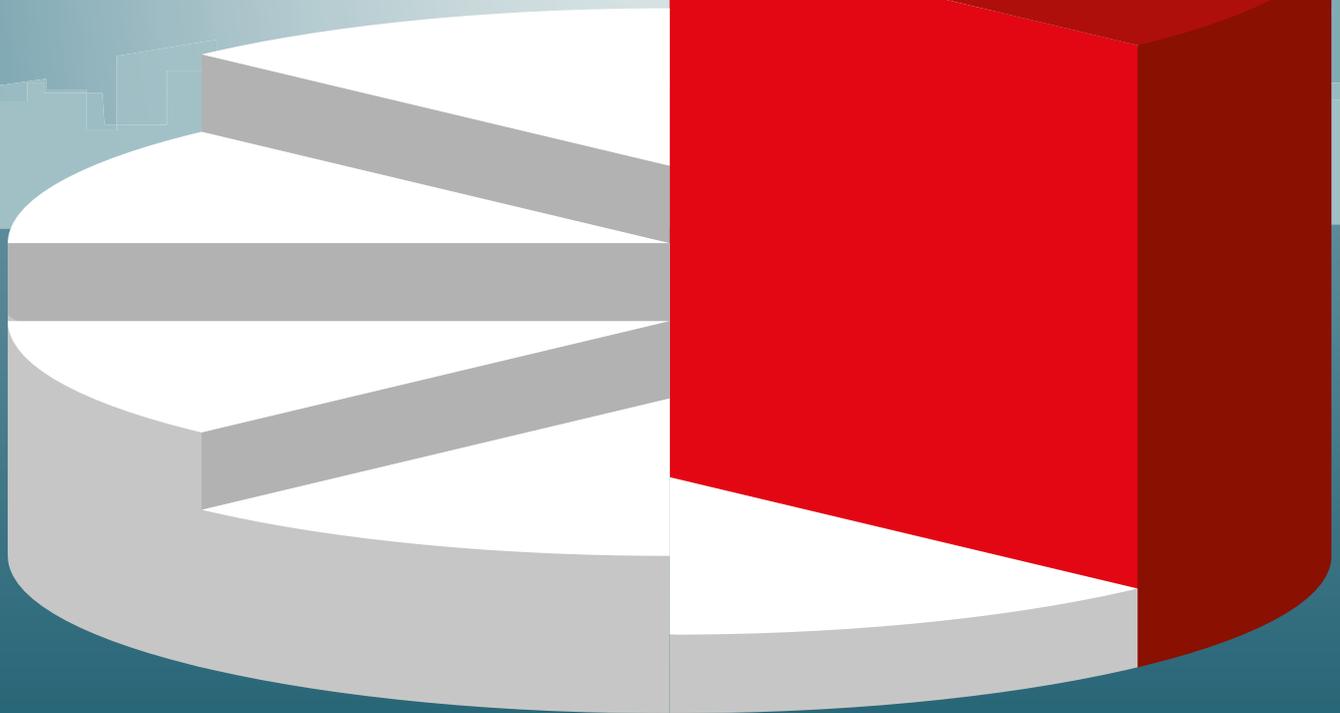
For example, the UK's post-Brexit regulatory environment – albeit in the context of equivalence or a free-trade agreement – has the potential to position the UK's FS sector for growth, both domestically and in international markets. This is a key opportunity to build on the UK's existing world-leading approach to innovation.

Conclusion: Prepare to thrive

With March 2019 just a year away, the race is on to secure a favourable Brexit outcome for FS.

Resolving the uncertainties of policy and implementation will help firms across the industry plan more effectively for a post-Brexit environment.

The challenge is great, but firms that prepare for and rise to it will be well placed to continue prospering – and to maintain the world-leading status of the UK's FS industry.



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