

Think Ahead

ACCA

# Brexit impact on financial services

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ACCA supports its **188,000** members and **480,000** students in **178** countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of **100** offices and centres and more than **7,110** Approved Employers worldwide, who provide high standards of employee learning and development. Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. It believes that accountants bring value to economies in all stages of development and seek to develop capacity in the profession and encourage the adoption of global standards. ACCA's core values are aligned to the needs of employers in all sectors and it ensures that, through its range of qualifications, it prepares accountants for business. ACCA seeks to open up the profession to people of all backgrounds and remove artificial barriers, innovating its qualifications and delivery to meet the diverse needs of trainee professionals and their employers.

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

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This report examines the impact of the UK's decision to 'exit' the European Union (EU), ie 'Brexit', on the financial services (FS) sector. In addition to factors affecting FS as a whole, it incorporates perspectives specific to five segments within the sector, namely, retail banking, corporate banking, investment banking, asset management and FinTech.

The report draws on a survey of the views of ACCA's members working in the FS sector around the world. The intention is to provide a perspective from accounting and finance professionals within FS organisations internationally. These individuals are typically at the heart of the decision-making processes (both planning and implementation) that shape their organisations' responses to Brexit.

Therefore, this is a bottom-up view that acts as a 'temperature gauge' to capture the mood of professionals on the front line, to complement other policy-level top-down views. Additionally, the perspectives are informed by interviews conducted specifically for this report, with six professionals working within or advising FS organisations.

Finally, the report also references existing research particularly where it relates to regulatory considerations. This is for the sake of completeness and context, and this report is not intended to provide a detailed technical opinion on these matters. It is primarily a view of the 'state-of-play' as obtained from the survey of ACCA's FS members around the world.

## **NET VIEW – RISKS VS. OPPORTUNITIES**

Respondents were asked whether, on the whole, they thought Brexit presented more risk or opportunity for their organisation. The number of respondents who viewed it as a net risk (ie risks outweigh opportunities) was more than double the number of those who viewed it as a net opportunity. This dynamic was more prominent in larger FS organisations relative to SMEs, the latter being a bit less concerned about the risks and a bit more hopeful about the opportunities.

## **RISKS – PREMIUM PLACED ON REDUCING POLICY-LEVEL UNCERTAINTY**

*Insufficient or unclear communication by government/regulators on the proposed approach* has emerged as a key area of risk

for survey respondents across all segments within FS. There appears to be an acceptance that a degree of disruption is inevitable, but the time it takes to prepare for it means that organisations place a high premium on finding out, sooner rather than later, what their working environment will be like. Obtaining as much guidance as possible, in the earlier stages, about likely developments appears to be as important as the eventual final outcome.

## **OPPORTUNITIES – COST REDUCTION**

Generally speaking, cost reduction was viewed as the most compelling opportunity presented by Brexit. This could be linked to a move to lower-cost locations or streamlining of operations. In addition to cost reduction, respondents were also alert to the possibility of deriving advantage from greater alignment with free markets, tactical benefits from devalued sterling (GBP), and acquisition opportunities.

## **READINESS**

About half the respondents have started planning, are in the advanced stages of planning, or have completed planning and taken the first steps towards implementation of a post-Brexit plan.

About a quarter of respondents argued that Brexit will not affect their organisation. This may be the case in various scenarios: for example, being in a country with low exposure to the UK or the Eurozone, or perhaps in an organisation/industry where levels of costs and revenues are fixed for the foreseeable future.

On the other hand, one-quarter of respondents admitted to having made no plans at all or to being unclear about what to do. Looking ahead, this group may need to start the process of scenario planning against various possibilities, to avoid being caught out by future events as they unfold.

## **BESPOKE MUTUAL RECOGNITION AGREEMENT**

Although the government has made it clear that the UK will leave the Single Market, the big question is what will replace the rights currently enjoyed within it? A good replacement would be a bilateral agreement, based on mutual recognition that allows for maximum two-way access between the UK and the EU.

Ultimately, the process for determining equivalence must be grounded in technical factors rather than political ones.

Continued regulatory and supervisory collaboration and coherence will be critical to ensuring that the regimes for FS remain broadly consistent and avoid accidental divergence. The UK should promote the development and use of international standards wherever possible to make it easier for the UK and EU to recognise each other's regimes. Safeguards will also be necessary to ensure fair and independent regulatory equivalence determinations, so that one side is not hostage to a unilateral withdrawal of access rights by the other. Ultimately, the process for determining equivalence must be grounded in technical factors rather than political ones.

### SEGMENT-LEVEL CONSIDERATIONS

#### Key risks

Across the segments, *Insufficient or unclear communication by the government/regulators on the proposed approach* is emerging as an area of concern. This is understandable given the complexity of the negotiations to follow, the variety of policy options and the uncertainty of their possible outcomes. The upcoming elections in the UK also mean that it is likely to take some time before clarity emerges.

#### Key opportunities

Respondents' perceptions of opportunities broadly concern cost opportunities and the potential for a more 'free markets' approach with less political intervention in business matters.

**Table E1:** The top risks perceived by different FS sectors

TOP RISKS	RETAIL BANKING	CORPORATE BANKING	INVESTMENT BANKING	ASSET MANAGEMENT	FINTECH
1st	Devaluation of the GBP	Insufficient or unclear communication by government/regulators on proposed approach	Insufficient or unclear communication by government/regulators on proposed approach	Insufficient or unclear communication by government/regulators on proposed approach	Insufficient or unclear communication by government/regulators on proposed approach
2nd	Insufficient or unclear communication by government/regulators on proposed approach	Devaluation of the GBP	Lack of sufficiently robust transitional agreement to cover period between leaving EU and finalising trade deals	Loss of passporting [ability to offer services in Euro-zone based on UK licence or vice versa]	Lack of sufficiently robust transitional agreement to cover period between leaving EU and finalising trade deals
3rd	Increase in UK inflation	Increase in UK inflation	Increased costs for setting up new subsidiaries/offices within EU or UK	Devaluation of the GBP	Increase in UK inflation

**Table E2:** The top opportunities perceived by different FS sectors

TOP OPPORTUNITIES	RETAIL BANKING	CORPORATE BANKING	INVESTMENT BANKING	ASSET MANAGEMENT	FINTECH
1st	Move to lower-cost locations reduces costs in the long term	Move to lower-cost locations reduces costs in the long term	In the longer term, greater alignment to free markets and less political involvement in business matters	Move to lower-cost locations reduces costs in the long term	In the longer term, greater alignment to free markets and less political involvement in business matters
2nd	Streamlining of operations to drive efficiencies	In the longer term, greater alignment to free markets and less political involvement in business matters	UK's ability to strike trade deals on its own can enable my organisation to access new growth markets	Streamlining of operations to drive efficiencies	Escape from excessive EU rules and regulations
3rd	In the longer term, greater alignment to free markets and less political involvement in business matters	Selling of non-core assets or businesses	Higher GBP value of revenues earned outside the UK due to weaker currency	Higher GBP value of revenues earned outside the UK due to weaker currency	Streamlining of operations to drive efficiencies

The UK is the world's largest net exporter of financial services, and in 2015 the EU accounted for 41% of the UK's total FS trade surplus.

This report explores the impact on the FS sector of the UK's vote to exit the European Union (EU), ie 'Brexit'.

Its aim is to act as a link between FS professionals, in particular professional accountants working within FS, and those examining Brexit from a more strategic/policy, ie a top-down perspective. It is hoped that the views of these professionals will complement and bring additional context to other top-down analysis developed by policymakers and advisers as they investigate options for approaches to Brexit negotiations. Accordingly, the report does not seek to opine on technical and regulatory issues, though it refers to these for completeness.

In addition to those who responded to the survey, the following individuals provided views specifically for this report:

- Alan Houmann, Head of Government Affairs, EMEA, Citi
- Lawrence Wintermeyer, CEO, Innovate Finance
- Lindsey Naylor, Partner, Oliver Wyman
- James Stewart, Tax Director, PwC
- Elizabeth Stone, Partner, Asset Management Taxation, PwC
- Ahmed Badr, Head of Legal, GoCardless.

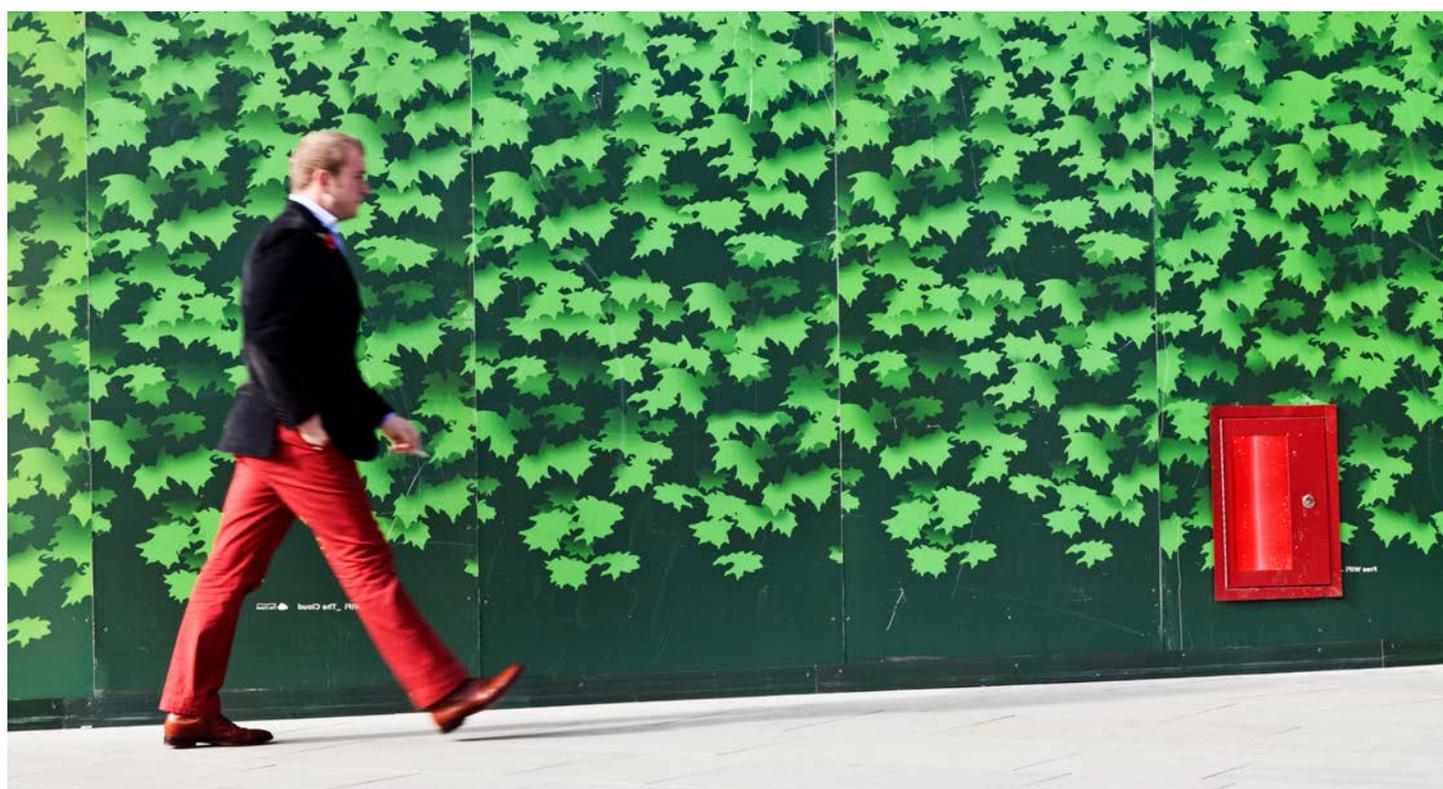
## FINANCIAL SERVICES (FS) AND THE UK

The industry occupies a premier position in the UK's economy. It employs 1.1 million people, earns between £190bn and £205bn in annual revenues and generates an estimated £60bn–£67bn in taxes each year (Oliver Wyman 2016).

The UK is the world's largest net exporter of financial services, and in 2015 the EU accounted for 41% of the UK's total FS trade surplus. The UK's relationships with the EU and other trading partners are therefore critically important.

Article 50 was triggered on 29 March 2017, marking the start of the two-year process for the UK to leave the EU. While only time will tell how this works out, there have been some early clues as to possible developments and the priorities of the UK government.

Prime Minister Theresa May's Lancaster House speech in January 2017 and the publication of the government's white paper signalled a possible leaning towards a so-called 'hard Brexit'. This could mean no membership of the European Economic Area (EEA), no access to the Single Market, and no participation in the Customs Union.



Confidence in the FS sector was below the overall level for all respondents in the immediate aftermath of the Brexit vote, which might be linked to the sector's shock at the 'leave' result.

ACCA has been tracking the views of its members within the FS sector, through global surveys, for several years. The views expressed are updated on a quarterly basis, and therefore reflect 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 255 FS respondents on average for a given quarter. A few headline observations are set out below.

### CONFIDENCE INDEX

ACCA tracks the level of confidence in the economic prospects facing the organisations where its members are working 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. Given the challenging recovery period in the aftermath of the 2008–9 credit crisis sentiment has in general been negative.

Confidence in the FS sector was below the overall level for all respondents in the immediate aftermath of the Brexit vote, which might be linked to the sector's shock at the 'leave' result. Nonetheless, as time has passed and there has been more acceptance of the new situation, FS confidence appears to be recovering.

### 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 (see Figure 1.1). FS as a sector has consistently underperformed the overall average, which may be linked to its being central to many of the issues associated with the global financial crisis, and the subsequently imposed regulatory controls. Additionally, greater automation may also be having a long-term structural impact on staff investment. FS recruitment and training levels suffered particularly around the time of the Brexit vote but, in line with the sector's improving confidence levels, has caught up with the overall levels in the couple of quarters since the vote.

Figure 1.1: Economic confidence within FS and all sectors

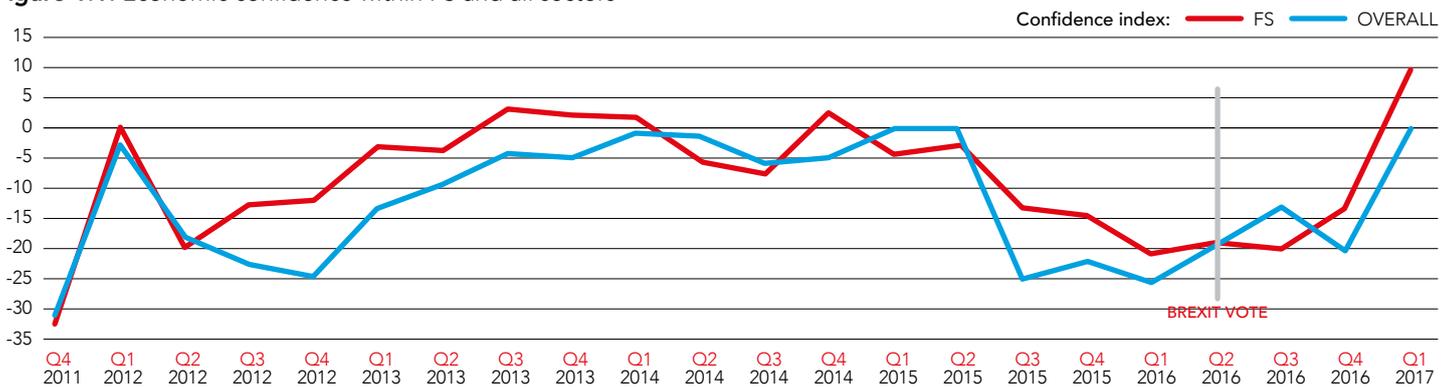


Figure 1.2: Staff investment within FS and all sectors

Increased investment in staff minus Reduced investment in staff: FS (red line), Overall (blue line)



The average view across all sectors shows that levels are flat with an equal number of respondents who thought the availability of investment opportunities was increasing as compared to those who thought it was reducing.

**AVAILABILITY OF INVESTMENT OPPORTUNITIES**

FS appears to have become more optimistic in the aftermath of the Brexit vote, despite the initial fall in confidence immediately after it, perhaps linked to the unexpectedness of the result. The average view across all sectors shows that levels are flat with an equal number of respondents who thought the availability of investment opportunities was increasing as compared to those who thought it was reducing. Nonetheless within FS, respondents seeing more investment opportunities outnumber those seeing fewer opportunities. Whether this reflects a greater appetite within the sector for spotting a good deal is anyone's guess – but at the very least, it does not appear to suggest a tendency to be cautious as part of a defensive retreat.

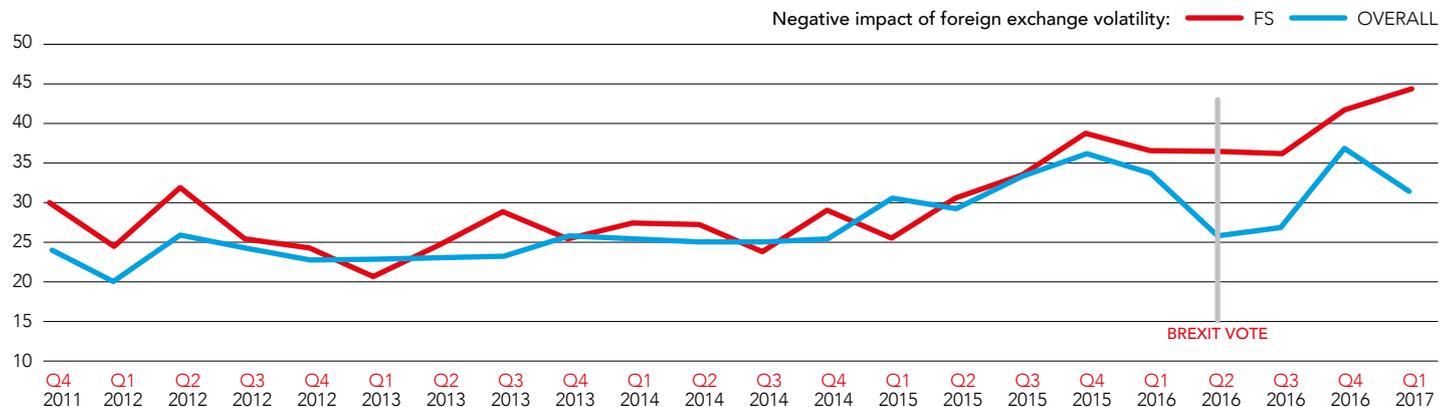
**EXCHANGE RATES**

Across all sectors there is a general increase in the perception of the negative impact of exchange rate volatility. This effect is more pronounced among respondents in FS than the overall all-sector average and appears to be enduring, whereas the overall average level of concern has seen some reduction in the most recent data. The fall in sterling (GBP) in the months after the vote may be one of the key factors here. Foreign exchange (FX) markets are very sensitive to sentiment and perceptions of uncertainty – the ability to achieve a smooth and orderly Brexit, with as few surprises/shocks as possible, will be particularly valued here.

**Figure 1.3:** Perceptions of availability of investment opportunities within FS and all sectors



**Figure 1.4:** Perceptions of the negative impact of foreign exchange volatility within FS and all sectors



The number of respondents who viewed it as a net risk (ie that risks outweigh opportunities) was more than double the number of those who viewed it as a net opportunity.

The previous observations are based on long-standing metrics that ACCA has been tracking since well before the Brexit vote. In addition, questions tailored more specifically to the effects of the Brexit vote were added to ACCA's quarterly global economic conditions survey (GECS) for data gathered between November 2016 and February 2017. This section examines the key findings from this initiative.

A total of 271 finance and accountancy professionals working within the FS sector responded to ACCA's survey. The respondents were a diverse group. Geographically, about one-quarter of them were in the UK while the remaining three-quarters were based elsewhere in the world. About one-third were categorised as 'senior management' – this includes job titles such as chief executive officer (CEO), chief financial officer (CFO), director, executive, founder, head, partner, senior executive, senior manager, senior vice president and vice president. Slightly fewer than half the respondents worked for small and medium-sized enterprises (SMEs). Slightly under one-fifth worked for organisations with a single office in one country – the others had more than one office, either all in one country or spread across countries.

### OVERALL PERCEPTION OF BREXIT

Respondents were asked whether, on the whole, they thought Brexit presented more RISK or OPPORTUNITY for their organisation. The number of respondents who viewed it as a net risk (ie that risks outweigh opportunities) was more than double the number of those who viewed it as a net opportunity. This was more prominent among larger FS organisations relative to SMEs, the latter being a bit less concerned about the risks, and a bit more hopeful about the opportunities.

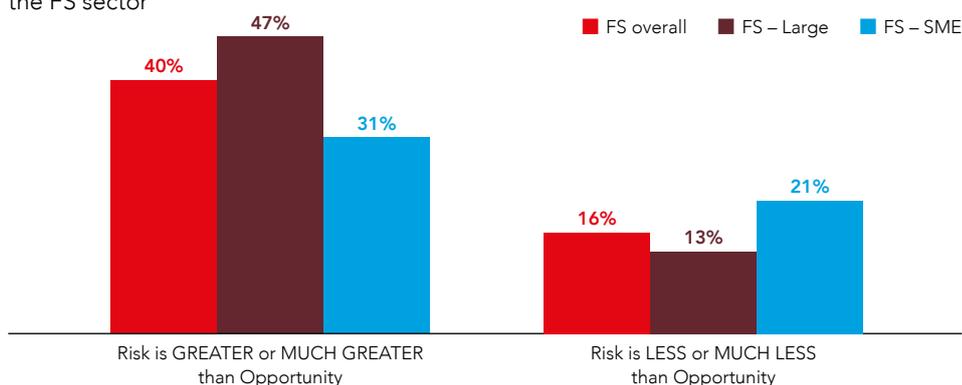
### READINESS FOR BREXIT

About half of the respondents are in a 'middle' group in relation to their level of planning for Brexit and their implementation of any plans. Most of this group have started planning; some are in the advanced stages of planning, while a select few have completed planning and started taking the first steps towards implementing their plans.

On either side of this middle group are two outliers, each representing about one-quarter of the respondents.

The first group is arguably of less concern than the second. This first group

**Figure 2.1:** Perceptions of risk and opportunity among SMEs and larger businesses in the FS sector



While a larger organisation might set up a project team to understand the implications of Brexit, an SME is unlikely to be able to afford this luxury.

comprises those who take the view that Brexit does not affect their organisation. This may be the case in various scenarios: for example, being in a country with low exposure to the UK or the Eurozone; or perhaps in an organisation/industry where levels of costs and revenues are fixed for the foreseeable future.

The second outlier is more concerning. Almost one-quarter of respondents admitted to having made no plans at all or to being unclear about what to do. Looking ahead, this group may need to start the process of scenario planning against various possibilities, to avoid being caught out by future events as they unfold.

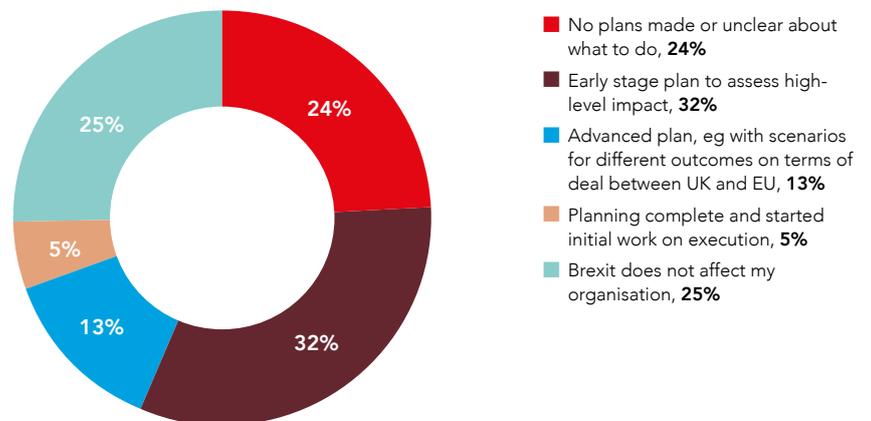
Looking at these two outliers, there is some divergence between organisations of different sizes, with a greater proportion of

SMEs than of large organisations in both groups (Figure 2.3).

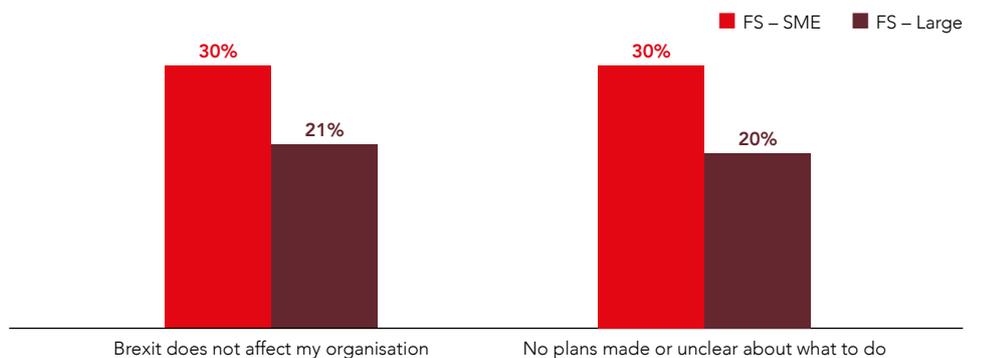
This may reflect many possible factors. For those that assume that Brexit will not affect their organisation, one reason might be having a more localised business model with little or no dependency on cross-border trade and labour.

One explanation for the lack of plans or clarity about what to do may simply be a matter of capacity. While a larger organisation might set up a project team to understand the implications of Brexit, an SME is unlikely to be able to afford this luxury. Fitting in a significant amount of bespoke reading and analysis linked to a single one-off event, on top of all the pressures of daily responsibilities might just be too much for some.

**Figure 2.2:** Proportions of businesses by level of readiness for Brexit



**Figure 2.3:** Perceptions of Brexit and planning for it among SME and larger FS businesses



Insufficient or unclear communication by government/regulators on proposed approach has emerged as the top risk perceived by UK respondents.

### LOSS OF PASSPORTING

Recent statements from the UK government have suggested that it may be difficult to secure passporting for FS firms once the EU exit has occurred. This is generally viewed as one aspect of the so-called 'hard Brexit' and poses particular questions for the FS sector, many parts of which rely extensively on passporting for cross-border transactions and servicing clients across boundaries. About a quarter of respondents classified the loss of passporting as a significant issue, or one that could threaten the viability of certain of their activities. On the other hand, slightly under one-third took the view that this would have no impact on their business (see Figure 2.4).

### SUMMARY OF KEY RISKS

Respondents were asked to provide a score between 1 and 10 for a range of risks, with 1 signifying the lowest level of risk and 10 the highest. Table 2.1 below summarises average risk scores across the respondents. This is done in descending order of UK scores, ie highest risk as scored by UK respondents at the top with the corresponding non-UK score for that risk shown alongside.

*Insufficient or unclear communication by government/regulators on proposed approach has emerged as the top risk perceived by UK respondents. This also ranks very highly among non-UK respondents, having the second-highest score for this group, marginally behind Devaluation of the GBP.*

Figure 2.4: Perceived impact of loss of passporting

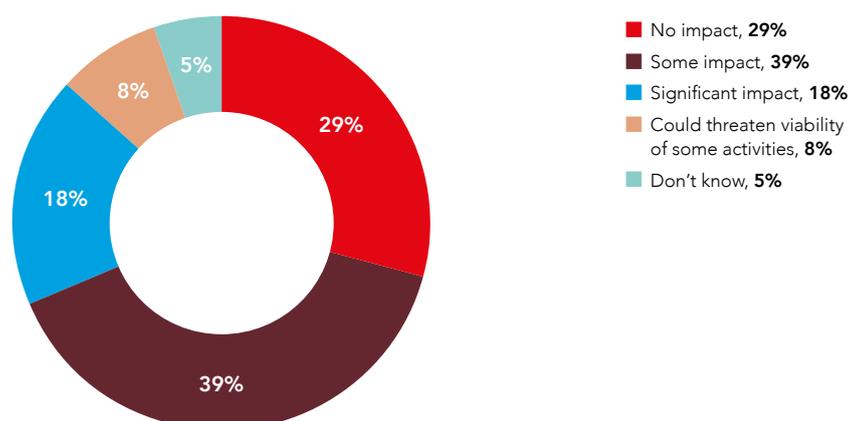


Table 2.1: Perception of relative seriousness of various Brexit-linked risks by UK and non-UK respondents

RISK SCORES	UK	NON UK	UK HIGHER THAN NON UK?
Insufficient or unclear communication by government/regulators on proposed approach	6.8	5.5	Yes
Loss of passporting [ability to offer services in Euro-zone based on UK licence or vice versa]	6.3	4.7	Yes
Lack of sufficiently robust transitional agreement to cover period between leaving EU and finalising trade deals	6.3	5.3	Yes
Devaluation of the GBP	5.9	5.6	Yes
Increase in UK inflation	5.7	5.3	Yes
Devalued perception of the UK among investors	5.7	5.1	Yes
Increased costs for setting up new subsidiaries/offices within EU or UK	5.6	5	Yes
Changes in operating model, organisational structure and internal processes	5.2	4.7	Yes
Difficulty in servicing clients based in the UK or EU	5	4.6	Yes
Some areas of business permanently moving away from London to Eurozone (eg euro denominated clearing)	5	5.2	No
Access to infrastructure for UK financial service entities (eg TARGET2 payments system for euro area)	4.8	4.8	Yes
Loss of, or difficulty in hiring, skilled workforce	4.7	4.3	Yes
Difficulty in transfer of funds in and out of UK or EU	4.7	4.3	Yes
Impact on data storage / privacy laws	3.9	4.2	No
Moving headquarters away from London	3.8	4.1	No

On the vast majority of risk factors, UK respondents perceive higher risk than non-UK ones, perhaps unsurprising given the more direct connection to the issue at hand.

On the vast majority of risk factors, UK respondents perceive higher risk than non-UK ones, perhaps unsurprising given the more direct connection to the issue at hand. There are, however, three issues where non-UK respondents perceive greater risk than those from the UK. Two of these relate to migration – namely of offices (headquarters) or certain lines of business. The lower UK scores may reflect prevalent arguments in some quarters in the UK that the scale, deep/longstanding skills pool and appeal of London will ultimately win out. Whether this reflects reality or misplaced confidence will become clearer in the years after the UK has left the EU. Views on *Impact on data storage/privacy laws* may be linked to the upcoming General Data Protection Regulation (GDPR), which is to come into force in the EU by mid-2018, and is perhaps not a great concern (yet) among UK respondents. This regulation is intended to strengthen data protection for individuals within the EU and to harmonise regulations throughout the region.

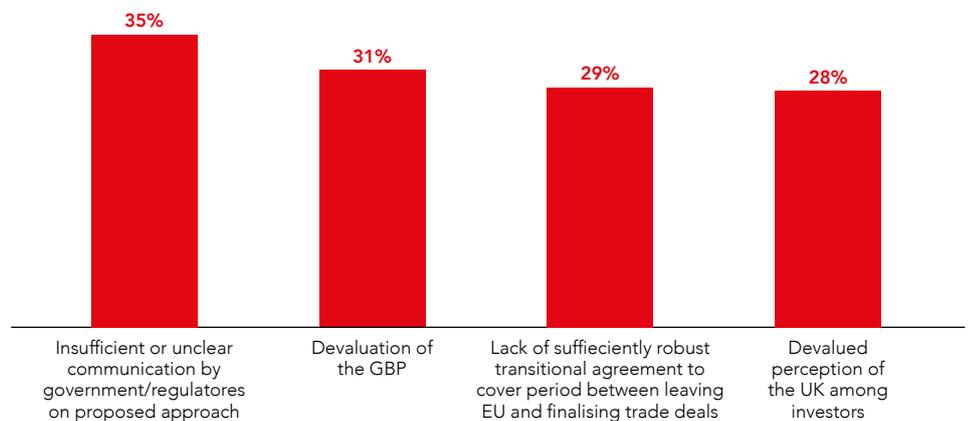
### HIGH RISK SCORES

When understanding risks, both volume (number of respondents) and value (individual risk score) play a part. Each of the risk scores in Table 2.1 is an average across the pool of respondents, and almost all lie between 4 and 7. In other words, the volume effect (with a larger number of respondents giving lower scores) dominates to provide this relatively 'middle of the road' range.

There are however risks that received scores at the top end of the scale, ie 8, 9 or 10 from some respondents. These scores have been categorised as 'high' risk scores and have been used to inform the view on high-value risks (see Figure 2.5).

The number of respondents who gave these items high scores was not large enough to raise the overall average, but it is instructive to examine risks that received high scores from the largest number of these respondents.

**Figure 2.5:** Risks perceived as 'high' by respondents globally



Overall, cost reduction was viewed as the most compelling opportunity presented by Brexit.

*Insufficient or unclear communication by government/regulators on proposed approach* again emerged as the risk most frequently given a 'high' score by respondents, about a third of all respondents globally. Many of the perceived risks of Brexit are ultimately the product of uncertainty, and a key stakeholder to reduce that uncertainty will be the UK government.

Uncertainty clearly has an optionality cost ('should my organisation prepare for this scenario or that one?'), but it also has a time cost. It takes most organisations several months, sometimes years, to move from analysis to scenario planning and then to change management and implementation.

It is not surprising that businesses will try very hard to reduce uncertainty and, if pushed, may well prefer to take a view for themselves (for example, their worst-case scenario) and start planning or implementing on that basis. This could result in sub-optimal outcomes not because of an inability of governments to

reach an attractive settlement eventually, but because of the prolonged uncertainty before getting one.

#### **SUMMARY OF KEY OPPORTUNITIES**

Opportunities were scored in much the same way as risks, ie on a scale of 1 to 10, with 1 being the least attractive opportunity and 10 the most attractive.

Overall, cost reduction was viewed as the most compelling opportunity presented by Brexit. Some opportunities may arise directly as a result of new ways of doing things following Brexit. As can occur when there are large-scale changes, this can sometimes also be an opportunity to push through cost reductions that organisations might have found difficult to justify in normal circumstances. In addition to cost reduction, respondents were also alert to the possibility of deriving advantage from greater alignment with free markets, tactical benefits from devalued GBP, and acquisition opportunities.

**Table 2.2:** The perception of opportunities resulting from Brexit

OPPORTUNITY SCORES	GLOBAL
Move to lower-cost locations reduces costs in the long-term	4.4
Streamlining of operations to drive efficiencies	4.4
In the longer term, greater alignment to free markets and lesser political involvement in business matters	4.3
Higher GBP value of revenues earned outside the UK due to weaker currency	4.2
Acquiring businesses due to lower valuations of potential targets in current market	4.1
Ability to grow certain product lines more quickly	4.1
Escape from excessive EU rules and regulations	3.9
UK's ability to strike trade deals on its own can enable my organisation to access new growth markets	3.9
Selling of non-core assets or businesses	3.8

The segments examined include retail banking, corporate banking, investment banking, asset management and FinTech.

FS is a diverse industry comprising many types of business that may have completely different characteristics and considerations. In order to examine this more closely, five segments are considered in this section to throw some light on the next level of detail, underneath the wider FS umbrella. The segments examined include retail banking, corporate banking, investment banking, asset management and FinTech.

## RETAIL BANKING

*Insufficient or unclear communication by the government/regulators on the proposed approach* emerged as a key risk – a common theme across the different segments.

In an industry as regulated as FS, organisations need certainty. It will take time to adjust business models to the new post-Brexit environment and, where required, obtain the licences to operate in different countries. The sooner firms have a clear understanding of what they face, the better they can adapt.

For example, Lloyds is understood to have decided it will transform its Berlin branch into a subsidiary to ensure that it can continue to service its limited European activities (Telegraph 2017). This may help it to support and develop its German savings accounts business. The bank plans to submit an application to the German regulator to change the branch's status in September.

It is important to recognise that while there are segment-specific characteristics, individual bank business models will also play their part. Barclays for example, has announced plans to hire approximately 2,000 new staff across the UK over the next three years, as it seeks to bring a lot of its technology development in-house in an effort to achieve better control of what it considers a core competency. 'In the face of Brexit, rather than decreasing employment or moving people out of the UK, Barclays is actually re-investing in the United Kingdom and growing our labour force in this country', said CEO Jes Staley (Bloomberg Brexit 2017).

## CORPORATE BANKING

Corporate banking is a sector that is likely to experience a significant impact from Brexit. The number one risk for this sector again centres on the need for clear communication from government and regulators.

Banks will not want to make unnecessary operating model changes to safeguard market access, but waiting in the hope of a deal could leave them scrambling at the last minute, and shifting operations to avoid being shut out of the EU market. If they wait too long, they risk further delays by being at the back of the queue for obtaining regulatory approval. This means that firms will have to make a decision on their operations no later than the end of 2017 and more likely by the third quarter.

Closely linked to that decision is the prospective loss of passporting, which is especially valuable for the banking sector. The key piece of EU legislation for wholesale banking is the Capital Requirements Directive (CRD IV), which covers deposit-taking, lending, payment services, broking, securities issuance and portfolio management. But CRD IV does not allow for third-country market access via regulatory equivalence.

For Alan Houmann, head of government affairs at Citi Corporate & Investment Banking, the costs and disruption of Brexit outweigh the benefits for banks – at least in the short to medium term. "The costs are quantifiable", he says. Any benefits, on the other hand, "are very long-term and hard to quantify, so they are beyond most people's planning horizons."

Where Brexit is creating an opportunity, is in forcing banks to take a fresh look at their business models. "The idea of the industry being concentrated in hubs is the norm. What this shows is maybe that is not the best way to behave." And while banks have spent much of the past 10 years since the financial crisis restructuring to improve efficiencies, cut costs and leverage new technology, adds Houmann, "Brexit will be an accelerator of that."

After Insufficient or unclear communication by the government/regulators on the proposed approach, the biggest risk for investment banking is that the transition may not be smooth.

### INVESTMENT BANKING

After Insufficient or unclear communication by the government/regulators on the proposed approach, the biggest risk for investment banking is that the transition may not be smooth.

"A deal on a transition period that comes late in the negotiation offers diminishing returns," says Citi's Houmann. "It might still be essential for some sectors with long adaptation needs, but for financial services the more uncertain the outcome the more work will be needed upfront."

For investment banking, the most important EU legislation is the Markets in Financial Instruments Directive (MiFID), and the soon to be implemented MiFID II and MiFIR (the Markets in Financial Instruments Regulation). This enables banks to execute orders for clients, trade and deal on their own account, and provide investment advice, underwriting, foreign exchange services and portfolio management.

The end of passporting could have a significant dislocation effect for existing UK-based activities – especially for the more

international parts of businesses. 'Sales and trading is where the highest impact would be', says Lindsey Naylor, partner at Oliver Wyman. 'Whereas other pieces, like retail banking and domestic insurance markets, will probably be less impacted'.

Brussels-based think tank, Bruegel, estimates that approximately 35% of London wholesale banking is related to clients based in the rest of the EU, 'varying from about one-fifth for UK-headquartered banks to a third for US-headquartered banks and half for EU27-headquartered banks. Thus, about €1.8trn (or 17%) of all UK banking assets might be on the move as a direct consequence of Brexit' (Bruegel 2017).

Open Europe, meanwhile, calculates that, via its London bases, as much as '14.5% of US investment banks' revenues can be linked to the passport' (Open Europe 2016). Although some products and services, such as foreign exchange, commodities and mergers and acquisitions (M&A), are unlikely to leave the UK, according to the Boston Consulting Group, euro-denominated asset classes may make a wholesale shift to Europe (Boston Consulting Group 2016).



In the short term, then, Brexit is likely to have a negative impact on investment banks, as uncertainty surrounding the UK's position further depresses revenues.

TheCityUK estimates that as many as 35,000 jobs could leave the UK (Wyman 2016). Yet relocation does not necessarily mean migration to an EU location: for some institutions, relocation costs and inefficiencies from a more fragmented environment may incite them to scale back or close parts of their business. 'Others – particularly those with parents located outside of the EU – could move activity back to their home country', states the Oliver Wyman report. New York, in particular, might be a beneficiary.

In the short term, then, Brexit is likely to have a negative impact on investment banks, as uncertainty surrounding the UK's position further depresses revenues. In the medium term, banks could face escalating costs as they build further trading hubs: the Boston Consulting Group (2017) calculates that individual European investment banks could see increases in annual operating costs of between 8% and 22%, depending on their operating models.

For some, Brexit might present an opportunity to cut costs by reducing headcount, and recruiting and training less-expensive local staff, as well as rationalising client and business portfolios.

## ASSET MANAGEMENT

As before, *insufficient or unclear communication by government/regulators* is a concern among survey respondents, as is loss of passporting rights.

In reality, various member state restrictions and technical and tax barriers mean the management company passport is of less value than equivalent passporting regulations in banking. So while the passport for marketing the fund itself is of significant value to the UK funds industry, many of the larger funds have multiple management companies, with one in each jurisdiction in which they have funds, rather than relying on the management company passport made permissible under UCITS IV (Undertakings for Collective Investment in Transferable Securities).

Aside from the fund passporting potential, the UCITS badge itself can be important for many investors; a number of European territories tax investors differently if they are invested in a UCITS versus a non-UCITS fund, even if the products are identical. "There is a concern for some of the big asset management houses that they have the right product mix to attract and retain UK, EU and non-EU capital," says Elizabeth Stone, an asset management tax partner with PwC. "As a result, many are launching new fund products now to ensure their future commercial flexibility."

**Table 3.1:** Selected bank relocation plans

BANK	POTENTIAL RELOCATION SITE	POTENTIAL IMPACT ON JOBS
Barclays	Dublin	150 jobs
HSBC	Paris	1,000 of its 5,000 UK staff
UBS	Frankfurt, Madrid and elsewhere in Continental Europe	1,500 of its 5,000 UK investment banking staff
JPMorgan	Continental Europe	4,000 of its 16,000 UK employees
Goldman Sachs	Various European locations, as well as New York	3,000 of its 6,000 London staff, including traders and senior managers
Morgan Stanley	Frankfurt or Dublin	300 jobs initially, and eventually up to 1,000 roles in sales and trading, risk management, legal and compliance
Deutsche Bank	Continental Europe	4,000 out of 9,000 UK staff

For individual firms, establishing new subsidiaries or adding ‘people of substance’ on the ground could mean there will be added costs – at least in the near-term to reorganise the business.

One mitigating factor is that UCITS and the AIFMD allow management companies to delegate portfolio management functions to asset managers in a non-EU/EEA country – as long as supervisory cooperation agreements exist. This way, UK-based asset managers should be able to continue providing portfolio management services. ‘Under such a scenario, only around 7% of total assets managed in the UK would be under direct threat from the loss of the passports in this sector,’ calculates the Open Europe report.

AIFMD also potentially allows its passport to be extended to non-EU managers wanting to market funds across the EU, but this will require the European Commission to ‘switch on’ the directive’s third-country access provision.

Separately, with the Markets in Financial Instruments Directive II (MiFID II) due to take effect in January 2018, asset managers are considering where to locate their MiFID-licensed entity.

While many AIFM or UCITS managers do not fall directly under MiFID II, EU-authorized managers that provide investment advice and portfolio management services to UCITS or AIFs will be subject to the directive’s provisions regarding these activities.

“To Brexit proof businesses, firms are looking at either a) setting up a new EU-based MiFID firm or b) upgrading their existing Luxembourg or Irish management companies to include the ‘top up’ MiFID permissions,” says Stewart. However, there

are only limited MiFiD permissions that can be added to a management company – portfolio management, investment advice, and receipt and transmission of orders.

“The analysis that firms are undertaking at the moment is to determine whether they currently use any of the other MiFID permissions in their EU business,” notes Stewart. “If they do, option ‘b’ is unlikely to be possible. The most future-proofed option is ‘a’, i.e. to move that MiFID license-holder into one of the remaining 27 EU states,” says Stewart.

The result could be a migration of jobs and loss of tax revenue out of the UK. For individual firms, establishing new subsidiaries or adding ‘people of substance’ on the ground could mean there will be added costs – at least in the near-term to reorganise the business. However, this could lead to an opportunity to reduce future operating costs by aggregating functions together and locating them in jurisdictions where staff and premises costs are lower.

Securing agreements with large and fast-growing international markets could further support the sector’s growth. The Investment Association notes that talks with China’s asset management association have focused on ‘exploring mutual recognition of UK and Chinese funds, and the possibility of new market access through a London–China stock connect mechanism’ (Investment Association 2016). Discussions with other countries and regions, such as India, Latin America, the US and Australia, will also be key to future overseas growth.



While London is likely to remain an important FinTech centre, its advantages need to be enhanced – including by strengthening relationships and expanding opportunities in markets around the world.

## FINTECH

Of the perceived FinTech-related risks, the highest-ranked are the lack of transparency of the negotiating approach – once again – and the potential for a ‘cliff edge’ (the lack of a robust transitional deal).

Ahmed Badr, head of legal at payment services provider GoCardless, agrees. “When you’re trying to plan how to face those challenges you’re doing so not only without knowing the details of the challenge, but also without knowing the time frames.” In anticipation of the loss of passporting rights, the firm plans to open an office in another EU member state – potentially France.

“What we don’t think that means, though, is us relocating to another country entirely. There are still many benefits to being in London, including (for the moment) access to talent, a business-friendly legal system, a forward-thinking regulator and quality of life. We foresee our central base still being here, but I think we will see more and more FinTech companies opening satellite offices, which may grow to be as important and large as [those in] the UK.” says Badr.

The point about satellite offices may be especially true if firms have clients who opt to move their European headquarters out of the UK. So while London is likely to remain an important FinTech centre, its advantages need to be enhanced – including by strengthening relationships and expanding opportunities in markets around the world.

One area of focus should be to continue to open up the banking system. “The biggest opportunities post-Brexit are to really extend our open-banking API [Application Programming Interfaces]<sup>1</sup> work and focus on more globally interoperable, open-banking and payment systems that will allow us to work with any territory in the world”, says Lawrence Wintermeyer, CEO of Innovate Finance, the membership association that represents the UK’s FinTech community.

Developing an open banking API standard makes it easier to securely share and use the financial data banks have historically held. That will enable third parties to develop and offer more appealing services and products, while customers can better compare and access services from different providers.

“Most of our fintechs don’t scale to Europe, they scale to the US or to Asia,” says Wintermeyer. “By focusing on more globally interoperable, open-banking and payment systems, it can allow us to better work with territories in the world focused on open-banking.”

The US, in particular, is a major retail market to scale in for fintechs. “Equally,” adds Wintermeyer, “if you’re in the global FX or remittance world, working either with retail clients or businesses, or e/mobile commerce, many of the emerging opportunities in Asia are vast.”

Whether the opportunity to escape EU rules and regulations will come to pass, however, is less certain.

“There’s some confusion around the cutting of red tape in financial services”, says Oliver Wyman’s Naylor. “A lot of the rules we have in the UK today are global – they just happen to come via the EU. We have to replace them with something very similar. And actually the PRA [Prudential Regulation Authority] and the FCA [Financial Conduct Authority] in the UK are two of the most stringent regulators in the world today.”

Therefore, she reckons, “It is by no means going to be a [regulation] bonfire”. Indeed, escape from regulation featured highly among FinTech respondents in ACCA’s survey as well, so there may well be a need for the sector to understand more clearly the reality of the implications here.

<sup>1</sup> Application Programming Interfaces (API) allow software components to interact to facilitate interoperability.

Continued regulatory and supervisory collaboration and coherence will be critical to ensuring that the regimes remain broadly consistent and avoid accidental divergence.

### **PREMIUM ON REDUCTION OF POLICY-LEVEL UNCERTAINTY**

*Insufficient or unclear communication by government/regulators on proposed approach* has emerged as a key area of risk for survey respondents across all segments within FS. There appears to be an acceptance that a degree of disruption is inevitable, but the time it takes to prepare for it means that organisations appear to be placing a high value on finding out sooner rather than later. As much guidance as possible, in the earlier stages, with respect to likely approach appears to be as important as the eventual final outcome.

Related to this is the fear of a 'cliff-edge' whereby the lack of early-stage clarity persists into the later stages, so that the limited two-year window of negotiations looks unlikely to produce a transition agreement. This is certainly of even greater concern for the UK now that a few months are also being taken up by the elections in June 2017.

The survey data also shows that about one-quarter of respondents having little or no preparedness for Brexit; a reduction in policy-level uncertainty might also benefit these organisations by inducing them to take more action.

### **BESPOKE MUTUAL RECOGNITION AGREEMENT**

The government has made it clear that the UK will leave the Single Market, but the big question is what will replace the rights currently enjoyed within it? A good replacement would be a bilateral agreement, based on mutual recognition that allows for maximum two-way access between the UK and the EU.

Continued regulatory and supervisory collaboration and coherence will be critical to ensuring that the regimes remain broadly consistent and avoid accidental

divergence. The UK may want to promote the development and use of international standards wherever possible to make it easier for the UK and EU to recognise each other's regimes. Safeguards will be necessary to ensure fair and independent regulatory equivalence determinations, so that one side is not hostage to a unilateral withdrawal of access rights by the other. Ultimately, the process for determining equivalence must be grounded in technical factors rather than political ones.

### **SEGMENT LEVEL CONSIDERATIONS**

It will be important for the government to engage with every part of the industry so that the deals it negotiates reflect the needs of different stakeholders. Each of the FS segments has slightly different requirements and the government will no doubt be seeking to factor that into its analysis.

For example, in banking, the government and banks may want to push for equivalence and the potential for third-country passporting to be included in the Capital Requirements Directive, CRD V. The UK may also wish to seek equivalence under the Markets in Financial Instruments Regulation, MiFIR, which offers the continuation of passport-like rights for many investment banking services (including those of foreign firms that are conducted through London). In asset management, it may be important to push for the Alternative Investment Fund Managers Directive (AIFMD) third-country passport to be 'switched on', and for equivalence to be granted under MiFIR. The government, regulators and industry may also seek to work together to create an innovative and tax-efficient UK funds regime that goes beyond UCITS. Within FinTech, a particular concern (though which may apply to other segments too) appears to be a flexible visa system that ensures the UK remains open to talented professionals and students.

Dealing with policy and implementation uncertainty will require organisations to be adaptable and to plan effectively.

Dealing with policy and implementation uncertainty will require organisations to be adaptable and to plan effectively. Ultimately, those that do so most effectively may be best placed to mitigate the risks and leverage the opportunities presented by Brexit.



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