Toward a Post-Brexit Business Landscape: A Financial Services Perspective

Abstract

While Brexit has caused a certain amount of uncertainty for enterprises across industries in the UK, it also brings with it big opportunities by establishing new trade relationships with countries outside the European Union (EU). We are yet to see how negotiations between the UK and Europe will pan out, but financial services firms in particular need a cohesive roadmap to navigate the post-Brexit landscape.

In this article, we outline some of the issues the financial services sector is facing and how businesses in this sector – and government – could approach the challenges ahead.

Reaching an Agreement

For starters, promoting and protecting the financial services industry across Europe should be a key priority for trade negotiators. This will be challenging, as the UK and EU have still not reached an agreement regarding the financial services market.

At the time of writing, the European Commission has rejected the City of London's proposal to strike a post-Brexit free trade deal on financial services – a major blow to Britain's hopes of ensuring full access to EU markets for one of the world's top two financial centres. The main driver for a smooth arrangement will be the EU financial institutions who operate in London and are constrained by EU rules. The UK ruled that EU banks operating through branches can continue without creating subsidiaries, which is an expensive process.

Businesses Must Plan Now to Transition to the Post-Brexit Environment

While on the regulatory front, many financial service providers are registering specifically with EU regulators to avoid segregation, transitioning to a post-Brexit scenario is proving to be tough. This is exacerbated by the fact that many enterprises are dealing with infrastructure issues, especially in the field of capital markets.

Contributing 7.2% of the UK's GVA and more than one million jobs across the UK, the financial services sector underpins the success of the broader economy. For several decades, financial services have been one of the UK's strongest assets, delivering a trade surplus of more than £60bn per year and more than £25 billion in tax revenues.[1]

London's success as the global financial centre has been primarily due to the industry's integration across borders. When the UK leaves the EU, large volumes of cross-border trade in banking and capital markets services between Britain and the bloc will be categorized under international trade, rather than internal economic activity within the Single Market. Britain's new status as a 'third country' will therefore have far-reaching consequences.

Achieving an effective post-Brexit arrangement for financial services will be important to Europe too. The UK accounts for 41% of insurance/reinsurance, 26% of asset management, and

24% of the banking market. This dominance might yet reinforce the City of London as the centre for non-EU markets. Over time, it can introduce new regulations that facilitates the establishment of financial services from Asia and non-EU European countries.

Ensuring Open Access Across the EU

Preserving a high level of cross-border market access is a priority for the sector. This can be achieved only by reproducing elements that work today in a future bilateral free trade agreement (FTA) between Britain and the EU. This will apply to:

- EU institutions established in the UK
- Non-EU institutions whose UK presence was the basis of their expansion into the EU
- UK institutions that operate in the EU

Although trade in financial services has, in the past, rarely been covered by FTAs, the importance to both economies of a dynamic, global financial services industry should lend itself a renewed focus during the upcoming talks. UK Finance is calling for a framework for trade in banking and capital markets services based on mutual recognition, whereby both sides align their regulatory practices and cooperate closely on regulation and supervision.

Without such an agreement that is based on cooperation, UK-based financial services companies could, at worst, be required to ensure compliance with EU rules from their EU base. It is interesting to note that the announcements of transfers of activities to Dublin, Frankfurt, Paris, and Amsterdam remain limited in scope and staff transfer.

Whatever the outcome, the UK and the EU will need to ensure that financial services firms have sufficient time to transition to these new arrangements. The complexity of both global compliance and systems changes in large organizations will require time to navigate, and the 19-month period proposed to transition from the Single Market is unlikely to be enough for this industry.

Chalking Out a Transition Roadmap

Negotiations between the UK and the EU are ongoing, and there is a wide range of outcomes that could affect UK-based, EU-based, and internationally-based businesses in a number of ways (see Table 1).

		Business Location		
		UK	Europe	Rest of the World
Home Country	UK	No Change	Providing services to the EU will be impacted if the UK losses its current European Economic Area (EEA) status. Consequently, possible market access options could be: • Need to seek authorization as per third-country equivalence regime under various regulations or • Set up subsidiaries in EU and obtain permissible passporting rights for countries within EU	Providing services to RoW countries will be impacted as UK needs to negotiate 100+ bilateral agreements with nearly 60 non-EU countries. Presently there are covered under Free Trade Agreement with EU.
	Europe	Providing services to the UK will be impacted and subject to the final Brexit agreement.	No Change	No Change
	Rest of the World	Service and market access to be determined as per fresh bilateral agreement between RoW countries with UK	No Change	No Change

Table 1: Outcomes for Financial Services Firms based on Location

With the final Brexit deal some time away, it is difficult for firms to make a detailed plan to handle the different transition scenarios. However, now is the time for firms to start outlining their core operating models for the post-Brexit era.

For the financial services firms working from the UK as their main European base, there are six key risks to address as part of the contingency planning:

- Potential loss of 'passporting' and licensing requirements for EU market access
- Likely fragmentation of existing UK business and operations
- Additional regulatory compliance requirements
- Increased operational and financial costs as well as transitional risks
- Immigration rule uncertainty and staffing constraints
- Economic downturn in the UK in the event of no deal

These risks will take time to mitigate and plan for, so preparatory work should begin now if it is not already underway.

Preparing for Reform Post Brexit

As financial services regulations become more complex – coupled with other issues around data, intellectual property (IP), and employment laws –the UK government must resolve a range of issues before Brexit takes effect. There are also some key aspects of the EU law where the UK might choose to diverge from current standards – making it more attractive for investment, or harder to do business from the EU. The UK Parliament is currently considering a Bill that would transpose all existing EU legislation into UK law after Brexit, ensuring continuity of legal treatment.

Some of the issues up for discussion about reform after Brexit include:

Data protection: The GDPR will apply by May 25, 2018, leaving the UK with two choices. Either it must adhere to these regulatory changes over which it will have no influence from outside the EU, or adopt UK-specific laws. According to the Information Commissioner's Office (ICO), the UK's new data protection rules largely transposes General Data Protection Regulation (GDPR) into its law and will apply post Brexit. Data protection, distribution, and technology will be at the centre of this negotiation.

Intellectual property: The EU has a single IP law, which the UK could choose to diverge from after Brexit. However, a 'hard Brexit' might lead to the UK's removal from the protection of this law if there is a risk of rights-holders being deprived of protection under divergent UK laws. A clear agreement needs to be in place for IP licenses and IP agreements, as they are territorially operated in the European Economic Area (EEA) as this could affect the scope of contracts and rights.

Lending restructuring and commercial contract terms: The EU rules on 'material adverse changes', the location of payment systems, illegality provisions in contracts, and insolvency have been the subject of political debate in the UK. There are suggestions that this could lead to regulatory divergence after Brexit.

Anti-trust: The UK Competition Act 1998 and Enterprise Act 2002 closely align with existing EU regulations, but any changes to these after Brexit could lead to divergence. The UK is unlikely to define anti-trust as EU-wide, but restrict it within itself. On merger rules, UK-acquired turnover might not count towards the EU's regulation thresholds. All deals involving the UK would need to be assessed under a new national mergers regime, broadly impacting other relevant acquisitions. Any new UK rules on enforcing M&A could also result in divergence. However, for financial services institutions that operate both in the EU and UK, the EU will remain competent for the approval of mergers that impact the competition across their own markets.

Tax: While direct taxation is a member state competence and not EU policy, tax laws must comply with certain basic principles of EU law. The UK government could choose to significantly change its tax rules – for example, around corporation tax – in order to make the UK a more attractive place to invest. But this could lead to the introduction of tariff or non-tariff barriers as retaliatory measures in the event of divergence.

What Lies Ahead for Financial Services Firms

Despite the continued uncertainty, which is likely to persist until the negotiations between the UK and Brussels have concluded, financial services firms should start putting a plan in place for 'Day 1', covering key elements of their operating model and infrastructure (Figure 1).

Transition Planning Imperitives					
Location Suitability Analysis	Legal Structure Evaluation	Regulatory Compliance Assessment	Operating Model and IT Assessment	Financial Costs and Risk Assessment	Workforce Realignment Analysis
• Locational suitability: strategic customers proximity, regulatory and political environment • Evaluation of 'Single Hub' or pan-European set-up • Licensing approval/ authorization requirements	• Legal structure optimization and group organization alignment • Corporate Tax implications • Third party contractual legal agreement review and negotiations	• Passporting and Equivalence conditions • Dual/multi jurisdiction regulatory compliance/ reporting requirements from surviving regulations	• Evaluation of optimal Hub/Distributed Operating Model • Enabling IT systems infrastructure planning • Enterprise Data infrastructure, residency and segregation planning • Vendors and Third-party providers arrangement	• Additional liquidity/cash management requirements • Forex/currency rate volatility implications • Risk in investment portfolio transfer • Increased operational costs	• Requirements of skilled and specialized resources and availability conditions • Staffing of operations - employees/ contractors under uncertain immigration rules • Relocation/ induction of staff for realigned model

Figure 1: Planning Imperatives for Financial Services

The long and uncertain negotiation process provides an opportunity for firms to reassess their business architecture, operating model, core process, and underlying IT infrastructure. Achieving the much-need consolidation and optimisation of operational process and IT platforms and an overhaul of business architecture with a customer-centric design would be helpful in this challenging period for businesses.

References

[1] Office for National Statistics, accessed March 22, 2018, https://www.ons.gov.uk/

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