HEDGING THEIR BETS

The impact of Brexit on the Financial Services industry

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REPORT


On 22 November 2017, ACCA (the Association of Chartered Certified Accountants) and the European Movement International (EMI) jointly organised a conference called “**Hedging their bets: The impact of Brexit on the Financial Services Industry”** in Brussels.

After a key note speech from **Jo Leinen**, MEP and President of the EM International, a panel of experts composed of **Guillaume McLaughlin**, Head of Cabinet of Guy Verhofstadt, EP Brexit negotiator, **Laura Muir**, Head for Strategy and Bank Structure at Barclays, **Tomo Ishikawa**, Head of Regulatory Strategy for EMEA at Bank of Tokyo-Mitsubishi UFJ, **Pablo Portugal**, Director, Public Policy and Advocacy at AFME was moderated by EMI’s Secretary General **Petros Fassoulas**. The debate confirmed that fragmentation and uncertainty are the enemies of financial markets. All speakers stressed the importance of early clarity on transitional arrangements and contractual continuity, so businesses and the financial industry can plan accordingly.

The importance of avoiding further market fragmentation and of continuing and strengthening the Capital Markets Union was also clearly stated. There was general consensus on that fact that we still don’t know how the post-Brexit world will look like. The EU-27 will be adjusting to the new reality and will need to develop its capital markets capacity to keep its competitiveness and attractiveness.

Concluding remarks were delivered by **Richard Ashworth, MEP**, and conclusions by **Anthony Walters,** Global head of Public Affairs at ACCA.

Main highlights

Jo Leinen MEP, President of the EM International

- Brexit is a challenge that we have to find a common solution for. The signal Brexit sends to Britain's global partners can only be negative. It adversely affects the UK's economy, hurts its main industry, weakens its standing in the world, diminishes its claim of being an open, trading nation and reduces its influence. It also compromises its security and its ability to shape the global decisions that affect it. Whichever way one looks at it, Brexit will have a regrettably negative effect.
- Inflation went up already by 2,3%, which makes the everyday life more expensive for citizens. Studies have also shown that the GDP would go down by 3% if the UK leaves the Single Market and the Customs Union.
- London is one of the biggest financial hubs in the world and we are all connected to it. Brexit will undoubtedly affect our financial markets.

Petros Fassoulas, Secretary General of EM International, moderated the session

Guillaume McLaughlin, Head of Cabinet of Guy Verhofstadt, EP Brexit negotiator

- It is very clear that there will be some advancement in the next two weeks. There is the awareness that the UK will have to contribute more to the Brexit exit bill. The exact amount is still to be clarified.
- The European Parliament considers that the Council has the driving seat regarding to financial issues. The EP is mostly working on the citizens' rights in this phase of the negotiations. These issues are still very worrying because the situation is very uncertain.
- The Parliament will push for simpler mechanisms for citizens to register and benefit from family reunification, certain social security benefits. If no progress will be seen, the EP will be adopting a resolution on 13 December.
- The main focus of the EP in the negotiations is to ensure continuity as much as possible. It needs to be made very clear that the European Union has its own integrity of the single market and that the UK is leaving the EU. The UK will become a third country, therefore there will no longer be passporting or financial services in the way we see them today. We still don't know how this new relationship will look like – this is a big question for the UK Government. The EU is offering the closest possible relationship after Brexit because it is the best solution. If on top of that we add the parameters that the UK proposes, we get a Canada-like relationship – nothing more. The restrictive conditions and disruptions are not being set by the EU.

- The EU institutions are completely unified on the Brexit issues. The EU is interested more in its own future than it is in the relationship with the UK. The EU also needs to consider the interest of EU-27. That will be the driving force behind the EU functions.
- The EU is not about building walls. It is essential that we find a good solution for Norther Ireland but it will be very difficult to do.
- The EU is aware of the need for planning. The European Commission has set up a team to deal with contingency planning. It is planning on the worst case scenario basis.
- Brexit is about regulatory divergence. The challenge will be to set up a mechanism to make sure the divergence is manageable.
- There shouldn't be problems in agreeing on transition period – the politics will be reasonably straightforward. The real problems are in the details and putting the transition in practice. There is also pressure to have short transition before the next general election in the UK.
- The future trading relationship will in many respects be easy. The problem will be to put a mechanism in place that ensures a level-playing field.

Laura Muir, Head for Strategy and Bank Structure, Barclays

- Barclays' priority is to put it European customers, clients and colleagues at the forefront of its plans. Most impact that we will see is in the corporate investment banking side, which is the most international part of the business. It is also the part that is most strategically important to the European Union from the point of view of providing access to the capital markets. Barclays plan is to continue providing this access.
- Barclays already has a subsidiary of its main operating entity in Ireland, which will serve as a hub for its EU business. However, there are many process and operational challenges to set up the new hub.
- Everyone is focussing on March 2019, however, you need at least need three months when setting up and testing out a new business. So the deadline for the most banks, if they want to prepare for the worst, is December 2018.
- Help is needed from policy makers. They need to acknowledge the fact that financial markets cannot have instability and uncertainty. Markets thrive when there is certainty.
- We need a commitment to a transition period that will allow businesses to make plans and comes reasonably soon. Transition period would allow financial institutions to manage any transfers, changes to their business in an orderly fashion and help ensure there is no market disruption.
- We would also like to maintain legacy cross-border contracts in the same entity they are currently held in. For a range of reasons, it will not be possible for financial institutions to move all legacy contracts to a new EU entity by the end of March 2019.

Tomo Ishikawa, Head of Regulatory Strategy for EMEA, Bank of Tokyo-Mitsubishi UFJ

- An analogy could be made between financial services and soccer. The quality of European soccer is great because of local and regional competition. Financial institutions also operate locally and regionally. Taking the example of the soccer analogy, what if you were told that in order to play in European league you need to have one more team? You simply cannot be as competitive as before. You want to make sure you have the best team anywhere you go.
- Brexit sends a message to financial services that they will need one team for the UK, one team for the EU, one team for Japan, one team for the US etc. This means more cost and customers will not benefit.

- Nevertheless, Brexit is happening and we need to address it. We need to introduce the same uniform for all the teams and a joint training programme. We must to achieve something that is efficient and benefits customers. We do this through outsourcing arrangement and global booking strategy. It is important for supervisors to understand the entire business model of the global banks, instead of just looking at the EU operations.
- Supervisory cooperation is critical to address the threat to financial instability. Political negotiations are important; however home and host supervisors can start the dialogues with or without the political agreement.
- Hopefully all the European initiatives, such as the CMU and Banking Union, will contribute to the EU attractiveness from the global perspective. Political uncertainty in the EU and the UK is not helping with investment decisions.
- Financial services are an ecosystem. Fragmented markets will affect the growth of other cities. However, it is not just about one physical location. We do not need to physically be in one place to build the ecosystem.

Pablo Portugal, Director at AFME's Public Policy and Advocacy Division

- The need for early clarity on transitional arrangements and contractual continuity are very important issues for the financial services industry. It is very important that industry receives early signal on transitional arrangements so it can plan accordingly.
- We need to avoid a number of cliff-edge scenarios. One of them relates to the ability to transfer data between the EU and a third country. In the absence of an adequacy decision when the UK becomes a third country, the UK-EU transfer of certain data would not be possible. Regulatory clarity on this situation is necessary. Access to financial market infrastructures is another important issue where clarity is needed.
- As regards contractual continuity, AFME has estimated that 1,3 trillion euros in UK-based bank assets are linked to cross-border products and services to EU-27 clients. These services are underpinned by a large volume of existing cross-border contracts. Their status would become uncertain if there are no adequate post-Brexit arrangements in place. Therefore, a transitional period or Grandfathering arrangements would help.
- While Brexit is a very important issue, the EU has its own priorities for the future. The Capital Markets Union (CMU) project is one of them and it is vital that it continues to maintain its momentum. Brexit cannot absorb all the resources. Brexit can make the case for the CMU even more important because after the UK becomes a third country, the EU will lose its largest financial markets centre.
- Fragmentation and uncertainty are the enemies of financial markets. The EU must remain focused on building and integrating its capital markets and maintaining openness. Just recently the Baltic States have decided to form a pan-Baltic capital market, which was very well received.
- We don't know how the post-Brexit world will look like and details of the future EU-UK relationship. The EU will need to develop its capital markets capacity. The EU-27 will be adjusting to the new reality.
- London has an important role today and we should really think about how the rest of the EU will fill that gap after Brexit. Emphasis should be given to EU competitiveness. The EU needs to make its markets attractive. It also needs to address taxation issues, regulatory disincentives and other impediments in order to compete globally.
- Financial markets benefit from the economies of scale and consolidation around products and services. If we look at central clearing, London is a big player in certain

derivatives but there are also EU centres that are big players in other clearing products. Players tend to converge around certain products and services where they create liquidity and an ecosystem. We might see a world where we see more of these processes in the future. Technology is a big enabler for that to happen.
- AFME's members would like to see post-Brexit arrangements that are reliable and stable. Market participants need to understand the arrangements and be able to work with them. We need to aim at minimising disruptions for the economy.

MEP Richard Ashworth
- The UK is making one of the biggest decisions at the time when the people have never been more divided. We are not yet ready to move from phase 1 to phase 2. People in the UK are not being given the facts.
- The referendum was held at a turbulent time and people were not explained well about the benefits of the EU. Instead people have been exposed to unrelenting negative messages in the press. Emotion won the argument at the expense of the facts.
- December Council will be a very significant moment. Many institutions and industries will have to take strategic decisions in the beginning of 2018.
- The negotiation is not with the European Commission but the 27 prime ministers. They represent the economy that is 6 times bigger than the UK economy. This cannot be ignored.
- The UK is not being expelled from the EU – it chose to leave and is now asking for a relationship. All parties agreed there would be two phases in this process.
- The next two weeks will be crucial for deciding the future new relationship that the UK will have with the EU. To move to phase two of the negotiation, both the EU and the UK agreed at the outset that sufficient progress needs to be made on three main issues: citizen rights, Northern Ireland and the financial settlement. There is still work to be done. On the important issue of citizens' rights, both parties agree this is a number one priority. A lot has been agreed in this area. The issues that are outstanding are family reunification, exported benefits, the need for simple lo-cost speedy registration process, criminality, voting rights, professional qualifications, movement within the EU. We also need to keep in mind that the EU has 27 territories, not one. Whatever arrangement the UK has, it does not mean that one can automatically move to another territory.
- The question of Northern Ireland and the border needs to be resolved as well. It is clear that the UK will not be in the single market or the customs union. The UK Government made it clear that there will not be a hard border between Northern Ireland and the Republic or the UK and Northern Ireland. How do we square that circle?
- There is no short answer to the question of financial settlement. The press is always talking about a "divorce bill" which implies competitiveness and unpleasantness. However, this is simply a demerger accountancy exercise.
- When the UK leaves the EU, it needs to answer the question whether it has the intention to cover the liability that in the future will need to be covered by 27 nations.
- 40% of the EU's budget goes into developing the single market. Most of it goes into developing poorer economies. Does the UK have the intention to contribute to that?
- The EU is running multiple joint European development projects, such as Erasmus, Horizon 2020, European Space Agency etc. All these projects are very important to the UK and the question again arises whether the UK wishes to continue to participate in them.
- There is a huge amount of activity on both sides at the moment.

- Strategic decisions are being made that will most likely be catastrophic for the UK. A transition period is not an adjustment period – it is an extension of the status quo. Unless there is a satisfactory agreement in December, it is unlikely that the 27 prime ministers will see any point in having a transition period.

Anthony Walters, Global Head of Public Affairs, ACCA

- We will most likely see a significant change in upcoming two weeks. The political situation should not be underestimated.
- Northern Ireland issue remains a huge concern and a challenge.
- Financial services have evolved over several decades and this creates a lot of complexity. This sector doesn't like uncertainty and businesses are starting taking measures as far as they can. It is very likely that contingency plans will come into effect sooner rather than later. What was clear from the discussion is that financial services are desperate to get clarity on transitional arrangements. However, the value of a transition period is fast diminishing with financial services firms already starting to put contingency plans into action. Transitional plans agreed at the eleventh hour will be of little value to the financial services sector.
- If no progress is made on 15 December or shortly after, it is very likely that businesses will be taking matters into their own hands. That might mean that jobs and investment will be moved out of London.
- Fragmentation is a big issue for companies. There is a risk of duplicating teams across Europe. The risk of fragmentation means loss for the UK but also for Europe as a whole.
- Hopefully European ecosystems are well developed to sustain the financial sector across the EU. However, it is important to sort out the issue of free movement.
- There is a need for collaboration and sharing information across sectors and EU governments.