

Brexit: what are financial services firms planning for?



The implications of Brexit will be hugely important right across the economy. But they are a particularly dominant theme for financial services, given the relative size of the sector in and for the UK, and given its regulation is currently done on a highly-integrated pan-EU basis. For many firms, it could be a huge potential shock-wave to their current ways of doing business.

What outcomes are possible?

At this stage in the process, there is still enormous uncertainty both about the final outcome, and the path by which we will get there. The Article 50 negotiations have barely begun. But for financial services, in A&M's view, there are really only three possible types of outcome:

1. The UK remains part of the EU Single Market for financial services, and the existing passporting rights, both into and out of the UK, are retained. The UK Government has said that it will not be seeking membership of the Single Market as a general matter. But some have floated the idea that it might be possible to remain in the Single Market for specific sectors, for example in return for a payment. This does not look likely.
2. There is a specifically-negotiated arrangement between the UK and the EU which provides for "mutual recognition" of respective standards and for cooperation in regulatory oversight. This is the outcome envisaged by Mark Carney in his recent speech¹, and could be consistent with the UK Government's aim of a strategic partnership agreement. The challenge is whether it could be negotiated in the two-year time-frame which Article 50 entails.
3. The UK becomes a "third country" alongside other non-EU nations. This is what would happen absent any other agreement. Access into the EU would be on the basis of "equivalence" decisions as provided for in sectoral EU legislation. Without a transition period, this would in effect be a "hard Brexit". While many pieces of legislation do have equivalence provisions, their coverage is patchy, and the equivalence decisions are in the hands of the EU. While the UK would start in a good position, as by definition it would be aligned to EU regimes, it would be a pure rule-taker going forward. The EU may also view the equivalence mechanism differently if a large proportion of their market were to be served via that route, as opposed to a minority.

What about incoming financial services firms to the UK?

But there are also issues in reverse: what happens to EU (and other EEA) firms currently doing business in the UK through a branch, or on a remote basis, rather than through a subsidiary? Of course in part, how the UK treats such branches is up to the UK itself. But at this stage of the negotiations, nothing is being given away. As a starting point for thinking about what could happen, the PRA is suggesting that banks should look at its current guidance for non-EEA branches.

This allows third country branching under certain conditions, taking account of the equivalence of the home state supervisory regime, and arrangements for resolution. But, more generally, the PRA says a large number of firms currently providing services in the UK may need to be authorised by the PRA, depending on the outcome of the negotiations.

¹: The high road to a responsible, open financial system. <http://www.bankofengland.co.uk/publications/Documents/speeches/2017/speech973.pdf>

The PRA wants to see contingency plans

The PRA clearly thinks firms should be planning for outcome 1 not occurring. It has recently written to all the banks, insurers and investment firms which it supervises to ask for a report on their contingency planning. In effect, it is asking what preparations firms are doing for outcomes 2 and 3, and for transitions to those outcomes which are immediate, or alternatively, more drawn out. The PRA has set a tight deadline of 14 July for responses, and is expecting full contingency plans that cover the most adverse potential outcomes.

What do firms need to do?

To meet the PRA's request, firms will need to work through some really key questions:

- As a starting point, are we doing cross-border business, and if so, how significant is it?
- What could our business model look like under the two key scenarios? Can we reliably make use of existing equivalence provisions?
- What would we need to do to make adjustments, in terms of location, regulatory permissions, staffing and operations? How much outsourcing could we do back to our home location? Where might we relocate to?
- How difficult would it be for us to make these changes?

How can A&M help?

Our team of senior former regulators has in-depth knowledge and insight into the European landscape, and the relevant regulatory regimes, challenges, and processes, and is partnered with industry professionals with extensive senior-level executive and advisory expertise. Our network of offices located in all major EU countries gives us a truly continental perspective.

We can:

- help firms analyse the impact of Brexit on their business model;
- help firms compose or review their response to the PRA;
- help firms design and take forward action to mitigate risks around Brexit.



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