



Brexit Industry Insights

Banking

September 2019

With the UK's default to leave the EU without a deal, the banking sector is vulnerable to disruption. The sector is faced with simultaneously navigating business growth in a maturing market and increased regulatory pressures, whilst mitigating the impacts of Brexit – including the free movement of capital and market access. The winners will be those in the sector prepared for change and alive to the opportunities.

Several factors ensured the financial services industry was among the first to begin Brexit preparations, including regulatory barriers to the continuity of service provision, the time taken to secure the correct authorisations and licences, and the importance of the industry to the wider economy.

Nevertheless, the European Central Bank (ECB) recently published a newsletter¹ calling on businesses to step up their no deal preparations, noting where contingency plans have not been implemented, 'banks should step up their preparations to minimise execution risks' and address operational challenges in readiness for implementing the target operating model agreed with supervisors.

As the financial services sector is among the most mature in its preparations for Brexit and has been through the process from impact assessments to implementation, there are lessons that can be taken and applied to the preparation of other sectors of the economy.

Brexit and the Banking Sector

The financial services sector is an essential part of the UK economy with exports of £61bn in 2018, 43% of which went to the EU², and over 1.1 million people employed in the industry in the UK alone³. The banking sector in the UK will be among one of the most impacted industries due to the level of regulation market participants are subject to, and the level of interconnection between the UK and EU banking systems.

The banking and wider financial services industry is a vital component of the UK economy, facilitating payments, investment and ensuring the rest of the UK can trade. A lack of market access for the UK financial services system to the EEA market may negatively affect the performance of the UK's economy. The potential impacts on investment, access to capital and the ability of banks to continue providing the same services as they currently do, could all have a negative impact on other industries.

1. ECB newsletter: <https://www.bankingsupervision.europa.eu/press/publications/newsletter/2019/html/ssm.nl190814.en.html>

2. Briefing Paper, House of Commons Library - Financial services: contribution to the UK economy. Available at: <http://researchbriefings.files.parliament.uk/documents/SN06193/SN06193.pdf>

3. Key facts about UK-based financial and related professional services 2019. Available at:

<https://www.thecityuk.com/research/key-facts-about-uk-based-financial-and-related-professional-services-2019/>

5. Equivalence decisions: From the outset, the EU made it clear that it would not grant mutual recognition to the UK's financial services industry. Concerns about the EU's equivalence regime including a lack of comprehensiveness, lack of transparency in the decision making process and the possibility of unilateral withdrawal of equivalence, combined with concerns around third country regimes under EMIR, encouraged firms to take prompt action following the referendum.



What does this mean for business?

Some of the key implications for businesses operating in the sector are:



Passporting

Current passporting arrangements which allow UK banks to operate in the EU with minimal authorisation, and vice versa, may come to an end. This would apply extra costs on UK-EU financial services trade as institutions would have to overcome significant regulatory hurdles to be able to continue in the provision of these services. It would put UK banks at a disadvantage in the provision of services in the EU.

We have seen more of a sense of urgency in businesses passporting from the UK than those passporting from the EU. This is due to the transitional measures provided by the UK government - including the temporary permissions regime - which will allow EU businesses to passport services into the UK for a limited period of time post-Brexit. Although the EU has issued transitional measures for capital markets and there have been Memoranda of Understanding (MoU) signed between EU and UK regulators, contingency planning has been done at the national, rather than an EU-wide, level.



Corporate treasury

Cash management services are typically not dependent on EU passporting. However many banks have been making changes to their product and corporate entity strategies, driven by numerous factors including the bank's own legal and regulatory framework. Therefore although Brexit may not necessitate changes directly, decisions taken by banks in other areas may impact the ability to continue offering the same services to clients.



Legal entity structures

UK banks holding branches in the EU may have to convert those entities to subsidiaries, a costly process, in order to continue providing financial services.



Contract Repapering

As the UK becomes a third country, there may be a need to repaper contracts to reflect the UK's new legal status. In addition to transferring permissions to EU entities, banks will be required to migrate relevant customer contracts to these entities. This is a significant task but one that is necessary to continue offering the same level of service to clients.



Tax

Restructuring in response to regulatory barriers has resulted in a number of tax issues for companies to manage, including assessing whether the activity transitioning to a new EU company is a transfer of a business going concern (i.e. with goodwill or intangibles attached) in order to determine potential exit tax charges and associated valuation issues.

Post-restructuring, the tax implications for ongoing operations present different tax challenges. For example, new cross-border charges for services provided by an old UK hub company to a new EU company will have transfer pricing and VAT implications. As will back to back arrangements where the UK company seeks to continue some of the key entrepreneurial risk-taking functions in respect of the financial assets that may now be originated and entered into by the EU company with EU customers. The employment tax position for staff moving to new locations will need to be considered.

In focus - regulatory recognition

Equivalence Decisions:

A third country can be granted equivalence by the European Commission in certain areas if they deem that country's standards and regulatory regimes to be of an equivalent standard to the EU's. This would allow that country's financial services covered by the equivalence decision to access the EEA market without the need for separate authorisation in each jurisdiction. This can be withdrawn unilaterally by the European Commission (EC) at any time.

Memoranda of Understanding (MoUs):

A framework in which supervisory authorities agree to cooperate and share information. There have been several MoUs signed between UK and EU supervisory authorities to continue cooperating in the event of a no-deal Brexit.

The UK's banking regulators, the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA), have agreed bilateral MoUs with their European equivalents including the European Banking Authority. These MoUs set out the expectations for supervisory cooperation and information sharing between the UK and EU/EEA national regulators.

Adequacy and personal data:

Personal data flows are regulated by the EU. Without the EU granting an adequacy decision, there would be restrictions on the flow of data between the UK and the EU. The Commission is not expected to start this process in respect of the UK until after the UK leaves the EU. The UK's Information Commissioner's Office has indicated that for a



People

Under a no deal, free movement of people will end once the UK leaves the EU. EU/EEA citizens resident in the UK before 31 October 2019 will retain their rights to settlement and access to services, and they will need to apply under the EU settlement scheme by 31 December 2020. EU/EEA citizens moving to the UK after 31 October 2019 will for a transitional period be able to move to the UK to live and work as they do now. But those wishing to stay beyond December 2020 will either need to apply for European Temporary Leave to Remain by 31 December 2020 or leave the UK. The UK is expected to introduce a new immigration regime from January 2021 for all EU nationals arriving in the UK after this date.

Multinational banks often have a highly mobile international workforce and are reliant on the efficient deployment of individuals around the world including within the EU. Post-Brexit changes will need to be factored into existing processes to avoid delays in putting feet on the ground and/or increased costs. For example, immigration requirements for UK nationals planning to work in the EU will need to be confirmed on a country-by-country basis including expected time lines for completion of the immigration process.

Dual social security liabilities could arise for employers and mobile employees if member states do not agree to reciprocal arrangements with the UK.

Preparation so far

The financial services sector as a whole was one of the first to mobilise resources and develop comprehensive plans to mitigate the impact of a no-deal Brexit scenario. As the banking sector is one of the more mature sectors in terms of Brexit readiness, there are lessons to be learned which could be applied to other industries.

From our experience in the industry and through interactions with clients, we have seen the key drivers of the relatively high degree of readiness for Brexit in the industry include:

- **Importance of regulatory change to the industry:**

Most European investment banking activity takes place in London, with businesses relying on existing European regulatory passports whereby London operations can serve the rest of Europe using one licence. The loss of passporting rights means many businesses simply cannot offer regulated services to the EU27 market from London without establishing an EU27 entity, in the absence of an equivalency decision for the UK's financial services system⁴.

- **Regulatory Timeframes:**

Businesses that established a new EU27 entity, or applied for authorisation from local regulators for an existing EU27 entity, had to allow sufficient time to have the relevant authorisations in place. Typically, the authorisations required by firms take around six to nine months, which necessitated an early response from affected financial services businesses.

time limited period in a no-deal scenario it will recognise EEA states as providing an adequate level of protection for personal data. However, this statement has not been reflected by the EU and therefore for business the critical data flows to assess are those personal data flows originating from the EEA. Unless the UK and the EU enter into a separate legal agreement, businesses will need to ensure appropriate legal safeguards (e.g. standard contractual clauses and for intra-group transfers, binding corporate rules) are in place to facilitate cross-border flows of personal data.

Case study

Deloitte aided a leading global US investment bank on its strategy to manage Brexit and the changes this will have on its business and operational model. We helped the client:

- Perform a Brexit impact assessment.
- Design and implement funding models for a new entity with front-to-back trade flows for all product classes.
- Create a margin and collateral approach to enable European clients to continue trading activity post-Brexit.
- Analyse tax consequences of business change including on implementation and under the future-state operating model.
- Assess the client asset protection requirements of the new regulator, formulating a plan to adapt the current client assets architecture.

We successfully brought together multiple business functions that had been operating in silos, and applied a systematic approach to manage the complexity and volume of analysis required.

- **Cooperation between the EU and UK regulators:**

There has been strong cooperation between the EU and UK regulators, including working groups set up by the ECB and the Bank of England. This has manifested itself in MoUs signed between competent authorities which aim to provide business continuity and minimise disruption in the event of a no-deal Brexit. These MoUs include those signed between the FCA and European Securities and Markets Authority (ESMA) that will allow certain activities, such as fund manager outsourcing and delegation to continue to be carried out by UK-based entities on behalf of counterparties based in the EEA.

- **Regulatory supervision:**

The FCA and the PRA have been transparent and communicative about their expectations of market participants through regulatory outputs and educational briefings, while also conducting supervision to ensure firms are making appropriate preparations. The FCA and PRA also required regulated firms to plan for the scenario of maximum change, i.e. a no-deal Brexit, and demanded evidence of firms' preparations to ensure the industry is sufficiently planning.

What can businesses do to prepare?

From our engagements with clients, we have seen several common actions taken by banks that have driven the relative success and maturity of the industry, these include:

- **Monitoring regulatory developments:** Banks have benefitted from having developed compliance functions which monitor developments from regulators. These functions have been integral in examining the regulator's publications and incorporating them into Brexit preparations.
- **Redirecting resources to build project teams to work out what changes are necessary and when to make them:** Banks were amongst the first firms to create Brexit taskforces whose purpose was to identify risks and develop mitigation plans. By acting quickly after the referendum, banks afforded themselves the time to make comprehensive plans leading to structural and operational changes to minimise the disruption to business as usual operations.
- **Identifying "decisions of no regret":** The lasting uncertainty around Brexit means businesses could not plan for a particular future state. By using the scenario of maximum change as a basis for planning banks were able to identify decisions of no regret which would benefit their business, or at least minimise disruption, independent of the future relationship between the UK and EU27.
- **Using Brexit as an opportunity to test resilience and operational efficiency:** The bulk transfer of existing portfolios from UK counterparties to EU counterparties provided an opportunity to test the industry's technological resilience. This helped to identify and address areas of weakness in banks' technology systems.
- **Manage all key stakeholders** to understand commitments and expectations. Engage with audit committees and liaise with trade bodies and regulators on preparations.



How can Deloitte help?

Deloitte has been supporting multiple businesses across a range of industries to understand the implications of, and prepare for, the UK's withdrawal from the EU. We have supported many clients with their Brexit planning. Our teams combine Brexit insights, industry knowledge and technical expertise to support our clients with their Brexit readiness planning – from risk assessment to applying the lessons learned to optimise for the future trading environment.

For further information please contact Deloitte Brexit Support at brexitsupport@deloitte.co.uk

Industry contacts

Amanda Tickel

Partner, Global Brexit Lead

Tel: +44 (0)20 7303 3812

Email: ajtickel@deloitte.co.uk

Francesco Bellasi

Director, Capital Markets

Tel: +44 (0)20 7007 1756

Email: frbellasi@deloitte.co.uk

Vishal VEDI

**Partner, Financial Services
Brexit Lead**

Tel: +44 (0)20 7303 6737

Email: vvedi@deloitte.co.uk

Further reading

No-deal guidance for the banking sector

UK No-deal Technical Notices:

Banking, insurance and other financial services if there's no Brexit deal

UK Business Preparation Tool:

Prepare your business or organisation for Brexit

European Commission Brexit Preparedness:

Financial Services and Capital Markets Union

Further guidance:

FCA Brexit guidance

Bank of England Brexit pages

ESMA Brexit guidance

European Central Bank

This no-deal guidance is not exhaustive. Companies should routinely review the latest official updates and technical guidance as and when they are published by the UK, EU, and individual EU Member States.

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