

Sector briefing

Financial services



Sector Briefing: Financial Services

The UK-based financial services industry is a significant contributor to the UK economy. The growth of the financial and related professional services sector in Northern Ireland has been one of our success stories, with a large variety of locally-owned and inward investing firms delivering world-class services, software solutions and specialist advice to customers around the world. Northern Ireland's fintech cluster is particularly strong and Belfast is the number one destination city globally for internationally-mobile financial technology investment (FT, 2016).

The inter-connectedness of a range of players in the financial and related professional services sector means that the potential effects of the UK's exit from the EU could be felt widely and across different types of businesses operating in, or providing services to, the financial services sector.

This document outlines the key concepts and priority concerns of the UK financial services industry in relation to Brexit negotiations.

Regulatory context

The impact of Brexit on the financial services sector in the UK will be heavily determined by the agreements between governments and regulators on a broad array of legislation. This includes a range of directives and regulations (e.g. MiFID, Solvency II, EMIR, AIFMD) which govern the client facing, sales, execution, risk management and back office activities of financial institutions including credit institutions, investment firms, insurers, fund managers, clearing systems and trade repositories based in the UK.

Agreeing the new general legal relationship between the UK and the EU and formulating the specific financial services regulations will be a complex and time-consuming task. Having sufficient transition arrangements in place will play a key part in reducing any threat to growth, competitiveness and financial stability. If the UK leaves the EU without retaining membership of the European Economic Area (EEA) then the UK Government will likely seek some form of bilateral agreement with the EU. The UK's influence on financial regulations globally and the strength of the sector in the UK will be two key factors driving the achievement of a comprehensive agreement with the EU.

NI financial services businesses welcome recent statements from the UK Government on the importance of an appropriate transition phase following the formal exit date of March 2019.

Potential post-Brexit scenarios

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At this stage, there are a range of possible outcomes. When assessing the operational rights or treatment of foreign banks in the EU, the EU determines whether the standards of regulation and supervision in a bank's home market are 'equivalent' to those of the EU (termed 'equivalence'). Equivalence is not negotiated but requested and is not available for all financial services or client types

At one end of the scale, the UK would continue to be recognised as having regulatory *equivalence* across a wide range of existing European legislation. This represents close to a 'status quo' option, with minimal disruption to existing arrangements.

At the other end of the scale, the UK would be moved to a '*third country*' relationship with the EU, without any recognition of regulatory equivalence. This would place significant restrictions on the EU-related activity that UK-based financial firms are permitted to undertake. Third country regimes created under EU law recognise equivalence for non-EU firms in certain circumstances only. This scenario will be very complex with impacts potentially varying considerably across individual businesses.

Key concepts/considerations

i) Data

Financial services firms rely on the ability to transfer and use personal data freely. Without an 'adequacy' decision from the Commission as to the UK's data protection regime, or other arrangements agreed as part of the Brexit negotiations, such flows could be disrupted if the UK is considered to be a third country for purposes of the General Data Protection Regulation (GDPR). Given the need for legal certainty, ensuring that UK firms can receive and transfer data is a priority for the UK financial services sector and the UK government is committed to negotiating 'uninterrupted and unhindered data flows' post-Brexit. The UK is currently working to implement the GDPR by 2018 so that it will be starting from a position of harmonisation with the EU.

ii) Passporting Rights

Currently the UK financial services sector relies extensively on the ability of firms authorised in any EU or EEA state to carry on permitted activities and provide services to clients located in another country without needing separate authorisation (termed 'passporting').

Passporting rights have been a key mechanism for financial services companies to grow business in the EU market. If the UK leaves both the EU and the EEA it will no longer be covered by the passporting frameworks established by EU directives or the

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freedoms for trade guaranteed by the EU treaties. Without passporting, the ability for the UK financial services sector to service business in the EU would be limited and depend upon whether equivalence is granted or the domestic national market access restrictions of individual EU countries permit it to do so.

iii) Impact on business models

The impact of Brexit on individual firms depends, in large part, on the way that their business is currently structured, the nature of services being offered and the location of clients. Certain aspects of a firm's business (notably cross-border client-facing activities) are most likely to be impacted by Brexit whilst others (e.g. domestic UK business or services delivered from the UK to clients beyond the EU) will largely be unaffected.

The potential loss of passporting and regulatory equivalence is prompting many firms to explore and/or put in place contingency plans and solutions to enable continuity of service to EU clients, post-Brexit. The models that are being considered vary depending on the individual firm's structure but involve using and transforming (by way of bolstering operations and obtaining additional authorisations and permissions as required) EU entities and branch networks to ensure that they are able to continue to service their EU client base on an ongoing basis following Brexit. These options clearly carry additional set up and other costs and may have longer term implications with respect to the movement of business from the UK to other financial centres in the EU and elsewhere.

In the same way, EU firms seeking to retain or gain access to the UK market after the UK's exit from the EU, will face similar uncertainties as those described above. They too will be exploring options for continued access to the UK financial services industry.

What will the future hold?

The outcome of the UK and EU negotiations will directly impact on the scale of the financial services sector in the UK. We could see UK firms:

- moving certain functions to EU locations and potentially outside of Europe.
- closing some business lines due to the re-evaluation of capital / returns.
- re-examining their cost base and seeking to optimise efficiencies

For Northern Ireland a key factor in the growth of the financial services sector locally has been the ability to act as a 'near shore' location to London, as well as support operations stretching from the East Coast of America through to Europe, the Middle

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East and Asia. The future success of the sector here will depend partly on how London's role as a financial centre continues to evolve in the context of Brexit.

However, there may be further opportunities for Northern Ireland from the growth of Dublin as a financial centre. And, as the final deal will inevitably mean that some things have to move around and change (like operations, technology, people, physical assets and supply chains) Northern Ireland must be poised to capture opportunities arising from this disruption.

In addition to the impact of Brexit, the industry is facing significant change as a result of reducing revenues and increasing compliance costs and capital requirements. In meeting this need to change and secure future growth, firms will need to identify and strengthen core businesses to drive growth and increase competitiveness.

In this context, Northern Ireland's proposition that combines talent excellence and cost-competitiveness with a proven track record in financial and related professional services and fintech continues to be relevant and compelling.

Conclusion

The impact of Brexit on the UK financial sector will depend on three things:

1. The adequacy of the withdrawal agreement between the UK and the EU;
2. The extent to which UK-based financial firms move operations before any agreement (adequate or not) is concluded;
3. The overall resilience of the UK financial sector to Brexit, through its broader global relationships and position.

The outcome of negotiations is impossible to predict but we do know that, regardless, there will be some disruption to the UK financial sector and change is inevitable. Further insight can be provided once the future relationship between the UK and the EU starts to take shape.