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How Brexit May Affect Banks' Business Models and the Financial System in the UK and EU: Opportunity to Revitalise the Existing Banking Structures?

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18.1 Introduction and Background

Britain's vote to leave the EU on 23 June 2016 (famously dubbed as "Brexit" vote) has brought significant amount of uncertainty to the UK and the EU, causing ripple effects across the global economies since. Brexit has become the main discussion topic not only for all government officials and public leaders in the UK and the EU political and economic circles but also has been seen as the ultimate danger—a sort of "Sword of Damocles"—that can destroy London's centuries-old financial sector and its long-reigning status as one of the world's leading financial hubs.

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Despite the considerable negative consequences of uncertainty in economies and financial markets, little progress has been made in the first six months since the vote to clarify the terms and conditions of the UK's exit. This was in large part due to the fact that no one in the UK or in the EU really knew how to design and orchestrate such an exit (no member state has ever left the EU since its inception). The principles are going to be defined as negotiations start with the UK trigger of Article 50 of the EU Lisbon Treaty (which took place end of March 2017 upon the Parliament's and peers approval vote in February). It is becoming increasingly apparent that resolution of the situation and UK's actual Exit might take several years (longer than originally considered and as stated in Article 50) and will likely depend on the extent of "Exit" scenario (i.e. "hard exit" vs. "soft exit") agreed on by the UK and EU officials.

However, one thing is certain—the ongoing uncertainty and prolonged negotiations will have significant implications on all UK-based financial institutions using "passport rights" to serve to their European clients (and vice versa[1]), particularly investment banks, asset and wealth managers, payments services and insurance companies. In fact, if passporting into the EU from the UK-based entities is not allowed in the post-Exit phase, transfer of certain activities from the UK to the EU will be inevitable, leading London to lose some business to other European financial centres, and even to locations outside the continent (e.g. New York City) should the international banks choose to move some operations back to their home territories. Many firms in the UK currently use passporting rights to access the EU Single Market. According to the UK's Financial Conduct Authority, the number of UK-based firms granted with the passporting rights under the EU legislations is approximately 5500, as can be seen in the table below (House of Lords EU Committee 2016) (Fig. 18.1).

In this chapter, we discuss the likely impacts of potential Exit scenarios on the UK- and EU-based financial institutions and on the City of London specifically. We present alternative options available especially for banks to ensure a smooth and orderly transition to a post-Brexit world and to use this period as an opportunity to build innovative and more efficient business models to help strengthen the UK and the EU banking systems in the aftermath of the 2008–2009 financial crisis.

	Total	Inbound	Outbound
Number of passports in total	359, 953	23,532	336,421
Number of firms using passporting	13,484	8,008	5,476

Fig. 18.1 Number of inbound and outbound passports issued by the Financial Conduct Authority and Prudential Regulation Authority (An "outbound" passport refers to a passport issued by a UK authority to a UK firm to do business in EU or EEA members states; and an "inbound" passport refers to a passport issued in an EU or EEA member state to a firm from that state, enabling it to do business in the UK (or other member states))

18.2 UK Financial Sector and London's Role as a Leading Financial Hub

UK's, and especially London's, role as a leading global financial centre is indisputable. With its many years of heritage, and first-class ecosystem based on a well-established infrastructure, large, experienced human capital base and strong regulatory framework, London, along with New York City, consistently leads the rankings as the world's global financial capital.

It is estimated that the UK's financial services sector earns £190–205 billion revenues annually, with over 1.1 million people[2] working in the sector across the country. Of the £200 billion revenues, approximately £40–50 billion is estimated to be from international and wholesale businesses related to the EU, that is, from EU client activities in EU-/euro-linked products, and about £25 billion of which is from banking alone (TheCityUK and Oliver Wyman 2016) (Fig. 18.2).

With its central time zone, English language, wide pool of investors and strong support from a world-renowned professional services sector, London has long been established as the main European hub for almost all international banks looking to service clients across the continent. Only one-third of all overseas banks operating in the UK are headquartered in another EU location outside the UK. For instance, US banks including JP Morgan, BAML, Goldman Sachs and Citigroup mainly use their UK-registered entities to access the EU,[3] with thousands of bankers and traders in their City offices performing EU-related transactions.

This relative importance (weight) of the City as the European hub for the global financial services sector is prevalent in the asset management and market infrastructure sub-sectors as well. More than 40% of all EU

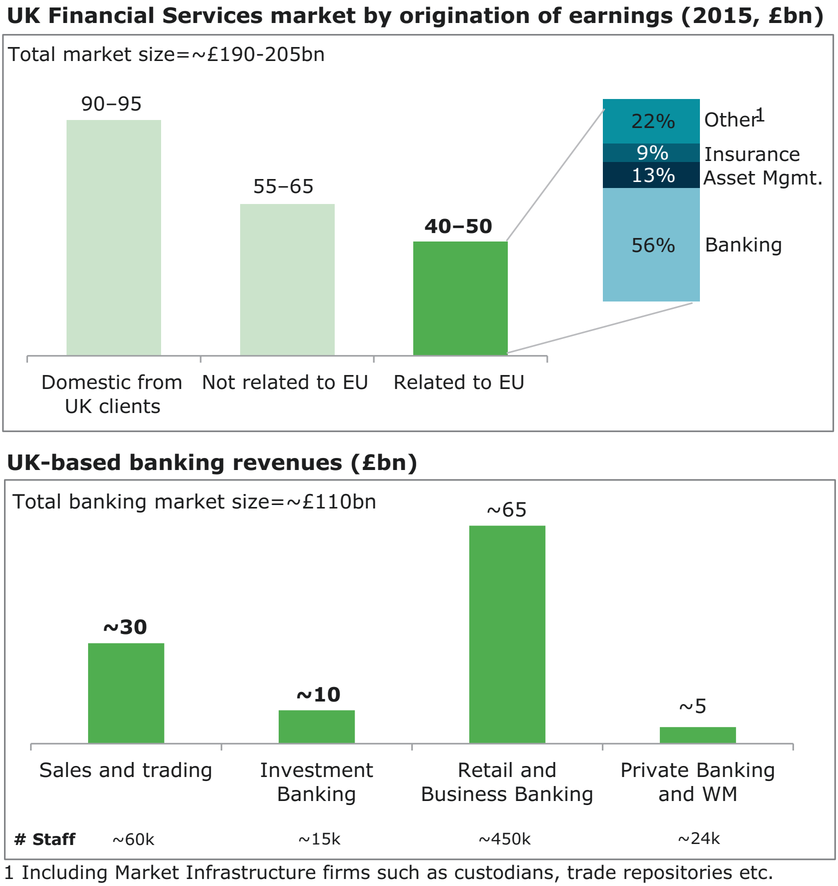


Fig. 18.2 UK financial services market by origination of earnings and banking revenues (TheCityUK 2016a, b)

AUM are based in the UK, and 40% of trading in EU27 stock markets are executed on platforms in the UK with few staff based within the EU27. UK also carries out 78% of the EU's FX business and 74% of OTC interest rate derivatives. And 59% of international insurance premiums are written in London (Financial Times 2016).

Although the extent of potential business losses from the UK-based financial services (and particularly banking) sector will depend on the level of access UK will have to the single market at the end of the Exit negotiations, it is estimated that at least 1–10% of the total revenues might be lost due to the UK's exit. Brexit is also likely to impact the level of employment in the sector, with up to 20–25% of UK-based staff at the leading international (especially US) banks potentially at risk to be moved to outside the UK. Some US banks such as JPMorgan and Citigroup have already announced their potential plans to move staff to EU-based entities in the event of UK's exit and loss of access to the Single Market.

Considering all these developments, maintaining London as a leading global financial hub is becoming an even more important task for the UK Government, officials and the financial sector leaders. Given the financial sector's weight on the UK overall GDP (c. 11.8% including the ancillary professional services sector) and its role in driving the economic growth, the sector's requirements such as the continuation of the passporting rights are considered as key agenda items in the government's negotiations with the EU.

Moreover, the sentiment that the loss of business from Brexit could be replaced by other emerging businesses in the City such as the renminbi trading has started to sour in the recent months as it has begun to be seen how Brexit might have spillover effects on such businesses going forward. Although the City of London has recently overtaken Singapore to become the world's second largest offshore renminbi centre behind Hong Kong, the average daily volume of renminbi trading in the City (more than US$40 billion[4]) is still much lower compared to daily euro-based transaction volumes spanning multi-trillion euros: it will therefore not be readily able to replace what is lost from the Brexit fallout.

London's role as the leading global "FinTech" centre might also come into question should young entrepreneurs and start-ups decide to shift their businesses elsewhere in a post-exit scenario—looking at other places such as Berlin, Paris or Amsterdam, further impacting the City's dominance among the financial capitals of the world.

18.3 Potential Exit Scenarios and Implications on UK-Based Financial Institutions

Brexit's extent of implications on UK-based financial services institutions will depend largely on the type and scope of the eventual Exit scenario agreed between the UK and the EU. The UK Prime Minister Theresa

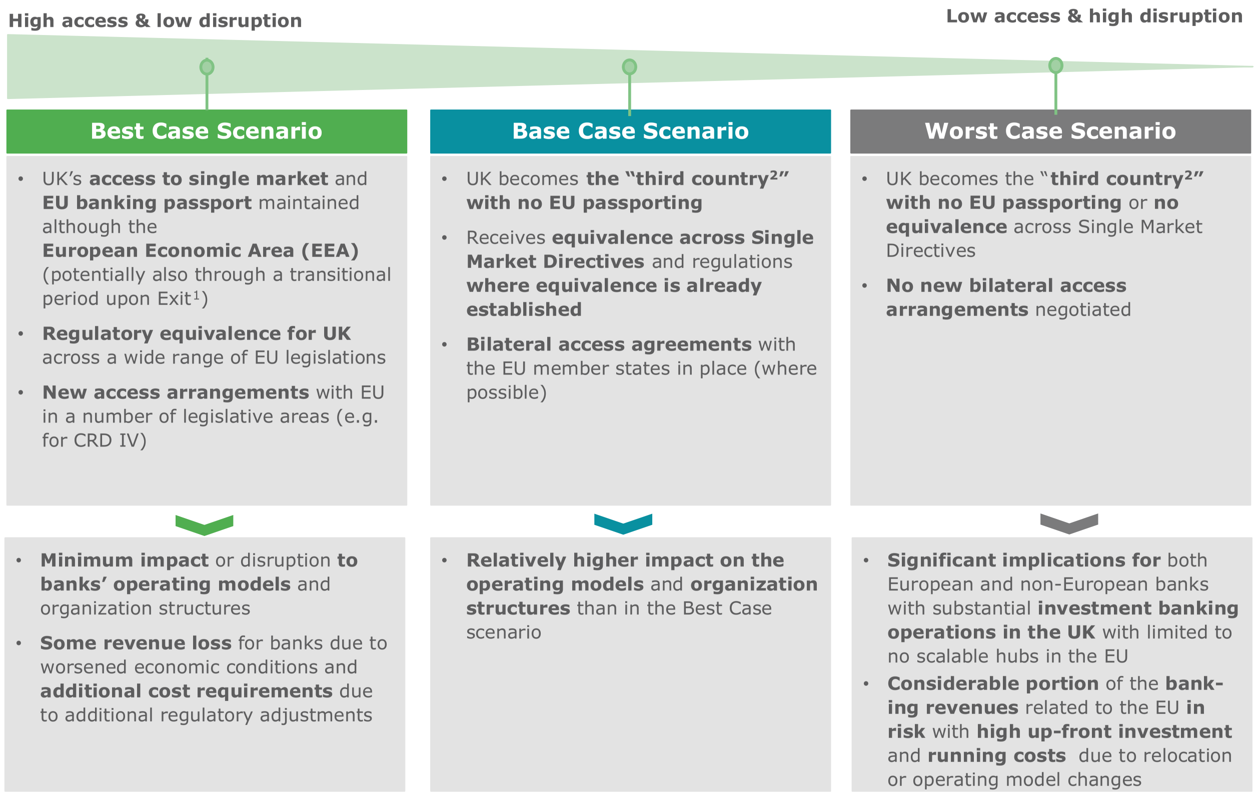
May announced during her speech laying out her Brexit plan that the UK might lose access to the Single Market at the end of the negotiations but that "her aim would be the greatest possible access to EU markets through a comprehensive free trade agreement" (Independent 2017). Given these circumstances, the spectrum of impact level might range from a less probable "high access/low disruption" model to a more likely "low access/high disruption" one, depending also on the financial firms' existing business models and cost bases (Fig. 18.3).

Best-Case Scenario:

- UK's access to Single Market and EU passport is maintained through full regulatory equivalence although UK is outside the European Economic Area (EEA).
- UK needs to negotiate new arrangements with the EU in a number of legislative areas such as the Capital Requirements Directive (CRD), where no regulatory equivalence currently exists.[5]
- Under this best-case scenario, we expect minimum level of disruption to existing operating models and organisational structures of financial services firms; however, some revenue loss due to worsened economic conditions and additional cost requirements resulting from regulatory adjustments might transpire.

Base-Case Scenario:

- UK becomes a "third country" with no single market access and passporting rights. UK receives equivalence across single market directives and regulations where regulatory equivalence is already established.
- Bilateral agreements are reached with the EU member states to retain access where possible (e.g. in specialty insurance).



1 Potential impact of a transitional period post exit from the EU is further discussed in the following sections of this document

2 Refers to when the UK moves outside the coverage of the EU Treaties, which enable Single Market access, passporting and regulatory equivalence

Fig. 18.3 Spectrum of Brexit implications (Monger et al. 2016)

Worst-Case Scenario:

- UK becomes a “third country” with no EU passporting rights or equivalence across the single market directives, and no new bilateral access arrangements are negotiated or put in place.
- This scenario would bring the highest level of disruption to financial services firms that depend on their UK entities to access the EU market. Should this case transpire, considerable portion of the revenues related to EU businesses are at risk with significant investment costs to be endured due to the relocation needed and the required operating model changes.
- In this scenario, UK-based banks and asset managers would not be able to serve to EU clients from their UK hubs, and unless bilateral agreements are reached with the individual member states, UK insurers and brokers would not be allowed to sell to the EU clients, thus leading such firms to relocate their operations outside of the UK.

Under the aforementioned scenarios, the organisations which would be impacted the most are going to be non-European (universal/investment) banks with no or limited existing hubs (operations) in the EU. On the other hand, for the UK banks serving predominantly UK customers, impacts on their operating models or organisations will likely be minimal.

Below, we present a brief overview of Brexit’s potential impacts on different types of financial institutions, starting with universal and/or investment banks.

UK Universal Bank Serving Mainly UK Customers:

- Brexit is likely to have downward pressure impact on both the retail and corporate banking’s revenue growth due to worsened economic conditions and consumer confidence in the UK economy (2018 earnings forecasts for the UK banks have already been cut by 12–27% due to lower loan growth and higher loan losses). And corporate banking revenue pools are likely to shrink in line with declining lending and payment volumes.

- Investment banking revenues might also be negatively impacted with ROEs continuing to be under pressure and falling. However, the performance of banks will vary largely based on their business and product mix. For instance, increased volatility might positively affect FX and rate trading, whereas in asset management, potential reduction in AUMs might lead to decrease in related revenues.
- Although we expect a minimum level of impact on this type of organisations by Brexit, certain investment banking operations, especially EU-denominated trading and clearing, might need to be moved to separate entities within the EU.
- In this scenario, banks that do not currently have separate EU-based entities might need to set up such entities and/or subsidiaries in the EU. As a result, transfer of both certain operations and people from the City to the EU-based centres might be required. For instance, one of the leading global UK banks, HSBC, has stated it might consider moving some EU-related operations and approximately 1000 people of its workforce from London to their Paris office.

European or International Investment Bank with Established Operations in the EU:

- UK's exit from the EU will likely have similar macroeconomic consequences and downward growth pressure for these banks due to worsened economic conditions both in the UK and across the EU, with European banks feeling the pain harder than their international counterparts that have less exposure to the European markets.
- The level of impact on these banks will vary depending on the scenario. Specifically, EU-denominated trading and clearing activities might need to be moved out of the UK if passporting rights are lost as a result of the Exit agreement.
- The banks that currently operate through "branches" in the UK might require additional capital for their UK businesses (e.g. Deutsche Bank). Such banks might need to convert their current legal structures from branches to subsidiaries and/or start capitalising their UK operations separately if the UK leaves the Single Market.

- Some banks in this category might even consider to move some or all of their other non-EU-related operations out of the UK should they think that the remaining UK operations would not provide them with enough scale or growth opportunity in the post-exit UK economy.
- Such banks have already started assessing their existing activities and operating models in the UK to decide which parts of the business should be moved under the different Exit scenarios (e.g. Citigroup announced in November 2016 that they had started looking into scenarios of moving some of their staff to Frankfurt.)

Non-European/International Universal Bank with No Existing Operations in the EU:

- In addition to the macroeconomic impacts as described above for the other two categories, potential loss of passporting rights would be one of the highest concerns for these types of banks which solely use their UK entities to serve the EU clients.
- These institutions would need to establish separate, capitalised subsidiaries (or branches) in the EU to access the European market, negatively impacting the banks' cost bases and efficiencies of their capital/liquidity management.
- The impact on the banks' operating models would be high as they would need to decide which activities to be kept in the UK versus to be moved to the newly set-up EU entities, and start making investments to build up the necessary infrastructure, IT systems and support functions in their new EU operations.
- Banks will be likely to move euro-denominated trading, clearing and custody operations to the EU, splitting their sales and trading desks between the UK and the EU and entering into new custody agreements with the EU entities.
- They might also need to move some risk management and back-office/support functions and roles (e.g. roles in balance sheet management, capital management, IT) out to the EU-based entities.
- However, the end operating model of the banks will largely depend on the UK's Exit agreement terms. In case, for instance, the UK is pro-

vided with an equivalence status under the Markets in Financial Instruments Directive (MiFID2) (which is to come into force in early 2018), then the banks might not need separate EU-based entities to serve the institutional clients in the EU, eliminating the need to move such operations outside the UK.

Banks' decisions as to which parts of their UK operations should be moved to which EU location(s) will depend on five main factors directly relevant to their business and operating models:

- Business and product mixes, including asset classes (i.e. weight of corporate vs. investment banking; extent of EU vs. non-EU-related asset transactions in the businesses)
- Locations of clients and their requirements (i.e. weight of UK and international clients vs. European clients in the portfolios)
- Regulatory and legal considerations (i.e. availability of strong regulatory/legal frameworks, financial funding/investors, competition and employment laws, easiness of doing business and data privacy requirements in the selected location)
- Tax regimes (i.e. choosing locations with lower effectives tax rates)
- Businesses' scale opportunities (i.e. potential to quickly build up and expand operations in the selected location)

However, trading and clearing of euro-denominated assets might need to be moved regardless of the banks' current operating models, with euro equity derivatives, euro rates and credit trading most likely to move. Other asset groups, such as FX, which are exempt from cross-border regulations, are more likely to continue to be performed in the UK.

Depending on their target business models and strategies, banks might also consider moving their other non-euro-based asset operations (e.g. Debt Capital Markets or OTC derivatives) to the EU or their home territories to gain from economies of scale.

We present below a high-level view of asset classes that are more likely to move to the EU in the case of Exit from the Single Market, including the potential impact of these assets on banks' revenue pools (Fig. 18.4).

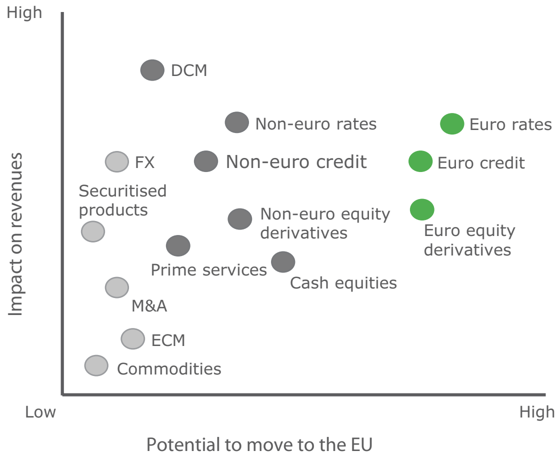


Fig. 18.4 Potential of move to the EU by asset class (Bubble sizes in the chart do not depict revenue sizes. Impact on revenues defined based on global revenue estimates of asset classes)

Brexit will have impacts not only on banks but also on a number of other UK-based financial institutions using passporting rights to access and serve the EU market. In the following section, we briefly summarise Brexit impacts on these organisations.

Asset Managers

Passporting rights will likely be an issue for asset managers. Although the UK might receive "equivalence" status under the Alternative Investment Fund Managers Directive (AIFMD), the UCITS Directive would require UK asset managers to establish an EEA-based gateway hub (i.e. domiciliation of funds in the EEA) in order to be able to serve and distribute to the EU clients.

Approximately €1 trillion of UCITS funds are currently domiciled in the UK, and among the asset managers based in the UK, only 54% are already domiciled in the rest of the EU. Therefore, we could expect some movement from the UK to the EU in this area in the post-exit world.

Impact on asset managers could be extended further as sales and trading (banking) activities migrate from the UK to the EU, causing some companies to start managing larger portions of their assets from their EU bases.

Hedge Funds

London is a leading financial centre for the global hedge funds. According to Preqin (a leading source of data and intelligence for the Alternative Assets industry), out of the 944 EU-based hedge funds it tracks, 590 (62%) are headquartered in the UK, managing a combined $500 billion of assets, compared with just $140 billion managed elsewhere in Europe (Reuters 2016).

Preqin's latest survey results as of November 2016 show that 24% of the UK-based hedge funds are uncertain about their prospects in the UK, and 6% are actively considering moving out of the UK in the event of a Brexit.

Market Infrastructure/Service Providers (e.g. Exchanges and CCPs)

Brexit and loss of passporting rights are likely to have impact on the market infrastructure organisations such as exchanges and clearing houses as well. Central counterparties (CCPs) are crucial for the settlement of securities and derivatives transactions, and thus, euro-denominated clearing houses such as LCH Clearnet might also need to move operations outside the UK (in this case, to Paris) or set up separately capitalised entities in the EU.

As clearing portfolios are more and more split across the UK and the EU, the cost of clearing in the UK might increase leading to inefficiencies and clearing operations moving out of the UK.

Payment Processors

If the UK leaves the Single Market at the end of the EU negotiations, banks in the UK could no longer be direct members of TARGET2 (payments system for the euro area). As a result, they might need to operate through subsidiaries within the EEA.

Corporate and Specialty Insurance

If the UK could not agree on bilateral agreements with the individual EU member states regarding the passporting rights of the insurance sector, the UK insurers and brokers might also need to move operations including underwriting, risk and portfolio management activities to the EU. The greatest impact, in that case, would be on Lloyds' of London.

18.4 Model Options Available for Banks (and Other Financial Institutions)

Given the ongoing uncertainty over the UK Government's Brexit plans and the proceeding Exit process to be followed with the EU states, banks and other financial institutions in the UK have already started assessing their strategic options and business models, considering near- and long-term implications and developing contingency plans. We expect banks to begin taking more concrete actions (i.e. moving certain operations) in case further clarity cannot be established in the near future. (At the time of this chapter being written, the UK Government was yet to present a White Paper outlining its detailed Exit plan strategies.)

In our view, a number of model options are available for banks and financial institutions, in general, in the light of Brexit. The "worst-case" scenario (as described in the earlier sections of this article) would amplify the challenges and risks for banks. However, we also believe that they could use this situation (period) as an opportunity to build more innovative, robust and effective business models that are more competitive in today's financial markets.

Strategic options available for banks will depend on the type of the organisation and will include the following main actions.

18.4.1 Non-European/International Universal Bank with No Existing Operations in the EU

This type of banks is likely to have three key strategic options to choose from, including:

- Setting up an EU-based legal entity (subsidiary) and moving EU-denominated operations to this entity;
- Moving EU-related operations to home countries [jurisdictions] (e.g. USA or Japan in the case of US and Japanese banks); and
- Scaling back the EU-related operations and focusing predominantly on the UK and/or international operations.

In order to set up a separately capitalised legal entity and move operations there, banks would need to deliver a number of activities which would require considerable time, energy and money:

a. **Selecting the new EU jurisdiction to relocate to:** The target jurisdiction will depend on a number of parameters such as the existing legal and regulatory framework, strength of laws, attractiveness of the tax regime, and financial, economic and geopolitical infrastructure present, in all of which London is currently best-in-class.

   However, many of the financial centres in Europe have already started trying to lure banks away from London in the wake of the referendum vote. For instance, it has recently been rumoured in the media that the German government is considering changing the labour laws to make Frankfurt more attractive for the banks looking to move their EU operations from the UK.
b. **Deciding on the legal entity structure:** Banks would need to set up separate legal entities in the EU should the UK lose access to the Single Market and the EU passporting rights. However, banks are likely to face with two different options as they decide on their target legal entity structures in the EU:

i. Setting up an "Intermediate Holding Company (IHC)" which combines banking and broker—dealer businesses into a single subsidiary (as we see in the USA in the aftermath of the 2008–2009 financial crisis), and
ii. Establishing a "subsidiary" including upgrading the current booking model and capitalising any existing structures (e.g. branches).

   Whichever option is chosen, implications on the capital, liquidity and compliance requirements will be significant for the banks.
c. **Obtaining regulatory approvals and bank licences in the new host jurisdictions:** As banks look to set up new entities in the EU jurisdictions, they would be required to receive approval for their internal capital and risk models (to calculate capital/liquidity requirements) and apply for a banking license in the chosen jurisdiction.

According to initial estimations, it might take banks two to three months to put a licence application together, and an additional six months to obtain an approval, making the whole process a rather lengthy and costly one.[6]

d. **Setting up the new infrastructure, IT systems, operations and corporate functions:** The new EU subsidiaries/entities would require headcount (both for the front and back office) and infrastructure including new systems and platforms, corporate and support functions including risk management, compliance and finance. All these would mean significant investment (capex) requirements and additional operating/administrative costs for the banks.

   According to a recent study by the Boston Consulting Group (BCG), building new operations in the post-Brexit might cause such banks' operating costs to increase by up to 22% (Morel et al. 2016). Costs that banks would need to incur would include compensation and relocation packages for the transferring staff, and/or hiring expenses in the selected locations as well, having significant impacts on the profitability of the banks during the transition period. According to one estimate, it might cost banks about £50,000 per employee to relocate staff to the EU, making the totals banks need to endure just for staff relocation tens of millions of pounds (depending on the size of relocation that would be required).

e. **Hiring and training staff in the new location:** Given the potential high cost of moving staff from the UK to the EU (and risk of losing valuable and experienced human capital), banks might choose to hire for their EU operations directly in the selected jurisdictions/markets. In that case, selection of the location gains more importance as it would be preferable to be set up in a market with access to a strong pool of talent that is relatively cheaper than in the UK.

18.4.2 European or International Universal Bank with Existing Operations in the EU

The main strategic options available for the banks in this category are:

- Moving to EU hubs and scaling up their European operations, and
- Reassessing the whole UK operations to decide either to invest in or to scale back/retreat from the UK.

Banks would likely start with performing a review of their current UK operating models and identifying scope and extent of operations (activities) to be moved to their EU hubs.

One of the key actions these banks would need to take is developing new capital and risk models for their UK and EU entities, and planning for capital increases in both their EU and UK bases.

They would also require strengthening their EU hubs with additional headcount and infrastructure investment to handle the increased capacity and scope of activities in the EU operations. Their preparations would involve moving specific staff from the UK to their European hubs and/or hiring directly for the EU operations.

18.4.3 UK Universal Bank Serving Mainly UK Customers

The strategic options available for the banks in this category would be similar to the ones we describe above for European or International Banks with existing operations in the EU:

a. Setting up an EU legal entity or moving EU-related operations to the existing EU entities
b. Reassessing the UK operations to invest in, transform and/or innovate

Some of the UK banks in this category already have EU-based subsidiaries (or entities). Such banks will largely work on to identify the scope of operations to be moved to these entities and to enhance their existing infrastructure, operations and talent pool in the EU. Those banks that do not own readily established EU-based entities would first need to identify the jurisdiction to relocate to and the entity structure, and then plan in detail to obtain the necessary approvals in the new selected location to set up their EU-based operations.

In either case, a detailed review and restructuring of the UK operations would be crucial to adjust the remaining UK business to lower transaction volumes and lay the strong foundation for future growth (Fig. 18.5).

In spite of all the uncertainties and complexities, Brexit could offer opportunities for all banks (both in the UK and across the EU) to assess their current operating models and fully restructure their organisations to radically reduce costs and uncover previously untapped business potential. Using a "Zero-Based" approach to designing and rebuilding their organisations, banks could achieve much leaner and simpler models with lower cost bases that could better compete with nimbler emerging business models such as FinTechs.

Banks could also look to gain additional efficiencies through innovative models and cross-bank (cross-sector) collaborations, including use of industry utilities or activity pooling/platform sharing initiatives, significantly renewing the face of the European banking sector and making it more competitive against international (US) rivals. Leveraging such outsourced, collaborative models for non-core business processes (e.g. post-trade processing, KYC and client reference data) and duplicative operations could help reduce banks' cost bases significantly.

Brexit process could thus provide the sense of urgency to address such opportunity to build up a simpler, more effective and profitable European banking sector.

18.5 Transition Period to the Post-exit

Considering the complexity of the negotiations period awaiting the UK after the trigger of Article 50, defining the post-exit financial services sector and the specific sectoral regulations is likely to take time. Having a "transitional period" between the UK's formal exit from the EU and the implementation of the new terms and conditions would be crucial to ensure a smooth exit process for the financial services sector and to minimise the negative effects on the UK and the EU markets.

The importance of "transitional arrangements" in the Brexit process has also been announced publicly by Mark Carney, governor of the Bank of England, who "urged the UK Government to seek transitional arrangements with the 27 remaining members of the EU" (Financial Times 2016).

Although a prolonged Exit period (longer than the two years required by Article 50) might meet with some resistance among the "Brexiteers" in the UK, we think a "transitional period" would help banks and other financial institutions properly prepare for the post-Exit world, especially in case of a "low access/high disruption" scenario.

Bank type	Key strategic options	Key consideration points
A Non-European or International Bank with no operations in the EU	Set up an EU legal entity (subsidiary) and move EU-denominated operations to this entity Move EU-related operations to home country (e.g. US or Japan) Scale back in the EU and focus on the UK and international operations	• Select the new EU jurisdiction to relocate to • Decide on the legal entity structure (branch, subsidiary or holding) • Obtain regulatory approvals and bank licences in the new host jurisdiction(s) • Obtain approval for new capital and risk models from the regulators • Set up the new infrastructure, IT, operations • Move /hire and train staff in the new location
B European or International Banks with existing EU hubs/operations	Move to and scale up the EU operations Reassess the UK operations: Scale back /retreat from or invest in	• Identify scope and extent of operations to be moved to the EU hub • Plan for capital increase and management strategies for the UK and the EU entities • Obtain approval for new risk models • Build up the EU infrastructure and operations • Redefine the UK strategy and business/entity model; transform where needed
C UK Banks serving EU clients from their UK bases	Set up an EU legal entity and/or move EU-related operations to any existing EU hub Reassess the UK operations: Invest in, transform and/or innovate	• Select the EU jurisdiction to relocate the EU-related business to or set up a new entity • Decide/review the EU legal entity structure • Obtain regulatory approvals • Enhance the EU-based infrastructure, operations and talent pool • Review the UK business model and deliver cost transformation or growth initiatives

Fig. 18.5 Strategic model options available for banks

As stated by a number of officials and sectoral leaders (including Mr Carney), all new rules and trade deals use some sort of phasing-in to be implemented. For instance, Basel rules have been phased in over an eight-year period and the Vickers reforms over a four to six years period. Therefore, using such a transitional period, even if not as long as six years, but longer than the two years, would be beneficial not only for the UK and the UK-based financial sector, but also for the overall financial stability of the EU.

18.6 Conclusions

As our analysis shows, the impact of the UK's exit from the EU on the financial services companies and the City of London will largely depend on the type of Exit scenario reached between the UK and the EU. The spectrum of impact level will range from a less likely "high market access/low disruption" one where the UK maintains its access to Single Market and EU passporting rights (though, we see this scenario even less likely upon the recent announcements by Theresa May) to a more likely "low access/high disruption" one where the UK becomes a "third country" with no EU passporting rights or "equivalence" status under the single market directives.

A "high-access and low-disruption" scenario accompanied with a sensible transitional period would be the most beneficial option for the financial institutions. However, if the UK loses the passporting rights at the end of the EU negotiations, it might be inevitable that some business will be moved from London to the other emerging European or global financial centres such as Paris, Frankfurt, Amsterdam, Dublin or NY. Although both the UK Government and the City of London expect a modest amount of business loss due to the Brexit, up to £18–20 billion of revenues and 100,000 jobs might be moved out of the City in case of a "hard exit".

Certain single market directives such as MiFID2 could decrease the impact of the Brexit (and loss of business from the City) if the UK is given an equivalence status to the EU under this regulatory regime as this directive could allow non-EU firms to provide services to institutional clients within the EU without the need to have a local presence in the EU.

Given London's indisputable role as one of the world's leading financial capitals, and other European centres' relatively sub-scales and less developed infrastructures and regulatory frameworks, it is hard to see the City losing its reign in the financial services sector altogether. However, it is likely that with the move of some business (especially, euro-denominated trading and clearing) to other financial centres, the UK could lose economies of scale and doing business in the City might get more expensive.

We do not foresee any of the other European financial centres taking the place of London in the aftermath of Brexit, considering their sub-scales and less interconnectedness with the global trade world. Therefore, the consequences of the Brexit should be of concern for the EU banking sector as a whole, and not just the UK.

Considering the higher costs, lower profitability and diversion of management attention Brexit would bring to the sector, we advise financial institutions to carefully assess their strategic options during the process, and be smart to take full advantage of the situation to build innovative, robust and more efficient business models.

Brexit could offer a valuable opportunity for both the UK and EU-based institutions to perform a full restructuring of their organisations including streamlining operations, digitalising end-to-end processes and using industry utilities or cross-bank activity-pooling/platform sharing initiatives to radically transform their businesses, and the European banking system.

Glossary

AIFMD Alternative Investment Fund Managers Directive

Article 50 Article 50 sets out the procedure by which a Member State can leave the EU

AUM Assets under management

CCP Central counter-party, also known as a clearing house

CRD Capital Requirements Directive

EEA European Economic Area

EMIR European Market Infrastructure Regulation

Equivalence Provisions in certain pieces of EU legislation allow market access to firms from non-EEA countries judged to have an equivalent regulatory and supervisory regime to the EU

EU	European Union
FX	Foreign exchange
KYC	Know Your Customer
MiFID	Markets in Financial Instruments Directive
OTC	Over the Counter. Refers securities traded outside a formal exchange
Passporting	The right for a firm registered in the EEA to do business in any other EEA state without needing further authorisation
ROE	Return on equity
UCITS	Undertakings for the Collective Investment of Transferable Securities

Notes

1. European banks using "passport" services to access the UK market.
2. Increasing to 2.2 million if jobs in supporting/ancillary services are included.
3. Citigroup also has a separately capitalised subsidiary in Dublin.
4. Daily volumes of overall renminbi trading reached US$61.5 billion in 2014, according to the City of London.
5. Investment banks obtain passport under CRDIV and investment firms under MiFID2.
6. The period to get an approval for the banking licence for retail banks might be even longer (circa nine months).

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