

# [Effect of brexit on the financial sector](https://assignbuster.com/effect-of-brexit-on-the-financial-sector/)

Brexit: A bleak future for the financialsector?

Abstract

The word “ Brexit” evolves from Britain and exit which is an unforeseeable situation that the UK is now facing. Brexit could causedamagesto the UK economy in the long term, especially those in financial sector. The solutions to lessen the impacts of Brexit have been illustrated in this essay. This essay also aims to discuss the impacts of Brexit on asset management services and thebanking industry. It will then evaluate these impacts on different aspects: international students, UK housing market, stock market and Britons who live in EU countries.

## Introduction

On 23 June 2016, the United Kingdom held areferendum whether to leave the European Union (EU) or not. Most Britonsbelieved beforehand that the UK would not leave the EU. Surprisingly, theresult was 52% of the voters decided to leave the EU (CFA INSTITUTE, 2017). Asa result, David Cameron who, at that time, was the prime minister of the UK hadto resign. Subsequently, the position in charge was taken by Theresa May. Following this step, on 29 March 2017, the UK government has formally announcedits invoking of Article 50 which is the initial step to formally exit from theEU. Thus, the word “ Brexit” evolves from Britain and Exit. The process must befinalized within two years. This means, in March 2019, the negotiation has tobe done. However, from a very recent Guardian article, this process could bepostponed because there are new variety ofregulations which need to be implemented and many institutions that require newstaffs to operate (Miller, 2017).

It appears highly likely that once Brexitoccurs, Britain will lose its right to tariff-free access to the EU market. Inother words, UK-based firms, especially those in the financial sector, may beunable to conduct their operations throughout the EU. As a result, overseasfinancial institutions whose European headquarters are located in the UK mustreconsider their decision on whether to continue operating their managementfrom the UK or not. This could cause long-term negative consequences to the UKeconomy. Therefore, this essay will discuss the impacts of Brexit on financialservices, particularly asset management and the banking, moving on this essaywill also evaluate these impacts on Britain’s post-Brexit future.

## Financial Services

Financial services are the economic activitiesthat are involved in the flow ofmoney in the financial system. The services include asset managementwhich is the service that aims to allocate money to maximize the profit. Additionally, the banking is an institution which mainly provides such servicesas accepting deposits and issuing loans to clients. Those activities havebecome one of the crucial parts of the UK economy and it provides anopportunity for the UK to influence world banking industry. According to theHouse of Lords EU Committee, 7-12 percent of GDP of the UK, 7-12 percent ofemployment ratio and 11 percent of tax receipts are ruled by the financialservices. Furthermore, the largest trade surplus of the UK in 2014 was thefinancial services which accounted for £58 billion of which £19 billion is thetrade with the EU country Austen, Hunt, Kelly, Naylor, & Sants, 2016). However, this positive circumstance could possibly be worsened by thereferendum which was held on 23 of July 2016.

This is also a major concern for the financialservices. As a consequence of Brexit, it is forecasted that the UK could lose31000-35000 job positions in financial services. In addition, the worstscenario, this number could increase to 40000 (Arnold, 2016). This numberaccounted for 3-4 percent of job position involving with the financial servicesin the UK (Austen et al., 2016).

## Asset management services

Asset management is referred to an activity ofgenerating returns for investors from the capital which is subsidized by investors. According to the Investment Association and the Financial Conduct Authority, the UK asset under management (AUM) is £6. 9 trillion, approximately, of which£2. 2 trillion is the overseas client. In addition, 55 percent of the overseasclient, or £1. 2 trillion, is the European clients (CFA INSTITUTE, 2017). Thiscan be said that the asset management industry has played a crucial part in theUK economy. Moreover, losing the right to access the EU market could possiblycause long-term problems to the UK economy.

After Brexit, the UK-based investment firmcould witness severe problems supporting the EU clients, as claimed byChristian Nolterieke, managing director at MyPrivateBanking Research(Greenhalgh, Mooney, & Williams, 2017). In order to serve clients andrecruit talented people in the EU, they must acquire the tariff-free license toaccess the EU market which the UK’s license will no longer be valid if theypursue Brexit. Moreover, the advertisement and marketing are also prohibitedfrom the non-european economic area (EEA), as stated by Nolterieke. There mightbe some solutions to cope with this issue. One of them is to establish anoffice in Europe. However, to do so, the business must be in a large scale. This is because establishing office in Europe requires high amount of capital, well-corporate structure, office, and people, as stated by Julie Patterson whois the consultant of asset management global Brexit at KPMG (Greenhalgh, Mooney, & Williams, 2017). Furthermore, to establish an office in Europe, the regulation of the Markets in Financial Instruments Directive, known asMiFID, requires 20 or more employers onshore. As a result, finding a partner ofbusiness in Europe could possibly be the most moderatemethod to lessen the effect of Brexit, as determined by NathanBostock who is now the executive directors of Santander UK (Gerrard, 2017). This is because the UK-based firm is still benefit from being a partner withEurope-based firm, even though the benefit is not fully equivalent to the past. It is a method called profit-sharing in which it could stimulate the UK andEurope economy in the long-term.

Surprisingly, in 2017, the research conductedby the CFA instituted, the institution which is the community of fund managers, have shown that two-thirds of the fund managers have not changed theirinvestment horizon after Brexit. Theoretically, this might be because the fundmanagers tend to invest in the equity market which the price of the equitycould increase when the pound is depreciated.

## The Banks

In this essay, the types of bank will becategorized into three types: commercial bank, retail bank and investment bank. Firstly, commercial bank is a financial institution which mainly provides suchservices as deposit and withdraw of money and offers loans tobig business. Secondly, unlike commercial bank, retail bank or consumer bankprovides the same services to customers in a non-business sector. Lastly, investment bank is not the bank who provides such services as accepting moneyor issuing loans services. On the other hand, it is the bank who providesadvises on stock market launch, mergers and acquisition or even taking overother company.

The impact of Brexit on these types of bankscould cause the similar problems as in asset management services. This ismainly because the EU requires the approval of Markets in Financial InstrumentsDirectives (MiFiD) to allow banks to operate in the EU. In order to maintainMiFiD status, the UK must be part of the European Economic Area (EEA). Thiscircumstance is not likely to occur if the UK favours a ‘ hard Brexit’. This isbecause ‘ hard Brexit’ means the UK has to relinquish its MiFid license as itwill no longer be valid. As a result, this occurrence causes the world’sleading financial institutions to leave the UK.

Paris has been one of the biggest rivals forthe European financial centre since the UK referendum. However, due to the highcorporate tax rate, 33. 3 percent, this effects Paris’s attractiveness to belessen (Stothard, 2017). In this sense, the opportunity is now belonging toDublin because 12. 5 percent tax rate in Ireland could attract the firms fromall over the world. Moreover, those firms who wish to move to Ireland do notneed to establish new banking license. This is exemplified by the announcementfrom the Bank of America, the second largest bank in America by total asset, that the bank has chosen Dublin as the headquarter office for its EU operationafter Brexit (Noonan, 2017). Brian Moynihan, chief executive officer of theBank of America, also told the Financial Times that “ We’ve been working withthe Central Bank of Ireland to get it all set up and it’s been a very smoothprocess so far. The government is trying to help us get through the regulatoryprocess.” (Noonan, 2017). As a consequence of the support from the governmentand an existing banking license of Dublin, it could support the Bank of Americato accomplish its process ahead of Brexit easily.

Frankfurt has also competed for the position ofpost-Brexit financial centre. From the announcement of Deutsche Bank, thelargest bank in German, they will transfer most of their assets and operationto Frankfurt in this autumn (Arnold, Martin, & Noonan, 2017). This could be one of the largest transferof single EU bank, as stated by the chief executive officer, John Cryan. Another decision made by Citigroup’s Europe, Middle East and Afica (EMEA) chiefexecutive office, Jim Cowles, that the bank decided to move theirs main tradingoperation to Frankfurt (Arnoldet al., 2017). This is because Frankfurt is well known for itsinfrastructure and skilled workers which the bank has already had on ground, asclaimed by Mr. Cowles. These actions from two of the largest bank in the worldcould threaten Britain’s economic in the long term, indeed. Undoubtedly, international banks such as Nomura Holdings, the fifth largest bank by assetand Sumitomo Mitsui Banking Corporation which is the third largest bank inJapan by asset have already published their plan on moving their main operationto Frankfurt after Brexit (Arnold, 2017).

Turning to another side of the issue, there areseveral private banks who are now enlarging their services in the UK. Accordingto the Financial Times, the senior executives at the following banks; CreditSuisse, UBS, Société Générale and Pictet announced that the companies willexpand their operation and investment in the UK (Arnold, 2017). Thisis because the UK is still attractive in terms of market potential. In otherwords, the wealthy clients still find an opportunity in the UK. This idea wasalso supported by Jakob Stott who is the EU head of UBS’s wealth managementbusinesses (Franklin & Gruber, 2016).

## Britain’s post-Brexit future

### International Student

The UK has been known for its quality ofeducation but this might be extravagant for international student to study inthe UK. However, due to the UK referendum, the pound sterling witnessed a hugedrop after the vote had been officially announced (Broadbent, 2017). This dropbenefits international students directly because the pound depreciated in itsvalue, comparing to other currency. In other words, international students inthe UK spend less budget on their course and accommodation. To illustrate, oneof Thai students claimed that the cost of their study which includes tuitionfee, accommodation and living expense is now 15 percent lower, approximately. This means there would be a soar in a number ofinternational applicants who desire to pursue the quality of the UK education.

### UK Property

Property in the UK has always been a target foroverseas investors, mainly London property. Due to the devaluation of poundsterling, overseas investors found that the UK property is reasonably priced. The study conducted by the property investment firm, JLL, showed that 28% ofthe housing market transaction in 2016 was done by Asian investors (Vaswani, 2017). This could directly affect the Britons because those Asian investorscould inflate the housing market by their unlimited demand. This means house pricescould be overvalued for British citizen who are in need of the house.

### Stock Market

The referendum also benefits the UK stockmarket. This is because those multinational companies whoare listed in the London Stock Exchange (LSE) receive their revenue in othercurrencies, mostly in dollars, which means the depreciation ofpound could boost the company’s profit (Inman, 2016). Asa result, the stock price of the company rocketed after Brexit which means itcreates the value for British company in the long term.

### British Citizens who live in EU country

Technically, if Brexit did occur, the Britishcitizens who live in the UK could become the illegal evacuees overnight. Thisstatement was also supported by Dominic Grieve who is the UK former attorneygeneral. Moreover, there is a possibility that British expats could lose theirright in the EU Health care system (Bennett, 2017). Thus, the negotiation mightinvolve such issues as the right to work, permitted license to possess the EUproperty or even the entitlement to access the EU health care system.

## Conclusion

In conclusion, the UK referendum could be thebeginning of a period of unpredictability, especially for those in financialsector. The asset management industry and the banks whose operations are basedin the UK could experience even worse predicament. As a result, someinternational banks are now seriously considering the proposals of moving theiroperation to the EU country, namely Frankfurt and Dublin. However, for those inasset management, the strategies have not been changed. Fund managers stilloptimistic on the UK equity market which directly benefits from weaker pound. Moreover, for those in private bank sector, there is a determination to expandtheir operations after Brexit. The weaker pound sterling also boosts the numberof international students and global investors in the UK, mostly those inhousing and stock market. For Britons who live in the EU, there is a concernabout losing their status as the EU citizens.

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