

# Effect of brexit on the financial sector



## Brexit: A bleak future for the financial sector?

### Abstract

*The word “Brexit” evolves from Britain and exit which is an unforeseeable situation that the UK is now facing. Brexit could cause damage to 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 the banking 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 a referendum whether to leave the European Union (EU) or not. Most Britons believed beforehand that the UK would not leave the EU. Surprisingly, the result was 52% of the voters decided to leave the EU (CFA INSTITUTE, 2017). As a result, David Cameron who, at that time, was the prime minister of the UK had to resign.

Subsequently, the position in charge was taken by Theresa May. Following this step, on 29 March 2017, the UK government has formally announced its invoking of Article 50 which is the initial step to formally exit from the EU.

Thus, the word “Brexit” evolves from Britain and Exit. The process must be finalized within two years. This means, in March 2019, the negotiation has to be done. However, from a very recent Guardian article, this process could be postponed because there are new variety of regulations which need to be

implemented and many institutions that require newstaffs to operate (Miller, 2017).

It appears highly likely that once Brexit occurs, Britain will lose its right to tariff-free access to the EU market. In other words, UK-based firms, especially those in the financial sector, may be unable to conduct their operations throughout the EU. As a result, overseas financial institutions whose European headquarters are located in the UK must reconsider their decision on whether to continue operating their management from the UK or not. This could cause long-term negative consequences to the UK economy. Therefore, this essay will discuss the impacts of Brexit on financial services, particularly asset management and the banking, moving on this essay will also evaluate these impacts on Britain's post-Brexit future.

## **Financial Services**

Financial services are the economic activities that are involved in the flow of money in the financial system. The services include asset management which is the service that aims to allocate money to maximize the profit. Additionally, the banking is an institution which mainly provides such services as accepting deposits and issuing loans to clients. Those activities have become one of the crucial parts of the UK economy and it provides an opportunity for the UK to influence world banking industry. According to the House of Lords EU Committee, 7-12 percent of GDP of the UK, 7-12 percent of employment ratio and 11 percent of tax receipts are ruled by the financial services. Furthermore, the largest trade surplus of the UK in 2014 was the financial services which accounted for £58 billion of which £19 billion is the trade with the EU country Austen, Hunt, Kelly, Naylor, & <https://assignbuster.com/effect-of-brexit-on-the-financial-sector/>

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 might be some solutions to cope with this issue. One of them is to establish an office 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-organized structure, office, and people, as stated by Julie Patterson who is 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 as MiFID, requires 20 or more employees onshore. As a result, finding a partner of business in Europe could possibly be the most moderate method to lessen the effect of Brexit, as determined by Nathan Bostock who is now the executive director of Santander UK (Gerrard, 2017). This is because the UK-based firm still benefits from being a partner with Europe-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 and Europe economy in the long-term.

Surprisingly, in 2017, the research conducted by the CFA Institute, the institution which is the community of fund managers, has shown that two-thirds of the fund managers have not changed their investment horizon after Brexit. Theoretically, this might be because the fund managers tend to invest in the equity market which the price of the equity could increase when the pound is depreciated.

## **The Banks**

In this essay, the types of bank will be categorized into three types: commercial bank, retail bank and investment bank. Firstly, commercial bank

<https://assignbuster.com/effect-of-brexit-on-the-financial-sector/>

is a financial institution which mainly provides such services as deposit and withdraw of money and offers loans to big business. Secondly, unlike commercial bank, retail bank or consumer bank provides the same services to customers in a non-business sector. Lastly, investment bank is not the bank who provides such services as accepting money or issuing loans services. On the other hand, it is the bank who provides advises on stock market launch, mergers and acquisition or even taking over other company.

The impact of Brexit on these types of banks could cause the similar problems as in asset management services. This is mainly because the EU requires the approval of Markets in Financial Instruments Directives (MiFiD) to allow banks to operate in the EU. In order to maintain MiFiD status, the UK must be part of the European Economic Area (EEA). This circumstance is not likely to occur if the UK favours a 'hard Brexit'. This is because 'hard Brexit' means the UK has to relinquish its MiFiD license as it will no longer be valid. As a result, this occurrence causes the world's leading financial institutions to leave the UK.

Paris has been one of the biggest rivals for the European financial centre since the UK referendum. However, due to the high corporate tax rate, 33.3 percent, this effects Paris's attractiveness to be less (Stothard, 2017). In this sense, the opportunity is now belonging to Dublin because 12.5 percent tax rate in Ireland could attract the firms from all over the world. Moreover, those firms who wish to move to Ireland do not need to establish new banking license. This is exemplified by the announcement from 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 operation after Brexit

(Noonan, 2017). Brian Moynihan, chief executive officer of the Bank of America, also told the Financial Times that “ We’ve been working with the Central Bank of Ireland to get it all set up and it’s been a very smooth process so far. The government is trying to help us get through the regulatory process.” (Noonan, 2017). As a consequence of the support from the government and an existing banking license of Dublin, it could support the Bank of America to accomplish its process ahead of Brexit easily.

Frankfurt has also competed for the position of post-Brexit financial centre. From the announcement of Deutsche Bank, the largest bank in Germany, they will transfer most of their assets and operations to Frankfurt in this autumn (Arnold, Martin, & Noonan, 2017). This could be one of the largest transfers of single EU bank, as stated by the chief executive officer, John Cryan. Another decision made by Citigroup’s Europe, Middle East and Africa (EMEA) chief executive officer, Jim Cowles, that the bank decided to move their main trading operation to Frankfurt (Arnold et al., 2017). This is because Frankfurt is well known for its infrastructure and skilled workers which the bank has already had on ground, as claimed by Mr. Cowles. These actions from two of the largest banks in the world could threaten Britain’s economic in the long term, indeed. Undoubtedly, international banks such as Nomura Holdings, the fifth largest bank by assets and Sumitomo Mitsui Banking Corporation which is the third largest bank in Japan by assets have already published their plan on moving their main operations to Frankfurt after Brexit (Arnold, 2017).

Turning to another side of the issue, there are several private banks who are now enlarging their services in the UK. According to the Financial Times, the senior executives at the following banks; Credit Suisse, UBS, Société Générale

and Pictet announced that the companies will expand their operation and investment in the UK (Arnold, 2017). This is because the UK is still attractive in terms of market potential. In other words, the wealthy clients still find an opportunity in the UK. This idea was also supported by Jakob Stott who is the EU head of UBS's wealth management businesses (Franklin & Gruber, 2016).

## **Britain's post-Brexit future**

### **International Student**

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

### **UK Property**

Property in the UK has always been a target for overseas investors, mainly London property. Due to the devaluation of pound sterling, overseas investors found that the UK property is reasonably priced. The study conducted by the property investment firm, JLL, showed that 28% of the housing market transaction in 2016 was done by Asian investors (Vaswani, 2017). This could directly affect the Britons because those Asian



investors could inflate the housing market by their unlimited demand. This means house prices could be overvalued for British citizens who are in need of the house.

### **Stock Market**

The referendum also benefits the UK stock market. This is because those multinational companies who are listed in the London Stock Exchange (LSE) receive their revenue in other currencies, mostly in dollars, which means the depreciation of pound could boost the company's profit (Inman, 2016). As a result, the stock price of the company rocketed after Brexit which means it creates the value for British company in the long term.

### **British Citizens who live in EU country**

Technically, if Brexit did occur, the British citizens who live in the UK could become the illegal evacuees overnight. This statement was also supported by Dominic Grieve who is the UK former attorney general. Moreover, there is a possibility that British expats could lose their right in the EU Health care system (Bennett, 2017). Thus, the negotiation might involve such issues as the right to work, permitted license to possess the EU property or even the entitlement to access the EU health care system.

### **Conclusion**

In conclusion, the UK referendum could be the beginning of a period of unpredictability, especially for those in financial sector. The asset management industry and the banks whose operations are based in the UK could experience even worse predicament. As a result, some international banks are now seriously considering the proposals of moving their operation to the EU country, namely Frankfurt and Dublin. However, for those in asset

<https://assignbuster.com/effect-of-brexit-on-the-financial-sector/>

management, the strategies have not been changed. Fund managers still optimistic on the UK equity market which directly benefits from weaker pound. Moreover, for those in private bank sector, there is a determination to expand their operations after Brexit. The weaker pound sterling also boosts the number of international students and global investors in the UK, mostly those in housing and stock market. For Britons who live in the EU, there is a concern about losing their status as the EU citizens.

## References

Arnold, M. (2017, July 30). MUFG eyes Amsterdam as post-Brexit EU base. *Financial Times*. Retrieved August 12, 2017 from <https://www.ft.com/content/158dcffe-7535-11e7-90c0-90a9d1bc9691>

Arnold, M. (2017, August 1). Brexit set to raise UK banks' costs 4% and capital needs 30%. *Financial Times*. Retrieved August 5, 2017 from <https://www.ft.com/content/9fdf35a4-7610-11e7-a3e8-60495fe6ca71>

Arnold, M., Martin, K., & Noonan, L. (2017, July 20). Citigroup and Deutsche Bank give Frankfurt a Brexit boost. *Financial Times*. Retrieved August 2, 2017 from <https://www.ft.com/content/1b38eb1a-6d55-11e7-b9c7-15af748b60d0>

Austen, M., Hunt, P., Kelly, D., Naylor, L., & Sants, H. (2016). The impact of the UK's exit from the EU on the UK-based financial services sector. *Oliver Wyman*. Retrieved August 2, 2017 from [http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/oct/Brexit\\_POV.PDF](http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/oct/Brexit_POV.PDF)

Bennett, A.(2017, March 30). What will Brexit mean for British expats?. *The telegraph* . Retrieved August 19, 2017 from[http://www. telegraph. co. uk/news/0/eu-facts-what-would-leaving-the-eu-mean-for-expats/](http://www.telegraph.co.uk/news/0/eu-facts-what-would-leaving-the-eu-mean-for-expats/)

Broadbent, B.(2017). *Brexit and the pound* . Bank of England. Retrieved from[http://www. bankofengland. co. uk/publications/Documents/speeches/2017/speech969. pdf](http://www.bankofengland.co.uk/publications/Documents/speeches/2017/speech969.pdf)

CFA institute(2017). *What It Means for Investment Management Brexit: A guide for investment professionals*. Retrieved from[https://www. cfainstitute. org/ethics/Documents/guide\\_to\\_brexit. pdf](https://www.cfainstitute.org/ethics/Documents/guide_to_brexit.pdf)

Franklin, J.,& Gruber, A. (2016, March 2). UBS considers acquisitions to expand wealth management in Europe . *Thomson Reuters*. Retrieved August 15, 2017 from[http://www. reuters. com/article/us-ubs-wealth-europe-idUKKCN0W41EB](http://www.reuters.com/article/us-ubs-wealth-europe-idUKKCN0W41EB)

Gerrard, B.(2017, July 13). Spanish business leaders suggest UK could be global trade hub post-Brexit. *The Telegraph*. Retrieved August 12, 2017 from[http://www. telegraph. co. uk/business/2017/07/13/spanish-business-leaders-suggest-uk-could-global-trade-hub-post/](http://www.telegraph.co.uk/business/2017/07/13/spanish-business-leaders-suggest-uk-could-global-trade-hub-post/)

Greenhalgh, H., Mooney, A., & Williams, A.(2017, August 2). Brexit is going to be a mess for UK wealth management. *FinancialTimes* . Retrieved August 9, 2017 from[https://www. ft. com/content/f2451362-147d-11e7-80f4-13e067d5072c](https://www.ft.com/content/f2451362-147d-11e7-80f4-13e067d5072c)

House of Lords EU Committee (2016). *Brexit: Financial Services* (9th Report of Session 2016–17). Retrieved July 10, 2017 from <https://publications.parliament.uk/pa/ld201617/ldselect/ldeucom/81/81.pdf>

Inman, P.(2016, October 4). Q&A: falling pound, rising markets. Why is Britain's currency suffering while shares in its biggest companies are soaring ?. *TheGuardian*. Retrieved August 12, 2017 from <https://www.theguardian.com/business/2016/oct/04/qa-falling-pound-rising-markets>

Kelly, J.,(2017, July 12). Investment in UK fintech tops pre-Brexit levels in first half of 2017. *Thomson Reuters* . Retrieved August 1, 2017 from <http://uk.reuters.com/article/us-britain-fintech-investment-idUKKBN1AA2VN>

Miller, G.(2017, August 12). Britain must ask for more time to negotiate Brexit. *TheGuardian* . Retrieved August 16, 2017, from <https://www.theguardian.com/commentisfree/2017/aug/12/britain-more-time-negotiate-brexit>

Noonan, L.(2017, July 21). Bank of America choose Dublin as EU base after Brexit. *FinancialTimes* . Retrieved August 1, 2017 from <https://www.ft.com/content/1fff392a-6e17-11e7-bfeb-33fe0c5b7eaa>

Stothard, M.(2017, July 7). Paris rolls out ' red-white-and-blue carpet' for banks. *FinancialTimes*. Retrieved August 12, 2017 from <https://www.ft.com/content/464c67d8-630e-11e7-91a7-502f7ee26895>

Vaswani, K.(2017, April 28). Brexit not deterring Asian investors from UK property market. *BBC*. Retrieved August 17, 2017 from <http://www.bbc.co.uk/news/business-39732816>

<https://assignbuster.com/effect-of-brexit-on-the-financial-sector/>