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Impacts of Brexit on the Banking Industry[1]

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Difficult Negotiations Continue on the Brexit

A national referendum on the UK's exit from the European Union (EU) was held in June 2016 and supporters for "Leave" won the majority of 52% against 48% for "Remain". In March 2017, Prime Minister Theresa May made a notification to the EU of its intention of withdrawal from the EU based on the provision of Article 50 of the Treaty on European Union. After two years negotiations from the notification, the UK is going to formally withdraw from the EU in March 29 2019[2].

Before withdrawing it is necessary for the UK to conclude an agreement with the EU on the withdrawal. The withdrawal agreement will include provisions on the civil rights of citizens living both in the UK and the EU across their borders, financial settlements of the UK contributions to the EU, an implementation period (tentatively agreed in March 2018 that it will be terminated at the end of 2020) and so on, most of which have been already agreed. The biggest remaining issue is the border between the UK and Ireland. As a backstop to the case where any special agreement cannot be concluded by the end of the implementation period, the EU intends to incorporate in the agreement a measure to retain only Northern Ireland in the customs union. However, the UK thinks this is unacceptable because it will divide the UK and this has made the negotiations between the UK and the EU rough going.

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[1] This article is based on the report the author gave to the International Finance Panel "BREXIT and Future of International Financial Centre 'CITY'" in the 2018 Autumn Annual Meeting of the Japan Society of Monetary Economics (Chaired by Prof. Eiji Ogawa of the Hitotsubashi University) held on Oct.20, 2018.
http://www.iima.or.jp/info_active/meeting/index2018.html

[2] Negotiation period can be extended by the unanimous agreement by the EU members.

Table 1 : Main Developments on the Brexit after the Referendum

2016	June 23	Referendum held over "Leave" or "Remain" in the EU
	July 13	Prime Minister Cameron resigns, succeeded by Theresa May.
2017	March 29	The UK government formally notifies its intention of withdrawal under Article 50 of the Treaty on European Union.
	June 8	In the Lower House election, the ruling Conservative Party loses majority.
	June 19	Negotiations start on the withdrawal between the UK and the EU.
	July 13	The government submits to the House the Withdrawal Agreement and Implementation Bill to legislate the EU laws which are effective in the UK to domestic laws and delibarations start.
	December 15	European Council acknowledges that "sufficient progress" has been made in the first stage, and decides to move to the second stage.
2018	March 19	The EU and the UK reach tentative agreement to end transition period at the end of December 2020. This agreement is accepted by the European Council of March 22-23.
	June 26	Legislating for the Withdrawal Agreement between the UK and the EU (the EU Withdrawal Act) enacted in the UK
	July 12	The government publishes a White Paper on The future relationship between the United Kingdom and the European Union (the Chequers Plan).
	August 23	The government publishes papers setting out advice for people and businesses in the event of the UK crashing out of the EU with no withdrawal agreement.
	Sept. 19-20	Informal European Council
	Oct. 17-18	European Council

(Source) Press releases of the UK government and the EU, Various reports

The withdrawal agreement should be ratified by the time of the UK withdrawal scheduled in March 2019, and, given the needed time for decisions to be made by the European Parliament and internal procedures to be implemented in the UK, it had been considered desirable that the negotiations would be concluded by the October meeting of the European Council (EU Summit Meeting). However, chaos has been intensifying over the direction of the negotiations as no progress was seen in the October meeting although an ad hoc meeting had been scheduled in November to promote needed procedures. The EU always stated when it comes to Brexit "Nothing is agreed until everything is agreed". If the withdrawal treaty is not successfully concluded, the agreements on the implementation period will be canceled and the UK will be faced with a "No deal Brexit" in March 2019 with everything remaining undecided.

Financial Industry after the Brexit: the UK Official Stance on the UK-EU Relationship as Seen from the Brexit White Paper

In the EU, financial institutions can operate within all EU member countries once the institution obtains a license in one of the member states, with no need to acquire new licenses in other member states (single passport system)[3]. Financial institutions in the non-EU countries

[3] Single passport system is applicable not only to the EU member countries but to all the countries of the European Economic Area (EEA) (participated by the EU 28 countries plus Iceland, Lichtenstein, and Norway).

usually obtain the license of financial business in the UK which has an international financial center of London, and under the UK passport they develop their business in other EU member states. Brexit means that these institutions will be unable to provide financial services within the EU based on the single passport system unless a separate agreement is arranged between the UK and the EU.

In the Brexit White Paper published in July 2018, the UK government provided basic policies to be taken after the exit, to create a free trade zone (with common rules with the EU) on the trade of goods while recovering the right to set original rules on services after withdrawing from the customs union (the single passport system shall become void). The government wishes to conclude a comprehensive agreement with the EU on the financial business given the deep relationship of the financial industry between the UK and the EU. Unless a special agreement is concluded, the UK is going to be treated as a third country partners to the EU, with the UK applied a third country equivalence regime[4].

Between August and September 2018 the UK government issued a series of warning papers on more than 80 industries to the UK businesses and people to prepare for a possibility of "no-deal Brexit". On the financial industry, the government asserted it is ready to take various measures to ensure financial stability. Specifically, it will introduce a Temporary Permissions Regime to EEA financial institutions to give them temporary licenses for 3 years, and also introduce a Temporary Registration Regime to non UK central counterparties, which will enable the EEA financial institutions to continue their business in the UK. On the other hand, however, the continuity of business of the British financial institutions in the EU will not be ensured unless relevant measures are taken on the side of the EU.

Responses of financial institutions in London : Which city will dominate as a financial center in Europe after the Brexit?

As the continuity of single passport system seemed to have been endangered from the early stage after the national referendum, non-EU financial institutions in London have applied for new licenses in the EU and successively revealed plans to establish new hubs and move their personnel to the EU. Also the EU-based financial institutions have taken a move to get a license from the British authorities. Amid the uncertain future situations, the financial industry has taken responding actions ahead of other industries. Some of the EU member states' authorities even called attention to financial institutions saying that unless they apply licenses by June or July 2018 they will not get the license in advance of the Brexit in March 2019.

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[4] Third country equivalence regime is a rule which permits the financial institutions in the third country to provide financial services in the EU only when the regulatory system on a specified financial service in that third country is determined as equivalent to the EU rules and regulations. It has been regarded as highly uncertain by the companies since the EU assesses the equivalence unilaterally and sometimes changes the assessments in short periods.

According to a survey conducted by the Financial Times in December 2017, 15 major financial institutions surveyed are expected to shift about 6% of their staff by April 2019.

The Japanese three megabanks currently operate their securities business in the EU countries under the UK-based license, and they have already announced that they plan to open new securities subsidiaries in the EU[5].

Table 2：Responses of Major Financial Institutions located in London

	Numbers of Staff in London	Estimate of departures from London by April 2019**	EU Headquarters after Brexit	Application for new license
JP Mogan	10,480	700	Frankfurt/Luxemburg	n.a.
Deutsche Bank	7,000	350	Frankfurt	○UK
Barclays CIB*	6,500	150	Dublin	○
Citigroup	6,000	250	Frankfurt	○
Goldman Sachs	5,959	500	Frankfurt	○
Morgan Stanley	5,000	100	Frankfurt	○
UBS	5,000	200	Frankfurt	×
Credit Suisse	5,000	250	Not Disclosed	Not Disclosed
HSBC CIB*	4,500	900	Paris	n.a.
Bank of America	4,500	400	Dublin	○
BNP Pariba CIB*	3,123	150	Paris	n.a.
NatWest Markets（RBS)	2,600	150	Amsterdam	○
Nomura Europe	2,270	75	Frankfurt	○
MUFG	2,100	90	Amsterdam	○
Société Générale CIB*	2,000	300	Paris	○UK

(Notes）*CIB：Corporate and Investment Banking、** Estimates by the FT
(Source）The Financial Times，December 12, 2017

Candidate cities for non-EU banks to move include Frankfurt, a site of the European Central Bank, Paris where the European Banking Authority is going to move, Amsterdam, Dublin, and Luxemburg. Currently Frankfurt is considered to be the most favored site, but the transition plans of major banks suggest the locations will be somewhat diversified rather than concentrating in Frankfurt only.

London represents one of the two largest international financial centers together with New York. According to the ranking records compiled by the Z/Yen, the two cities have been competing each other for the top and the second rank by a narrow margin since 2007 when the ranking started to be published, leaving the third and the followings far behind. However, the ranking published in September 2018 found London fell to the second, surpassed by New York,

[5] Regarding the commercial banking business, Mitsubishi UFJ Financial Group and Mizuho Financial Group have already acquired the license in continental EU countries to do business there. Sumitomo Mitsui Financial Group operates its banking and securities businesses under the UK license and has announced it will newly acquire the license for both banking and securities business in Germany to establish local corporations in the continental EU.

while Frankfurt and Amsterdam made a significant leap in the EU from 20th to 10th and from 50th to 35th respectively. These changes in the ranking may reflect the moves of banks for a shift to the EU. Evaluation of London has also been lowered in such items as "infrastructure" and "reputation", suggesting the possibility that the sense of uncertainty over the Brexit was reflected on this. Yet, the difference is still wide between London and other major European cities.

Paris may be the only city that is comparable in its size to London which has a population of somewhat below 9 million, while other major European cities are much smaller, each with a population of around 1 million. There is a problem with these cities of whether the shifting financial institutions can secure sufficient human resources there. The employment in the finance-related industries in London reaches 790 thousands including those in legal, accounting, and consulting areas[6].

Looking ahead, there is a possibility that part of business such as euro-denominated transactions will shift from the UK to the EU, but the advantages of London as an international financial center will remain in such areas as extensive financial infrastructure, abundant human resources in legal, accounting, consulting and related services, and ample financial and economic information. On the other hand, for many financial institutions that have utilized London as a hub of their international financial business, it will be unavoidable for them to see a decrease of effectiveness and an increase of cost due to separation of their operations between the UK and the EU, and they will be faced with the need to review their European businesses.

Table 3：Ranking of Global Financial Centers in Europe

	Ranking		EU Members	Euro Area
	September	March		
London	2	1		
Zurich	9	16		
Frankfurt	10	20	○	○
Luxemburg	21	21	○	○
Paris	23	24	○	○
Geneve	27	26		
Amsterdam	35	50	○	○
Dublin	37	31	○	○
Munich	39	35	○	○
Hamburg	41	29	○	○
Edinburgh	43	43		
Monaco	46	54	○	
Glasgow	50	49		
Vienna	51	64	○	○

Assessment of London

	Ranking	
	September	March
Business Environment	1	1
Human Capital	2	2
Infrastructure	3	1
Financial Sector Development	2	2
Reputational and General	2	1

(資料) Z/Yen, "The Global Financial Centres Index", Sept. 2018, Mar.2018

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