Brexit preparations and short-term implications

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Preparing for Brexit

Our preparations for Brexit entered their final stages during autumn 2018 and into 2019. With the necessary authorisations in place, on 1 December we completed the cross-border merger of our main UK-based banking entity into our existing Irish entity. This followed many months of detailed engagement with supervisors and means that our primary European banking entity is now based in Dublin, with approximately EUR 50 bn in assets, and branches in Amsterdam, Brussels, London, Frankfurt, Madrid, Milan, Paris, Stockholm and Zurich. A full management team and governance structure is now in place and, where necessary, staff relocations have been completed. After nearly two years of work, our European bank has now moved from 'project' phase to 'business-as-usual'.

Preparations for our EU investment firm, which is based in Paris, are now in the final stages. In Q4 2018 we received the necessary authorisations to commence formal set-up, which allowed us to begin the process of connecting to the relevant market infrastructure. Trading operations have now commenced, management and governance appointments have been made and, where necessary, many staff have relocated into new offices in Paris.

While these processes have involved a significant amount of work for my own colleagues, the same is true for colleagues in the relevant authorities, and we are grateful for the commitment and engagement of staff at the CBI, ECB, ACPR, AMF, PRA, FCA and other National Competent Authorities, that has allowed Bank of America to manage its Brexit preparations so smoothly.

We also welcome the steps taken by regulators and policymakers in the UK and the EU in order to prevent a cliff-edge in the event of a no-deal Brexit, as well as the actions taken by individual Member States and indeed the United States. These are particularly important in the fields of derivatives clearing and contract continuity – so far they have helped the financial services sector prepare for all possible outcomes, and longer term they will play a key role in maintaining financial stability as Brexit continues to develop.

With our Brexit preparations now largely complete, we have also been supporting clients with their own changes in terms of how they engage with us. I am

>>> confident that we will be able to function smoothly and to service our clients seamlessly whatever the final outcome of the Brexit negotiations. Indeed, I believe the sector as a whole is now well-prepared – the longer lead times in finance, driven by the need for authorisations, capitalisation and oversight, are helpful in terms of horizon scanning and outcome modelling. We must not be complacent, however; and we are all aware that some Brexit outcomes may pose difficulties for our clients and the wider economy.

That said, we are embracing our European future and we are excited about the opportunities that our new structure will offer. While centralisation in London brought benefits in terms of cluster effects, so a more diversified European approach is likely to bring benefits in terms of being geographically closer to more European clients. The challenge will be to ensure that the sector maintains a 'virtual cluster' to avoid fragmentation of liquidity and regulation, and to keep costs down for our customers.

To this end, it is important that the UK and the EU continue to work together in support of the financial services sector – and supervisory co-operation, regulatory co-ordination and co-ordination in international bodies will all be important in this respect. Moreover, we would encourage the UK, the EU and the US all to work together to ensure continued high standards of regulation in financial markets – ten years from the financial crisis, the need for international co-operation is more important than ever. ●

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Brexit – we are prepared

At the time of writing, it is still not clear how Brexit will take place. Currently Member States and EU institutions are preparing for the worst outcome, which is a no deal Brexit.

Preparations need to be made in two different strands. The first one relates to legal and practical arrangements. The EU legal framework, but also the national ones, have to be thoroughly examined in order to identify areas where amendments are necessary and helpful to mitigate any harmful effects. Due to the high number of EU legislative acts in the field of financial services, it was mainly in the hand of the EU-institutions to pave the way for a smooth transition by adopting equivalence decisions and delegated acts. In addition, ESMA and the Bank of England agreed on an MoU for the recognition of CCPs established in the UK but also in Member States in case of a no deal. This agreement covers a crucial area for financial stability by ensuring continuity and legal certainty. At national level, the legal amendments in the field of financial services are of limited size and the EU platform for contingency measures helps to foster exchange of views and best practices by Member States.

The second strand of preparation relates to the need to raise awareness. It is the task of the financial industry to inform customers and clients about the steps they have taken and how they are implementing them. It is in their responsibility to prepare and adjust their business to a new environment. The public sector can contribute to this effort by making publicly available all necessary information and by being in permanent contact with stakeholders to inform them about any new developments and findings. >>>

>>> It is hard to predict whether all these preparations for the no-deal scenario would in fact be sufficient to avoid market disruptions. The contingency planning certainly reflects the best of our knowledge. But you can never exclude irrational behaviour.

Even if market disruptions can be avoided and financial stability is preserved, short-term adverse effects might arise, some of which need to be handled by the competent authorities. Contingency measures are of temporary nature and measures taken at national level might differ. The result would be new fragmentation in the markets. The temporary nature of these measures gives us time to adapt to the new situation and to establish a new relationship with UK in crucial areas which avoids supervisory arbitrage and tries to make the best in economic terms of a difficult new economic and political situation: a situation where market access and obligations need to be addressed in a balanced way to guarantee level playing field and overall stability by ensuring a high level of supervision and credibility. This outcome should be in the interest of all participants, and we are working hard to achieve it. ●

Mario Nava

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Brexit and then what?

The Commission has urged private stakeholders throughout to ensure preparedness for all possible outcomes including a "no-deal" scenario in which the United Kingdom would leave the European Union with no agreement pursuant to Article 50 paragraph 2 of the Treaty on the European Union in place. To support private sector preparedness, the European Commission has published over 70 preparedness stakeholders' notices, including several notices in financial services alone.

The European Supervisory Authorities, the European Central Bank and the Single Resolution Board also provided guidance to the public on Brexit-related matters in the financial services sector.

In parallel, the European Commission has been assessing possible risks for the financial system related to the UK's withdrawal without an agreement, building on own analyses and the input from other relevant European institutions like the ECB and the European Supervisory Authorities. The European Central Bank and the Bank of England have analysed risks in a technical group.

On the basis of these assessments, the Commission concluded that in order to safeguard financial stability in the EU27, only a limited number of contingency measures was necessary. These included two time-limited equivalence decisions, which were adopted on 19 December 2018, one allowing EU clients to access UK-based central counterparties, the other relating to central security depositaries services (CSDs) from the UK. The Commission announced its EU level contingency measures in its Communication of 19 December 2018 on "Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: Implementing the Commission's Contingency Action Plan".

Following the Commission decisions, ESMA has completed the recognition process of UK CCPs and on UK CSDs. The Commission has also put forward a number of technical provisions targeting central bank (and in some cases also Debt Management Offices') exemptions in a number of areas. >>>

>>> Overall, based on a thorough risk analysis, the Commission considers these the only EU measures necessary in financial services. The Commission continues to monitor financial risks that may arise from Brexit, in coordination with the ECB, the European Financial Supervisory Authorities, Member States and stakeholders.

Member States are putting in place measures to address residual risks at national level, thus reducing further the risk that a disruptive Brexit translates into financial instability. The Commission is actively working together with Member States to ensure that measures are targeted to the risks, and that they are limited in scope and duration, on the basis of the principles for national contingency measures mentioned in the Commission Communication of 19 December 2018. ●

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Brexit – preparation, challenges and opportunities for SMBC

From the beginning, client service has been at the heart of SMBC's Brexit planning. At the time of writing there is still a real risk of a no deal Brexit on 29 March 2019. The lack of certainty makes business decision-making more difficult, but, having assumed from the start the worst outcome – no deal – we have worked hard to ensure that we can maintain service to our clients without disruption through Brexit and beyond.

Over the last three years SMBC has run a major project to plan and execute our Brexit strategy as regards both our banking and securities businesses. Without an existing EU 27 bank or investment firm in the group, significant time was devoted to deciding where we would set up our new entities. There followed intensive analysis of the regulatory issues and we started the close communication with regulators (in the UK and Japan and in all the EU countries where we have a presence) which continues today. Eventually we opted for Frankfurt and have built a new bank and a new investment firm there. This has entailed major investment in real estate and headcount. We have transferred capital, implemented the necessary systems and joined the relevant market infrastructure. The majority of the branches of our UK bank will be transferred to the new German bank. We are confident we will be ready for business when Brexit occurs.

However, major challenges will remain. Cost, uncertainty and fragmentation are the prime sources of these.

After Brexit, we will initially be providing to our clients the same services as we provide today, but at much greater cost. This is a necessary evil and the inescapable consequence of our Brexit strategy. Tight cost control has been a key factor in our planning, but avoiding inefficiencies in allocation of resources after Brexit will be a major challenge.

Ongoing uncertainty on all levels is a major aspect of Brexit. Much has been written about loss of passports, contract continuity and related issues and, in the absence of an EU-wide regime, different member state regimes are now being put in place. But the patchwork of provisions they create brings its own complexities. >>>

>>> Generally, financial institutions and major corporate clients are well prepared for Brexit. Some smaller corporates however need a lot of guidance and regulators are understandably focused on this. But in the absence of certainty, there is an element of conduct risk in all customer interactions.

Likewise, there has been talk of a regulatory "glidepath" – a period of adaptation to a new regulatory state that has not yet been defined - but there is currently little clarity as to what the final destination is or when we must land.

Fragmentation is of course the central theme of Brexit. Longer term there is no doubt that there will be regulatory divergence between a post-Brexit UK and the EU. Banks will need to manage the stresses that this may cause for their businesses. We also see fragmentation of governance in the creation of new legal entities with their own management and board structures, and there is fragmentation in the inefficiency of capital and liquidity transferred to these entities.

The above challenges will impact banks' business models, including marketing, risk management and booking. However, the challenges have their benefits too and there will be opportunities for any bank able to exploit these. When planning for Brexit one of our key goals was to put ourselves at the financial heart of Europe. By setting up operations in Frankfurt we will have achieved this and we fully intend to operate as a European bank.

We will find solutions to operational inefficiencies. Potential areas of work include adapting major processes (such as credit, KYC and marketing) to the new realities of Brexit. At a European level we will review our management structure and governance. And longer term we will consider a rationalisation of our legal entity structure. There is room for SMBC to grow in the EU 27. Our Brexit-related investment in Germany and other EU 27 member states will drive further development of our business in those markets.

SMBC will find solutions to the challenges of Brexit and fully intends to benefit from the opportunities it presents. ●