Latest Brexit developments and future of EU-UK relations

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The changing climate of UK-EU relations

It is a hazardous business predicting the future and relying on such predictions perhaps even more so. One of Shakespeare's characters in Macbeth asks the three witches at the beginning of the play "if you can look into the seeds of time and say which will grow and which will not, speak, then, to me". Rather inevitably, from the audience perspective at least, the future for poor old Banquo is short-lived and doesn't turn out quite the way he might have hoped, and that was with the benefit of accurate predictions.

Nevertheless, we have an innate desire to understand what the future might be like, and for governments and businesses it's essential to prepare for tomorrow and the day after. For the financial services sector in Europe, Brexit looms large in any such considerations and in recent years – government, firms and regulators - we have all been focusing intensively on preparations. These are, rightly, the preoccupations of today. But they will not be the preoccupations of tomorrow.

Instead, I can see the importance of financing and supporting the transition to a zero-carbon economy occupying a greater and greater significance in our work. In five years, green finance will be a central issue at events such as Eurofi, and globally. Climate change is shaping up to dominate the future of the financial services sector just as it is becoming a predominant theme for society, governments and other sectors of the economy.

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>
> \- KATHARINE BRADDICK

The scale of the climate challenge is well understood but the changes that will be required in the financial services sector, less so. Taking an example, 70% of banks in the UK now consider climate change as a financial risk, good progress, but only 10% of UK banks are taking a long-term strategic approach to managing the financial risks from climate change. In the coming years it is essential that governments and the sector move beyond thinking only about green finance as how to finance green initiatives – though that must continue of course. Attention must also be turned to how

>>> we will transition to a green financial system, and that will mean making fundamental changes to the way that decisions are made.

This change is starting to happen. One of the most influential initiatives to emerge is the Financial Stability Board's private sector Task Force on Climate-related Financial Disclosures (TCFD), supported by Mark Carney and chaired by Michael Bloomberg. This has been endorsed by institutions representing $118 trillion of assets globally. An increasingly large proportion of the private sector is now beginning to implement the TCFD recommendations and in September 2017, the UK became one of the first countries to formally endorse them.

In the UK, we have also launched the Green Finance Institute, with a mission to accelerate the domestic and global transition to a clean, resilient and environmentally sustainable economy. As the principal forum for public and private collaboration the GFI will foster greater alignment of public and private sector initiatives, create commercial opportunities for finance providers and drive the global green finance agenda through international dialogue, partnerships and trade.

As a global financial centre and the first major economy in the world to set a target of net zero greenhouse gas emissions by 2050 the UK will continue to demonstrate leadership in this field, in both thought and action. It is in that context that we published a Green Finance Strategy earlier this summer (https://www.gov.uk/government/publications/green-finance-strategy).

I may not be able to look into the seeds of time, but I can confidently predict that green finance will grow to dominate discussion in the financial services sector. ●

Denis Beau

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Keeping the momentum for both preparing and strengthening the financial European system

It is the responsibility of the financial industry itself to prepare for the consequences of Brexit, starting with the loss of the benefits of the European financial passport for UK institutions. In this regard, regulatory and supervisory bodies have stated from a very early stage the principles that should be followed by supervised entities (in particular the prohibition of empty shells). Furthermore to cope with the consequences of the British withdrawal in the absence of a deal, supervisors have (i) engaged institutions, (ii) monitored actively the design of detailed and prudent plans and (iii) followed their implementation. Most major players have already taken the necessary design steps and started implementing their initial plan for «Day 1», but some concerns linger regarding the preparedness level of smaller players, particularly electronic money and payment institutions.

The relevant measures have been taken by public authorities at both European and national levels to deal with the specific risks of a no-deal Brexit that could threaten financial stability or consumer protection. At the European level, these measures include the temporary and conditional recognition of British CCPs, or temporary waivers on mandatory clearing and bilateral margin exchange for a limited >>>

>>> category of products. Member States have also adapted their domestic regulations. In France, legislation has been enacted to ensure continuity of financial contracts (e.g. OTC derivatives or insurance contracts), introduce some ISDA master agreements under French law and maintain an extended access to UK settlement systems by French entities.

The decision of the European Council to extend the Article 50 TFEU period allows for a few more months to prepare for a possible hard Brexit, but has translated in a loss of momentum in the preparation process. Therefore, the message must be restated with emphasis on the need for all to continue preparing actively for a no-deal. For banks, efforts should be maintained or stepped up in order to fully implement target operating models.

The momentum should also be kept in further strengthening European financial services as a reshaping of the landscape is inevitable. The most plausible scenario is that of an integrated polycentric network of financial centers.

Among the challenges to be met to that end is the design of post-Brexit equivalence regimes. In this regard the developments introduced by EMIR2 regarding both the power – via ESMA – to directly supervise third-country CCPs which have a systemic footprint vis-à-vis the EU and the reinforcement of the equivalence regime are most welcome. They remain to be implemented. The monitoring and control of equivalence decisions could also be improved by granting more power to the ESAs, and by providing the European Commission with more gradual options through flexible tools in the case of regulatory divergence: for example, temporary, partial or conditional lifting of equivalences.

But most importantly, we should pursue the efforts towards building an integrated and efficient European financial system. The way forward is what François Villeroy de Galhau and Jens Weidmann termed the "Financing Union for Investment and Innovation". It should notably be built on (i) a consolidated banking system with more pan-European financial institutions able to operate seamlessly at least within the single jurisdiction which the euro-area should be reaping the full benefits of the Banking Union (ii) reclaimed sovereignty in retail payments through genuine pan-European payment solutions (iii) resolute progress on the Capital Markets Union on topics such as the harmonization of insolvency regime. ●

Nobuyuki Kawabata

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SMBC – preparations for Brexit

In preparation for the original Brexit deadline of 31 March 2019, SMBC implemented a major project to plan and execute our Brexit strategy as regards both our banking and securities businesses. We built a new bank and a new investment firm in Frankfurt and transferred the majority of the branches of our UK bank to the new bank there and were ready for business before the deadline.

Like all market participants we now face the uncertainty of the next few weeks and the real possibility of a no-deal Brexit on 31 October. However, in order to ensure that we would be able to maintain service to our clients without disruption through Brexit and beyond, our basic planning assumption from the start was that there would be a no-deal Brexit. This has enabled us to be as well prepared as we can be for Brexit, although we recognise that there is still work to do. >>>

>>> SMBC has carried out an intense programme of customer communications and our major corporate and financial institution customers appear to be well prepared for Brexit. However, it is vital that all of our customers are aware of the implications of Brexit and we have found that some smaller corporates have needed guidance. It is quite possible that further customer communication will be required as 31 October approaches.

A key issue for SMBC has been to assist customers to transition where appropriate from our UK entities to our new German entities. Good progress was made on this, but as 31 March approached the uncertainty relating to Brexit meant that the pace of transitions slowed and of course after Brexit was delayed customers understandably considered that transition had become less urgent. We continue to work on ensuring a smooth transition for customers and this will continue for some time after 31 October.

SMBC must build up the revenues of its new entities in Germany – original assumptions have been revised due to the slower pace of customer transitions. A recent market survey in the City indicates that SMBC is not alone in finding that the delay to Brexit has resulted in a higher expense ratio in its new entities than originally planned. This will need to be carefully managed.

SMBC was able to hire all the staff it needed in Frankfurt in order to be ready to start operations on 31 March and had limited need to move staff from London or elsewhere. However, the uncertainty associated with the delay in Brexit has meant that staff moves are perhaps more challenging than before.

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> \- NOBUYUKI KAWABATA

In order to support the operations of its new entities in Germany, SMBC will use its significant middle and back offices in the UK. This will ensure efficiencies of scale and lower potential operational risk. In order to achieve this, a significant overhaul of group service level agreements, policies and procedures has been undertaken. While efforts will be made to reduce the complexity of these arrangements, this greater focus on outsourcing will require maintenance and ongoing work and we will continue to build the necessary governance structures for this.

As regards cross-border business from the UK into the EU 27 certain national regimes have been introduced in the EU 27 and generally they are helpful. However, they are country-specific and relate mainly to investment business.

As regards cross-border lending business, marketing from the UK into the EU 27 will become much more difficult - cross-border service provision by third country banks may be tolerated in certain countries for certain products, but it is very difficult to develop a coherent marketing strategy on such a patchwork of regimes. This is of course an area of interest for many firms - we will continue to monitor developments carefully and SMBC's staff in the UK will need to support its new entities in Germany, particularly in structured product areas.

We expect the EU 27 and the UK to remain strategically aligned in respect of major regulatory initiatives, but the UK will not become a passive "taker" of EU regulation given the leading role its authorities have taken in developing new regulations and the importance of financial services to its economy. There is now generally an acceptance that UK regulation will start to diverge from EU regulation, even though lawmakers may seek to achieve the same regulatory outcomes. This will present challenges that firms operating cross-border into the EU 27 will have to manage with care. ●