



Association for Financial Markets in Europe

Bridging to Brexit

Insights from European SMEs, Corporates and Investors

27 July 2017

Rick Watson, Managing Director and Head of Capital Markets, AFME
Eriola Shehu, Principal, the Boston Consulting Group
Chris Bates, Partner, Clifford Chance LLP

Report Overview from AFME

Rick Watson, Managing Director and Head of Capital Markets, AFME

Report Findings from BCG

Eriola Shehu, Principal, the Boston Consulting Group

BCG conducted 70+ interviews with treasurers and CEOs of SMEs, large corporates and investors, along with the trade associations representing them in multiple EU28 countries

- Pan-European SME association and several others (representing over 12 million individual businesses throughout EU-28)
- Large corporate interviewees represented 22% of the Euronext 100 index and 22% of the FTSE 100 index
- Investors representing 42% of EU28 AuM



SMEs



Investors



Large Corporates



Associations



SMEs most concerned about direct Brexit impacts, such as trade barriers, customs compliance, diverging regulatory regimes

Opinions on effects of Brexit-related wholesale banking changes are divided

- 44% do not expect effects of a hard Brexit on the banking sector to flow through to them; 33% fear they will be first segment hit by adverse impacts; 22% were unsure

Of the 3 segments interviewed, SMEs are most worried about adverse impacts to their access to wholesale banking services. Key concerns

- ~60% of SME interviewees use only 1 bank – and find switching difficult
- Brexit-related price increases for risk management products

SMEs need a Plan B for to manage any disruption to their banking arrangements; few however have developed

- 55% say they have made no Brexit plans, 27% have carried out some internal planning and only 18% have executed some actions

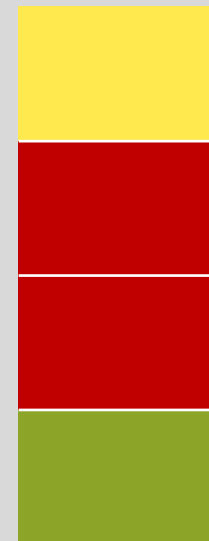
Product

Financing operations

Financing capital expenditure

Managing risk

Managing cash



"SMEs are first in the firing line [when there is a credit squeeze]" – UK SME

"Switching banks would not be easy; This would be something new for us and we would find the process difficult" – EU27 SME

Large corporates & investors feel they will not be much affected

- Multiple banking relationships; several banks underwrite loan facilities; market access for securities & derivatives...
- Feel Banks would subsidiarise to continue serving them

They acknowledge Brexit may impact access to products and product pricing in certain areas

- Long term financing, risk management
- Cash pooling and cost of liquidity management

Administrative burden could be significant

- Need to re-write contracts, e.g.

Some specific concerns

- Industrial firms with financing arms which engage cross-border with customers may be affected
- Loss of “passporting” could create costly frictions in fundraising / distribution processes
- Insurers fear disruption to cross-border policy distribution

Product	Investors	Large Corp.
Financing operations		
Financing capital expenditure		
Managing risk		
Managing cash		
Fundraising and distribution		
Access		
Investments		
Portfolio Mgt		
Fund admin		

"I imagine that the UK banks will create a European subsidiary we will be able to deal with" – EU27 Corporate

We have moved our cash pool out of the UK [as a result of Brexit]" – Anonymous

"There is going to be a lot of re-papering... for some firms it will be under control but it will be a lot of work in certain cases" – EU Association

BANKING BOOK



€180 bn
of loans
outstanding from
UK-based banks
are to EU27
corporates & SMEs

4%
of loans
outstanding to
EU27 corporates &
SMEs



€13 bn
of bank equity
capital which may
**need to be
transferred**

TRADING BOOK



€380 bn
of trading RWAs
booked in
the UK support
EU27 clients

68%
of UK-booked
trading
RWAs to EU28
clients



€57 bn
of bank equity
capital which may
**need to be
transferred**

The **€70 bn** of equity capital that may
need to be transferred represents..



~9%
of impacted bank
equity capital*

The movement of this capital could
involve...

€15 bn
of structural
change costs



and a **0.5-0.8 ppt**
impact on bank RoE

...and could give rise to capital inefficiencies
amounting to

~€20 bn
of additional
equity capital



Currently booked in London, there is...



€83 tr

of €-denominated cleared
swap_s

or...

33%
of notional OTCs



Migration of this volume from London to the EU27 could
result in...



€30-40 bn

of additional initial margin which
represents a
~40-50% increase

and...

€3-4 bn
of additional default fund
contribution which represents a
~20-30% increase



Overwhelming majority of interviewees call for Brexit negotiators to maintain existing levels of market access for clients to both UK and EU27 financial services firms

- 80% of EU27 and UK interviewees want the financial services market to remain as close as possible to the current model providing maximum access to capacity and services.

Interviewees and "supply side" analysis also suggest specific recommendations to minimize disruption if current arrangements can't be maintained

- **"Grandfather"** existing cross-border contracts to minimize legal and operational disruption to businesses.
- **Provide regulatory support and sufficient time** as forming new legal entities and re-documenting client relationships are labour intensive and time consuming.
- **Allow transitional arrangements.** Temporarily allow risk-transfer between the EU27 and UK. Capital covering EU27 risks should be allowed to remain in London until the banks build up the required capability – risk management functions, compliance processes etc. – in local EU27 jurisdictions.
- **Fill gaps.** UK policy makers should establish alternative funding schemes to substitute for loss of funding that UK businesses may face from no longer having access to EIF & EIB.

Interviewees all seek clarity. Many businesses feel they cannot sensibly make post-Brexit plans without knowing the "deal"

CLIFFORD
CHANCE

A person in a red dress is sitting on a blue carpet with a large, repeating geometric pattern of white and blue chevrons. The person is positioned on the right side of the frame, looking down at something in their hands.

HOW WILL BREXIT IMPACT END USERS' ACCESS TO WHOLESALE BANKING SERVICES?

LONDON 3 July 2017

Chris Bates

Where do we go from here?



Article 50 negotiations

Triggered by UK notice to European Council
2 year period to negotiate withdrawal: UK Government served notice on 29 March 2017

Long-term UK-EU agreement(s)

No prescribed timeline: EU Treaties only provide for EU to enter into treaties with "third countries"

Negotiations with third countries

Replacing EU FTAs and other arrangements

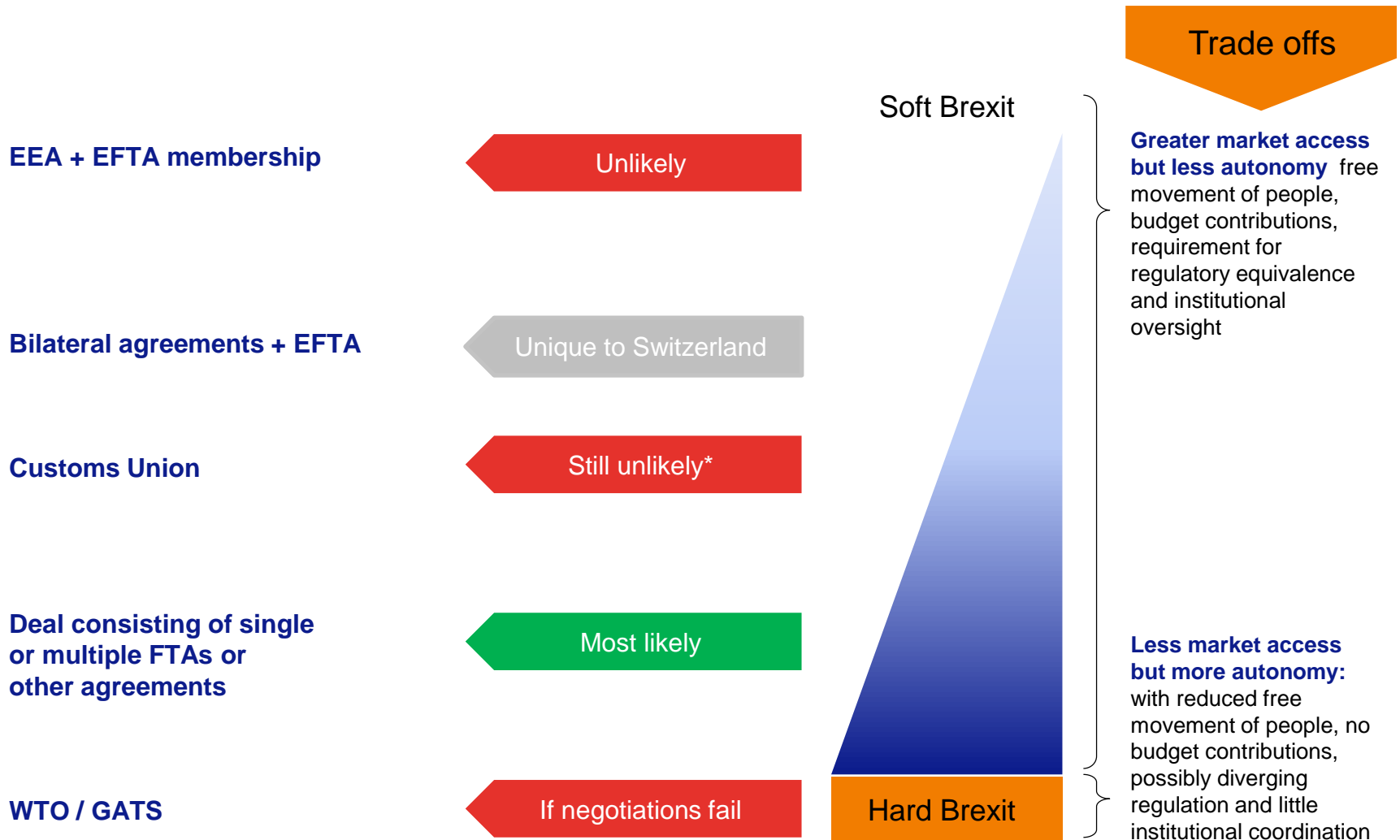
Limited impact on existing arrangements

Resetting domestic laws

Repeal Bill : Major amendments to UK law and regulation

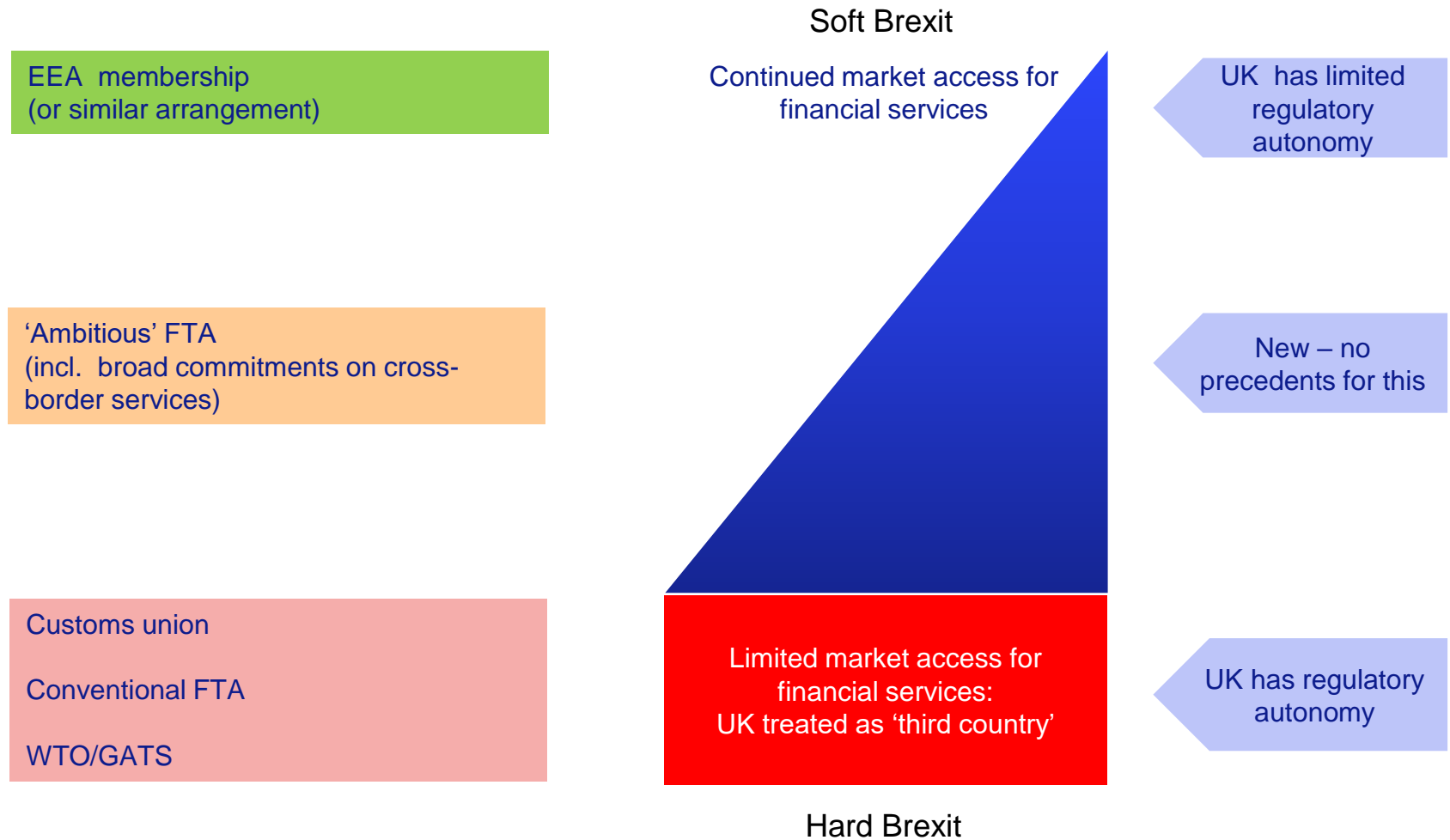
Limited changes needed to EU law

What kind of Brexit?



*Lose freedom to conclude trade agreements with third countries

What kind of Brexit for financial services?



Why does market access matter?



'Third country' treatment for non-EU banks

Most key banking and capital market services are regulated activities (with some variance e.g. corporate lending and spot FX)

Patchwork of differing Member State approaches to licensing requirements for cross-border services to local clients

Some liberal regimes, but many onerous and difficult to navigate

Branches do not provide access to whole EU market

Limited EU harmonisation: MiFIR third country regime depends on Commission equivalence decision, limited scope and subject to withdrawal on short notice

Plus restrictions on non-EU banks' access to financial market infrastructure

Asymmetry with EU access to UK markets

UK law facilitates wholesale cross-border activity, e.g. 'overseas persons exclusion', corporate lending

Accommodating position for wholesale branches of third country banks

The UK is the EU's largest financial centre generating 24% of financial services income in the EU

45% of Euro FX trades and 41% of FX trades worldwide are executed in the UK

49% of global OTC interest rate derivatives trading is executed in the UK (vs. 17% in the rest of the EU)

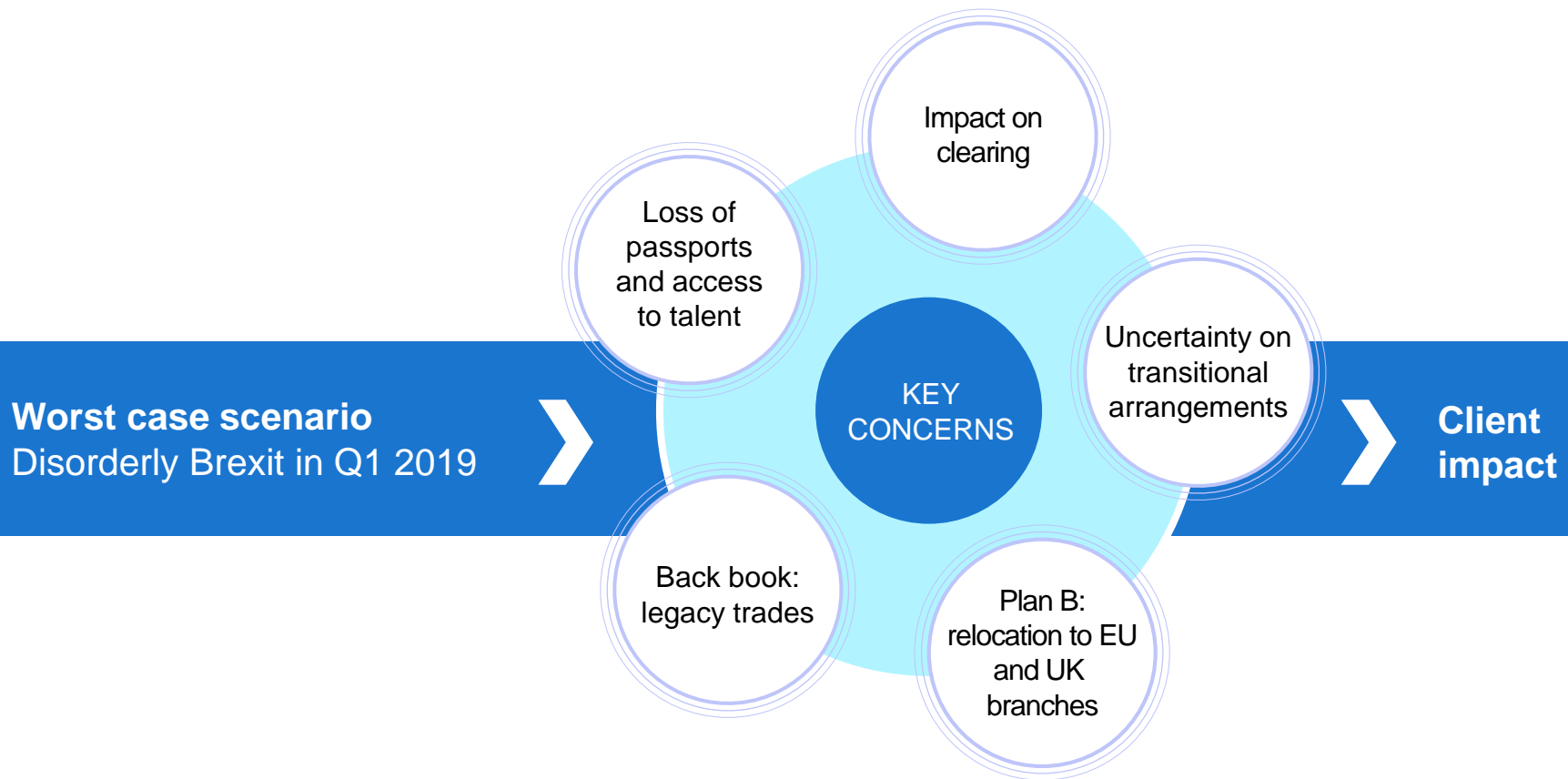
46% of the EU's equity capital is raised through UK capital markets

76% of the EU's flow of alternative finance goes through UK financial markets

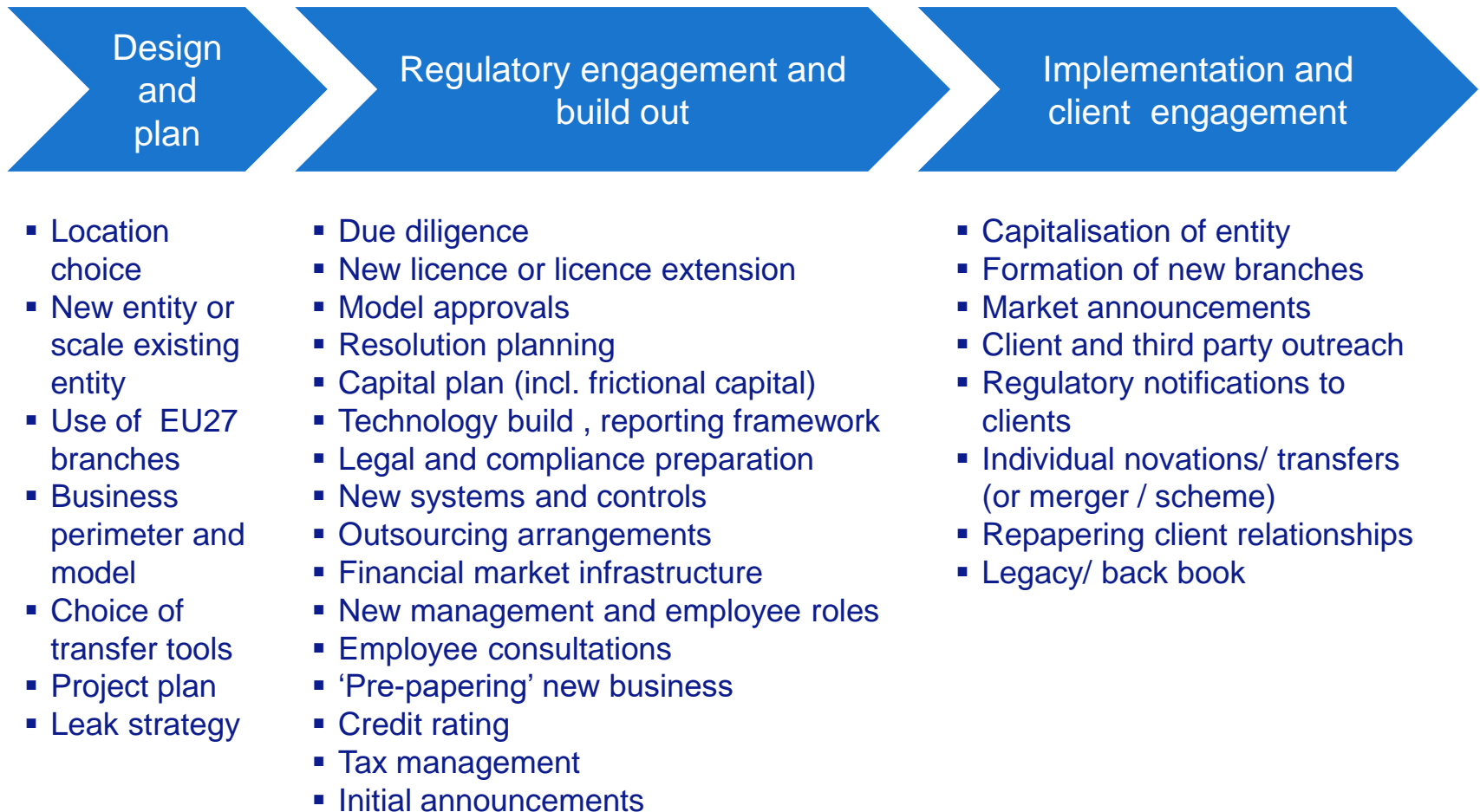
37% of European assets under management is managed in the UK

Source: AFME

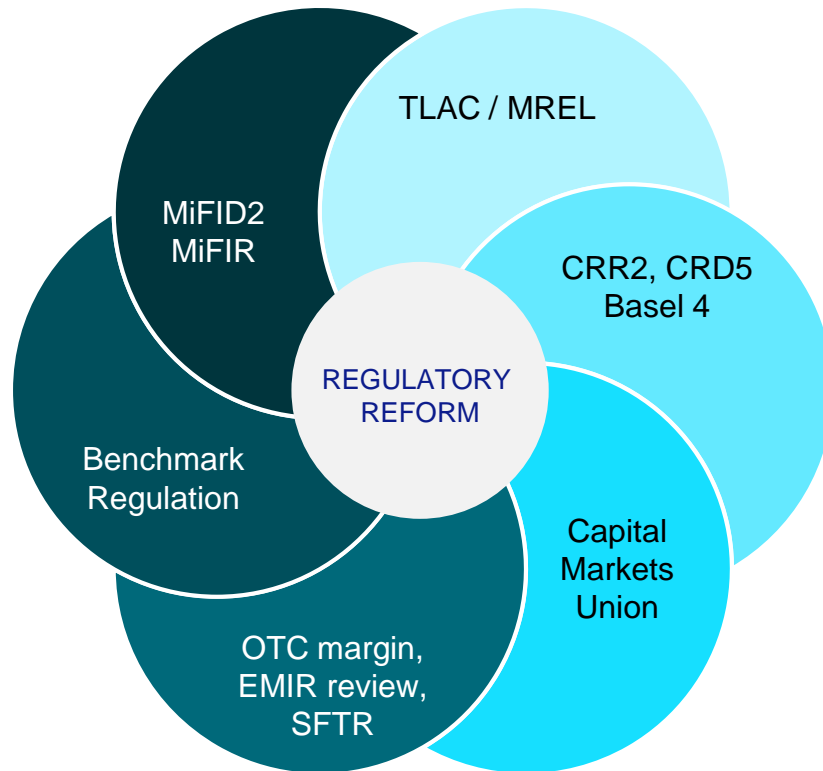
Impact on capital markets firms and clients



Hoping for the best but planning for the worst

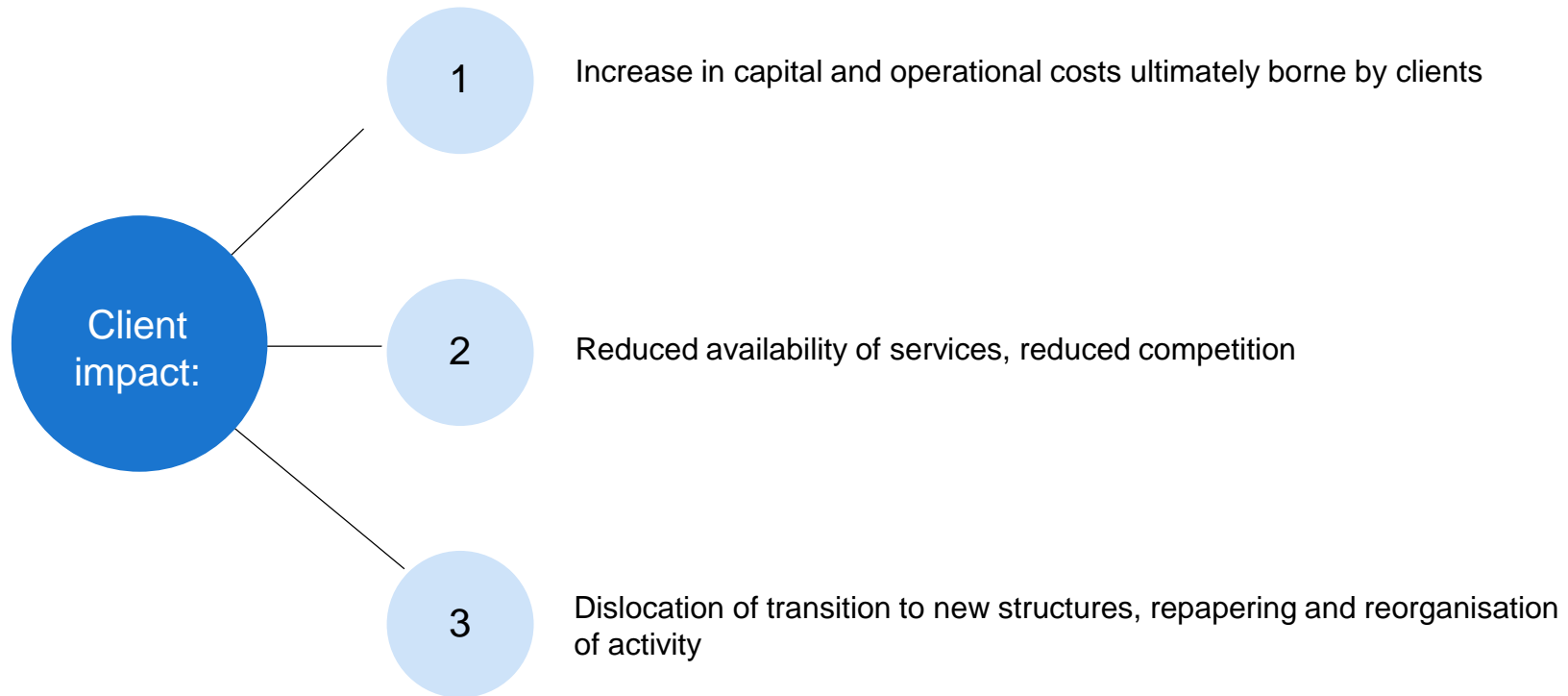


Managing regulatory change



- EU proposals requiring non-EU banks to form intermediate parent undertakings (IPUs) for their EU operations cuts across bank structural frameworks for US, UK and other banks.
- Risks that recognition arrangements not in place for e.g. clearing on UK CCPs, exemptions from intragroup margin, trading on UK venues
- Impact of Brexit on MifFID implementation (recalibration, change of instrument scope, reporting, etc.)
- Similar impacts on benchmarks, CRAs
- Regulatory workload

How could this affect end users of banking and capital markets services?



Topic Guide – Brexit















**CLIFFORD
CHANCE**
Financial Markets Toolkit
Topic Guide – Brexit

Brexit
The UK has voted to leave the EU in the referendum held on 23 June 2016.
This topic guide helps you to navigate relevant legislation and provides commentary on Brexit.
This Topic Guide features:

- Topic overview and current status
- Clifford Chance briefings, call recordings ("Insights on Brexit") and seminar videos
- Legislation
- External links
- Possible implications of a Brexit: area by area

Contacts:

 Phillip Souta Head of UK Public Policy, (London) T: +44 20 7006 1097 E: philip.souta@cliffordchance.com	 Chris Bates Partner, (London) T: +44 20 7006 1041 E: chris.bates@cliffordchance.com	 Marc Benzer Partner, (Frankfurt) T: +49 697 199 3304 E: marc.benzer@cliffordchance.com	 Andriani Ferti Lawyer, (Brussels) T: +32 2533 5057 E: andriani.ferti@cliffordchance.com
 Kate Gibbons Partner, (London) T: +44 20 7006 2544 E: kate.gibbons@cliffordchance.com	 Jessica Gladstone Partner, (London) T: +44 20 7006 5963 E: jessica.gladstone@cliffordchance.com	 Simon Gleeson Partner, (London) T: +44 20 7006 4979 E: simon.gleeson@cliffordchance.com	 Dan Neidle Partner, (London) T: +44 20 7006 8811 E: dan.neidle@cliffordchance.com
 Michel Pette Avocat of Counsel, (Paris) T: +33 1 4405 5244 E: michel.pette@cliffordchance.com	 Mark Poulton Head of Corporate, (London) T: +44 20 7006 1434 E: mark.poulton@cliffordchance.com	 Malcolm Sweeting Senior Partner, (London) T: +44 20 7006 2026 E: malcolm.sweeting@cliffordchance.com	 Deborah Zandstra Partner, (London) T: +44 20 7006 8234 E: deborah.zandstra@cliffordchance.com

Access to the most high value content, such as the Topic Guides and our seminar videos are only available to registered users of the Financial Markets Toolkit.

You can request full access to the Financial Markets Toolkit by sending an email to FMToolkit@cliffordchance.com. Once registered, you only need to log in once for access to all areas of the Toolkit.

© Clifford Chance, 2016
Clifford Chance, 10 Upper Bank Street, London, E14 5JJ.

www.cliffordchance.com

Clifford Chance LLP is a limited liability partnership registered in England & Wales under number OC232571.
Registered office: 10 Upper Bank Street, London, E14 5JJ. We use the word 'partner' to refer to a member of Clifford Chance LLP or an employee or consultant with equivalent standing and qualifications.

Attorney Advertising
Prior results do not guarantee a similar outcome.

www.cliffordchance.com

- Visit our on-line resource: The Financial Markets Toolkit
- <http://financialmarketstoolkit.cliffordchance.com>
- Equipping clients for the global financial markets



The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets that support economic growth and benefit society.

London

39th Floor
25 Canada Square
London, E14 5LQ
United Kingdom

Tel: +44 (0)20 3828 2700

Brussels

Rue de la Loi 82
1040 Brussels
Belgium

Tel: +32 (0)2 788 3971

Frankfurt

Skyper Villa
Taunusanlage 1
60329 Frankfurt am Mai
Germany

Tel: +49 (0)69 5050 60 590

www.afme.eu