BREXIT

WHAT'S AT STAKE FOR THE UK'S FINANCIAL SECTOR

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London is the world's leading international financial center, rivaled only by New York. This explains the large contribution that financial services make to the United Kingdom's economy. Banks, insurers, asset managers, and associated firms collectively contribute about $147 billion in gross value added (GVA) to the economy, employ over a million people, pay about $80 billion in corporate and income taxes, and contribute a $98 billion surplus to the nation's balance of payments. (Our estimates are based on an exchange rate of 1 British pound for every 1.2 United States dollars.)

Brexit raises concerns about the future of the UK's financial sector.

The impact on the sector will depend on the details of the Brexit deal that is ultimately struck with the European Union (EU). If "passporting" is preserved, so that UK financial firms are entitled to serve customers anywhere in the EU and UK and EU regulation are deemed "equivalent" across a broad spectrum of EU directives, then Brexit will have a limited impact on the access of UK-based financial firms to the EU.

In this "high access" scenario, Oliver Wyman estimates only modest downside from Brexit: the loss of about $2.4 billion in revenue from EU business, 3,000 to 4,000 jobs at risk, and tax revenues reduced by less than $600 million. London will likely remain the financial hub of Europe, with the concentration of skilled workers, interconnected firms, and supporting infrastructure that explain its current preeminence.

But significant uncertainty remains. At the other end of the spectrum, Brexit negotiations may not preserve passporting and equivalence. A "low access" scenario, in which access to the single European market is far more restrictive than it is today, would result in a much greater impact on the UK's financial services industry.

We assessed the likely effects of Brexit across the financial sector if firms are only entitled to limited access to European Union customers. The effects will be greatest in international and wholesale banking, which account for just under half of total financial services revenue in the UK. By our estimates, the first-order effects – those arising directly from lost EU-related business – would include a $11 billion to $15 billion reduction in GVA, about 30,000 lost jobs, and a $4 billion to $6 billion reduction in tax receipts. (See Exhibit 1.)

These losses would be compounded by knock-on effects throughout the wider financial services ecosystem. For example, an operational function may need to be located in the same place as the business it supports. When a global bank shifts its EU-customer-facing activities from London to Frankfurt or Paris, some of the support functions will go with them. By diminishing London's leading position in European financial services, a hard Brexit will lessen London's role overall.

Limited access to the single European market would put 75,000 jobs and $12 billion in tax revenues at stake

EXHIBIT 1: BREXIT'S IMPACT ON THE UK'S FINANCIAL SECTOR

IF UK FIRMS ARE NOT ENTITLED TO SERVICE CUSTOMERS ANYWHERE IN THE EUROPEAN UNION AND THE UK, AS MANY AS 75,000 JOBS AND $12 BILLION IN TAX REVENUES COULD BE LOST

Note: Estimates are based on a 1:1.2 exchange rate from British pounds to US dollars.

We expect the losses from such second-order effects to be as large as first-order losses: roughly doubling the loss in GVA, to $22 billion-$27 billion; job losses in the range of 65,000 to 75,000; and a reduction of between $10 billion to $12 billion in tax receipts.

Of course, some compensating gains may result from new arrangements outside the EU. The UK is best placed to make the most of these opportunities, however, if it remains a leading financial center in Europe.

Our analysis suggests that a high access scenario, with a clear and sensible transition period, would minimize disruption to the industry, benefiting customers who have come to rely on London as a uniquely skilled and connected center for financial services. These customers come not just from the UK, but also from the EU and around the world. A high access scenario would also enable the UK to maximize the potential growth opportunities that could arise from the UK's exit from the EU.

THE BEST OUTCOME

As such, the best outcome for the consumers of UK-based financial services, be they from the UK or the EU, would include a number of key features: Continued adherence to global norms concerning matters such as the delegation of portfolio management, clearing of reserve currencies, and exemptions on margins for intragroup exposures will be important. Current levels of access to international markets (which the UK currently enjoys due to its EU membership) should be retained through equivalence agreements with non-EU countries.

Equally critical will be the grandfathering of mutual rights of access and equivalence that are already recognized by the EU today, for example, in capital and payments regulation. (Indeed, the UK should consider seeking inclusion in ongoing regulatory projects to improve European financial services, such as the Capital Markets Union and the Single Euro Payments Area.) In addition, the UK should continue its engagement with the formulation of global financial regulations, through international forums such as the Basel Committee. And finally, issues such as data sharing, tax, judicial/insolvency processes, and access to talent will need consideration. Securing sensible agreements in these areas will be important for all industries, not just financial services.

Even if all of this is achieved, Brexit will have material legal and operational implications for financial firms in the UK and EU. They must be given ample time to make the required changes: five years, at a minimum. If there is no certainty around the transition period, the outcomes in terms of relocation and reduction in revenues, tax, GVA, and employment could be the same as in the low access scenario, regardless of the regulatory outcome, as firms will be most concerned with ensuring continuity in their ability to service customers.

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