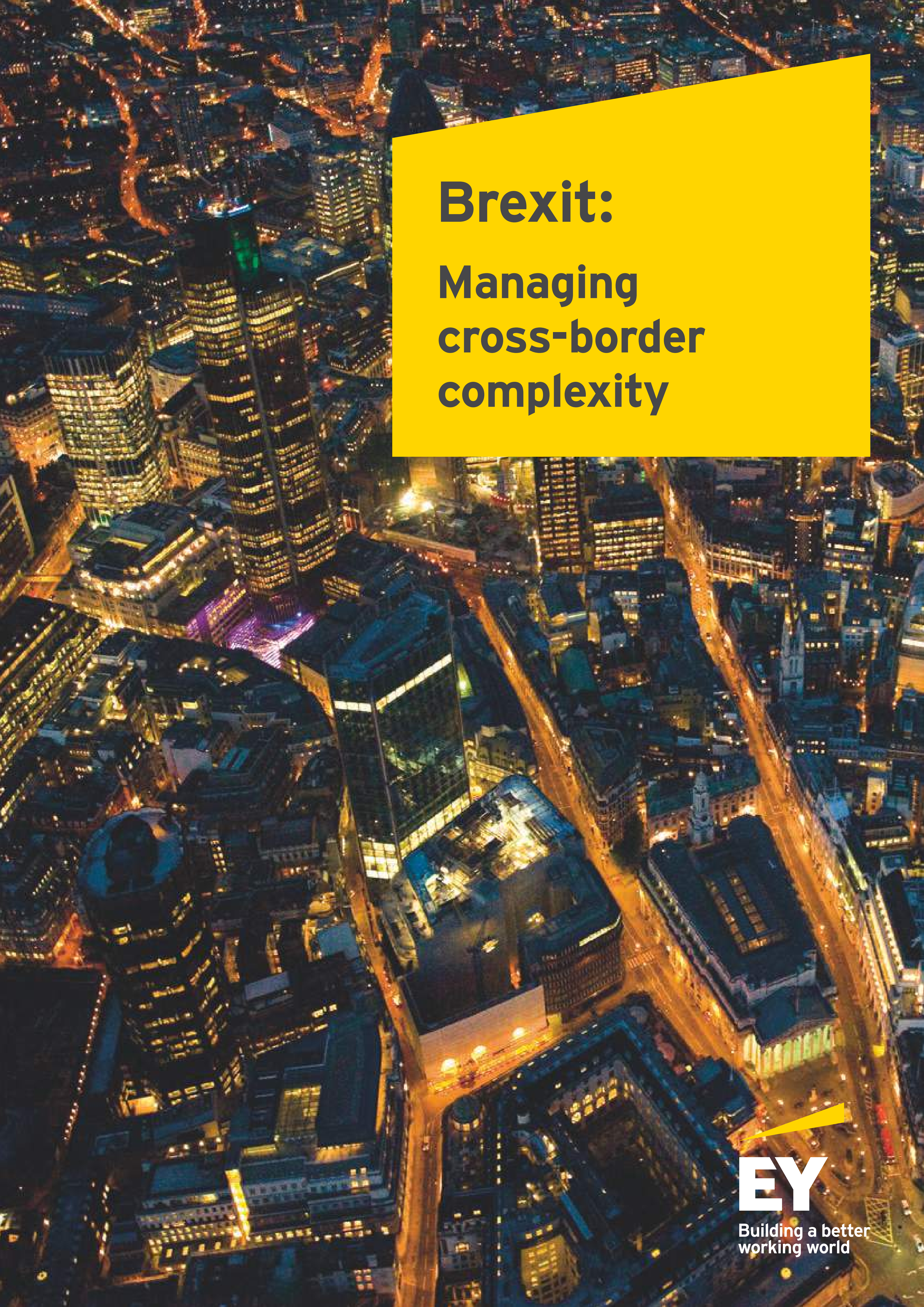


Brexit:

Managing cross-border complexity

EY
Building a better working world

Contents

Introduction

The submission of the ‘Article 50 letter’ by the British Government to the European Commission on 29 March fired the starting gun for Brexit negotiations. It is likely, therefore, that the UK will depart the European Union (EU) on 29 March 2019 on terms which are, currently, highly uncertain. This will oblige financial institutions with significant operations in the UK and the rest of Europe to plan for, and implement against, significant and complex change. The Prime Minister expressed confidence on 29 March that a comprehensive deal with the EU on all major matters could be sealed within the next two years. Both sides have already begun to talk about ‘transitional’ or ‘implementation’ phases, although the EU’s chief negotiator Michel Barnier and the leaders of the main groups in the European Parliament have all stated that these cannot last more than three years. In practice, however, we believe the window of opportunity to put plans in place will be potentially as little as 18 months, and that delay beyond that period will seriously compromise plans’ effectiveness.

EY has invested in developing insights and preparing practical approaches to dealing with the considerable operational challenges posed by Brexit. This paper, the fifth in a continuing series, concentrates on addressing the broad implications for financial institutions across banking, insurance, wealth, asset management and market infrastructure. We discuss difficult technical questions across a range of disciplines; examine the likely components of a closely coordinated integration plan; and suggest the recipe for success in implementation whilst continuing smoothly to meet the demands of shareholders, regulators, and other stakeholders.

Our thoughts are based around extensive experience of working with clients in both public and private sectors, many of whom are in various stages of their Brexit planning to prepare for and deliver necessary change. We would like to take this opportunity to thank all those who have contributed to our thinking and to welcome further debate and discussion. We look forward to engaging with you around this vital issue as we all work to maintain a strong and resilient financial services sector across the UK and Europe.

David Barker
Managing Partner
EY EMEIA Financial Services,
Transaction Advisory Services

1. The clock is ticking ...

On 29 March 2017 Prime Minister Theresa May submitted a letter to Donald Tusk, President of the European Council, informing the Council and the EU Commission formally of the UK's intention to leave the EU under the terms of Article 50 of the Lisbon treaty. This starts the official process of exit. Unless an extension of the negotiating period is unanimously agreed by all parties, the UK will depart from all EU political institutions and most likely from the EU single market on 30 March 2019.

The leadership of all financial institutions based in the UK, and of many major institutions in the other 27 EU countries, will now need to activate their detailed operational plans to deal with significant and unprecedented changes in the European marketplace. Urgent attention will be required since, in practice, the implementation window is far less than two years (see overleaf), and no plan, however well-conceived, will be likely to survive unaltered in the face of the considerable volatility and uncertainty that will characterise the coming 18–24 months. In addition to all the usual rules for large and complex programme management, plans and their implementation infrastructure will need to be particularly robust, flexible and capable of rapid response.

The UK Government's letter lays out the basis upon which Britain intends to conduct negotiations. Its principal points are 'The Government has made it clear that it seeks a 'deep and special partnership' with the EU, including a 'comprehensive free trade agreement' delivering a 'friction-free' trade environment, and 'maximum freedom' for UK-based businesses to 'sell to, and operate within' the Single Market. However, the leaders of all the major party groups in the European Parliament, which has a veto on both the withdrawal agreement and any free trade deal, have drafted a resolution which states that the Parliament 'considers that a state leaving the Union cannot enjoy similar benefits as an EU Member State and announces, therefore, that it will not consent to any agreement that would contradict this'. For Her Majesty's Government the red lines (i.e., non-negotiable elements) are control of borders (i.e., an end to 'free movement of labour' from EU member states) and a complete rejection of the jurisdiction of the Court of Justice of the European Union (ECJ) within the UK — although note that existing EU law will continue to apply in the UK until and unless it is repealed or amended by the UK Parliament, and some role post-Brexit for the ECJ in a Court of Arbitration for trade disputes may well ensue.

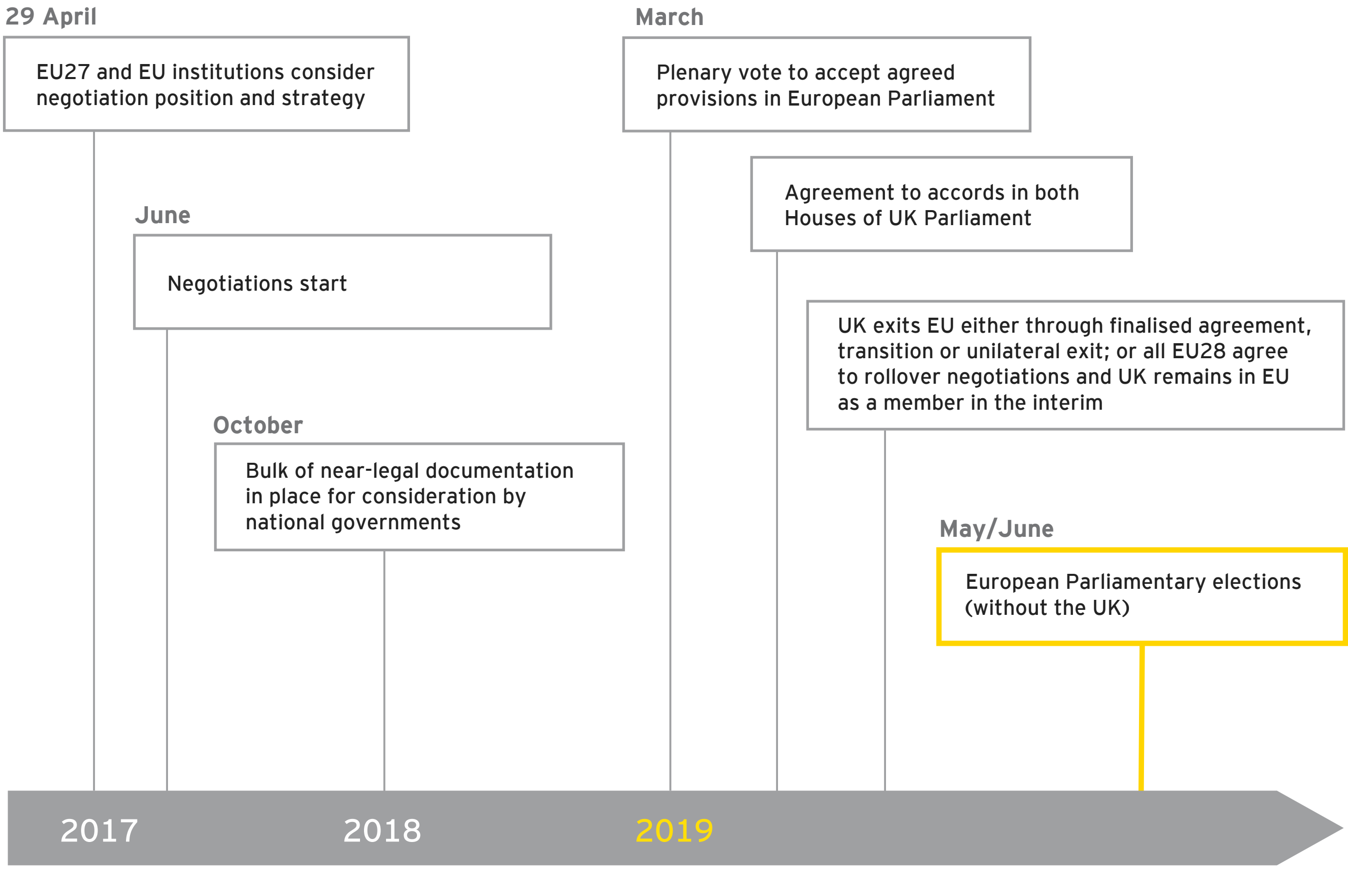
There will be three big areas to negotiate:

1. The 'settlement' in respect of financial obligations that the UK will be asked to pay as its share of alleged future EU liabilities and as a price for exit: Some in continental Europe suggest the number should be as high as €60 billion euros in cash, and some eminent lawyers in the UK suggest that there is no legal basis for the claim and the correct answer is zero.
2. Exit/transition arrangements. There are several thousand specific laws and rules which will need review and amendment, and a plethora of practicalities to be resolved in detaching the UK from the EU and its institutions. We think it unlikely that every single one will be resolved during the 12 months or so available for practical negotiation, and that therefore attention will fall on the most significant and binding, with a long tail of secondary issues to be tidied up after the two year period.
3. Future 'end state' trade and political relationships between the UK and the EU either by means of a global treaty or a series of specific accords. It is highly likely that all parties will wish to maintain amical political relationships, cooperation in a multitude of areas (most notably in the areas of security and defence), and trade relationships in most areas although not under single market rules.

One side claims that nothing else can even be discussed until the bill is agreed and settled in full, whereas the other suggests, negotiations on all areas can proceed in overlap if not in parallel. We anticipate an eventual compromise on the amounts, timing and specie of the settlement, as well as elements of other negotiations proceeding in parallel. The rights of UK and EU citizens will also be a subject of much focus.

Timetable

On the assumption that unexpected political or economic gales do not blow negotiations significantly off-course, and assuming negotiations in practice are conducted constructively, a likely timetable is as follows:



When holiday periods are factored in this timetable demonstrates that in practice, assuming no major disruptions, little over 12 months are available for substantive negotiations of the three principal themes outlined previously. Few commentators or participants currently believe that this is feasible and therefore forecast either a complete rupture between the UK and the EU or an extended negotiation/transitional period. Although the latter is possible, paradoxically, this increases the need to make and implement concrete decisions quickly, because waiting for certainty as a pre-requisite for planning is unlikely to pay off in time.

Outcomes

There is a wide range of possible outcomes made all the less predictable by the complexity and unprecedented nature of the exercise, and by the likely economic and political volatilities against which negotiations will be conducted, not the least of which will be the profound debate within EU institutions and member states about the future nature and direction of the EU itself. Our research amongst clients and policy makers suggest three distinct end states are being actively contemplated:

1. ‘New relationship’: An amicable deal in place covering most of the fundamental, political and economic arrangements with a transition period for implementation of between three to five years.
2. ‘World Trade Organisation (WTO) rules’: A failure to agree an amicable or workable deal within the Lisbon Treaty deadline results in the UK ‘walking away’ from negotiations in two years’ time, unilaterally withdrawing from EU obligations, and relying on WTO rules for future trade relationships.
3. ‘Associate Member’: As a result of domestic political pressures in the UK and unspecified ‘reforms’ in the EU, a means is found both optically and practically through which the UK becomes an ‘Associate Member’ of the EU with comprehensive access to the single market but no participation in political institutions or initiatives.

We know that most financial institutions have reached, or are close to reaching, strategic decisions in respect of the future shape of their businesses in the wake of Brexit. Most have assumed a future in which the UK is not a part of the single market or the Customs Union and where ‘passporting’ into the EU will no longer be available to UK-based institutions. It is also assumed that unlimited movement of labour to and from the continent will become more difficult. As a result decisions have been (or are shortly to be) made among other things on:

- The location and establishment of head office, subsidiaries and operational activities
- Business governance, corporate ownership and management structures
- Location of operational activities, both front and back office
- Desired or most likely regulatory status of businesses throughout the relevant geographies
- Relocation of key staff
- Tax considerations
- Key milestones and deadlines
- Implementation and change management programmes

Once firms have finalised their strategic road maps, focus will turn to implementation. Time is short, and new models may need to be implemented, tested and authorised by March 2019, if not sooner.

2. Implementation challenges

Delivering a complex, multi-jurisdictional delivery programme is difficult. Some organisations will already have worked on similar plans for potential Scottish Independence, the Eurozone crisis and other geo-political events. Once strategy and planning are verified, it involves coordinating many different parts of the business as well as managing external relationships with supervisors, clients and other third-parties. The intricacies in delivering such a programme during the next two years will be also be complicated by the negotiations, which could have a direct impact on plans. Accurately separating signal from noise in the environment will be key to maintaining strong leadership around the delivery programme.

Timings

Whatever the likely time estimate for implementation you arrive at initially, it will turn out not to be enough, and will have overlooked some unknown contingencies. It will be essential to evaluate rigorously the amount of free time and capacity that are available for implementation, and the constraints that puts on any programme. For example, any authorisation period by a supervisor will take a minimum of three months and likely much longer. Testing of any new operation is essential and will take time. There will no doubt be unforeseen issues that arise during the implementation, so contingencies will need to be built in. Firms will also need to build in their own internal time required for board review and approvals, and for onboarding new people or board members in existing or new jurisdictions. Different parts of the business will need to be aligned and communicated effectively. Legal and tax opinions and/or ruling from tax authorities will be required, and the tax ruling process is likely to take up to six months in many EU member states and longer in some. There is then the time required to simply develop and build out the new model, ensuring the infrastructure works and, possibly most importantly, that clients remain well looked after and reassured during the changes.

It is worth bearing in mind that the solutions devised to take firms to April 2019 may not be optimal in the longer term. When the broader picture emerges business should look again at their European business and operating models to ensure they met their long-term strategy.

Implementation — a worked example

Any cross border structural programme is complex and unique, involving a range of internal and external stakeholders. Below is a sample of key questions firms will need to consider to implement their planned Brexit response. The plan is likely to involve setting up new entities in order to continue serving its clients in both the EU and the UK.

1. Perimeter — what parts of my business should go where?

- Where are my existing European Economic Area (EEA) and UK clients and from which entity will I continue serving each of them?
- Using my client data, do I understand my clients' businesses, which entities they currently operate from, and how they might change due to Brexit?
- Should I be looking at my clients' immediate counterparties or at a client grouping (e.g., how do I classify a EEA car maker with a large UK subsidiary)?

2. What business model am I aiming to achieve across different business lines in the short and longer term?

- Can I develop a viable business model for each business line post Brexit in different jurisdictions? Will I be able to articulate this to supervisors?
- What is the impact of change and how should I implement, e.g., if 40% of my business is in the EEA, should I move 40% of my front office, or are there more nuanced ways to implement this?
- What cross-border should I pursue? Will there be regulatory impacts to this? What will EEA supervisors permit?

3. What are the requirements of my new operational model?

- What is my current model and what steps are required to implement a new model — operations, technology, finance, risk, treasury, legal, tax (including Value Added Tax (VAT)), compliance, HR, third-parties, governance?
- Which assets should I wind-down or sell?
- Which assets should I move from existing jurisdictions to new jurisdictions?
- What new resources and capabilities need to be built or bought?

4. How should I revise my financial model?

- How do I build a new financial model using revised business and operational models?
- How do I best analyse the groups capital, liquidity and funding projections?

5. What internal and external approvals do I need and when do I need them?

- Am I getting feedback at the right time internally and externally?
- Have I had the right feedback on the plans that already exist?
- Have I kept regulators in all jurisdictions appraised of our plans and ensured they have sufficient time to comment and build confidence?
- Have I allocated sufficient time to engage with tax authorities to obtain tax rulings and otherwise manage tax risk?

6. What is my implementation plan?

- What are my detailed approach, timeline, milestones, interdependencies, critical path, delivery risks and mitigating measures?
- Have I built in contingency planning for potential design changes?
- What am I telling clients, investors, trading partners, press and staff?
- Have I budgeted correctly and have sufficient resources in place?

7. Implementation execution — how do I migrate to the target solution?

Perimeter clients, assets, liabilities, positions and employees will all need to be transferred in. To achieve this, you will need to consider whether:

- Have client engagement principles been established?
- Have your workforce, trading partners, contractors and sub-contractors been made aware of the new structures?
- Have the range of available transfers mechanisms have been fully understood?
- Have contracts been reviewed to understand which mechanisms may be applicable?

There will not be a singular approach, contracts will therefore need to be allocated to different mechanisms taking first three points into account and client engagement will need to comment accordingly.

8. Implementation — how should I build capability?

- What is the nature of the target state? What am I transferring in?
- Am I establishing new branches? Have discussions taken place with the host regulator?
- Have I expanded capability to comply with host reporting?
    - Have the right staff been hired?
    - Has new infrastructure been put in place?
    - Have new policies and procedures been created?

9. Implementation execution — have the intragroup services been enhanced and strengthened?

- Should the host commission services from other group companies? How will I achieve this?
- Have intragroup agreements been augmented/strengthened?
- Have my service levels been negotiated and established?
- Have we agreed KPIs to support these?
- Have we strengthened our service management framework? Has appropriate management, governance and control of future service provision been established?

10. Implementation execution — how should I manage execution risk?

- Has programme governance been established and will it be effective? E.g., risk/issue identification, problem solving, escalation, decisions.
- Are regulator relationships mapped? Is regulator stakeholder management frequent and clear?

Checklist for Boards

Are supervisors engaged at the appropriate time and been given the correct information?

Do we understand the financials/cross-border/risks and have the supervisors' confidence before starting further work on plans?

Does our first submission to supervisors ensure they understand the risks in our business, its future viability and will support the application? Where is the submission being managed from, the UK or the new jurisdiction?

Are our people informed and engaged?

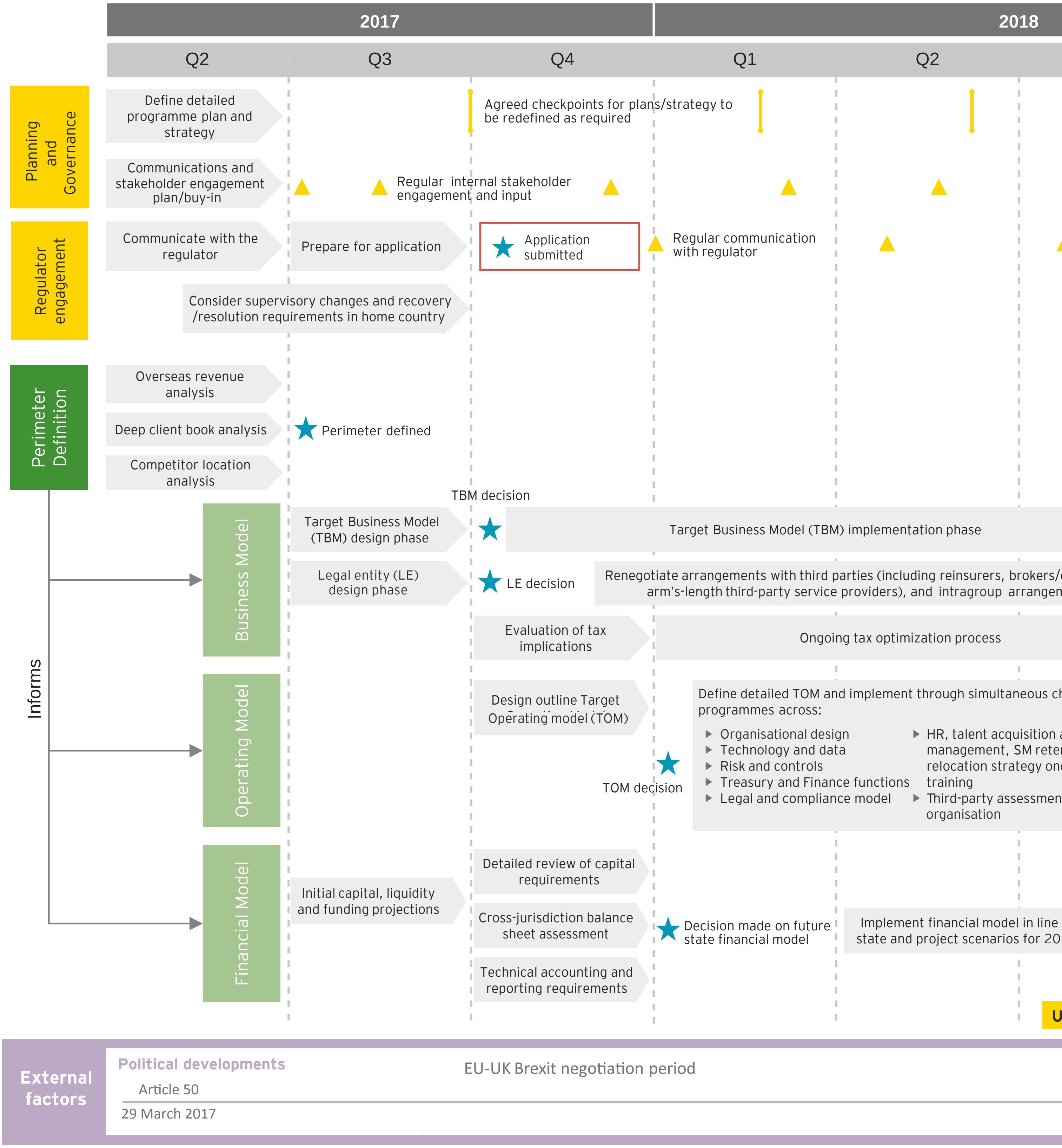
Can we get the right board members for any new entities, given some may face delays in taking up roles, or lack the right skills?

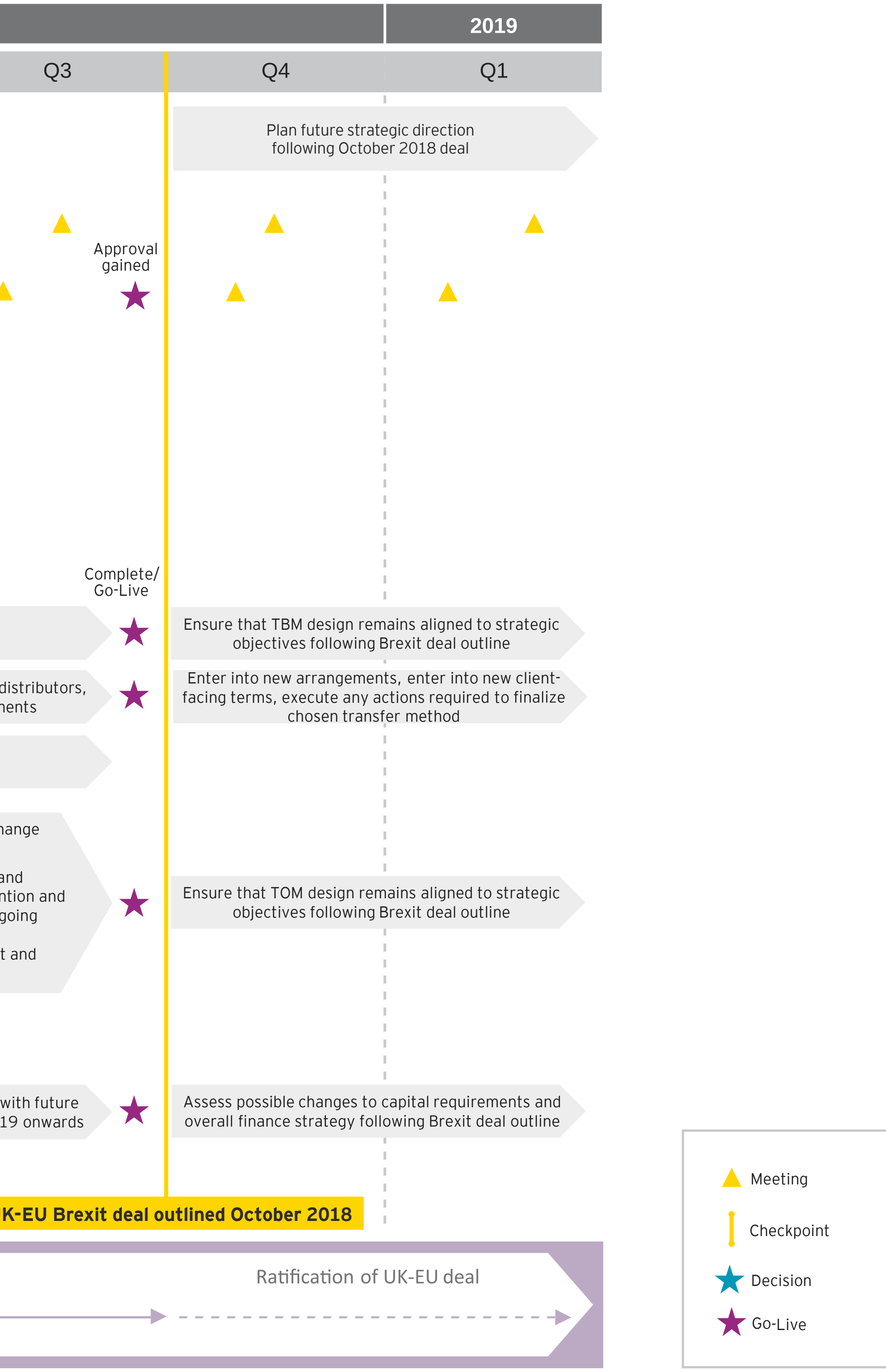
Do we understand how Brexit will impact our clients?

Are our clients and customers aware of our plans and are we discussing how we will continue working with them where appropriate? Do we need to get their feedback?

3. Example Brexit implementation plan

Complex programme planning across the Brexit timeline




2019
Q3
Q4
Q1
Plan future strategic direction following October 2018 deal
Approval gained
Complete/ Go-Live
Ensure that TBM design remains aligned to strategic objectives following Brexit deal outline
Enter into new arrangements, enter into new client-facing terms, execute any actions required to finalize chosen transfer method
Ensure that TOM design remains aligned to strategic objectives following Brexit deal outline
Assess possible changes to capital requirements and overall finance strategy following Brexit deal outline
K-EU Brexit deal outlined October 2018
Ratification of UK-EU deal
Meeting
Checkpoint
Decision
Go-Live

4. Technical considerations

As plans are finalised and firms face the next 24 months of time pressured activity, there is a range of issues that will continue to affect strategy and implementation. Some of these are unforeseeable, meaning maintaining a degree of flexibility and fleetness of foot will be important. Others are becoming clearer. We focus, in particular, on the key issues of regulation, tax, data, accounting and talent.

Regulation

Regulatory challenges are among the most significant questions that financial services business need to address when considering their post-Brexit business and operating models. The UK's departure from the EU and EEA will mean that the provisions in EU financial regulation that allow cross-border provision of services for EEA member countries, will cease to apply.

Equivalence and transition

Several of the applicable directives envisage the possibility of firms from third-countries being granted access to the EEA for certain types of business (or otherwise for exposures to third country exposures being treated as if they were within the EEA, and therefore more favourably than exposures to other countries). Favourable treatment is dependent on the country being deemed 'equivalent' or 'recognised'. The test of equivalence varies by directive. Typically, it is in part technical, based on similarity of regulatory standards and supervisory cooperation; and in part political, dependent on matters such as reciprocal access.

The conclusion that many institutions have drawn is that the current equivalence framework is too patchy and unreliable to be the basis for planning a Brexit response on a sustainable basis, with continued ability to serve clients.

Authorisations

As businesses have progressed their Brexit thinking, it has become evident that having a business that holds the appropriate regulatory permissions to undertake business with clients is a key critical path item. Firms are considering two major ways of achieving this, namely:

- Use existing branches: Some EEA countries allow branches of third country firms to do certain types business in their country, subject to national, rather than EU, regulatory requirements. The particular types of allowed business vary by country. This model would not, generally, allow for cross-border provision of services within the EU27 (or, for branches in the UK, for services from the UK to the EEA).
- Set up a new subsidiary: Establishing a new authorised firm in the EU27 will permit the new firm to serve clients on a cross-border basis within the EU27. It will need to gain authorisation — a process that can take a considerable time (see below) depending on the type and complexity of business involved.

Fully functioning entity

Any new authorisation will need to satisfy the applicable regulatory and supervisory standards. Whilst businesses are typically looking to minimise change that will be disruptive and costly, neither EU nor UK regulators will sanction a streamlined process that could result in firms that do not pass core authorisation conditions being authorised. Regulators have been clear that they will not authorise businesses without the appropriate business plan, governance, mind and management, decision making, risk management, financial resources and adequate recovery and resolution capability in the entity within their jurisdiction.

Preparing an application for a new authorisation to satisfy these requirements will typically take several months for a large or complex firm. There are stipulated time frames for the authorities to consider an application once it is complete; the process from start to finish could take 18 months or more for a large firm, and associated approvals, such as for models, may typically take longer. Firms have recognised that it is important to establish regulatory dialogue early on in the process, particularly for more complex businesses.

Ensuring the viability of each institution

The potential for duplication of activity, or for fragmentation of business leading to capital inefficiency and frictional operational cost, means that many firms are considering not just where to site business, but whether it will remain viable in the new construct. There is a risk that either some services to customers will be withdrawn or become more expensive as a result.

Key questions include:

- Client preferences: Clients may be facing their own Brexit challenges, and may have preference to deal with a financial services provider in a particular jurisdiction due to perceptions of strength of regulation and client protection, legal environment, or other factors.
- The need for appropriate infrastructure to support client-facing staff in each jurisdiction.
- The need for appropriately empowered governance mechanisms, and individuals, in each jurisdiction.
- Regulatory relationships and existing presence: A firm with an existing presence in a particular country, and established regulatory relationships, may feel that helps with new authorisation.
- Potential capital costs if it does not prove possible to sustain current risk and capital efficiencies resulting from netting and compression of exposures in central counterparties.

- Limits on the level of intergroup exposures if firms seek to do business under a 'back-to-back' model, which would seek to retain market risk exposure management predominantly in a central hub.
- Interdependencies with other key regulatory initiatives, such as the European Commission's proposals for a European intermediate holding companies or Solvency II.

Overall, regulators will be looking for institutions to be clear about what, if any, assumptions institutions are making to support their business plans, including about the continuation of existing benefits of EU membership. They will also look to see that those plans have been appropriately stressed for both Brexit and other potential risk factors.

Approvals for new cross-border models

Certain firms will need to consider new booking models that might operate between new and existing entities. Understanding and being able to explain why these models exist and how they manage risk is critical.

General principles: the model should be clear, coherent and understandable.

Remote booking: certain remote booking might be possible, but, it will require Risk management frameworks with proper authority, governance, process, controls and adequate documentation and reporting.

Risk management framework: there should be a robust risk management framework around the booking model with clear approaches for different products or trading books as required. The framework should include governance, delegation of authority, risk appetite, approvals, monitoring, reporting, and absolute clarity around roles and responsibilities and three lines of defence.

Governance: the Board and the executive team of an EU financial institution is responsible for the risks on its balance sheet and must have the authority and the autonomy to control and manage these risks, including being able to refuse risks or exposures. The board must approve the risk appetite statement considering the remote/booking model and risk transfer mechanisms.

Process and controls: an EU financial institution must be in control of what is booked onto the balance sheet. The nature of the controls will differ on a product or transaction–type basis. The regulators will generally be pragmatic but the institution must fully understand the risks it is assuming and can demonstrate the capability to effectively manage the risks it assumes.

Resolvability: any cross-border structure should not impede an orderly wind-down or resolvability. The structure should not make it harder for the institution to continue in resolution, given its reliance on services from the rest of the group, or to separate any entity from the wider group.

Tax

There are potentially significant tax implications arising from the UK leaving the EU and any consequential restructuring of the group to accommodate Brexit. Understanding and managing tax issues will be a critical part of the implementation programme.

Points to consider include:

Corporate income tax neutrality when restructuring into EU hubco

The question of whether it will be possible to achieve corporate income tax neutrality needs to be considered both from the perspective of the UK and from the perspective of overseas branch jurisdictions. From the UK perspective, the key question will be whether there has been a transfer of people, assets, business (including goodwill) from the UK tax net to the new EU hubco jurisdiction. From the branch jurisdiction perspective, the key question will be whether it is possible to fall within domestic reorganisation reliefs (which will be on the basis of the EU Merger Tax Directive) which provide for tax neutrality. Each jurisdiction has its own specific detailed rules and conditions, but as a broad rule of thumb it will be necessary for the new EU hubco to issue shares to the UK transferor in consideration for the assets transferred. Often, tax rulings will be required. In any event, for these reliefs to apply, it will also be necessary to effect the transfer before the UK leaves the EU as it is generally required that the transferor must be resident in an EU Member State to obtain neutrality.

VAT

From a VAT perspective, the key issues will be ensuring that any Brexit-driven transfers or group reorganisations are tax neutral and, thereafter, that new operating models are VAT-efficient.

'Transfer of going concern' (TOGC) provisions typically allow UK businesses to be transferred VAT-free. There are strict TOGC criteria which must be met; however, where they are not, certain assets transferred may become chargeable to VAT. UK VAT groups can also be used to ensure that transfers do not give rise to a VAT cost. These considerations will need to be replicated on a jurisdiction-by-jurisdiction basis, as the treatment of each in-country transfer will be subject to local rules. These can differ markedly across Europe and there may be not be a 'one-size-fits-all' route to neutrality. To the extent that any business, or part thereof, is re-housed from one jurisdiction to another, there may be further complexities. Whilst VAT-free cross-border business transfers may be possible, they do need careful attention.

Any reorganisation is likely to result in new entities, branches and intercompany service flows. With these comes the potential for additional VAT costs, as well as the accompanying compliance and reporting requirements. For example, local VAT grouping may allow certain new services to be provided free of VAT, but it could simultaneously give rise to VAT costs where services are provided cross-border. This is a result of European litigation that held that a branch-to-branch supply is no longer disregarded where the provider or customer branch is a member of a local VAT group. Businesses should, therefore, look at their future operating model at a pan-European, rather than national, level.

Changes to existing models

As financial services groups move into a post-Brexit structure, careful consideration will be needed as to the changes required to the current booking models/risk management frameworks and how those changes are effected in practice. In particular, to the extent that transfer pricing methodologies are used to ensure that revenues and profits are properly allocated to the relevant market risk taking functions, such methodologies would need to be revised in light of the post-Brexit operational structure, this may also require consideration of transitional strategies where, for example, trading books are moved over time.

DTAs

For those institutions, in particular, that count tax losses or other tax attributes towards their DTAs, it will be important to ensure that those tax attributes are not lost in a Brexit re-structuring, both from a UK perspective and from an overseas branch perspective. Rules will differ from country to country. For example, in Germany and Italy, even in an otherwise tax-neutral transaction, it may not be possible for the new EU hubco to fully benefit from the losses going forward. In contrast, for example, in France and Spain, it should be possible, subject to a number of conditions being met, for the new EU hubco to so benefit.

Double tax treaty network

The availability and application of double tax treaties with respect to the new EU hubco needs careful consideration.

This could be relevant to the location of the new EU hubco and its position in the corporate group. For example, dividends paid post-Brexit by a new EU hubco located in Germany to a UK parent, under current law, would be subject to 5% withholding tax under the UK/Germany double tax treaty. This is on the basis that, post-Brexit, reliefs from withholding tax currently available under the EU Parent-Subsidiary Directive would (subject to any change in law) no longer be available to UK companies.

It could also be relevant to trading activities undertaken by banking front-office desks, or to corporate lending activity. Say that a bank sets up a new EU hubco in Ireland and undertakes various equities and fixed income trading/corporate lending activities there. The tax treaty position for the new Irish entity may be less favourable as compared to the UK. For example, interest paid by entities from Hong Kong, Portugal and Singapore to Irish entities have a less favourable tax treaty position as compared to interest paid to UK entities, and a similar point applies to dividends paid by Spanish or Swedish entities.

Short-term business travellers

The UK has recently sought to tax employment income of overseas branch employees to the extent they exercise their employment in the UK. This has led to considerable compliance issues for financial services groups. It will be necessary to consider whether a similar issue arises for potential destinations for new EU hubcos looking to passport through the EU through branches. For example, Ireland has a dispensation period of 30 days or less spent in Ireland applying to any non-resident employee, including those from branches. In contrast, Germany has (similar to the UK) more recently sought to tax employment income of overseas branch employees to the extent they exercise their employment in Germany.

Bank levies

Any banking group moving balance sheet from the UK to an EU jurisdiction will need to consider both its position with regard to obligation to make contributions towards the EU Single Resolution Fund and any local bank levy liabilities.

US tax

US tax will be important for US headquartered groups in particular. One key consideration will be whether a Brexit re-organisation is tax neutral for US tax purposes; this will require a detailed and granular analysis of the business that is being restructured. Thought also needs to be given to US tax reform, and in particular proposals to reduce the rate of US federal income tax from its current level of 35% to a much lower number. Prior to reform, non-US tax may not represent an overall cost to the group to the extent that US foreign tax credits are available; post-reform, non-US tax may represent an absolute cost. Consequently, the importance of managing European effective tax rates, in a post-Brexit European group, will increase.

Data

Data forces its way on to the critical path because supporting the TOM to be fully ready on day one, a successful data migration is key. In order to coordinate the data migration activities from one legal entity to another all impacted strategic data repositories and applications must be analysed, documentation of the data flows created/updated and coordination of the data preparation and the associated remediation tasks must be planned and executed against. A data readiness checklist should be created and the end-to-end testing to ensure adherence to the TOM must be resourced correctly and executed against the desired timelines. In addition a reporting process against the data readiness checklist gives senior management the confidence to make critical go-live decisions; this should also include appropriate shared services. Typically there is a lack of available subject matter experts to help with data and technology application analysis, therefore the associated cost can be a multiple of original estimate. Other considerations include technology and data retention, i.e., management of historical data and how technology applications impact the data over its lifecycle should part of the data governance over the migration; understanding data protection and privacy is key as the co-location of data will be in multiple jurisdictions with each jurisdiction potentially applying different rules. Finally the management of third-party vendors and associated service-level agreements covering more than the UK jurisdiction is a consideration and evidence of outsourcing being well governed to minimise operational risk will be required by central banks.

Accounting

Accounting implications for group reorganisations

Whilst there are several considerations to be taken in to account during such an assessment (e.g., regulatory environment and licence application, taxation, availability of real estate, etc.), the accounting for group reorganisations under International Financial Reporting Standards (IFRS) is notoriously complex. For example, 'business combinations under control' is scoped out of IFRS 3 and companies are required to develop their own policies and then apply this policy consistently. Dependent upon the policy adopted, the balance sheet of the entities, and therefore the regulatory capital, can vary significantly. Understanding the desired target structure and the steps required to effect, it should be considered as part of any company's Brexit planning.

Changes to existing booking models

Alongside the need to consider different legal entity structures, financial institutions are also having to consider the changes required to the current booking models. With many considering back-to-back booking models, at least in the short term, this raises some interesting considerations both from a regulatory and an accounting perspective. Furthermore, financial institutions will have to consider their existing and future hedging arrangement dependent upon their booking model.

Financial reporting — disclosures

In July and October 2016, the Financial Reporting Council (FRC) issued guidance relating to the financial reporting of listed UK companies. In particular, it reiterated the need to disclose the potential impact and associated risks resulting from the vote for Brexit. The FRC stated that:

- Directors must consider the nature and extent of risks and uncertainties arising from the result of the referendum and the impact on the future performance and position of the business.
- As part of the assessment of principal risks and uncertainties, boards should consider whether the referendum vote gives rise to solvency, liquidity or other risks that may threaten the long-term viability of the business; and any implications for the viability statement in the annual report.
- The FRC is expecting boards to provide an explanation of any steps that they are taking to manage or mitigate those risks.

People and talent

As we enter in to the period of negotiations UK listed companies should continue to monitor the impact of Brexit on their business and the risks that are presented as a result of Brexit.

HR will need to understand and address the limited availability of talent for key business functions in the UK long before Brexit outcomes are known. Workforce planning and analytics models will need to be reviewed and updated in light of this data, employees may need to be relocated, policies updated and recruitment required.

Organisations will also have to consider the impact of Brexit on their operating model and the cost of sourcing and deploying talent. Current approaches to the use of non-UK contingent and permanent labour and will need to be reviewed under new labour frameworks. The transition to a new economy (irrespective of Single Market membership) will generate an increased workload for key functional areas — finance, HR, IT, risk and legal. HR teams need to work with the business and their functional counterparts to proactively identify what these skills will be. They then need to have a plan to develop or secure these skills and resources, at a time that all other firms in the market will have similar needs — the talent pool may become increasingly smaller.

5. Conclusion

Brexit will be just one of the major forces shaping the structure and nature of financial services in the current decade. Just as the political elements of Brexit will be conducted within a complex web of potentially profound political change within Europe, so an explosive compound of environmental changes will affect financial services. These include in no particular order:

- The pivot of the global economy eastwards
- The demographic challenge in Europe
- The emergence of new significant competitors
- The opportunities and threats posed by technological change
- The change in public perceptions of financial services providers
- The damage to traditional profit models wreaked by 'unconventional' monetary policy and economic stimulus initiatives by central banks
- A new complexity and stringency in the regulation of financial institutions

For certain classes of business and types of institution the whole business model itself is being called into question, and survival and reinvention are the key strategic priorities.

In addressing this shift in its strategic position, we do not expect the UK to become a deregulated offshore trading centre. Whilst it is likely that liberation from some of the more stringent elements of EU legislation will be attractive, the UK authorities will not wish to lead a charge to the regulatory bottom, nor to sacrifice London's hard won reputation for regulatory excellence and prudence. However, UK regulatory authorities have demonstrated vision and flexibility in providing a responsive regulatory framework within which new classes of business can develop and prosper — in respect of the nascent crowdfunding industry for example where London has speedily become the most significant location in Europe — and we can expect similar responsiveness in respect of other new businesses and activities.

Whilst the effect of Brexit may well prove material for some business models and firms, overall, we do not anticipate that Brexit will prove catastrophic for the City or its citizens. Over the last century, UK Financial Services has shown a formidable capacity for resilience and self-reinvention, and those qualities will continue to be in evidence. In the rear mirror of history, Brexit may come to be seen as a noteworthy but not revolutionary event.

6. Our experience of advising on complex change

Time is short and acting fast will be critical to the success of a change programme.

EY has an exceptional breadth of specialist skills throughout our European Financial Services network, helping support financial institutions manage large complex delivery programmes through regulatory, legal, operational and tax change.
Our experience includes:

Bank entity establishment and business relocation for Swiss G-SIB in Ireland

EY helped a globally significant Swiss investment bank establish a presence and move business operations to Ireland, working with the client to develop a decisive business strategy that incorporated local regulatory, tax, cultural and client requirements. EY leveraged its extensive network of experienced regulatory and legal professionals to drive focused workshops on critical aspects of the bank. A key deliverable was to support the preparation of a business case to aid in the pursuit of a banking licence authorisation from the Central Bank of Ireland. EY utilised its regulatory expertise to ensure key stakeholders had a clear understanding of the impact of the external political and regulatory environment across the programme and the business.

"Our Global Regulatory Network was key to aiding the client in preparing an application to the local regulator. We leveraged our understanding of the Irish legal and prudential landscape, as well as our extensive experience across Europe in driving similar banking authorisation programmes."

Cormac Kelly
EY Ireland
Executive Director
Performance Improvement Advisory

Brexit experience – Global investment bank

EY is supporting a global investment bank in their Brexit planning, including assessing feasibility of the Banks' Brexit plan from an accounting, regulatory and tax perspective. This included considering alternative locations for the Brexit effected businesses as well as detailed consideration of the impact of the transition from the current to future corporate structure and operating model, and support for the preparation of a regulatory licence application. The team consisted of subject matter professionals across multiple functional areas and geographies, working together to deliver an integrated approach.

Volcker Rule implementation

Our Spanish team assisted a Global bank with Volcker Rule implementation. Our highly-integrated team used a seamless global approach to create a strong central management function, core frameworks and processes. Critical success factors of the project included robust governance scaled to the size and complexity of the program, strong technical knowledge applied consistently across all aspects of the program, and proactive issues/risk socialisation and resolution with key executive stakeholders across all impacted areas of the bank.

"The global team expedited execution in a shorted timeframe without compromising quality of results by working closely with all key stakeholders globally including legal, risk, compliance, and the business to meet all key program objectives in a timely fashion."

Arturo Derteano Maraña
EY Spain
Partner, Performance Improvement Advisory

A design of a cross-border bank merger

Advising a bank in Germany on the design of a 'Eurobank'. Our Regulatory professionals from across Europe worked with the bank to assist the cross-border merger of their other European subsidiaries. The team prepared their business plan for the new combined entity, including regulatory figures, provided advice concerning the operational integration of the merged entities and managed an intricate relationship with the regulator.

"*Our European Financial Services business helped the bank navigate multiple markets in creating in a fully integrated pan-European model.*"

Dirk Auerbach
EY Germany
Partner, Assurance

Tax restructuring in the Netherlands

EY assisted a client in evaluating various restructuring scenarios to replace a UK financial institution with a Eurozone entity, in order to retain EU passporting rights. The advice included regulatory guidance on how the EU and local bonus-cap rules would apply, assessing the corporate tax implications, and understanding employee taxation for short term business travellers with respect to UK residents.

"Here, we used an EU-wide team to provide understanding of local tax and regulatory rules, as well as our People Advisory Services in providing advice on movement of labour, international travel, and employee tax."

Ton Daniels
EY Netherlands
Partner, Business Tax Advisory

Operation restructuring in France

EY supported a leading French bank in restructuring the operations of their personal finance business across six countries in Eastern Europe. We worked with the client to design the legal operations and analysed the resulting tax implications, creating an implementation action plan. We designed a target model and performed transfer pricing analysis to ensure key stakeholders in the central project team and local business teams across Europe had a clear understanding of the tax constraints and opportunities.

"This engagement took full advantage of our network of professionals across the EU, allowing us to freely operate cross border, combining numerous areas of expertise such as tax, legal, operations, and strategy."

Matthieu Dautriat
EY France
Partner, Business Tax Advisory

Brexit experience - Inbound bank

EY conducted a revenue analysis across the business in order to identify the 'at risk' revenues which relied on access to EEA clients. From this, we provided legal and regulatory guidance on how the client could protect its 'at risk' revenue by retaining access to the EU via a European subsidiary. EY built a target post-Brexit operating model and target business model, provided recommended booking model and legal entity structure, and answered 80 regulatory, legal, political, and tax questions related to Brexit. We helped the client create a two year Brexit plan allowing them to take no-regret actions and be prepared for the impact of Brexit in April 2019.

"Through leveraging our regulatory, tax, and government experts from across the EU, we are able to provide timely and detailed advice to clients on how best to respond to Brexit, both in terms of immediate location assessment and wider strategic planning over the coming months of uncertainty."

Pierre Pourquery
EY UK
Partner, Capital Markets Brexit Leader

7. Contacts

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Notes

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About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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EYG No. 01540-174Gbl
ED 0133

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