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CloserLook

Brexit: What now for US investment managers?

The world turned upside down?

The decision by voters in the United Kingdom to exit the European Union, known as “Brexit,” was a surprising one: prognosticators in the days leading up to the vote assigned a fairly low probability for the “leave” supporters to come out on top.[1] Additional uncertainty related to the potential for additional EU member nations to seek an exit, or even for constituencies within the UK to seek their own path with respect to the EU, have the potential to further complicate an already challenging situation.

Financial institutions in the UK and Europe will bear the brunt of this event over both the short and longer term, as the timetable for full separation will take two years following invocation of Article 50 of the Lisbon Treaty. What about their counterparts in the United States? Some very large US firms operate globally, with a meaningful presence in the UK and Europe. For them, the impacts are more direct and immediate. But many more US financial institutions are purely domestic, so the impacts of Brexit will be part of larger regulatory and economic forces that may emerge as the UK executes its departure.

In the remainder of this document, one of a series of reports, we will explore the implications of Brexit for the investment management business in the United States, looking at financial, regulatory, operational, and strategic considerations for US FSI executives. Those interested in understanding the impact of Brexit on other financial industry sectors are encouraged to review our companion pieces in this series.

[1] Justin Wolfers, “Brexit Hits U.S. Stock Market Harder Than an Election,” *New York Times*, June 24, 2016.

Implications of Brexit on US investment management firms

With the disruption Brexit has brought, uncertainty has hit the capital markets in such a magnitude that US investment managers have to address both short-term and long-term implications. In the short term, the perceptions of investors and their financial advisers must be priority one. After the first few weeks, as uncertainty and volatility in the capital markets transition to business planning and problem solving, investment managers can shift focus.

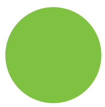
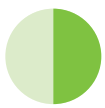
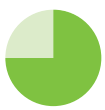
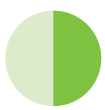
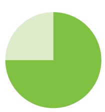
In this environment, relevant communication through distribution channels to investors, across all locations, is critical. One communication approach that can reassure investors and financial advisers alike is process-oriented. In this approach, investment managers describe the steps that their professionals are taking to manage all the portfolios through uncertainty, volatility, or opportunity in line with the long-term investment philosophy of the firm, especially those with European and UK exposure. Firms that manage these three factors with stability and professionalism through the market disruption phase of the Brexit are likely to be best positioned when the dust settles, as the initial turmoil transitions to the reality of managing regulatory and organizational change.

As the short-term volatility transitions to a long-term "new normal" for Brexit, investor and financial adviser communication can shift back to a pre-Brexit cadence. In this phase, the emotionally charged perceptions will have waned, and investment managers can shift focus to organizational problem solving. Firms will have to address investment strategy refinement, product registration implications, distribution structures, regulatory and compliance developments, and subsidiary jurisdiction, to name some of the major areas of effort. History has shown that UK business is adaptable and resourceful. These characteristics will be exercised over the coming months and years as the country navigates a period of great change.

In this phase, the uniqueness and complexity of each investment manager drives the amount of effort needed to optimally manage Brexit implementation. Simply put, the degree to which an investment manager operates globally, with varied and complex product structures, exponentially drives required effort to manage Brexit implementation. There is likely to be a strong difference along the product type dimension for Brexit impact. PE firms with European portfolio companies may present more complex business models to navigate through Brexit due to the nested nature of portfolio company operations, compared to hedge fund and mutual fund managers that steer clear of the operations of their portfolio holdings.

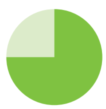
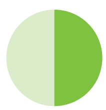
As of this writing there is one key fact; Britons have passed a nonbinding resolution to leave the EU. What happens next comes without recent precedent. Accordingly, there are still major structural uncertainties associated with Brexit, perhaps the largest of which is British membership in the European Economic Area (EEA), which affords UK firms the ability to distribute investment product across Europe. As with many governmental and regulatory changes before it, Brexit's true impact will develop over time as the details are hashed out between the UK and the governing bodies in the EU. The following table shows some of the top implications.

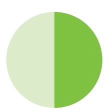
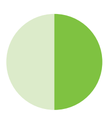
Areas of focus

Strategy and business model		
Implications	**Scale of impact**	**Likely impact on US investment management firms**
Splintered distribution structure		• Firms that distribute across the EU from a UK subsidiary face the largest potential impact as regulatory permissions shift from the EU umbrella to a new approach.
Strategic product review		• Firms may need to conduct product performance reviews through the initial disruption and post-Brexit product line changes.
Talent review covering territory and eligibility to work		• Given redrawn political lines, firms may need to validate that the right talent is in place, with potential organizational change compounded by visa and immigration changes.
Vendor review		• The financial and operational impact on vendors serving the UK and EU territories will need to be assessed.
Data and process review		• Enterprise processes (customer, trading, and regulatory) and data repositories for new cross-border regulatory compliance need to be reviewed.

Key: No impact Minimal Moderate Material High

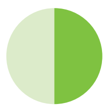
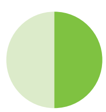
Areas of focus

Regulatory strategy		
Implications	**Scale of impact**	**Likely impact on US investment management firms**
Duplication of development		• Firms may have to maintain EU regulatory compliance while preparing for UK regulatory scrutiny.
Country-level coordination		• Asset managers face potential cost increases stemming from regulatory compliance with differing country level agreements for firms with centralized UK-based European operations.

Operations		
Implications	**Scale of impact**	**Likely impact on US investment management firms**
Increased operating costs		• Firms may need dual operations for European and UK operations.
Staffing risk		• Firms face the risk of securing appropriate talent for new or burgeoning satellite offices in UK or continental Europe.

Key: No impact Minimal Moderate Material High

Areas of focus

Contingency planning		
Implications	**Scale of impact**	**Likely impact on US investment management firms**
Ongoing political and governmental changes may lead to prolonged and exacerbated uncertainty		• Brexit vote may possibly be followed by other political shifts, necessitating preparation for significant changes in the EU operational climate. Among the considerations: • What does the British withdrawal mean for the remaining EU states? • Will the UK remain intact through these changes? • How will company risk be affected in the context of a new EU that could possibly shrink further?
Track implementation and provide input		• Utilize comment periods and lobbying opportunities to shape results during implementation.
Consider acquisitions		• Consider M&A opportunities to fill operational gaps on either side of the EU/UK divide.

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Contacts

Industry leadership

Patrick Henry
Vice Chairman
US Investment Management Leader
Deloitte & Touche LLP
+ 1 212 436 4853
phenry@deloitte.com

Deloitte Center for Financial Services

Jim Eckenrode
Managing Director
Deloitte Center for Financial Services
Deloitte Services LP
+1 617 585 4877
jeckenrode@deloitte.com

Author

Doug Dannemiller
Research Leader, Investment Management
Deloitte Center for Financial Services
Deloitte Services LP
+1 617 437 2067
ddannemiller@deloitte.com

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Rajan Chari, Partner, Deloitte & Touche LLP
Paul Kraft, Partner, Deloitte & Touch LLP
Peter Poulin, Advisory Principal, Deloitte & Touche LLP
James O'Riordan, Partner, Deloitte UK
Christopher J. Spoth, Managing Director, Center for Regulatory Strategy, Deloitte & Touche LLP

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Michelle Chodosh, Marketing Manager, Deloitte Services LP
Lisa DeGreif Lauterbach, Financial Services Industry Marketing Leader, Deloitte Services LP
Seth Raskin, Marketing Manager, Deloitte Services LP
Lauren Wallace, Lead Marketing Specialist, Deloitte Services LP

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