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# BREXIT AND FINANCIAL SERVICES

## THE NEED TO PLAN AHEAD

Britain's decision to leave the European Union will have a major impact on the global financial services industry, and not just for organizations based in the UK.

From a people perspective, two areas of strategic importance for the financial services industry are workforce implications and the impact of retirement liabilities.

First, workforce repercussions will continue to emerge as political fallout from the vote becomes clear. However, certain fundamental issues around workforce location require significant planning regardless of what happens next. Fortunately, most, if not all, regulated participants in the banking and asset management industry will already have robust contingency plans in place to deal with disasters and market disruption. In the face of tight regulation around operational risk, many will also have thought through the implications of Brexit in terms of evaluating alternative locations for their UK operations. Some will opt to stay, and some will opt to move elsewhere, but all market participants will be impacted in some way by the decision.

Skilled labor from EU countries makes up a large percentage of the workforce in the UK financial services sector, particularly in London. It's likely that restrictions will be placed on EU workers within the UK workforce, so companies should review their workforce plans. In an era of rapidly evolving business models in banking and asset management, especially the disruption coming from digital challengers and fintech, it isn't just traditional financial services expertise such as lending, portfolio management and compliance that are hard to find. New skills such as ecommerce, innovation and big data analytics are also scarce. Less freedom of labor movement makes it all the more critical for talent managers to access smart tools — such as workforce analytics and long-term strategic workforce planning — to future-proof the organization.

Attraction and retention strategies should also be reviewed, as the fundamental employee value proposition may have changed. The UK banking sector is also likely to seek changes in banking regulation, particularly as it affects pay. We may see an end to the bonus caps and other EU-sponsored controls, although the Financial Conduct Authority and Prudential Regulation Authority will want to ensure that the direction and spirit of the Financial Stability Board's requirements continue to be fully met in the UK.

For organizations that decide to move some or all of their business, relocating staff or creating entirely new centers of operations and trading outside the UK may be a complicated undertaking. Although dramatic exchange rate movements may make some locations more or less attractive in the short term, few organizations will be basing investment decisions on volatile market and asset prices. Relocation decisions are more likely to be based on external labor market fundamentals, which require in-depth analysis of key drivers such as local labor costs, current and future skills availability, comparative costs of living and employment legislation. For example, companies should be considering the impact of an end to reciprocity on state healthcare costs for foreign nationals across member states.

Robust internal and external data and insight is critical to inform the right decision. As well as undertaking external labor market analyses, human resources functions should be working closely with other support functions, such as finance, legal and compliance, to create taskforces that can understand the big picture. They should also partner with consultants, such as Mercer, that can provide valuable expertise and knowledge not available within the organization.

The second major people impact we see for financial services relates to the provision of retirement benefits for employees. As large employers in the UK, financial services organizations are responsible for a significant portion of the country's pension plans.

The funding status of traditional final salary or defined benefit plans feeds directly into the balance sheets of plan sponsors in terms of a potential liability. In financial services, regulated firms are also required to set aside capital to mitigate the balance sheet risk of such liabilities. As capital adequacy rules, particularly for banks, have progressively tightened under increasingly burdensome regulation, the risk-adjusted cost and the impact on the balance sheet of maintaining and managing defined benefit plans has spiraled.

Market volatility and uncertainty in the wake of the Brexit vote will also have a major impact on the value of plan assets set aside to meet future pension liabilities, consequently creating greater variability in capital costs. Financial services organizations may therefore need to accelerate plans to review and mitigate defined benefit pension liabilities and deal with asset volatility. It has never been more important for plan sponsors to work in partnership with plan trustees to arrive at sensible outcomes.

And it doesn't stop there. Defined contribution pension plans, in which the employee, not the employer, bears the risk of meeting future pension needs, will also be impacted by market uncertainty as the underlying investments in these plans fluctuate in value. Employers need to pay close attention to the impact on the financial wellness of employees who are depending on defined contribution plans to fund retirement. This may require a fundamental review of the overall employee benefits package and should certainly entail an appraisal of the intrinsic value employees perceive in their "total rewards," perhaps through the use of employee surveys. This is all the more poignant for financial services, given the tight regulatory system imposed on the cash element of total rewards in terms of fixed and variable pay.

Finally, communication on the part of the employer is critical to address the many concerns employees may have about Brexit. A communication strategy aligned to the overall business goals and objectives requires expert understanding of the issues involved.

**Financial services organizations should be making full use of the many internal and external resources available. Mercer is a leading consultant in advising financial services companies on managing their people issues. Our experts are ready to advise on any of the issues outlined in this note.**

For more information on how Mercer can help you navigate the complex issues and implications of the Brexit vote for the financial services industry, please contact:

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