



# Forging ahead

**UK-ASEAN business  
after Brexit**

September 2016



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# Foreword



**Karen Briggs**

Head of Brexit  
KPMG in the UK

**Britain is living through a moment that only comes along once or twice a century: a point when a country asks itself, “where do we want to go?” and even “what do we want to be?”.**

British voters set the direction when they voted to leave the European Union in June. But it will be the UK Government and the European Union that will ultimately decide the destination, after intensive negotiations in the years ahead.

In the meantime, business continues. The UK has confounded the gloomier predictions of economic crisis, so far. A swift political transition has settled markets and a rash of up-beat data has even led to talk of a ‘Brexit boom’.

This is certainly a moment of opportunity — both for the UK to look beyond Europe towards regions like South-East Asia — and also for businesses overseas to take a look at assets in the UK.

The coming period will be highly uncertain however. Clients in both ASEAN and the UK need to appreciate the risks and the political undercurrents at play, while still exploring the opportunities above the surface. We have written this report to help you navigate both those risks and rewards.



**Tham Sai Choy**

Chairman  
KPMG in Asia Pacific

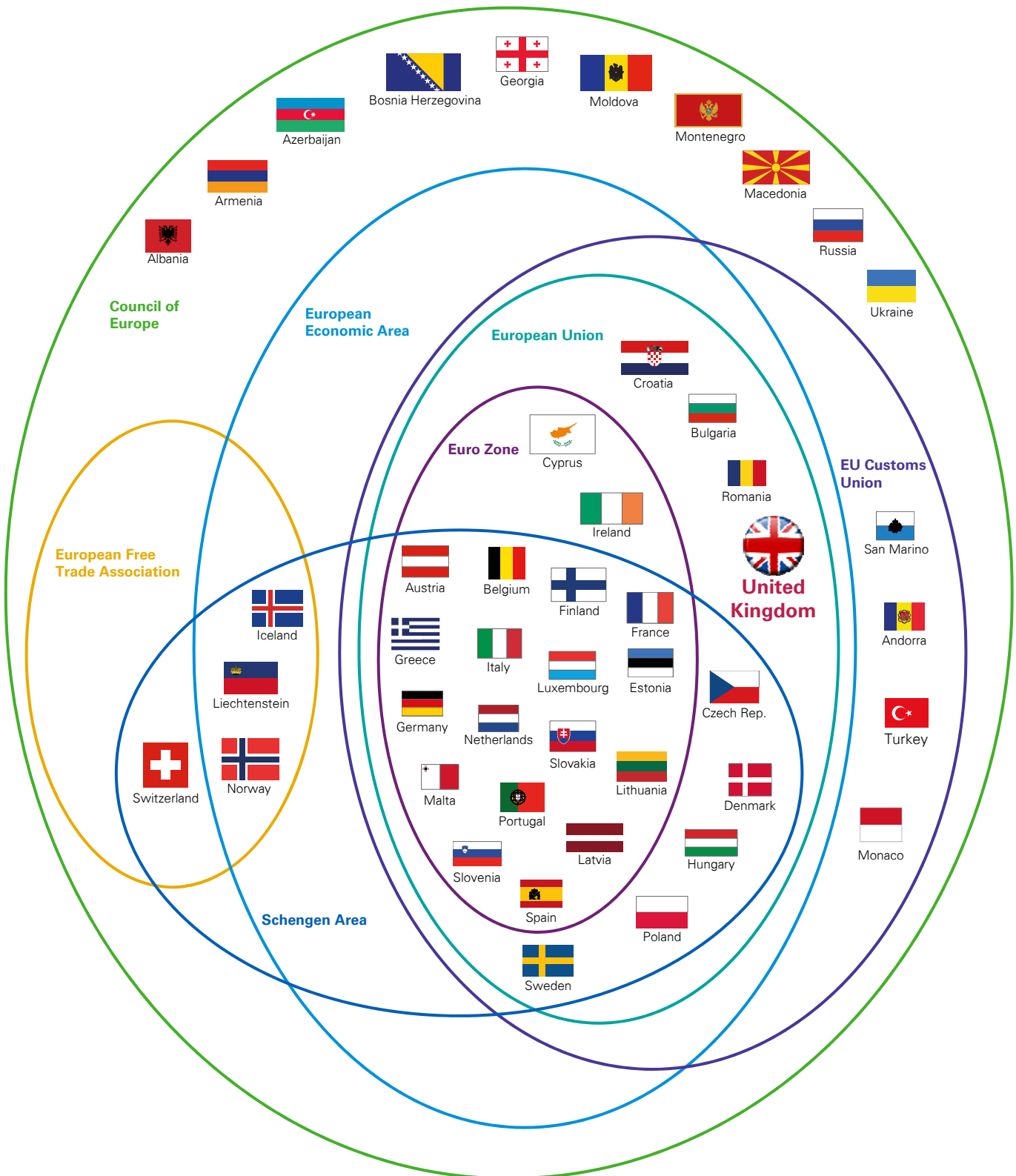
**For many years, the UK has been a close trade partner to South East Asia, and a critical entry point for that region’s businesses in Europe. So the uncertainty created by Britain’s decision to leave the EU undoubtedly complicates the equation for foreign businesses.**

While the UK is an important destination in its own right, it will have to consider how to re-position itself if it is no longer that springboard to the EU. Much hangs on talks between Brussels and London.

From the UK’s perspective, a rising ASEAN is an opportunity it cannot ignore. South East Asia is a diverse region in transition that is both a rich source of foreign direct investment and a burgeoning market. The ten-nation bloc is home to 600m people, a rising middle class and a young and well-educated population, which is bolstering the global workforce and delivering a demographic dividend to its economies.

The UK will now need to reformulate its ties with ASEAN countries. But with a common interest in furthering our mutual economic well-being, strengthening our historic links and building on the UK’s existing interests in the region, I am confident a new and stronger relationship lies ahead.

# The UK's current position in Europe



# 'Hard' Brexit' or 'soft' Brexit

## What kind of deal will the UK get?

'Brexit means Brexit' has become the cliché of the summer. But the pledge Theresa May made on the day she became prime minister now raises more questions than it answers.

Beyond taking the UK out of the European Union, what does Brexit actually mean? What kind of relationship does Britain want with the soon-to-be 27-member EU, and what are the chances it will get its wish?

If the UK could wave a magic wand, it would probably ask for something like this: Norway's access to the Single Market, Switzerland's flexibility on regulations, Iceland's control of its borders and Turkey's membership fee. Unfortunately, even the most ardent Brexiteer would concede that is nigh on impossible. That in turn means the government has some difficult trade-offs to make.

In fact, the question of what Brexit model to pursue is perhaps the most difficult any British prime minister has had to answer since the Second World War. Does the UK maintain something similar to the status quo — the so-called 'soft Brexit' route — and maintain close trading relations with its near neighbours, as Norway and Switzerland have done? Or does it effectively tear up the post-1973 settlement and seek a 'hard Brexit' that would cost it access to the world's biggest economic bloc but see it gain greater control over immigration, economic strategy and its trading relationships?

### Not Norway. Not Canada

Which way the UK goes is still up for grabs it seems. In a statement after the cabinet's first post-summer meeting, the PM's spokeswoman echoed a key 'Leave' demand by saying the new relationship with the EU 'must mean controls on the numbers of people who come to Britain'. David Davis, the new

secretary of state for exiting the EU, backed that up by telling parliament it was 'very improbable' the UK would remain in the Single Market. However, the prime minister has appeared to soften her stance in recent days and distanced herself from Mr Davis' comments.

What is clearer is the prime minister's determination not to be forced to adopt a cookie cutter model based on a previous agreement between Norway, Canada or Switzerland and Brussels. 'The model we are seeking is one unique to the United Kingdom and not an off-the-shelf solution,' Mrs May's spokeswoman said.

**Remaining members are splitting and coalescing into rival groups**

This appears to be part of an effort to change the language around Brexit and move away from the idea that the eventual deal must involve some trade-off between free movement and access to the Single Market<sup>(a)</sup>.

### One versus 27

If predicting the UK's negotiating position months or even years from now is difficult, guessing Europe's negotiating position will be harder still. The UK does not face a monolithic bloc. Based on analysis of European media and the public statements and meeting schedules of European politicians, we believe the union's 27 remaining members are splitting and coalescing into rival groups: the northern Europeans, an enlarged Visegrad Group to the east; and a Mediterranean alliance, led by France.

The Mediterranean group's principle aim seems to be preventing the contagion and disintegration of the Eurozone and the wider European Union. According to

this theory, they need to show that leaving the EU hurts — to make Brexit as painful as possible — to halt anti-EU sentiment at home and to stop other countries too. Countries in the northern bloc, which include Germany, broadly prioritise continued free trade and may be tempted to take a softer line with the UK to support exports. Lastly, the Visegrad will seek to protect their citizens in the UK. Poland for example might prioritise the rights of its estimated 790,000 of citizens living in the UK.

### Power plays

Ultimately, the settlement between the UK and EU will depend not just on the alignment of interests, but who holds most power and who needs a deal most. For instance, the EU-27 and UK are each others' most important trading partners. Proportionately however, while the UK relies on the EU to buy almost half its goods exports, only 16% of the goods the EU exports are bound for Britain. One-nil to the EU.

On the other hand, the UK is slated to pay £47.5 billion into the EU budget from 2016-2020. That would leave a major funding hole that remaining EU states might want help filling. The EU may also be very keen to do a deal. As political risk consultancy Eurasia Group explains on page 6, the EU faces serious challenges in the coming years linked to the Eurozone, immigration and other thorny issues. It may be some time before we get anything more than vague outlines of negotiating positions on either side.

**It could be some time before we get any more than the vague outlines of any deal**

# Euro crisis?

## How events across the Channel might affect Brexit



**Federico Santi**  
Europe Analyst, Eurasia Group



**The eventual shape of the exit deal Britain signs with the European Union will depend as much on the dynamics within the EU27 as any decision taken in London. That makes the course of political and economic events on the Continent vital in forecasting the outcome of negotiations.**

Here political risk consultancy Eurasia Group set out possible trajectories for the EU in the next two to three years — and the probability they ascribe to each scenario — before setting out what that could mean for the UK.

### Scenario and impact summary

#### 3. Upside scenario (10% probability)

EU and especially Eurozone states respond to Brexit by integrating more closely.

**Brexit impact:** EU leaders, free from the threat of further exits, are more likely to make concessions to the UK in negotiations.

#### 1. Baseline scenario (60% probability)

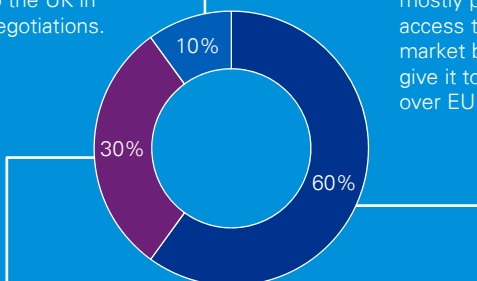
The EU does not fragment further, but is left vulnerable to the economic crises. Eurozone countries are particularly exposed.

**Brexit impact:** The UK can expect an agreement that mostly preserves its access to the single market but does not give it total control over EU migration.

#### 2. Downside scenario (30% probability)

Several states leave the euro.

**Brexit impact:** EU leaders take a harder line in Brexit negotiations, causing greater disruption to trade and investment in the UK. Some kind of deal is reached, however, and the UK is not forced to fall back on existing World Trade Organisation agreements.



### 1. Baseline scenario

*No more exits; 'shallow' integration (60% probability)*

In the run-up to French and German elections in 2017, and to a lesser extent afterwards, the EU27 take limited steps towards closer economic and political integration. Despite structural problems in the Eurozone, which get in the way of its ability to respond to economic crises, the integrity of the EU is sustainable unless it suffers severe economic or political shocks.

Eurosceptic parties hold on to recent gains, but it is unlikely they make a major breakthrough that leads to further exits. Brexit ensures EU referenda get more attention in several countries. But the likelihood of any actually taking place is low — only in a handful of countries, notably the Netherlands, is a UK-style referendum a remote prospect. Add to that stronger opposition, the very different contexts in those countries and the higher price of leaving (particularly for Eurozone countries), and the likelihood of another successful exit bid lower still.

### Brexit implications

In this scenario, EU leaders want to avoid making a positive example out of Brexit. However, they balance this against the damage a messy separation or no deal at all would do to trade and investment. This is particularly the case in states that are still economically fragile after the financial crisis.

An agreement based on the European Free Trade Association (EFTA), giving the UK more or less unfettered access to the Single Market, would look a lot like full EU membership. The UK would have to contribute to the EU budget and accept free movement and the primacy of EU law. This is not politically feasible for either side, but especially in the UK given likely opposition from Brexit campaigners and would be vulnerable to rejection in any referendum on joining EFTA. The EU-UK agreement is more likely to be an ad hoc, comprehensive free trade agreement that also covers services. The extent to which Britain's dominant services sector had access to the Single Market will be a one of the main issues in negotiations and will have a significant impact on the UK's long-term economic future.

Even the most extensive free trade agreements do not typically give access to services markets, but public support for the agreement in the UK will be contingent on it granting greater control over immigration. This trade off is likely to dominate the negotiations: the more control over immigration, the less access UK firms get to the EU services market.

Timing is critical. Negotiating a free trade agreement in the two years set by Article 50 is a huge challenge, on top of which exit negotiations have to happen simultaneously. Extending the time is equally tough because it requires approval by all EU parliaments. Some kind of bridge agreement is likely to be needed to allow the UK continued access to the Single Market until negotiations are concluded, but getting one is not a given.



## 2. Downside scenario

### *Fragmentation risks re-surface (30% probability)*

There's no immediate risk of other countries following the UK out of Europe. But despite the negative short to medium term impact of Brexit on the British economy, the vote to leave sets a precedent for Eurosceptic parties elsewhere.

Three factors fuel the risk of fragmentation:

- The challenge presented by refugees already in Europe with the possibility of new inflows from Syria and Turkey
- The increased likelihood and frequency of terrorist attacks in France and other countries
- A sputtering economic recovery

Against this backdrop, Eurosceptic sentiment in core EU member states and domestic political issues in a number of countries combine to block a quick and coordinated response to a possible future economic crisis.

Periphery Eurozone countries are especially vulnerable, especially Greece and Portugal. But Italy represents perhaps the biggest risk to Eurozone cohesion over the medium term. The country faces the possible collapse of its government after a referendum later this year, and the success of the Eurosceptic Five Star movement in 2018 elections. A Five Star administration wouldn't threaten Italy's euro membership directly, but would likely not be well received by the markets. Italy's economy would struggle to respond effectively to falling trade and investment.

More broadly, the EU would struggle to manage a new recession. If one or (more likely) several member states faced economic crises, bailouts, which are always a political challenge, would become even more testing, due to 'austerity fatigue' in periphery Eurozone members and 'bailout fatigue' in core states.

In a worst-case scenario these issues lead to the exit of one, or more likely, several member states from the Eurozone, the EU or both. A smaller but more economically and socially cohesive currency block is left behind.

### *Brexit implications*

This scenario has major repercussions for the UK. If Eurozone recovery falters, potentially to the point of triggering another recession, there is even greater reason to avoid the disruptions to trade and investment that would result from a collapse in the talks.

A new Eurozone crisis makes EU membership less appealing for non-euro EU member states. As the prospect of their own exit becomes less remote they have cause to be more lenient to the UK.

But Eurozone countries, Germany and France most of all, have much louder voices in the negotiations. In Eurozone countries, difficult negotiations about the internal Eurozone crisis use up political capital. The need to counter Eurosceptic sentiment at home means there is less incentive to grant compromises to the UK. In the end, EU and Eurozone membership is a more significant national interest for these countries than the potential losses in trade and investment with the UK.

In addition, the EU Parliament and Commission, both inclined towards federalism, are heavily involved in the process and

their desire to discourage further exits is reinforced in this scenario.

Overall then, a new EU crisis increases the risk that Brexit negotiations result in a less than optimal agreement. Although a breakdown in the process and reinstatement of the WTO regime would remain unlikely, the UK risks losing a greater degree of access to the EU Single Market, particularly on services. For instance, in addition to losing euro clearing licences, EU-based financial institutions could face losing passporting rights to operate in Eurozone countries.

## 3. Upside scenario

### *Deeper integration (10% probability)*

In a more positive but less likely scenario, the EU responds to Brexit with greater integration, particularly in the Eurozone.

French and German elections in 2017 could lead to better coordination between these two core Eurozone members. With the next round of elections far off on the horizon, the leadership of both countries has the political space to advance contentious reforms to EU institutions, buoyed by sustained economic recovery.

We could see this scenario if the leaders of these countries recognise the long-term, structural threat to the integrity of the EU posed by Brexit. They respond by strengthening EU institutions to ensure that the union can continue to deliver growth, can respond efficiently to future economic crises and can improve quality of life for the majority of its citizens.

Under these circumstances, the UK is less of an impediment to greater security and defence cooperation. Eurozone states can also take critical steps to resolve structural issues in the Eurozone's economic governance — most significantly, completing a banking union and instituting the capability to unleash a sizeable counter-cyclical fiscal policy at an EU level — where some states subsidise others in response to crisis. That might look like a more 'political' EU budget or mutualised debt issuance for example.

### *Brexit implications*

This scenario is not hugely different from the baseline in terms of its impact on Brexit negotiations, but is a little more beneficial for the UK.

Core Eurozone countries are potentially distracted by negotiations over advancing integration. But the scenario implies that the immediate risk of further exits is perceived to have receded, leaving EU leaders more inclined to make concessions to the UK (most significantly on free movement) to avoid damaging economic relations.

# What happened on 23 June?

## Some thoughts looking back



**Rachel Hopcroft CBE**  
Head of Corporate Affairs,  
KPMG in the UK

**Most people thought the vote would be tight, but that the Remain camp would edge it. So the shock the morning after was palpable — on both sides. Even Boris Johnson — one of 'Leave's chief campaigners and now foreign secretary — reckoned Remain had it as the polls closed.**

That shock has morphed into other, more complex, emotions as time has gone on. On the Remain side, mainstream and social media reflected people's sense of personal crisis and despair at Britain's future. Revellers at Glastonbury — the weekend after the vote — were said to be as gloomy as anyone could remember at the music festival.

For just over half of the electorate who voted to leave, there was a sense of liberation — that Britain was casting off a distant and unaccountable institution. The 'freedoms' that Remain had campaigned on — to work, travel and trade with Europe — were precisely the freedoms that many Leave supporters had never felt in the first place.

Leave supporters felt empowered — that they were finally being listened to. Among them were the four million who had voted for the United Kingdom Independence Party (UKIP), at last year's general election, but who were left with one MP under Britain's 'first past the post' system. In a vote where every vote would count, the turnout in areas favouring Leave was extremely high by historical standards.

So as much as this was a vote about Britain's membership of a 28-nation grouping designed to promote free trade and

cooperation, it was also a protest on behalf of 'ordinary people who felt left behind'. Indeed, Theresa May's first speech on the steps of Downing Street focused on how her government would defend the interests of ordinary people.

And if there is one issue that motivated this group more than any other, it was immigration. Academics and newspaper pundits have made much of demographic trends in the vote — old 'Leavers' versus young 'Remainers'; the north for 'Out' and the south for 'In' (in fact Scotland was strongly in the Remain camp and the south of England voted to leave just as much as northern areas of England). But through divisions of class, region and age, immigration came through time and again as a unifying factor for Leave voters. 'Take back control' — of both Britain's borders and a perceived loss of sovereignty to Brussels — was the most resonant slogan of the campaign.

**Leave supporters felt empowered – that they were finally being listened to**

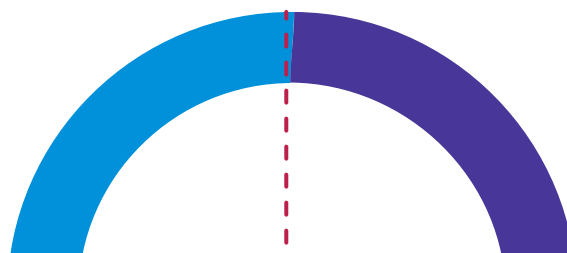
Recent governments have certainly struggled to get a handle on the immigration issue, missing their own immigration targets. The Remain camp then failed to effectively counter the charge that higher levels of immigration lay behind a shortage of school places, longer-waiting times to see doctors and the rising cost of housing — all issues that have as much to do with a failure of supply as sky-high demand.

And then there is the fact that Britain has just never been that 'European' in the first place. That was always General De Gaulle's point in arguing against British membership of the Common Market in the 60s. Perhaps he was right. Research from the London School of Economics shows the UK has consistently been the most Eurosceptic of all the European nations over the last four decades.

For 43 years, Britain has sat reluctantly inside Europe wondering what life might be like outside. It will be interesting to see if attitudes change now that we find ourselves outside, looking in.

### UK votes to LEAVE the EU

Leave  
**51.9%**  
17,410,742 votes



Remain  
**48.1%**  
16,141,241 votes

Electorate 46,501,241

Turnout 72.2%

<http://www.electoralcommission.org.uk/find-information-by-subject/elections-and-referendums/upcoming-elections-and-referendums/eu-referendum/electorate-and-count-information>



# The economic impact: A new dawn breaks



**Yael Selfin**

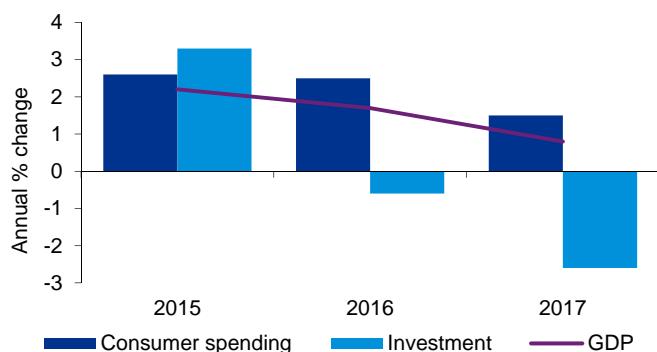
Head of Macro Economics,  
KPMG in the UK

**The EU referendum result will trigger changes to the UK economy. In the short term, uncertainty and concerns over the nature of future trade agreements will see the economy weaken. The medium and long-term prospects of the UK economy will depend on a range of policy decisions.**

The prime minister has already announced that, faced with the new challenges ahead, previous fiscal targets will be abandoned. This should see stronger government spending in coming years, though concrete plans may not materialise until late in the year.

The uncertainty around the shape of Britain's exit, and the prospects of a smaller internal market for those companies based in the UK are likely to hit investment hardest (see chart below).

## Prospects for UK GDP



Source: ONS, KPMG.

Consumer spending may also falter, while exports should benefit from the lower pound and add some momentum to growth. Overall, this could see UK GDP growth easing to 1.7% in 2016, before a further decline to 0.8% in 2017.

The pound is expected to remain low and volatile in the short term, perhaps falling even further than the sharp decline we've already seen since the referendum results, causing a significant rise in inflation in coming months.

## Alternative scenarios

The uncertainties surrounding the current outlook are almost unprecedented. A lot will depend on the path the new government decides to take, as well as on the actions of businesses and households as more information emerges in regards to the exit arrangements.

The Brexit vote has put increasing pressure on the UK government to address net migration and meet its 100,000 target. A fall in net migration will have a larger proportional impact on the labour force than on the overall population because migrants have higher labour market participation than the wider population. It is still unclear how far and how fast the government will move to address migration concerns expressed during the referendum. Our stress scenarios incorporate some of these possibilities, together with assumptions about further changes to the exchange rate and risk premium.

**Our first stress scenario** sees consumer spending fall and investment declining more sharply. Government spending picks up slightly and exports remain strong, but together they are not enough to offset the shortfall in demand, and the UK economy grows by 1.2% in 2016 before contracting by 0.7% in 2017. This stress scenario is somewhat akin to the performance of the UK economy in the early 1990s.

**Our second stress scenario** sees an even sharper contraction in investment and a more acute retrenchment by consumers. Export performance disappoints despite the weaker pound, although imports are also curtailed thanks to softer domestic demand. A significantly weaker economy puts further pressure on government revenue, leaving it with little room for additional spending to boost the economy. The worsening environment sees the economy grow by only 0.8% in 2016, before contracting by 4.8% in 2017. This stress scenario represents a much more significant setback to the economy, with overall economic performance broadly akin to that experienced in the Great Recession of 2008-9.

# Article 50: How the UK's exit mechanism works



**Catherine Barnard**  
Professor of European Union  
Law University of Cambridge

**Once an obscure provision in the 2009 Lisbon Treaty, Article 50 is now centre stage in the Brexit debate as the rulebook by which the UK will leave the EU. The man who wrote it, former Italian Prime Minister Giuliano Amato, said he never intended it to be used. It was meant to be a 'classic safety valve'. Its 256 words now hide a myriad of legal questions and uncertainty.**

Some things are clear however, in particular that the decision to withdraw from the EU must be made in accordance with the UK's own constitutional requirements. But what are these? The prime minister says it's her decision to start the process to leave the EU, using her 'prerogative' or executive powers. Others argue that an Act of Parliament is required since the decision to start the Article 50 process goes to the core of the UK's membership of the EU. These questions will be examined in an important case going to the High Court in October and then on to the Supreme Court in December.

There's a further issue about Scotland and Northern Ireland, both of which voted to remain in the EU. What say will these nations have in the process?

## When to press the trigger?

This domestic debate is proving contentious because the EU wants the UK to get on with triggering Article 50 so that the highly complex divorce process can begin. The delay and uncertainty is damaging for the EU, distracting it from other pressing issues such as the Eurozone and the migrant crisis.

For the UK, the delay is necessary practically, politically and legally. Practically, to allow time to set up its new Brexit department and to work out what exactly it wants from the negotiations. Politically, because elections in France and Germany next year may usher in new heads of state with different agendas regarding the UK. And legally, because once Article 50 is triggered there are just two years to complete the negotiations (when Greenland left the EU, exit negotiations took three years, and this for a sparsely-populated country with only one big issue to resolve — namely fish). The two-year period can be extended, but only by the unanimous agreement of all 27 states, thus putting the balance of power in the hands of the EU.

For these reasons, it is thought Article 50 will not be triggered until January 2017, and could even be delayed until Autumn 2017, after the French and German elections.

## 'A disorderly exit'

As to the divorce negotiations themselves, failure to reach an agreement within two years (and no extension) will mean a disorderly exit from the EU. This would be unwise, given the vast range of issues at stake (such as long-term research funding, the status of EU nationals living and working in the UK and moving UK-based EU agencies across the Channel).

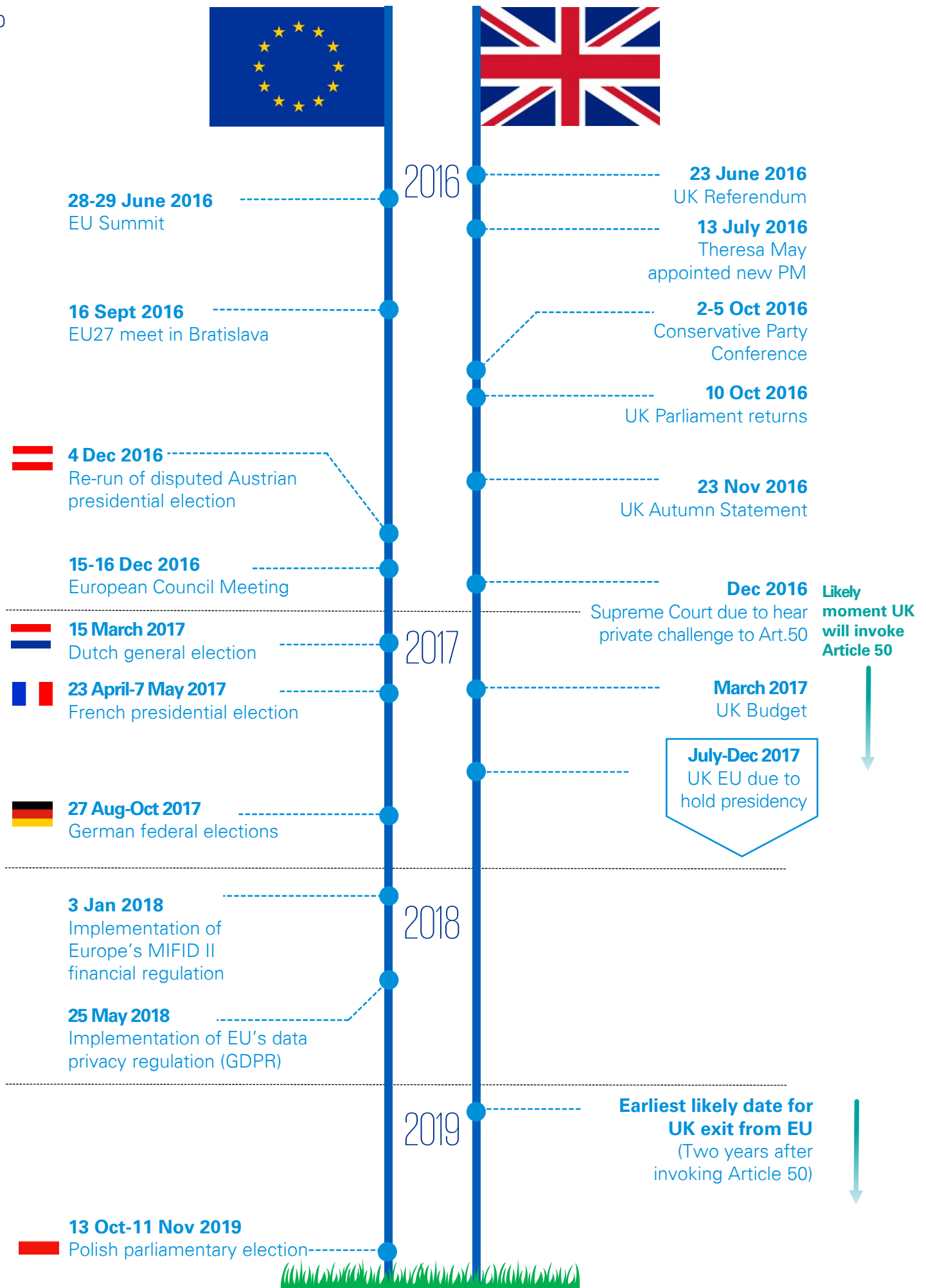
**The delay and uncertainty is damaging for the EU, distracting it from other pressing issues such as the Eurozone and the migrant crisis.**

**For the UK, the delay is necessary practically, politically and legally**

It is one thing for member states to agree to the divorce agreement by a 'qualified majority' decision. It is quite another for the parties to agree the future shape of the relationship between the UK and the EU. Article 50 is virtually silent on the latter. It merely says that the arrangements for the UK's withdrawal should take account of 'the framework for its future relationship with the Union'.

Article 50 thus imposes no obligation for there to be a future relationship. If there is to be one, the form that might take is subject to heated debate. And any future relationship may need to be decided by unanimous agreement in the Council of Ministers together with the agreement of up to 38 national and regional parliaments.

If the UK were to change its mind, Article 50 makes no provision for the process to be stopped. But the majority view is that the divorce does not become final until the agreement is reached; there is time for a rethink. However, the current political debate suggests that Article 50 will be triggered sooner rather than later and that the UK is heading for the door.







Trade ties

# The UK-ASEAN opportunity



**Stephen Ball**

Lead Partner, UK-ASEAN  
Business, KPMG in the UK

**To many in South East Asia, Britain's decision to remove itself from the world's largest economic bloc looked like a self-inflicted wound. Whether illogical or inspired, nerves in ASEAN have calmed since the vote. Warnings of economic catastrophe failed to materialise — so far at least — and governments in the region such as Singapore have said Brexit's economic impact on them is likely to be modest in the medium to long term. That seems like a fair assessment to us.**

Yes, companies in ASEAN need to examine the implications of a potential loss of access to the Single Market via subsidiaries in the UK. However, they should also consider the potential upside of new trade deals between the UK and ASEAN states as a result of the UK's new-found status.

## UK hungry for trade deals

With its relations with Europe thrown into doubt, the UK will be keen to develop deeper relationships in the region. It can build on its historic ties with Singapore and Malaysia and also much of the groundwork laid by David Cameron. The former prime minister was the first European leader to visit Myanmar after the start of its return to civilian rule, and led a trade mission to ASEAN last year.

The UK has much to gain from closer relations. Right now, its businesses do more trade with Belgium — a country of 11 million people — than Indonesia, Malaysia, Vietnam and Singapore combined. The opportunity cost will be even starker in 10 or 15 years' time: by 2030, ASEAN is projected to be the fourth biggest market in the world after the US, EU and China and should deliver more than \$2 trillion in new consumption by 2020 according to the IMF. Already its middle class is estimated to stand at 300 million.

The UK's new Department for International Trade under Liam Fox will want to conclude free trade agreements (FTAs) quickly — once it is free to do so outside the European Union. That is likely to mean doing deals with individual ASEAN states, not the association itself based on the experience of the EU,

whose own efforts were frustrated before it pursued individual bilateral agreements. Still, an EU-ASEAN FTA remains long-term goal for the EU and the FTAs it has signed with Singapore and Vietnam now set the benchmark for the rest of the region.

We would expect London to focus on fast-growing Vietnam, Indonesia — with its 256 million citizens — and the UK's traditional partners — Singapore and Malaysia. Singapore is the UK's largest trading partner in the region and the agreement the EU has already struck there (that should come into force in 2018 or 2019) could prove a useful template to accelerate a trade deal with the UK too.

## The feeling's mutual

South East Asian nations are also likely to be keen to engage with London. While FTAs with the EU will remain a higher priority in most ASEAN capitals, an agreement with the UK could serve them in a number of ways.

A Britain independent of the EU may do away with the non-tariff barriers and other regulations that Asian exporters currently contend with. The UK should also be a nimbler negotiating partner rather than a bloc of 28, which must get signoff from each member state in order to ratify. Malaysia's prime minister has already said he sees Brexit as an opportunity to improve relations, especially in trade and investment.

At the same time, ASEAN states could look to gain from the UK's weaker negotiating position without the heft of the EU's internal market behind it. So too the fact that it lacks enough experienced negotiators. Lastly, they know that the UK may need them more than they need the UK: Asia took 16.3% of British exports last year, while the UK didn't rank as a top 10 trading partner for any major Asian nation<sup>(a)</sup>.

At a political level, there is greater will for trade deals in the region where perhaps there wasn't two years ago. Talks to conclude the Trans-Pacific Partnership trade deal — to which ASEAN members Malaysia, Vietnam, Singapore and Brunei are parties — has changed the conversation, adding to the sense in these countries that trade is core to their growth story.

Lastly, we should not discount completely the political and historic role Britain has played in the region, nor its status on the world stage. The UK is still the world's fifth largest economy, a member of the UN Security Council and a military player in the region. Privately, a trade deal with the UK would be seen as a feather in the cap in many parts of the region. Meanwhile for the UK, it would send a useful signal that it was re-emerging as an independent player on the world stage.

# The UK-ASEAN opportunity

## Start with Singapore

We know that a bilateral trade agreement between the UK and ASEAN is highly ambitious given its historic record.

The UK would probably hit some of the problems the EU experienced — namely ASEAN members' differing levels of economic development and EU objections to the human rights situation in some countries. ASEAN has also only signed six bilateral trade agreements — none with countries outside the region. Its agreement with Australia and New Zealand took nearly 20 years to come into force.

Singapore then is the obvious partner for the UK to talk to first. The two countries have strong relations and are Commonwealth partners.

Singapore has an open stance on free trade and already has 20 FTAs, in addition to the soon-to-be ratified agreement with the EU. The EU deal is particularly useful: the UK could ask the Singapore Government to duplicate the existing EU deal — with a few minimal changes — and fast-track legislation. Starting from scratch, it might take eight to nine years to reach agreement.

Given how long a full FTA might take, what steps could the two sides take to deliver some market access a lot sooner?

First, the UK and Singapore could look at **Trade and Investment Framework Agreements (TIFAs)** which provide strategic frameworks and principles for dialogue on trade and investment issues and serve as a forum to meet and discuss issues of mutual interest.

Meeting at least once a year, the senior-level conversations typically cover issues such as market access, labour, the environment, protection and enforcement of intellectual property rights.

Second, the two could look to sign a **Bilateral Investment Treaty (BIT)** programme. Their basic aim is to protect foreign investments in countries where investor rights are not already protected through existing agreements, encourage market-oriented domestic policies and support international legal standards to support these objectives.

## London back on ASEAN's flight plan

### Asia House

After a hiatus before the referendum and immediately after, we are now starting to see South-East Asian ministers coming to London once again. These visits are a sign that, at the very least, ASEAN states are willing to engage with Britain.

Still in question however, is the longer-term impact of Brexit on the UK's engagement and ambitions with ASEAN and the member states. Businesses have noted positive early signs while they wait for more formal policy announcements.

The broad network of businesses we talk to appear to welcome the new Department for International Trade (DIT) as a vehicle that can place ASEAN among the UK's priorities.

However, they also worry the UK may revert to a position of 'benign neglect' towards the region, which they feel was the case prior to David Cameron's 2012 visit to the region. That concern is fuelled by DIT's apparent focus — thus far — on trade ties with Britain's traditional English-speaking partners, plus the big Asian economies of China, India and Japan.

In terms of protecting their interests in Europe, a number of our corporate contacts in the UK have already approached government departments to make their case, in particular stressing the importance of continued UK access to EU markets.

Overall, we believe ASEAN should view Brexit as an opportunity. Yes, the UK is in uncharted territory, but with that comes room for manoeuvre and a chance to deepen ties.

*Asia House is the centre of expertise on Asia. It drives economic and political engagement between Europe and Asia by providing a forum for decision makers, business leaders and opinion formers to engage in high-level discussions that direct.*





# Sector perspectives



# Investing in UK Plc



**Maggie Brereton**  
Partner, Deal Advisory,  
KPMG in the UK

## With the fall in the value of sterling and decreasing company valuations post Brexit, many are expecting UK plc to become targets for overseas buyers.

Strong British companies now trade at significantly lower valuations, even though the fundamental qualities that make that company and its products attractive to consumers, like strong brands or unique technology, have not changed.

Companies on the FTSE350 index with a mostly UK-focused business have suffered particularly. The opportunity for overseas buyers is clear, however converting that opportunity is not always straightforward. The UK takeover process is unique and bidders need to be well prepared and aware of the complexities in the rules.

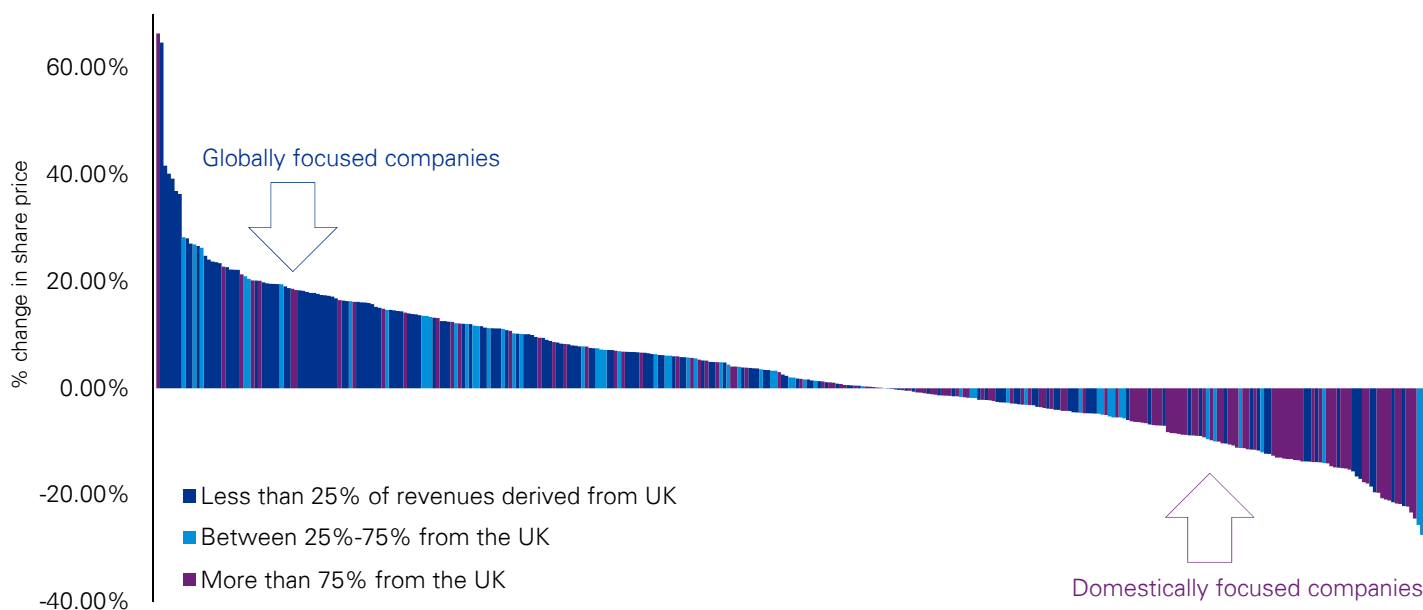
Over the past few years, the number of takeovers of publicly-listed firms has steadily risen, and though domestic deals and purchases from North America predominate, in recent years Japanese buyers have moved in. The £24 billion takeover of ARM Holdings Plc by Japan's Softbank was a highly significant transaction just after the Brexit vote.

So how difficult is it to take over a UK plc? All are subject to the 'Takeover Code' and regulated by the UK Takeover Panel, and that code has changed significantly, and in my opinion, got tougher in the past five years. Companies need to pay extra attention to what they do in the lead-up to deal. The panel's has also extended its remit to oversight of the post-deal space. For example, the panel now have the power to make sure a company has to honour any undertaking it makes before a deal, about life afterwards such as not closing a factory or laying off staff. So what companies say in the run-up to an offer is particularly important.

It can feel like the rules are onerous at first glance, but at their heart their central objective is to make sure all shareholders are treated fairly in takeover bids. Tough rules also provide a competitive advantage for some by discouraging others that might not have readily-available funds for example.

The underlying fundamentals for British companies remain in place. We expect to see many more approaches for UK plcs in the coming months as suitors capitalise on lower share prices and sterling's weakness.

## Performance of FTSE350 from 23 June to 30 August



# Tax and the impact on foreign companies



**Tim Sarson**

Partner, Tax Effective Value Chain,  
KPMG in the UK

**Fiscal matters lie at the heart of the EU and a Brexit will have potentially significant implications for multinationals doing business with the UK. From a tax perspective, they need to consider three areas: customs, VAT and corporation taxes.**

## Customs

The EU is a customs union with no duties inside. Member states share common external tariffs with third countries.

Until the two sides negotiate Britain's exit, we don't know what the tariffs and non-tariff rules will be, either between the UK and EU or between the UK and the rest of the world.

However, on paper one of the big draws of Brexit for the UK might be its ability to negotiate free trade agreements with other groups on potentially more favourable terms than it might get as part of the EU. That might include arrangements with the Commonwealth (of which Singapore, Malaysia and Brunei are members) as well as ASEAN.

It is unlikely the UK would change significantly the customs duties on imports from outside the EU. Nor would we expect to see the UK introduce substantial duties on imports from the EU. However, it's still not clear what terms the EU or the rest of the world would be willing to offer UK businesses. That will in part depend on how quickly new trade agreements can be negotiated with the UK's major trade partners. Given the expected growth of ASEAN over the next few years, it is reasonable to expect negotiations over a free trade agreement with ASEAN will be high on the UK Government's agenda.

## VAT

Brexit will restore the UK's right to alter its VAT after four decades of harmonisation inside the EU. That gives the UK Government the option to radically overhaul the rules. In practice it's unlikely to change much. VAT contributes a

sizeable chunk of Britain's tax income and we can't see any major advantage in moving much from the existing EU-derived system, except perhaps to create further exemptions or rates in some cases.

One tangible consequence though is that companies would probably face 'import' VAT on goods entering the EU from the UK and vice versa. Ultimately, that could create an unwelcome cash flow cost between paying for the goods and recovering the VAT.

**Plans to cut the corporation tax rate to show Britain is 'open for business', but by 2020 it will still be the lowest rate in the G20 at 17%**

## Corporate Tax

The UK acts as a foreign direct investment gateway into the EU and it is estimated that half of EU headquarters of third party multinationals are based in the UK because of a number of favourable domestic tax rules, its extensive double tax treaty network and its EU status.

The new chancellor, Philip Hammond may have scrapped his predecessor's plans to cut the corporation tax rate to show Britain is 'open for business', but by 2020 it will still have the lowest rate in the G20 at 17%.

In light of Brexit many investors will understandably wish to assess the tax impact of continuing to use a UK holding company structure. However, overall, we would expect most would conclude that Brexit would have little or no impact on their group corporate tax position. In most cases, the UK's bilateral tax treaties with individual member states mimic favourable arrangements within the EU.

Brexit may therefore offer the UK an opportunity to introduce (or reintroduce) tax measures that EU rules bar them from adopting. For example, the European Court of Justice of the EU has become increasingly proactive in curtailing member state laws where it perceives them to discriminate or be akin to state aid. Recent outcomes of the Commission's enquiries into multinationals tax arrangements are an example of this.

That said, if the UK diverged substantially from the EU system, that might make it less attractive to inward investors and reduce its leverage in negotiations with the EU. We don't see big changes in the short to medium term after a Brexit.



# Financial services: City will endure but Europe risks losing out



**Giles Adams**

Partner, Regulatory Compliance,  
KPMG in the UK

**For almost three months, debate about the future of Britain's finance sector has centred on 'passporting' — the question of whether banks in the UK can sell services into Europe after Brexit. This is as much an issue for foreign banks using London as their European gateway as British institutions.**

So what would happen if the UK did lose its passporting rights? And how would that loss affect the ASEAN region, its banks and businesses?

Right now, the message to Europe's political leaders from the UK's finance sector and its customers across Europe seems to be unanimous: 'no change please'. The City of London is the lynchpin in Europe's financial system. Whether a Spanish corporate is looking to issue bonds or an Italian manufacturer wants to insure operations around the world, London is where that tends to happen. Seventy eight percent of Europe's foreign exchange activity and half its fund management takes place in the UK for example .

## Europe needs the City

The City is an ecosystem that is impossible to replicate: a place where bankers, brokers, lawyers, accountants, advisers, fintechs, funds and intermediaries meet, speak a common language and operate under a trusted legal and regulatory framework. Europe needs the City just as much as the City needs Europe.

Despite that, political considerations on the Continent and the ambition of some to develop their own finance sectors at the expense of London may thwart access from the UK. Axel Weber, UBS Chairman and former head of the Bundesbank, has cautioned against such an approach, saying competition between Rome, Paris, Madrid and Frankfurt may simply push global players to set up elsewhere.

This is the danger for Europe — and the opportunity for Asia — especially for cities like Singapore. Big global banks are not making huge profits in Europe in the first place. While Europe's top banks struggle to meet targeted return on equity (ROE) and are working hard to meet higher capital requirements and

trim back, well-capitalised Asian banks are surging ahead. Global players may be tempted to skip Europe altogether and relocate capital eastwards.

## Prepare for the worst

So even if logic dictates the continuation of a free and open system with London at its centre, companies need to prepare for the worst. That is why financial services institutions are already making contingency plans based on the full gamut of possibilities from negotiations. Banks and other players in the sector are looking at their options and when they might need to trigger those plans. That includes how they might need to relocate some staff to Dublin, Paris and other EU cities rather than wait for a deal to emerge.

There is time — at least two years — however. Gaining the necessary regulatory approvals in other jurisdictions is a lengthy process and no institution should risk finding itself without a licence to trade.

There may yet be a way that firms in the UK can sell into Europe without the passport. Europe's MIFID II regulations, which take effect in January 2018 (before the UK is due to leave the EU), grant financial institutions outside the European Economic Area the right to sell financial services inside it — as long as that country's regulations are deemed as 'equivalent' to its own. As the UK's rules will be the same as the EU's when it exits, it would be difficult to argue the UK does not qualify, at least initially.

## Kept calm. Carried on

Whether or not that happens and irrespective of Brexit, London will remain at the centre of the global financial system. Yes, the referendum is a major challenge to the UK's financial sector, but we should not forget that most of its business - domestic, European and global — will continue to course through the City unaffected.

This fact was perhaps reflected the day after the Brexit vote and the story that didn't break on 24 June: there was no market dislocation or a repeat of the chaos we saw in 2008. The Bank of England's steady hand, and a similarly mature response from authorities across Europe and the Federal Reserve, maintained stability.

In the next few years, Britain's finance sector will need that solidity as it faces a challenge of extraordinary complexity in untangling itself from Europe's financial system. Nevertheless, its primary domestic and global role remains undimmed: to serve as an vital source of credit to facilitate the functioning of the wider economy. I have no doubt it will meet that challenge and continue to be a dependable centre of trade finance and foreign direct investment for both South East Asia and Europe.

***78% of Europe's  
foreign exchange  
activity and half its  
fund management  
takes place  
in the UK***





# Real Estate: A welcome market correction



**Stephen Barter**

Chairman, Real Estate Advisory,  
KPMG in the UK

**UK property stocks and real estate funds suffered as news from the referendum count rolled in. Some investors rushed to withdraw their money, causing several funds to suspend redemptions. But while that story grabbed the immediate headlines, most investors have been far more level-headed in their reaction. Soon after, most suspensions were lifted, and it seems likely some investors were switching from real estate funds to over-discounted property shares — not exiting the sector all together.**

Since then, stability has started to return, helped by Theresa May's swift appointment, support from the Bank of England, and a recognition that Brexit is unlikely to trigger any substantial credit crunch or market crash.

If anything, the Brexit decision led to a welcome correction for UK real estate, both residential and commercial. Prices for both sectors eased around 10% to 15% — accelerating an existing trend of cooling transaction volumes, particularly in London. That cooling should help to sustain a cycle, which had appeared to be overheating, right through to 2018.

## Opportunity knocks

The pound's dip to around \$1.30 — an almost 15% devaluation — has delivered a significant further win for overseas investors. Combined with lower pricing, foreign investors can snap up property for up to 30% less than a couple of months earlier. Suddenly the UK market offers better value than in three or four years.

We have seen some opportunists respond. For example, a client closed the funding of a West End development to an Asian investor, the week after the referendum, firmly at the pre-Brexit price. But so far, many are in 'wait and see' mode, at least during the summer lull. So are people right to hover on the sidelines?

In some respects, Brexit has helped the market. The Bank of England cut interest rates in August and it has signalled they

will be lower for longer. This will help to underpin asset prices. Bond yields have similarly slipped to all-time lows. That means that with property yields moving out, the spread between property yields and 'risk-free' government bonds is the widest it's been for several years.

The Bank has also signalled its willingness to support lending by providing liquidity to the market. Although lending terms have inevitably become a little more expensive, there are few signs of banks withdrawing from the market and they remain well capitalised. Meanwhile demand from investors is strong.

The economy remains stable, despite gloomy predictions of an immediate meltdown after an 'out' vote. As Yael Selfin sets out on page 8 of this report, GDP growth is expected to slow to below 2% in 2017. We don't see inflation becoming a concern, despite the exchange rate devaluation, not least while oil remains sub-\$50 a barrel.

While some developers may slow the number of projects in the pipeline, most will want to take full advantage of lower land prices. Most have low gearing, so there is little chance of damaging exposure there.

## Questions over the City

The big question mark remains occupational demand, particularly for London offices and in financial services. The extent to which financial institutions will need to base more people in the EU — and less in London — will depend on the course of EU-UK negotiations around issues such as passporting and bank settlement. It is impossible to say right now what proportion of London's office stock that will affect, directly or indirectly, but there is bound to be some negative impact. How significant that is, and how far other positive impacts counteract it, time will tell.

Most deals that had been in motion before the referendum are completing. We are also hearing increasing reports of interest from Asian investors looking to take advantage of better value. Meanwhile, lower construction activity is actually helping correct the serious under-capacity and skills shortages in the market, which had been pushing up construction prices significantly.

Despite these concerns, the UK's historic strengths should endure. Britain is the most sophisticated and best-researched property market in the world. And importantly, it is a market that needs a lot of new housing. Theresa May's government has already re-committed to major infrastructure projects such as the High Speed 2 rail link, plus greater development outside London in the shape of the 'northern powerhouse' and the 'Midlands engine' initiatives. The referendum exposed some deep-seated social issues, and we expect tackling these issues by investing in, and rebuilding communities, to become an important objective for the new government.



# Infrastructure: Slower pipeline today, but that may help in long run



**Richard Threlfall**  
Partner, Head of Infrastructure,  
KPMG in the UK

**Britain's construction industry will probably be one of the worst affected by the Brexit vote, certainly in the short term. Construction demand correlates closely to economic growth, but also overreacts to economic sentiment. So whatever slowdown in growth we see, the impact in construction is likely to be worse.**

Indeed the Markit/CIPS UK construction survey in July showed output falling at the fastest pace since 2009 in the immediate aftermath of the vote, though it did bounce back in August.

It might be less seriously affected than construction, but government-led demand for infrastructure will feel the impact of Brexit too. Existing programmes, especially in highways and rail, are likely to continue as planned. Most regulated utility programmes should also remain on track (though in the longer term if interest rates rise that may put pressure on the financial robustness of more highly leveraged players).

The major risk on infrastructure is where significant political or Treasury decisions are required. The coming 12 to 24 months is likely to be one of the most challenging periods in decades for the UK Government and it is not unreasonable to assume it will be distracted by stabilising the economy, focusing on the best Brexit deal and forging relations beyond Europe.

## **Pipeline uncertainty**

The government has already delayed a decision on South-East airport capacity to the autumn. In the near term, we expect a significant fall in demand and uncertainty over the pipeline of projects.

This is not necessarily bad news from an external investor perspective. The UK construction industry is very domestic, fragmented, inefficient and ripe for consolidation. The fall in the value of the pound and the pressures in the industry are likely to accelerate the opportunity for acquisition.

## **Investment needed**

The industry is conscious of significant technological opportunities but lacks the margins to invest. It is also characterised by an ageing workforce, a lack of diversity and a lack of modern skills. There is widespread expectation that either offsite, prefabricated construction, or on-site 3D printing and robotics could transform the industry in the medium to long term. But it seems likely that external investors and/or alliances with technology businesses will be needed to trigger that change.

There is a welcome trend among clients to procure more effectively, on the basis of long-term alliances and relationships rather than cost-driven tenders. Public policy will continue to require transparent competition for work, but exit from the EU could lead to some changes in tendering rules.

**Offsite, prefabricated construction, or on-site 3D printing and robotics could transform the industry in the medium to long term**

There are early signs that investor interest in the infrastructure market is being maintained despite the Brexit vote. We are also seeing signs that the UK will continue to be an attractive market thanks to its commitment to long-run infrastructure development and an acute shortage of housing, which will eventually re-ignite demand.

Now seems like an opportune time for ASEAN companies to maintain their interest and in particular look for opportunities to buy into existing businesses looking for offers, as the market tightens..



*If the UK continues  
to attract tourists  
and capital from Asia  
there is every chance  
that the economy  
will weather Brexit  
and even emerge  
stronger*



# Leisure and hospitality: Buoyed by tourist dollars



**John Taylor**  
Real Estate and Hospitality Advisory  
KPMG in the UK

**The pessimism of 'Brexit day' seems like a distant memory. The UK, and London in particular, has been remarkably robust. Attracted by the weaker pound, tourists have flooded into hotels, restaurants and shops. But a number of concerns persist.**

Business focused hotels will have to wait for people to get back to work after the summer to truly gauge the impact of the vote. There is a strong correlation between the regional hotel market and GDP, so if, as expected, Brexit impacts GDP growth, it can expect to take a hit.

That said, anecdotally, regional performance continues to be robust while London hotels are down on last year (though broadly still performing well). The hotel market may also be affected by costs that are dollar based and therefore higher since the drop in value of the pound.

## **New investors in town**

Equity and debt investors remain cautious but open for business. It has been heartening to see a number of new Asian clients since Brexit, particularly from Singapore and China. From a global perspective London continues to be a top three city for real estate and hospitality investment and is seen as a safe haven economically, legally and from a security perspective.

A number of existing and potential clients made it their business to be in London on 24 June so they could understand the implications of the referendum result. This is a good sign, underlining their interest in doing business here. Indeed, several have been trying to get into the market for some time and are encouraged that some less well-financed and robust investors have backed off. But they also want to get their timing right, to benefit from the weakness of the pound but avoid a rapid fall in prices after completing their deals.

Right now, we are seeing a number of large hospitality transactions, some of which have bridged the Brexit vote. Not many sales processes have collapsed and we expect key deals to close soon, after the summer break.

It is fair to say that the debt markets paused for breath in the immediate aftermath of the referendum. Lenders needed time to get their heads around the potential impact of the vote on their books and clients, and to decide their appetite for risk linked to uncertain valuations.

## **Cheaper to borrow, cheaper to buy**

In light of this initial nervousness, credit processes are taking longer, debt pricing has increased and terms are tight in comparison to the fluid market of 2015. But investors remain open for business and, crucially, deals are getting done in the bank market.

Another effect of the vote is that benchmark interest rates have fallen to historic lows. For borrowers with pre-existing fixed debt this has increased the cost of breaking arrangements and refinancing. But for those with sufficient credit strength there are opportunities to borrow money at historic low rates. An example is IHG's recent issuance of a 10 year £350 million bond with a 2.125% coupon.

The market is paying close attention to real estate valuations, though post-Brexit transaction evidence is limited. Norges Bank announced a 5% drop in the valuation of their portfolio. We have heard examples of banks asking potential borrowers for revaluations and reductions in values of above 5%, but not of investors succeeding chipping prices down by 30%. I would say a 5 to 10% recalibration is more typical.

So the feared seizing up of real estate and hospitality has not transpired. If the UK continues to attract tourists and capital from Asia there is every chance that the economy will weather Brexit and even emerge stronger.



**Existing and potential clients made it their business to be in London on 24 June so they could understand the implications of the referendum result**





# Airlines: Looking for a safe landing



**James Stamp**  
Partner, KPMG in the UK

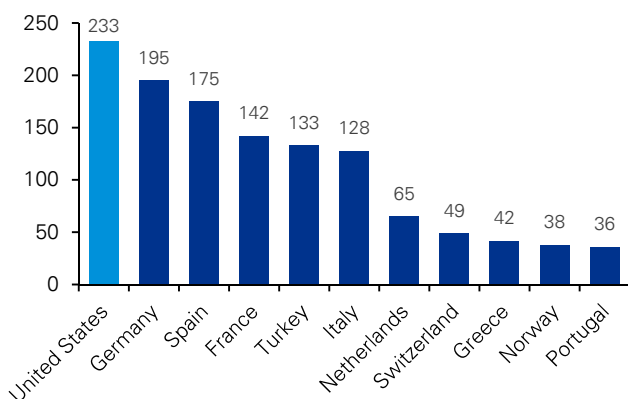
**Airline stocks around the world tumbled as the news of Brexit filtered through. Shares in listed UK airlines lost as much as a third of their value<sup>(a)</sup>. So was this a knee-jerk reaction to uncertainty or the reflection of a change to the sector's long-term fundamentals?**

The UK's airline sector certainly merits the global attention. It is the EU's biggest airline market and home to some of its biggest airlines. That lofty position is supported by a number of European agreements — agreements that have now been plunged into uncertainty.

For example, a UK-owned airline can fly Paris-Berlin just as easily as London-Madrid. At a global level, the EU gives UK carriers access to other markets via bilateral deals — the most important being *Open Skies* with the US. The EU has similar deals with Canada and Australia, others in the wings with New Zealand and Brazil, and potentially more to be signed with China, Turkey, the Gulf States — and ASEAN.

A future with the UK outside these agreements would represent a drastic change, not only to the UK's aviation

## EU air passengers by country



Note: Represents ECAA countries plus candidate countries

Source: Eurostat

a) Amongst a sample of airlines and based on change in share price between 28 May and 28 June 2016. (Source: Google and Yahoo Finance)

market but also to the European Union and global stakeholders beyond. So what are the UK's options?

To maintain access within the EU, perhaps the most straightforward would be **renewed membership of the European Common Aviation Area (ECAA)** — a liberalised aviation market for states inside the EU, and some outside, based on the principles of free market access and so on. The potential issue for the UK is that its founding treaty effectively mandates as a condition the free movement — a touchstone issue for Brexiteers during the campaign.

Second, it could negotiate an **'umbrella' bilateral agreement** with the whole of the EU. The Swiss have done this already, but that was part of a much wider trade deal, and — crucially — required Switzerland to agree to the EU's four freedoms on the movement of goods, services, capital and labour.

If negotiating with the EU is too hard or required too many concessions, the UK could negotiate a **series of bilateral agreements with individual EU states**. For example, 39% of Ireland's incoming passengers are flying from the UK, while for Spain it is a fifth. These countries are more likely to favour a deal that keeps the visitors coming. However, if the airline wants to fly more complex routes, involving multiple countries, then the agreement of all of those other countries is required. A series of apparently straightforward negotiations quickly turns into a spiders' web of inter-related negotiations.

For European airlines flying beyond Europe, the EU has 50 pan-EU aviation agreements with non-EU countries. The UK would have to renegotiate or update these if EU law didn't apply.

Agreements such as Open Skies goes still further. This is a comprehensive agreement with a global strategic partner, which has fundamentally changed the market for trans-Atlantic travel and led to a number of joint ventures, such as IAG with American and Virgin Atlantic with Delta. These give airlines the right to cooperate on capacity, scheduling, and even pricing under anti-trust immunity rules.

Leaving the EU complicates other issues too, such as how airlines obtain airport slots, staff their flights, and even sell ancillary products.

And we haven't even raised the issue of demand. Passenger numbers from a country and that country's GDP correlate closely. If Britain's economy does dip, it will almost certainly impact the number of trips abroad that British people take.

In the longer term, the UK's growth will depend far more on more connections to the fastest growing parts of the world, such as South East Asia. It is no secret that the UK has had a protracted debate about where to site new airport capacity to reach these markets. A decision on where to build it and starting to roll would send a declaration of intent at this vital moment — that the UK is open for business.

# Energy and commodities trading



**James Maycock**  
Corporate Risk and Regulatory  
KPMG in the UK

## **In the short term, ASEAN groups with investments in the UK will continue to be able to access EU's commodity derivative markets without significant impact.**

ASEAN energy and commodity firms trading commodity derivatives in the EU<sup>(a)</sup> for hedging or speculative purposes will be able to continue to do so under the existing regulatory regimes.

The UK is still a member of the EU until its formal exit and so EU law continues to apply. That is both in the form of directly applicable regulations, such as EMIR (which covers over-the-counter derivative transactions) REMIT (regulating the wholesale energy market) and MAR (market abuse), as well as directives which have been implemented into national law, such as the first Markets in Financial Instruments Directive (MiFID I).

### **Medium term: 2018 until 2019/2020**

Companies should also prepare for MiFID II, which will form the cornerstone of EU financial markets, since it will apply from January 2018 — before the expected date of the UK's exit.

MiFID II will have a significant impact on EU energy and commodity markets in a number of ways. It will introduce limits on the size of a position a person can hold in commodity derivatives traded on EU-trading venues, and economically-equivalent OTC contracts. It will require EU commodity derivative participants to undertake an 'ancillary business' test if they want to remain exempt from authorisation by financial regulators. Lastly, following a transitional period, non-EU commodity derivative participants will need to be subject to an equivalent regime if they want to access EU markets.

These changes may see firms requiring regulatory authorisation to continue existing activities or exiting product lines, amending operating models or even relocating certain business out of the EU to jurisdictions such as Singapore. ASEAN companies should keep a watching brief as market participants begin to grapple with implementation in earnest over the coming months.

### **Long term: 2019/2020 and beyond**

The post-Brexit regulatory environment will depend on the nature of the future relationship between the UK and the EU. For example, if the UK remains part of the European Economic Area (EEA), alongside countries including Norway, most European regulation such as MiFID II is likely to continue to apply.

In the case that the UK does not join the EEA and an amended regime cannot be agreed, ASEAN energy and commodity firms with a regulated UK entity trading derivatives will no longer be able to use the MiFID II passport to provide investment services and activities throughout the EU. Instead, they will need to look to the MiFID II third country regime to access the EU market, or establish a MiFID-compliant EU branch or subsidiary. Non-financial firms accessing EU and UK markets for own use purposes are unlikely to be impacted.

It is too early to say what the post-Brexit UK regime will look like, particularly given incentives in MiFID II to retain an equivalent regime, and the UK's G20 commitments around the integrity of commodity markets.

Of course, strategy decisions about location will be based on more than just regulation. Factors such as population, GDP, commodities demand, time zones, skills and experience undoubtedly play a part. Regulated markets like the London Metals Exchange, ICE Futures Europe and CME Europe, are also important. These venues may have more political influence in a post Brexit-UK that is keen to maintain its pre-eminent status in global commodities trading.

### **Next steps**

It is important to keep in mind that nothing changes immediately. ASEAN energy and commodity participants with operations in the EU should continue with plans to implement upcoming EU legislation. However, they should also start to consider their strategic options for accessing the UK and EU markets in the post-Brexit environment. Vitally, they should keep these plans fluid as negotiations develop and the future becomes clearer.

Note:

a) MiFID II applies throughout the EEA

# Conclusion

If any issue dominates conversation in British homes and offices today it is Brexit, and rightly so. June's vote was a historic decision that is likely to re-orientate the country economically and politically and make a real impression on ordinary people's lives. In the maelstrom of events however, it is vital to retain a sense of perspective. Brexit is only one of multiple drivers of change for business and for many, not the most significant.

Brexit will induce paralysis in some businesses as they weigh their options against an uncertain future trading environment. We suspect the winners will be those who evaluate likely scenarios and choose the right approach in those situations, appropriately managing the risks all the while.

Brexit undoubtedly places domestic and international business in a period of real uncertainty. After leaving, the country's trading future with Europe depends on negotiations with 27 others – plus the Commission in Brussels – each with an agenda that may only be tangentially related to economic self-interest.

However, it is also true that international businesses face major uncertainty all the time – whether entering a new market, facing new regulations or confronting innovative disruption. Brexit is merely another layer of the uncertainty upon which good businesses thrive.

We should not forget that the Brexit vote offers some certainties, and potential upsides, too. For all the unknowns over UK's economic performance, Single Market access or global trade deals, international businesses can find real opportunities to invest in the UK thanks to a devalued pound and lower valuations on a range of assets. In the current environment, investors need to weigh known benefits against the unknowns raised by Brexit.

The fog created by the June referendum does not affect the UK alone. As Federico Santi from Eurasia Group points out in this report, the UK and European Union both face serious challenges in the years ahead. It speaks volumes that while the FTSE100 fell 3% the day of the referendum result – broadly in line with the Dow – Germany's Dax Was down 7%, the CAC40 in France 8% and the Milan bourse down 12%. Brexit is just one issue the Eurozone is grappling with right now.

It will take time for the parameters of Britain's new relationship with Europe to emerge. But based on this initial market assessment, the UK remains a relatively attractive European location for inward investment.

Undoubtedly, we will see ups and down as the Brexit negotiations play out: moments in which the UK steers towards closer relations with the EU; others when it seems set for something more distant. Economic logic may trump political expediency in the end, giving the UK a very high degree of access to the Single Market while allowing its leaders to take action on immigration. That route seems to be in the interests not only of the UK, but also Europe and the wider world.

Heartening as that might sound, organisations cannot cross their fingers and hope for the best. They need to plan for the other possible outcomes – whether that be creating European subsidiaries or gaining regulatory approvals within other European Union countries on a "no regrets" basis.

Ultimately, Britain's decision to leave the EU means it must cast its gaze beyond Europe. In that search, the UK will find no better trading partners than the countries of ASEAN. Britain and the region have strong ties going back centuries. Brexit now offers a chance for both sides to renew those ties and forge a new relationship. It will be an exciting ride, if not always a comfortable one.



**David Sayer, Partner and Member of the Board,  
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Let's continue the conversation ...

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