BREXIT

THE CALM AFTER THE STORM

Words:
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DESPITE PREDICTIONS OF APOCALYPTIC PROPORTIONS IN THE WAKE OF THE BREXIT VOTE, IT SEEMS THAT VERY LITTLE HAS ACTUALLY CHANGED – AND THE UK AND EU ARE STILL DOING BUSINESS WITH ONE ANOTHER. IT'S A SITUATION THOSE IN THE CHANNEL ISLANDS ARE WATCHING VERY CLOSELY

ANY BRITISH CITIZEN who'd been fired up into space for a fortnight from late June would have returned to Earth and had their mind truly boggled. They'd have burned their way through an atmospheric entry and splashed down to a country in the wake of the Brexit vote – a tide of wild volatility, the UK suddenly heading out of Europe, sterling hitting a 30-year low, David Cameron resigning, Boris Johnson and Michael Gove facing off in a cartoon-like leadership scrap, neither of them becoming PM, Theresa May becoming PM, and apocalyptic talk of constitutional havoc as it emerged that the Leave campaign had had no plan whatsoever all along. All while anti-Brussels cheerleader Nigel Farage sat in Brussels and did his best to make his peers feel glad to see the back of Britain – before handing in his own resignation.

But if our hypothetical astronaut would have been shocked and no doubt rather nervous about what was going on, he or she wouldn't have been alone. The rest of the world was too.

In the immediate aftermath, the picture did look grim – HSBC and Goldman Sachs warned of moving jobs out of the UK if the country left the EU, and City property funds barred investors from withdrawing their cash as the Bank of England warned that risks to the financial system had begun to 'crystallise'.

But now that time has passed, the situation seems to have calmed down. May met German Chancellor Angela Merkel and made it clear that she wouldn't be triggering Article 50 any time soon. Indeed, the timeline, depending on which pundits you listen to, could be anywhere between 2017 and the twelfth of never. In the meantime, the banks are still here, and the markets have been surprisingly resilient.

As reports of four horsemen on the horizon proved premature, the press duly moved on to other important matters, like the Olympics and Gary Lineker presenting *Match of the Day* in his undercrackers.

Yet while the engines of the Brexit supertanker remain fully engaged, its rudders locked in a slow turn away from the continent, the dominant mood among everyday folk remains one of speculation. While very little has become concrete, one thing is clear: all this uncertainty is not good for business.

"Uncertainty is the killer," says Jersey Senator Sir Philip Bailhache. "People can't make plans, they're reluctant to make investment decisions, and all that tends to stultify the economy.

"We're hoping the UK government will very soon articulate its aspirations, so that others who depend upon that decision are able to do their own thinking."

INS AND OUTS

The positive view is that there's very little reason to suspect the Channel Islands will be affected – they're outside the EU and not technically part of the UK. And if and when the UK leaves the EU, it may well simply wind up in the same position as the Channel Islands have been all along.

"I can't see anything fundamentally changing at the moment," says Rob Kirkby, Executive Director at KPMG in the Channel Islands. "There's been no overnight shift of business elsewhere. When meeting clients, you don't get the sense that anyone's incredibly worried about this, or that business optimism has crashed. Fundamentally it's a political shock, not an economic shock, and it's certainly not bad news."

His attitude seems bold, given the circumstances, but Kirkby may have a point. Take, for example, financial services, which are of huge value to the GDP of both Guernsey and Jersey. Brexit is unlikely to spark a drop in demand. Private clients use Jersey as a tax-neutral platform for various assets around the world, and that needn't change – while corporate work tends to channel global capital towards London, and is driven by how buoyant the capital markets are.

With the FTSE recovering quite well, and no possibility of Channel Islands links to London changing in the wake of the vote, those opportunities should continue.

Finally, there are funds, which Geoff Cook, CEO at Jersey Finance, describes as "the biggest EU market for us by a mile". The main impact in this sector has been delayed transactions and slower decision-making – which had already kicked in in the run-up to the vote.

"I think our funds industry will have a flatter period, followed by a gradual return as people realise the world hasn't fallen apart and asset prices haven't gone through the floor," says Cook. "But we'll lose some of the buoyancy we had in the first half of 2016.

"In the short-term, the sterling book will be depressed by flatter UK interest rates. But lots of our growth comes from elsewhere – two-thirds of our deposits are in dollars or euros; 75 per cent of our new business originates outside the EU. That'll help us improve the margin on our bank deposits."

Meanwhile, Jersey Finance is releasing a report in October on Jersey's value to Europe, focusing on capital investment flows to the EU and highlighting Jersey's contribution.

The key thing, says Cook, is that Jersey's access to the EU won't change. "We're an ESMA-approved jurisdiction as a third country," he says. "That status, which allows us to provide services to the EU on the same basis as the US and Switzerland, was negotiated independent of our relationship with the UK."

There is, however, one important EU access right that was negotiated with the UK – concerning trade of goods. Jersey is an EU member in this regard, under Protocol 3. When the UK withdraws from the EU, that right – to export agricultural and industrial products to the region free of tariff – will disappear with it.

"The principle concern with Protocol 3 relates to our fisheries industry," says Senator Bailhache. "Most of the fish caught in Jersey waters are exported to France and through France to the EU. If we didn't have the Protocol we'd have to overcome a tariff barrier of 12.5 per cent in practical terms."

Other areas show little signs of direct suffering. Tourism may even get a boost from the weak pound, which is encouraging for European tourists, while UK tourists may prefer to holiday locally as foreign destinations become increasingly unstable.

Construction also stands to benefit from the pound's devaluation, while digital – often expounded as a great opportunity for the islands – is a largely borderless pursuit anyway.

"Look at the successful digital centres like Israel, Singapore and Shoreditch," says Kirkby. "None is dependent on EU funding for things like R&D, in the way that medical labs are. Brexit changes nothing. It's going to be business as usual on the digital front."

RISK AND RETURN

Despite all the optimism, continued uncertainty brings with it a number of risks that can't be completely ignored – most of which, should they arise, would be beyond the Channel Islands' control.

First, any negative impact felt by the UK economy and the City of London may well pass on to Jersey and Guernsey. Then there's the fact that, if the UK is no longer in the EU, it won't be able to fight the Channel Islands' corner – so the latter may have a tougher time making progress with negotiations. Recall how, when Jersey wound up on a French blacklist of uncooperative jurisdictions, the UK stepped in to clear up the issue.

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There's also a danger that, regardless of their true status, other countries will wrongly assume the islands are part of the UK, and treat them as such.

The final, and possibly most startling risk, is that the EU revisits the issue of passporting and AIFMD access in the wake of Brexit. While there's no logical basis to think it would, the overriding message here is: nothing is certain.

The result is that it's hard for businesses to plan when they still have to work out not only how to respond, but what they're responding to.

"Businesses are looking at a range of possibilities that aren't clear yet," says John Harris, Director General at the Jersey Financial Services Commission. "So they won't have a plan, as you can't have a plan until what's happening becomes clearer."

For now, all Channel Islands businesses can do is review their business models, keep an eye on how Brexit is affecting them and their clients, stay close to their networks and take an entrepreneurial view to see whether there are any opportunities.

That last word is an important one. Senator Bailhache isn't alone in believing that, amid all the uncertainty, opportunities do exist. "Our financial services industry is closely linked to the City of London, so if the fortunes of the City diminish, so will Jersey's to an extent," he says. "On the other hand, if the City flourishes, Jersey will too."

For starters, there's the obvious draw of the weak pound. There are signs that Asian investors are going into London commercial property on the basis that the fall in prices and UK currency effectively gives them a 20-25 per cent discount. As one of the key centres for structuring foreign direct investment into the UK, much of that work will come through to the Channel Islands.

Meanwhile, the UK may well be seeking other opportunities beyond the EU – whether that's China or the US – and the Channel Islands may be able to benefit here too. "Negotiating trade deals with China alone is too hard for us," says Harris. "But being part of a future deal between the UK and China could make a lot of sense."

Then there's the fact that work with the UK may now operate under different, more favourable rules. "The UK will no longer have to fully enforce all the EU restrictions that have applied in the past," says Dominic Wheatley, Chief Executive of Guernsey Finance. "As a Crown Dependency, I'd hope we could negotiate special access arrangements to reflect the more flexible environment that the UK would be operating in. There are no changing circumstances that don't generate new opportunities."

And the potential opportunity doesn't just come from the UK. The Channel Islands are also a source of vital foreign capital for EU member states.

"Things have moved on massively since the days of currency regulation," says Julian Hayden, Director at Hawksford. "There's free movement of capital globally and Jersey is in a fantastic position to facilitate that and benefit from it. So, even if the UK catches a cold, we'll continue to do well in the EU and the global market. And if the UK benefits economically from being able to go solo from the EU, Jersey could benefit from that too – because of the vast amounts of money we invest from London abroad and vice versa."

Indeed, the world doesn't end at the EU's borders. And not only are those in the Middle East and Asia an increasingly important source of business for the Channel Islands, but they're closely observing events in the area themselves.

While many reacted to the news of the UK public's decision with bemusement, there's no reason to assume the universal reaction is disapproving.

Eric Major, CEO of Henley and Partners, works with high-net-worth individuals relocating to Jersey. "I had a conversation with a wealthy Hong Kong client, who was saying that only in the UK, with its rule of law, would an issue like Brexit get resolved so quickly – with no cars on fire or turbulence," he says. "Within weeks, the UK had a new Prime Minister and things were confidently back in hand. Would the same thing have happened in Turkey or Russia? No. That's what high-net-worth individuals see in the UK time and again – that's why they continue to invest there. And that won't change."

Hawksford's Hayden recalls attending a family office meeting the week after the vote, at which lawyers and advisers from Spain, Germany and Austria couldn't have been less concerned.

"People were genuinely surprised," he says. "But all of these seasoned advisers thought things would be just fine in the long run – and nobody was saying the UK had done anything really crazy."

Indeed, the truth of how crazy Brexit is won't fully emerge until there are some hard figures available. Channel Islands business leaders will be keen to see evidence of business flows and trends into next year, to help see through the volatility. Eyes will be on figures for house prices, tourism, immigration and, of course, those reflecting banking and funds, not least the flow of capital from the islands to the EU and London.

But ultimately, even with such financial data to hand, there's very little the Channel Islands can do until the convoluted negotiations between the two other parties have played out. The job, for now, is to focus on things within their control.

"We'll be very low down the UK's priority list in its negotiations with the EU, so will have to look to paddle our own canoe more," concludes Rob Kirkby. "And we'll have to do so in partnership with Guernsey – we can't see it as a chance for competitive advantage. We have to work together." ■

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BREXIT AND CHANNEL ISLAND WORKERS

One of the Channel Islands' key concerns in the wake of the Brexit vote will be ensuring it can continue to attract bright people into the islands, particularly those who will provide jobs.

One important question revolves around visas. Currently a company recruiting an EU national doesn't have to secure them a visa, just the usual work licences. But, should a company wish to recruit someone from outside the EU, it needs to organise work visas too, which can be a time-consuming process. It's uncertain at this point how Brexit will affect this.

While there seems to be a political commitment to cement the rights of those EU nationals already resident in the UK, there's a huge amount of political force in the country behind the idea of restricting free movement. How would this affect the Channel Islands? Again, nobody knows. And, again, the Channel Islands' moves here will be largely dictated by the UK.

Then there's the question of whether any downturn in the UK economy would affect people's perceptions of working in the Channel Islands. While there's no concrete reason it should, given the Channel Islands' cultural ties and physical proximity to the UK, it is possible.

But even here there are potential opportunities. "One individual contacted me within a month of the vote to say he's relocating his business back to Guernsey from the UK," says Dominic Wheatley, CEO of Guernsey Finance. "I thought the timing was interesting. He didn't deny that Brexit had made a difference."