

2017 Economic Outlook for CFOs

WEATHERING DISRUPTION
IN A POST-BREXIT WORLD



11 Finance, Credit & Risk Experts Weigh in on The Post-Brexit Risk Landscape

The charter of enterprises to grow hasn't changed, but the difficulty of this endeavor is surely increasing in 2017. In spite of the increased connectedness in advanced economies, the world also might just be getting smaller.

The Zurich-based research organization KOF Swiss Economic Institute, which produces a comprehensive globalization index measuring economic, social and political globalization, has found that the growth of globalization throughout the 1990s and 2000s has actually stalled since the 2008 financial crisis.

Massive public debt coming out of the recession and political turmoil are cited as potential causes of the plateau in globalization. And, the effects of this slowdown are far-reaching. Long-term damage such as dissipation of economic growth, a legacy of toxic politics and a slowdown in innovation are just some of the effects of what some experts are calling deglobalization—a stagnation or contraction in cross-border relationships. Current events seem to be bearing this out. The recent Brexit Leave vote, uneasy trade relations among countries, reduced GDP growth worldwide and the emergence of more restrictive migration policies all point to a global relational environment that is contracting, not expanding, according to Dun & Bradstreet's economists. McKinsey notes that there is a decreased movement in goods and trade since the 2008 recession, one of the key symptoms of deglobalization.



History suggests that periods of deglobalization like the one we're now in can have effects that last for decades—including isolationism in rich countries.

Yet, globalization isn't really going away—at least in the digital sense. “There are certainly parts of the world that are behaving in a more isolationist way, and using data to do it. But deglobalization is a bit of an illusion in some ways. You can retrench and be less global if you want. Companies, countries have the ability to some extent to shift the amount of dependency they have on cross-border debt, on cross-border imports and exports and balance of trade. But, at the end of the day, supply chains are global; value chains are global. Customers are everywhere. It's like trying to prevent oxygen from crossing the borders,” says Dun & Bradstreet Chief Data Scientist, Anthony Scriffignano. So, if there's no preventing the spread of most data across borders, what does deglobalization mean for business relationships?

Our data is growing, but our relationships are fragmenting.

We know that technology is connecting us more than ever. We know that our capacity to communicate with each other is at an all-time high, and at breakneck speed. And, we also know that digital and data flows may replace, or at least supplement, the concept of globalization, contributing at least 10% to world GDP and adding \$7.8 trillion in 2014 alone. Yet, although these patterns are emerging, the risks of disconnection are also very real.

Finance leaders must reckon with risk. And what this means today is very different from what it meant even a year ago. Risk and opportunity are embedded in data, in digital communication, in the dizzying pace of innovation. “The financial community changes at its own pace, but at the same time this idea of risk is getting turned on its ear by data. If you think about the kind of risks that an organization faces, the types of risks that it had yesterday don't go away.” Yet concurrently, Scriffignano states, finance leaders must also think about new threats that deglobalization poses such as cyber security, cyber terrorism and the new dynamic of cross-border decision-making today. All must be grappled with. All must be accounted for. What we haven't reckoned with, or even begun to understand, is the risk of disconnection in the midst of hyperconnection.

 The new paradigm for decision-making is using the data we have at our disposal to ask meaningful questions, generate true insights—and answer meaningful questions. 

WHAT'S NEXT FOR FINANCE, CREDIT AND RISK LEADERS?

Keep calm. Carry on. Here, eleven experts on finance, geopolitics and risk share their insights on understanding, grappling with—and leading through—a post-Brexit, hyperconnected and disconnected business environment. These experts come from leading academics at institutions like Claremont Graduate University to technology innovators in the compliance space. We also sought expertise from advisory firms such as Paul Hastings, PwC, and Eversheds who maintain a bird's eye view—and ear to the ground—on what to expect in a post-Brexit world in 2017.



3 OBSERVATIONS FROM DUN & BRADSTREET'S ECONOMIST TEAM ON BREXIT

1. **Even in 2017—and possibly beyond—it will be too early to assess the political and economic impact of Brexit.** Article 50 of the Lisbon Treaty, which allows for a country in the EU to voluntarily leave the union, still requires invocation – the European Union and the United Kingdom must negotiate the terms of the UK's departure. As a result, it is unclear how Brexit will affect citizens, businesses and countries. In other words, the practical implications of Brexit may take many years to unfold. The practicalities of navigating an EU departure are not always clear-cut.
2. **Longer term, patterns in global trade and investment flows will change as the UK begins the process of actual exit from the EU.** Global growth is likely to slow during the transition process, a negative for the US economy, as well. However, there will also be new opportunities for the US to expand trade and forge new alliances which will require a well-calibrated policy response from the government.
3. **Finance, credit and risk leaders in the United States should be prepared for significant policy changes.** The US Federal Reserve will turn more cautious in the wake of the market volatility and refrain from making any changes to the policy interest rate until it feels confident that markets have calmed and stabilized to be able to absorb any policy change. Further, the appreciation of the dollar and the monetary loosening expected in the UK and the EU imply de facto tightening in monetary conditions in the US. Recently, the Fed pledged to provide dollar liquidity as it expects pressures in global funding markets. Finally, dollar strength will keep a lid on US domestic inflation, keeping inflation below the Fed's target longer. Dun & Bradstreet has thus changed its baseline interest rate forecast; we no longer expect the Fed to raise interest rates at its July 2017 meeting.

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Mary Shelton Rose, an Advisory Partner at PriceWaterhouseCoopers and leader of the firm’s US Brexit Response office, where she helps clients navigate risks and opportunities linked to Brexit. In this guide’s concluding chapter, she discusses how companies are managing their business risk through detailed scenario planning, improving their ability to act quickly once the realities of Brexit come into focus.

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Economic Uncertainty in a Post-Brexit World

Perspectives from Bodhi Ganguli, Lead Global Economist at Dun & Bradstreet

Even in times of uncertainty, the global markets, like the weather, exhibit patterns that watchful meteorologists recognize and rely on to make informed predictions. Many organizations lean on their CFOs to be fiscal guides through both smooth and turbulent times. But what happens when the future is hazy, and a clear perspective doesn't exist?

Bodhi Ganguli, Lead Global Economist at Dun & Bradstreet, provides clients with monthly in-depth analysis and forecasts for the US economy and collaborates with the Advanced Analytics team to leverage proprietary microdata to produce unique macroeconomic insight. He is a regular speaker at Dun & Bradstreet forums and client conferences where he presents Dun & Bradstreet's US and global economic outlook. He also holds a Ph.D. in economics from Rutgers University. In this interview, he discusses the current global economic climate and advises CFOs on what global trends they can monitor to help their organizations navigate global geopolitical uncertainty and a volatile financial market.

Q: Based on your research and analysis, what are the top risks that CFOs should be monitoring in the global markets right now?

BG: Brexit presents a systemic risk to the global financial system because of the impact it has on the global markets. In general, the markets have a short memory. At first, they reacted very strongly to the news of Brexit. Now that the vote has passed, the markets have gone back to normal as if it hadn't happened.

Technically, the actual process of Brexit hasn't even started yet. That process will begin once the UK invokes Article 50 discussions in early 2017. The discussions may cause fluctuations in the market again, but the actual process of exiting the EU will take at least two years of negotiations. Right now, the plan is for the UK to leave the EU by Q1 2019. That's when the real Brexit will happen and naturally there's still a lot of uncertainty still surrounding this event.

Aside from Brexit, there are several other undercurrents of risk that are also flowing through the global economy that should be pointed out:



- **Geopolitical risks:** There are a number of trade agreements that hang in the balance now that the results are in for the recent and volatile US election. Both presidential candidates, Donald Trump and Hillary Clinton voiced their dislike with the Trans-Pacific Partnership and Trump has called both NAFTA and NATO into question.

- **Foreign exchange risks:** Amidst all of these changes, it's important to examine how various currencies behaving globally.

- **Interest rate risks:** A handful of central banks are cutting interest rates to zero and a few now even have negative rates. But the US Federal Reserve might do the opposite and plan to raise rates. There isn't enough evidence yet to say whether this is a good or bad thing.

Keeping all of these risks in mind, the one word I keep using to define the volatility of the market and the aura of uncertainty is "divergence." Every country within the global economy is different and because of that, there isn't a one-size-fits-all solution. There's a divergence in terms of currencies, interest rates, politics and even in terms of outlooks.

Some countries have a better outlook on the economy right now than others. Outlook is important because we don't have a coherent global economy. By nature, there are imbalances that create risk and uncertainty, and businesses don't like uncertainty because it implies risk.

 By nature, there are imbalances that create risk and uncertainty, and businesses don't like uncertainty because it implies risk. 

Q: At what point do you think that we're going to start to see the impact of Brexit? Will we see it before, during or after the negotiations?

BG: We won't see the real impact until after the negotiations begin. This is because what we're seeing right now before the negotiations even start, is just a lot of posturing and theorizing from leaders in the UK and in the EU. It's pure speculation at this point, no one really knows what will happen.

There are a few hypotheticals that are important to consider when looking to the future. A soft Brexit would mean that the EU renegotiates most of the trade discounts that it has for the UK and business is allowed to continue as usual, but the UK

regains its sovereignty. Alternatively, a hard Brexit will occur if the EU doesn't allow them to keep those discounts and instead forces them to re-negotiate new bilateral treaties with every country in the European Union — a process that would take years.

Q: Are there patterns that you see arising, as they pertain to the recent US election?

BG: There are two major global trade negotiations that Donald Trump came out strongly against: The Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). Now that Donald Trump has been elected president and he opposed both the TPP and the TTIP, it doesn't look like either of these agreements will pass. However, it's important to note that this would most likely have been the case with a Clinton presidency as well.

Now that the UK will depart from the EU and it's unlikely that these agreements will pass, global trade will become even more complicated. The US may even have to go back to the drawing board and start fresh on new trade deals. There's going to be a new government and new opportunities for discussions and negotiations.

Q: How can CFOs best prepare themselves, in light of all of these economic shifts?

BG: Whenever there is global uncertainty, especially of this magnitude, it's difficult for CFOs to make informed decisions. Any decisions that can be pushed back until things stabilize should be pushed back for the time being. Additionally, we can expect to see consumers become more conservative with spending while things are uncertain. This is typical behavior, but it won't necessarily last.

But there aren't just risks to consider, there are opportunities too. For example, it could be to the US' advantage to negotiate a new trade treaty with the UK due to Brexit. Also, it's important to keep an eye on global currencies. The pound fell precipitously after the Brexit vote, but the US dollar could strengthen. If the dollar is strengthening, depending on whether you're a net importer or exporter, your business could either benefit or hurt. If you know for sure the dollar is going to strengthen as a result of all the uncertainty, how do you hedge for that? How do you plan your cash flow? How do you plan your investment? So, all of these fluctuations aren't necessarily bad.

Q: What are some signals, data points or forecasts that you recommend monitoring to track potential risks and opportunities?

BG: I'd start by recommending that CFOs monitor how fiscal and monetary policies are doing globally.

Monetary policy has been a major player globally with all of the central banks handling most of the heavy lifting, before, during and after the recession. It's clear that in many countries, monetary policy is running out of ammunition. This is why it's important to

prepare for the possibility that there could be another downturn in the near term. If that happens and interest rates in many advanced economies are already in the zero or negative percentiles, what more would central banks be able to do? This is one of the issues we're monitoring closely and we would recommend that others monitor too.

Over the past few years, fiscal policy hasn't complemented monetary policy very well. Governments need to step up to coordinate with each other to develop a coherent fiscal policy that supports monetary policy to boost growth and buffer global economies so that they can weather the next slowdown.

Q: What changes can we expect to see in the global markets over the next few years?

BG: Globally, we can expect advanced economies, like the US and the UK, to grow very slowly. Emerging economies, like India and China, will grow at a faster pace and remain ahead of the advanced economies. There are too many risks and uncertainties in the global economy, we won't start to see much growth until we have dealt with those.

In 2017, we've forecasted a 2.7 percent growth globally and we expected the global economy to end in 2016 at 2.2 percent — which shows a very slow and low rate of growth. For reference, the growth rate in 2015 was 2.5 percent, so you can see that it's slowed this year as advanced economies definitely are growing a lot more gradually this year than before. We expect that the recovery will begin in 2017 at 2.7 percent and then by 2018 it will increase back up to 3 percent, which is considered a strong number for global growth.

Commodity prices are also important to examine within the context of the global market. For example, when oil prices were at their peak they were close to \$100 - \$110 a barrel. At the end of 2016, oil prices were as low as \$43 a barrel. They are expected to increase to \$50 and then \$63 in 2017 and 2018, respectively. But this means that they won't reach their peak even within the next three years based on both supply and demand, as well as the global economy in general.

When the dollar appreciates, commodity prices fall. We expected a slight appreciation of the dollar at the end of 2016 when the Federal Reserve was expected to raise interest rates. When the Article 50 discussions begin for the UK at the beginning of 2017, the uncertainty will most likely cause the value of the pound to decrease and increase the dollar. Whenever there's uncertainty, money flows out of emerging markets and back into safe-haven currencies, like the US dollar for example.

For CFOs, it's a good time to consider opening operations in countries where there are emerging markets and the growth rate is high — even though business continuity is riskier. You should also avoid industries that are weaker globally, such as manufacturing. Instead, focus on consumer-based industries as consumers are driving growth in almost every country, especially in the US.

Navigating the Economic Landscape of a Post-Referendum UK

Perspectives from Markus Kuger, Lead UK Economist at Dun & Bradstreet

Amidst the uncertainty, there's no doubt that turbulent times are ahead for the UK as it begins to navigate the uncharted waters of exiting the EU. The hard truth is that there will be a real economic impact that doesn't bode well for business in the short-term. From the GBP decreasing in value to the potential loss of the EU labor in the UK, companies need to start planning now to survive what will be a long haul.

Markus Kuger, a leading UK economist at Dun & Bradstreet, who specializes in macroeconomic theory, monetary policy, European policy and labor economics. Kuger has a Diplom-Volkswirt (comparable to a Master's Degree in Economics) from the University of Wuerzburg. He also served as Robert-Schuman Scholar in the European Parliament in Brussels, where he worked with the Parliament's Committee for Economic and Monetary Affairs. Here he provides an economic risk analysis of the post-referendum UK and shares which trends CFOs should be monitoring the most closely.

Q: What is your overall analysis of the state of the economy in the UK now that the vote to Leave has been confirmed?

MK: We've been watching the situation in the UK — before and after the Brexit vote — very closely. Before the EU referendum passed, the UK's risk rating was at the same level of the US's. The UK has been consistently rated an EB2A rating. Immediately after the referendum, we've downgraded the country's risk rating twice by two quartiles to DB2C, this is the same risk level we have for Belgium.

When the prospect of a hard Brexit was rising in October, we downgraded the UK's risk rating even more. They're now at DB2D, the same level as France and Japan. This is an even more dire rating for the UK than DB2C and the UK has now reached the lower bound of our 'low risk' category. One more downgrade and it would fall into our 'slight risk' category where enough uncertainty over expected returns exists to warrant close monitoring of country risk.

However, there is room for optimism. Currently, Brexit isn't having the immediate negative impact that was widely predicted. The economy is doing just as well now as it was before the referendum. Though, to be cautious, we are skeptical about whether this will continue throughout 2017. Our prediction is that economic growth will significantly slow in the next year and that inflation will increase.

We expect Article 50 to be invoked in March 2017 and that it will take two years for the UK to complete the exit process, which

means Brexit won't actually occur until 2019. Two years isn't enough time for the UK to negotiate the new, post-Brexit relationships with the EU. It is more likely that they'll work out a interim agreement to get them through the next few years. We believe that they'll be fully independent of the EU by the mid-2020s at the earliest.

Q: What criteria do you use to create global economic risk ratings for each country?

MK: We use nine different types of criteria. I'll share a summary of each one to give you a broad perspective of what goes into creating a country's risk rating.

- 1. Short-term economic outlook:** This criterion examines the economic outlook for the next 6-8 quarters for each country. We query for data on things like inflation, and unemployment rates.
- 2. Long-term economic growth potential:** For long-term, we look at all of the short-term criterion as well as demographics, physical infrastructure and more.
- 3. Market potential:** For this, we look into the country's free trade agreements and examine how easy it is for businesses to enter that market.
- 4. Foreign exchange risk:** It's important to also consider how much the exchange rate is changing and how consistent it is.
- 5. Transfer risk:** We examine how easy it is to access the banking sector in the country and measures the complexity of cross bonded transactions.
- 6. Business regulatory environment:** The business culture is important to look at as well. We assess the sophistication of the country's institutions and how they fit into the business regulatory environment.
- 7. Business continuity:** For this criterion, we look at the stability of a country's supply chains and, in the case of natural disaster, how quickly they'd be able to repair the damage and reassume business.
- 8. Political insecurity risk:** We also look at how political events will impact the country's economy. This includes elections, new governments, and regions who are at-risk for experiencing a civil war, invading another country or being invaded.
- 9. Expropriation and nationalization risk:** With this last criterion, we investigate how safe business investments are within each country. For example, this includes making sure that the government isn't attempting to expropriate foreign investors to fill their own pockets.

Q: What are the biggest risks associated with Brexit, in your opinion?

MK: With EU law still in place until at least 2019, the biggest issue at the moment is the weak exchange rate which has two impacts. First, the depreciation of the pound against the dollar and other global currencies since the referendum has led to a loss of price competitiveness of US and EU companies selling to the UK (but increased the competitiveness of British companies selling abroad). This reduces the chances of exporting to the UK but also made it cheaper for foreign investors to buy British assets. At the same time, the weak pound is fuelling inflation. Consumer prices are currently increasing by the highest rate in years (although some of this is also caused by rising global commodity prices) and I expect the central bank's 2.0% inflation target to be breached soon. This development is weighing on households' disposable income and will thereby also negatively impact on the economy going forward.



Q: What are some of the long-term issues that you see down the road?

MK: We have a few business sectors that are currently doing really well because of Brexit. For example, tourism and manufacturing are at an all-time high. It's much less expensive for American and Eurozone tourists to visit the UK right now and it's caused the tourism industry to skyrocket. The same applies for British manufacturing. So, there are some who feel that the weaker pound will continue to drive this change.

However, tourism relies on inexpensive labor from the EU. Many hotel concierges, restaurant servers and housekeepers are from EU countries. If the deal after Brexit does not include the freedom of labor for low-skilled workers, labour shortages would slow down growth.

Simultaneously, manufacturing relies on foreign direct investment from the EU as well as exporting its products across the Channel. Depending on how the post-Brexit EU-UK settlement looks like, the current boom in the sector can be short lived, especially if tariffs are implemented.

The biggest worry over the long run is that the Brexit vote will lead to a break up of the whole EU. Anti-EU parties are already doing well in many countries (without having come into power yet) and it cannot be ruled out completely that either the euro or, even worse, the EU will collapse over the long run. Such an event will send a huge economic and political shock around the globe and international trade flows would change significantly in such a scenario.

 The jury is still out on what the real impact of Brexit will be. It will be a while before CFOs begin to see any impact on payment performance and insolvency. One of the key risks at the moment is that the economy will probably slow down — it's the most likely scenario. 

Q: What's the biggest risk facing CFOs?

MK: The jury is still out on what the real impact of Brexit will be. It will be awhile before CFOs begin to see any impact on payments performance and insolvency. One of the key risks at the moment is that the economy will probably slow down — it's the most likely scenario. And when that happens, payment performance should suffer across the board. This is especially worrisome as payments performance in the UK is already below the European average, according to our proprietary data. For CFOs that manage payment terms, they'll need to keep an eye on how the payments performance of companies is performing across the board. The impact won't be immediate, but just because it's not here yet, doesn't mean it's not coming.

Chapter 3

Anticipated Ripple Effects in the Asia-Pacific Region

Perspectives from Isaac Leung, Senior Economist (Asia-Pacific) at Dun & Bradstreet

Isaac Leung and his team at Dun & Bradstreet cover political, economic, and commercial risks in China, India, Japan, Australia, New Zealand, Southeast Asia and three sub-Saharan countries.

They take a full-spectrum view of country risk, analyzing nine core elements: short term economic outlook, long-term economic potential, immediate market potential, currency risk, exchange controls (transfer risk), business regulation, risks to the supply chain (such as natural disasters, infrastructure problems and criminal actions), expropriation/nationalization risk, and insecurity/civil disorder risk. They incorporate Dun & Bradstreet's proprietary datasets to build a data science practice within their broader economic and econometric capabilities.

Here we discuss reactions to the Brexit vote in the Asia-Pacific, as well as the most prominent geopolitical risks and business uncertainties unfolding in the region today.

Q: How do companies and leaders in the Asia-Pacific view the Brexit vote?

IL: Brexit attracted plenty of APAC media attention in the initial aftermath of the vote. Much of the discussion focused on the potential impact on China's currency, because the pound sterling is part of the basket of currencies against which the People's Bank of China references the yuan. And generally, the vote may have given Asian leaders a sense that there was more political fluidity in the western industrial countries than they previously realized.

But the news receded from headlines quite quickly, and Brexit's effect on the region may be modest, though we have yet to see Trump's election have a larger influence in comparison. In the short term, the US vote may spur capital flows out of APAC countries, especially China, due the effect on US benchmark treasury yields and the anticipation of a longer sequence of US Federal Reserve rate rises. It may also leave room for China to show more leadership in the region—for example, by spearheading alternative free trade groupings such as the Regional Comprehensive Economic Partnership. This Partnership is the surviving Asian free trade area concept that may now proceed in a way that the Trans-Pacific Partnership won't.

Q: What are the most prominent geopolitical risks within the region today?

IL: The first major area of uncertainty is the South China Sea. This has been a staple of discussions in the defense community over the last 15 to 20 years regarding the balance of naval power in the area, as well as how far countries like Japan will go to contain the perceived rise of China as it develops a blue water navy.

Another scene is crystallizing in the South China Sea around Chinese construction of artificial islands and runways in the disputed area. We are watching which Southeast Asian countries are accepting China's claims in the area (or acceding to them even if they don't accept them explicitly) versus those countries that are sticking with the US line. Singapore and Vietnam are looking to be more aligned with the US while Malaysia and the Philippines seem to be making more overtures to China. What many people aren't aware of is that China's construction is not a purely military move. The country has seen a substantial depletion of fishing grounds in its own waters, and it needs to allow its fishing fleet to go abroad to improve its national food security.

Then there's the North Korean nuclear conflict. North Korea's nuclear and ballistic missile capabilities are developing more rapidly than people may have expected, despite sanctions such as the ones the UN extended after the 2016 nuclear tests. More activity in this area could alter the military balance of power in the region.

In South Asia, the India-Pakistan confrontation has been escalating because of recent cross-border militancy from Pakistan into India. Even while it seems to be contained, it's something to consider. During exchanges over the line of control, we had Pakistan's country risk rating on negative for at least a month because of the uncertainty about a potential mobilization like the one we saw in 2002.

Q: Looking ahead, what other changes are business leaders anticipating in APAC?

IL: One important contributor to uncertainty and change over the next decade will be the accelerated aging in populations of high- and mid-income Asian countries. This could slow their economic growth overall, but also create substantial opportunities in areas such as healthcare and consumer credit. For example, in China, you will see many young people who are the only person in their family in their twenties. They will have access to new financial benefits that their parents and grandparents can bestow upon them.

So even though the demographics are negative going out to 2030, you'll see opportunities from an aging population, and also from a wealthy younger cohort that have more financial resources per capita.

How to Survive the Brexit Divorce Proceedings—A Tactical Guide



Perspectives from Matthew Bugeja, Geopolitical Consultant

Likening Brexit to a divorce proceeding of epic proportions might seem glib — but when considering how emotions from both parties will come into play — it's not so far off. The EU and the UK have a history of trade negotiations that go back long before the referendum. The tone that both parties take in the upcoming negotiations will play an important role in the final outcome. CFOs who are monitoring the situation closely, can read between the lines as they strategize and plan for their organization's future.

Matthew Bugeja is a geopolitical consultant who specializes in international relations, finance and economics. He provides geopolitical forecasting and political risk consulting services to companies, organizations and leaders. He is also a visiting lecturer for the Department of International Relations at the University of Malta. Here Bugeja discusses how CFOs can best assess changes in the market as it reacts to the Brexit negotiations, to help them plan for the future of their company.

Q: What have been some of the analyses or projects that you've been doing around Brexit?

MB: My team and I have been analyzing the situation globally since the first Brexit discussions. In the beginning, we were all trying to figure out whether Brexit would actually happen and the consensus across the board was the same: no one was expecting these results. Now we have to figure out what it all will mean and no one knows the answer yet.

 Over the next few months and years, the Brexit divorce proceedings are going to be very complex. Until we know the results of the French and German elections this year, it will be extremely difficult to predict what the outcome of Brexit will be. 

Over the next few months and years, the Brexit divorce proceedings are going to be very complex. Until we know the results of the French and German elections this year, it will be extremely difficult to predict what the outcome of Brexit will be. Both elections will dictate the tone and perspective that the EU will have on Brexit and the UK going forward. The best thing to do right now is to gather as much information as possible and seek to understand the underlying circumstances that led to the Brexit decision.

Q: What are some of the complexities and considerations that could come up during the French and German elections?

MB: The one question on everyone's mind right now is exactly what type of Brexit does the UK want? This is something that even the UK won't figure out very quickly. They'll have to begin formulating the answer to this right now, as well as creating the teams that will run the negotiations with Brussels. Between now and March 2017, the UK is planning to begin the Article 50 negotiations. During this time, we'll begin to learn what to expect out of Brexit. Theresa May seems to be willing to steer the UK towards a 'hard' Brexit, which would effectively take some bargaining power away from Brussels, but would also incur considerable economic costs for the Brits themselves.

What should be understood is that these will be the most complex divorce proceedings in the last 100 years of Western Civilization to date. If we think about this terms of a normal divorce where feelings and emotions come into play, the unpredictability will be easier to understand. There will be uncertainty, distrust and maybe even some malice. These are the things that the markets will need to watch closely. What I've suggested to people at this point is to avoid not jumping to conclusions too quickly. If you're looking to make an investment right now, consider the long term because there will be a lot of ups and downs during the next few years.

Q: What do you mean by waiting to jump to conclusions?

MB: What I mean by waiting to jump to conclusions is that it's too early to make any decisions for the short term. While a lot of people are sharing their opinion, we're still just making a lot of educated guesses right now, even if the initial indications are that the UK will look to cut all ties to the EU Single Market. Even though before the referendum, many business leaders shared that they weren't in support of the UK leaving the EU, so far there hasn't been a notable impact on business in the UK. It's still too early to know what the real impact will be. For example, the financial industry in London has thrived thanks to their access to the EU single market and the fact that they have passporting rights to the EU. It's been very lucrative for them. If they lose that

access, it will be a huge hit to the UK economy. Right now, that's not something we'll have clarity on. It's too soon to make any decisions until we know more.

The tone that London takes in the negotiations and the tone from Brussels will be very telling. At this point, it doesn't seem like the EU will be interested in giving too much leeway to the UK. While the UK is determined to see Brexit through, the EU views this as an insult to them because they already feel as if they offered quite a lot of leeway to the British government under David Cameron and those terms were rejected. As a result, they might not be interested in offering any more leeway to the UK. Additionally, if they're too lenient, other EU countries might be emboldened to exit the EU as well. This is a huge clash of agendas. How the EU handles Brexit will set the tone for Europe for decades down the road.

Q: What are your thoughts on the predictions that are being made right now on what we can expect from Brexit? Why are these predictions so misleading?

MB: There are a lot of people who are in denial about the amount of uncertainty we're facing. They're either predicting that Brexit won't happen because it's "impossible" or they're trying to offer some semblance of certainty, which is something we're seeing in the private sector. The fact is that no one really knows. At this point, the only real indications we have are from the economic data that has come out of the UK and we have to bear in mind that the UK is still a full member of the EU right now.

Right now, all we have is a referendum. UK Prime Minister Theresa May and her government could wake up tomorrow morning and decide not to exit the EU. It would be political suicide at this point for them to do that, but technically they could. The UK is in a very complex position. Even May's cabinet is divided. She has people on her team who campaigned to Remain as well as people who campaigned to Leave — and they all have to work together. There isn't enough of a consensus within her cabinet to start negotiations yet. Plus, Scotland, Ireland and Wales are putting a lot of pressure on May's government to negotiate a good deal for them as well. Then there are complicated situations, such as Gibraltar, a British Overseas Territory that is heavily reliant on Spain and needs access to the EU. It's going to be very difficult for May to negotiate a deal that will make everyone happy.

Q: What are some of the ripple effects that you foresee happening across the global financial markets, particularly in Asia and the US?



MB: Over the past 100 years, we've become increasingly interconnected. We've even gotten to the point where automated trading is taking place. Whenever there's even a tiny ripple in the market, it can lead to massive implications.

In terms of market impact, one positive for the American market is that if the UK fails to get a good deal when it comes to their

financial services, New York could be the ultimate beneficiary — rather than Paris or Frankfurt. This would have a positive impact on the US economy, though it would be a blow to France and Germany.

The market impact on Asia is a different story. Given what's happening in Asia economically at the moment, Brexit raises a few concerns. China's economic expansion is experiencing a slight decrease, which is worrisome for their neighbors who are dependent on China's massive consumption needs. Businesses in Asia could be hurt by Brexit if global demand for Asian exports slows down. This could hinder the economic growth in those emerging markets.

In a world of over 200 nations, one nation leaving the EU shouldn't have a massive impact. Yet our financial institutions rely on London to manage the movement of our money. If someone says the wrong thing during the process of these negotiations, we might see the money start to move in a different direction. Which is why the best thing to do right now is to remain calm, as I mentioned, and not jump ship too quickly. It will take a few years, but we'll have economic certainty again once the negotiations begin to wrap up.

 **At this point, the best thing that CFOs can do is determine how much risk they're prepared to take on.** 

Q: How can CFOs, in particular, prepare their companies for risk and economic uncertainty?

MB: At this point, the best thing that CFOs can do is determine how much risk they're prepared to take on. For example, when entering a casino, a smart gambler will have decided how much money they're prepared to lose as well as how much they want to win before they walk away. CFOs should start outlining different scenarios and decide which ones they'd be happy with. The most prudent strategy right now is to assess how much risk you're prepared to take should the Brexit negotiations head in a direction that will impact your company's performance.

Q: What are some examples of different scenarios that CFOs can consider as they plan for the near-future?

MB: Sure, let's say an investment firm, based in London, is making a decent turnover year-over-year. Before Brexit, their future looked strong, but now they have a few concerns. The first thing that

they're going to need to reevaluate is what currency they're trading in. The Great British Pound had drastically decreased in value months immediately after the referendum result. This has been good for British exporters, but not for businesses who import to the UK or use the Pound abroad. The London-based investment firm will ask themselves whether or not they should be using the Pound in trade. They'll have to look into other currencies to use, such as the US Dollar, the Euro or the Japanese Yen.

The second thing that the CFO at this London investment firm will need to re-examine is what they'll do if they lose their passporting and equivalence rights in the EU. At the moment, British financial services companies are able to trade within the EU, on the continent, because of these passporting rights. Without those passporting rights, they could lose access to the EU market. In London, this will have a massive considerable impact on everyone in the area. Some of London's largest employers are financial institutions, such as Goldman Sachs and Bank of America. If these companies lose their passporting abilities, there could be layoffs that would have a ripple effect across the entire region.

CFOs will want to closely monitor the strength of the Pound and what their access to financial services will be across Europe, post-Brexit. They need to keep a close eye on what's developing and what the key players are saying.

Chapter 5

Setting the Stage for Current and Future Trade Agreements

Perspectives from Tom Willett, Director of Economic Studies at Claremont Graduate University

Long before Brexit, the pillars of the European Union's fiscal rules were in flux. After the wake-up call that was the sovereign debt crisis of 2009, the countries within the EU began to operate more sustainably, but the groundwork for UK's dissatisfaction with the EU had already been laid. As global financial markets become increasingly interconnected, when one country stumbles, the impact is felt by many.

Tom Willett is the Horton Professor of Economics and Director of the Claremont Institute for Economic Studies in the Department of Economics, Claremont Graduate University and Claremont McKenna College. Here he discusses how the EU crisis set the stage for Brexit and what the vote to Leave will mean for international trade agreements going forward.



Q: How would you summarize the current state of the global financial markets and how they're interconnected?

TW: My analysis of the European financial markets is a little counterintuitive. I've argued that the markets in Europe actually functioned better after the European sovereign debt crisis than they did before.

This is because at the outset the EU was overly optimistic about the success of the monetary project. This optimism caused them to allow for imbalances that only increased over time. For example, the risk premium on Greek bonds was only marginally higher than the risk premium on German bonds, even though Greece and a handful of several other EU countries had several fiscal deficits.

When the Germans initially designed the Euro system they were concerned about inflation, monetary policy and fiscal deficits. They geared the monetary agreement to favor the private financial markets to overcome these issues, believing that those markets would remain stable. Unfortunately, they were wrong and the decision resulted in a massive inflation problem for the EU. Just like the real estate bubble that burst in the U.S. in 2008, there were a number of red flags that, had people paid attention, could have prevented this from happening.

The biggest problems that they had were with the private sector. There was a rampant amount of over-financing and building in Greece, yet the banks continued to finance the deficit. Once the crisis started, the global market overreacted and the outcome was a huge wake-up call for the EU. After that, the EU started to pay more attention to problems they had previously ignored. It became popular to say that the markets had become too pessimistic, and while there is a little truth to this, they actually started to operate more sensibly.

 There was a lot of political pressure to spend more and tax less. 

Q: Part of the problem also stemmed from EU countries breaking some of the monetary rules that were implemented before the crisis. What exactly were some of the rules that were created optimistically and why were those rules broken?

TW: There was a lot of political pressure to spend more and tax less. Because of this, they created rules, such as limiting fiscal deficits to 3 percent GDP to prevent things from getting out of hand. However, there was no way to enforce these rules. That in itself was the subject of much debate.

I predicted at the time that the rules would be effective with smaller countries, but not if larger countries, such as France or Germany, ran into trouble. Which is, ironically, exactly what happened first. There were strong political pressures in both countries to not increase taxes or cut government spending. To meet these demands, they were given exemptions by the EU.

The system was set up in a way that didn't impose sanctions on countries automatically. When a rule was broken, it triggered discussions among the council ministers i.e. the representatives of each country. Germany and France were given exemptions under special circumstances. The other EU countries were not really in a position to push back either. However, once the precedent was created for exemptions of this nature, it became much more difficult to enforce the fiscal deficit limitation on the smaller EU countries. The monetary system pretty much broke down from then on, leading to the crisis in 2009.

Today, the monetary structure of the EU has been strengthened, but it is yet to be determined whether it will hold up or not. When a temporary breach occurs, it's not much of a problem if it occurs in isolation. However, when it happens consistently, the system begins to fail — and every country claims that their breach will be a temporary one. Because of this, the rules have to be enforced politically, which makes enforcing them very complicated.

Q: How did this instability in the EU contribute to Britain's vote to Leave, i.e. Brexit?

TW: In EU countries there is a constant struggle between the desire to hold on to their national sovereignty versus accessing the benefits of international cooperation. What makes this even more complicated are what we refer to in economics as “time and consistency problems.” When costs and benefits exhibit different patterns, both humans and governments tend to prioritize benefits over costs. For example, you may want to eat an extra slice of pizza for dinner, but later on, you may regret that decision when it increases your waistline. The EU consistently exhibits a similar pattern by agreeing to things for the immediate benefit without fully considering the long-term costs.



During the design of the EU, the rules and agreements that they made weren't strict enough, such as allowing for temporary exemptions to the fiscal limits. However, if they had said up front that countries would lose a lot of their national sovereignty, we probably wouldn't have the EU today.

Q: What were some of the perceived financial costs and benefits of Brexit, for both the short and long term?

TW: What's interesting is that finance had almost nothing to do with the vote — even though it should have been a major consideration for the people of the UK. While economic dissatisfaction, immigration reform and a negative perception of EU bureaucracy all played a role, the biggest driver for the vote to Leave was the campaign itself. The arguments for the benefits of leaving were very simple, but the arguments for the benefits of staying were much more complicated.

The general perception that the Leave campaigners strove to create was that the UK could exit the EU without suffering any losses and many people were convinced. With fewer bureaucratic regulations and less immigration, they promised more economic prosperity for UK citizens. They would talk about how much the UK contributed to the EU financially, billions every year, without mentioning the huge amounts of money that came back to the UK as well.

Additionally, much of the Leave campaign exaggerated how easy it would be for the country to separate itself. The process is much more complex and will result in a certain amount of costs. For example, all trade agreements need to be completely renegotiated. This will be no easy feat. Take, for example, the free trade agreement that was negotiated for over six years between the EU and Canada. Although many people don't know this, most trade agreements in the EU require a unanimous vote from all members. Canada's agreement was voted down by Belgium because their government will only support a treaty if all of their regional governments support it. Which means that out of the entire EU, about three million people were able to strike down the whole trade agreement.

 While economic dissatisfaction, immigration reform and a negative perception of EU bureaucracy all played a role, the biggest driver for the vote to Leave was the campaign itself. The arguments for the benefits of leaving were very simple, but the arguments for the benefits of staying were much more complicated. 

Q: From what you're saying, it sounds like there might not even be a timeline in place for this major transition.

TW: It will take much longer than Leave voters anticipated to begin the exit process. While a pure trade deal doesn't take very long to execute, trade agreements today are usually about much more than simply tariffs and trade. Governments have to take into consideration services, the harmonization of regulations and dispute settlement procedures — which are much harder to negotiate. Additionally, the UK doesn't have the professional capability to negotiate these kinds of trade agreements because for decades they have been done through the EU. This will most certainly slow things down.

Q: What could be some of the ramifications of not having a definite timeline?

TW: The ambiguity around the timeline will have the biggest impact on the financial industry in London. These companies will want to maintain their access to the financial markets and services within the EU. They'll want to be able to continue to do business without having to deal with complications, such as new licensing or losing the ability to passport, which allows financial service providers to freely trade across the EU. They're the most worried about how Brexit will impact their status as the main financial center globally. While much of the speculation that another EU city will take London's place is exaggerated — no other EU city

has the services, talent or depth of knowledge — this will definitely hurt the UK's dominance in finance.

There is a small group of people, such as economist Patrick Minford, who believe that Brexit will reduce trade barriers and be good for the UK economy. This is a possibility as an aggregate price drop in imports would be in the economic interest of the UK. However, this possibility seems unlikely politically. The new Prime Minister, Theresa May, hasn't shown a strong inclination for free trade and to date, her stance seems to be set in increasing industrial policy rather than decreasing it.

Q: What are the challenges that the UK will likely face as they begin the exit process?

TW: The biggest challenge is that the government would like to restrict immigration, yet still maintain their access to the single market. Many of those in favor of leaving the EU have mistakenly believed that they could follow in Norway's footsteps. Norway isn't a member of the EU, but they are a member of the single market through their membership in the European Free Trade Association (EFTA). What the Leave voters didn't fully understand is that, like Norway, they would no longer have a say in any of the EU's rules and they won't be able to restrict movement and immigration. The freedom of mobility is such an essential right to the EU, it's highly unlikely that they'll negotiate a trade deal that restricts it. There is a long road ahead for the UK and the EU as they navigate this new territory, and the result might not be exactly what the Leave voters had in mind.

Market Volatility and Crisis Environments: An Investor's Birds-Eye View

Perspectives from Ralph Drybrough, Managing Partner at Fort Point Capital and Co-Founder of StratiFi

Unprecedented geopolitical events highlight the need for investors and enterprises to revisit their approaches to risk management and protect themselves from extreme market events in the future.



We speak with Ralph Drybrough, Managing Partner at Fort Point Capital and co-founder of StratiFi, which builds technology for advisors to help their clients address market volatility in their portfolios. Drybrough brings a wealth management perspective to the discussion of market risk and argues that we need to examine geopolitical events over broader time horizons and with an eye toward their interconnectedness.

Q: How are you thinking about risk management and market volatility today?


RD: I work with investors to manage risk in their portfolios, and I place special focus on market volatility and extreme events. Individuals and enterprises alike need to consider how stressed markets and global crises can affect their holdings or their businesses.

At Fort Point Capital and StratiFi, our approach to portfolio diversification takes a step beyond the traditional wisdom, which is to hold a variety of asset classes. If stocks drop, bonds provide a valuable offset—they ideally are a source of strength in your portfolio that helps mitigate the boom and bust experience of investing in equity only. It's an important first step, but it's also usually where the exercise starts and stops.

We need to ask ourselves: is there really portfolio diversification if a global crisis occurs, and assets suddenly correlate and drop in a coordinated fashion?

 When you pull back, you see a series of risks that have continued to mount in the global economy and the geopolitical arena. 

We help clients think about these “tail environments,” or crisis environments, with substantial market declines approaching 20% or more. Our strategy is to build portfolios with another source of diversification by treating risk or volatility itself as an asset class. For example, clients might incorporate the VIX index (CBOE volatility index) into their portfolio and give it a seat at the table alongside stocks, bonds, cash and alternatives.

 We need to ask ourselves: is there really portfolio diversification if a global crisis occurs, and assets suddenly correlate and drop in a coordinated fashion? 

Q: Are investors and companies paying more attention to potential tail environments in light of recent geopolitical events?

RD: People are reexamining what risk management means in a time when unprecedented events are unfolding. Brexit is a fascinating base case for this: pundits in most markets said it was very unlikely to happen, yet it did.

When you pull back, you see a series of risks that have continued to mount in the global economy and the geopolitical arena. We believe they are introducing more uncertainty relative to any time in the past half century. The Brexit vote occurred in June 2016 and the US election followed shortly after. We have important elections and constitutional referenda in 2017 across Europe, as well as new, and rather fluid, developments with global forces such as ISIS. There's a policy experiment where we saw \$13 trillion of global negative-yielding debt in the US in the second half of 2016, as well as the increasing threat of cyber terrorism and beyond.

Taking these collectively really highlights the need for people to have volatility strategies that protect against both known risks and unforeseen circumstances alike.



Known risks are systemic and measurable in markets -- phenomena like overvaluation. Then you have exogenous risk, or event risk, which is beyond our ability to predict and quantify. Examples

include acts of nature, nuclear reactor meltdowns and pandemics. I believe people focus more on known risks, and don't focus enough (if at all) on the unknowables.

Q: How can people reframe their view of risks, especially the "unknowables?"

RD: Most people have, at maximum, a 50- to 100-year historical perspective. Those sound like big numbers, but people need to examine the past with even broader time horizons. What's more, they tend to view geopolitical events like Brexit in isolation, and aren't thinking about domino effects and daisy chains. History will draw rather straight lines of causality between events that, as they unfolded, were perceived as idiosyncratic in nature.

People also need to seek out contrarian points to challenge their strategies, spending less time talking about what they're doing right and more time critiquing and taking steps to protect themselves against forces that they cannot control. What we're seeing unfold in the world right now should be creating a tailwind for more thoughtful examination of risk, for individual investors and enterprises alike.

 What we're seeing unfold in the world right now should be creating a tailwind for more thoughtful examination of risk, for individual investors and enterprises alike. 

Brexit & the New European Unitary Patent

Perspectives from Stuart Bartow, Partner at Paul Hastings

Some CFOs and risk officers will want to explore uncertainties relating to research and development expenditures. The legal vantage point provides additional context for these uncertainties.

The patent system in Europe is about to undergo a significant change. Currently, there are two distinct but related legal regimes for patent procurement in Europe. In the first regime, patents can be obtained on a national basis within each country.

Alternatively, in the second regime, there is a mechanism for obtaining a European Patent from the European Patent Office under an agreement called the European Patent Convention.

However, the existing European Patent can only be enforced on a country-by-country basis, and must be validated in each country participating in the European Patent Convention.

To streamline patent enforcement and validation across Europe, a new option has been planned: an optional “unitary patent,” which is a type of European Patent that would have effect in all participating countries, with centralized procurement, enforcement, and validation proceedings. This third option was slated to become available in late 2016 or early 2017, but Brexit has complicated its introduction.

Stuart Bartow is a partner in the Intellectual Property practice of Paul Hastings, LLP, an international law firm that serves a wide range of clients including Fortune Global 500 companies and leading financial institutions. Bartow’s Silicon Valley-based practice focuses on complex litigation and other disputes concerning high technology. Here he discusses the planned unitary patent and the potential impact of Brexit on its future.

Q: What is the European unitary patent?

SB: The Unitary Patent—more formally the “European Patent with unitary effect”—is a planned type of European Patent which will provide inventive rights across contracting member states in Europe. The Unitary Patent will be effective, enforceable, and contestable across all participating states upon opt-in to unitary effect by the grantee.

A “European Patent” has been available under the European Patent Convention (EPC) since the 1970s, but the existing form of European Patent is enforced and validated only on a country-by-country basis. The Unitary Patent, in contrast, will have “unitary effect” across the participating member states and will have centralized enforcement and validation proceedings.

With respect to enforcement, the Unitary Patent will be enforced in a new judicial body called the Unified Patent Court. The central division of the UPC’s Court of First Instance (there will be

regional and local divisions as well) is planned to have its seat in Paris, with sections in London and Munich. An appellate branch will be seated in Luxembourg, and the existing Court of Justice of the European Union would serve as the court of last resort for appeals concerning certain EU law issues.

Planning for the UPC has been underway for years, and planning had been proceeding apace fairly recently towards a potential 2016 or 2017 start date. And then came the Brexit vote in June 2016, which threw a bit of a wrench into things—at least temporarily.

Q: How does the Brexit vote affect plans for the Unified Patent Court?

SB: At least as the UPC is currently agreed and planned, the UK’s departure from the EU had the potential to impact its ability to participate in the UPC scheme. Thus, the Brexit vote created substantial uncertainty.

By way of background, the Unified Patent Court Agreement is the multi-lateral agreement that would bring the UPC formally into being. Twenty-five out of twenty-eight EU member states signed the agreement, but the agreement only enters into force after it is ratified by thirteen contracting states, which must include Germany, France, and the UK. Of those three essential ratifying states, only France has ratified so far.

What makes things problematic for the UK in ratifying is that the agreement was drafted such that only EU member states can participate in the UPC. Although the UK remains a member of the EU for the time being, once the Brexit process has concluded—let’s say about two years from now—that will cease to be the case. Moreover, the agreement mandates the application of EU law within the UPC. In view of the June 2016 referendum, the UK government has suggested that the UK likely is unwilling to be bound in any respect by EU law and by EU legal institutions such as the Court of Justice of the European Union, to which the UPC would need to defer on certain EU law issues. Those two complications, among a few others, created a potential impediment to the UPC going forward with the UK as a participating state.

So, in short, after the Brexit referendum, it became clear that there were both legal and political impediments that would need to be cleared in order for the UK to participate. I was at a conference in Paris in October 2016 where some of these issues were discussed by some of those closest to the planning, and it became clear to me that stakeholders on both sides believe there is a path to resolving the existing legal impediments. And indeed, the UK government announced in November 2016 that it was still making

preparations to ratify the agreement. However, there are still political issues looming that will need to be resolved, such as whether the UK is willing to assent to the primacy of EU law in patent disputes. Issues such as this will most likely need to be resolved in the context of the broader UK-EU negotiations over exactly what form Brexit will take—for example, whether we see a “hard” Brexit or some moderated form of departure.

Q: How is Paul Hastings evaluating scenarios and risk factors with respect to future changes in patent law?

SB: We’re monitoring the situation with the UPC carefully. Our colleagues in our London offices are close to the action, and so that helps our firm anticipate upcoming developments. And the rest of our practice group around the world is paying attention as well. At the moment, the UPC Preparatory Committee believes that the UPC can start up around the end of 2017, and we’ll need to see whether that timing works out or not.

From a risk perspective, if the Unitary Patent and the UPC somehow failed to come online, then we’re essentially dealing with known risks, because we’ll have the existing European patent system under the European Patent Convention. The situation gets a little more complicated if Unitary Patent and the UPC come online but the UK does not participate. Then we’ll have a situation in which much of the EU will have a unitary system, but the UK, one of the larger markets in Europe, will continue to have its own enforcement and validation scheme on a purely national level.

Q: What steps is the Paul Hastings team taking with its clients to prepare, particularly Fortune 500 companies with a presence in the EU and around the world?

SB: We know that business leaders who deal with intellectual property are following the Brexit situation carefully. We’re working with our clients to prepare for and adapt to whatever result ultimately comes about. Of course, we try to plan for every contingency. At least for the time being, however, the Brexit referendum has introduced some uncertainty regarding what patent procurement and enforcement will look like across Europe in the coming years. And these developments certainly will be interesting to watch.

Prioritizing Post-Brexit Response Activities

Perspectives from Rachel Broquard, Partner at Eversheds Sutherlands (International) LLP

There is no one-size-fits all Brexit response strategy. The referendum and its ripple effects on law, immigration, and trade policies will have vastly different implications from business to business and sector to sector. This makes it difficult for companies to grasp the universe of potential change and prioritize their responses.

C-level executives are turning to third-party experts and sector-specific research to improve their visibility into an unpredictable future. Rachel Broquard is a Partner in the City Corporate practice of Eversheds Sutherland, a leading global law firm and a source of highly specialized research on Brexit across many sectors and areas of law.

Broquard advises global multinational corporations and domestic UK corporations on the implications of Brexit, and is a member of an Eversheds Sutherland Brexit steering committee composed of experts in areas such as trade law, competition law, employment, and contracts. We speak to her about the key areas to watch and the importance of creating a tailored strategy to assess the unique impact of Brexit on each business.



Q: What areas do you focus on in your Brexit research?

RB: It's tricky to operate a business in this climate of uncertainty, particularly in terms of planning and forward-looking strategy. So anything we can do to help our clients think about what may happen in the future gives them a framework within which to operate.

We have undertaken a considerable amount of research about how Brexit could impact different sectors and areas of law. For example, we look at how UK laws might change in the future, what Brexit means for UK and non-UK companies, potential tariff levels in a scenario where the EU and UK do not reach a free trade agreement by the withdrawal date, and so on. Our clients operate in a broad range of industries around the globe, so we have written resources for specific sectors, such as retail, food and drink, diversified industries, financial services and chemicals. (These sector deep dive articles can be found in the Resources section of Eversheds Sutherlands' [Brexit hub](#).)

And when we work directly with clients we take a closer look at their particular circumstances, such as their location and corporate structure, what their activities and manufacturing capabilities are, and the nationality make-up of their employee base.

We continuously strive for clarity by monitoring political and legal developments in the UK and EU, and in fact we have a dedicated awareness team that keeps us up to date with Brexit developments. We also liaise with various chambers of commerce and trade bodies, make submissions to parliamentary committees

 The biggest impacts will differ greatly from company to company depending on the sector, type of business, and how they are set up. 

setting out our views and those of our clients, attend seminars and conferences to hear what other experts say, and run our own thought leadership events where industry members share what's happening in their sector.

Q: Of all the ways Brexit could impact businesses in the UK, which are you watching most closely?

RB: The biggest impacts will differ greatly from company to company depending on the sector, type of business, and how they are set up. For example, the potential loss of passporting rights is huge for financial services businesses. Uncertainty in this area is leading them to think carefully about how they are structured and whether to take preemptive action.

Other businesses will be most impacted by restrictions on employing EEA citizens in the UK and vice versa. This is a big concern for the food industry, which relies on seasonal workers, many of whom are non-UK citizens from the EEA. And new migration policies may draw a distinction between workers who are already in situ and those seeking free movement after Brexit, which may impact on recruitment strategies of businesses.

Another area to watch is import-export friction at the border: potential tariffs and non-tariff barriers, customs formalities, rules of origin, and so forth. This could have a significant impact on the cost of doing business if we end up without a free trade agreement at the withdrawal date.

There is also the potential loss of freedom to provide services in the EEA without having an established place of business there, and vice versa for businesses based in Europe providing services in the UK. Generally speaking, free trade agreements tend to cover goods only (rather than services).

And we are looking at the potential longer-term risk of regulatory divergence between the UK and the EU, which again could increase costs for business.

Q: How do you contextualize your research on Brexit to greater geopolitical uncertainty?

RB: Brexit needs to be viewed in the context of what else is happening in Europe. It's by no means the only item on the agenda of the EU-27.

Eversheds Sutherlands has offices in a number of European jurisdictions and across the world including the US, which helps us put Brexit into the broader context. The main thing we do is work with other professionals, such as economists and accountants, to undertake micro- and macro-analyses to ensure that the research and advice we are providing takes into account some of the larger issues facing our clients' businesses. We also work with business analysts to support our advice as it applies to specific sectors.

Q: What challenges should C-suites, particularly CFOs, anticipate?

RB: First and foremost, if they have not already done so, they must closely monitor fluctuation in foreign exchange and put a strategy in place that deals with volatility. This is likely to have a real impact on margins.

Secondly, businesses are likely to face workforce challenges with UK workers in the EEA and vice versa. As I mentioned, there could be potential issues with recruiting talent to businesses in the future, due to changes to the migration system in the UK and the UK being treated as a third country for EEA migration. The exact nature of the restrictions may differ by country depending on their immigration laws.

Another challenge for C-suites is to ensure that their concerns are heard by government. As the government enters UK-EU negotiations, they will be considering carefully how Brexit will impact businesses. Companies should therefore have a clear strategy, which starts with an analysis of the likely impact of Brexit on their business, and then communicate their views to government officials and interest groups.

Businesses may also need to adapt their corporate structure in response to the ways that Brexit impacts their operations. This could involve cross-border mergers, moving around logistics sites, setting up subsidiaries in different jurisdictions, and rethinking how their manufacturing and import and export matrices are structured. Longer term contracts (particularly those spanning across the UK exit date) should be reviewed and amended appropriately.

Finally, executives should carefully consider what they need to disclose in corporate financial reporting with regard to risks and the potential impact on operations.

Q: What functional steps are you encouraging your own clients to take?

RB: If they haven't done so already, companies need to pull together the appropriate people across their organization to understand the likely impact of Brexit on their operations. They need to bring non-executives on board as well so the company can call on their vast experience and expertise to help with business planning.

They should also think about involving third-party experts, such as external legal counsel, accountants, and public policy advisors. For example, at Eversheds Sutherlands we're helping clients with trade risk analysis, Brexit-proofing contracts, anticipating future regulatory change, and assessing the impact of factors such as workforce nationalities.

Broadly, we encourage companies to stay abreast of Brexit-related developments and appropriately communicate their concerns to government officials in the UK and EU-27 as early as possible.

 Companies should therefore have a clear strategy, which starts with an analysis of the likely impact of Brexit on their business, and then communicate their views. 

How to Mine Business Intelligence to Manage Risk

Perspectives from Martin Sciortino, Chief Enterprise Risk & Audit Officer at Dun & Bradstreet



Effective risk management starts with the right information. When companies uncover quality business intelligence, they can better navigate their earliest decisions about how to address a risk, whether they choose to take direct action or simply monitor it. Post-Brexit businesses face intensifying pressure to find smarter ways to arm themselves with insights, as a rapidly changing geopolitical environment introduces more uncertainty and risk than ever.



Here Martin Sciortino discusses powerful approaches to risk management, as well as risks to watch in 2017 and beyond. Sciortino is the Chief Enterprise Risk & Audit Officer at Dun & Bradstreet. Previously, he was Dun & Bradstreet's Chief Financial Officer for Europe, based in the United Kingdom.

Q: Dun & Bradstreet has been immersed in the world of business insight and risk management for 175 years. What advice do you have for organizations that are unsure how to begin navigating uncertainty?

MS: Insight is at the heart of risk management. Managing a risk starts with a decision about whether to monitor it, fix it or get ahead of it. What kind of information do you need to be able to make this decision?

Dun & Bradstreet provides that type of insight as it applies to credit risk, for example, but there are many other risks that companies must manage. Data as a service provides key information about the external world, and a new and effective way to gather internal intelligence is to source it from employees on the front lines of the business and bring it up to a higher level to see risk holistically across the company.

 Risks don't remain in silos, and an issue in one area will spread to another area if people don't collectively address it. 

 Insight is at the heart of risk management. Managing a risk starts with a decision about whether to monitor it, fix it or get ahead of it. What kind of information do you need to be able to make this decision? 

Q: How does this new way of assessing business risk differ from the old approach?

MS: In the past, a strategy group or audit group within the company would interview employees to uncover its business risks. While this is still a valid way to do it, in a rapidly changing geopolitical landscape, companies need to get ahead of all the uncertainty. The more a company experiences changes in strategy, customers and technology, the more important this becomes.

Instead of keeping the interviewer group separate from operational employees, companies can embed risk management closer to the front lines of the business. There are key people who deal with issues from a customer perspective, regulatory perspective, IT security perspective and more, day in and day out. Rely on them and empower them to assess risk. This helps you uncover the most valuable information which really influences decision-making at a high level.

MS: We also recommend that companies assemble a cross-functional team with leaders from finance, legal, people management, IT, etc. Risks don't remain in silos, and an issue in one area will spread to another area if people don't collectively address it. For example, if a company is dealing with a cybersecurity risk, it cuts across the business, begins to impact customers, which affects the sales function, and so on. Companies need to break down the walls and create a mechanism for people to communicate and look at risk holistically through operational lenses as well as legal and financial ones.

Q: What are some of the biggest risks that C-suites should be watching for in the coming years?

MS: There are a few risks that have a consistent presence and are only intensifying:

- **Cybersecurity:** This is a key risk that will be around for a long time for many companies.
- **Regulatory environments:** The regulatory environments in the US and Europe affect everyone, even companies that aren't regulated (because of their regulated customers).
- **The pace of innovation:** Customers are demanding newer, refreshed products at a faster pace than ever. How do companies keep up? Innovation is no longer just a question of getting ahead; sometimes it's simply to maintain their customers' baseline expectations.
- **Change fatigue:** How can teams keep their workforces energized instead of exhausted by the efforts of keeping up with corporate change?

Q: What causes change fatigue?

MS: Overactive M&A activity is one cause. A company goes into acquisition mode, and the integration of so many capabilities, technologies, customers and employees gets tiring. Their organization is diluted, they've lost sight of why they did the acquisitions in the first place and they still need to figure out how to integrate everything to create a seamless offering.

There are also simply overworked employees. In an environment where you're constantly pumping out new products and trying to meet customer demands, you must look out for your people.

Q: What risks tend to blindside companies? Is there anything in the coming years that has a high probability of catching someone off-guard?

MS: We call these risks "black swans." This is when there's a low probability of an event happening, but if it does, it will disrupt your business model. A black swan falls off your radar because it's so unlikely and generally unexpected, but it can change everything overnight.

Black swans differ from company to company. A simple example is a type of competitive risk where a giant player with much more financial capital than you have moves into your space with a new offering and starts taking your market share. One day it was business as usual, and the next day you find yourself in reaction mode.

Regulatory risk is another example that will be highly relevant in the next few years, where a policy changes with a stroke of a pen and heavily influences your business. There are also reputational risks: all of a sudden your company is in newspaper headlines because of an event that damages your reputation.

Q: What has made Dun & Bradstreet so successful in long-term strategic planning and weathering change for 175 years?

MS: It comes down to being adaptable. Roll with the punches and accept changes outside company walls, because nothing is perfect. Our management team is very open to change; in fact they look for it in order to advance our strategy and prevent us from being stuck in the past. Companies need to look forward, both to get ahead of risk and to grow.

Data-Driven Agility, Technical Flexibility and Transparency: The Post-Brexit Formula CFOs Need

Perspectives from Stephen Ufford, CEO and founder at Trulioo

With London considered by most to be the center of the financial world, the UK's exit from the EU is no small matter for fintech companies. While many predict that it will take a long two to three years for the UK to completely exit the EU, for the heavily regulated finance industry two years seems like hardly any time at all. The finance industry already struggles with compliance, paying billions in fines every year. The re-negotiation of trade agreements, policies and laws will make compliance even more of a challenge for financial institutions.

Stephen Ufford, the CEO and founder at Trulioo, a global ID verification company, has made it his mission to provide fraud prevention and compliance systems for hundreds of innovative customers in the fintech space, including payment providers, eCommerce merchants and acquirers, financial services providers, online gaming and online marketplaces. Trulioo is able to verify the identity of over four billion people, across 60 countries using identity intelligence data. Here Ufford discusses how regulatory technology that is agile, flexible and transparent will help companies, especially financial organizations, remain compliant during economic uncertainty.

Q: Why are agility and flexibility so important to Trulioo, so much so that you put them at the forefront of your organization?

SU: To put it simply, I think that the market demands that now. I see regulatory technology as an enabler of financial technology, whether if that tech is a 20-year old system or a new breed of fintech. Regulatory technologies (regtech) are what make financial technologies work for consumers and because fintech is extremely nimble and adapts quickly to changes, regulatory technology needs to function in the same way. Just consider the last five years, fintech solutions have gone mobile first, cloud first and cross-border at a remarkable speed — and all driven by consumer demand.


For Trulioo, we wanted to design our product around solving the pain points of fintech. We knew that in order to do that, we ourselves needed to be just as adaptable and flexible as our customers. Whether a condition in one country changes or consumer preferences change, our customers need to know that they can rely on us to adapt right along with them.

Q: Speaking of your customers, what are some of the questions or concerns that you're hearing from them in regards to Brexit?

SU: Our primary use case is automating the customer onboarding processes for fintech companies. For example, if a consumer signs

up for a new account with either one of our payment customers or banking customers, we use that consumer's data to automate that process. As regulatory and financial technology is still relatively new, there are still many questions about how using and storing consumer data can be done globally. There's a huge demand for global products that can move money around the world, such as peer-to-peer economy models that require trust across borders.

Prior to Brexit, the fintech world still hadn't worked out all of the kinks in this process and now that Brexit has been announced, there are even more questions and confusion. Our customers want to know how they can remain compliant when handling consumer information, whether they can move data across borders, what the status of regulations is today and what it will be tomorrow. There's no shortage of questions and we don't have all the answers yet. To bring this back to my point about agility and flexibility, they are even more important now than ever.

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Q: Can you give me an example of something that might change very quickly? Something that might necessitate a very drastic technical shift.

SU: As the number of digital transactions grow, so do global compliance concerns. While before, we had a very simple, physical way of establishing consumer identity, relying on things like passports or driver's licenses. Regardless of whether you were in Europe, Canada or the US, that was a pretty well-known method. Now that we have banks who are moving money all over the world online, we have start-ups that began as chat applications or gaming platforms and are now managing billions of dollars in digital transactions. Many of these models were kept under close examination when we understood what the compliance regulations were.

The problem facing us today are the repercussions of running afoul of fast-changing international regulations. Before, if someone from Canada was paying someone in the UK, they knew how to do that compliantly. However, now that could all change. A financial company could be moving trillions of dollars a week, but if they pay even just \$100 to the wrong person they could lose their license, face expensive fines or even wind up with a jail sentence. Compliance is the number one concern right now. The fact that this is happening in the UK complicates the problem even more since London is the world's fintech and money management hub.

As the number of digital transactions grow, so do global compliance concerns.

Q: What areas of their business should CFOs of Fortune 500 companies be looking at to be more flexible and agile?

SU: CFOs should be looking into investing more in the cloud first and analytics that will give them insight into policy across the organization second. For CFOs who are trying to assess organizational risk, especially in the regulatory environment, analytics are crucial to understanding what you're doing in different countries, how you're moving money into countries, like the UK and what regulations you should be following. To avoid fines, the cloud will give you the agility that you need and analytics can help you get the right controls in place to see the whole global view of the business. We can't just function within one region anymore.

CFOs should be looking into investing more in the cloud first and analytics that will give them insight into policy across the organization second.

Q: What are some things that companies shouldn't overlook when they're looking to invest in cloud technology for finance, for instance?

SU: Well, for example right now we're working on rolling out a product with one of the biggest banks in the world and so far the biggest obstacle is that they still have a number of rigid, out-of-date policies. To adopt technologies, such as the cloud, you can't have these kinds of policies because they will prevent agility. For example, if your compliance team wants to use a new analytics dashboard that will give them insight into their onboarding process all over the world, you have to be prepared to remove your policy that requires that the cloud provider submits a background screening of every employee at their data center. That wouldn't really work and being rigid about a policy like that — especially when your competitor isn't — can cause your organization to fall behind.

Many enterprise organizations haven't yet adapted their policies so that they can take advantage of the tech solutions that would help them weather changes in the global economy, including Brexit. So many people in the compliance space know that these changes are coming and that they'll need to bring in new technologies, but they're stuck with rules that were written long before cloud technology was available. Right now, I'm seeing this scenario play out over and over again, especially at large financial institutions.

Q: What should the leadership on these teams do to help their organizations become more agile and adaptable?

SU: There are three things CFOs can do to start helping their organizations become more agile:

1. Partner with vendors who complement your existing infrastructure. Make it clear that you're not trying to replace the solutions you already have; most organizations don't have either the desire of the time to rip out billion-dollar systems that are working. Especially when it comes to regulation technology, a lot of these systems were built over decades ago, so a divestment would be a huge undertaking. Instead, looking for vendors who will help you become more compliant and more nimble, but won't require you to rebuild.



2. Update internal security and compliance. The next wheel that I would set in motion is to ensure that all of your internal security and compliance policies are up to date. This includes looking into new technologies and making sure your systems are completely current.

3. Set aside budget for acquiring new, innovative solutions. There are a lot of innovation leaders in this markets who are looking for solutions that will help address Brexit, but they don't have any budget. I would start setting aside time and resources for these individuals to do more than just analyze the market, but actually make moves to acquire new solutions. No one is in a better position to make this happen than the CFO.

Q: How can CFOs best distinguish which software solutions are truly agile and able to help their organization evolve with changes?

SU: The most important thing to look for in any product is transparency. If you have a product that works really well, but you don't know why, how can you expect it to be agile and subject to change later? For example, if you're running an identity or KYC scoring product that is performing well and meeting all of your benchmarks, but you can't see into the product to know what data it's using, it's not transparent. This will make it difficult if you need to change it later to meet new compliance terms, for instance.

In today's environment—even more so after Brexit—transparent products will be the most successful in the long term. As the CFO, you need to know how your products work to be able to predict whether they'll continue to working for your company in the future.

 As the CFO, you need to know how your products work to be able to predict whether they'll continue to working for your company in the future. 

Q: How will a more streamlined technical strategy minimize any potential losses, surprises or twists and turns in the global economy that could happen?

SU: The biggest challenge businesses will face with Brexit will be striving to comply with the new rules — and regulation technology is all about compliance. CFOs will need to look closely at the technology they use today for compliance and make sure that it's up to scratch. If you think as a CFO that compliance is expensive, try dealing with the costs of noncompliance.

Before, companies would go with the absolute minimal viable option when it came to developing a technical strategy for their compliance. However, the world is changing fast and compliance won't be a stack of papers and policy any longer, which means it will require a change in mentality around spending and allocating budget for the best systems and tools. At the end of the day, you want to know that the solution you have will prevent your company from paying millions in fines.

Companies Chart Their Paths for a Post-Brexit Future

Perspectives from Mary Shelton Rose, US Brexit Response Leader at PriceWaterhouseCoopers

For decades, the EU has simplified trade regulations to allow labor, capital, goods, and services to move freely across borders. Companies across the world that rely on the UK as a base for business in Europe can no longer take these benefits for granted when Brexit is set in motion.

Some businesses are asking what steps they can take to prepare for economic changes, while others consider a “wait and see” approach. However, with Brexit’s lengthy negotiations processes, the clarity needed to take action won’t emerge quickly.

Mary Shelton Rose is an Advisory Partner at PriceWaterhouseCoopers and leads their US Brexit Response office, where she helps clients navigate risks and opportunities linked to Brexit. She discusses how companies are managing their business risk through detailed scenario planning, improving their ability to act quickly once the realities of Brexit come into focus.

Q: What discussions are U.S. based companies having about risk management in the wake of the Brexit vote?

MSR: Brexit has surprised people at almost every turn. From the vote’s passing, to the timing of Theresa May becoming Prime Minister to the planned trigger of Article 50 before the French and German elections, it has been fascinating to watch as this unfolds. Brexit has raised many questions about what’s in store for businesses engaged in global trade or use it to reach the rest of the continent.

At PwC, we’re having conversations about this with companies in nearly every industry, including financial services, industrial products, consumer retail, pharmaceuticals and many others. We’re watching Brexit developments closely and discussing them with CEOs, CFOs, COOs and boards every single day.

Ultimately, everyone is asking what Brexit and the UK’s future relationships with the EU will look like.

Companies with direct operations in Europe are taking a close look at their businesses to understand how new regulations and currency volatility might affect their operations, talent pool and supply chains.

Q: Which internal variables are companies evaluating? How is PwC helping organizations lay out a path for the future?

MSR: There is no one prescriptive approach to prepare for Brexit. Every industry and every company will be affected differently.

At PwC we’re helping companies do their own situational analysis to determine their unique exposure to Brexit. We then

assist them in scenario planning to anticipate a variety of Brexit outcomes and what each one will mean for their business.

This type of foresight will allow companies to set plans in motion as soon as they get more clarity on Brexit. This is a marathon, not a sprint, and we’ll only see which scenarios manifest as we reach the end of the negotiations.

Q: How can companies define their areas of exposure?

MSR: We use a framework to evaluate four key factors:

1. The depth of your ties to the UK economy.
2. Your exposure to the UK’s legal, regulatory and tax environment.
3. Your supply chain: how much you rely on selling goods and services across borders.
4. Your workforce: how much you depend on free movement of labor between the EU and the UK.

An assessment of these areas of exposure will help you understand the implications of changes to strategic assumptions that underlie your business and help you make informed decisions about taking action for different Brexit scenarios.

Let’s take a closer look at supply chain, which is a very meaningful area of focus for CFOs to evaluate because of substantial cost changes. We’re encouraging businesses to map out their flow of goods and services today, as well as how it would look in various exit scenarios.

If the UK is no longer part of the single market and new customs borders impose customs duty and import VAT on all the goods that cross the border, how will that affect your cost of trade? At minimum, you’d have to comply with new administrative requirements. You also might begin to rethink your supply chain and the flow of goods, or need to make expensive modifications to your technology systems to accommodate new circumstances. How would all these costs, which don’t exist today, affect your company’s economics?

Your workforce is another area to evaluate immediately. What would immigration changes mean for your key talent? Would they be able to work in the UK? What are the critical skills for your business, and how would you backfill them if you no longer have access to key talent? Additionally, how would a pension deficit impact your workforce? It can take years to answer these questions, so proper preparation and planning are essential.

Companies should seek to understand the demographics of their employees, identify people in key talent positions and assess whether they'll have the necessary access to human capital. We're also encouraging organizations to have meaningful communications with their people about the topic. As you can imagine, this is a very personal issue for individuals who might be impacted by Brexit.

Q: Are clients taking proactive steps or opting for a "wait and see" approach?

MSR: There are certainly companies that are taking proactive steps, while others have decided to "wait and see." Even these organizations should be doing situational analyses and scenario planning. I call this an informed wait and see. It helps companies understand their vulnerabilities and opportunities, anticipate what operational changes might look like, determine whether investments in the UK make sense and so forth.

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Q: Will scenario planning for Brexit encourage or stifle corporate innovation?

MSR: I think scenario planning can be a very innovative exercise. The vote isn't very old and we're already seeing a wide range of activities, more engagement and evaluation.

Sometimes these discussions are about how Brexit will disrupt a company's business as usual. In other cases, they have a different tone because the company is at an inflection point where they need to make a significant decision about a big transaction or capital investment.

Q: How can CFOs and other business leaders increase their chances of a successful risk management initiative?

MSR: Have a point of view. Have informed, cross-functional conversations. Stay as closely connected with the UK and other governments as possible.

Conclusion

As the transactional footprints and digitalization of social behavior expand in breadth and velocity, relationships are all we have in an environment where disconnection shapes the dialogue in business. And data does not give us better relationships, but insight does.

Prioritizing finding truth and meaning in data to grow the best relationships may be what helps to tie a business world rocked by disruptive global events such as Brexit together. The increase of the breadth and depth of the finance role isn't changing, but the potential to affect change and drive strategic narratives is also at an all-time high. It's up to the strategically-minded CFO to understand and lead through this uncertainty—while keeping calm and carrying on. It's a tall order, but one that the CFO is uniquely equipped to adopt.

Dun & Bradstreet can help...

- Advance the relationships with the most potential upside
- Reduce the tension between risk and opportunity
- Bring together disconnected data

To learn more about data-inspired risk management, visit dnb.com.

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ABOUT DUN & BRADSTREET

Dun & Bradstreet (NYSE: DNB) grows the most valuable relationships in business. By uncovering truth and meaning from data, we connect customers with the prospects, suppliers, clients and partners that matter most, and have since 1841. Nearly ninety percent of the Fortune 500, and companies of every size around the world, rely on our data, insights and analytics. For more about Dun & Bradstreet, visit [DNB.com](https://dnb.com).

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