

Brexit Implications for UK and Continental European Banks

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We believe the major UK banks remain resilient in the face of Brexit-related volatility. These banks have:

- Dominated their domestic UK bank space in most any product one can think of. Their market leadership provides robust defenses against stress. Plus, despite well-developed capital markets, the banks lead financial intermediation in the UK.
- Diverse business platforms, with healthy global footprints that further diversify earnings and insulate operations from UK-based volatility
- Made substantial progress in cleaning up asset quality and litigation issues post-Global Financial Crisis as well as trimming and refocusing operations. Thus, the major British banks are well-positioned should Brexit lead to a weakening in asset quality.
- Better controlled risk appetites post-Crisis, and risk management systems are stronger. Part of this is regulation-driven, and part is due to evolved business views of management.
- Greatly improved capital levels since the start of the Crisis. Given strict regulation, it is doubtful that such credit metrics would be weakened.

Near term, Brexit will likely crimp major UK banks' earnings, and heighten volatility of the overall British business environment. However, we expect the UK to endure, and that the major British banks will manage through this adversity.

We also believe that the major Continental European banks can withstand Brexit-related volatility.

- Few major European banks have material exposure to the UK in the form of domestic banking operations in Britain. While more banks have material London-based capital markets platforms, these can be more easily relocated should the need arise as Brexit negotiations progress.
- Most European banking systems are highly concentrated, and a handful of banks usually dominate their domestic bank spaces. This market leadership has, if anything, strengthened in recent years due to consolidation, and it provides robust defenses against stress. Moreover, European banks – even more than in Britain -- hold the commanding heights of financial intermediation given less-developed capital markets.
- Major European banks commonly have diverse business platforms – some especially so. Similar to British banks, this further diversifies earnings, and insulates them from UK-based volatility.
- Similar to UK banks, major European banks' risk appetites have been reined in post-Crisis.
- Major European banks have greatly improved their capital since the start of the Crisis. Though some have been more successful than others, the overall trend has been towards robust capital levels, which are periodically assessed via stress tests. This key bank creditworthiness support pillar should not be weakening anytime soon.

We view the major Continental European banks as diverse franchises providing robust defenses against Brexit risks. Spectrum believes that any earnings and capital pressure should not shift fundamental creditworthiness.

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