



CONSERVATIVE EUROPEAN FORUM

# THE FINANCIAL SERVICES INDUSTRY POST-BREXIT

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## Introduction

It is now over five years since Britain voted to leave the European Union, 22 months since Britain formally left and 10 months since Britain departed the European single market. It is therefore timely to take stock at the position of the City of London which, partly as a result of Britain's membership of the European Union, had developed into the financial centre of the Union.

The paper describes the emerging new relationship between Britain and the European Union, specifically

in respect of financial services, assesses the likely long term impact of this on the financial services industry in the UK and finally sets out a number of proposals for action that needs to be taken to secure London's position as one of the major global financial centres.

The paper draws heavily on my 2018 study Brexit and the financial services industry - the story so far, published by the Centre for European Reform, much of which is still apposite.

## The new position of the City in relation to the EU

The City's position in relation to the European Union is at one level quite simple. Britain is now a third country with no greater access to the single European market than other third countries. However, there is a significant difference compared with all other countries in that London has been the financial centre of the European Union. Most of the major international financial institutions have run much of their European business from a London headquarters without the need for separately capitalised and regulated institutions in other EU member states.

There have been some in the EU who have never been satisfied with so much financial services business being concentrated in London. Now that Britain is no longer in the EU they have the opportunity to seek to move as much business as possible to the EU 27. One of the stated justifications for this is that the EU cannot afford to have so much of its financial services business based outside of the Union and therefore outside of its political and regulatory reach. But equally important factors have been the wishes to “take back control” and to attract business that had previously been done from London.

In the aftermath of the Referendum, the British financial services industry fought a rear-guard action, for rather too long, in the hope of retaining London's position in EU financial markets. At first the economic argument was used, that the European economy benefits from economies of scale by having a single large financial centre and that it would therefore be damaging if this was lost. This argument simply did not work. In the same way that Britain has been willing to sacrifice some economic prosperity in order to “take back control”, so European countries have done the same. The same logic applies to attempts to build a banking union. It may seem attractive to smaller European countries for their corporates to have better access to major banks in other European countries,

but those smaller countries might prefer to have stronger domestic banks even if this is slightly more costly for their corporates. The City then promoted the idea of mutual recognition of regulatory outcomes, but this was never likely to fly because it did not accord with political priorities in the EU.

The British government took an early decision that Britain would be outside of the single market and from that decision it was inevitable that there would be either no or very limited special arrangements for the financial services industry. This was formalised in the “Chequers agreement” in 2018 when it was accepted that the existing EU equivalence arrangements would apply. Previously, the City had been vocal in explaining how these would be inadequate in that they covered only a fraction of the financial services market, equivalence could be withdrawn at 30 days' notice and equivalence decisions were political as much as technical.

It is no surprise that the EU has made limited equivalence decisions and these have been on issues essential to maintain financial stability, particularly in respect of the derivatives markets. But even those decisions are time-limited, the intention being that as much business within the EU as possible should move from London to somewhere in the EU27. Some have contrasted the much larger number of equivalence decisions made by the UK with the small number made by the EU. There is a simple explanation for this. The UK's decisions have been made in the knowledge that they would help keep business in the UK. The EU's decisions have been made with a view to shifting business from the UK to the EU.

So the position is now clear. The EU wishes to attract business from the UK such that a much higher proportion of financial services business in the EU is done from within

the EU. The British financial services industry tacitly accepted this some years ago, which is why the major financial institutions have established fully-fledged businesses in the EU member states, have shifted a significant number of contracts from Britain to the EU and have moved assets and jobs. For the financial services industry this is not a big deal. The cost to the major

American investment banks is pretty modest and only a fraction of their overall regulatory and compliance costs. It matters little to them whether the business is done from London, Paris or Frankfurt. The losses are to jobs and tax revenue in Britain, not to the financial services industry as such.

## The impact on the City

The common view outside of the City seems to be that the impact of Brexit on the City so far has been much less than had been anticipated with some commentators saying that only about 7,500 jobs have been lost compared with earlier estimates of 75,000. However, this comparison is seriously flawed and the early estimates of the likely impact of Brexit on taxation and jobs in the UK still look reasonable.

Following is the comment on potential job losses in my 2018 CER paper –

The alternative scenarios were analysed in a report by the Oliver Wyman consultancy (The impact of the UK's exit from the EU on the UK-based financial services sector, 2017). It concluded that if the UK retained market access on near to current terms the impact would be only modest, with 3,000-4,000 jobs at risk and tax revenue falling by less £500 million a year. At the other end of the spectrum, if the UK had no special status with the EU, the industry would lose £18-20 billion a year in revenue, which would put 31,000-35,000 jobs at risk along with £3-5 billion a year of tax revenue. There would also be a knock-on impact on the ecosystem that could result in the loss from the UK of activities that operate alongside those parts of the business that leave, the shifting of entire business units, or the closure of lines of business due to increased costs. An estimated further £14-18 billion of revenue, 34,000-40,000 jobs and £5 billion in tax revenue per annum might be at risk.

We are clearly at the unfavourable end of the spectrum with the forecast 31,000 - 35,000 jobs being at risk together with £3-5 billion a year of tax revenue. And on top of this the potential knock-on impact of the ecosystem which would roughly double these figures. There was no

suggestion that these numbers would apply immediately Britain left the European Union or even before it.

The consultancy EY's Brexit Tracker, the source of the 7,500 figure, records jobs that have actually been moved as recorded in public pronouncements by financial services firms. But most firms don't make such announcements and "jobs moved" are only a small part of jobs at risk. Moving people is expensive and for the most part financial services firms want to recruit locally. There may well be a shortage of suitably qualified people, at least in the short run, but in due course supply will respond to demand. It is also worth noting that employment opportunities for UK nationals will in future be more limited. EU citizens will have a strong competitive advantage when competing for financial services jobs in future, eroding further the strong UK influence over the global industry. This is not helped by the comparatively poor language skills of the British.

Currently, there is much "double running" and EU regulators have been willing to allow time for functions to move from the UK to newly established EU-based businesses, although there is now concern among some EU regulators that UK-based entities are "gaming the system". Covid has of course complicated the position and raised an interesting point about where jobs are actually based given the move away from business being office-based. Over the next few years major financial institutions will review their experience of their businesses operating in new EU centres together with all the other factors that influence location decisions and decide where to concentrate activities and where to reduce activities. This is very relevant to the many jobs which could be in London or anywhere else.

The position has been well summarised by Jamie Dimon, J P Morgan's CEO, in his March 2021 Letter to Shareholders—

London has been a major financial center that, under all laws and regulations, could conduct business throughout Europe. For most of us, the bulk of our operations (i.e., risk, compliance, audit, legal, regulatory, market-making, investment banking, research and asset management) were performed centrally in London. It was hugely efficient for all of Europe – and for financial services companies as well. London is a magnificent place to do business in terms of the rule of law, human capital, technology, transportation, language and many other facets. But future financial regulations were left uncertain in Brexit; and it is clear that, over time, European politicians and regulators will make many understandable demands to move functions into European jurisdictions. Because of this – and because of strong European efforts to compete with London – Paris, Frankfurt, Dublin and Amsterdam will grow in importance as more financial functions are performed there. Even so, few winners are likely to emerge from this fragmentation.

During this transition, our costs (most of which will probably be passed on to customers in one form or another) will go up as functions become duplicated. We may reach a tipping point many years out when it may make sense to move all functions that service Europe out of the United Kingdom and into continental Europe. But London still has the opportunity to adapt and reinvent itself, particularly as the digital landscape continues to revolutionise financial services. Innovation is key to preparing for doing the business of tomorrow versus relying on the shifting ways of the past.

The impact on jobs in Britain is being and will continue to be felt in a number of different ways –

Jobs moved as a direct consequence of Brexit – the headline figures published by EY.

- Business-as-usual adjustments in where staff are located – vacancies increasingly being filled in EU27 centres that might previously have been in London.
- The ending of doubled running, with a gradual rundown of some activities in Britain.
- Businesses expanding in the EU27 that were it not for Brexit would have expanded in Britain.
- Businesses that might have established a first European base in London instead locating in the EU 27.
- Support services – consultancies, law firms, public affairs companies, trade associations, IT support etc rebalancing staff to match changes in the location of their clients. Representational work is a particularly good example. Pre-Brexit most of the EU financial services legislation was “made in Britain” and consequently much representational work aimed at EU outcomes was done in Britain. Now it is done in Brussels, Frankfurt and Paris.

There will be no press announcements on employment in the EU as a result of all but the first of these factors, nor will any figures be included in the EY Brexit tracker. Indeed, some do not lend themselves to any measurement. For example, a Chinese financial institution may have taken London off its short list for its European centre as a result of Brexit – but there is no way of knowing whether the business would have come to London were it not for Brexit.

The full impact of Brexit on the financial services industry can be known only by comparing jobs and tax revenue in a few years' time with the best estimate of what would



have been the position without Brexit. This will no doubt make an interesting study although it is not really relevant to what the policy response should be.

My 2018 paper included some data, largely for 2017, shown in the box below, on the importance of the financial services industry to the UK economy. The comparative figures for 2021 and later years will provide a reasonable estimate of the impact. A simpler measure would be the change in the proportion of the staff of the major international banks in Europe who are based in Britain, from which an extrapolation can be made of the potential loss of tax revenue.

### The importance of financial services to the UK economy (2017)

The UK has a financial services trade surplus of £61 billion, much higher than any other country. £18.5 billion of this surplus is with the EU-27.

The UK accounts for 37 per cent of global foreign exchange trading, 39 per cent of Over the Counter interest-rate derivatives trading and 16 per cent of cross border bank lending.

The UK insurance industry accounts for 21 per cent of European insurance premiums.

The UK financial services industry paid £71.4 billion in tax in 2016, 11.5 per cent of the UK's total tax revenue.

The financial services industry employs over 2 million people in the UK.

The best recent analysis of the impact of Brexit on the financial services industry in the UK is a report by the think tank New Financial Brexit and the City – the Impact So far (May 2021). It concluded -

We have identified more than 440 financial services firms in the UK that have responded to Brexit in some way by relocating part of their business, staff, or legal entities to the EU (a lot higher than our previous estimates). We have identified more than £900bn in bank assets (roughly 10% of the entire UK banking system) that have been or are being moved.

The worse news is that this analysis is almost certainly a significant underestimate of the real picture: many firms will have slipped below our radar (particularly banks and asset managers that are already headquartered in the EU). 'Getting Brexit done' is only the end of the beginning of the process: given the limited equivalence arrangements in place, over time we expect there to be a drip-feed of business and activity from the UK to the EU. As the EU takes a tougher line on the location of activity and individuals we expect these headline numbers to increase in future.

And in respect of jobs it commented -

Jobs on the line: we think the debate about how many staff have been moved so far and whether that is higher or lower than expected a few years ago is a red herring. That said, we have identified around 7,400 staff moves or local hires in response to Brexit, but this is derived from only a small minority of firms, and we expect this number to increase in the next few years. The bigger issue is not jobs leaving the UK but new jobs in the EU being created in future that might otherwise have been created in the UK.

New Financial correctly observed –

The real impact of Brexit is unlikely to fully emerge until the dust finally settles in a few years' time, if ever.

In this context it is worth noting that there was no government impact analysis or any form of planning or modelling conducted to measure impact against which actual outcomes can be measured. This contrasts with the

requirement to produce very detailed impact assessments of policy proposals that in the greater scheme of things are tiny when compared with some of the Brexit-related decisions.

## What needs to happen

So, what should Britain do now? We certainly need to “get over Brexit”. Brexit has happened, it is not going to be reversed, and Britain will be treated by the European Union in respect of financial services as a third country. The EU as an entity and individual member countries of the EU will seek to ensure that as much financial services business as possible in the EU will be conducted from within the EU. While of course Britain should seek to secure favourable equivalence decisions, there is no expectation in the industry that much will be achieved – and in any event it is too late for many businesses, as they simply could not pause activities on 1 January and then be prepared to resume them at an unknown date in the future. Britain has lost business, jobs and tax revenue as a result of Brexit and there is more to come. But that impact can be mitigated by appropriate policy responses. Jamie Dimon’s words are relevant –

But London still has the opportunity to adapt and reinvent itself, particularly as the digital landscape continues to revolutionize financial services. Innovation is key to preparing for doing the business of tomorrow versus relying on the shifting ways of the past.

My 2018 paper argued that to maintain the largest possible financial services industry in the UK requires the following –

- A clear vision of the sort of economy Britain wants to be – ideally, open and liberal.
- A liberal policy on migration – from within and outside the EU. This will be difficult to achieve given the Government’s objective to reduce net immigration to under 100,000.
- A tax regime that attracts business to the UK. This does not mean a low-tax environment, but

rather one that recognises that businesses and people are mobile.

- A review of regulation to ensure that international competition issues have due weight, while continuing to operate within agreed international norms.
- A massive strengthening of financial diplomacy aimed at securing as much market access as possible.

This list still seems appropriate.

It is almost taken for granted that the British economy is both open and liberal and that the operating environment for businesses in Britain is good. Britain scores well in any analysis of ease of opening a business and running a business. The progress that is being made in establishing free trade agreements is indicative of this although most of them simply roll over the previous EU agreements and collectively they fall a long way short of compensating for the adverse effects up withdrawal from the European Union.

However, one trend since my 2018 paper is less than helpful in this respect. There seems to be a policy in the British government of distancing itself as far as possible from the European Union to the extent at times of even refusing to say those words. Britain seems more willing to seek strong bilateral relations with countries outside Europe rather than with its biggest single neighbour. The European Union is a single entity in respect of trade and to an increasing extent in other respects. The unpleasant and divisive Brexit debate has died down but there still seems to be an element of Europe bashing which is unhelpful in economic and political terms. The delay in giving the EU Ambassador to London diplomatic status is perhaps the best example of this. The battle of Brexit is

over and Britain now needs to develop an effective working relationship based on mutual trust and respect with the European Union.

It will be recalled that immigration played a large part in the Brexit debate and indeed in the re-negotiation of Britain's membership of the EU pursued by the Cameron government. Immigration from the EU countries was seen as being a significant problem. Opinion surveys show that it has ceased to be a problem over the last few years, partly because EU immigration has substantially fallen. However, to a large extent it has been replaced by immigration from outside the EU, something that was predictable but rather got lost in the emotional Brexit debate.

The current Prime Minister has a very different approach to immigration from his predecessor, which is welcome. The absurd 100,000 net immigration target has been ditched. Arrangements have been put in place to protect the position of the many million nationals of the EU 27 who have made a significant contribution to the British economy and society. However, the Home Office is wedded to complex schemes which have the effect of deterring the very people that Britain wants from seeking to come here. When Britain was a member of the EU many bright young people from the EU 27 came to Britain not with well-established businesses and a significant income but rather with an idea, entrepreneurial skills and a willingness to work very hard. While the new immigration rules accommodate established businesses, they do little to help such people. It is not that the world is seeking to come to Britain but rather that Britain is competing for international talent against many other countries. An immigration policy needs to recognise that.

On taxation it was never the case that Britain was going to become a low tax regime similar, for example, to Singapore. Indeed, the decision of the Chancellor to make

a substantial increase in the rate of corporation tax and the strong position that Britain has taken in the international negotiations to reduce tax arbitrage is further evidence there is no prospect of Britain becoming a low tax regime. However, there are a number of tax measures that can be taken to help Britain's competitiveness. An obvious one is the onerous bank balance sheet tax, an issue that the Government has already recognised in the context of the decision to raise the rate of Corporation Tax. The problem is that such tax changes generally involve complex issues which take substantial time to work through and there is limited bandwidth to handle these issues in the Treasury and in the regulatory bodies. It is significant, and perhaps ironic, that the Investment Association recently called for tax changes on collective investment schemes that would enable Britain to compete more effectively with funds domiciled in Luxembourg. The FT report of its proposals on 25 April 2021 neatly summarises the irony of taking decisions following Brexit that will enable Britain to compete on equal terms with institutions in the EU –

The abolition of taxes on UK investment funds is among sweeping post-Brexit reforms the government should consider to ensure the City of London thrives as a global centre for asset management, according to an influential trade body.

The Investment Association, which represents the UK's asset management industry, will call this week for rule changes to encourage the development of innovative new funds that will not suffer any tax disadvantages compared with directly competing European funds.

It also wants the government to consider moving to a full exempt tax regime for all UK funds to allow the City to compete more effectively against rival European fund hubs in Dublin and Luxembourg.

There does seem to be a willingness in government to tackle such issues and it is important that that is done.

While immigration was one feature of the Brexit debate perhaps the dominant expression was “taking back control”, based on the false assumption that Britain was being ruled from Brussels. Within the financial services industry it was generally accepted that far from being ruled from Brussels Britain had, thanks to the work of its officials, ministers and MEPs, successfully established a regime that enabled London to become the EU’s financial centre. There was never any prospect of significant financial deregulation as a result of Brexit, a position made clear by government ministers, by regulators and indeed by the industry itself. The fact is that the most onerous financial regulation has been entirely home grown. One good illustration of this has been being ring fencing of the banks which has proved to be very costly, and has had adverse public policy effects. By way of example of the impact, Goldman Sachs decided to limit the size of its retail bank to below the threshold by which it would be caught by the provisions. This measure has arguably done nothing to promote financial stability and indeed did not really address any of the actual causes of the original financial crisis.

The various financial trade bodies are making proposals for the post-Brexit world. The London Market Group (wholesale insurers) in July published its proposals (A new relationship with the European Union), which are typical of those made by the financial industry generally. They include –

- Recognise the nature of the large complex risks we cover and the sophisticated corporate buyers we serve, through a more proportionate approach to regulation.
- Ensure that the London Market remains the most attractive home for large risks through

an international competitiveness duty for UK regulators.

TheCityUK, the promotional body for the whole of the financial services industry, published its proposals in September (Making the UK the leading global financial centre: An international strategy for the UK-based financial and related professional services industry). Its proposed strategy had three elements –

- Securing the UK’s IFC ecosystem by making it more globally competitive. This included proposals to attract talent from overseas, reviewing the regulatory regime to ensure that it is proportionate and coherent and reducing the overall tax burden on UK-based banks.
- Growing the UK’s share of key global financial and related professional services markets, primarily through an ambitious trade and investment policy.
- Building global market capability in the key areas of future global demand by: making the UK a global hub for data and technology; putting the UK at the heart of global sustainability markets; making the UK the world’s leading gateway to international investment opportunities; and positioning the UK as a world leader in risk expertise and risk management.

There is a willingness within government to consider what can be done on such issues and no doubt there will be some changes that will help Britain’s competitiveness. Ideally, these need to be supercharged. Regulators are risk averse and left to themselves are unlikely to favour any significant deregulation. Government has outsourced what should be political decisions on regulation. Britain has costly and intrusive financial regulatory regime. This has been and will continue to be a deterrent to the expansion of financial services business in Britain. There is little accountability of regulators in Britain, although to be fair both the Bank of England and the Financial Conduct

Authority are rather more accountable than most others, including their EU counterparts.

The final issue, the expansion of financial diplomacy, is universally accepted within the government machinery but hardly understood anywhere else. I have already made the point that Britain was very effective at getting its way within the EU and generally its view became the European view which could then be reflected in negotiations in the various international agencies such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the International Organisation of Securities Commissions. Britain can no longer operate in this way but rather is on its own. This requires

significantly greater resources being devoted to the international bodies and also to bilateral contacts in the jurisdictions with international financial centres, in particular the USA, Singapore, Hong Kong and China. It is also relevant to note here that much of the representational work on financial services that used to take place in Britain by international financial companies has now shifted to the EU and Britain needs to be effective in its relationship with the EU at both political and regulatory level. Left to themselves regulators generally will cooperate but there also needs to be effective political support. Britain will need a much stronger representation in Brussels now it is no longer a member of the EU than it had when it was.

### About the author

Sir Mark Boleat has held a number of leading positions in the public, private and voluntary sectors. He was Chairman of the City of London Corporation's Policy and Resources Committee (effectively the political leader of the City) from 2012 to 2017. In this capacity he was also Deputy Chairman of TheCityUK and the International Regulatory Strategy Group. He has previously been Director General of the Building Societies Association, the Council of Mortgage Lenders and the Association of British Insurers, a director of a number of listed and private companies, and a member of the Regulatory Policy Committee and the Gibraltar Financial Services Commission. He is currently Chairman of Link, which runs the UK's cash dispenser network, and a Vice Chairman of the Advisory Board of the International Business and Diplomatic Exchange. He was knighted in the 2017 Birthday Honours for services to the financial services industry and local government in London.

\*The views and ideas expressed in this paper are not necessarily the views and ideas of the Conservative European Forum nor should they be considered to represent Conservative European Forum policy.



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