

## EU exit and financial services

November 2016

- **The financial services sector is the lifeblood of the London and UK economies.**
- **London is Europe's financial hub and a leading global financial centre.**
- **EU membership has brought the financial services sector two major advantages: access to skilled migrant workers and a free passport to sell products and services across the region's single market.**
- **But following the EU referendum result, both of these are at risk.**
- **And while EU exit may offer new opportunities in non-EU markets and other financial services, the risk of losing free access to the single market outweighs them.**
- **London's financial and related professional services are a strategic asset for both the UK and the EU and any future EU exit deal must recognise that.**

London is a global financial powerhouse. But after the EU exit vote, its status as a financial services world leader is under threat. London and the UK cannot afford to risk, arguably, their most successful economic sector.

The London Assembly Economy Committee has taken evidence from representatives from the financial services sector and industry experts to understand the risks associated with EU exit for the sector.

This short report sets out these risks, explores what the future might hold for the City, and considers how the Mayor can respond to protect its success.

**The London Assembly Economy Committee is holding a series of meetings to explore the effect of EU exit on key sectors in London. If you have any comments or would like to find out more you can get in touch via [matt.bailey@london.gov.uk](mailto:matt.bailey@london.gov.uk).**

## EU exit and financial services

November 2016

### The importance of financial services to the London and UK economies

**The financial services sector generates a substantial share of UK economic activity.** The financial and insurance sector contributed eight per cent (approximately £133 billion) of the total value created in the UK economy in 2014 (measured using nominal gross value added (GVA)).<sup>1</sup> London accounts for more than half the UK's total nominal GVA in the financial and insurance services industry.<sup>2</sup> Other cities also have significant financial services sectors, including Manchester and Edinburgh, and there are important links between them all.

**Financial services are one of our best export industries.** The sector generates a large trade surplus for the UK. Financial services together with insurance and pension services ran a £55 billion trade surplus in 2015, almost two thirds of the overall trade surplus in services. This trade surplus helped to offset some of the trade deficit created by other sectors. However, the UK still runs a trade deficit overall, which was £39 billion in 2015.<sup>3</sup>

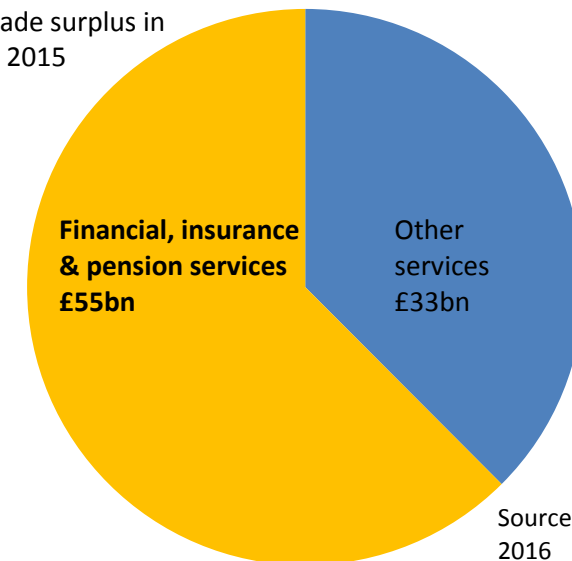
**The financial services industry is an important source of tax revenue.** In 2014-15, HMRC calculated the 'banking sector' contributed seven per cent of the £291 billion collected from taxes on earnings and onshore corporation tax.<sup>4</sup> According to the City of London Corporation, the

<sup>1</sup> "Gross Value Added (GVA) is a measure of the increase in the value of the economy due to the production of goods and services." (ONS)

financial services sector as a whole generated more than £60 billion in tax revenues in 2014-15.<sup>5</sup>

### Financial services together with insurance and pension services made up almost two thirds of the UK's overall trade surplus in services in 2015

UK total trade surplus in services in 2015



While the financial services sector is not a major employer in the UK, it does support many jobs in other related professional services.

## EU exit and financial services

November 2016

### London's role as a leading global financial centre

#### **London is Europe's financial hub and a leading global financial centre.**

London consistently ranks top of the Global Financial Centres Index, ahead of New York, Hong Kong and Singapore.<sup>6</sup> Its share of the global financial services sector is large and well diversified, both in terms of markets and activities. It employs 360,000 people and is home to over 250 foreign banks; the highest concentration in any financial centre.<sup>7</sup> London is Europe's leading centre for management of hedge funds, sovereign wealth funds and private equity funds. It is also the European headquarters for many companies: 40 per cent of the top 250 companies have their global or regional headquarters in London. In contrast, Paris, the second most important host city, has eight per cent.<sup>8</sup>

**The success of London's financial services industry can be attributed to a number of factors.** These influences include its legal system, the English language, established complementary services industries and a flexible labour market in comparison to many other EU countries. London's success is also partly due to EU membership which has brought the financial services sector two major benefits: access to skilled migrant workers (nearly 11 per cent of the City's 360,000 workers come from elsewhere in the EU<sup>9</sup>) and a free passport to sell products and services across the region's single market. Both of these benefits are at risk from the UK's exit from the EU.

### The risks to the financial services sector following EU exit

#### **The UK financial services industry relies heavily on passporting rights.**

Data released by the Financial Conduct Authority (FCA) show nearly 5,500 UK-registered companies use passports to access the EU market.<sup>10</sup> According to Lord Hill, the former EU Commissioner for Financial Stability, Financial Services and Capital Markets Union, passporting has allowed British banks to make over €1,000 billion of loans and to take out a similar amount of euro deposits.<sup>11</sup>

**"Passporting allows firms in one EU member state to trade across the entire Single Market. This arrangement reduces the costs and administration that would otherwise be involved and means UK financial firms can offer services across the whole of the EU without requiring further authorisations or meeting local regulations (for example, requirements on capital or liquidity). Passporting rights also avoid the need to set up a subsidiary as a separate legal entity, which would require its own governance and risk management." Bank of England<sup>12</sup>**

**The UK has become a major hub for non-EU financial services firms because of the benefits of passporting.** Typically, non-EU firms wishing to supply financial services in the EU would need to establish a subsidiary in the EU and would also need EU authorisation to confirm the home-country regulation is "equivalent". Once set up, companies can operate cross-border on the basis of this single licence. Passporting

## EU exit and financial services

November 2016

gives firms a free choice under EU single market rules for how they organise their business, and a clear legal framework for how they do business. For this reason, a number of non-EU financial services firms have set up significant offices in London. According to the US International Trade Commission, 40 per cent of US-owned foreign affiliates' sales of financial services are located in the UK.<sup>13</sup>

**The removal of passporting could create significant upheaval for UK and non-EU firms with subsidiaries in the UK.** If passporting rights were removed UK financial firms would have to establish subsidiaries within the EU. And non-EU (especially Swiss and US) firms with subsidiaries in the UK to service the EU would need to establish an EU subsidiary to service EU customers. This could mean non-EU firms moving their existing subsidiary from the UK to somewhere else in the EU.<sup>14</sup>

**The costs from removing passporting without an adequate replacement could also be sizeable.** Research by TheCityUK suggests around £20 billion of EU-linked revenue could be at risk.<sup>15</sup>

**And the removal of passporting rights would not just hurt the UK.** The FCA data shows 8,000 companies registered elsewhere in the EU use passports to access the UK. Some of these firms use passporting to run their businesses as “branches” in the UK, rather than as separate capitalised subsidiaries.<sup>16</sup>

**While passporting is crucial to large parts of the financial services sector, not everyone will lose out.** According to a report by Open Europe, around a fifth of the banking sector's annual revenue is tied to

the passport, but other sectors such as asset management and insurance are much less reliant.<sup>17</sup> The changing landscape may also improve conditions for UK-based retail banks. Banks are required to ring-fence their retail operations by 2019. According to Jayne-Anne Gadhia, Chief Executive of Virgin Money, UK-only retail banks are likely to be in a stronger position as they will not be affected by the complexity of the future. As she told the committee, there will be opportunities for UK retail banks to give “a better service, better products and more innovative solutions for customers.”<sup>18</sup>

**Passporting rights could be retained if London can show its regulatory regime is “equivalent” to the EU's.** A clause in the second iteration of the Markets in Financial Instruments Directive (MiFID 2) provides financial firms outside the EU with a means to provide services to customers inside it. The provision in question allows financial firms from outside the EU to offer trading, brokerage and underwriting services to European institutional (but not retail) clients, as long as the regulatory regime where the firm is based is deemed “equivalent” to that of the EU.

**However, the equivalence provision has not yet been tested.** The MiFID 2 does not come into force until early 2018. The decision rests with the European Securities and Markets Authority (ESMA), based in Paris. There is evidence the decision could be a protracted process. A similar clause in the European Market Infrastructure Regulation, which governs the trading and clearing of derivatives, was tested between

## EU exit and financial services

November 2016

America and EU. It took over three years before American regulations on clearing-houses were deemed equivalent by the ESMA.<sup>19</sup>

**And even if London did secure equivalence, it can't be guaranteed in the future.** As Miles Celic, Chief Executive of the TheCityUK, explained to the committee, equivalence is a static determination, and EU regulations will continue to change. While London could be equivalent in the short-term, it may not be in the future. The UK would also have little say on any changes to regulation once it is outside the EU. More likely, the City and government will have to come up with creative ways to mitigate the loss.

### Could EU exit free UK financial services from EU regulations?

**The evidence the financial services sector has been held back by EU regulations appears to be limited.** Campaigners in favour of leaving the EU said removing some regulations would boost London's financial sector. But, as the committee heard, there was unlikely to be any advantage in lighter touch financial regulation as standards are increasingly set at an international level. And as firms have looked for higher standards of regulation following the 2007/8 financial crash, London has increasingly been seen as a beacon of regulatory expertise. According to Professor Niamh Moloney of the London School of Economics, the UK has been an important expert and influence on how EU law has developed. To dismantle this knowledge base would be a retrograde step.<sup>20</sup>

"Whether or not we want equivalence, whether or not we want passporting - we would throw away regulation at our peril.

Jayne-Anne Gadhia, Chief Executive, Virgin Money.<sup>21</sup>

### Protecting the status of EU talent

**The financial services sector's ability to recruit skilled workers from other European countries could be restricted if new immigration controls are introduced.** Approximately, one in ten of the City's 360,000 workers come from other EU countries.<sup>22</sup>

**The Government has sent mixed messages on how EU migration will be managed in the future.** The Home Secretary has suggested skilled EU migrants may have to apply for visas with conditions similar to those placed on migrants from outside the EU. But the Chancellor has said high-skilled migrants could be exempt from controls. He said the Government would use control over free movement "in a sensible way that will facilitate the movement of highly-skilled people between financial institutions and businesses to support investment in the UK economy."<sup>23</sup>

**The uncertainty around immigration controls could be preventing companies from hiring and deterring EU workers from applying for jobs in the UK.** While it may be too soon to assess the full effect of EU exit on recruitment, according to the Institute for Public Policy Research, there was a 14 per cent downturn in jobs advertised in the financial

## EU exit and financial services

November 2016

services sector in London in July and August compared with May and June.<sup>24</sup>

**Any new immigration system should not automatically exclude people without job offers.** The committee heard about the importance of a skills-focussed system that recognised the value of human capital. For example, many talented coders from the EU are coming to the UK and setting up in Silicon Roundabout or Shoreditch where they are developing apps or algorithms that can help create or grow businesses. This kind of entrepreneurship is not easily captured by a points-based immigration system. A skills-based immigration system will be more successful in the long-term as opposed to one that is, according to Miles Celic, “simply about moving people around into individual jobs that already exist.”<sup>25</sup>

**London could look to develop its own visa system to allow skilled workers to work freely in the capital.** The City of London Corporation<sup>26</sup> and the London Chamber of Commerce and Industry<sup>27</sup> have both published reports on the potential for regional visas, and the Mayor has said he will consider the proposals. Variations of regional work permits have been used in other countries. Shanghai recently made it easier for foreign citizens to gain permanent resident status, as part of a package of policies aimed at establishing the city as a leading innovation economy. And in Canada, while provinces must follow national immigration minimum criteria, they can set their own policies for the migrants they want to attract.<sup>28</sup> A visa system was also put in place in Scotland in 2004 to allow foreign citizens who studied there to stay for

two years, but the scheme ended in 2008. A Scottish government cross-party group said last year the work visa should be reintroduced but the Home Office has said there are no plans to do so.<sup>29</sup>

### What might the future hold for the City outside the EU?

---

**London could expand its global reach to protect it from the fallout of the UK leaving the EU.** The committee heard how there were significant growth opportunities in Asia, Africa and Latin America, particularly as these markets become more developed and consume more services, where London is a global leader. However, being outside of the EU would not in itself make expanding in these markets any easier or more likely.

**Some industry experts have suggested London could become the “Greater Guernsey” by expanding off-shore finance for global, non-EU markets.** But operating on a smaller scale could result in London losing its competitive edge. Martin Sandbu, of the Financial Times, has suggested London could thrive if its operations were scaled back, but has also raised concerns about whether this would “dry out some of the liquidity pool and cluster advantages that make the City so competitive outside Europe.”<sup>30</sup> He also questioned whether non-European jurisdictions such as China would continue to do business with London under these terms.

**EU exit could provide a spur to strengthen London’s position as a hub for Fintech.** Companies such as Transferwise, Zopa and Funding Circle



## EU exit and financial services

November 2016

are transforming how companies and individuals raise, lend and transfer money. Banks are increasingly competing for talent with Google, Facebook and start-ups as artificial intelligence and robotics transforms the world of work. A report by Ernst & Young put London as the global capital for Fintech<sup>31</sup>, and guests agreed there was an opportunity to build on its expertise in Fintech to mitigate any losses from EU exit. They also agreed there was an opportunity for the Mayor to encourage entrepreneurship in Fintech development through educational and skills support.

“Fintech is an enormous potential advantage for the UK. We are a centre of global expertise and innovation.”<sup>32</sup>

Miles Celic, Chief Executive, TheCityUK

### And what should the Mayor’s role be?

---

**The Mayor has been a strong advocate for protecting the City.** He recognises, as this committee does, the strategic importance of London’s financial and related professional services as a high value asset for the UK economy. He needs to keep making the case that this is not just about protecting jobs in London but in other cities with financial and other related professional services too.

The Mayor has set out his asks to government: a guarantee that EU citizens already in the UK can stay once the UK leaves the EU; a

commitment to remaining in the single market; the retention of passporting rights; and a seat at the negotiating table for London in Brussels. This committee broadly supports these asks. While passporting is a complex issue, with no single financial passport used across the financial services sector, this committee would certainly support the retention of passporting rights for the UK’s banking sector, given the enormous tax revenues it generates for public services across the country. Similarly, the committee would support the need for the closest possible access to the single market when the UK leaves the EU. Protecting the status of skilled EU workers in the UK is vital. The mixed messages on future immigration controls from the government have not been helpful, and we would urge the Mayor to continue to press for clarity on this issue.

At the same time, this committee recognises the landscape will undoubtedly change for the financial services sector when the UK leaves the EU. We have heard how London has an opportunity to strengthen its position as a hub for Fintech. We would urge the Mayor to explore how he can support the development of a skills strategy that can help this growing sector in the future.

## EU exit and financial services

November 2016

### Endnotes

- <sup>1</sup> [Regional Gross Value Added \(Income Approach\): December 2015](#) (ONS 2016)
- <sup>2</sup> [Regional, sub-regional and local gross value added estimates for London, 1997-2014](#) (GLAE, 2016)
- <sup>3</sup> [The Pink Book: 2016](#) (ONS, 2016)
- <sup>4</sup> [The EU Single Market: The Value of Membership versus Access to the UK](#) (IFS, 2016)
- <sup>5</sup> [Total Tax Contribution of UK financial services eighth edition](#) (City of London Corporation, 2016)
- <sup>6</sup> [Global Financial Centres Index 20 \(2016\)](#)
- <sup>7</sup> [Key facts about the UK as an international finance centre](#) (TheCityUK, 2015)
- <sup>8</sup> [London crowned business capital of Europe](#) (London Futures, 2014)
- <sup>9</sup> Census 2011, CityUK
- <sup>10</sup> [Letter from Financial Conduct Authority to the Treasury Select Committee Chair, 17 August 2016](#)
- <sup>11</sup> [Commissioner Hill's speech at Chatham House, the Royal Institute of International Affairs](#)
- <sup>12</sup> [EU membership and the Bank of England](#)
- <sup>13</sup> [The EU Single Market: The Value of Membership versus Access to the UK](#) (IFS, 2016)
- <sup>14</sup> [The EU Single Market: The Value of Membership versus Access to the UK](#) (IFS, 2016)
- <sup>15</sup> [The impact of the UK's exit from the EU on the UK-based financial services sector](#) (Oliver Wyman, 2016)
- <sup>16</sup> [Banks fear chill wind of EU 'passport' freeze](#) The Financial Times (2 September 2016)
- <sup>17</sup> [How the UK's financial services sector can continue thriving after Brexit](#) (Open Europe, 2016)
- <sup>18</sup> [Transcript of Economy Committee, 11 October 2016](#)
- <sup>19</sup> [Financial tonic](#) The Economist (9 July 2016)
- <sup>20</sup> [Transcript of Economy Committee, 11 October 2016](#)
- <sup>21</sup> [Transcript of Economy Committee, 11 October 2016](#)
- <sup>22</sup> Census 2011, CityUK

- 
- <sup>23</sup> [European bankers will be exempt from migration curbs after Brexit](#) The Daily Telegraph (8 September 2016)
  - <sup>24</sup> [Slump in finance sector recruitment in aftermath of Brexit vote](#) (IPPR, 2016)
  - <sup>25</sup> [Transcript of Economy Committee, 11 October 2016](#)
  - <sup>26</sup> [Regional visas - a unique immigration solution?](#) (PwC, 2016)
  - <sup>27</sup> [Permits, points and visas: securing practical immigration for post-Brexit London](#) (LCCI, 2016)
  - <sup>28</sup> [We should regionalise immigration decisions – starting with a London visa](#) City AM (26 August 2016)
  - <sup>29</sup> [Solution to student work visa row 'possible'](#) BBC News, (3 March 2016),
  - <sup>30</sup> [Can the City of London thrive after Brexit?](#) The Financial Times (9 July 2016)
  - <sup>31</sup> [UK Fintech on the cutting edge: an evaluation of the international Fintech sector](#), (Ernst & Young, 2016)
  - <sup>32</sup> [Transcript of Economy Committee, 11 October 2016](#)