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Konrad Adenauer Stiftung

"The City and Brexit - British and German perspectives"

London, 16th May 2017

CONFERENCE REPORT

Introduction

In the second of its series of post-Brexit referendum discussions, the Konrad-Adenauer-Stiftung, the Federal Trust and Global Policy Institute brought together a panel of experienced financial experts to discuss the implications for the City and the UK financial services industry now that Article 50 has been triggered.

Chaired by Graham Bishop, a former Salomon Brothers banker, and today one of the leading authorities on EU banking regulation in the UK, the panel also included Nicky Edwards, the former Director of Policy and Public Affairs at TheCityUK, Gergely Polner, the Head of Public Affairs at Standard Chartered Bank, and Nicolas Maclean, a former investment banker who once served as a part-time political assistant to Mrs Thatcher.

Opening the meeting, the Director of the Konrad-Adenauer-Stiftung, Hans-Hartwig Blomeier, noted that thanks to the calibre of the panel, it was hoped that the discussions would be able to focus (in contrast to the British media) on "substantial issues" which could offer some insight into "what really will happen to financial services in the UK".

Brendan Donnelly, Director of The Federal Trust, noted that in trying to evaluate the effects of Brexit on the City "we are discussing a small part of the Brexit process" but one which is perceived in differing ways. For some the UK's financial services were seen as a "trump card". For others it was a distinct area of vulnerability in negotiations.

Panel Discussion

Nicky Edwards

Nicky Edwards opened the programme with some basic figures. The City annually contributed 70 million sterling in tax receipts. 35% of Europe's wholesale banking activity currently took place in London and nearly 2 million people were employed by UK financial services. Two thirds of these were living beyond the M25. Substantial "back offices" of banks were in such diverse locations as Leeds and Bournemouth. It was therefore inevitable that any reduction in financial services activity would have "great consequences for the UK".

Ms Edwards pointed out that in accordance with the Bank of England's instructions all major financial institutions currently located in the City of London were expected to draw up contingency plans for a "worst-case scenario" by July 14th. These plans would be affected by the narrative emerging from Brussels, which was resolutely pushing the EU point of view through a sophisticated system of leaks. Such "transparency" would, Ms Edwards believed, give the banks much food for thought as they worked out their post-

Brexit planning. The EU narrative was also an essential corrective to the debate in the UK which she characterised as "insular and unrealistic".

On the positive side, she noted that even after Brexit, the City would retain certain distinct advantages: time-zone, Rule of Law, language and culture.

But, she observed, it was difficult to imagine the financial "eco-system" in the UK not being diminished by Brexit, not least because it will be increasingly difficult to lure talent to a UK held hostage to anti-immigrant rhetoric.

Specifically, she noted that following Brexit initially all EU client-facing risk and trading functions would have to be relocated to countries within the EU 27. This was not a "capital-lite" process and would undoubtedly affect the profitability of the institutions concerned. Other lines of business would have the option of moving either to the US or the Far East which for institutions headquartered in those regions would have certain costing attractions.

With regard to insurance, Ms Edwards believed that the industry as a whole was reluctant to give up the idea that passporting of insurance services could not be preserved. Lloyds had opened up a small office recently in Brussels but had not committed any substantial resources towards a major relocation.

Another sector of the City likely to be seriously affected was Asset Management. Ms Edwards noted that currently 1.5 trillion of the 5.7 trillion funds under management in the UK belonged to institutions from elsewhere in the EU. There was a possibility of these funds remaining in London by securing "third party delegation" exemptions through an agreement between the EU 27 and the UK based on current MIFID regulations. This element of the negotiation would be watched keenly by the industry in London as negotiations proceeded.

With regard to the clearing of euro-denominated derivatives, Ms Edwards believed that there would be reluctance on the part of participants to move to Paris or Frankfurt where governments could be expected to monitor more closely derivative clearing than the Bank of England.

This latter view was, however later contradicted by the chairman (Graham Bishop) who noted that this business, huge in scale (currently 50 times bigger than UK GDP), could not survive in London post-Brexit on account of the perceived risk that the UK central bank might not have access automatically to ECB funds in the event of a trade going wrong.

Concluding her presentation, Ms Edwards pointed out that the voice of the City was not currently being heard as clearly as during previous British governments: an overstretched Whitehall was prioritising industries in accordance with their degree of compliance with the government's Brexit stance. The view in many parts of the country was that if the City were to "suffer" and bankers leave, many would "line the streets to wave them goodbye".

Nicolas Maclean

Drawing on his long experience of the City, Nicolas Maclean invoked historical precedents to underline the fragility of the City's current pre-eminence as the financial centre of much of the world. In the 15th century that role had been occupied by Siena. In 1914, London had shared it with Vienna and Paris. The removal of the current passporting system would damage London's standing and a fragmentation of the current arrangements was inevitable.

Dublin, Frankfurt and Paris would all go to great lengths to welcome and attract financial services. Moreover by leaving the EU, the UK was losing its say in the very making of the financial architecture of Europe. Talk of "equivalence" could not really conceal the fact that the City was "losing control" of the regulatory process which underpins all its activities. The UK would no longer have any say in making the rules in its largest partner's financial markets.

This was a high price to pay to satisfy the desires of a few Hedge Fund managers eager to escape the monitoring and restriction of their bonuses by the "Nanny Brussels state".

Gergely Polner

Noting that he was only describing his own personal views, Gergely Polner explored how the City would cope with the increasingly probable scenario of "No Deal".

The largest EU corporates such as Siemens would be in his view the least affected. They had large offices here and indeed it was not to be excluded that some of these might even beef up their presence in London.

The picture was different for Asset managers and insurers who he believed in the event of "No Deal" would not be able to sell their products into the EU.

They would also be impacted by the fact that the large European pension funds were subject to restrictions on the amount they could invest with non-EU managers.

EU banks with branches in the UK would be affected immediately after a "No Deal" Brexit as they currently conduct business in the UK on the basis of EU passporting rules. New agreements would have to be negotiated if these privileges were to be preserved.

On the whole, however, Mr Gergely predicted lower staff movement numbers than currently speculated in the media, not least on the grounds of cost. Banks would in his view try to retain as much of the status quo as possible even following a "No Deal".

Discussion

In the discussion which followed a number of wide-ranging questions were posed. These included questions on what the impact of Labour's policies might be on the City, the effects of a "cliff-edge" scenario for financial services and what the UK might be expected to look like socially and economically in twenty years time. Another theme was the direction of travel for sterling.

There was a consensus that Labour's policies were unlikely to help the City. Their electioneering campaign amounted to a "last person switch off the lights" attitude as far as City traders were concerned. The latter had already campaigned vigorously and effectively against the EU's suggested "Tobin tax" on share trades a few years ago. They were unlikely to be impressed by identical policies being put forward by the Labour party.

Mr Gergely noted that technology had made the actual geographical location of financial centres less central to activity than during earlier periods. Trading can take place in any city, in any part of the world.

Mr Maclean predicted dire consequences for the UK arising from leaving the Single Market and spoke of a "drift away from the UK". Several of the panel drew attention to the exceptionally large external trade deficit the UK economy was running and the fact that further devaluation of sterling could not be ruled out. As Mr Gergely observed: "Sterling is the best indicator of the success of Brexit. Should it become apparent that Brexit will be unsuccessful there will be high volatility because at present a negative

Brexit event is not priced into sterling's current level". In this context, panel members recalled the 1976 sterling crisis which was only resolved through IMF intervention. The view, bandied about in parts of the media, that devaluation was "a good thing" was dismissed as wishful thinking.

The issue of consultation between the government and the City provided scope for further analysis from Ms Edwards. She emphasised that the current concentration of policy-making within a few hands at Number 10 was distorting the usually relatively smooth-running Treasury/City lines of communication. As a result the City's voice was becoming far less audible.

The former MP, Lord Taverne, asked the critical question for many when he tried to gauge the prospects of a "shift in public opinion". The timing for this would be critical but in his view, the chances of such a shift had been severely diminished by the prospect of a Conservative landslide in the forthcoming election. Brendan Donnelly noted in reply that ultimately the weakness and disadvantages of Brexit would become powerfully apparent even to many of those who had voted to leave. The "Vote Leave at no cost" segment of the Brexit vote was unlikely to survive contact with the realities awaiting the country over the coming years. Whether that could reverse the process quickly or in the mid-term remained to be seen. As Nicolas Maclean pointed out, it would be probably left to the younger generation to pick up the pieces and reapply to join the EU in a generation to come.

Conclusion

Summing up, Graham Bishop noted that the City would be impacted in many ways both small and large by Brexit. The government's current Brexit strategy could not be described as in any way compatible with the interests of the City as presently configured. The European Court of Justice and the European Central Bank were both indispensable parts of the smooth running of financial services in the Single Market. The UK's decision to leave the Single Market would, as well as jeopardising many lines of City business, place a question mark over the UK's ability to maintain the global dominance of English Law. By turning its back on these institutions the UK was in danger of marginalisation as well as fragmentation. Yet the government was considered unlikely to be able to compromise on any of these issues on account of its visceral hostility to freedom of movement of persons.

The Director of the Konrad Adenauer Stiftung, Mr Blomeier, bringing the meeting to an end noted that the consensus opinion in the room was that whatever the consequences for the City of the UK leaving the Single Market, the one thing that was undoubtedly clear was that, as Brendan Donnelly observed, "we should not rely on the political class to ride to the country's rescue".

Richard Bassett
23rd May 2017