TheCityUK

Addendum to the International Regulatory Strategy Group (IRSG) response to HM Treasury's *Balance of Competences Review –Single Market: Financial Services and the Free Movement of Capital.*

This note was prepared with assistance from Oliver Wyman as part of a study Business at Risk which analyses wholesale banking market activity and poses a number of scenarios that may negatively affect the UK's financial centre. Following discussion with HM Treasury, the note is presented as additional evidence on the single market, financial services and the free movement of capital.

A significant portion of the UK's Financial Centre ecosystem is made up of the issuers, investors and intermediaries of the capital markets. Europe-based resources at the wholesale banking intermediaries are very concentrated in the UK; UK-based investors also form a critical mass, with nearly 40% of European assets managed in the UK; issuers are distributed far more evenly with GDP across Europe.

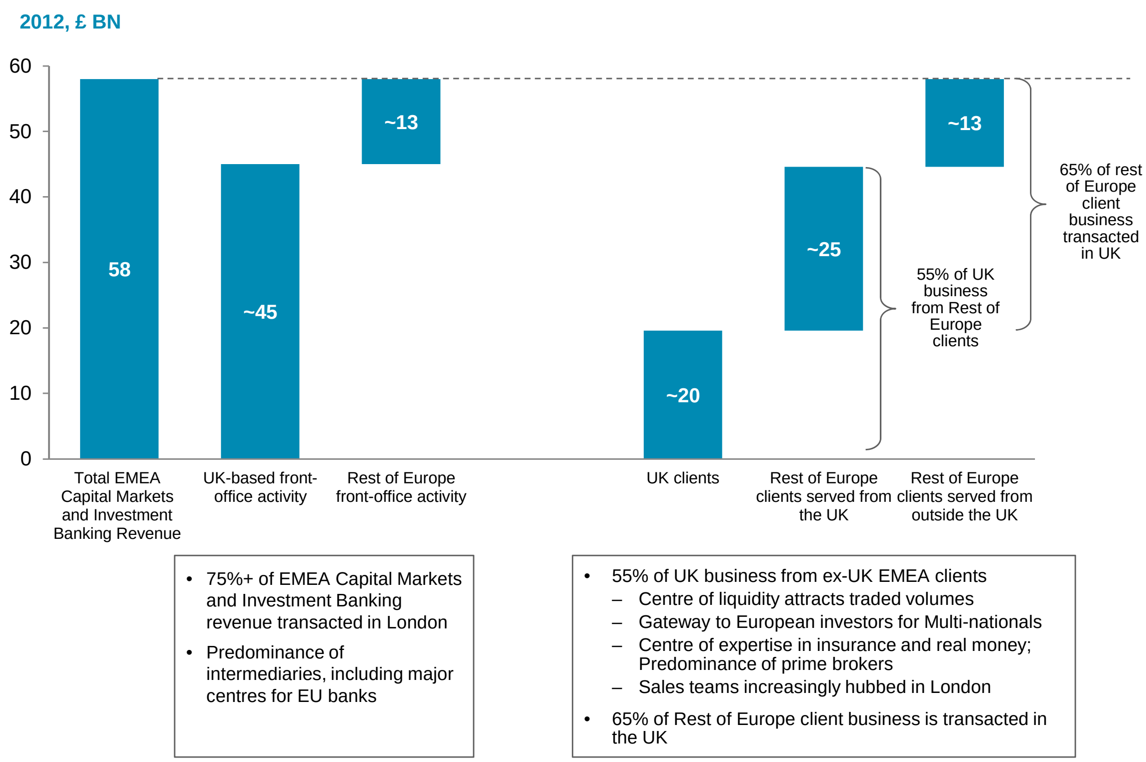
Figure 1: Capital Markets Ecosystem

Through the lens of Investment Banking and Capital Markets revenues we have examined the interdependence of the UK Financial Centre and the Capital Markets and Investment Banking client base across Europe.

As can be seen from Figure 2, access to a Single European Market in Financial Services is crucial for the size and health of the UK's financial centre. Over 75% of European Capital Markets and Investment Banking revenue is transacted in the UK. This is an activity base that employs over 150,000 people on the sell-side alone; asset managers who are on the client-side of this activity add another 50,000. These internationally mobile activities between them generate approximately £25BN of the UK financial services industry's total tax contribution of £65BN.

In these markets, the UK and the rest of Europe are mutually dependent. 55% of UK-based revenues are paid by European clients outside the UK. But the UK is also crucial for clients across Europe. That same UK-based revenue represents 65% of all business generated by European clients outside of the UK. The UK is the Financial Centre for Europe.

Figure 2: EMEA Capital Markets and Investment Banking Revenue[1] segmented by front office and client location



Any activity which disturbs the ability to serve this non-domestic client base would result in a strong erosion of UK activity, and would also likely result in a strong erosion of European clients' access to capital markets. While some of this activity would migrate to financial centres elsewhere in Europe, the fragmentation of liquidity and of issuer-investor touchpoints would diminish European markets overall.

A primary focus of the Balance of Competencies review must be to retain access to the single market in financial services.

Unification of Financial Services rule-making across Europe has so far not disadvantaged the UK's financial centre; instead the advantages that the UK has accumulated, including language and legal environment, the talent pool and labour force mobility, the historically attractive tax environment, the supporting professional services ecosystem and general quality of life have enhanced the UK's ability to attract this business in a single market.

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[1] Fixed Income, Currencies, Commodities, Equities and Investment Banking; Source: Oliver Wyman proprietary data and estimates, research and analysis, BIS, World Federation of Exchanges

In interviews, UK market participants raised concerns regarding the effects of new European regulations and their effects on the single market – in particular Banking Union and EMIR market infrastructure requirements. There is a credible fear that the mechanisms required to create a single supervisory regime, and particularly a single resolution environment, may damage the competitiveness of the UK's financial centre.

Protection of the Single Market is enshrined in the ECB's SSM-creating regulation, which states: "No action, proposal or policy of the ECB shall, directly or indirectly, discriminate against any Member State or group of Member States as a venue for the provision of banking or financial services in any currency."[2] Nonetheless, diligence is required on the detailed mechanisms of how this will function. A balance will need to be struck between the processes and rules that might sensibly be required for effective European regulation and effective functioning of the single market.

Specific concerns raised by market participants include the following (ordered from most to least-likely):

- Regulatory pressure by all national regulators, including the UKs, discouraging global booking in domestic legal entities, especially with respect to derivatives exposure;
- The possibility to require key market infrastructure to be within the Eurozone (current ECJ dispute), or interacted with by Banking Union entities;
- Possible customer or bank pressure to transact with Euro-window-accessible or SRM-resolvable entities; and
- A possible requirement for Eurozone licensing of individuals with domicile requirement

Amongst the most important mitigants to the above risks are:

- Clarity over the role of the Bank of England in concert with the Single Resolution Mechanism; means of access to Euros in stressed conditions
- Support for the EBA in ensuring that the regulatory rulebook ensures no unintended disincentives to UK operations; of particular importance will be the handling of intra-group large exposures
- Resolution of disagreements on market infrastructure location

The UK has a vested interest in the solidity and strength of Banking Union; as the institutions and mechanisms of Banking Union are designed, UK actors must make further contributions by helping to design the plumbing which will allow Banking Union to connect with Europe's primary Financial Centre in the UK.

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[2] Article One, EU Council Regulation No 1024/2013 (15 October 2013) "Conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions"