BRIEFING FOR THE FIRST MINISTER

MEETING WITH KEITH SKEOCH, CHIEF EXECUTIVE, STANDARD LIFE INVESTMENT

29 March 2017

Key message	The Scottish Government is supportive of the financial services industry and welcomes Standard Life's contribution to Scotland's economy.
What	Meeting
Why	This is an introductory meeting.
Who	**KEITH SKEOCH, CHIEF EXECUTIVE, STANDARD LIFE**  Keith was appointed Chief Executive of Standard Life plc in August 2015. He has been Chief Executive, Standard Life Investments since 2004. He has been a Director since joining in 1999 as Chief Investment Officer, and has also been on the Board of Standard Life plc since 2006. Prior to that, from 1980 to 1999, Keith was with James Capel (HSBC Securities from 1996) where his previous roles included; 1998 Managing Director of International Equities, 1993 Director of Economics and Strategy, 1984 Chief Economist and in 1980 International Economist. Keith started his career in 1979 at the Government Economic Service. Keith has held a number of key industry appointments and responsibilities. He is a board member of the Financial Reporting Council and the Investment Association.
Where	Parliament
When	29 March 2017 - 15:00 – 15:30
Likely themes	• Brexit issues • Independence • Merger of Standard Life and Aberdeen Asset Management • Standard Life full year results announced 24 February 2017.
Supporting official	**REDACTED**
Attached documents	**Annex A** - Background/Recent issues **Annex B** – Standard Life/Aberdeen Asset Management Merger **Annex C** - Financial services and Brexit

ANNEX A

BACKGROUND

Standard Life plc, employs 6,300 people through operations in the UK, Europe, North America, Asia and Australia. Standard Life plc is listed on the London Stock Exchange with around 1.2 million individual shareholders. They administer £357 billion and support around 4.5 million customers and clients in 45 countries across the globe and support around 25 million more through their Indian and Chinese associate and joint venture businesses. (All figures as at 31 December 2016).

Standard Life Investments was launched as a separate company in 1998 and has established a reputation for innovation in pursuit of clients' investment objectives. Standard Life Investments manages £269.0 billion* on behalf of clients worldwide. Their investment capabilities span equities, bonds, real estate, private equity, multi-asset solutions, fund-of-funds and absolute return strategies.

Headquartered in Edinburgh, Standard Life Investments employs more than 1,700 talented professionals. They maintain a presence in a number of locations around the world including Boston, Hong Kong, Paris, London, Beijing, Sydney, Dublin and Seoul. In addition, they have close relationships with leading domestic players in Asia, including HDFC Asset Management in India and Sumitomo Mitsui Trust Bank in Japan.

Their investors include pension plans, banks, mutual funds, insurance companies, fund-of-fund managers, endowments, foundations, charities, official institutions, sovereign wealth funds and government authorities.

Recent Issues/Engagement

March 2017 – Announcement - Merger – Standard life/AAM – See **Annex B**

24 February 2017 – Standard Life full year results published

- Increased assets under administration by 16% to £357.1bn with modest net outflows of £2.6bn, representing less than 1% of opening assets, driven largely by our mature books of business
- Operating profit before tax up 9% to £723m

8 February 2017 - John Gill, Chief Risk Officer, Standard Life attended the meeting with Mr Brown and the Association of British Insurers to discuss potential impact of Brexit on insurance sector.

11 October 2016 - Gary Gillespie and Professor John Kay met with Jeff Newton and John Gill from Standard Life to discuss the implications of Brexit for Standard Life operations. Standard Life are possibly the only UK insurer/investment manager who operate on a passport basis in the EU. It is not on a big scale however is still important.

Key points from the discussion are as follows:

- **REDACTED.**
- **REDACTED.**
- **REDACTED.**

- They recognise the benefits of passporting in simplifying the regulatory landscape. They are regulated by UK PRA/FCA who liaise with 'college of regulators' Europe which means they deal with one UK regulator covering their business in EU also.
- **REDACTED**.
- Any distortion to passporting potentially leads to high regulatory costs, longer lead times to get approval, loss of capital synergies and disruption to customers.
- They would also need to deal with legacy busine **REDACTED**.
- Outwith EU, they have business in Hong Kong, operations in India and they sell in the US through third parties.
- Around 4 per cent of their staff are EU resident.

ANNEX B

Standard Life and Aberdeen Asset Management Merger

Issue

Standard Life and Aberdeen Asset Management have agreed to a merger of the two companies. Subject to shareholder approval the merger will be effective in the third quarter of this year.

The new company will continue to be based in Scotland although no decision has been taken on location of company headquarters.

Job Losses

There is no indication from either company on scale of any job losses, although significant savings of £200m per year, are expected as a result of the merger.

Martin Gilbert, CEO Aberdeen said "*We don't know the number of job losses. In the world of asset management you have to be either big or small. This makes us bigger which makes us better for our clients and provide a much better service for them*." FT.com, 6 March 2017

Recent performance

Last month Aberdeen reported £10.5bn in net outflows from its funds in the three months to end of December - Aberdeen's 15th consecutive quarterly outflow.

In their 2016 annual report Aberdeen noted that "*The asset management sector is at a critical point. We face an increasingly competitive market with the rise of passive and smart investing putting pressure on traditional models. This, combined with greater regulatory requirements, has resulted in downward pressure on margins and increasing complexity*."

Brexit

The new company will hold £660bn in assets under management, and will become the UK's largest and Europe's second largest fund manager (source FT.com). Both companies have established an European presence, providing financial services to customers across the EU. Aberdeen operates in the EU through locally regulated subsidiaries, primarily in Luxembourg.

While details of Brexit are still unknown it is not clear what changes either company would have to make to their operating models to ensure continued access to EU markets.

Background (from official press release)

Standard Life and Aberdeen Asset Management confirmed today (Monday 6 March) that they have reached agreement on the terms of a recommended all-share merger of Standard Life and Aberdeen. The Combined Group will in due course be branded to incorporate the names of both Standard Life and Aberdeen.

The companies believe that the merger has a compelling strategic and financial rationale through combining Standard Life's and Aberdeen's complementary strengths to create a world class investment group.

The Boards of Standard Life and Aberdeen believe that the Merger will:

- Harness Standard Life's and Aberdeen's complementary, market leading investment and savings capabilities which would deliver a compelling and comprehensive product offering for clients covering developed and emerging market equities and fixed income, multi-asset, real estate and alternatives.
- Reinforce both Standard Life's and Aberdeen's long-standing commitment to active management, underpinned by fundamental research, with both global reach and local depth of resources.
- Establish one of the largest and most sophisticated investment solutions offerings globally, positioning the Combined Group to meet the evolving needs of clients.
- Create an investment group with strong brands, leading institutional and wholesale distribution franchises, market leading platforms and access to long-standing, strategic partnerships globally.
- Bring scale, as one of the largest active investment managers globally with £660 billion of pro forma assets under administration and financial strength, transforming the Combined Group's ability to invest for growth, innovate and drive greater operational efficiency.
- Deliver through increased diversification an enhanced revenue, cash flow and earnings profile and strong balance sheet that is expected to be capable of generating attractive and sustainable returns for shareholders, including dividends.
- Result in material earnings accretion for both sets of shareholders, reflecting the significant synergy potential of the Merger.

The Combined Group

- The Combined Group will be headquartered in Scotland.
- The Combined Group will draw on its broad expertise and harness the talent in both companies to optimise the benefits for clients and shareholders.

Following completion of the Merger:

- Sir Gerry Grimstone, Chairman of Standard Life, will become Chairman of the Board of the Combined Group, with Simon Troughton, Chairman of Aberdeen, becoming Deputy Chairman.
- Keith Skeoch, CEO of Standard Life, and Martin Gilbert, CEO of Aberdeen, will become co-CEOs of the Combined Group.
- Bill Rattray, of Aberdeen, and Rod Paris, of Standard Life, will become CFO and CIO respectively.
- It is envisaged that the Board of the Combined Group will comprise equal numbers of Standard Life and Aberdeen directors.
- Standard Life and Aberdeen have agreed that the Combined Group will include, and operate under, branding drawn from both the Standard Life Group and the Aberdeen Group.

Standard Life will be required to seek the approval of the Standard Life Shareholders for the Merger at the Standard Life General Meeting. The Merger will also be conditional on the approval of the Standard Life Shareholders of the issuance of the New Shares at the Standard Life General Meeting.

The merger is expected to become effective in the third quarter of 2017,

Commenting on the Merger, Keith Skeoch, CEO of Standard Life said:
"*We have always been clear that it is Standard Life's ambition to become a world-class investment company and that this would be achieved through continued investment in diversification and growth, coupled with a sharp focus on financial discipline. We are therefore delighted that this announcement marks another important step towards achieving that ambition. The combination of our businesses will create a formidable player in the active asset management industry globally. We strongly believe that we can build on the strength of the existing Standard Life business by combining with Aberdeen to create one of the largest active investment managers in the world and deliver significant value for all of our stakeholders*."

Commenting on the Merger, Martin Gilbert, CEO of Aberdeen said:
"We believe this merger is excellent for our clients, bringing together the strong and highly complementary investment capabilities of each firm with a breadth and depth of talent unrivalled amongst UK active managers and positioning the business to meet the evolving needs of clients and customers. This merger brings financial strength, diversity of customer base and global reach to ensure that the enlarged business can compete effectively on the global stage."

Commenting on the Merger, Sir Gerry Grimstone, Chairman of Standard Life said:
"This merger brings together two fine companies and I'm greatly honoured to be asked to chair the combination. I look forward to welcoming our new colleagues. We will be successful as long as we continue to put our clients, customers, employees and good governance at the heart of what we do."

Commenting on the Merger, Simon Troughton, Chairman of Aberdeen said:
"*The strategic fit is compelling and creates a business with minimal client overlap and which is diversified by revenues, asset class and distribution channel. The combination will result in a material enhancement to earnings and this, coupled with a strong balance sheet, will facilitate significant investment in the business to support growth, innovation and a progressive dividend policy."*

Karen Rodger, Financial Services Policy, x41205

ANNEX C

FINANCIAL SERVICES AND BREXIT

- The financial services sector is important to Scotland, for its direct contribution to our economy and for the essential support it provides to consumers and businesses in all economic sectors. Continued uncertainty over the UK Government's negotiating position risks jobs and future investment in the financial services sector across the UK.
- Now that the UK Government has made clear its intention to leave the Single market it is essential that the UK Government sets out how it intends to protect the financial services sector and Scotland in the forthcoming negotiations.
- The Scottish Government will explore differential options for Scotland and is considering all possible steps to ensure Scotland's continuing relationship with the EU, including seeking an agreement that will ensure Scotland retains Single Market membership, even if the rest of the UK leaves.
- But we must also include the option of independence if it becomes clear that is the best or only way to protect our national interests.

<u>1. Economic Contribution</u>

- GDP in the Financial Services sector[1] increased by 0.8 per cent in 2016 Q3 compared with the previous quarter and by 12.3 per cent over the year[2].
- The Financial Services sector contributed £8.3 billion in Gross Value Added (GVA) to Scotland's economy in 2015, 6.5 per cent of total Scottish GVA. This was slightly lower than the UK overall (7.2 per cent) and significantly lower than London (16.3 per cent).
- Employment in Scotland's Financial Services sector was 86,200 in 2015 (3.4 per cent of total employment in Scotland).
- In 2015, international exports by the Scottish Financial Services sector[3] are estimated at £1.3 billion. Specifically, exports to the EU are estimated at £210 million and Non-EU exports at £1.1 billion. Exports to the rest of the UK are estimated at £7.6 billion.

Recent report by 4-consulting – '*Economic Impact of Leaving the European Union'* – presented to Economy and Fair Work Committee on 2 November 2016 highlighted the importance of financial services:

"Edinburgh's economy is <u>more reliant on financial services than the London economy or any other UK city economy. Edinburgh's share of financial services is markedly ahead of most large European cities.</u>

"The latest available data from the Office for National Statistics (ONS) shows that financial services accounted for a higher share of Edinburgh's national economy (23.8%) than London (18.9%) or any other city in the UK. This is measured by Gross Value Added (GVA) in 2014.

"Additional data published by Eurostat shows Edinburgh's economy is more reliant on financial services than any other European city (for which data is available) apart from Luxembourg. (Eurostat data for some cities was only available for 2013)"

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[1] GPD and employment data for the Financial Services sector are for SIC (2007) Section K – Financial and Insurance Activities.

[2] The July 2016 publication of Scottish GDP coincides with two major annual publications (the Scottish Supply-Use Tables and UK Blue Book). As in previous years, these publications have led to revisions of the time series of Scottish GDP. Additionally, an annual update from the Bank of England has particularly affected the Financial and Insurance Industries data, however it appears that the variation from the previously published quarter is likely to also be the result of a genuine increase.

[3] Exports figures relate to SIC (2007) Divisions 64-66.

2. Employment

4-consulting report estimates that 20,000 EU nationals work in the banking and finance sector in Scotland. We need assurance that the rights of these workers will be protected and that the financial sector in Scotland will continue to be able to attract talented workers from across the EU.

Financial Services Employment in Scotland by Sub-Sector

	2012	**2013**	**2014**
Banking	46,400	45,900	46,600
Life and Pensions	11,000	9,400	8,200
General Insurance	2,000	2,400	2,200
Asset Management	19,600	16,400	16,900
Intermediation	12,100	11,300	12,500

- The sector accounts for around 3.5% of total employment – similar to the proportion in the UK as a whole.
- Overall, Scotland's share of GB financial services employment was 8.3 per cent in 2014.
- Life and pensions employment has fallen over recent years but the industry retains significant footprint in Scotland with more than 25 per cent of GB employment located here.

3. Firms in Scotland

Institutions **headquartered in other parts of the UK** have substantial operations and customers in Scotland - for example Barclays, HSBC and Santander. In recent years **new entrants** to the UK banking sector, such as Tesco Bank, Virgin Money and Sainsbury's Bank, have all established a significant operational and headquarter presence in Scotland.

- **Asset management and servicing -** Six of the top ten asset servicing firms (in terms of worldwide assets under custody and administration) have operations in Scotland, including BNY Mellon, JP Morgan and State Street. . Aberdeen Asset Management, AEGON Asset Management UK, Alliance Trust, Baillie Gifford and Co, First State Investments, Scottish Widows Investment Partnership and Standard Life Investments all have a significant presence in Scotland.
- Scottish Financial Enterprise estimate that the value of funds under management in Scotland is around £800 billion .

Life and pensions - Over 25 per cent of GB employment in the life and pensions sector is located in Scotland in firms including Standard Life, Scottish Widows, Aviva and Royal London.

General insurance - a mature market with a long-established reputation and wealth of experience. A number of firms that provide services across the UK have operations located here, including Esure and Direct Line.

4. Large firms dominate employment in the sector in Scotland

- The top ten financial services companies by employment account for two thirds of employment in the industry in Scotland. In the UK as a whole, the top ten companies account for 35 per cent of employment.

Country	Top 10 Financial Services Businesses Employment	All Financial Services Employment	Top 10 Share of All Employment
Scotland	58,510	88,510	66%
UK	364,740	1,037,650	35%

5. Foreign owned firms have a significant presence in the industry in Scotland.

- In 2015, foreign owned enterprises accounted for 6 per cent of the total number of enterprises in financial services (and 20 per cent of employment in the sector[4]).
- For the economy as a whole, the average level of foreign ownership of Scottish enterprises is 1 per cent and the average level of employment accounted for by these firms is 17 per cent[5].

6. Exports

- The EU accounts for around 155 million of the £8.6bn exported by financial services in Scotland (1.8%), with the vast majority (£7.4bn) going to the rest of the UK.
- The UK financial services sector exports around 33% of its financial, insurance and pensions services exports to the EU. Within this, non-insurance financial services export most intensively to the EU and account for the larger share of jobs in the broad sector.

BREXIT IMPLICATIONS

7. Access to EU market

- White Paper acknowledges strategic importance of the financial services sector and claims that the UK Government will "*be aiming for the freest possible trade in financial services between the UK and EU Member States."*
- It is not yet clear what form such an agreement might take or what provisions will be made to allow transition to a new regulatory regime.
- Unless agreements on access are put in place, the UK would lose access to the full EU market for financial services though current passporting mechanism.
- Scottish based companies operating in EU markets would have to set up a base of operations in another European state to allow access to continue.
- Some companies (e.g. Aberdeen Asset Management) already have operations elsewhere in the EU that may allow them to continue to offer some services to the European market. RBS also currently hold operating licenses in Ireland, Netherlands and Germany).

- **There are no real examples of trade agreements/deals on financial services outside of the EU.** This is mainly due to the importance of financial services to the national economy and therefore subject to regulation "prudentialism" to protect national economies from the failure of financial services

City UK have called for the UK and EU to agree:

- a framework for the mutual recognition of regulatory regimes, going beyond the existing equivalence regimes

4 Businesses in Scotland 2013. "Foreign owned" is defined as outside the United Kingdom.

5 Foreign owned firms are those enterprises with ultimate ownership outside the UK. The country of ownership is based on where the enterprise is ultimately registered (i.e. where the parent company is incorporated).

- continued close cooperation between the FCA/PRA, the European Supervisory Authorities and Member States' competent authorities, as well as the Bank of England and the ECB.
- the ability to market and provide agreed services to existing and new customers, transact business with them, and manage their money efficiently
- acceptance of professional qualifications, practice rights, standards for regulated products and services and especially prudential regulation set by the relevant regimes
- non-discriminatory access to market infrastructure and free cross-border data flows.

8. Transition Agreement

- Even if a trade agreement is reached in 2 years, regulators and institutions will need a transitional legal framework in order to restructure operations in line with the newly agreed legal and regulatory frameworks.
- Firms will require time in relation to granting of licences to operate in Europe and approval/assessment of capital models can also take years. Also need to consider the physical costs of operational set-up to expand the entity, staff, risk controls, real estate etc.
- Smaller companies are less likely to have the organisational structures in place to deal with loss of passporting and changes to regulatory regime and will be highly dependent on transitional arrangements while they adapt their business models. Scotland has more small financial services companies than rest of UK.

9. Current arrangements - Passporting

Financial services is an area that has benefitted significantly from harmonization, mutual recognition and the ability to provide cross border services. The system of "passporting" has enabled financial institutions to reduce or to avoid substantial costs associated with operating local subsidiaries by instead converting these into passported branches of an entity registered in another EU country. Currently, banks and investment companies authorized in an EEA state are entitled to provide services to clients in other EEA states by exercising the right of establishment via a branch or to provide services across borders, without further authorisation requirements.

The passporting regime covers services including deposit taking and lending, insurance (life and non-life), reinsurance, investment services management and offering of Undertakings for Collective Investments in Transferrable Securities (UCITS), alternative investment funds, payment services and electronic money.

It is likely that cross-border banking and investment banking and foreign exchange activities would be most affected by the loss of passporting;

- Depending on the agreement reached it may only affect a subset of the industry – for example PWC analysis focuses only on a sub-set of the UK banking sector. Specifically non-EU banks. (specifically they model a 25% reduction in banking activity attributable to non- EU banks).
- If the UK could secure Equivalence determinations by the European Commission, this would be likely to facilitate market access for a range of financial services activities.
- However, these will not cover banks' ability to provide cross-border services in a number of core areas. (these include lending, deposit taking, FX, and other investment banking areas outside scope of MiFID II)
- For example, non-EU banks are required to be licensed to conduct deposit taking activities in individual Member States (under the Capital Requirement Directive – CRD IV).

- In practice passporting could affect the provision of both retail and investment banking on a cross – border basis and UK-based banks currently operating via branches in other EU member states.

10. This would translate into an increase in non-tariff barriers

- Banks and institutions could adapt to market restrictions by setting up branches that would enable them to continue to service EU clients.
- Over the long term – it is likely that some trading activity could migrate to the EU, along with market infrastructure including exchanges, clearing houses and CCPs. (Central Counterparty Clearinghouses)
- Therefore the balance of some investment decisions could tip in favour of relocation to EU hubs, particularly in services relating to serving EU customers.

ALTERNATIVE OPTIONS

11. EEA membership ("Norwegian model")

Passporting does not require full EU membership. Membership of the EEA would allow Scotland to continue to benefit from access to the EU's single market, but with reduced influence on development of regulation. However, EU leaders have been clear that retention of passporting capability requires acceptance of EU rules and requirements.

- The UK White Paper appears to rule out this option *8.2 "We do not seek to adopt a model already enjoyed by other countries."*
- The Scottish Government has put forward a solution under which Scotland should continue to be a member of the European Economic Area, even if the UK leaves. Such a differentiated approach would allow Scotland to continue as a member of the European Single Market in addition to – not instead of – free trade across the UK. This approach will require UK cooperation and should form part of the UK Government's Article 50 process.
- The proposed integrated solution for Scotland ensures continued membership of the Single Market, and collaboration with EU partners on key aspects of policy and participation in EU programmes.
- As part of the proposal Scotland will remain part of the UK single market – goods and services will still be able to move freely across the UK. As such, the external UK border will still be the current UK border with the EU.

12. Equivalence

It is possible for 'third countries' outside of the EU single market to obtain access to the single market for some financial activities through a mechanism known as 'equivalency' – provisions have been made to offer market access to companies based in **countries that can demonstrate that their financial regulation matches the standards set by Europe.**

- Equivalence does not cover all areas of financial services and any agreement may be subject to extra conditions.
- There could be issues with delays around being granted equivalence.
- Equivalence is determined by the European Commission and can be revoked unilaterally by the EC at any time, particularly if a home country deviates from EU standards.

CONCLUSIONS

- Difficult to assess full impact of Brexit until precise terms of negotiation and eventual economic and regulatory relationship between UK and EU is known.
- Further detail needed on the level of market access that can be agreed and what transition arrangements will be made.
- Challenges facing the financial services sector in Scotland largely reflect those facing the wider industry across the UK
- It is likely that the implications for passporting are likely to be felt most in investment banking activities and in non-EU firms servicing EU markets. This may suggest that activity in Scotland may be less affected than activity in the UK and London.
- The balance of some investment decisions, and in particular decisions of non-EU firms could tip away in favour of relocation to EU hubs, particularly in services relating to serving EU customers.

Karen Rodger, Financial Services Policy, x41205
February 2017