


BRIEFING FOR THE FIRST MINISTER

MEETING WITH JEREMY BROWNE, THE CITY OF LONDON CORPORATION'S REPRESENTATIVE FOR THE CITY TO THE EU

Thursday 27 April 2017

Key message	<ul style="list-style-type: none">• 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.• It is essential that the UK Government sets out how it intends to protect the financial services sector and Scotland in the forthcoming negotiations.• Despite our disappointment in the UK Government's decision to leave the Single Market, the Scottish Government remains committed to working with the UK Government and other devolved administrations to further Scotland's interests within the negotiations with the European Union.• Helpful to understand the City of London's Corporation concerns and priorities for Brexit negotiations; explore the potential to collaborate on shared concerns; and receive some intelligence on current atmosphere in Brussels and EU capitals, before negotiations start.
What	Meeting with Jeremy Browne, the City of London Corporation's Special Representative for the City to the EU.
Why	Mr Browne requested a meeting with the First Minister during his visit to Edinburgh to attend a number of engagements [Please see Annex B].
Who	<p>Jeremy Browne, the City of London Corporation's Special Representative for the City to the EU.</p> <ul style="list-style-type: none">• Appointed Special Representative for the City Corporation to the EU since September 2015, with the role to ensure that the Corporation's interests are represented at EU Institutions and in Member States.• As Special Representative, he covers a range of EU issues including the UK EU Referendum and the Capital Markets Union.• Former Minister of State in the Foreign and Commonwealth Office (2010-12); Minister of State in the Home Office (2012-13) and Member of Parliament (2005-2015). 

	<p>Since the EU Referendum, Mr Browne has been engaging extensively with EU Member States, EU Institutions and Financial Market and Trade actors to put the case for preserving London as Europe's financial centre. Mr Browne has been to each Member State at least once - some up to three times - and has also visited Norway and Switzerland.</p> <p>Mr Browne will be accompanied by Alastair Ross (Association of British Insurers, Head of Public Policy for Scotland, Wales and Northern Ireland) and Jonathan Pallant (European Policy Adviser, City of London Corporation)</p>
Where	FM's Office, The Scottish Parliament
When	Thursday 27 April, 15:00-15:30
Likely themes	EU Referendum, Brexit Negotiations, and Financial Services
Supporting official	[REDACTED]
Attached documents	<p>Annex A: Background Note</p> <p>Annex B: Jeremy Browne's Visit Programme</p> <p>Annex C: Financial Services and Brexit</p> <p>Annex D: International Regulatory Strategy Group (IRSG) Report on Financial Services post-Brexit</p>

BACKGROUND NOTE

Role of Special Representative for the City of London

- Since the referendum Mr Browne and colleagues have been travelling to capitals across Europe meeting directly with Finance and Foreign Affairs Ministries, Central Banks, Cabinet Office and Financial market actors and trade bodies as well as with the UK Ambassadors to put the case for preserving London as Europe's financial centre.
- Although the key role is to promote and protect the interests of the City, this extends to representing the interests of wider financial centres in the UK, including Edinburgh through the International Regulatory Strategy Group (IRSG) which is co-supported by the City of London and City UK.
- In addition, the City of London is also active on a trade association group of European Financial Centres on which Scottish Financial Enterprise is also active. The purpose of this group is to facilitate inter financial centre dialogue and communication and to develop positions of joint advocacy on policy.
- Mike Neilson joined the last dinner event of the European Financial Centres in December 2016 and the City Corporation's Deputy Chair of Policy and Resource, Catherine McGuinees, attended the SNP Party Conference in October 2016.

Background to City of London representation in Brussels

- The Brussels office is located in Scotland House and was established to strengthen relations between the City of London and EU institutions.
- The City Office in Brussels represents the needs of an international financial marketplace. It liaises between the City and both the EU institutions and Member States – strengthening dialogue between them.
- Aiding better contact with EU decision-makers and key figures elsewhere in the EU.
- It focuses on cross-sectorial issues in which pan-EU policy making could affect the competitiveness of international financial services and therefore the EU's economic growth. It facilitates wider City contacts by staging networking events and briefing meetings with MEPs, European Commission officials and Member States' representatives.

City Office in Brussels's strategic aims

- To help shape the evolution of more effective financial services within the EU – assisting in the creation of a coherent strategy for future growth and development of the single market for financial services.
- To promote the interests of the wider City as a key international marketplace – acting as a focal point in Brussels for UK-based international financial services through informal contacts with decision makers.
- To act as a channel for regular communication between EU officials and MEPs and the international financial services community on matters of collective interest.

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JEREMY BROWNE'S VISIT PROGRAMME

Wednesday 26th April

14:00-15:00: Meeting with the Conventor and Members of the Scottish Parliament's Culture, Tourism, Europe and External Relations Committee

16:00-16:45: Alyson King, Deputy Director for Policy, Sven Baaz, Economic Advisor and Tom Cartlidge, Senior Policy officer, Scotland Office

18:30-22:30: Association of British Insurers (ABI) Future Leaders Event Two: Brexit and trade: the impact on UK businesses.

Jeremy Browne guest speaker

Thursday 27th April

10:00-11:00: [REDACTED], Head of Financial Services, Scottish Government

12:00-13:00: Meeting with Standard Life (TBC)

13:30-14:30: Lunch with Geoff Aberdein, Head of Public Affairs, Aberdeen Asset Management and Alistair Ross, Head of Government Affairs, ABI Scotland

15:00-16:00 Meeting with Nicola Sturgeon, First Minister of Scotland (Scottish Parliament, Edinburgh EH99 1SP)

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.

1. Economic Contribution

- GDP in the Financial Services sector¹ decreased by 1.3 per cent in 2016 Q4 compared with the previous quarter. However, compared to Q4 2015 GDP in the sector increased by 7.1%.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 sector³ 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 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.

"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)"

¹ GDP 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	2015
Banking	46,400	45,900	46,600	48,200
Life and Pensions	11,000	9,400	8,200	8,500
General Insurance	2,000	2,400	2,200	1,800
Asset Management	19,600	16,400	16,900	14,900
Intermediation	12,100	11,300	12,500	12,700

- The sector accounts for around 3.4% of total employment. Overall, Scotland's share of GB financial services employment was 8.4 per cent in 2015.
- Life and pensions employment has fallen over recent years but the industry retains significant footprint in Scotland with more than 26 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 sector⁴).
- 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 cent⁵.

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 through 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
- 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

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).

- 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.

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IRSG REPORT ON FINANCIAL SERVICES POST-BREXIT

International Regulatory Strategy Group (IRSG)

The [IRSG](#) is a practitioner-led body comprising leading UK-based figures from the financial and professional services industry co-sponsored by the City of London Corporation and TheCityUK. In recent months the IRSG has published reports on “The EU’s Third Country Regimes and Alternatives to Passporting” and “The Implications of Brexit on Central Counterparties (“CCPs”)” – pertinent in the context of the political debate surrounding the relocation of euro clearing activities from London to the EU.

More recently, the IRSG has published its recommendations as to how the UK and EU-27 can ensure reciprocal market access post-Brexit. The report, entitled [‘Mutual recognition – a basis for Market Access after Brexit’](#), develops a potential mechanism for reciprocal market access based on the comparability of regulatory and supervisory regimes and reviews options for access criteria, the mechanisms for maintaining regulatory alignment, and how possible disputes between the UK and EU in relation to access could be resolved.

The paper concludes:

- Where global standards exist, and are robust and detailed, the criteria for access should be based on these. These could include those set by the Basel Committee on Banking Standards, International Organisation of Securities Commissions (IOSCO) and the Financial Stability Board (FSB).
- A joint UK-EU committee or forum could be established to make sure that regulation and principles of supervision are monitored as they evolve over time and to assess the materiality of divergences, for example consulting on new legislation before it would be brought into effect.
- A dispute resolution mechanism is necessary to put in place in case of failure to agree on the materiality of regulatory divergences. This report sets out a menu of models of dispute resolution mechanisms which already exist in free trade agreements or other arrangements. But the report suggests that an entirely new model might equally be developed. These disputes could be referred to a new independent panel, made up of global standards setters (such as the FSB or IOSCO) or a new panel of experts predominantly from outside the UK and EU.

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