Will financial sector nationalism win over in the post-Brexit battle?

By Vicky Pryce, Visiting Professor at Birmingham City University and board member of the Centre for Economics and Business Research

Over a month now since the end of the transition period and despite the continuing focus on the pandemic, Brexit issues continue to feature prominently. From the attempt to renegotiate the Northern Ireland Protocol which after all was the epicentre of Boris Johnson's deal, to the news that half of lorries now depart the UK for the Continent empty[i], that trade with the EU has fallen by 68% compared to a year ago[ii], to serious increases in delivery costs and confusion about where VAT payments may be due, the list is getting longer by the day.

But all this is still centred on goods and the extra bureaucracy which has been estimated by HMRC to be some £8b a year, almost the same as the UK's net contribute annual contribution to the EU. But the services issue remains unresolved. Worth reiterating, the UK's economy is some 80% services and yet the Trade and Cooperation Agreement signed last December was drafted along the lines of a straightforward free trade agreement (FTA) hardly touches the sector. Huge non-tariff barriers for services remain.

I have written about the plight of the financial sector before. But it is interesting that the City of London has just finally become a lot more vocal about the fact that they have been largely ignored during the negotiations. Much emphasis has been placed on achieving equivalence so that both sides can respect each other's regulation and allow trading across to be unhindered.

The Bank of England has allowed EU financial sector firms to continue to operate as before for a while, not reciprocated by the EU but there has nevertheless a temporary equivalence regime for central counterparties has been granted allowing euro-denominated clearing to continue in the UK for 18 months post transition[iii]. But the mood has darkened about the chances of reaching agreement on an actual equivalence regime next month. So well into 2021, with the UK a third country as far as the EU is concerned, there is still no clarity. And in the meantime many financial institutions have been voting with their feet- or rather with their capital.

By late 2019, even before the UK formally exited the EU, investment banks had already moved some £900bn of assets from UK to EU, with Dublin at the time the biggest beneficiary[iv] . More have moved since. Relocations of staff, many of which had taken place before the formal exit on January 31, 2020, were less than had been forecast but appear to have accelerated in the latter part of last year[v]. We had seen that over the past five years, though UK hiring's also increased, the largest asset managers have upped the number of staff located in the EU by 38% with Brexit uncertainty cited as one of the main reasons.[vi]

And more recently, with EU regulators fearing that companies would be attempting to set up letterbox entities in EU countries to bypass the problems created by Brexit, companies have had to demonstrated that they had sufficient numbers on the ground to carry out the amount of business those entities are meant to be doing with EU clients. Many smaller investment managers however who cannot afford the costs of setting up subsidiaries in Europe are anxiously awaiting the outcome of equivalent discussions as at present, in theory at any rate, third country rules do not allow them to market their services directly to EU clients from UK headquarters[vii].

Since the end of the transition period on December 2020, Euro-quoted EU listed shares[viii] can no longer be traded in the UK[ix]. Yes, the UK has agreed the resumption of trading in Swiss shares as it is no longer bound post- Brexit by the Brussels withdrawal of equivalence to Swiss stock exchanges in 2019[x]. But that is scant relief as London lost £6b of daily share dealing immediately post transition[xi].

Is 'equivalence' the panacea it is meant to be? Apparently not in the eyes of many financial service companies which are worried that it leaves a lot of uncertainty in the air. The Swiss experience is a good case in point. As explained by an Bundesbank member in a recent article [xii], the first thing to bear in mind is that equivalence does not apply to areas such as basic banking services. With mutual recognition and therefore 'passporting' having disappeared, this needs to be negotiated country by country complicating procedures and raising costs.

In truth, equivalence leaves so much uncertainty that it offers no real basis for long term investment as it can be revoked, at any time- and by either side. The situation between the EU and Switzerland over the past decade is testimony to that. That doesn't give one much hope that the end result will be a win-win .The chances are that no other centre in the EU, even if they do attract a certain amount of business from the City, will be able to develop London's ecosystem which so far has served the EU well.

It will be more likely that New York, Singapore and Shanghai will be the ones taking over, just at a time when the EU is beginning to focus on strengthening the role of the Euro post- Covid and increasing the continent's financial resilience against any future shocks. And the City will also suffer despite the ability it has often demonstrated in the past of reinventing itself. Let's hope that the negotiators are given enough room to think more expansively than the early terms of reference for their discussions seemed to suggest.

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[i] https://www.thetimes.co.uk/article/empty-lorries-leave-britain-as-brexit-trade-laws-unnerve-exporters-35hpdxgw3

[ii] https://www.theguardian.com/politics/2021/feb/06/fury-at-gove-as-exports-to-eu-slashed-by-68-since-brexit

[iii] https://www.euractiv.com/section/economy-jobs/news/brexit-big-bang-to-trigger-tectonic-trading-rift-in-europe/

[iv] https://www.independent.co.uk/news/business/news/banks-brexit-moves-assets-billions-uk-eu-a8818116.html

[v] https://www.funds-europe.com/news/brexit-financial-firms-transfer-1trn-of-assets

[vi] https://www.ft.com/content/e45564eb-e76d-4015-8179-f68158a8cabd

[vii] https://www.ft.com/content/e8f51cdb-39e9-4a82-aa95-a1120c351db1

[viii] https://www.cityam.com/eu-to-allow-post-brexit-share-trading-for-london-listed-firms/

[ix] https://financialpost.com/pmn/business-pmn/euro-share-trading-exits-london-for-eu

[x] https://www.ft.com/content/5fa7cdd2-83d6-476c-b32c-9c054d76e6c1

[xi] https://www.ft.com/content/586d32c3-ffc9-488b-9763-07dac3a30354

[xii] https://www.ft.com/content/9c3e640d-2b96-4795-b567-248c1a6cc2e8