European Institute

Financial regulation and the protection of Eurozone outs

Report of the hearing on 27th November, 2015

LSE Commission on the Future of Britain in Europe

Rapporteurs:
Waltraud Schelkle (LSE)
Hjalte Lokdam (LSE)

Foreword

This is the report of a hearing that took place on 27 November, 2015, at the LSE. Participants were invited for their expertise on financial regulation and European integration, not for any particular views they hold about Britain's relationship to the European Union.[1]

We are extremely grateful for the constructive debate in which the participants of the hearing engaged as well as for the feedback we received on a first draft. These contributions were given on a personal basis and should not be attributed to the respective organisations. The report also benefited greatly from background information generously provided by Professor Niamh Moloney from the LSE Law department before and after the hearing. Marion Osborne provided excellent organisational support. David Spence helped us greatly with the final drafting. Any remaining errors are our responsibility.

London, 11 December 2015

[1] See the list in the Appendix.

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1. Introduction

The topic of this hearing was the EU's regulation of financial services and the relationship between outsiders and insiders of the monetary union. The hearing was therefore concerned with two crucial determinants of economic benefits and costs from membership.

EU financial regulation has moved up the political agenda due to the North-Atlantic financial crisis since 2007-08 in the wake of which a Single Rulebook was introduced for all EU member states. The euro area crisis since 2010 gave this a further boost with the Banking Union that has split the Single Market into euro-insiders and euro-outsiders. The ECB got supervisory powers for all banks in the euro area, which makes it, in terms of assets, the authority with the largest prudential responsibility in the world. The relationship with the Banking Union is of vital importance to the City which happens to be the financial centre of a currency union to which it does not belong.

The hearing made clear that nobody expects there to be a major immediate disruption in case of an exit from the EU. The UK financial sector has strengths as a global financial centre and its financial services have a great variety that do not all depend on banking with mainland Europe. But there was also a consensus that the City in particular would lose business and employment over the medium to long term. The EU would have no incentive to give UK financial institutions and their regulation a status that would facilitate trade. On the contrary, agreements to assist euro-denominated business in the UK through central bank cooperation could be revisited if the UK would cease to be a member state of the union.

More important is, especially in light of the experience of a North Atlantic financial crisis, to consider what the UK taxpayer would lose from a Brexit. Participants agreed that past UK governments were very apt in seeking the EU legislation and regulation they wanted for domestic purposes. This was not necessarily, as one participant forcefully put it, protection of the City from Europe but protection of the UK taxpayer from the City, using Europe. The hearing discussed at lengths the threats to economic stability and fiscal sustainability that an oversized financial system poses to any nation state. It would leave the UK taxpayer more exposed to the costs of financial instability.

The report has the following structure: the section after the summary discusses the crucial questions if Britain were to stay in the EU. Does its financial sector need different regulation than the rest of the EU? And how problematic is its status as an outsider of the European monetary union? The following section discusses the eventuality of a Brexit. How would this affect liquidity provision in the case of another crisis? And how would its access to the EU financial markets change? The conclusions note points of disagreement and consensus among the experts at the hearing.

2. Summary

- All participants expected job losses for UK banking but nobody expected the UK to lose its status as a financial centre. Banking is vulnerable to losing its role as a gateway into the euro area, while other financial and business services would remain competitive.
- The extent of job losses would largely depend on the equivalence of British regulations to EU regulations. This points to a Norwegian solution in which the UK would either keep or adopt the core of EU financial regulation even though it is outside the Union.
- Keeping most of the existing EU regulations was not seen as a major drawback for the UK and its financial services, including insurance, because the UK had been influential in shaping these regulations. Exceptions, in which the UK was overridden by an EU majority, concern the regulation of hedge funds and bankers' bonuses.
- The rather limited outcome of the February 2016 re-negotiation of the UK of an emergency break for euro –outsiders was in line with what the participants in this hearing expected. This reform allows euro-outsiders to throw sand in the wheels of euro area legislation, but not stop it entirely.
- An explanation is the UK's own ambivalent position vis-à-vis further integration of the euro area. Chancellor Osborne conceded a "remorseless logic" of further integration required to stabilise the euro area but the government also fears being left outside the room where agreements are prepared.
- Assets and liabilities of UK-resident banks are largely denominated in currencies other than the British Pound, hence a liquidity crisis will typically require swap arrangements with other major central banks.
- Central bank cooperation is likely to continue, because it has a long tradition predating the euro and is of vital mutual interest. The size of financial institutions and the length of emergency support required would make this imperative for the Bank of England and the European Central Bank.
- This continued cooperation would not stop the European Central Bank pressing for euro-denominated business to move to a member state of the Eurozone, bringing it under the ECB's jurisdiction as a prudential authority and lender of last resort.

Waltraud Schelkle, 18 May 2016

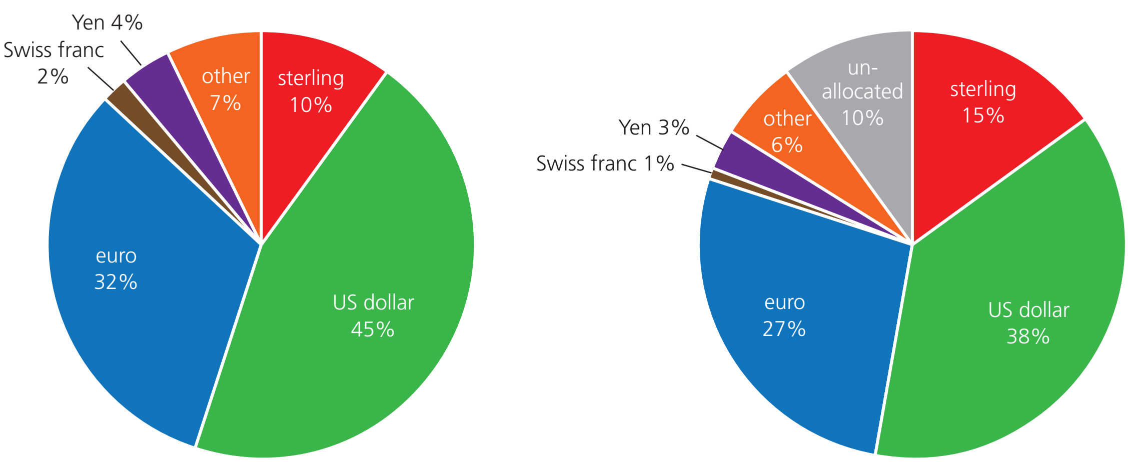
3. How different are the interests of the UK in financial regulation?

The initial discussion revolved around the question how different the UK financial system is compared to those in Continental Europe. There was consensus that it is different, but whether this makes the UK financial system unique and in need of separate regulation or safeguards was much debated. There was also agreement that the integration dynamic of the EU, namely predictably stronger financial integration of the Eurozone, affects the UK financial sector. Yet while agreeing that the UK has a fundamental interest in the stabilization of the Eurozone, participants discussed at length whether it necessarily follows that the UK is, or seeks to be, an obstacle to the process.

3.1 Differences in size, structure and connectedness

Participants remarked on several features making the financial system in the UK possibly so distinctive as to create predictably different UK interests in EU financial regulation. Did the sheer size of the UK financial system make for relevant difference? Angus Armstrong suggested that size, complexity and number of UK systemically important financial institutions create a potential exposure for the British taxpayer that may become too large to underwrite. This requires a Bank of England which can act as an almost 'infinite' lender of last resort to manage this tail risk – which the Bank can do as long as Pound Sterling liquidity is required, as in particular Graham Bishop remarked. This raises the question of central bank cooperation, for

Graph 1: External business of MFI operating in the UK by currency, 9/2015



Source: *Bank of England (2015a, Table C3.3); outstanding amounts, expressed in US-$ as of Q2 of 2015, are rounded* instance in emergency liquidity access for systemically important banks and central counterparties (CCPs) as well as cross-border resolution of banks. The following graph indicates that banks ("Monetary Financial Institutions", MFI) operating in the UK have more claims and liabilities in other currencies than in Pound Sterling.

In particular Sharon Bowles and Nicolas Véron disputed that the UK was in a unique position in this regard. Though to different degrees other financial centres such as Luxembourg also have large institutions, which are active across borders, and this raises the question of responsibilities if liquidity and solvency issues arise[2].

Simon Gleeson did not think that UK finance was so different ("finance is finance"), yet with one exception. He argued that the global rather than national character of the UK financial centre gives it a particularly intense interest in permissive third country regimes. These regimes set out the legally binding conditions under which financial businesses from outside the EU ("third countries") endeavour to sell their products in EU markets. The countries in which they are headquartered must have laws and supervision in place equivalent to EU provisions. Access to one member state acts as a "passport" and allows selling in all EU financial markets. If countries, such as China, do not have such equivalent provisions, their banks or insurers will have to establish subsidiaries at high cost. The UK would prefer such third country regimes to be based on broad principles, while the European Commission and the ECB seem to prefer "line-by-line" equivalence. Nicolas Véron again doubted this was a UK-specific concern. Rather, third country treatment is a European problem arising mainly through the UK insofar as the UK acts as a gateway to the EU for financial businesses from China and elsewhere. But if it were not for the UK, the EU would still have the problem of ensuring foreign businesses conform to equivalent standards of proper conduct and prudential supervision etc.

> The characteristics that make the UK financial system different do not necessarily make it require different regulation.

A Bank of England (BoE) report on "EU membership and the Bank of England" from October 2015 highlights how large, different and connected the UK financial system is and to what extent it is connected to the EU. Data is from 2013-14; all values have been converted to Pound Sterling at historical exchange rates.

- The UK is the EU's largest financial centre with 24% of market share (gross value added); Germany comes next with 16%. Financial services contribute about 8% to income and just under 4% of employment. The EU itself has the second largest financial services sector in the world, with about £550 b value added, after the United States with £736 b.

2 See more on swaplines and CCPs below.

3 Examples for US-UK differences cited by Rosa Lastra were insurance regulation, stress tests, macro prudential instruments and ring fencing of commercial banking. The exception of a US-UK consensus was, in her view, bank resolution after the Lehman default.

- The UK is the largest exporter of financial services in the EU, with 40% market share, while the EU as a whole accounts for about half of all financial services exports in the world.
- The UK is the leading global market for cross-border banking, derivatives trading and insurance services. In turn, two thirds of all cross-border investment involves the EU (65% each of all cross-border banking and portfolio investment; 75% of all foreign direct investment). Other EU countries are, as a group, the largest investment partners of the UK and account for about 40% of all UK cross-border investment.

It seems fair to conclude that the UK financial centre, in particular the City, is as much global as it is European. Karel Lannoo remarked that from a historical perspective, "this financial centre has grown with the single market"; chart 1.4 in the BoE report lends some support to his conjecture of a "direct correlation". This would suggest that the characteristics that make the financial system different do not necessarily make it require different regulation. Sharon Bowles supported this very strongly for the massive reregulation exercise in recent years, for example in terms of flexibility on capital requirements and the mother of all directives: "due to the volume of knowledge and information available from the UK [MiFID II] was crafted around many UK wishes such as open access." A similar point was made by Mark Nicholson for insurance and the Solvency II Directive: for "insurance companies regulated previously in the UK, there was perhaps less change than for other European insurers".

3.2 Outsider status and the dynamic of Eurozone integration

If the specific needs of the UK's financial system do not warrant a major effort of renegotiation, does the dynamic of Eurozone integration suggest that the UK government should seize the moment and ask for safeguards? This view was expressed by Raoul Ruparel, who referred to "the Greek bridge loan as a watershed moment of potential caucusing from the Eurozone against the non-euro countries." The solution of opting in on a bilateral basis "relied on Eurozone countries fighting the UK's case for them and the good-will of the Eurozone", which Ruparel believed was not "a sustainable model going forward." He was concerned about the institutions founded to rescue the euro area being introduced with a "Single Market justification", banking union in general and the recently proposed European deposit guarantee scheme in particular. He argued safeguards were necessary for Eurozone-outsiders against negative effects resulting from intensified integration of the currency union. This was seconded by Lukas Marek. He argued that new member states, such as the Czech Republic, were treaty-obliged to commit to seeking membership of monetary union, yet this union was a moving target and no longer the same as when the commitment was made.

Sharon Bowles granted that there are "tensions between financial stability and the single market" in prudential regulation. "For the sake of both the single market and raising standards, the EU has moved from directives to maximum harmonising regulations." This creates a "dilemma" for member states like the UK that prefer to go beyond that maximum, for instance setting higher capital requirements in the interest of financial stability (and possibly competitive advantage). In this particular example, the relevant Directive (CRD4) allowed a member state to add up to 3% to the capital buffer. This "constrained flexibility" was also exercised in other areas, such as macroprudential measures, by setting limits to national discretion.

Her interpretation of PM Cameron's letter to Council President Donald Tusk (Cameron 2015) is that he wants "protections for the City, which isn't actually protection of the City from Europe. It is protection of the tax-payers from the City. Do European regulations, being too inflexible, prevent that?" She saw this as the substance of what the government wants to negotiate in this area, and also interpreted recent speeches by Mark Carney (2015) in this light. But there is another side to the dilemma: "The concern that the Commission voices is that having additional capital – or other standards - in some countries but not others fragments the single market and can be used in protectionist ways."

This point led to a discussion about the "choice" the UK had made with respect to banking union. Nicolas Véron insisted that the banking union was a project of both the single market and the Eurozone. He referred to a speech by Danièle Nouy on 24 November 2015, in which the head of the Single Supervisory Mechanism argued that the banking union had been a long time coming and the financial crisis acted merely as a decisive catalyst for it (Nouy 2015). For instance, the Lamfalussy legislative process had prepared the ground for a Single Rulebook and European Supervisory Authorities had also been created already. In this light, the UK's decision to stay out of the banking union was therefore choosing the outsider position rather than having it imposed by the Eurozone: "By adopting the stance that there is a remorseless logic to Eurozone integration in 2011, the UK government has made the choice of favouring a two-tier system for the Single Market." The UK government played an active role in bringing this about and was "generous" in the sense that the administration "extracted a very small price for its assent to the SSM [Single Supervisory Mechanism] regulation". This generosity reflected enlightened self-interest. Chancellor Osborne wanted the Eurozone to fix its problems in order to avert negative effects on the British economy. Whether chosen or imposed, the two-tier banking union has settled in now.

Both John Springford and Simon Gleeson considered the quest for safeguards in detail and saw the UK in a paradoxically weak negotiation position. The UK's status as a global financial centre is so linked to its being the gateway to the EU, while also being a financial centre for the EU, that experts realise that Brexit would hurt the City significantly. Hence, neither saw much chance for the various options being floated. John Springford went through the list:

- There cannot be a veto about future rules without completely disrupting European integration.
- The double majority voting as practiced in the European Banking Authority is also unlikely to be transferred to other institutions, because it would give a minority of outsiders a de facto veto over the majority of insiders.
- Reducing the extent of Qualified Majority Voting when a member state's significant interest is concerned, as both Raoul Ruparel and James Sproule had advocated, is excluded as well as risking to undermine the functioning of the EU.
- An emergency brake procedure that could be pulled if enough Eurozone-outs said that a particular piece of proposed legislation was going to damage them would just mean a pause but those affected could not simply get rid of such legislation.

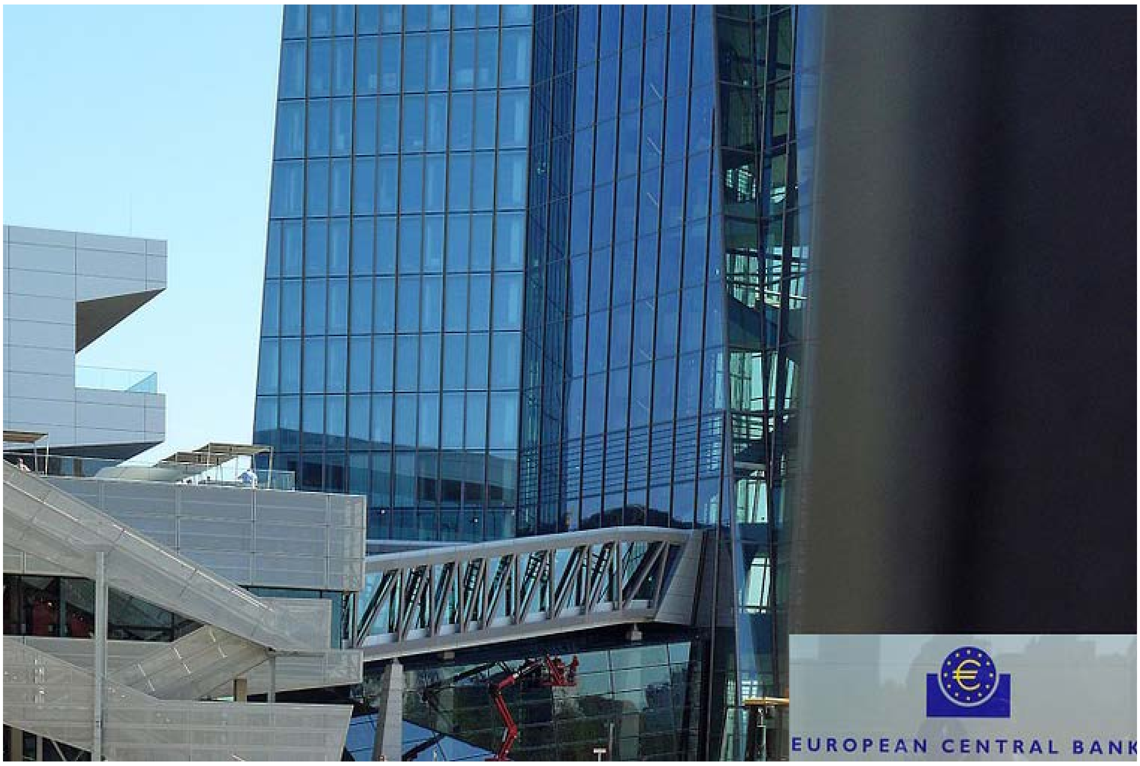
In financial regulation, the UK prefers to go beyond the maximum set by EU harmonization.

Simon Gleeson took the example of bonus rules to explain why all these safeguards are unlikely to work. The rule that says fixed pay has to be 50% of total pay is regarded in the UK as "a major damage to manage its financial centre". But in order to counter this, the UK government would have had to stop the entire legislative package (CRD IV) of which the bonus rules were only a very small element. "You are very much in favour of 98% of what's in the CRD but the idea that you are going to get a line-by-line veto that allows you to apply an emergency brake to individual articles or sub-articles of the Directive does seem highly implausible."

This led Sharon Bowles to emphasize how important it is "to be in the room" when new projects are started and legislation crafted. The Capital Markets Union was a case in point. It was of great interest to the UK because the City has a disproportionately large stake in capital market finance, even compared to banking. Being in the room also seemed important to her in order to prevent early on any steps that are separating insiders from outsiders. Her example was the Five Presidents report (Juncker et al 2015) which she saw as "a little bit insensitive towards euro-outs and there is perhaps a hint that they are trying to say that there is a special single market in the Eurozone that is different than the one outside." If one is never in the room, she argued, it does not require conscious caucusing of the Eurozone-ins to come up with insensitive projects. She drew the analogy of the glass ceiling that professional women face and their male colleagues find hard to see.

James Sproule had the most radical idea on how to ensure the UK would be in the room: “In the US, we have the Federal Reserve System of many different federal reserve members on the board. It is interesting: the New York Fed is always on the board and the others all rotate. And given the weight of interests of the UK in this, maybe there is a case for taking a lesson from it and saying ‘Look, because of the UK’s predominant interest in this we always are in the sub-committee on it, whereas the others shift.’ There is just a disproportional interest.”

Raoul Ruparel expressed scepticism as regards this substitution for safeguards: “if we are not in the euro there are going to be rooms that we are not going to be in. You can say that the UK decided not to be in the banking union, but was the UK ever going to be part of a banking union that was under the guise of the ECB? You have the ECB Governing Council having the final decision: can the UK ever join that?” He did not think so: “It would be a big transfer of power. You can complain about that but the reality is that there are going to be rooms we are not [..] in, so we have to work towards finding safeguards that are reasonable and work for a number of different countries.”



4. What would Brexit mean?

What would Brexit mean?

The answers to this question covered the whole spectrum. James Sproule thought "Brexit could be a success" and Small and Medium Enterprises were not fearful of a "vindictive" EU but expected a "pragmatic" reaction – an optimism he did not entirely share, however. Others were less concerned. One participant inferred from Harold James' (2012) history of European monetary integration that the euro "emerged out of the habit of central bank cooperation" and was "very reluctant to believe that if we were to leave, that habit would be relinquished". By contrast, Karel Lannoo and Graham Bishop expected "free provision of services [to be] finished" and cooperation between central banks seriously impaired. Rosa Lastra made the more political point (in a submission before the hearing) that "there's a real danger London as an international financial centre will lose its shine outside the EU". Contrary to a common perception, she did not find U.S. and UK regulators seeing eye to eye on many issues[3], hence the UK could not simply side with the U.S. and work through international fora like the Financial Stability Board. The following gives a succinct account of somewhat technical issues that should be all part of a wider debate.

4.1 Central bank cooperation

The panel discussed central bank cooperation at length, following the size-argument Angus Armstrong had begun. As shown in graph 1 above, UK banks have assets and liabilities of over $4.5 trn each that are 85-90% denominated in other currencies than Pound Sterling. Graham Bishop outlined the scenario in which a UK bank or central counterparty (CCPs) with major Euro liabilities gets into a squeeze: the Bank of England would have to go to the ECB saying "we have this problem, let us have €5-10 billion over night, please." This would be quite a large sum for the ECB, given its paid-in capital of €10.5 b. In the event of a loss, the ECB would have to go back to its members, the national central banks in the Eurosystem, and some of the members would have to ask for their government's approval to send more money. "You very quickly get into a situation where resolving a liquidity problem in the City, however it has arisen (we should think about CCPs as an obvious one), the ECB is the provider of the money. There is no way the UK can provide it." In this scenario, namely that "the lender of last resort to a substantial chunk of the City's activities is going to be a foreign central bank over which we have no control", customers might say: 'actually if I want to be sure about the lender of last resort kicking in in the moment of crisis, I think I would rather deal with somebody who is under the direct supervision of the people who print the money.' So there is a big issue, which is highly technical; but in the end this is real practical power politics."

David Lascelles objected: it was inconceivable that the ECB would simply refuse to provide a swap line to the Bank of England if there were a major crisis brewing on its doorstep. "Surely we have

[3] Examples for US-UK differences cited by Rosa Lastra were insurance regulation, stress tests, macro prudential instruments and ring fencing of commercial banking. The exception of a US-UK consensus was, in her view, bank resolution after the Lehman default.

had many crises in the past where we have not only drawn on continental bank liquidity but on North American bank liquidity." This objection was seconded by Sharon Bowles, who argued that the dependence was mutual: the ECB was not "really interested in swap lines with sterling until they discovered the exposure of Ireland to Sterling, which is when things got a bit more evened out." The ECB had benefitted from swap lines with the Fed, the latter quite unperturbed by the fiscal risks involved

Graham Bishop thought there were two reasons why dependence on such ad hoc mutual support may now be more problematic. First, there was the sheer size of behemoths like the Royal Bank of Scotland which require lifelines for much longer than just 3-6 months. The BoE (2015b: 9) reports that the EU headquarters 14 out of 30 global systemically important banks, compared to only 8 in the U.S.; 4 of them are in the UK (HSBC, Barcleys, RBS, Standard Chartered). Partly for that reason, swaplines between central banks that used not to pose credit risks may now do so. One may add that under the institutional set-up of the Eurozone, the fiscal risks to member states could be much more worrying than in the U.S., triggering the doom loop between banks and sovereigns. Hence, the ECB may face resistance from member states if the liquidity support to the Bank of England leads to losses, especially after it had just cut its links with the EU.

The other reason why dependence on mutual support was not a given lay in the new systemic risk presented by central counterparties (CCPs) for clearing, especially in derivatives trading. CCPs are increasingly important because of international regulation in the aftermath of the financial crisis (Domanski et al 2015). Nicolas Véron was adamant that this was a significant challenge of mutual concern: it is not clear whether CCPs are a Single Market or a Eurozone issue. The legal dispute over the question whether CCPs' clearing derivatives of euro contracts can be located outside the Eurozone[4] was in his view both an illustration of this uncertainty and also a great distraction from the common interest. "[T]here is a problem in CCPs that is entirely new, is entirely about derivatives, makes them much more important as a new category of players compared with the past, and therefore the past is not a guide to the future. I think the policy challenge has to be set out much more specifically. [..] The UK is not unique in having a big international CCP, there is also one in Germany, so we have two in the EU. But we have to think about what is a consistent regime." Graham Bishop added to this that "a CCP non-bank resolution [..] was meant to come already but it hasn't: it seems to be very difficult."

Graham Bishop was also unconvinced that the Court case settled the question of whether a central bank can ask for the CCP to be located in their area of supervisory jurisdiction if their business is in the currency the central bank issues. "[T]he UK sued [..] on the grounds that [the ECB] was talking about securities and the ECB's statutes didn't permit that, and

[4] Court case T-496/11 ended with a General Court ruling that "[annulled] the Eurosystem Oversight Policy Framework published by the ECB in so far as it sets a requirement for CCPs involved in the clearing of securities to be located within the eurozone". As a consequence, the BoE and the ECB agreed on intensified information exchange as well as on formal swap arrangements (BoE 2015C).

the [European Court of Justice] said the UK was right on this very narrow question of whether it was outside the ECB's powers. [..] [The ECB] are not being put off because the various global regulators talk about the national central bank, the supplier of the currency, to be in a position to know what is going on in its currency, which is perfectly reasonable."

CCP regulation is therefore one more of these rooms in which the UK may want to be. But it is not clear whether this would be greatly affected by the UK's relationship to Europe as it is a matter of regulation stipulated by the G20. However, Sharon Bowles recalled a relevant EU-U.S. dispute in this context: "if you want to know whether the EU can get political about this you only have to look at us being unable to find equivalence with U.S. CCPs on an entirely political point. The EU got fed up with being pushed around and the snootiness of the U.S. over things [..]. If [the EU is] capable of that with the U.S., I wonder what the response would be if [the UK] left. They will try to get the maximum of our cake, our leverage has gone at that point." It seems likely that the ECB would not let the issue of CCP location rest if the UK leaves the EU, for more or less good reasons.

Central bank cooperation is of mutual interest but new systemic risks may make it more problematic.

4.2 Third country status for the City

The answer on what Brexit would mean for the City depends largely on the nature of third country status the UK might achieve. Simon Gleeson argued strongly that if banks and regulated firms would seek and get "a full set of third country equivalences, they can to some extent continue as normal. If they don't, they have to establish subsidiaries in the Eurozone to do that business…. that needs passports that you won't get. [..] This is why all roads lead to Norway." Either way, Brexit would not imply massive changes to the way financial services markets operate, unless "we have an outbreak of childishness and a sort of deliberate closing of the European borders. If that happens, it won't just happen in finance. If that happens, it will be a major detriment to the UK economy, and it will have a major detrimental effect on the European economy that will in turn impose a further detriment to the UK economy. So either nothing happens or something happens which is far worse than just the impact on financial services."

But apart from this childishness scenario, Simon Gleeson was not too worried about the effects on the City as it has an "embedded architecture": "There is no place that has an infrastructure even close to that which is in London." Nicolas Véron agreed, with one qualification: "in most scenarios of separation, even in the most bitter, not much happens to the business of the City because the City has structures that others don't have. [..] The complication arises in the next crisis.

Because here is where systems are tested and this is very path dependent. So I don't think you can have a simple answer to that question because it depends on the story of the separation and of the crisis itself."

Others were more pessimistic as regards even normal times. The most concrete warning and prediction came from Tony Halmos: "There is absolutely no doubt that a considerable number of international firms currently based in London are considering their options. Some of them have already made decisions about new businesses which they have already decided not to put in London because of the uncertainty already around this issue. If we vote to stay in, this might change but not necessarily. An interesting example is that an international bank decided to put a stream of work in Warsaw rather than in London, solely because of the uncertainty about our membership of the EU: in the single market, not in the Eurozone. [..] Some [international firms] are already going, some of them say they will go, and, this is only a guess, but of the 400.000 financial jobs in London and the 1.000.000 in the UK I think that about 150.000 in London and 350 – 400.000 of the million will go over ten years. They won't go dramatically over one night, it will be bit by bit."

The response of U.S. American banks would be crucial in Karel Lanoo's view. This is first of all because U.S. banks are much "stronger" than UK and Continental European ones. And they use the UK as a gateway to the Eurozone. "American institutions know extremely well how important the regulatory environment is. The moment [the UK doesn't] have full equivalence probably some of these businesses will shift back to the U.S. These institutions are enormous.
And the moment the UK leaves, a lot of this business will move; which will affect the rest of the City." From his Italian and banking background, Lorenzo Codogno supported this prediction: "Before monetary union, banks had to have local branches. With the monetary union many banks migrated [from Milan] to London based on a cost analysis. [..] [H]ow much would this imply in terms of migration, I don't know but there will be some migration."

On the basis of a more extensive analysis with the late Philip Whyte, John Springford came to a balanced but ultimately negative conclusion: "[T]he reason why we have seen such large investments is not only because of the EU. Obviously it is about the deep and liquid markets here, it's about conglomeration effects more broadly, it's about the labour market and the skills that we have, it's about the legal regime, it's about the time-zone and so forth. But the question is whether the sign of the effects of Brexit on the City would be positive or negative? It seemed pretty clear to us that it would be negative, because if you look at the third country regimes [..], then you see that essentially the ability of financial institutions to be able to sell to customers across borders [..] is quite tightly circumscribed." They expect the EU to harden its stance: "They will be pretty insistent that quite a lot of cross-border activity would not be acceptable and that which was acceptable, they would insist on some pretty strict equivalence tests." The conclusion seems to be, as Tony Halmos put it: "The honest supporters of Brexit say, well that's fine but it's not about that at the end of the day, it's about the future standing of Britain. If people say that there won't be any economic effects then they are living in a sort of lala-land."

There were dissenting voices pointing out that "the City" is not as homogeneous as the label makes it sound, and hence the effects of Brexit should be differentiated. While it is difficult to find an exact breakdown for the City, the BoE Quarterly Bulletin (Burgess 2011, p. 236, Table B) shows that in 2010, banks and building societies had a share of 57% in UK financial services, other financial intermediaries had 9%, insurers and pension funds 19%, and auxiliary services 15%. This lends some support to the distinction between financial services and business services. Business services are much bigger than financial services. The UK is very competitive in the latter and has a massive surplus. The effect would therefore depend on whether business services are so tied in with banking services.

Raoul Ruparel generalized this point, namely that "the City [..] is not homogenous". He did not deny that "the large international institutions that are a predominant part of the City will be seriously affected but we also have to accept that other parts of the City, asset managers in particular, smaller and medium sized, don't recognize the same benefits from the Single Market. And the passport for them doesn't work as well." They might even benefit from more flexibility in regulation. In his view, this is one of the reasons why a lot of hedge funds advocate Brexit, the other being their "particular political persuasion". Similarly "[o]n the broader professional services side, the internal market is not particularly complete and it doesn't work particularly well [..], so the opportunity costs for the broader services are lower." These changes would not spell the end of London as a financial centre. "There are many ways of being a financial centre. "

5. Conclusions

The UK financial system is different, given its enormous size, the significant role specific sectors in it play, and given the interconnectedness of the City. Whether these differences matter for financial regulation of banks, capital and insurance markets has been quite controversial among the participants. Handling third country regimes seems the only issue where all saw the UK to have a fundamentally different position, both now and in a potential future outside the EU.

This singular difference suggests there are no easy wins for renegotiation in this area. The paradox of the City's weakness of strength, noted by John Springford also contributes to this: the City is the most important European financial centre and these strong business interests weaken its bargaining position. Sharon Bowles did not even believe that the UK is seeking so-called safeguards in respect of financial markets "other than the wider general check on merits, subsidiarity and reduction of legislation". One may of course see these general checks somewhat ignored in the present frenzy of building a banking union, and Raoul Ruparel certainly was of this view. But what may help are some moves in the EU, namely "a more capital market friendly environment through the capital market union and together with increasing international coordination of market regulation," to quote Sharon Bowles again. Another issue, forcefully argued by Nicolas Véron and Graham Bishop, is the regulation-driven rise of central counterparties.

They should be an obvious cause for common concern, especially after the Court ruling strengthened the UK's position (see footnote 4).

The position of David Cameron's administration seems to reflect this weak case for major negotiations in this area. This is, as Tony Halmos reminded us, a far cry from the situation in 2011, when David Cameron tried to use his leverage in the negotiations on the fiscal compact to extract concessions from other member states. "There was coincidentally a meeting of senior people from across the City. The crucial point was that because [the list of demands] was created without any consultation and was all written from the point of view of excluding Britain, basically the City was up in arms about it. And it was presented by the media as 'we are saving the City,' to which the first reaction was 'well if we want to be saved we will go to St Pauls and pray and nobody asked us if we wanted to be saved.'" It is the government that has changed its position: "The way it is now being presented is obviously a hundred miles away from that, and it is absolutely spot on to do it as formulated in the Dear Donald letter. That's the way to handle it. There are Eurozone-outs, we are not the only one, and that is the right way to put it. The chances of success for this to work are rather high." This optimistic conclusion may not be shared by all participants but it is a fair summary of the deliberations to see the Eurozone outsider status of the UK as a challenge but not as an obstacle to EU membership.

Participants List

First	Surname	Title
Angus	**Armstrong**	Director of Macroeconomics, NIESR
Graham	**Bishop**	Consultant on EU Integration
Sharon	**Bowles**	Former Chair of the European Parliament Economic and Monetary Affairs (ECON) Committee; now London Stock Exchange and Systemic Risk Council
Lorenzo	**Codogno**	Former Chief Economist Italian Treasury; Visiting Fellow European institute LSE
Simon	**Gleeson**	Professor; Partner at Clifford Chance, London
Tony	**Halmos**	Director of the London Commission in the Policy Institute and visiting Professor at King's College; former Director of Public Relations at the City Corporation
David	**Lascelles**	Co-Director of the Centre for the Study of Financial Innovation (CSFI)
Rosa M	**Lastra**	Professor of International Financial and Monetary Law, Queen Mary University of London
Karel	**Lannoo**	Senior Research Fellow at CEPS, Brussels
Lukas	**Marek**	Coordinator Economic and Financial Committee (EFC) and Ecofin Council, Czech National Bank
Mark D	**Nicholson**	Associate Director, Standard & Poor's Financial Services LLC
Raoul	**Ruparel**	Co-director, Open Europe
John	**Springford**	Senior Fellow at the Centre for European Reform (CER)
James	**Sproule**	Chief Economist and Director of Policy at the Institute of Directors (IoD)
Nicolas	**Véron**	Senior Research Fellow at Bruegel and the Peterson Institute

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LSE European Institute

Contact us with any questions

European Institute
Cowdray House
London School of Economics and Political Science
Houghton Street
WC2A 2AE

General Enquiries

Email: europeaninstitute@lse.ac.uk
Telephone: +44 (0) 20 7955 6839