Changing Places

The growing opportunities for financial centres in Europe

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MPG

Introduction

The last decade and the one that lies ahead may well be remembered for seeing one of the most significant transformations in Europe's financial services industry.

The global financial crisis prompted a sea-change in regulatory oversight but also created muted economic growth and record low interest rates that has encouraged innovation among product providers to meet the demands of investors seeking alternatives to traditional investments. Going forwards, the onset of globalisation, supported by breath-taking advances in technology, has also meant financial services companies in other regions that are increasingly turning their attention to the affluent market that lies within the European Union.

These companies, many of which are from regions that previously had under-developed financial services industries but have now matured enough to compete on the world stage, will have only been encouraged by Brexit, which could weaken the market position of the UK in Europe. The nature of the UK's exit will depend on the subsequent negotiations. But what is certain is that in a globalised world there will increasingly be non-EU - including UK - companies wishing to establish operations in the single market and there will be opportunities for the continent's financial centres to attract their business.

To help provide a clearer picture of what might lie ahead, Managing Partners Group and Citigate Dewe Rogerson commissioned research[(1)] among financial services professionals globally to gauge their thoughts on how Europe is set to change.

The world comes to Europe

One of the greatest achievements of the EU has been the single market. But the move towards borderless trade has not been smooth: in relation to financial services, this has only been achieved through successive waves of regulations to override the rules that applied in each country and which, in practice, could create bureaucratic hurdles that prevented non-domestic firms from competing.

The EU financial landscape has now evolved under the auspices of the European Systemic Risk Council, a range of industry-specific regulators, including the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). The regulatory regime they apply is respected worldwide and standards such as the Undertaking for Collective Investments in Transferable Securities (UCITS) are a mark of quality recognised internationally.

The attractions of operating in a regulated market, together with the extensive affluence within it, makes the EU increasingly attractive to financial services providers in other regions. These providers will increasingly want to access the EU and will look to financial centres to provide them with the platforms to do so. With the potential for Brexit to place the UK outside of the EU this will likely make the continent's other centres even more attractive.

So where will these prospective new entrants come from? The most common reason cited among our survey[1] of industry professionals for an increase in financial companies setting up branches or subsidiaries in EU financial centres over the next three years was 'UK companies ensuring they have access to the EU' (**83%**). However, the second most common reason cited was financial services companies in China becoming much stronger and wishing to expand in Europe (**54%**), followed by emerging market companies wishing to do so (**37%**); financial companies from other regions wishing to target their own nationals who have moved to Europe (**37%**); and US firms wishing to increasingly focus on Europe (**20%**). One in three (**34%**) said the EU was enjoying stronger economic growth and therefore attracting more financial services companies from all over the world.

According to our survey[(1)], China will generate the most significant rise in non-EU financial services companies wishing to set up offices in the EU over the next three years, with more than four out of five (**83%**) saying this, including **24%** who expect the increase to be 'significant'. Other parts of Asia also scored highly, with other figures including Japan (**55%**) and Asia Pacific (excluding China and Japan) **60%**. Over three in five (**63%**) anticipate there will be a rise in US companies setting up in the EU. Other results included Canada (**56%**); Africa and the Middle East (**49%**); and Australia and New Zealand (**46%**).

In terms of sectors, the one seen as most likely to see the highest increase in the number of non-European companies looking to set up offices in the EU was fund management (**57%**), including 19% who thought the rise would be 'significant'. This was followed by private banking/wealth management (**51%**); private equity (**46%**), hedge funds (**46%**) and insurance (**46%**).

All of these new entrants will be assessing the EU's numerous financial centres to ensure they meet certain requirements. For the industry professionals we surveyed, the most compelling factor for these new entrants is a comprehensive legal and regulatory framework, with **66%** saying this was 'very important' and another **31%** saying it was 'important'. This was closely followed by the tax regime, which **97%** said was an 'important' or 'very important' consideration. Other criteria considered to be 'important' or 'very important' included economic stability (**94%**); political stability (**91%**); skilled workforce (**86%**); good transport links, both domestic and international (**86%**); quality of education (**80%**); use of English as an official language

(**71%**); quality of healthcare (**49%**); and lifestyle and culture (**40%**). Contrary to some opinions that financial professionals like to work in sunny climes, only **3%** thought that weather was an 'important' consideration!

Brexit

For many, the UK electorate's decision in 2016 to leave the EU was a surprise result. It sent political shockwaves around Europe and wobbled financial markets.

Brexit will have implications for many economic areas of life in Europe but the main focus in the UK has been on what it will mean for the industry that perhaps has the most to lose, financial services. The UK has traditionally been a dominant player in this sector and it is a key source of tax revenue, especially through its main centre, the City of London.

The extent to which financial companies based in London might move operations into the EU is a key issue. For example, several leading banks have announced such moves. A Deutsche Bank executive was quoted[(2)] in the Financial Times as saying nearly half of its 9,000 staff in the UK could be forced to leave the country under pressure from regulators because of Brexit; Goldman Sachs says it will move jobs away from London and increase its European presence before the UK leaves the EU[(3)]; and JP Morgan could move up to a 1,000 City jobs ahead of Brexit.[(4)] Lloyds of London, a key establishment in the City of London, has even announced that it will set up a 100-strong office in Brussels in order to maintain a foothold in the EU.[(5)]

The extent to which UK companies will need to establish a presence within the EU will depend to a large extent on how 'hard' or 'soft' Brexit actually is. If the outcome is soft and the UK retains full access to the common market, similar to the situation with Norway, then the need for an operation within the EU is clearly diminished. But if Brexit proves to be hard and the UK finds itself completely out of the EU with nothing but World trade Agreements to rely on then the need for a presence in the EU will clearly be greater.

Research[(6)] commissioned by Managing Partners Group and conducted among institutional investors worldwide in March, around the time that Article 50 was triggered by Prime Minister Theresa May, gave a definitive result: more than seven in 10 (**73%**) institutional investors believe Brexit will be 'hard', including **29%** who believe it will be 'very hard'. More than four out of five (**82%**) also believe the number of UK-based financial services firms generally seeking to establish subsidiaries in the European Union will increase over the next three years due to Brexit. While **44%** believe that UK asset managers specifically will probably get to passport their funds into the EU after Brexit, around **30%** believe this will not happen.

Although a sizeable minority in the survey believe UK asset managers will be able to passport their funds in the EU after Brexit, this will probably be unlikely – current members of the European Economic Area such as Switzerland, Liechtenstein and Norway do not have this privilege. As such, it is likely that many asset managers and other UK financial services companies will look to establish a secondary entity somewhere in Europe post-Brexit. If the UK were to be deprived of passporting rights or equivalence then there is little doubt that other domiciles will be eager to increase their market share.

Our latest research[(1)] reveals that industry professionals believe the sector of financial services that is most likely to re-domicile or set up branches or subsidiaries in EU centres as a result of Brexit is fund management: **65%** of respondents said there will be an increase in the level of UK firms in this sector doing so over the next three years. Results for other sectors included: private banking/wealth management (**62%**); hedge funds (**54%**); insurance (**51%**); and private equity (**50%**).

Whatever happens with regards to Brexit, the feeling among industry professionals was that its impact will last: our survey[(1)] found that **29%** said Brexit would be 'very damaging' and **57%** 'slightly damaging' to the UK's financial services sector after one year but **51%** and **26%** respectively believed it would still be so after five years. A lot fewer thought that Brexit would be beneficial to the UK's financial services industry but the benefits would come through over time: **3%** thought it would benefit the UK's financial services sector after one year but the percentage rose to **14%** of respondents when a five-year perspective is taken. Only **9%** and **6%** thought Brexit would have no impact over one and five years respectively.

Conclusion

The European Union faces many challenges in the next few years. How it copes with Brexit and even the possibility of other countries wishing to leave, as well as maintaining the integrity of the Eurozone if faced with more financial crises, are uncertain. But despite these challenges, the EU will remain a highly attractive place to do business. The continued attractions of the EU mean it will provide great opportunities for its financial centres to attract new business from companies both within its borders and beyond, including firms from the UK and globally. Our research shows there will be opportunities to capture a share of that market.

But these financial centres operate in a highly competitive market and they will have ensure they offer the right attributes, including effective regulatory and tax regimes, highly educated and experienced workforces, technological infrastructure and all the lifestyle benefits that appeal to workers in one of the world's better-paid industries. But having all the right attributes will not be enough – these centres will have to ensure their key stakeholders fully appreciate they have the right credentials. They will need to promote themselves, differentiate their propositions in a crowded market and provide clarity around their leadership

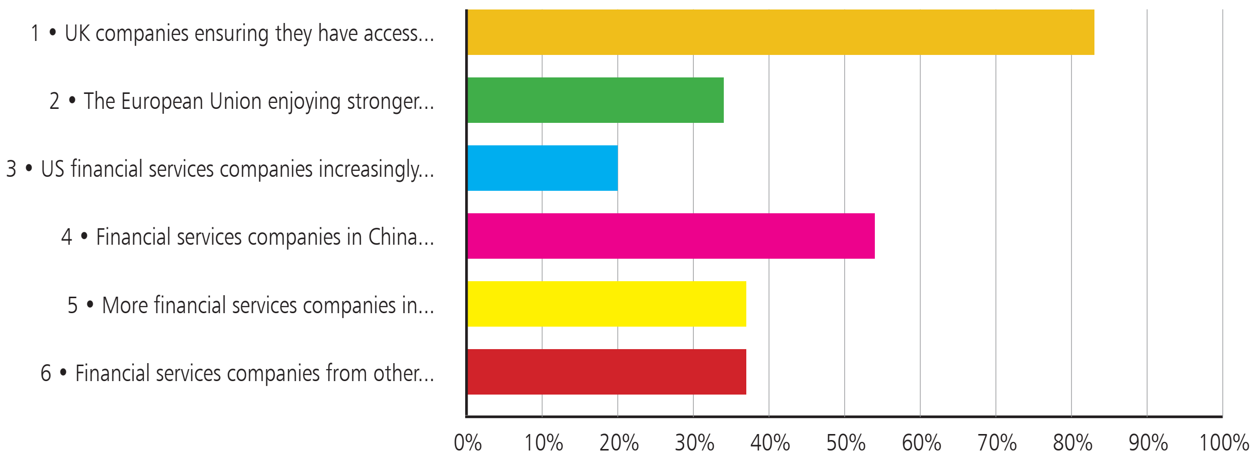
And PR will be a crucial part of that.

(1) Source: 41 industry professionals involved in institutional investment, hedge funds and private equity, were surveyed between 28 April and 8 May 2017
(2) Source: FT, 27 April 2017
(3) Source: BBC, 21 March 2017
(4) Source: BBC, 3 May 2017
(5) Source: BBC, 29 March 2017
(6) Source: 51 institutional investors globally were interviewed, 20-28 March 2017

The outlook for subsidiaries and new offices in Europe's financial centres

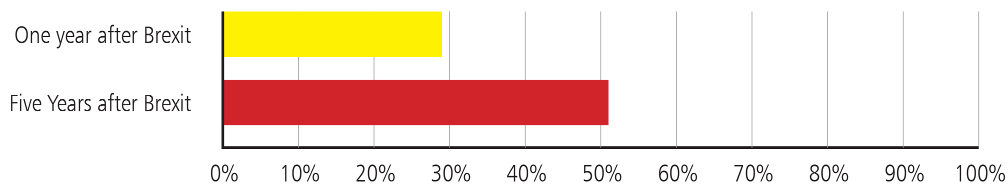
Industry professionals involved in institutional investment, hedge funds and private equity were surveyed globally between 28 April and 8 May 2017.

Question 1: Which of the following factors do you believe will contribute to an increase in financial companies setting up branches of subsidiaries in EU financial centres over the next three years?



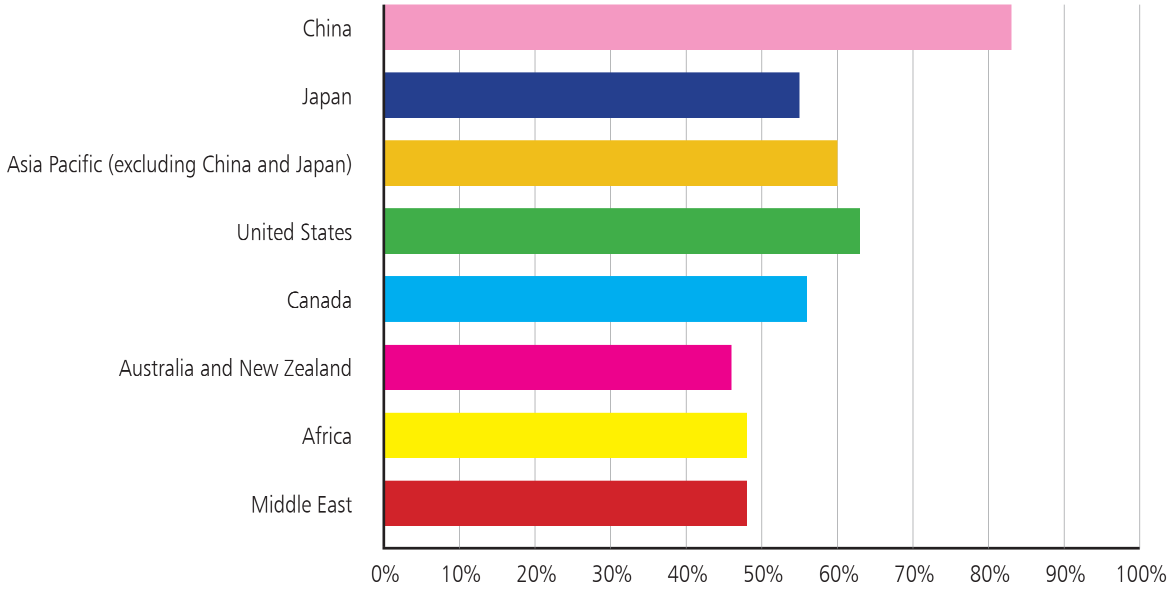
Answer Choices		Responses
1	UK companies ensuring they have access to the EU market	**83%**
2	The European Union enjoying stronger economic growth and attracting more financial services companies from around the world	**34%**
3	US financial services companies increasingly wanting to focus on Europe	**20%**
4	Financial services companies in China becoming much stronger and wanting to expand into Europe	**54%**
5	More financial services companies in emerging markets looking to expand into Europe	**37%**
6	Financial services companies from other regions increasingly wanting to set up offices in Europe to target nationals from these countries who have moved to Europe	**37%**

Question 2: What sort of impact do you think Brexit will have on the UK financial services sector over the following timeframes?



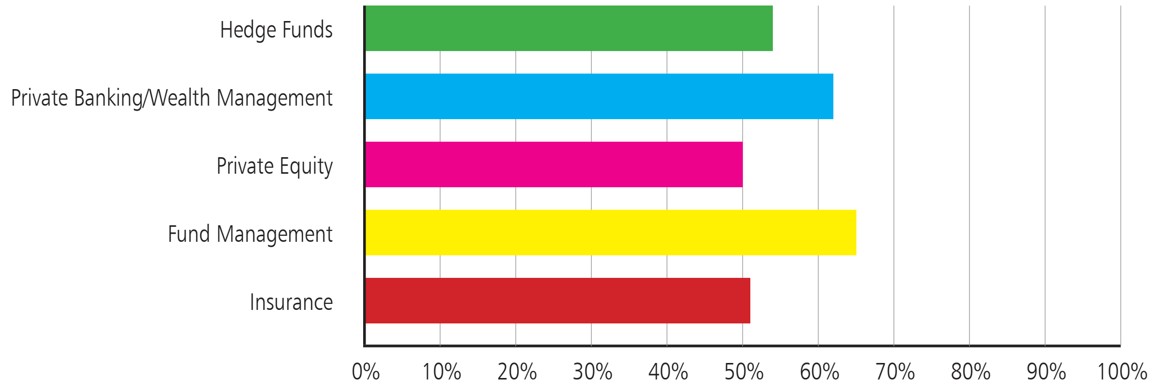
	It will be very damaging	It will be only slightly damaging	It will have no impact	It will benefit the sector	Don't know
One year after Brexit	**29%**	**57%**	**9%**	**3%**	**3%**
Five Years after Brexit	**51%**	**26%**	**6%**	**14%**	**3%**

Question 3: Over the next three years, how do you see the number of financial services companies from the following regions/countries setting up offices in EU financial centres?



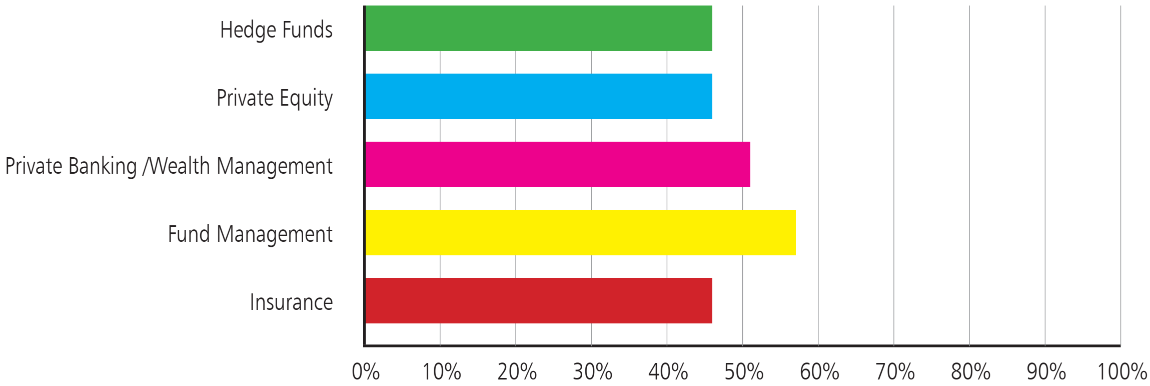
	Increase significantly	Increase slightly	Stay the same as now	Decrease slightly	Decrease Signficantly	Don't know
China	24%	59%	7%	0%	2%	7%
Japan	15%	40%	33%	3%	3%	8%
Asia Pacific (excluding China and Japan)	15%	45%	25%	5%	3%	8%
United States	15%	48%	20%	7%	5%	5%
Canada	12%	44%	29%	5%	2%	7%
Australia and New Zealand	10%	36%	44%	0%	2%	7%
Africa	7%	41%	37%	5%	5%	5%
Middle East	7%	41%	41%	2%	2%	2%

Question 4: Over the next three years, how do you see the level of UK based financial services companies in the following sectors redomiciling or setting up branches or subsidiaries in EU financial centres as a result of Brexit?



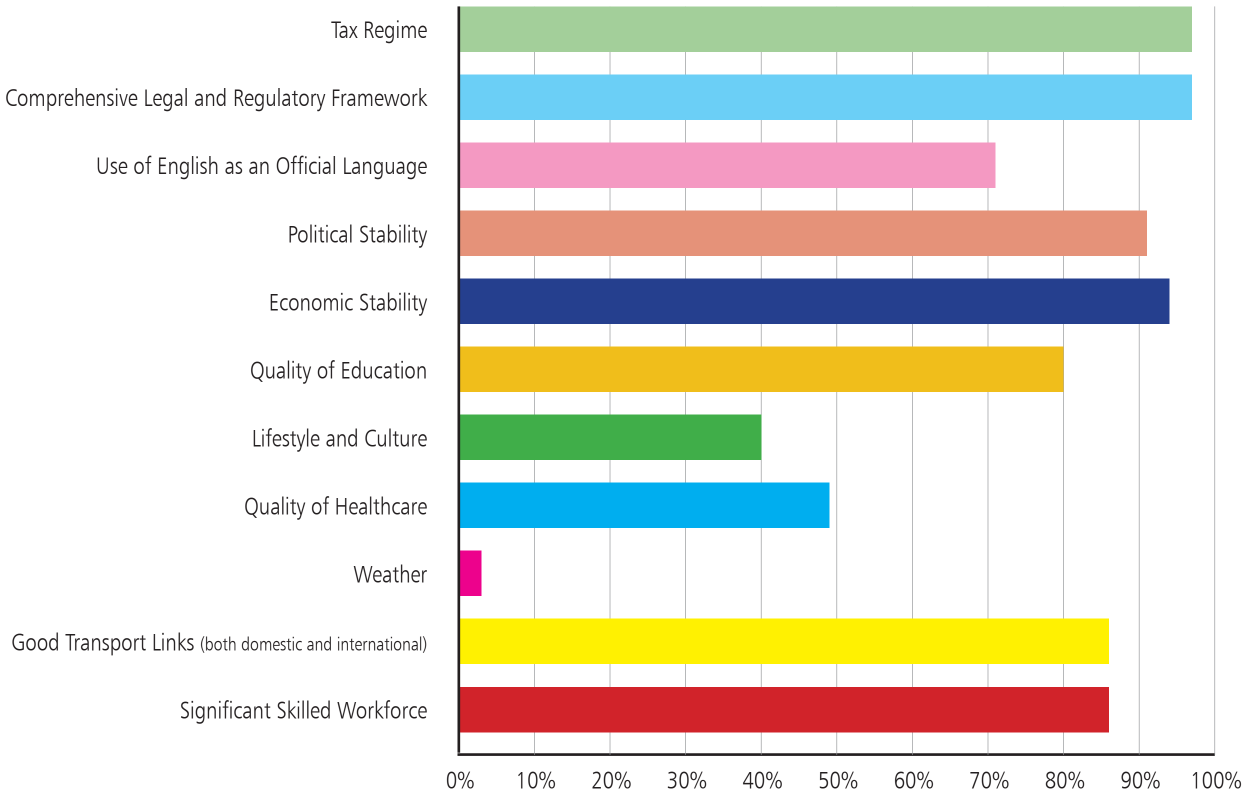
	Increase significantly	Increase slightly	Stay the same as today	Decrease slightly	Decrease Signficantly	Don't know
Hedge Funds	24%	30%	30%	11%	0%	5%
Private Banking/Wealth Management	16%	46%	19%	11%	5%	3%
Private Equity	19%	31%	28%	8%	8%	6%
Fund Management	21%	44%	14%	8%	11%	3%
Insurance	19%	32%	35%	5%	3%	5%

Question 5: Over the next three years, how do you see the number of non-European companies from the following sectors setting up offices in Europe changing?



	Increase significantly	Increase slightly	Stay the same as now	Decrease slightly	Decrease Signficantly	Don't know
Hedge Funds	14%	32%	32%	14%	3%	5%
Private Equity	24%	22%	35%	11%	3%	5%
Private Banking /Wealth Management	16%	35%	29%	8%	5%	5%
Fund Management	19%	38%	30%	5%	3%	5%
Insurance	11%	35%	35%	5%	0%	14%

Question 6: When thinking about companies that are considering re-domiciling or setting up a subsidiary in another country, how important do you believe the following factors are?



	Very important	Important
Tax Regime	48%	49%
Comprehensive Legal and Regulatory Framework	66%	31%
Use of English as an Official Language	17%	54%
Political Stability	54%	37%
Economic Stability	46%	48%
Quality of Education	20%	60%
Lifestyle and Culture	6%	34%
Quality of Healthcare	11%	38%
Weather	0%	3%
Good Transport Links (both domestic and international)	32%	54%
Significant Skilled Workforce	46%	40%

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