



The UK and the European Union Insights from ICAEW – Financial services



The issues at the heart of the debate

This paper is one of a series produced in advance of the EU Referendum on 23 June 2016 looking at the nature of the relationship between the UK and the EU for financial services.

What the Remain Campaign says

Leaving the EU would damage the competitiveness of the City of London and the UK's financial services industry more broadly. While a tailored financial agreement between the UK and the EU is possible, its content would be uncertain and could see Britain being considered as a less-regulated 'off-shore' centre by the remaining member states and therefore treated as such. Leaving the EU could see other financial centres on the continent such as Frankfurt and Paris increase their influence.

What the Leave Campaign says

London is a historic and leading global financial centre which could thrive outside of the EU. What attracts financial and professional services companies to the UK is the high level of skills available. This would continue to be the case if the UK left the EU.

On 23 June, the British people will have their opportunity to decide whether to stay in or leave the European Union (EU). ICAEW would like to see a wide-ranging evidence-based debate over the coming months so that our members, as well as the wider electorate, can make an informed choice when casting their votes. To achieve this, ICAEW has produced a series of reports focusing on the UK's relationship with the EU in three areas: trade, employment and financial services.

To gain a better understanding of the ties between the financial services sector and the EU this report focuses on the insurance industry, and business and professional services.

Of course, the impact to this sector of a UK will depend, to a large extent, on the nature of the deal that the UK is able to secure in post-UK exit negotiations. If the UK voted to leave the EU on 23 June, there would be a two-year period during which the current rules governing the relationship between the financial services industry in the UK and EU companies would not be altered. Further analysis is needed here and should focus on what a tailored financial agreement between Britain and the EU might look like.

Financial Services and the EU

London forms a vital part of the overall UK economy. The City is home to over 8.5m residents and accounts for roughly 22% of the UK's economic output. The capital has developed into a largely service-based economy, the service sector representing over 90% of workforce jobs,¹ and is a leading global centre for industries such as finance, insurance and business services.

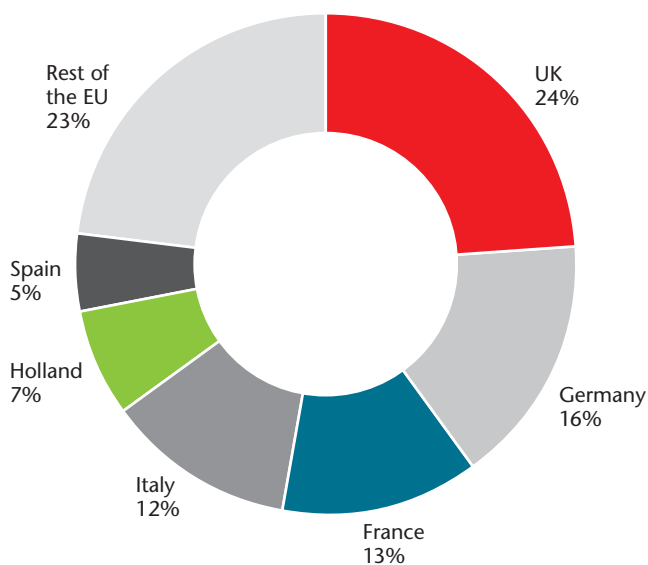
Exports form an important source of demand for businesses in each of these industries. In fact, London is the largest financial exporter in the world and home to the London Stock Exchange. The EU is currently a key trading partner for the UK economy as a whole, a relationship we examine in more detail below.

Financial Services

Finance is the largest industry in London by gross value added (GVA) and plays a vital role in the wider UK economy. Financial services, including the insurance sector, accounted for around £127bn of UK GVA in 2014, some 8% of the UK's total GVA, and trade in financial services makes up a substantial proportion of the UK's surplus in the trade of services. London itself accounted for 50.5% of total UK output in the financial and insurance sector in 2012.

The UK financial sector plays an important role in financial services activity across the whole of the EU, accounting for almost a quarter of all EU financial services income and 40% of financial service exports from the EU.

Figure 1
Share of EU financial services activity, gross value added (2014)



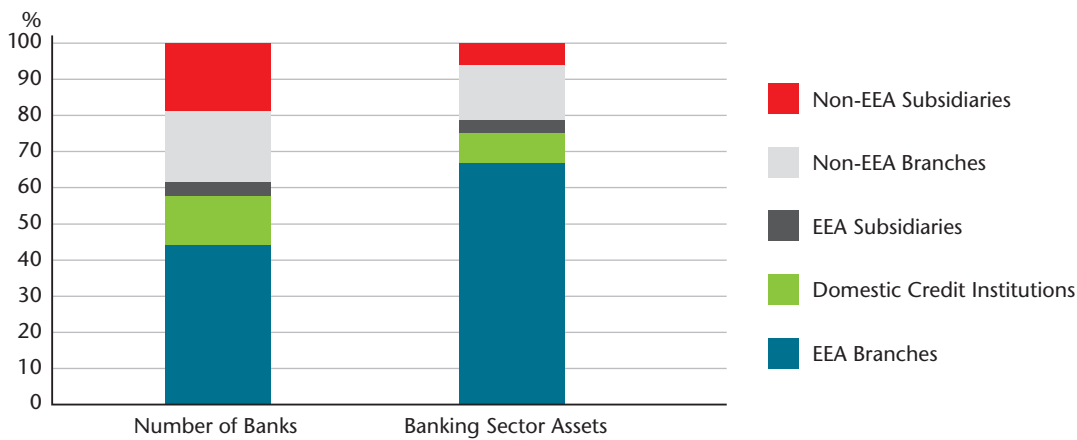
Source: Bank of England

¹ Office for National Statistics, Q2 2015



The UK's financial sector covers a broad range of activities, providing a global centre for industries such as banking, asset management, hedge funds and private equity, and attracts a considerable amount of activity from across the globe. By the end of 2013, there were 255 foreign banks operating in the UK. Of these, 80 institutions were incorporated in other countries within the EEA,² accounting for 12% of total banking sector assets in the UK.

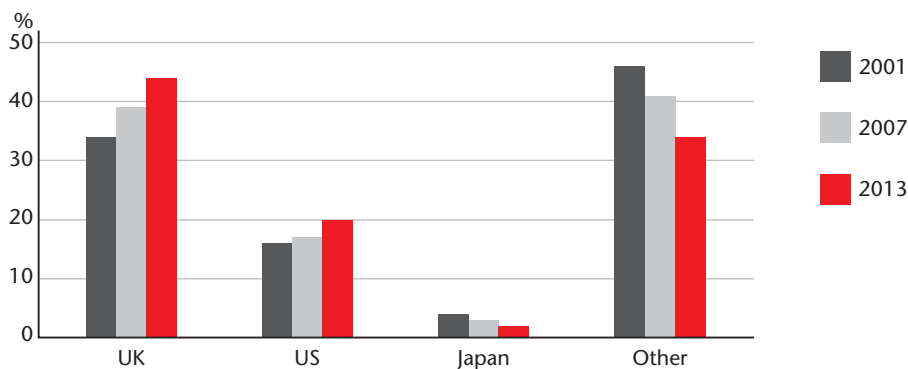
Figure 2
Percentage of banks and banking sector assets in the UK (as of the end of 2013)



Source: European Banking Authority, Cebr Analysis

The UK is the world's leading foreign exchange centre, accounting for just fewer than 41% of global foreign exchange market turnover.³ The euro forms an important part of the UK's foreign exchange trading, with an average daily turnover of \$930bn in April 2013. This represents 44% of all global euro-denominated trading and twice as many euros as all other EU member states combined.

Figure 3
Share of global euro denominated FX trading (April each year)



Source: Bank for International Settlements, Bank of England, TheCityUK

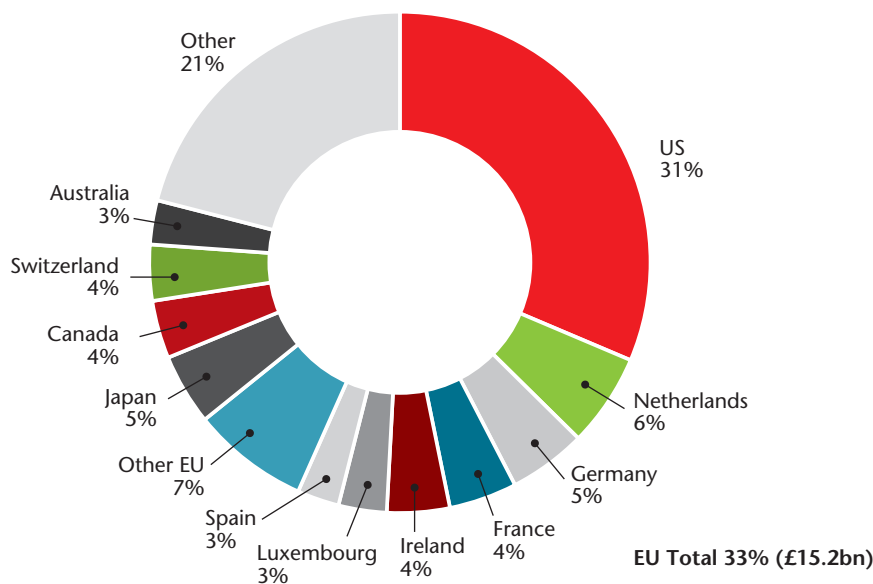
² European Economic Area – represents the internal market of the EU and three of the four member states of the European Free Trade Association (Iceland, Liechtenstein and Norway)

³ Bank for International Settlements, April 2013



The UK's financial services trade surplus, which totalled £46.3bn in 2012. The EU is the UK's single biggest market for financial services exports, generating a trade surplus of £15.2bn according to estimates from TheCityUK. This represents 33% of the UK's total trade surplus in financial services.

Figure 4
UK trade surplus in financial services with selected countries, £mil (2012)



Source: Office for National Statistics, TheCityUK estimates

A withdrawal from the EU could have a profound impact on the shape of our financial service sector. While the EU market provides an important source of demand for the industry in the UK, the key risk in such a scenario would be the ability of financial institutions based in the UK and London to continue to provide banking and trading services across the EU and European Economic Area (EEA) as part of the passporting rights they currently hold while the UK is part of the EU. Without these rights, there is a risk that global banks could choose to transfer their business through other financial centres in the EEA where they would maintain those rights. Over time, this movement will likely weaken some of the core strengths of London as a principal global hub for financial services, such as the pool of international talent and financial infrastructure, and see the gravity in European financial markets transfer to other key financial centres in Europe. As a result, the continuation of passporting rights is likely to be a key issue for UK policymakers if the UK decides to leave the EU.

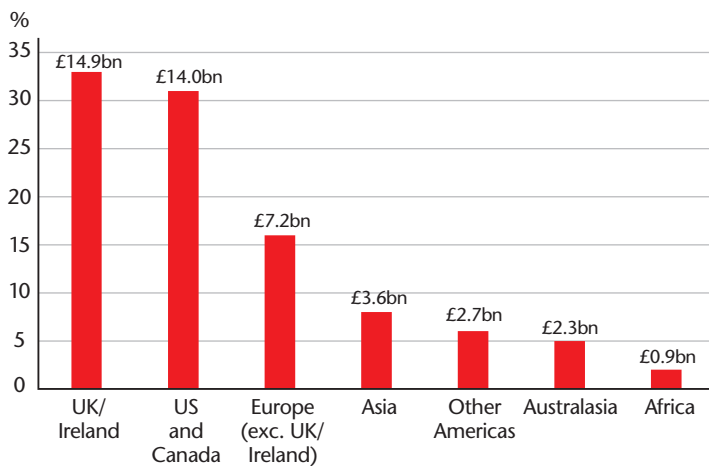


Insurance

The UK insurance industry is the largest in Europe and the third largest in the world, behind the US and Japan.⁴ The UK insurance industry contributed £29.7bn to UK GVA in 2012 and employed over 314,000 people across the country.⁵ However, the industry in the UK is highly international, with companies from across the world operating out of the country. Of the 387 authorised life insurance companies in the UK, 177 are headquartered in another European country, passporting in under the EU Third Life Directive. Similarly 562 of the 911 authorised general insurance companies in the UK are headquartered in another European country and passport into the UK.⁶

However, the UK's insurance industry is not just supported by the participation of businesses operating in other EU countries but also by global demand for the services offered. The London Market is a distinct part of the UK insurance industry, an international market for both general insurance and reinsurance. Within this market, foreign firms account for around two-thirds of premiums purchased in 2013. As shown in **Figure 5**, Europe, excluding the UK and Ireland, accounted for around 16% of the gross insurance premiums sold in the London Market. Incorporating Ireland's share of activity, it is clear that the EU is an important source of demand for the UK insurance industry. However, the share of premiums sold to the US and Canada suggests that the UK has some level of competitive advantage in insurance and that European demand for UK insurance products is not wholly tied to the ability to trade freely across the EU.

Figure 5
Origin of gross written premium on the London Market by location of the insured (2013)



Source: London Market Group, Boston Consulting Group

⁴ Swiss Re, Sigma No 3/2014

⁵ Association of British Insurers, 2014

⁶ Bank of England, July 2014

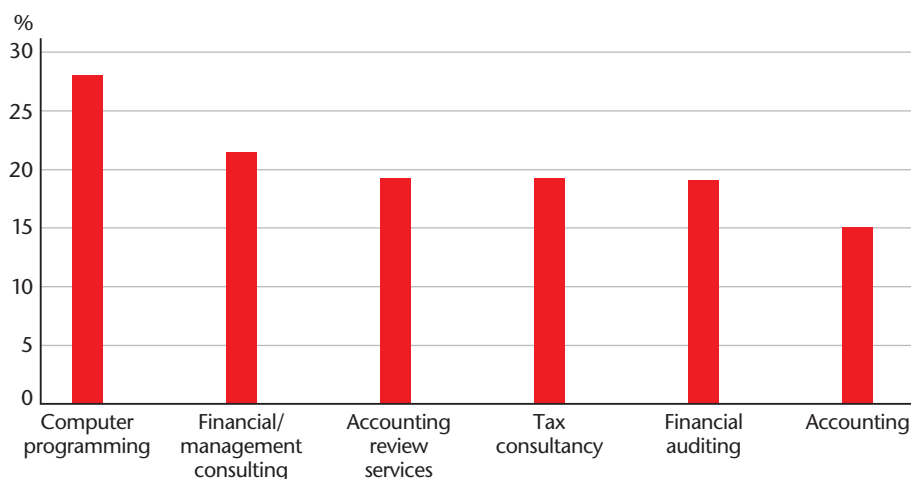


Still, the EU has clearly played a role in shaping the UK insurance industry. Not only does the passport scheme under the EU Third Life Directive allow insurance companies headquartered elsewhere in the UK to operate in the UK, it also helps boost the attractiveness of cities such as London to global insurers by simultaneously allowing them access to other EU markets. At the other end, the EU drives the regulatory environment for the UK market. Being outside of the EU would give policymakers more discretion over the design of the regulatory environment in the UK. However, the UK would also surrender influence on EU regulation, something the UK may be compelled to follow in order to continue trading with the EU and remain competitive as a global insurance hub.

Business and Professional Services

Alongside finance and insurance, London is also a global hub for industries within the business and professional services sector such as accountancy, consulting and legal services. For example, London is the headquarters for 4 of the world's 10 largest law firms⁷ and each of the Big Four professional services consultancies (PwC, Deloitte, EY and KPMG) who have significant presences in the City. Two are officially headquartered in London. As such, the professional, scientific and technical activities category has the highest levels of employment across the whole of the London labour market, employing around 800,000 people over the third quarter of 2015.

Figure 6
UK's share of EU total turnover in business and professional services industries (2012)



Source: Eurostat, Cebr analysis

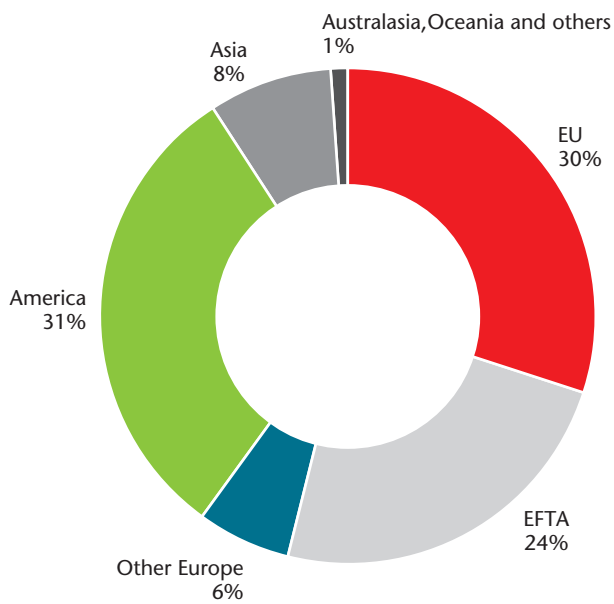
⁷ The Am Law 100, 2015



As shown in **Figure 7**, the UK makes up a considerable share of the total EU turnover in a number of professional services industries. While the UK economy accounted for around 16% of EU GDP in 2014, almost all of the sectors contributed a greater share to total EU turnover. This is particularly apparent in the computer programming and finance/management consulting sectors, where over 20% of EU turnover is accounted for by the UK.

The overall sector, as with financial services, provides a positive contribution to the UK's trade balance. The EU is an important source of demand for UK professional services exports, accounting for 38% of total overseas trade and 30% of the sector's trade surplus. Including the additional markets that form part of the European Free Trade Association, 53.7% of the trade surplus in the professional, consulting and R&D services industries is accounted for by countries within the European Free Trade Agreement (EFTA).

Figure 7
Share of UK trade surplus in professional, management consulting & R&D services by region (2013)

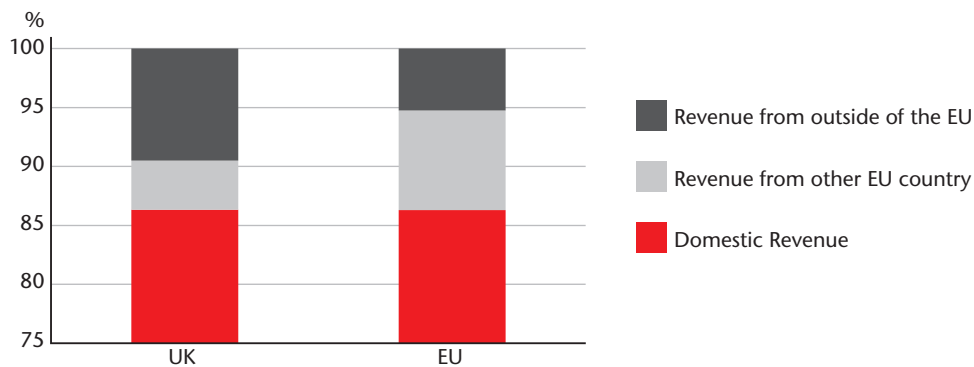


Source: Office for National Statistics, Cebr analysis



However, as shown by the data for the accountancy sector in **Figure 8**, some of these industries are less reliant on demand from the EU compared with equivalent businesses in other EU countries. While the UK and the EU as a whole had similar shares of domestic turnover in the accountancy sector, the share of revenue accounted for by other EU countries, at 4.2%, was less than half of that seen for the EU as a whole. Further, the sector in the UK received a higher share of its revenues from clients outside of the EU in 2012, suggesting that the sector in the UK is not heavily reliant, relative to other industries, on demand from the EU.

Figure 8
Turnover of Accountancy services by location of client⁸



Source: Eurostat, Cebr analysis

The financial and insurance service sectors account for just under a fifth of demand for accounting, bookkeeping, auditing and tax consulting services in the UK. As such, any negative impacts of an EU exit on these industries are likely to indirectly filter into the professional services industries. However, it is possible that such an impact would be offset to some extent by the competitive advantage that the UK has established in these sectors. While a bank, for instance, may relocate to another EU state in order to continue to benefit from the access to other EU markets, it may continue to use auditors based in the UK.

If British voters decide to leave the EU, the UK will have to strike a new trade deal governing the relationship between the UK and EU financial services industries. Much of the impact on financial services will therefore depend on what this deal entails and further analysis is needed to better understand what it might look like.

⁸ Data for UK from 2012. EU shares estimated using 2010 data – the most recent available for the whole of the region.

ICAEW is a world leading professional membership organisation that promotes, develops and supports over 145,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession.

As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

Because of us, people can do business with confidence.

ICAEW is a founder member of Chartered Accountants Worldwide and the Global Accounting Alliance.

www.charteredaccountantsworldwide.com

www.globalaccountingalliance.com

ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

T +44(0)20 7920 8100

E contactus@icaew.com

icaew.com

 [linkedin.com](https://www.linkedin.com) – find ICAEW

 twitter.com/icaew

 facebook.com/icaew

