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TRADE POLICY RESEARCH CENTRE

THE CITY AND THE UK'S EU MEMBERSHIP

**Discussion Paper
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This discussion paper is an initial assessment intended to serve as a catalyst for detailed discussion of the sort of agreement the UK should negotiate with the EU regarding financial services and insurance if the UK were ultimately to determine to leave the EU. It reflects comments on an earlier version released to a small group in January 2015. Professional advice is needed on certain legal aspects of this paper. All constructive comments and criticisms will be welcomed.

Note: In this paper the term "The City" is used as shorthand for all UK-based financial services and insurance activities including those concentrated in Edinburgh and the rest of Scotland and in other financial centres in the rest of the UK as well as those concentrated in the City and the rest of London.



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INTRODUCTION

The Trade Policy Research Centre (TPRC) would prefer the UK to remain a member of the European Union provided acceptable reforms can be negotiated to the basis of its membership. But it argues that if the UK is unable to negotiate such terms it should be prepared to negotiate to leave the EU but “Stay in Europe for Trade” through a new inter-governmental customs union agreement with full UK voting participation in customs union policy decisions and internal market harmonised trade regulation¹. This paper looks at the City in that context.

EXECUTIVE SUMMARY

1. The City is finding its activities increasingly constrained by the EU supervisory and regulatory regime under which it is required to operate. On its own the UK would never have chosen to introduce much of the growing body of EU financial services and insurance regulation to which it is now subject. Of the UK’s four recent appeals to the European Court of Justice (“ECJ”) against seriously discriminatory EU measures only one has succeeded. One has already been dismissed and it is quite likely that neither of the other two will succeed.
2. The City is a hugely important and growing contributor to the UK’s balance of trade. There is no statistical evidence that EU regulation has liberalised trade in financial services between the UK and the EU. The TPRC believes that most of the UK’s financial service and insurance² exports to the rest of the EU are “wholesale” in nature and therefore not dependent on the UK’s EU membership. There are no obvious grounds for arguing that EU regulation enables the UK to manage the financial services and insurance sector better than it could do on its own.
3. The weight of published City opinion remains strongly in favour of the UK’s continuing EU membership. So does Whitehall opinion as regards the City (as well as other areas of business). The pro-EU side of the argument has been making most of the running.
4. None of the four papers and one book written from a Eurosceptic perspective which the TPRC has reviewed has examined in any detail the important question of how the UK government should seek to protect and promote the interests of the City if the UK were to leave the EU. Nor has there been any organised effort to orchestrate City opinion to seriously consider the eventuality of the UK leaving the EU.
5. The City benefits from a unique list of attributes which ought to ensure its continuing success as a global centre of excellence, irrespective of whether or not the UK remains a member of the EU.

Note (1): The TPRC’s thinking is summarised in Ronald Stewart-Brown’s CapX article on “Staying in Europe for Trade” on 13th November 2014 (<http://www.capx.co/staying-in-europe-for-trade>).

Note (2): In this paper the term “insurance” includes both insurance and pension services for the purpose of trade statistics in line with the categorisation in The Pink Book on the UK Balance of Payments.

6. The UK needs to define a new strategy to support the City's ability to make the best possible contribution to the UK's economy including its balance of trade.
7. Arguably, the Single Market in services, especially financial services and insurance, is much more about EU integration through EU-wide legislation than it is about trade liberalisation. The UK needs to consider what trade-related dimensions of the Single Market in services, including passporting rights, it should negotiate to retain and build on whether it stays in the EU or leaves it.
8. The UK needs to prepare and hold in reserve a plan for negotiating the trade basis for financial services and insurance (as well as other service sectors) on which it would leave the EU if the EU proves unwilling to negotiate constructively. This should be part of a comprehensive new trade agreement also covering trade in goods. The TPRC believes there should be no insuperable difficulty in principle in negotiating such an agreement. Formal legal advice is needed on this question as soon as possible.

The UK will need to consider how the economically significant benefits of passporting rights could be retained either by negotiation or by activation of such rights as the UK and all other WTO members have by virtue of the commitments the EU has made under the GATS (General Agreement on Trade in Services). The TPRC believes the main UK sectors where passporting rights are of economically significant benefit are fund management and insurance, whose combined cross-border exports to the rest of the EU in 2013 were less than 9 per cent of the UK's total financial service and insurance exports worldwide. Formal legal advice is needed on this question as soon as possible.

9. There should be no great difficulty of principle in the UK recovering supervisory and regulatory control of the UK financial services and insurance sector from the EU in the context of withdrawal.
10. The TPRC believes that the downsides for the City of a well-negotiated UK withdrawal from the EU would be quite limited and comfortably outweighed by the benefits of being able to offer a more attractive and less *dirigiste* UK regulatory regime to foreign investors, established UK-controlled groups and more entrepreneurial businesses, both for business with Europe and for exporting into the much greater and faster growing markets open to them in the rest of the world free of the burden of inappropriate EU regulation.

TEN MAIN POINTS

- 1. The City is finding its activities increasingly constrained by the EU supervisory and regulatory regime under which it is required to operate. On its own the UK would never have chosen to introduce much of the growing body of EU financial services and insurance regulation to which it is now subject. Of the UK's four recent appeals to the European Court of Justice ("ECJ") against seriously discriminatory EU measures only one has succeeded. One has already been dismissed and it is quite likely that neither of the other two will succeed.**

After the financial market crash of 2008 there was never any going back to the old days when the City's traditional belief in *laissez faire* and trust principles went with too loose a system of regulation, exacerbated by the tripartite approach to the governance of the UK's financial sector introduced by Gordon Brown. But there was surely no reason why the UK could not have put its own house in order in this sector with a much stronger regulatory structure, including much tougher sanctions than previously against banks and individuals who broke the rules.

But following the crisis a new overarching supervisory regime was established at EU level in January 2011 consisting of three European Supervisory Authorities (ESAs³) and the European Systemic Risk Board (ESRB). These were granted wide-ranging powers over all financial services and insurance activities EU-wide, including the City. Under these EU bodies the new UK Coalition Government which came into power in 2010 established two new UK-level authorities under the Financial Services Act 2012, the Prudential Regulation Authority⁴ and the Financial Conduct Authority⁵. The effectiveness of this new two tier supervisory régime has yet to be tested in a crisis.

In addition, since the onset of the crisis the EU has introduced a large number of new regulation and tax measures. These have included the Resolution and Recovery Directive, the Markets in Financial Instruments Directive II (MIFID II), the Undertaking for Collective Investment in Transferable Securities Directive IV (UCITS), the Money Laundering Directive, the Market Abuse Directive, the Single Resolution Mechanism, the Prospectus Directive, the Takeover Directive, Solvency II, the Alternative Investment Fund Managers Directive, the European Market Infrastructure Regulation and the measures listed in Table A on page 6 below. Only one measure, the Single Resolution Mechanism, applies to just the Eurozone banking union. The rest apply to all EU members, including the UK.

Note (3): The three ESAs are the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority.

Note (4): The Prudential Regulation Authority (PRA) is part of the Bank of England and was set up under the Financial Services Act 2012. It is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. This includes promoting the safety and soundness of these firms and, specifically for insurers, helping ensure an appropriate degree of protection for policyholders. It contributes to the Bank's core purpose of protecting and enhancing the stability of the UK financial system.

Note (5): The Financial Conduct Authority (FCA) was set up alongside the PRA under the Financial Services Act 2012. It supervises the conduct of over 50,000 firms and financial advisers, and regulates the prudential standards of those firms not covered by the PRA. Its aim is to enable consumers to use financial services with confidence with products that meet their needs and to ensure that markets and financial systems remain sound, stable and resilient.

On its own the UK would never have chosen to introduce the new EU-level supervisory régime to which the City is now subject. And whilst, as discussed in Section 3 below, the weight of published City opinion remains strongly in favour of the UK's continuing EU membership, a new Europe Economics report for Business for Britain shows that the UK would never willingly have introduced 10 of the EU's 20 major new wholesale regulations since 1999⁶. As discussed on page 11 below, there has been considerable City disquiet about six EU measures in particular.

The UK has accepted two such measures, the Prospectus Directive and the Alternative Investment Funds Directive, without a fight. However, in a speech on 15th January 2014 George Osborne specified four other recent EU regulation and tax measures where proper legal protection for the rights of non-euro members was essential if the UK was to stay in the EU: UK-based clearing of euro-denominated transactions, the financial transactions tax, bankers' bonuses and short-selling, each of which is described in Table A on page 6. George Osborne has appealed to the ECJ against all four such measures, but so far only one such appeal has succeeded. Unfortunately there are good grounds for fearing that none of the other three will.

The UK's one success came on 4th March 2015 when the ECJ annulled the ECB's requirement that clearing houses with large exposure on euro-denominated transactions should be located in the Eurozone, although this decision will remain subject to appeal until 4th May 2015. But on 20th November 2014 George Osborne had to accept the final failure of his action at the ECJ against the EU's bankers bonus cap. Furthermore it looks unlikely he can now overcome the ECJ's adverse rulings on short-selling on 22nd January 2014 and on the proposed financial transaction tax (FTT) on 30th April 2014 although EU finance ministers have yet to agree the final form of the FTT and may perhaps never do so.

The abiding fear must be that the Eurozone countries will increasingly use their qualifying majority on the Council of Ministers to caucus against the best interests of non-Eurozone countries such as the UK to impose discriminatory new Single Market legislation which they would surely have blocked if they had retained their veto.

It has been suggested that the double majority voting principle recently introduced for European Banking Authority (EBA) regulation requiring separate majorities amongst the Eurozone countries and the non-Eurozone countries could serve as a precedent for giving similar protection to the UK and other non-Eurozone countries in other areas of EU legislation. But this may prove wishful thinking.

Note (6): Europe Economics report for Business for Britain on "How UK Wholesale Financial Services Regulation Differs from what the UK would Choose for Itself" – December 2014.

TABLE A⁷

Four EU regulation and tax measures which the UK has appealed against at the ECJ

<i>Name of Measure</i>	<i>Purpose</i>	<i>Problem for UK</i>	<i>Current status</i>
ESMA Short Sale Restrictions – Regulation 236/2012	To reduce risks to the stability of sovereign debt markets perceived to be posed by uncovered credit default swap positions, providing for temporary suspensions in some cases.	Restricts freedom of UK financial institutions to hedge balance sheet exposures.	UK appealed against adverse initial ruling by European Court of Justice (ECJ) on 22 nd January 2014. Appeal widely expected to fail.
Capital Requirements Directive IV – Directive 2013/36/EU - restrictions on variable remuneration	To restrict freedom of UK financial institutions to offer potentially very high bonuses to employees based on performance.	Grants European Banking Authority the power to prevent UK financial institutions offering employees unlimited shares of profits resulting from their activities, thus ensuring that some of the most talented people will refuse to work in the City. Will limit bonuses to 100 per cent of base salaries or, with shareholder approval, 200 per cent. On 4 th March 2015 it emerged that the EBA intends such restrictions to apply to all UK banks and building societies, not just the bigger UK banks as had been earlier hoped ⁸ .	ECJ made final ruling on 20 th November 2014 against UK appeal.
Financial Transaction Tax – February 2013: IP/13/115	To generate tax revenues from financial transactions contracted by financial institutions based in Germany, France, Italy and Spain and seven other EU members states.	Financial transactions from UK with participating EU member states will be taxed, undermining the City’s competitiveness compared to non-EU locations. Uncertain extent of coverage and degree of extra-territorial impact on UK, but material costs to UK economy realistically feared.	Initiated in January 2013 under “enhanced cooperation”. Final form yet to be decided. UK has appealed against initial adverse ruling by ECJ on 30 th April 2014. Appeal widely expected to fail.
ECB location policy under Eurosystem Oversight Policy Network	Ensuring ECB is able to regulate central counterparties which are responsible for more than €5 billion in credit exposure or 5 per cent of the market	Would have restricted settlement of euro-denominated transactions to financial institutions based in Eurozone.	On 4 th March 2015 the ECJ accepted an appeal by the UK against the ECB’s Eurosystem Oversight Policy Framework’s previous requirement that central counterparty clearing houses with average daily net credit exposure of over €5 billion in one of the main euro-denominated product categories should be located within the Eurozone. The ECJ has the right to appeal against the decision on points of law up until 4 th May 2015.

First, there is no reason why this concession for EBA regulation could not be reversed by qualified majority voting on the Council of Ministers. Second, this concession will expire if the number of non-Eurozone members falls below five, which could happen by 2020⁹ if all the Central and Eastern European members of the EU join the euro leaving only Denmark, Sweden and the UK outside the Eurozone. Third, Lord Hill, the new EU Commissioner for Financial Services, has made it clear that this concession for EBA regulation should not be seen as a precedent applicable to any other area of EU legislation.

Note (7): Much of Table A above is sourced from the Europe Economics report for Business for Britain referred to in Note (4) above. The TPRC is grateful for Business for Britain’s consent for this purpose.

Note (8): Source: Daily Telegraph 4th March 2015

Note(9): Source: Europe Economics: “EU Financial Regulation – A report for Business for Britain”, 17th June 2014

Arguably, also, it is now time for the UK to recognise that the ECJ will never become the impartial arbiter between national interests such as its own and the EU's it might reasonably have hoped for if the ECJ were not constitutionally dedicated to ever deeper integration. The ECJ's longstanding track record of using its judicial discretion to further EU integration was well exemplified by its rulings in the *Pringle v Ireland* case in 2012 and the *Thesing and Bloomberg v ECB* case in February 2014 where the survival of the euro was at stake¹⁰. Its integrationist credo was well illustrated in a speech on 9th December 2014 by Vassilo Skouris, the ECJ's President, instructing Jean-Claude Juncker as President of the European Commission that his key task was to prevent the critics of the European Union from reducing the powers of the ECJ or the European Commission¹¹.

- 2. The City is a hugely important and growing contributor to the UK's balance of trade. There is no statistical evidence that EU regulation has liberalised trade in financial services between the UK and the EU. The TPRC believes that most of the UK's financial service and insurance exports are "wholesale" in nature and therefore not dependent on the UK's EU membership. There are no obvious grounds for arguing that EU supervision and regulation enables the UK to manage the financial services sector better than it could do on its own.**

The UK's financial services and insurance sectors made net contributions of £38.1 billion and £20.4 billion respectively to the UK's balance of payments in 2013, as shown in Annex A on page 24. The financial services sector's net contribution had increased by 16 per cent over the five years since its post crisis low of £32.8 billion in 2008. By contrast over the same five year period the insurance sector's net contribution had increased by 76 per cent from its level of £11.6 billion in 2008, representing a strikingly impressive growth rate of 12 per cent per annum.

Overall the City's aggregate net contribution of £58.5 billion in 2013 paid for over half of the £110.2 billion deficit on trade in goods which the UK ran in that year. A considerable further contribution was made by ancillary services associated with the City such as legal, accountancy and other business services as well as spending by foreign businessmen on restaurants, entertainment, hotels, shopping etc.

As shown in Annex B on page 25, £16.1 billion (42 per cent) of the UK's £38.1 billion surplus on trade in financial services in 2013 derived from trade with the rest of the EU. By contrast, only £3.9 billion (19 per cent) of the UK's £20.4 billion surplus on trade in insurance in 2013 derived from trade with the rest of the EU.

UK financial services exports to the rest of the EU were £19.4 billion in 2013, which represented 41 per cent of its total financial services exports in that year, as also shown in Annex B. The TPRC believes most of the UK's financial services exports to the rest of the EU are "wholesale" in nature and therefore not dependent on the UK's EU membership.

Note (10): Source: Article entitled "The Rule of EU Law" by Dr Gunnar Beck published by CapX on 4th December 2014 (<http://www.capx.co/the-rule-of-eu-law>)

Note (11): Source: Bruno Waterfield, The Daily Telegraph 10th December 2014.

In particular, it is difficult to see why any of the UK's monetary financial institutions' (primarily banks') exports to the rest of the EU should be dependent on the UK's EU membership. Total UK monetary financial institutions exports accounted for 60 per cent of total UK financial services exports in 2013 (£28.0 billion out of £46.7 billion as shown in Annex A on page 24), but no breakdown is available for such exports between the rest of the EU and the rest of the world.

UK insurance exports to the rest of the EU were just £4.0 billion in 2013, which represented only 18 per cent of its total insurance exports in that year, as shown in Annex B on page 25. The TPRC believes most of the UK's insurance exports to the rest of the EU are "wholesale" in nature and therefore not dependent on the UK's EU membership.

Analysis of the UK's financial services exports to the rest of the EU and to the rest of the world over the period since 2004, the first year in which the relevant analyses became available in the annual UK Balance of Payments "Pink Book", and 2013 shows no evidence of any trade liberalisation benefit to the UK emanating from Single Market regulation and supervision of EU financial services markets, as shown in Annex C on page 26.

3. The weight of published City opinion remains strongly in favour of the UK's continuing EU membership. So does Whitehall opinion as regards the City (as well as other areas of business). The pro-EU side of the argument has been making most of the running.

Organised City and government opinion remains strongly in favour of the UK remaining a fully committed EU member. The editorial stances of the Financial Times, The Economist and the BBC continue to be resolutely pro-EU. TheCityUK and the Centre for European Reform put out in 2014, between them, three well-funded and heavyweight papers, each adamant about the overall importance of the UK remaining a fully committed EU member, as set out in Table B on page 10. In addition HM Government's 2014 review of the balance of competences between the UK and the EU for the financial services sector concluded that it was "broadly appropriate", as also shown in Table B.

Other City organisations which have consistently made the pro-EU case in the City include Business for New Europe, the City of London Corporation, the Institute of Chartered Accountants, the British Bankers Association and Lloyd's. So have numerous individuals who are chairmen or chief executives of leading UK and US international banks.

The pro-EU side of the argument has been allowed to make most of the running in the City. There has been no organised expression of the very considerable resentment felt by many in the City at the ECJ's final ruling against the UK on bankers' bonuses and its now widely expected final rulings against the UK on short-selling and the financial transaction tax.

To the TPRC's knowledge, none of those organisations and individuals who insist on the UK remaining a committed EU member has sought to quantify the economic benefits they claim the City enjoys as a result of the UK's EU membership. Indeed there has been a strong tendency for proponents of the benefits of UK EU membership for the City to avoid being specific as to precisely what these are relative to the position if the UK were not a member of the EU. So far as the TPRC is aware, none of them has even begun to address the arguments developed in this paper.

In reality, of course, no meaningful analysis of the benefits for the City of continuing membership of the EU can be made except by comparison with the City's position if the UK ceased to be an EU member. Such an analysis would require assumptions about the basis on which the UK would have left the EU, as discussed in Section 8 below.

Although many senior individuals in independent investment management organisations are privately strongly Euro-sceptic their views have found little public expression. The Investment Management Association (IMA) has taken a generally pro-EU line and initially saw the UCITS Directive¹² as an excellent example of harmonisation working well for the benefit of the UK investment management industry, although others argue that no one has been very successful marketing collective funds from the UK and many in the UK investment industry have recently had problems with new regulatory initiatives under it.

Nor, until recently, had New City Initiative, a think tank whose membership comprises 44 such organisations running some £400 billion in assets, expressed an EU-critical stance on issue. However, on 23rd December 2014 it and Open Europe announced they will be publishing a joint paper in the near future proposing that fund managers who do little business with the EU should be able to negotiate an exemption from EU regulation¹³.

Note (12): The UCITS (Undertaking for the Collective Investment of Transferable Securities) Directive was introduced in the 1980s as the first step towards a pan-European investment vehicle. is the acronym which is generally used for the EU's Directive.

Note (13): Financial Times 23rd December 2014.

TABLE B

Papers arguing importance for the City of the UK remaining in the EU

<p>Centre for European Reform Commission: “The Economic Consequences of Leaving the EU” (93pp) - June 2014</p>	<p>General line is that the UK benefits from full participation in the Single Market and that the City would therefore be damaged if the UK ceased to be part of it. But its 18 page chapter on “The City of London” contains no serious economic assessment of the benefits to the City of UK membership of the EU.</p> <p>Introductory Summary contains the surprising statement that “Outside the Union, the UK would lose access to the Single Market unless it signed up to EU rules”, ignoring the certainty that the UK could retain access to EU markets on a WTO basis like the USA and the high probability that it would be able to negotiate preferential access to EU markets on a reciprocal basis.</p>
<p>TheCityUK: “Analysing the Case for EU Membership” (97pp) - April 2014</p>	<p>Takes strong line that “Continued EU membership is essential to this country’s economic wellbeing”. But although TheCityUK represents the City this paper gives less than one page of space (on p10 in the Executive Summary and repeated on p22) to any description of the EU Single Market for Financial Services. It contains no discussion at all of the nature of EU supervision and control of the City’s activities (see above).</p>
<p>The CityUK and Clifford Chance: “A Legal Assessment of the UK’s Relationship with the EU” – A Financial Services Perspective” (62pp) – April 2014</p>	<p>Considers and dismisses five scenarios for UK leaving the EU: EFTA-EEA relationship with EU like Norway; EFTA + bilateral sectoral agreements relationship with EU like Switzerland; customs union relationship with EU like Turkey; comprehensive free trade agreement relationship with EU; WTO-based relationship with EU like USA or Japan. Claims that “The Internal Market in Financial Services represents a tremendous achievement, especially in the context of passporting and the ability for firms to easily access a market of 28 member states and over 500 million consumers.” Asserts that “a blend of mutual recognition and harmonisation has been able to cater for difficult and sometimes contentious policy areas such as financial services, where products can be complex and the need for consumer and investor protection is high” whilst recognising that “harmonisation is not always the best answer”.</p> <p>Describes EU financial services passport as relevant to banking services, non-life insurance, life insurance, reinsurance, insurance mediation, investment services, managing and offering of collective investments (UCITS), alternative investment funds, payment services and electronic money. Omits to offer any analysis of the economic benefits of passporting.</p> <p>Expresses concern that UK nationals represent only 4.6 per cent of Commission staff as compared to the UK’s 12.5 per cent share of the EU population and notes that the situation is set to deteriorate further as the largest cohort of UK nationals in the Commission is in relatively senior positions and UK nationals represent only 2.2 per cent of entry level administrators. Tacitly concedes that the UK can do little to remedy this under-representation in the near term.</p>
<p>HM Government: Review of the Balance of Competences between the UK and the EU. The Single Market: Financial Services and the Free Movement of Capital – Summer 2014</p>	<p>Concludes that “in the areas covered the balance of competences, as intended in the EU Treaties, is broadly appropriate, but is often undermined by poor policy-making”. Considers that “focused reform is required to ensure the success of the Single Market and justify the current balance of competences.” Observes that the shift in the focus of the EU’s approach to rule-making from market-opening to financial stability in the last five years following the financial crisis “has raised questions regarding the quality of the policy-making process and the resulting rules”.</p>

Individuals like Helena Morrissey (Chief Executive, Newton Capital Management) who speak out publicly against UK EU membership are rare. However, there are other City leaders who have spoken out about the inappropriateness of EU Single Market regulation for their sectors:

- Over 60 prominent City figures signed a letter organised by Business for Britain to The Sunday Times on 22nd June 2014 expressing extreme concern about Britain’s difficulties in preventing the introduction of the Financial Transaction Tax, the Alternative Investment Fund Managers Directive, the Prospectus Directive, bonus caps, bans on short-selling and the then proposed restriction of euroclearing to eurozone clearing houses.
 - Garry Jones, the chief executive of the London Metal Exchange, has complained about “Brussels red tape and the European regulators which are curtailing the City’s ability to do what it does best: making money.... There has to be a more pragmatic market-friendly regime.... Some regulations such as the European Market Infrastructure Regulation, which were intended to make markets safer, have actually created the environment for greater risks in certain areas¹⁴.
 - The Wealth Management Association (formerly APCIMS and originally the Association of Private Client Investment Managers and Stockbrokers) has questioned the need for Single Market regulation in its sector, pointing out that “retail financial services are national in offering, not EU wide; there is very little retail cross-border use of financial professionals; retail investors tend to stay within their cultural origins and language groupings when selecting professional advice and help¹⁵.
 - John Nelson, the Chairman of Lloyd’s has complained that “The volume of [EU] regulation is extraordinary and most of it is unnecessary and counterproductive.... The amount of regulation around Solvency II, the new capital rules which are being drawn up to govern insurers operating in the EU, has been absurd. It has cost Lloyd’s £300 million but we could have introduced it for a fraction of the cost.... This epitomises the problem with bureaucracy in Europe.¹⁶”
4. **None of the four papers and one book written from a Eurosceptic perspective which the TPRC has reviewed has examined in any detail the important question of how the UK government should seek to protect and promote the interests of the City if the UK were to leave the EU. Nor has there been any organised effort to orchestrate City opinion to seriously consider the eventuality of the UK leaving the EU.**

The TPRC has reviewed four recent papers and one book written from a Eurosceptic perspective and focussing wholly or partly on the adverse consequences of EU membership for the UK’s financial services sector, as shown in Table C on page 12. None of these papers begins to address the question of how the UK should negotiate the financial services dimension of the new preferential trade agreement it would seek to negotiate with the EU if it ultimately determines to leave the EU, as discussed in Section 8 below.

Note (14): Daily Telegraph interview by Andrew Critchlow, 15th December 2014.

Note (15): APCIMS note on “Standards to Preserve the Single Market in Financial Services”, April 2013

Note (16): Evening Standard interview by Jamie Dunkley, 29th July 2014

TABLE C

Recent papers and book written focussing wholly or partly on the adverse consequences of EU membership for the UK’s financial services sector

<p>Europe Economics (report for Business for Britain): “EU Financial Regulation” (42 A4 pp) – June 2014</p>	<p>Assesses EU financial regulation and the history of the UK’s declining influence over it and sets out an eight page assessment of the UK’s policy options whilst remaining a member of the EU, which the TPRC consider limited in practice. Notes that “Leaving the EU is clearly a complicated issue, an analysis of which would require an extensive discussion of transitional arrangements and of what alternative treaties and geopolitical arrangements the UK would seek outside the EU – all of which goes beyond the scope of this current report”.</p>
<p>Europe Economics (report for Business for Britain): “How EU Wholesale Financial Regulation Differs from what the UK would Choose for Itself” (21 A4 pp) – December 2014</p>	<p>Detailed assessment of 20 EU regulation and tax measures affecting UK wholesale financial services which have been introduced since 1999, as discussed on pp 5-6 above. Concludes that the UK would never of its own volition have introduced 10 of the 20 major new wholesale financial regulations introduced by the EU since 1999. Does not address the question of how the UK should negotiate its future relations with the EU regarding financial services and insurance in the event the UK determines to leave the EU.</p>
<p>The Mayor of London: “The Europe Report: A Win-Win Situation” (109 A4 pp) – August 2014</p>	<p>Comprehensive review of position and prospects of the London economy, particularly the financial services sector, within the EU context. Concludes that UK’s best option is to lead reform in the EU, particularly:</p> <ul style="list-style-type: none"> - reform of the relationship between the Eurozone and non-Eurozone countries; - completion of the Single Market, particularly regarding Single Market in services and movement of people; - sector specific reform, important examples of which for London are the digital Single Market and financial services; and - halting unnecessary regulation, reforming the EU budget and repatriating social and employment legislation. <p>Concludes that UK’s second best option is to leave EU with goodwill on both sides and comprehensive free trade agreement. Does not give detailed consideration to how this would work.</p>
<p>Professor Tim Congdon: “The City of London in retreat” (36 A5 pp) - The Bruges Group, September 2014</p>	<p>Describes how the City of London was by far the most dynamic part of the UK economy from the 1960s to 2008 and still remains massively important to London’s prosperity and to the economic well-being of the UK as a whole. But observes how the City of London is now in retreat, with excessive and unfriendly EU regulation largely to blame. Focuses particularly on the new rule-making powers endowed under the Lisbon Treaty to the European Systemic Risk Board, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority. Notes that the powers of these authorities are set by the Council of Ministers by QMV, with no UK right of veto. Concludes that if UK remains in the EU on the present terms it will become increasingly difficult for Britain to further its role as the world leading centre for international business services. Quotes Wolfgang Munchau’s comment in the Financial Times on 4th March 2013 that “If the Eurozone has a collective interest in anything, it is to stop the City acting as its main financial centre”. Argues need for radical re-appraisal of UK’s membership is essential but give no consideration to alternative modes of exit.</p>
<p>Open Europe: “Continental Shift: safeguarding the UK’s financial trade in a changing Europe” (49 A4 pp) - December 2011</p>	<p>Detailed analysis of market trends, regulatory threats, structural bias against the UK in the EU voting system etc. Only considered potential UK remedies which might be available to the UK whilst remaining a member of the EU, which are arguably limited in practise. No consideration given to possibility of UK withdrawal.</p>
<p>Roger Bootle: “The Trouble with Europe” (216 C5 pp) – Nicholas Brealey Publishing – April 2014</p>	<p>Devotes only four pages to “The EU and the City of London”. Describes prospect of growing EU influence or control of the City’s practises and institutions as “the City’s nightmare” and “death by a thousand cuts”. Considers that if UK were to leave the EU it would probably secure a favourable and close trading relationship with the EU in the form of a free trade agreement. Does not consider how this should be structured for UK financial services sector.</p>

Nor, apart from UKIP fund-raising activities, has any effort been made to orchestrate City opinion in favour of the UK leaving the EU. The deep concern about EU supervision and regulation of City activities felt by many individuals working in the City at all levels gets very little public expression.

The main reasons appear to be:

- First, there is no body explicitly charged with thinking through the City's best interests with regard to the EU despite financial services being widely recognised as one of the UK's most important business sectors.
- Second, most individuals of high standing have, for whatever reasons, been deterred from raising their heads above the parapet in defence of the City's interests. This would apply not only to people working for US, German, French or Japanese banks but also to those working for British organisations.

5. The City benefits from a unique list of attributes which ought to ensure its continuing success as a global centre of excellence, irrespective of whether or not the UK remains a member of the EU.

The City's pre-eminence as a world financial centre pre-dates the UK's accession to the EU. It has only continued to increase since, especially following "Big Bang" in 1986. Today it is widely regarded as a global market leader in many areas including foreign exchange, international bank lending, securities and derivatives trading, capital markets, insurance, asset management, financial law and accountancy services and latterly, carbon markets.

The UK is the largest net exporter of financial services and insurance in the world, with a trade surplus more than double that of any other country. Globally, the City accounts for 46 per cent of the international market in over-the-counter interest rate derivatives and 37 per cent of the turnover in foreign exchange transactions, amounting to hundreds of trillions of US dollars annually¹⁷.

As one of the few genuinely global financial centres providing the full gamut of cross-border financial services, the City has carved out a central position for itself amongst the world's time-zones. Irrespective of whether the UK remains a full member of the EU or not, the City will surely remain the location of first choice for many international banking, broking and other types of financial service businesses.

The City's attributes combine to form a virtuous circle which would surely ensure its continuing prosperity if the UK were to leave the EU. It has a market infrastructure capable of supporting very high levels of financial activity. It benefits from the perceived integrity of its markets and participants and the pre-eminent status of the English language in international business communication. Its regulatory environment is still relatively accommodating (despite the growing incursion of EU-sourced regulation) whilst the UK legal system has an unrivalled reputation for predictability and transparency.

Note (17): HM Government (2014): "Review of the Balance of Competences between the United Kingdom and the European Union. The Single Market: Financial Services and the Free Movement of Capital" – see Table B on page 10.

The City also enjoys a critical mass of expertise, both in finance and related ancillary services such as accountancy and law. Furthermore, Britain has a tradition of openness and a favourable tax regime towards foreigners which, combined with London's unique range of amenities, should surely ensure that the City continues to be seen worldwide as a highly attractive place to work.

The UK's proximity to the rest of the EU should ensure that the City will always be widely seen as a global hub uniquely placed to serve financial markets in all the rest of the EU as well in the USA and the rest of the Americas in all of Asia. As such, provided that the UK can safeguard its competitiveness the City ought always to continue to be able to attract high quality foreign investment.

For non-EU financial institutions seeking to break into EU financial services markets the City offers an obvious bridgehead. So it is not surprising that in 2013 41 per cent of UK financial services exports went to the rest of the EU. But it is reasonable to question how many of such exports were dependent on the UK being "in" the Single Market. Arguably, the large majority of such exports were of a wholesale nature which did not depend on the UK being a member of the EU. And few would now argue that the City has suffered through the UK having stayed out of the euro.

While some have argued that the City would suffer grievously if the UK left the EU with a growing share of its business seeping away to continental centres such as Frankfurt and Paris, it is doubtful whether this argument would stand up to detailed examination:

- First, it may reasonably be asked whether great banking businesses such as Deutsche Bank and Paribas would really decamp from the City out of political pique if the UK left the EU. In reality the inertia factor would probably be very strong.
- Secondly, the City's continental customers are presumably buying financial services from the City because they represent the best quality at the best price. Would they really decide to go against their shareholders' best interests and switch to continent-based suppliers of such services out of deference to the European Commission or to the governments of the countries where they have their head offices?
- Thirdly, the economy of the rest of the EU would be damaged by any impairment of its access to financial services provided by the City. A CEBR report in 2005 estimated that "If London's financial cluster did not exist, the cost of financial services in the EU would rise 16 per cent and EU GDP would be €33 billion lower in the short term, €23 billion over the medium term, with the loss of 100,000 jobs¹⁸."

Note (18): Centre for Economics and Business Research report on "The City's Importance to the EU Economy" published by the Corporation of London in February 2005 and quoted in Open Europe's December 2011 paper "CONTINENTAL SHIFT: Safeguarding the UK's financial trade in a changing Europe".

6. **The UK needs to define a new strategy to support the City's ability to make the best possible contribution to the UK economy including its balance of trade.**

Barclays' decision in May 2014 to reduce the number it employs in investment banking by a quarter followed similar decisions by Royal Bank of Scotland and UBS. The low 2.7 per cent return on equity achieved by its investment bank in 2014 suggests it can now never hope to re-establish itself as a global player¹⁹. There is now no possible UK challenger to the global dominance of the five US investment banking giants – JP Morgan Chase, Bank of America Merrill Lynch, Goldman Sachs, Citigroup and Morgan Stanley.

The UK therefore needs a well-articulated strategy to ensure that the City builds on all its great competitive strengths to ensure that it makes the strongest possible contribution to the UK economy over the coming decades. In particular, this means making London as attractive a base for global operations as possible for the US investment banks and other foreign-owned financial services businesses as well as UK-owned and EU-owned ones. The danger of assets and people relocating from the UK to less heavily regulated financial centres around the world needs to be taken seriously. So too does the loss to the UK economy resulting from businesses and people choosing to move to such centres in preference to the UK.

Such a strategy also means doing everything possible to encourage entrepreneurial and privately owned enterprises in the financial service sector, subject to appropriate regulatory controls. As part of this strategy the UK should do all it can to negotiate radical reforms to the EU with powers flowing back to member states. On the subsidiarity principle these should include all financial services and insurance legislation which it is not necessary to retain at the EU level to facilitate intra-EU trade. However, there may be limits to the extent to which this is possible.

Ultimately, there may be too wide a gap between the EU's essentially *dirigiste* economic philosophy and the City's traditional free market values for the UK to be able to pursue its reasonable objectives for the governance of its financial services and insurance sectors whilst still remaining a full EU member.

Note (19): Source: Allister Heath, Daily Telegraph 4th March 2015.

7. **Arguably, the Single Market in services, especially financial services and insurance, is much more about EU integration through EU-wide legislation than it is about trade liberalisation. The UK needs to consider what trade-related dimensions of the Single Market in services, including passporting rights, it should negotiate to retain and build on whether it stays in the EU or leaves it.**

The term “free movement” in EU Treaties has markedly different meanings according to whether it is used in the context of goods, services, capital and persons. Free movement of goods within the Single Market may rightly be seen as the ultimate in free trade although, as in any customs union, it must come with a common tariffs policy and, in the case of the EU, it also comes with harmonisation of product standards. By contrast, legislation to develop the Single Market in services is arguably much more about EU integration through EU-wide supervision and regulation than it is about trade liberalisation. Free movement of capital and free movement of persons are conceptually different from the first two categories of free movement and are not strictly to do with trade as such.

Viewed through this prism, the negatives of the Single Market in financial services and insurance for the UK far outweigh the positives. All the EU legislation listed in Section 1 above is primarily about EU integration. Yet the only such measure which make special concessions for the UK’s non-Eurozone status is the Single Resolution Mechanism and the possibly only temporary double majority voting arrangement for new regulation by the European Banking Authority.

In fact, Lord Howell in his visionary new book “Old Links and New Ties”²⁰ reaches the conclusion that “For services the Single Market is almost non-existent – exactly the area where Britain needs to play to its strengths”. Certainly, it is difficult to see how EU-level harmonisation of regulation plays any useful trade liberalisation role in sectors such as transportation, travel, communications, computer and information, royalties and license fees, and other business services which together accounted for 72 per cent of the UK’s service exports to rest of the EU in 2012²¹.

And, as discussed in Section 2 above, there is no statistical evidence of any trade liberalisation benefit to the UK emanating from EU regulation of financial services markets. However, there is wide belief in the value of EU “passporting rights” to facilitate banks and firms authorised in any EU member state marketing their financial service and insurance products elsewhere within the EU on the basis of a regulator to regulator notification system²². Such rights are particularly valued by US investment firms who see the UK as a gateway into Europe.

Note (20): Old Links and New Ties, David Howell, IB Tauris 2014, p139.

Note (21): Source: The Pink Book 2013. Owing to statistical errors in The Pink Book 2014, as originally published on the Office for National Statistics website, comparable figures for 2013 are not yet available.

Note (22): Passporting rights facilitate EU-wide marketing of certain financial and insurance products and services, either by cross-border export or by exercising Single Market rights of establishment. Products and services to which passporting rights apply include life insurance, reinsurance, financial instruments (MIFID), collective investments (UCITS) and alternative investments (AIFMD). Passporting rights also extend to Norway, Iceland and Liechtenstein under their European Economic Area (EEA) with the EU in 1992.

Starting from first principles, however, the optimal list of benefits for the financial services and insurance sectors which the UK would seek from the Single Market or any alternative preferential trade agreement it might negotiate with the EU would comprise:

1. Unrestricted access for all UK cross-border exports of financial service and insurance products to all other EU member states.
2. Unrestricted rights for all UK financial service and insurance businesses to establish affiliates in all EU member states (rights of “commercial presence”) on the same terms as local companies (“national treatment” in the language of GATS (the General Agreement on Trade in Services)). It would be particularly important for EU citizens to be free to benefit from City investment and insurance expertise if the EU eventually takes measures to disaggregate the *bancassurance* model which dominates much of the personal banking sector in the EU.
3. Mutual recognition of all relevant UK professional and trade qualifications in other EU member states on *quid pro quo* basis for UK recognition of equivalent qualifications from other EU member states.
4. Unrestricted freedom for UK nationals to supply services in all other EU member states.

A comprehensive assessment of the extents to which EU Single Market membership has so far yielded these benefits for the UK financial services and insurance sectors is urgently needed as a prerequisite for future negotiations. Existing analyses such as the UK government’s reviews of the balance of competences between the UK and the EU need to be reviewed for this purpose.

8. **The UK needs to prepare and hold in reserve a plan for negotiating the trade basis for financial services and insurance (as well as other service sectors) on which it would leave the EU if the EU proves unwilling to negotiate constructively. This should be part of a comprehensive new trade agreement also covering trade in goods. The TPRC believes there should be no insuperable difficulty in principle in negotiating such an agreement.**

The UK will need to consider how the economically significant benefits of passporting rights could be retained either by negotiation or by activation of such rights as the UK and all other WTO members have by virtue of the commitments the EU has made under the GATS (General Agreement on Trade in Services). The TPRC believes the main UK sectors where passporting rights are of economically significant benefit are fund management and insurance, whose combined cross-border exports to the rest of the EU in 2013 were less than 9 per cent of the UK's total financial service and insurance exports worldwide. Formal legal advice is needed on this question as soon as possible.

- 8.1 The TPRC argues that if the UK is unable to negotiate an acceptable basis for continuing EU membership it should negotiate to “Stay in Europe for Trade” through a new inter-governmental customs union agreement with full UK voting participation in customs union policy decisions and internal market harmonised trade regulation on the basis advocated in Ronald Stewart-Brown’s CapX article on 11th November 2014²³. The TPRC sees a strong case for the UK government negotiating to heads of terms stage the bases on which UK would stay in or would leave the EU before holding an IN or OUT referendum.

- 8.2 In the TPRC’s view it should be possible for the UK to negotiate with the EU a new inter-governmental trade agreement to “Stay in Europe for Trade” for trade in services as well as goods. Legal advice is required as to the precise basis on which this could be done. But there can be no doubt that the UK would be in an extremely strong negotiating position:

- First, the UK would have the moral high ground of having done all it could to negotiate an acceptable basis for continuing EU membership, which the TPRC argues should be for little more than trade. (Martin Howe QC has independently developed this negotiating approach under the title “zero-plus” in his excellent recent Politeia publication on the subject²⁴.)
- Second, once EU negotiators understood the UK was really set to leave they would surely quickly recognise that agreeing for the UK to “Stay in Europe for Trade” would be the best way for the UK to leave in the mutual interest of both the EU and the UK.

Note (23): “Staying in Europe for Trade” by Ronald Stewart-Brown published by CapX on 11th November 2014 (<http://www.capx.co/staying-in-europe-for-trade>).

Note (24): “Zero Plus: The Principles of EU Renegotiation” by Martin Howe QC, published by Politeia in 2014.

- Third, the question of how rapidly the UK would reduce its annual contribution to the EU budget (£19.4 billion gross and £11.3 billion net in 2013²⁵) would give it the negotiating whip hand in negotiation.
- Fourth, once the UK corporate sector had acknowledged that the TPRC’s “Stay in Europe for Trade” approach to leaving the EU was workable, as the TPRC believes it can be persuaded to do, the probable substantial majority for leaving in the opinion polls would give the UK government strong moral authority in negotiations.

8.3 As regards trade in services the UK’s new trade agreement with the EU would need to be compliant with Article V of the GATS, which governs preferential liberalisation of trade in services between WTO member countries. Its prime requirement is that any such agreement should have “substantial sector coverage”. The TPRC does not anticipate this would be a problem for the UK and the EU given that their starting point for negotiation would have been the *status quo* of the Single Market in services, which does comply with Article V of the GATS.

8.4 An independent assessment is needed of the benefits conferred on the UK by EU passporting rights over and above the rights the UK would have as a WTO member under the GATS. The TPRC believes such benefits may only be economically significant for the fund management and insurance sectors. These sectors’ aggregate exports to the rest of the EU in 2013 were £5.9 billion²⁶, less than 9 per cent of the UK’s aggregate financial service and insurance exports worldwide of £68.5 billion²⁷ in 2013

Comparative assessments are also required of the costs and difficulties to UK insurance, fund management and other financial services businesses if the UK were no longer part of the EU of establishing new affiliates in different EU member states under the rights they would have under the EU’s commitments under the GATS as compared to such costs and difficulties using EU passporting rights. It may be that passporting rights are only of decisive economic significance in relation to EU member states where the case for establishing new affiliates is marginal.

Note (25) Source: The Pink Book 2014

Note (26): UK insurance exports to the rest of the EU in 2013 were £4.0 billion whilst UK fund management exports to the rest of the EU in 2013 are estimated at £1.9 billion (total UK fund management exports worldwide of £4.6 billion times 41.4 per cent, the proportion of total UK financial service exports going to the rest of the EU). Sources: Annexes B and C, and ultimately The Pink Book

Note (27): Source: Annex B, and ultimately The Pink Book 2014.

- 8.5 The EU's commitment to allowing non-EU banks and other financial services businesses to set up subsidiaries or branches in EU member states under the GATS, otherwise known as "rights of commercial presence" (or Mode 3 of trade in services in WTO jargon), is impressively open²⁸. Evidence for this is the apparent ease with which US investment banks have established affiliates at will all around the EU. Legal advice is needed regarding the extent to which the UK could effectively use the EU's GATS commitments on financial services as a separate source of leverage in negotiations with the EU.
- 8.6 The European Securities and Markets Authority has stated that it intends to allow non-EU alternative investment fund managers to opt to passport into the EU as from 2015 (although it has not yet published its detailed proposals). This precedent would appear to make it difficult for the EU to argue against the principle that a withdrawing UK should be able to retain passporting rights for all financial and insurance products and services covered by Single Market directives. Legal advice is required as to the case the UK could have for arguing the EU had no right to restrict such extra-EU passporting EU rights only to alternative investment fund management.
- 8.7 A reasonable minimum negotiating objective for the UK would be a standstill agreement to secure the continuance of existing rights of commercial presence within the rest of the EU already established for UK financial services and insurance businesses already under the EU treaties, existing rights of access to retail and other regulated markets in the rest of the EU, and mutual recognition of professional qualifications
- 8.8 The UK would need to negotiate the best possible arrangement it could achieve outside the EU for the settlement of euro-denominated transactions. Existing arrangements that non-EU countries like the USA currently have with the EU in this regard need to be investigated. A key issue is how best to ensure that UK-based banks have access to last resort euro facilities at the ECB. It may be that they and also the London-based clearing houses such as LCH.Clearnet and ICE Clear Europe would need to reinforce their presence in the Eurozone. One anecdotal source, which the TPRC intends to pursue, suggests that Japan has negotiated an acceptable arrangement to clear euro-denominated transactions in Tokyo.

At worst, the City ought to be able to retain most of its high value added business from dealing and advisory work relating to the Eurozone. Clearing is, after all, essentially a computerised / mechanical process to which UK-based banks ought to be able to continue to have access at market-determined rates, whilst London's insurance markets ought to be able to provide cover for new credit risks arising for UK-based banks if they no longer had direct access to last resort euro facilities at the ECB.

Note (28): The EU's commitments on financial services are set out in the Understanding on Commitments in Financial Services which forms part of the WTO Agreements as an adjunct to the GATS and to which both the EU and the USA are party. They set a "bottom line" for UK access to EU financial services markets in the event the UK were to leave the EU without any form of preferential trade agreement. Legal advice is required as to the precise extent to which the passporting rights from which US investment firms, in particular, benefit through having affiliates in the UK offer superior market access to that which they would anyhow have under the Understanding on Commitments in Financial Services.

8.9 The UK would also need to negotiate full participation in the new plans for a European capital markets union announced by Lord Hill, the EU commissioner for financial services, on 18th February 2015. This would include types of non-bank finance such as securitisation and private placements which are highly important sources of finance for smaller companies in the USA.

8.10 One difficult area on which legal advice will be needed is the extent to which it would be in the best interests of the UK to negotiate to continue to participate in a common regulatory framework for services with the rest of the EU if it left the Single Market in services. If not, how otherwise should the UK seek to negotiate the best possible framework for future regulatory cooperation with the EU?

8.11 One major advantage of the UK leaving the EU with a new preferential agreement on trade in services as outlined above would be that it would become free to negotiate new preferential agreements for trade in services with third countries independently of the EU. It would also become free to pursue dialogues on regulatory cooperation with third countries in its own right rather than having to work through the EU. This could be particularly advantageous for UK trade in services with Commonwealth countries such as Australia, Canada, India, New Zealand, Singapore and South Africa, and with the USA.

When resources are available, detailed studies need to be carried out on the feasibility and potential benefits of such agreements.

8.12 Lastly, in the context of the UK negotiating the terms of its withdrawal from the EU the UK would need to look carefully at the downside of not being party through the EU to any new opening of US financial services and insurance markets to banks and insurance groups based in the EU through the proposed EU-US Transatlantic Trade and Investment Partnership Agreement (“TTIP”) if such negotiations had succeeded by the time of the UK’s withdrawal.

However, financial services look likely to be one of several major stumbling blocks in the TTIP negotiations as the US government is not prepared to accept EU-US regulatory cooperation as a precondition for further progress on the chapter on financial markets access. Furthermore, in the TPRC’s view, for this and many other reasons the TTIP talks now have little chance of successful conclusion within the foreseeable future, let alone being ratified by the US Congress or the European Parliament.

In any case, it may be questioned how far EU negotiators will want to go to help champion the UK financial services and insurance sectors in greater penetration of US markets. (Arguably, the UK would be better off negotiating in its own right to improve their access to US markets rather than having to rely on the EU to negotiate on its behalf as at present.)

8.13 The UK should of course continue to participate in international agreements or conventions to which it is party independently of its EU membership. These would include the Basel Accords developed to establish global voluntary regulatory standards for bank capital adequacy, stress testing and market liquidity risk. Arguably, there is no possible value for the UK in being subject to an extra layer of banking regulation from the EU.

9. There should be no great difficulty of principle in the UK recovering full supervisory and regulatory control of the UK financial services and insurance sector from the EU in the context of withdrawal²⁹.

If the UK proposed to leave the EU it would need to conduct a comprehensive review of all UK laws and regulations deriving from the EU to decide whether to amend or scrap each single item of such legislation. Many EU-derived laws and regulations would be desirable to retain of their own merit or out of inertia. Other EU-derived laws and regulations would presumably be so deeply embedded in UK regulatory practise as to be impractical to consider removing.

Without doubt, however, Parliament would wish to scrap or amend a substantial body of EU-derived law and regulation relating to financial services and insurance as well as other areas of trade and areas not specifically related to trade. The task of amending UK domestic law in preparation for exit would certainly be very substantial but should surely also be achievable given the unique opportunity that EU withdrawal would give Parliament to introduce a new UK statute book.

Three categories of EU laws would need to be considered:

- Directly applicable EU laws such as EU regulations and parts of the EU treaties which form part of the internal law of the UK, via the gateway of Section 2(1) of the European Communities Act 1972 (“ECA 1972”), would automatically lapse as from the date of withdrawal
- Acts of Parliament enacted to implement EU directives or other obligations
- UK regulations made under Section 2(2) ECA 1972 to implement EU directives

With specific regard to EU-derived financial services and insurance regulation, as discussed in Section 1 above, the UK would need to conduct a comprehensive review of every EU-derived law and regulation to decide which to retain, which to amend and which to scrap. This exercise would be need to be carried out in tandem with preparations for negotiating the financial services chapter of the new preferential trade agreement which the UK should seek to negotiate with the EU as part and parcel of its withdrawal agreement, as discussed in Section 8 above.

10. The TPRC believes that the downsides for the City of a well-negotiated UK withdrawal from the EU would be quite limited and comfortably outweighed by the benefits of being able to offer a more attractive and less *dirigiste* UK regulatory regime to foreign investors, established UK-controlled groups and more entrepreneurial businesses, both for business with Europe and for exporting into the much greater and faster growing markets open to them in the rest of the world free of the burden of inappropriate EU regulation.

Note (29): The primary legal source for this Section 9 is “Zero Plus: The Principles of EU Renegotiation” by Martin Howe QC, published by Politieia in 2014.

STATISTICAL ANNEXES

Annex A: Contribution of the City to UK Balance of Trade 2006-13

- * The UK financial services sector is a huge contributor to the UK's balance of trade. Its surplus has recovered steadily from its post-crash low of £32.8 billion in 2008 to a record level of £38.1 billion in 2013.
- * The UK insurance sector's surplus has grown steadily from £9.6 billion in 2006 to £20.4 billion in 2013. In 2013 it accounted for 35 per cent of the City's aggregate £58.5 billion surplus contribution to the UK balance of payments.

Annex B: Breakdown of City trade between rest of the EU and the rest of the world

- * The rest of the EU accounted for 41 per cent of UK financial services exports in 2013 but only 18 per cent of UK insurance and pension services exports.
- * The rest of the EU accounted for 42 per cent of the UK's financial services trade surplus in 2013 but only 19 per cent of its insurance and pension services trade surplus.

Annex C: Assessment of trade liberalisation benefit to UK of EU regulation of financial services

- * Over the period 2004-2013 UK financial services exports to the rest of the world grew at 11.0 per cent per annum.
- * Over the period 2004-13 UK financial services exports to the rest of the EU grew at 8.5 per cent per annum.
- * There is no evidence of any trade liberalisation benefit to the UK emanating from Single Market regulation and supervision of EU financial services markets.

ANNEX A
Contribution of the City to UK balance of trade: 2006-14

FINANCIAL SERVICES

£ billions	2006	2007	2008	2009	2010	2011	2012	2013
Exports								
Monetary financial institutions	20.5	24.8	24.6	26.4	26.4	29.4	27.7	28.0
Fund managers	3.2	4.9	5.0	3.6	4.4	4.3	5.3	4.6
Securities dealers	8.9	11.2	10.2	7.8	5.3	5.8	4.2	4.9
Baltic Exchange	0.7	0.8	1.0	0.7	0.8	0.9	0.5	0.3
Other financial institutions	3.6	3.5	2.5	5.1	7.9	6.4	7.4	8.9
TOTAL	36.9	45.2	43.3	43.6	44.8	46.8	45.1	46.7

£ billions	2006	2007	2008	2009	2010	2011	2012	2013
Imports								
Monetary financial institutions	4.2	4.8	5.8	4.9	5.4	5.8	5.3	5.8
Fund managers	0.6	0.7	0.9	0.7	0.9	1.0	1.2	1.1
Securities dealers	1.6	1.0	1.1	0.7	0.4	0.3	0.4	0.3
Baltic Exchange	-	-	-	-	-	-	-	-
Other institutions	1.6	2.9	2.7	2.9	2.1	2.8	2.2	1.4
TOTAL	8.0	9.4	10.5	9.2	8.8	9.9	9.1	8.6

£ billions	2006	2007	2008	2009	2010	2011	2012	2013
Balance								
Monetary financial institutions	16.4	20.0	18.8	21.5	21.0	23.6	22.4	22.2
Fund managers	2.6	4.2	4.2	2.9	3.5	3.3	4.1	3.5
Securities dealers	7.2	10.2	9.1	7.1	4.9	5.5	3.8	4.6
Baltic Exchange	0.7	0.8	0.9	0.7	0.8	0.9	0.5	0.3
Other institutions	1.9	0.6	(0.2)	2.2	5.8	3.6	5.2	7.5
TOTAL	28.9	35.8	32.8	34.4	36.0	36.9	36.0	38.1

INSURANCE AND PENSION SERVICES

£ billions	2006	2007	2008	2009	2010	2011	2012	2013
Exports								
Direct insurance	9.8	9.7	9.5	11.8	12.7	18.1	18.1	17.6
Reinsurance	1.7	0.4	2.0	2.1	0.7	0.6	0.5	2.0
Auxiliary insurance services (insurance brokers)	1.6	1.6	1.7	1.9	1.9	2.3	2.4	2.2
TOTAL	13.1	11.7	13.2	15.8	15.3	21.0	21.0	21.8

£ billions	2006	2007	2008	2009	2010	2011	2012	2013
Imports								
Direct insurance	0.1	1.0	1.1	1.0	1.6	1.4	0.7	1.3
Reinsurance	3.4	1.0	0.5	3.0	1.5	1.5	0.9	0.1
Auxiliary insurance services (insurance brokers)	-	-	-	-	-	-	-	-
TOTAL	3.5	2.0	1.6	4.0	3.1	2.9	1.6	1.4

£ billions	2006	2007	2008	2009	2010	2011	2012	2013
Balance								
Direct insurance	9.7	8.7	8.4	10.7	11.2	16.7	17.4	16.3
Reinsurance	(1.7)	(0.6)	1.5	(0.8)	(0.8)	(0.9)	(0.3)	1.9
Auxiliary insurance services (insurance brokers)	1.6	1.5	1.7	1.9	1.9	2.3	2.3	2.2
TOTAL	9.6	9.7	11.6	11.8	12.2	18.1	19.4	20.4

Source: The Pink Book 2014

ANNEX B

Breakdown of UK trade in financial services and insurance and pension services between the rest of the EU and the rest of the world in 2013

2013

Exports	Financial services <i>£ millions</i>	Insurance and pension services <i>£ millions</i>	TOTAL <i>£ millions</i>
Rest of EU 28	19,350 (41.4%)	4,019 (18.4%)	23,369 (34.1%)
Rest of world	27,375 (58.6%)	17,765 (81.6%)	45,140 (65.9%)
TOTAL	46,725 (100.0%)	21,784 (100.0%)	68,509 (100.0%)

Imports	Financial services <i>£ millions</i>	Insurance and pension services <i>£ millions</i>	TOTAL <i>£ millions</i>
Rest of EU 28	3,290 (38.3%)	165 (11.6%)	3,455 (34.5%)
Rest of world	5,308 (61.7%)	1,257 (88.4%)	6,565 (65.5%)
TOTAL	8,598 (100.0%)	1,422 (100.0%)	10,020 (100.0%)

Balance	Financial services <i>£ millions</i>	Insurance and pension services <i>£ millions</i>	TOTAL <i>£ millions</i>
Rest of EU 28	16,060 (42.1%)	3,854 (18.9%)	19,914 (34.0%)
Rest of world	22,067 (57.9%)	16,508 (81.1%)	38,575 (66.0%)
TOTAL	38,127 (100.0%)	20,362 (100.0%)	58,489 (100.0%)

Source: The Pink Book 2014

ANNEX C

Assessment of trade liberalisation benefit to UK of EU regulation of financial services

Analysis of the UK's financial services exports to the rest of the EU and to the rest of the world over the period since 2004, the first year in which the relevant analyses became available in the annual UK Balance of Payments "Pink Book", and 2013 shows no evidence of any trade liberalisation benefit to the UK emanating from Single Market regulation and supervision of EU financial services markets.

UK Financial Services Exports

Year	To rest of European Union		To rest of world		Total		
	£ millions	Change from previous year	£ millions	Change from previous year	£ millions	Change from previous year	
2004	8,496	-	11,785	-	20,281	-	
2005	9,254	8.9%	14,149	20.1%	23,403	15.4%	
2006	13,640	47.4%	20,192	42.7%	33,832	44.6%	
2007	17,226	26.2%	26,648	32.0%	43,874	29.7%	
2008	20,540	19.2%	32,281	21.1%	52,821	20.4%	
2009	19,167	(6.7%)	27,341	(15.3%)	46,508	(12.0%)	
2010	17,633	(8.0%)	26,450	(3.3%)	44,083	(5.2%)	
2011	19,898	12.8%	28,527	7.8%	48,425	9.8%	
2012 _a	(Note (1))	18,000	(9.5%)	27,960	(2.0%)	45,960	(5.1%)
2012 _b		19,637	-	25,454	-	45,091	-
2013		19,350	(1.5%)	27,375	7.5%	46,725	3.6%
Growth rates							
2004-2008			24.5% p.a.		28.6% p.a.	27.0% p.a.	
2008-2010			(7.3%) p.a.		(9.7%) p.a.	(8.8%) p.a.	
2010-2012 _a			1.0% p.a.		2.8% p.a.	2.1% p.a.	
2007-2012 _a			0.9% p.a.		1.0% p.a.	0.9% p.a.	
Note (2)							
2004-2012 _a			9.8% p.a.		11.4% p.a.	10.8% p.a.	
2004-2013			8.5% p.a.		11.0% p.a.	9.9% p.a.	

Source: The Pink Book - editions from 2005 to 2014

Note: (1) The Pink Book has given geographical breakdowns of UK financial and other service exports and imports since 2004. Each edition gives these figures for the two previous years. Thus the 2014 edition gives figures for 2013 and 2012. The figures given in one year's Pink Book are often revised in the next year's Pink Book. The latest revisions are always given in the above table. To comply with new international standards, the methodology of collecting services data from the Pink Book 2014 onwards is now different from previous editions; therefore, data after and prior to 2012 are no longer directly comparable. However, growth rates 2004-2012_a and 2012_b-2013 may be amalgamated for an overall growth picture.

Note: (2): Owing to the changes in methodology introduced in The Pink Book 2014 referred to in Note (i) the figures in this Annex III, which are taken from successive Pink Book editions between 2005 and 2014, cannot be reconciled with the figures in Annexes I and II, which are taken solely from The Pink Book 2014. It may therefore be appropriate to treat the breakdowns of UK financial services exports in this Annex III in the period 2004 to 2011 between those to the rest of the EU and those to the rest of the world with a degree of caution. However, there is no reason to believe that the general patterns shown in the above table are unreliable.