POLICYBRIEF
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MAKING THE BEST OF BREXIT FOR THE EU27 FINANCIAL SYSTEM

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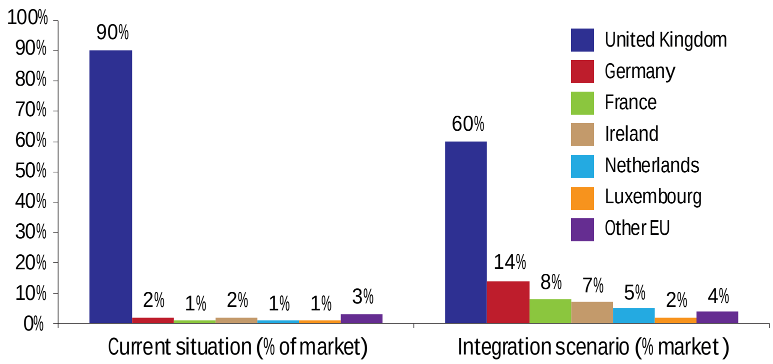
POTENTIAL MIGRATION OF WHOLESALE MARKETS FROM LONDON TO EU27



Source: Bruegel. Note: Market shares as a percentage of the total European wholesale markets. See page 5 for definitions.

THE ISSUE

e United Kingdom's exit from the European Union creates an opportunity for the remaining EU27 to accelerate the development of its nancial markets and to increase its resilience against shocks. Equally, Brexit involves risks for market integrity and stability, because the EU including the UK has been crucially dependent on the Bank of England and the UK Financial Conduct Authority for oversight of its wholesale markets. Without the UK, the EU27 must swiftly upgrade its capacity to ensure market integrity and nancial stability. Furthermore, losing even partial access to the e cient London nancial centre could entail a loss of e ciency for the EU27 economy, especially if nancial developments inside the EU27 remain limited and uneven.

POLICY CHALLENGE

e EU27 should upgrade its nancial surveillance architecture to minimise the nancial market fragmentation resulting from Brexit and the corresponding increase in borrowing costs for rms. While some decline in cross-Channel integration is unavoidable, the EU27 should move quickly towards a fully integrated single market for nancial services, with harmonised rules and consistent supervision and enforcement. Policy initiatives need to include governance reform and greater empowerment of the European Securities and Markets Authority, further steps towards banking union and third-country regimes for the supervision of market infrastructure rms (eg clearing houses), similar to those in the United States. With policy integration, there will be less need for nancial rms to move to one location, reducing the pressure for all facilities (infrastructure, o ces with trading oors, residential housing) to be in one city.

2 WHOLESALE BANKING ON THE MOVE

To assess the extent to which wholesale banking could shift to the EU27, we estimate the current size in London of that market segment, which comprises the issuing and trading of debt and equity securities, foreign exchange trading and derivatives. Table 1 provides an overview of total (retail and wholesale) UK banking assets, amounting to €10.3 trillion. Our ballpark estimate is that about 50 percent of total UK banking assets is related to wholesale banking in London[4].

To o er nancial market products to EU27 clients, banks need a passport under the Markets in Financial instruments Directive (MiFID)[5]. Based on discussions with market participants throughout Europe, we estimate that about 35 percent of London wholesale banking is related to EU27-based clients, varying from about one fth for UK-headquartered banks to a third for US-headquartered banks and half for EU27-headquartered banks. us, about €1.8 trillion (or 17 percent) of all UK banking assets might be on the move as a direct consequence of Brexit.

As for employees, Goodhart and Schoenmaker (2016) provide detailed data for the London operations of the top ve US investment banks, which together account for about a third of London wholesale banking. Panel A of Table 2 suggests that 35 percent of the corresponding sales might move to the EU27. e number of positions that will move with this volume of business depends on business considerations of the investment banks and on the 'substance requirement' of the EU supervisors. is requirement enables supervisors to demand su cient 'substance' in the form of management, sta and internal control systems as part of the licencing procedure. At a minimum, it is expected that the new EU27-based entities will need to have autonomous boards, full senior management teams, senior account managers and traders, even though much of the back-o ce might stay in London or elsewhere in the world[6]. We thus estimate that 10 to 15 percent of positions might move, or about 3,300 positions at the ve top US investment banks (Table 2, Panel B). As US investment banks count for one third of London wholesale activity that might move, our estimate for the entire wholesale banking segment would amount to 10,000 banking positions moving from London to the EU27. In a separate paper (Batsaikhan *et al*, 2017), we estimate that a further 18,000 to 20,000

4. [illegible] (2017) [illegible]

5. D[illegible] 2004/39/EC, http://ec.europa.eu/ nance/securities/isd/index_en.htm.

6. [illegible] (2012), [illegible] “ e licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder e ective supervision on both a solo and a consolidated basis.”

Table 1: Wholesale banking in London (end-2014)

B[illegible]	[illegible]		[illegible] L[illegible]		[illegible] E 27 [illegible]		
	A[illegible] ([illegible])	% [illegible] K [illegible]	A[illegible] ([illegible])	% [illegible]	A[illegible] ([illegible])	% [illegible]	% [illegible]
M[illegible] K [illegible]	4,583	45%	1,375	30%	275	20%	6%
M[illegible] K [illegible]	1,489	15%	0	0%	0	-	0%
O[illegible] K [illegible]	321	3%	0	0%	0	-	0%
[illegible]							

7. [illegible]

8. [illegible] 6.1 [illegible] 5.0 [illegible] E[illegible] 27 [illegible] 1.2 [illegible] (ECB Monetary Statistics, D[illegible] 2016).

9. [illegible], [illegible], D[illegible], D[illegible] J[illegible] K[illegible] (2015).

10. O[illegible]

assumes integration, there is less need for all activities to move to one location, which reduces the pressure to (and price of) having all facilities (infrastructure, offices with trading floors, residential housing) in one city. In this scenario with a more geographically spread industry, 35 percent of EU27 wholesale finance might be in Frankfurt, 12-20 percent each in Amsterdam, Dublin and Paris, and an

15. M FI [illegible] M[illegible] F [illegible] I [illegible] (https://ec.europa.eu/info/law/markets- nancial-instruments-mi r-regulation-eu-no-600-2014_en). EMI [illegible] E [illegible] M[illegible] I [illegible] (https://ec.europa.eu/info/business-economy-euro/banking-and- -nance/ nancial-markets/post-trade-services_en).

16. [illegible] E[illegible] B[illegible] A [illegible] (EBA), [illegible]

recognition of equivalence. is generates too much reliance on third-country