THE FUTURE OF UK BANKING AND FINANCE

by Panagiotis Asimakopoulos,
Christopher Breen,
and William Wright

A blueprint for domestic and international reform

NEWFINANCIAL
Atlantic Council

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ABOUT NEW FINANCIAL

New Financial is a think tank that believes Europe needs bigger and better capital markets to help drive growth and prosperity.

We think this presents a huge opportunity for the industry and its customers to embrace change and rethink how capital markets work. We work with market participants and policymakers to help make a more positive and constructive case for capital markets around four main themes: unlocking capital markets; rebuilding trust; driving diversity; and the impact of Brexit.

We are a London-based social enterprise funded by institutional membership from different sectors of the capital markets industry.

New Financial is registered on the EU Transparency Register, registration number 435008814959-36

ABOUT THE ATLANTIC COUNCIL

The Atlantic Council is a nonpartisan organization that galvanizes US leadership and engagement in the world, in partnership with allies and partners, to shape solutions to global challenges. The Atlantic Council provides an essential forum for navigating the economic and political changes defining the twenty-first century by informing its network of global leaders. Through the papers it publishes and the ideas it generates, the Atlantic Council shapes policy choices and strategies to create a more free, secure, and prosperous world.

The GeoEconomics Center works at the nexus of economics, finance, and foreign policy with the goal of helping shape a better global economic future. The Center is organized around three pillars - Future of Capitalism, Future of Money, and the Economic Statecraft Initiative.

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FOREWORD

The banking and finance industry is one of the most successful industries in the United Kingdom. It makes a major direct contribution to the UK economy as a sector in its own right, plays a vital role in supporting the wider economy, and sits at the heart of the global financial system. Brexit has been a seismic change for the UK's position on the world stage and for the UK banking and finance industry itself. Crucially, it also provides the UK with a unique opportunity and imperative to rethink and recalibrate the future of banking and finance.

In the past few years, the UK government has launched a wide-ranging and vigorous series of reviews into different aspects of the supervisory and regulatory framework that the UK inherited from the European Union. It has published more than thirty major reviews and consultations from the UK Listing Review on public equity markets and the Solvency II review on insurance to the Wholesale Markets Review on trading and the Khalifa Review on fintech and innovation. There are currently more than 130 live regulatory briefs underway in the UK.

However, it has been six years since the Brexit referendum, more than two years since the UK formally left the EU, and more than a year since the UK left the single market. Over this period there has been little concrete change, and in many sectors there is no clear timetable for legislative reform. With the next election due in just two years - and with the added pressures from the disruption from Brexit, the Covid pandemic, and now the war in Ukraine - the government should move quickly to ensure that the UK economy gets all the help it needs.

The UK is starting from a position of strength: in most sectors markets are deep and liquid, London is the dominant financial centre in Europe and it is the world's second largest international financial centre.

Unfortunately, there are also some sectors where the UK has been losing ground over the past few decades such as public equity markets and IPOs, and others where its framework is out of sync with international norms.

It pays to be bold in this moment. The framework inherited from the EU was designed for all 28 member states and is not tailored to the unique needs of the UK banking industry or the UK's unique role as a global financial centre.

This report doesn't just identify the "low-hanging fruit." It calls for a new regulatory framework that is dynamic, outcomes-based, and data-led. Our recommendations will also require buy-in beyond the financial bubble. Accessing talent demands a simpler and faster visa system. Maintaining competitiveness will require a closer look at taxation.

For London to fall behind other financial centers would be a terrible loss for the UK but also for the United States, which benefits greatly from the world's second financial hub being a close ally. New Financial and the Atlantic Council GeoEconomics Center believe the UK financial sector can continue to play a key role in the international financial system, provided the reform agenda is finally enacted. This is a once-in-a-generation opportunity.

Atlantic Council GeoEconomics Center & New Financial

EXECUTIVE SUMMARY

The banking and finance industry is one of the most successful industries in the United Kingdom. As a sector, it makes a huge direct contribution to the UK economy, plays a vital role in supporting the wider economy, and sits at the heart of the global economy as a dominant European and global financial center. Brexit provides the UK with a rare opportunity—but also an imperative—to rethink its role as a banking and finance hub. The current position is a good place to start, but faster coordinated action on taxation, regulation, and access to world-class talent is needed to ensure the UK remains well ahead of competitors.

This report outlines an ambitious blueprint for the future of UK banking and finance in three broad areas: rebooting domestic capital markets to enable the industry to better support the UK economy; improving the international competitiveness of the UK as an international financial center; and mapping the potential role the UK could play in developing global cooperation and partnerships.

Key Findings

1. **A good place to start:** The banking and finance industry in the UK has a strong platform on which to build as it charts a new path.
   - **A direct contribution:** The sector employs 1.1 million people across the UK, accounts for 7 percent of UK gross value added, and generates more than 10 percent of all tax receipts.
   - **Supporting the economy:** More than 95 percent of large UK companies use capital markets to finance investment and manage their risks. UK capital markets are twice as deep relative to gross domestic product as in the rest of Europe.
   - **A global financial center:** The UK's role as a European hub is underlined by the fact that in sectors where firms can choose where to locate their businesses, the UK accounts for between 40 percent of asset management activity in Europe and over 80 percent of derivatives and foreign-exchange trading.
2. **Warning signs:** In a number of sectors, the UK has been losing ground over the past few decades. The number of listed companies has fallen by more than 40 percent in the past twenty years, while the UK's share of global initial public offerings has dropped from 13 percent to less than 4 percent over the same period. The amount of long-term capital invested is far below the levels of comparable developed economies. Brexit has directly caused the relocation of some operations in foreign equity trading and derivatives.
3. **Out of line:** The UK has been a strong advocate of global standards, but in some areas has become an unfortunate outlier in applying additional rules and constraints. These include the taxation of banking and finance (where the UK has the highest total tax rate).
4. **Growth potential:** Our analysis suggests that the UK has the potential to achieve as much as 40 percent growth in its capital markets. If the UK industry can close half the gap between UK and US capital markets, nearly two thousand additional companies a year could raise an additional $75 billion per year in the capital markets, an increase of around 40 percent. The same analysis suggests a potential increase in pools of long-term capital of around $2.5 trillion. This growth would significantly boost economic growth, innovation, productivity, and investment across the UK.
5. **The scope for reform:** There are two main types of potential reform. First, addressing the low-hanging

fruit left behind by EU rules which are not appropriate for the unique UK market. Many of these have already been identified in the various reviews. The UK should accelerate implementing changes. Second, regarding UK-specific rules, the UK should be wary of going above and beyond the standards implemented in other markets. This process of reform is not a race to the bottom but a sensible reappraisal of which parts of the current framework make sense, which don't, and how the overall framework can be improved while balancing financial stability, customer outcomes, investor protection, and international competitiveness.

6 **Priorities for reform:** Five broad principles for reform cut across domestic markets and international activity.

- The UK should develop a clear strategy for the future, backed up with metrics and milestones and supported by closer cooperation between government departments.
- The new rules framework should be dynamic, agile, outcomes based, and data driven.
- Prudential and market policy should not block the industry from supporting the wider UK economy, nor put UK firms at an obvious international competitive disadvantage.
- The taxation of financial services should incentivize wider participation and investment and also serve competitiveness.
- The recalibration of the UK framework should take a "digital first" approach with the aim to take a global lead in areas such as data sharing, open banking and digital IDs.

7 **Rebooting domestic capital markets:** Domestic markets in the UK are deep, efficient, and liquid. There is, however, scope to reform the framework for banking and finance to help make them more dynamic, and enable the UK industry to better support the government's leveling up agenda to reduce inequalities among regions, and the transition to net-zero carbon emissions.

8 **Ensuring the competitiveness of the UK:** While the UK is a dominant international financial center, international finance has become more competitive in recent years. It is even more imperative that the UK framework does not put firms at a clear competitive disadvantage.

9 **International alignment and cooperation:** In a post-Brexit world, the UK is a significant "free agent," and can play a significant role in helping to shape global standards on a par with the three economic superpowers: the United States, the EU, and China. In key areas such as sustainable finance, fintech, capital requirements, and trading rules and the principles of international regulation, the UK's scale, expertise, and experience can play an important role. The UK also can build on its long history as an international crossroads for trade in financial services and develop closer bilateral relations with developed markets such as the United States, Switzerland, Japan, and Australia based on openness and collaboration.

10 **The transatlantic relationship:** The US and UK financial systems are already highly interconnected, but there is scope for a deeper transatlantic relationship. The UK banking and finance industry is already mid-Atlantic. It is closer to the US in its approach to open markets and its outcomes-focused approach to supervision and regulation. In markets such as derivatives, trading, clearing, asset management, and international capital raising—where the United States and the UK represent a de facto global market between them—there is an obvious case for closer cooperation.

2:
KEY THEMES

A GOOD PLACE TO START

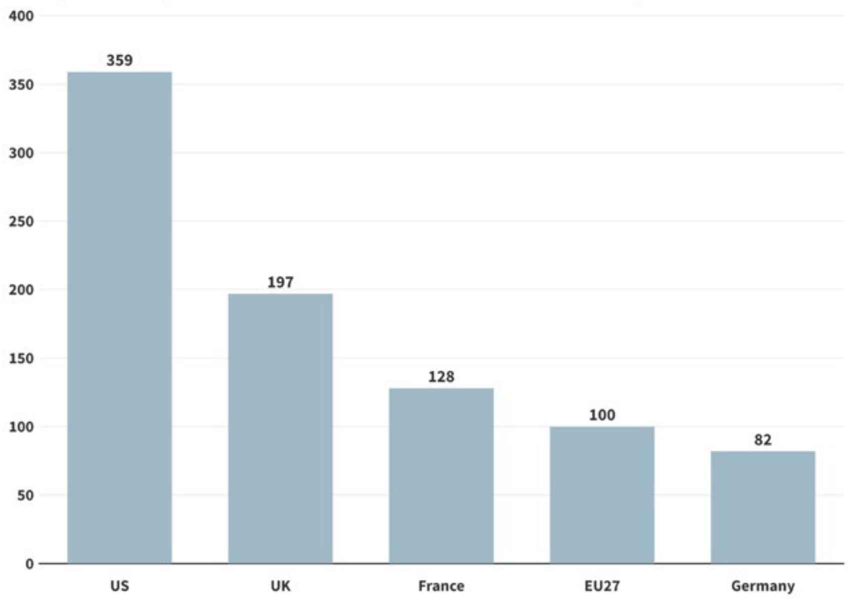
Before thinking of the future of banking and finance in the UK, it is worth reflecting on the starting point for the industry and the vital role it plays in the UK today. The banking and finance industry is one of the most successful industries in Britain: it is vital to the UK economy as a sector in its own right and in the support and funding it provides to the wider economy. It also plays an important role as a European and global financial center, and as a significant source of exports. While Brexit has inevitably caused some disruption, banking and finance has a strong foundation in the UK and, with political support, can forge a new path.

- **A big contribution:** The banking and finance industry employs more than 1.1 million across the country—with two-thirds of staff working outside London—representing around 3 percent of the total UK workforce, according to City of London Corporation data. It is a highly productive industry, accounting for more than 7 percent of overall UK gross valued added. It is the biggest single sector in terms of tax contribution, generating around £76 billion in tax a year or over 10 percent of all tax receipts. The sector generates more than £80 billion in annual exports and a trade surplus of more than £60 billion, and financial services represent around a third of all inward foreign direct investment in the UK, according to our analysis of data from the Office of National Statistics (ONS).
- **Supporting the UK economy:** The UK has deep and vibrant domestic capital markets across the board, which play an important role in supporting the wider UK economy. It has the largest and deepest capital markets of any major economy outside of the United States. These capital markets provide more than £170 billion ($225 billion) in funding a year for around 1,500 UK companies, and the UK has around £6 trillion in pools of long-term capital in the form of pensions, insurance assets, and retail investment.[1]

In most cases, UK capital markets seem mid-Atlantic: UK capital markets are, relative to gross domestic product (GDP), twice as deep as in the EU, but only half as deep as in the United States, according to our analysis of twenty-five sectors of activity. More than 95 percent of the one thousand largest UK companies use the capital markets to raise money and manage their risks, according to our recent research report, The Value of Capital Markets to the UK Economy.[2] However, domestic banking and finance activity in the UK has stagnated over the past five years. Average growth across twenty sectors of UK domestic activity in the three years to the end of 2019 was 0 percent, compared with a global average of 16 percent, according to our research on financial centers. We think this underlines the need for the UK to review the framework for banking and finance, and inject more dynamism into domestic capital markets.

Measuring Market Depth (2020)

Average size of capital markets relative to GDP across 25 sectors of activity rebased to EU=100



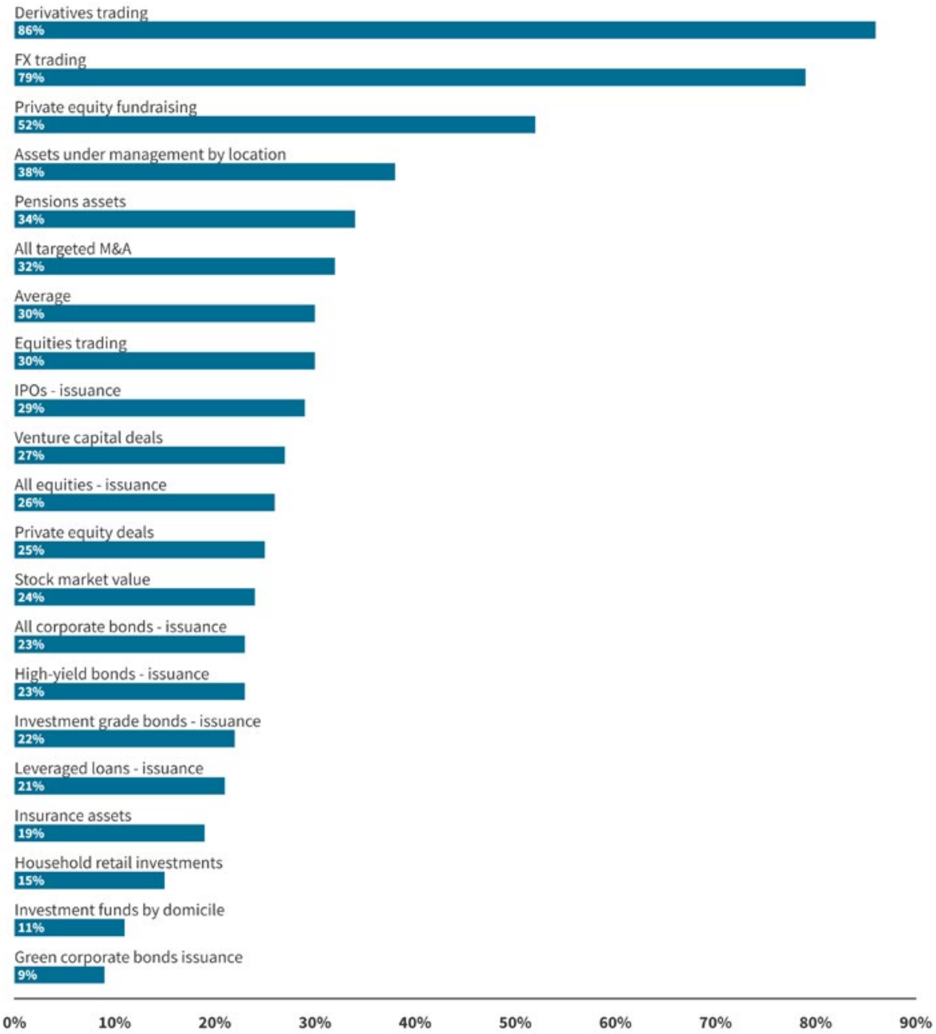
Source: New Financial

1 New Financial's analysis of data from Dealogic, ONS, UK Pensions Regulator, Investment Association, and Her Majesty's Revenue and Customs; and William Wright, "Unlocking Productive Investment," New Financial, February 2021, https://newfinancial.org/wp-content/uploads/2021/02/2021.02-Unlocking-productive-investment-New-Financial-FINAL.pdf.

2 William Wright and Eivind Friis Hamre, *The Value of Capital Markets to the UK Economy*, New Financial, May 2020, https://newfinancial.org/wp-content/uploads/2020/05/2020.05-The-value-of-capital-markets-to-the-UK-economy-New-Financial-FINAL-EXTERNAL.pdf.

UK Share of European Activity by Sector (2020)

The share of UK activity in Europe (UK+EU27+EFTA) by sector of activity



Source: Dealogic, EFAMA, Eurostat, ONS, BoE, AFME, ECB/BIS, Insurance Europe, FESE/local exchanges, Invest Europe, OECD, WTW, Fidessa/WFE, ECB, BIS, CCAF

- **A dominant European financial center:** For many decades London has been the main financial hub serving the EU economy and the gateway to the EU for international companies from the United States and around the world. While Brexit has changed the European landscape, the UK remains the dominant financial hub in Europe with an average share of just over 30 percent of all banking and capital markets activity in Western Europe, slightly more than France and Germany combined (27 percent). In international sectors where firms have discretion over where they locate their businesses, the UK has an even bigger share. For example, the UK accounts for 38 percent of all assets under management in Western Europe, just over half of all private equity fundraising, and over 80 percent of derivatives and foreign exchange trading.

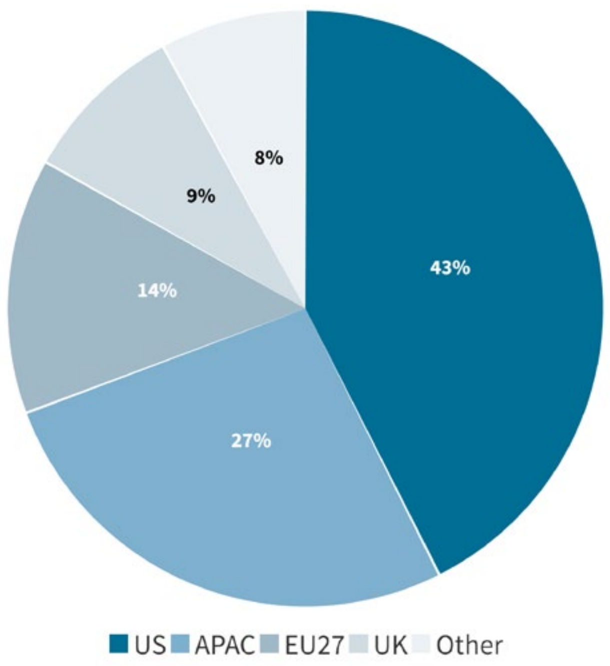
Brexit means that some activity has already had to relocate. Nearly five hundred firms operating in the UK have relocated part of their activities to the EU and while the total number of jobs affected so far is only around ten thousand, we expect more jobs and more activity to relocate in the future. EU authorities are keen to ensure that more business that involves EU customers or counterparties—particularly clearing, trading, and asset management—is conducted inside the EU.

In the run up to the UK's departure from the EU, the big debate in the UK focused on the trade-off between divergence from the EU rule book and access to EU markets. The more the UK diverged from the EU framework, the less access firms would have to EU customers from London through equivalence arrangements. However, that ship has sailed: the EU has only granted temporary and limited equivalence in two areas (clearing and settlement) and firms have relocated parts of their business to ensure access and continuity. This means that the UK now has more freedom to diverge from EU rules where it thinks it makes sense to do so, without the risk of the City losing further access to the single market.

- **A global financial center:** the UK is one of just two truly global financial centers, along with the United States. It plays an outsize role as a crossroads for international banking and finance with a global share of 19 percent of activity (compared with 25 percent for the United States) more than double its main rivals in Asia and five times more than France or Germany. In markets such as derivatives trading and foreign exchange, the UK is the clear global leader: it accounts for half (50 percent) of global interest-rate derivatives trading and just under half (48 percent) of all foreign-exchange (FX) trading.

Global Financial Market Activity (2020)

US, APAC, EU27, and UK shares (%)



Source: New Financial

While the United States had a commanding lead in our recent survey on global financial centers, the UK is much closer to the United States when it comes to international activity, with a score of 56 out of a possible 100, compared to 76 for the United States. Despite the rapid growth of its main rivals in Asia in recent years, the UK is well ahead of Hong Kong (21) and Singapore (14).

A far higher proportion of business conducted in the UK is international in nature than in the United States or other large European finance centers. In the thirteen sectors where the analysis measured international activity, we found that 45 percent of activity in the UK is international, three times higher than in the United States (although a little less than in Hong King and Singapore). For example, 83 percent of FX trading in the UK does not involve sterling, compared with just 11 percent of trading in the United States that does not involve the dollar. This means that more dollars are traded in the UK every day ($1.6 trillion) than in the United States ($1.2 trillion)

- **A robust framework:** one of the common themes running through the reviews of different sectors in the UK is that the framework that it inherited broadly works well. That is not surprising given that the UK has used its experience and expertise in banking and finance to help shape the EU rule book over many years. However, in many sectors there are aspects of the EU's often detailed and prescriptive approach that are inappropriate for the UK market, and that have been identified by the government as adding cost and complexity to markets without improving outcomes. These include market structure and many of the reporting and transparency requirements from the EU's Markets in Financial Instruments Directive (MiFID II) in derivatives, equities, and fixed-income markets; the cumbersome listings process; and the Solvency II regime for insurance.[3] Having identified these issues, the government needs to address them more urgently.

3 For more on the Solvency II review, see "Speech by John Glen MP, Economic Secretary to the Treasury, to the Association of British Insurers Annual Dinner," UK Government (website), February 21, 2022, https://www.gov.uk/government/speeches/speech-by-john-glen-mp-economic-secretary-to-the-treasury-to-the-association-of-british-insurers-annual-dinner.

KEY THEMES FOR RECALIBRATION AND REFORM

There is a danger that the UK will seek to boil the ocean, setting an impossible task in shaping the future of banking and finance. So far, the government has defined an ambitious vision for the future of banking and finance in its report, A New Chapter for Financial Services,[4] but it must do more. For starters, a set of core principles that cut across domestic and international markets could help define how the government and the industry think about and prioritize potential reforms. A clear plan and a strategy for the industry are essential and should be accompanied by a detailed plan with appropriate priorities, outcomes, targets, metrics, milestones, and accountability to help achieve it. The plan would also be supported by closer coordination between the dozen or so government departments and agencies responsible for delivering it.

This plan would make a clear separation between urgent and longer-term issues, and identify whether, how, on what basis, and when the government will address them. The risk of trying to change everything at once is that nothing gets changed. Issues where the government and industry agree on the need for change—such as reporting requirements for derivatives trading—should be fast-tracked on a clear timetable. (For example, there is no clear legislative timetable for what has been agreed so far in the Wholesale Markets Review.) Philosophically, at a time when the EU is seeking to attract business by requiring it to be conducted in the EU, the UK should be focusing on actively making people want to do business here. The government should set a clear ambition to create a more dynamic, agile, outcomes-based, and data-led framework.

A More Agile Approach

- The government should set a clear ambition to create a more dynamic, agile, outcomes-based, and data-led framework. Measures could include shortening the consultation and review process; accelerating the government response time and policy process; focusing on iterative improvements to the regime to keep up with new developments rather than moving from one Big Bang to the next; including reviews and sunset clauses in all new proposals; and accepting a degree of experimentation (and potentially failure) in regulation and policy.
- The starting point should be: how can we improve the framework we have inherited from the EU to ensure it delivers the outcomes it set out to achieve? This work will involve making rules more flexible, less prescriptive, and more focused on more measurable outcomes. For example, the EU green taxonomy is a pioneering piece of work in a vital area: how can the UK make it better?
- A key part of this approach would be identifying and analyzing examples of what works well in other markets and how aspects of best practice can be incorporated into the UK model to limit a "not invented here" approach (for example, perhaps, the United States for IPOs; the Netherlands and the Nordic states for pensions; or Australia for rights issues).
- A fundamental theme should be to expand the approach adopted in the Wholesale Markets Review[5] (WMR) and other reviews to identify, reduce, improve or eliminate aspects of the rule book that add little or nothing to market efficiency or customer outcomes, but which add significant complexity and cost. Examples from the WMR include proposals to abolish volume limits on dark trading in equity markets and significantly improve reporting and pretrade transparency in derivatives markets.

Rethinking Prudential and Market Policy:

- Prudential policy in banking, insurance, asset management, and markets will have a huge impact on the future of the industry at a domestic and international level. In each sector there should be an "acid test" based on outcomes. From a domestic perspective, does the existing framework impede or undermine the industry's ability to support UK companies, individuals, and the wider UK economy? From an international perspective, does the existing framework put UK firms or firms based in the UK at a clear, measurable, and practical competitive disadvantage to their international peers? In cases where the answer is "yes," UK policymakers and supervisors would make data-led and outcomes-based cases for improvement or clarify why the framework should be retained and on what basis future review would be conducted.

4 Rishi Sunak, *A New Chapter for Financial Services*, HM Treasury, July 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/998102/CCS0521556086-001_Mansion_House_Strategy_Document_FINAL.pdf.

5 *Wholesale Markets Review: Consultation Response*, HM Treasury, March 1, 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057897/Wholesale_Markets_Review_Consultation_Response.pdf.

The Bank of England (BoE) building is reflected in a sign, after the BoE became the first major world's central bank to raise rates since the coronavirus disease (COVID-19) pandemic, London, Britain, December 16, 2021. REUTERS/Toby Melville

- In banking, the UK should review how the capital, liquidity and resolution frameworks applied to subsidiaries can constrain groups unnecessarily, as well as the additional impacts of tougher clawback and malus rules on bonuses[6]- not least to avoid the potential of the EU framework being less onerous for banks. In addition, the UK should take the opportunity of the current ring-fencing review to ensure banks operating in the UK are not at a competitive disadvantage compared to banks operating in other jurisdictions. At a time when the new Basel framework is being implemented, it is important that the UK stays aligned with its peers on capital requirements.

- In insurance, while the Solvency II review is big a step in the right direction,[7] there is a danger that reductions in the risk margin are offset by changes to the matching adjustment or eligibility criteria, which would limit the industry's ability to put more long-term capital to work in the UK economy—and could mean that EU insurers have a more dynamic regime.

- In markets, many aspects of the EU rule book on fixed income and derivatives go far beyond the Group of Twenty (G20) requirements, and there is broad agreement between the government and the industry that rules on market structure and transparency in fixed income and derivatives are not working. There is scope to improve these inherited rules and pare them back to something closer to the intended G20 guidelines that would be more in line with the US model.

- There is an inevitable trade-off between financial stability, competition, and consumer/investor protection in the mandates of Bank of England supervisors, but there is a danger of protecting consumer to the point of excluding them or at the cost of the industry's core operations. Adding outcomes, wider participation, and underlying purpose to these mandates could help redress this balance.

Taxation

- The UK should conduct a fundamental review of the important role that tax policy plays in shaping the behavior of investors, issuers, and intermediaries in both the domestic and international markets.

6 Regarding clawback and malus rules, see *Renumeration, Supervisory Statement*, Bank of England, Prudential Regulation Authority, Updated July 2021, https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2021/ss217-december-2021.pdf?la=en&hash=306F4FF65B53992AC84FFE4FD419BBECF94071D5.

7 See "Speech by John Glen MP, Economic Secretary to the Treasury, to the Association of British Insurers Annual Dinner."

- From a domestic perspective, changes could include tax incentives or discounts for investment in UK assets, particularly for retail investors (for example, a lower rate of tax on dividends or capital gains from UK companies, addressing the tax differential between debt and equity funding, or widening the scope of tax incentives for investing in unlisted assets).

- From an international perspective, this could focus on whether the tax regime for banks, which was adjusted after the 2008 financial crisis (including the bank balance sheet level and a corporation tax surcharge), is still appropriate, and whether the multiple tax regimes for UK investment funds could be simplified. As things stand, the total effective tax rate on UK banks (including a surcharge) is higher than in Frankfurt or New York and this gap is forecast to grow, according to research by PwC.[8]

Digital First

- The UK should put "digital first" at the heart of its supervisory and regulatory approach and review how a framework designed for an analog age can be improved. The UK should build on its expertise in fintech, the success of open finance,[9] and its experience with regulatory sandboxes to develop a forward-looking approach to new technologies such as blockchain and crypto assets that would support the domestic industry in the UK and attract more international business.

- It should also focus on how existing processes and rules can be shortened and improved using technology which is a key theme of the current review of Secondary Capital Raising (for example, one firm recently had to postpone a shareholder meeting to approve an acquisition because it couldn't source enough paper to send the required documentation to more than a million retail shareholders[10]).

- As the line between financial services and information technology firms becomes increasingly blurred the UK should aim to take a global lead in finance in areas such as data sharing and privacy standards, cloud computing in banking and finance, digital IDs and passports, tech firms specializing in regulation (regtech), and leveling the playing field between incumbents and new entrants.

REBOOTING DOMESTIC CAPITAL MARKETS

In the wake of the COVID-19 pandemic, Brexit, and growing geopolitical challenges, the UK needs to reform the framework for banking and finance to make it more dynamic and to enable the industry to better support the UK economy, the government's regional leveling up agenda, and the transition to net-zero carbon emissions. These domestic challenges are divided into five broad groups:

- Unlocking long-term investment and widening participation: The UK is blessed with about £6 trillion in long-term capital in the form of pensions, insurance, and direct retail investments—by far the largest and deepest pool of capital in Europe—but only a tiny proportion (a few percent) of that is put to work in the form of productive investment (such as infrastructure, renewable energy, and growth equity). The proposed reforms to Solvency II and the development of a Long-Term Asset Fund structure[11] are a good start, but the UK can go further in recalibrating the regulatory and tax regime to incentivize more investment and widen retail participation in capital markets.

- Rebooting public equity markets: Equity markets are at the heart of driving innovation and productivity growth, and the UK has the largest and deepest public equity market in Europe. In recent years, however, the UK has lagged the US market in attracting high growth and technology firms. The UK can build on the reforms outlined in the UK Listing Review, the Secondary Capital Raising Review,[12] and the Wholesale Markets Review to simplify the market structure and reduce administrative processes in equity markets, encourage wider retail participation in markets, and develop tax and regulatory incentives in favor of equity for issuers and investors.

- Financing innovation and growth: Large UK companies are not constrained in their access to capital markets but many smaller companies and scaled-up firms lack access to growth capital and equity markets. A cross-government focus on these "scale-ups" and a revised regulatory and tax regime to encourage wider investment in them could help strengthen the growth company ecosystem in the UK, along with potentially developing a dedicated corporate bond market for smaller issuers and a hybrid equity market between "fully public" and "fully private."

8 *2021 Total Tax Contribution of the UK Banking Sector*, PwC, https://www.ukfinance.org.uk/system/files/UK-Finance-2021-TTC-report-251021.pdf.

9 Open finance is the sum of all tax paid by banks as a percent of pretax profit. See 2021 Total Tax Contribution, PwC, 4.

10 Asset manager abrdn was among the firms affected by a global paper shortage, according to media reports. See CityA.M., https://www.cityam.com/abrdn-forced-to-delay-1-5bn-interactive-investor-takeover-due-global-paper-shortages/.

11 Productive Finance Working Group, *A Roadmap for Increasing Productive Finance Investment*, September 2021, https://www.bankofengland.co.uk/-/media/boe/files/report/2021/roadmap-for-increasing-productive-finance-investment.pdf?la=en&hash=F92ADDFB1B815895AAFCC21CE6A29C5B0A74D6B7.

12 For more on these reviews see UK Listing Review, March 3, 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966133/UK_Listing_Review_3_March.pdf; and Secondary Capital Raising Review, October 12, 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1024641/Call_for_Evidence_UK_Secondary_Capital_Raising_Review.pdf.

- Fostering innovation and competition: The UK has one of the most innovative ecosystems for financial services in the world, as reflected in its position as a global hub for fintech and for international activity. The UK can build on the recommendations of the Khalifa Review, a government-sponsored review of UK fintech, and focus on competition, open finance, and digitization to ensure that London remains a financial center fit for the future.

- Supervisory framework and regulatory process: The starting point for this report is that the UK has inherited a framework from the EU that was not designed for the specific needs of the industry in the UK. While much of that framework works well, the UK can accelerate the implementation of proposals in the Regulatory Framework Review and the Wholesale Markets Review and build on them to develop a more tailored supervisory architecture and regulatory approach that is more efficient and dynamic—and which combines this agility with clear political accountability. At the same time, in many cases the UK has set rules that are higher than required under EU law, and more than a decade after the financial crisis it may be good time to review whether they should be recalibrated.

ENSURING THE COMPETITIVENESS OF THE UK

The UK has acted as a crossroads for international banking and finance for centuries and its position as a global financial center has been cemented over the past few decades in the EU. However, it is facing rapidly growing competition from financial centers in the Asia-Pacific region, the increasingly mobility of financial activity, and the impact of Brexit. The EU has already encouraged or enforced some relocation to the single market from the UK; as the scale of the industry's operation in the EU increases, firms may be tempted to move more of their UK operations to them.

In addressing international competitiveness the UK should keep in mind that there are a number of areas where the UK regime is out of sync with global norms and standards. These include the taxation of banking and finance (where the UK has the highest total tax rate), ring-fencing (where the UK is the only major market with an equivalent structure), and rules around pay and bonuses (where the UK has so far retained the EU bonus cap that it opposed while it was in the EU and also applied its own malus and clawback provision). The challenge here is that these are highly sensitive issues and there is limited political appetite to address them in the short term. The focus should be on what is urgent and the attainable, rather than the important but unfeasible.

The UK should focus on four key areas to ensure its industry remains internationally competitive:

- Supervisory and regulatory framework: Over the past few decades, the UK has set some of the highest prudential supervision and regulatory standards in the world, often going above and beyond EU requirements. The government is already adding "competitiveness" as a secondary mandate for UK supervisors; in this, a new environment outside the EU, it should review any aspects of the current framework around capital requirements, structure, regulation, and reporting that may put UK firms or those that choose to base parts of their business in the UK at a clear and measurable competitive disadvantage.

- Taxation in banking and finance: While the overall UK tax system is internationally competitive, there are elements such as the corporation tax surcharge for banks and the bank levy that make the total tax rate on banks higher than in the United States or Germany, according to research by PwC. It is encouraging that this surcharge will be reduced from 8 percent to 3 percent of pretax profits, effective in April 2023,[13] but the government could review other aspects of taxation across the industry such as the taxation of investment funds, capital gains, and trading to simplify and harmonize them.

- Talent and immigration: A dynamic international center needs access to the best talent from around the world. Some of the political rhetoric around Brexit and immigration can sometimes seem at odds with this, and the UK will need to ensure that the immigration system is as flexible and open as possible for high-skilled staff, within existing constraints. The UK should also focus on developing homegrown talent by investing in science, technology, engineering, and mathematics (STEM) education.

- The wider environment: Banking and finance do not operate in a vacuum, so it is vital that the UK ensures that the wider business, legal, and social environment is as open and supportive as possible. This will require a cross-departmental effort to ensure alignment between issues such as inward investment, company law, personal taxation, transport, infrastructure, and housing.

13 *2021 Total Tax Contribution*, PwC.

INTERNATIONAL ALIGNMENT AND COOPERATION

In the business of banking and finance, the UK has longed played an important role as a global financial center. Over the past few decades, it has played an active role in shaping EU and global standards, and the UK already has close relationships with many financial centres around the world. Post-Brexit, the UK is a significant "free agent" and has an opportunity to develop closer bilateral relations with important markets such as the United States, Switzerland, and others, and to play a leading role in shaping global standards and norms. The following will be essential for this impactful role.

- A transatlantic partnership: On many issues such as sustainable finance and open markets, the United States and the UK are closer philosophically and in regulatory approach than the UK is to the EU. In a world of superpowers competing to set global standards, this similarity presents an opportunity for the United States and the UK to work more closely together to project shared values. We identified ten sectors of activity where the two nations are already the first- or second-largest market in the world (such as derivatives and FX trading), which may be obvious candidates for closer cooperation to create de facto global standards.

- A new deal with the EU: After years of hard negotiations and often hostile rhetoric, the UK should focus on rebuilding its relationship with the EU at a political level and taking advantage of the already deep economic and financial ties, common history, and shared values and interests. This would involve focusing on common threats such as sanctions on Russia, cybersecurity, or money laundering; developing new formal and informal structures for cooperation now that the UK is outside the formal institutions of the EU; and encouraging supervisors and regulators in the UK and the EU to resurrect and build on their good working relationship.

- Global partnerships: The UK government is already in advanced bilateral discussions on closer regulatory cooperation with markets as diverse as Australia, Japan, and Switzerland. These discussions represent an opportunity for both sides to develop closer relations, to coordinate regulatory reform in global forums, and to reduce barriers to financial services trade and investment. This could help set an example of how different markets can cooperate more closely, help address the balkanization and deglobalization of financial regulation, and help influence global standards outside of more formal structures like the EU.

- The geopolitics of finance: As the recent overwhelming financial response to Russia's invasion of Ukraine has underlined, banking and finance can play a geopolitical role. Close alignment and cooperation between highly developed financial markets can help provide a powerful common front against potential geopolitical threats from nations, such as Russia and China, or cybersecurity, money laundering, and terrorism.

- Sharing expertise: The UK has an opportunity to share its expertise in a number of fields with developed and developing markets alike. Aside from its obvious experience and expertise in financial regulation, the UK is a leading global market in areas such as trading and posttrade activities, fintech, international capital raising, open finance, and sustainable finance. It also is one of the most advanced markets in its approach to sustainable finance and stakeholder capitalism, which are likely to be dominant themes for the next few decades.

Britain's Prime Minister Boris Johnson, France's President Emmanuel Macron and US President Joe Biden talk as they arrive at NATO Headquarters in Brussels, Belgium, March 24, 2022. Brendan Smialowski/ Pool via REUTERS

THE CURRENT STATE OF THE RELATIONSHIP BETWEEN THE UK AND THE UNITED STATES

Why should the United States care about the City of London? At first glance, Brexit may seem like an opportunity for the United States to win some international business from the UK. However, it is important for the United States that the UK remains a strong domestic and international financial center. The close ties of the two—in terms of cross-border activity, a market-oriented mindset, and direct regulatory cooperation—provide a strong platform for future collaboration.

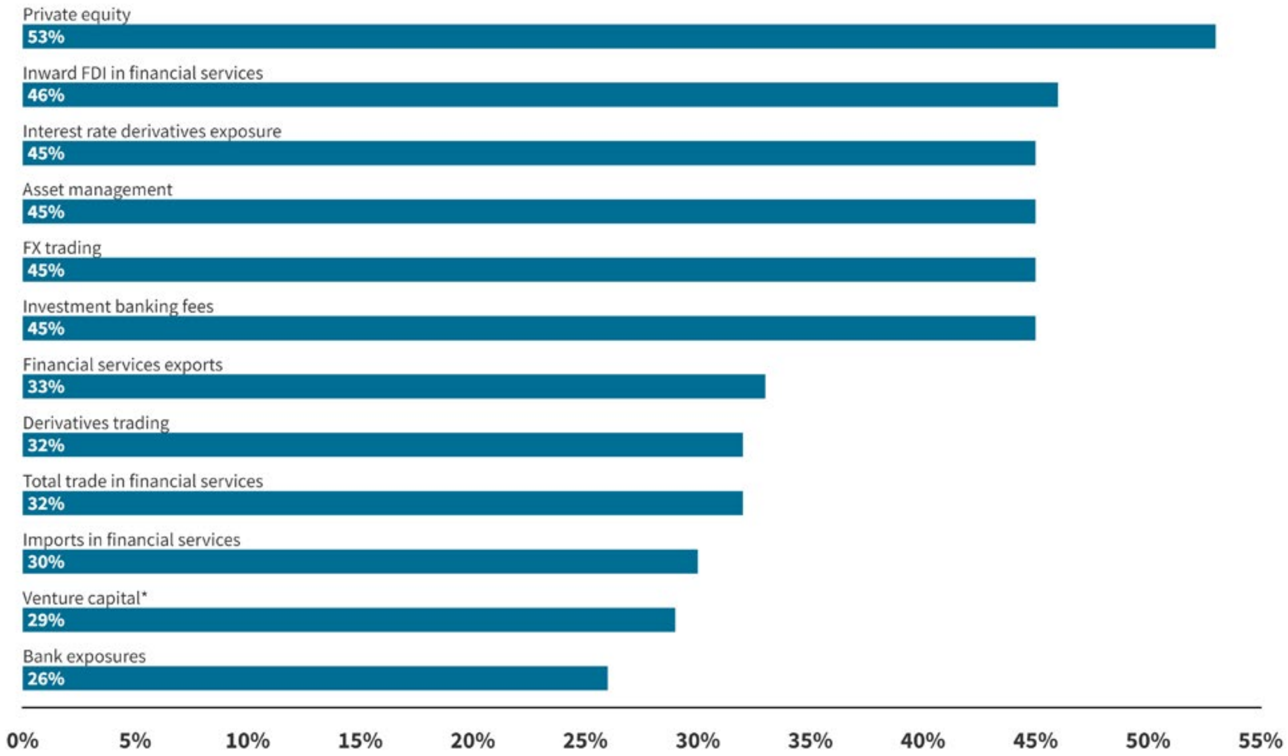
The UK acts as the international beachhead and gateway to the rest of Europe for many of the largest US financial institutions. This is reflected in the high market share of US firms in the UK market, according to New Financial's analysis. US investment banks account for around 45 percent of investment banking fees generated in the UK; and US-owned asset managers run 45 percent of the assets under management in the UK. In private equity, just over half of all investment in the UK in the past three years have been made by US-owned buyout firms, and US venture capital firms represent at least 29 percent of all technology investment in the UK.

There are high levels of cross-border activity between the two countries across all the metrics we analysed. The European Securities and Markets Authority (ESMA) estimates that just under a third (32 percent) of the UK's total trade in financial services is with the United States (an average of $43 billion a year in the three years ending in 2020), the same level as with the whole of the EU; and direct investment in financial services in the UK from the United States accounted for nearly half of all foreign direct investments in UK financial services.[14]

The UK also hosts a huge amount of trading activity involving a US counterparty or the US dollar. FX trading involving the dollar accounts for nearly half (45 percent) of all FX trading conducted in the UK (meaning that more dollars are traded in the UK than in the US itself), while a third of all derivatives trading in the UK involves the dollar.

14 Unpublished ESMA estimate furnished to New Financial.

US Share of UK Banking and Finance Activity in Selected Sectors



Source: Dealogic, ONS, BIS, Investment Association, ESMA, Preqin

Definitions

Private equity: % of all private equity deals in UK by value where the acquirer is a US private equity firm

Inward FDI in financial services: Stock of inward FDI in financial services from the United States

Investment banking fees: US investment bank's share of UK investment banking fees in 2021

FX trading: % of FX spot and derivatives trading in UK involving the US dollar

Asset management: % of assets under management in the UK run by US-owned asset managers

Interest rate derivatives exposure: %of interest rate derivatives trading in UK involving a US exposure

Financial services exports: % of all UK financial services exports to the US

Total trade in financial services: % of all UK financial services trade (exports + imports) involving the US

Derivatives trading: % of derivatives trading in UK denominated in United States dollars

Nearly half (45 percent) of all interest-rate derivatives in the UK involves a US exposure, ESMA estimates.[15]

Government regulators and senior staff from both countries have been cooperating directly through the UK-US Financial Regulatory Working Group (FRWG), meeting twice a year since 2018. Two memorandums of understanding (MOUs) between the US Securities and Exchange Commission (SEC) and the Financial Conduct Authority (FCA) are in place and concern consultation, cooperation, and exchange of information related to the oversight and supervision of financial services firms and related to entities covered in the alternative investment fund industry. The FCA and the Commodity Futures Trading Commission (CFTC) also have an agreement in fintech innovation, authorities have agreements on prudential measures for insurance and reinsurance sectors, and the Bank of England and the CFTC have joint oversight of US clearing firms operating in the UK.

15 Unpublished ESMA estimate.

THE GROWTH OPPORTUNITY

While UK capital markets are already highly developed, we think there is realistic and sustainable growth potential of around 40 percent in domestic capital markets activity. This growth would help the domestic market overcome a period of relative stagnation over the past few years; it also would help support the UK economy to recover from the combined shocks of Brexit, the pandemic, and the war in Ukraine; help implement the UK government's regional leveling up agenda; and help finance the transition to a more sustainable economy.

We measured the depth of selected sectors of domestic capital markets relative to GDP with the United States, and estimated the growth potential by asking: what would UK markets look if they closed half the gap in depth compared with the United States?

Overall, we estimate that UK companies could raise an additional $75 billion a year from capital markets, an increase of just over 40 percent compared with the average of the past three years.

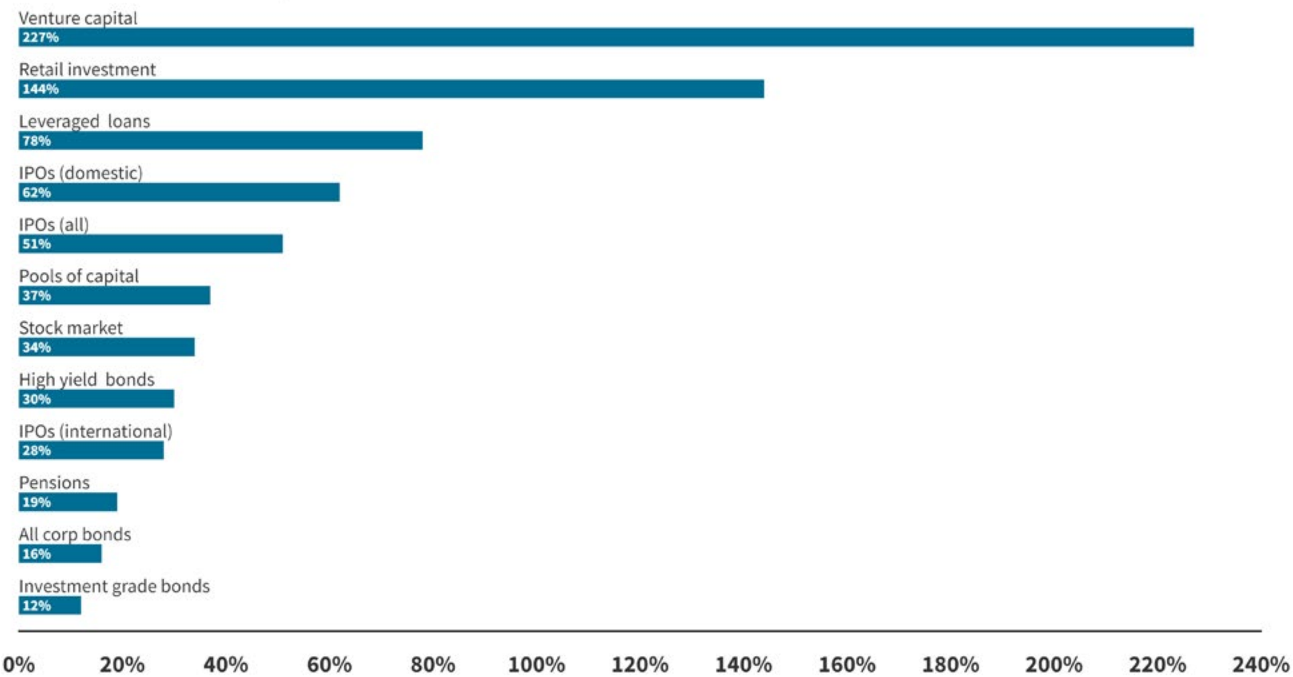
Our analysis also shows the huge potential to transform pools of long-term capital in the form of pensions, insurance, and direct retail investments that the UK needs to provide for a more sustainable future. An additional $2.5 trillion in pools of long-term capital could be put to work in the UK economy—a 37 percent increase from current levels—and direct retail investment in funds and securities would more than double.

The IPO market could be revitalized and flourish, attracting more UK and foreign companies. An additional thirty-five UK companies could raise an extra $6 billion a year in the IPO market (an increase of 62 percent on the three-year average); the UK stock market would then grow by around a third, adding $1.2 trillion to its market capitalization.

The most dramatic increase would be in funding high-growth companies. Venture capital funding in the United States is five times larger relative to GDP than in the UK; however, if the UK could close half of this gap—and there is no particular reason why it cannot—venture capital investment would more than triple and inject an additional $7 billion a year into high potential companies.

UK Growth Potential

Increase in value (%) by sector if gap in market depth (value as a % of GDP) vs. US market halved



Source: New Financial

3:

BLUEPRINT FOR RECALIBRATION & REFORM

DOMESTIC MARKETS

In the wake of the COVID-19 pandemic, Brexit, and growing geopolitical challenges, the UK needs to reform the framework for banking and finance to make it more dynamic, and to enable the industry to better support the UK economy, the government's leveling up agenda, and the transition to net-zero carbon emissions. These domestic challenges are divided into five broad groups:

- Unlocking long-term investment and widening participation.
- Rebooting public equity markets.
- Financing innovation, productivity, and sustainable growth.
- Fostering innovation and competition in financial services.
- Revsing the supervisory framework and regulatory process.

UNLOCKING POOLS OF LONG-TERM CAPITAL AND WIDENING PARTICIPATION IN CAPITAL MARKETS

The starting point for big and effective capital markets is deep pools of long-term capital. The UK is overflowing with about £6 trillion in pensions assets, insurance assets, direct retail investments, and endowment funds, but not enough of this is allocated to long-term productive investment such as infrastructure and renewable energy, UK-listed equity, or venture capital and growth capital.

Just 12 percent of this huge pool of capital is invested in the UK stock market, and less than 1 percent of the £4.6 trillion in pensions and insurance assets is invested in UK unlisted equities. Over the past twenty years, defined benefit pension schemes (the largest component of UK pensions) have reduced their allocation to UK equities from 48 percent in 2000 to less than 3 percent, while UK insurers and asset managers have halved their allocation to UK equities. More than 90 percent of the money raised by venture and growth funds in the UK comes from overseas investors.

At the same time, retail participation in the UK is much lower than in the United States. While retail activity in US markets have been a significant driver in recent years (perhaps too significant), just 8 percent of the UK stock market is owned directly by individuals. Just one in twelve adults of working age directly own shares, and just one in twenty took advantage of the tax benefits to invest in a stocks and shares individual savings account (ISA) last year. Retail participation in private markets, such as venture capital investment trusts or private equity, is even lower.

No silver bullet will unlock more productive investment and widening access to capital markets. Broadly, though, four main buckets of potential reform could spur improvement: getting more money into pools of long-term capital, making those pools of capital more efficient, ensuring they have the right vehicles and structures in which to invest, and recalibrating the supervisory and regulatory regime.

The review of Solvency II, the Productive Finance Working Group,[16] and proposed reforms to pensions by the Department of Work and Pensions are all pushing in the right direction. Here are some more specific recommendations on unlocking capital and widening participation:

Unlocking capital

1. Conduct a fundamental review of the structural, cultural, and regulatory barriers to long-term productive investment across the whole chain of pensions, insurance, and retail assets. While the UK has about £6 trillion in pools of long-term capital, the structure and framework actively discourages productive investment: most defined benefit pension schemes are closed or mature; defined benefit pensions are small and fragmented; personal pensions and retail investing are restrained by daily liquidity requirements; and Solvency II requirements make investment prohibitively expensive. This may require more radical structural and cultural changes as well as specific regulatory changes.
2. Push ahead with expanding participation in automatic-enrollment pensions by removing the age and earnings limits, and push for further consolidation of defined contribution schemes to significantly reduce the number of schemes from its current 28,000.
3. Rethink the stewardship code to encourage investors and companies to place more emphasis on long-term rather than short-term investment.

16 Productive Finance Working Group, *A Roadmap for Increasing Productive Finance Investment.*

People walk during the morning rush hour in the financial district of Canary Wharf in London, Britain September 28, 2020. REUTERS/Toby Melville

Widening participation

4 Introduce a pilot scheme of "financial health checks" to drive more people toward existing financial education and literacy initiatives, and to engage more with their money (see New Financial's recent concept paper on financial health checks[17]).

5 Review the rules on guidance and advice to ensure that potential investors with smaller portfolios have access to a sufficient level of advice to actively engage in capital markets.

6 Widen tax incentives for retail investors seeking to invest, particularly for private markets, and explore the feasibility of a dividend or capital gains tax discount on UK securities for UK investors.

7 Identify the existing barriers for retail investors to access more private capital and illiquid assets to help close the "exclusivity gap." The returns from private capital and illiquid assets can exceed the returns from public markets by as much as 5 percent a year, but these markets are effectively off limits to most individuals and smaller pension schemes.

8 Encourage and enable the wider use of technology and platforms to make it easier for retail investors to invest and to participate in a wider range of markets (such as the PrimaryBid platform for retail participation in IPOs and bond issues).

REBOOTING PUBLIC EQUITY MARKETS

Public equity markets drive growth and investment by providing long-term risk capital at scale; they fuel innovation and productivity growth; and they democratize long-term wealth creation.

Equity markets broadly work well in the UK: they are deep, liquid, efficient, and surrounded by a flourishing ecosystem. Through these markets, UK companies raise around £35 billion. However, over the past twenty-five years, public equity markets in the UK have been in structural decline. The number of companies listed on them has roughly halved, the value of new issues has fallen by two-thirds, and the number of new issues has dropped by three-quarters. This has left the UK with a much less dynamic market than in the United

17 "An Introduction to Financial Health Checks," Concept Paper, New Financial, February 2022, https://newfinancial.org/wp-content/uploads/2022/02/2022.02-Introduction-to-financial-health-checks-concept-paper-from-New-Financial.pdf.

States: technology stocks represent less than 2 percent of UK market capitalization, compared with over 30 percent in the United States. This helps explain why UK equities trade at 30 percent, on a forward earnings basis, compared with global markets, and the risk of creating a vicious circle of lower returns, lower demand, and less supply.

The UK Listing Review led by Lord Hill has already addressed some of the barriers for technology companies listing in the UK, for example, by reducing free float requirements and allowing dual-class share structures in the premium segment; reviewing the regimes for special purpose acquisition companies (SPACs); and streamlining prospectus requirements. The Secondary Capital Raising Review is looking at making it quicker and easier for companies that have already listed to raise money on the stock market by simplifying and shortening the process. The Wholesale Markets Review has proposed removing some of the rough edges of EU rules in terms of the regulatory perimeters of different types of trading venues, and some transparency and reporting requirements.

We think there are some additional initiatives and areas the UK can explore further to attract more companies to public equity markets and increase investment in equities, including these specific recommendations for:

Attracting companies and investors

9 Take a global lead on reducing or eliminating the tax differential between debt and equity finance and potentially experiment with a tax-deductible corporate equity allowance or notional interest deduction or setting tougher limits on the amount of debt that is tax deductible to encourage more equity financing.

10 Build on the recommendations of the UK Listing Review and Secondary Capital Raising Review to ensure that the UK has "best in class" processes and rules in place for equity capital raising. Commit to measuring the outcomes of these changes after one and three years and update or recalibrate them accordingly.

11 Develop a more proportionate supervisory and disclosure regime for smaller companies seeking access to equity markets and the ecosystem of brokers, advisers, and investors that support them. Encourage and support an industry-wide coalition to drive greater use of equity markets by smaller companies.

12 Reform the nominee system and apply a "digital first" approach to reconnect the direct link between individuals and the shares they own.

13 Review whether the corporate governance and disclosure regime for listed companies may have gone too far. While high standards are a hallmark of high-quality markets in the past twenty-five years, there have been more versions of the corporate governance code in the UK than there have been prime ministers. This review could include whether the regime could be adjusted for all but the largest listed companies, and how to reduce the disclosure gap between public and private companies.

14 Build on the Wholesale Market Review to identify, reduce, and potentially remove additional rough edges from MiFID II, which add complexity and cost to market participants in the secondary market without improving outcomes for market efficiency and investors.

FINANCING INNOVATION, PRODUCTIVITY, AND SUSTAINABLE GROWTH

The UK has experienced a fall in productivity growth since the global financial crisis that shows no sign of ending. In addition to investing in infrastructure and education, the UK will need to increase innovation and invest in digitization, automation, and artificial intelligence to boost productivity. At the same time, the UK has to address the economic inequality between its different regions and meet its climate change goals to transition to a more sustainable economy.

Capital markets can play a significant role in allocating the funding needed for this rebalancing of the UK economy and better supporting high potential growth companies and small and medium enterprises (SMEs), which are struggling especially in the aftermath of the pandemic.

Policymakers and regulators should take a holistic approach to the whole ecosystem of capital markets and specifically focus on the funding ladder and the ecosystem around the different stages of funding. The Khalifa Review, industry-led Productive Finance Working Group, and previous work on the patient capital review[18] have made a strong start. Here are some more recommendations for:

18 "Patient Capital Review," Policy Paper, HM Treasury and Department for Business, Energy & Industrial Strategy (UK.gov website), January 23, 2017, https://www.gov.uk/government/publications/patient-capital-review.

Fostering an ecosystem

15 Review the impact of the Jumpstart Our Business Start-ups (JOBS) Act, passed in the United States in 2012, and which elements could be transplanted to the UK market to ensure that high-potential and scale-up companies have access to the wider possible pools of capital at every stage of their growth, and that investors have access to the widest possible range of companies.[19]

16 Explore the potential for a hybrid market, or "third way" between private and public markets. This could be a venue for private companies (large or small) that need to raise funding in the form of equity or quasi-instruments such as preferential shares or convertible debt. Trading would be periodic rather than continuous; disclosure and governance requirements would be closer to those for companies with listed bonds than fully listed equity; and tax incentives could be provided for issuers and investors.

17 Explore the potential for a "minibond" market for smaller companies, potentially modeled on successful markets in Italy and Spain, to provide smaller companies with better access to a wider pool of capital. A good starting point is a paper written by Rt Hon Rishi Sunak, now chancellor of the Exchequer, when he was a backbench MP in 2017.[20]

18 Encourage local government to work more closely with industry and universities to help foster local clusters of innovation. Support local and regional government to build capacity to develop more investment-ready infrastructure projects. This capacity is often limited outside of big metropolitan authorities, which could mean that areas of the UK that would most benefit from investment are unable to procure it.

19 Increase funding and reform the governance of the British Business Bank, a state-owned economic development bank, to enable it to significantly increase its work in facilitating finance for SMEs (it currently has a stock of funding of around £9 billion supporting 95,000 companies in its core programs).

FOSTERING COMPETITION AND INNOVATION IN FINANCIAL SERVICES

Efficient and liquid financial markets require transparency, competition, and integrity. This encourages innovation in the form of new products and new entrants, increases liquidity, improves the efficiency of capital allocation, and reduces costs for issuers, investors, and intermediaries.

Overall, the UK has one of the most innovative banking and finance industries in the world, and it is a strong global hub for fintech companies. However, there are aspects of the current framework that can be reformed particularly around open finance, access to data, and more proportionate supervision and regulation.

A crucial aspect of improving competition and innovation is a systematic process to identify, reduce, or remove aspects of regulation and reporting that create significant costs for markets participants, but which generate limited benefits to customers.

Adjusting regulation and reporting

20 Implement the agreed proposals on transparency rules across markets, which can play a big role in improving competition and efficiency but may add undue costs and complexity when transparency is for its own sake. Build on the Wholesale Markets Review to identify, improve, and reduce reporting and transparency rules designed for equity markets that do not work as well (or at all) in nonequity markets. In fixed income and derivatives markets in particular, pretrade transparency risks becoming a box-ticking exercise that generates data that clients, intermediaries, and regulators do not use. For example, in derivatives markets, companies have to comply with the EU's European Market Infrastructure Regulation (EMIR) and MiFID requirements while supervisors and regulators use only the data supplied under EMIR for oversight purposes. The UK should embrace something closer to the US approach in fixed income and derivatives markets.

21 Ensure a level playing field for smaller and mid-tier financial services companies and new entrants by developing a more proportionate framework around capital and reporting requirements, corporate governance rules, and disclosure requirements.

19 Rishi Sunak MP, *A New Era for Retail Bonds*, Centre for Policy Studies (website), November 15, 2017,
20 Sunak, *A New Era*.

Traders work on the trading floor of Barclays Bank at Canary Wharf in London, Britain December 7, 2018. REUTERS/Simon Dawson

22 Promote the digitalization and standardization of markets and investment to reduce costs, improve transparency, and reduce the timescales. Push for the digitalization of the issuance process, provide incentives to companies and investors to use platforms to connect issuers, banks, and investors, and encourage the development of more standardized documentation.

23 Push ahead with the development of a consolidated tape to promote competition and transparency in bond and equity markets. Nonfinancial barriers to competition should be identified and removed (for example, some tax incentives for equity investment refer solely to shares listed on the London Stock Exchange).

24 Accelerate open banking and finance by replacing the Open Banking Implementation Entity with a new and expanded entity with more resources, more representation from new entrants, and technical working groups for improving technology and data flows. Standards and processes for transferring business from one provider to another need to be simplified and standardized so that they work as well in practice as in theory.

TOWARD A NEW SUPERVISORY ARCHITECTURE AND REGULATORY APPROACH

Brexit has shifted responsibility for the framework for UK banking and finance from the EU to British policymakers, supervisors, and regulators. The UK has a once-in-a-generation opportunity to reshape its supervisory and regulatory architecture to make it fit its new position outside of the EU, to tailor the framework for the UK market, and rethink its regulatory approach to banking and finance to reflect its prominent international position and the role of London as a global financial center.

The UK needs to recalibrate its supervisory and regulatory architecture and process to ensure that the UK has a dynamic, agile, proactive and accountable framework that balances the importance of financial stability and investor protection with the imperatives of encouraging growth and capital formation. The UK government's Future Regulatory Framework (FRF) Review, whose consultation process concluded in February 2022, has laid much of the groundwork for what the framework might look like. We offer additional recommendations:

Making improvements

25 Focus on developing a more dynamic outcomes-based approach to supervision and regulation to rationalize the framework and ensure that rules can keep up with market developments and changing risks. This approach would include a dashboard to measure targets, timelines, impact, progress, and outcomes, and would introduce a greater degree of experimentation into the supervisory process within clearly defined parameters.

26 Amend the structure and remit of committees in the Parliament (both the House of Commons and the House of Lords) to reflect the importance of financial services, establish a special financial services committee (or Sub Committee) to work alongside the Treasury Committee, and provide the committee with additional resources.

27 Provide government departments' supervisors and regulators with more resources and financial expertise. A mix of secondments from the industry and increasing salaries, benefits, and training to attract and retain talent from the private sector would help ensure a higher degree of technical expertise and independence.

28 Take a digital first approach to regulation and take a lead on regtech to help rationalize the UK framework, reduce costs, and improve efficiency in financial services. Aim for an approach similar to the Monetary Authority of Singapore's ambition of having a single interaction with any given firm on any given issue.

29 Explore expanding existing mandates of regulators and supervisors to include facilitating capital formation (one of the SEC's three mandates) or widening participation in banking and finance. While there is a risk of adding too many mandates to UK supervisors, it is striking that they do not have specific mandates based on the underlying purpose of the banking and finance industry.

ENSURING THE COMPETITIVENESS OF THE UK

The UK has acted as a crossroads for international banking and finance for centuries, and cemented its position as a global financial center in the EU over the past few decades. However, in some key areas of banking and finance, international activity has declined in the past decade including foreign bank assets, foreign equity trading, foreign companies listed in the UK, and more recently some derivatives trading. The UK is facing rapidly growing competition from financial centers in the Asia-Pacific region, the increasing mobility of financial activity, and the impact of Brexit. The EU has already encouraged or enforced the relocation of some activity from the UK, and as the scale of the industry's operation in the EU increases, firms may be tempted to move more of the UK operations to them. The UK should focus on four key areas to ensure it remains internationally competitive:

- Supervisory and regulatory framework.
- Taxation in banking and finance.
- Talent and immigration.
- The wider environment.

SUPERVISORY AND REGULATORY FRAMEWORK

One of the biggest challenges for the UK is finding the right balance between maintaining a robust and stable financial system and reforming the supervisory and regulatory framework to retain, enhance, and increase the international competitiveness of the banking and finance industry. We think there is scope for the UK to increase the competitiveness and attractiveness of the industry without reducing standards or hindering financial stability.

There are two main areas for reforming the supervisory framework. First, identify and address the low hanging fruit in the EU framework: the items that are not appropriate for the UK market. Second, review UK-specific aspects of the framework to consider whether they can or should be adjusted in light of Brexit and the UK's current status and future outside the EU.

A cash machine ATM that offers withdrawals in either Pound Sterling or Euros is seen in Canary Wharf Financial centre in London, Britain, June 30, 2016. REUTERS/Russell Boyce

Adjusting the framework

30 Take a more holistic view on the framework for UK banks, insurers, and investment firms and assess the overall impact on their competitiveness relative to their US and EU peers. Overall, UK banks face much higher effective capital requirements than their peers. In addition, intragroup capital requirements could be improved to further support cross-border business models and operations, in particular the treatment of exposures between a UK entity and entities in equivalent jurisdictions, such as the US.

31 The government should respond quickly to the review on ring-fencing led by Keith Skeoch.[21] In its current form, forcing banks with retail deposits of more than £25 billion to ring-fence them from the rest of their business acts as a disincentive to international firms looking to expand in the UK market.

32 As for insurance, in its review of Solvency II, the UK should implement a principles-based approach to long-term risk and consider the competitive pressures UK companies face from non-EU insurers. A data-led and outcomes-based assessment should focus on whether US and EU firms are better able to perform their core functions, than their UK peers.

33 Build on the UK's dominant role in global derivatives markets by tailoring the framework it has inherited from the EU, which is very EU27-centric and goes far beyond G20 commitments. This would focus on reducing or removing transparency and reporting requirements that don't help price formation, efficiency, or liquidity, and removing competing or redundant reporting requirements.

34 Establish a one-stop shop for financial companies wanting to enter the UK market such as those established by the Monetary Authority of Singapore and Paris Europlace, and a single trade body and promotional agency for UK banking and finance. If a financial services company in Asia wants to open a UK business today, who should it call: the Bank of England, FCA, HM Treasury, the Department for International Trade, TheCityUK, the City of London Corporation, or London First?

21 *Final Report of the Ring-fencing and Proprietary Trading Independent Review*, https://rfpt.independent-review.uk/.

35 Build on the UK's expertise in fintech to actively attract innovative companies and products by improving the authorization process, focusing on an activity-based regulatory approach, developing regulatory initiatives such as the FCA sandbox, and taking a lead in digital and crypto assets.

36 Build on and improve the EU's green taxonomy to create a more open, more flexible, and less prescriptive framework for domestic and international sustainable finance. This framework would be more likely to align with the approaches to environmental, social, and governance (ESG) analysis and investing in the United States and the Asian framework, and could form the basis for a broader global framework.

FINANCIAL SERVICES TAXATION

As one of the UK's most successful global industries, it is not surprising that banking and finance generates nearly 11 percent of total tax receipts in the UK—more than any other sector. Yet there are concerns that the UK banking and finance industry is overtaxed relative to other countries, reducing its competitiveness on the global stage.

The UK should ensure that the tax regime for banks, financial services, and the wider economy encourages investment (inward and domestic), drives innovation (with R&D incentives), incentivizes wealth creation, and does not put the UK financial services industry or international firms operating in the City at a clear, measurable, and practical competitive disadvantage.

In addition to corporation tax, UK banks pay a bank levy that is calculated based on the size of their assets in the UK and a corporation tax surcharge of 3 percent (which was recently reduced from 8 percent). As a significant employer with often well-paid staff, the industry makes a significant contribution through employment taxes such as income tax and national insurance. These taxes combined form a higher effective total tax rate for banks in the UK than in the United States or Germany, according to research by PwC,22 and could be a significant factor in decisions about future investment and location. In addition, the gap between the UK and its global competitors is forecasted to grow even after the reduction of the surcharge, which will further deteriorate the competitiveness of UK banks.

Another area of focus should be the complex tax framework around asset management and investment funds. For example, there are five different tax regimes applying to investment funds in the UK, and taxes on investment funds are higher than in other jurisdictions such as the Republic of Ireland and Luxembourg.

22 *2021 Total Tax Contribution*, PwC.

POOLS OF TALENT

A globally competitive and attractive banking and finance industry requires access to deep pools of talent and expertise. The UK needs to attract and enable access to international talent while simultaneously deepening its domestic talent pool.

Since Brexit, the UK has made it clear that it wants to remain an open economy, a champion of free trade, and one of the world's dominant international financial centers; at the same time, it wants more control over immigration. This requires a delicate balance between an immigration regime that gives the UK more control and one that is flexible enough to accommodate different sectors' needs such as highly skilled and higher-paid staff in finance and technology (and, for that matter, highly skilled but lower-paid staff in sectors such as healthcare and social services).

The points-based system introduced by the government was designed to attract the "brightest and the best" by setting a minimum salary requirement for specific roles with discounts for more qualified people. However, the current system can be improved to help address some of the challenges different sectors have faced after Brexit and throughout the coronavirus pandemic.

Recruiting and retaining talent

37 Simplify and improve the business and high-skills visa system, including:

- Speeding up business visa-processing times.
- Allowing international staff to work in the UK for longer without visas and simplify the process for long stays of up to six months, potentially under a hybrid visa for short-term business travel (as outlined in TheCityUK report on 'Global Talent Mobility' https://www.thecityuk.com/assets/2021/Reports/fa233ae25b/Global-talent-mobility-Ensuring-UK-competitiveness-v2.pdf)
- Extending graduate visas beyond two years to encourage more international talent to stay in the UK.
- Introducing a simpler visa-sponsor management system that provides more flexibility (particularly for smaller firms) to reassign and change visas.
- Embracing postpandemic hybrid working with a revised visa system for cross-border remote working.

38 Include reciprocal talent and immigration clauses in future free trade agreements to encourage labor mobility and help set new global standards and principles for

Graduates gather outside the Sheldonian Theatre after a graduation ceremony at Oxford University, in Oxford, Britain July 15, 2017. REUTERS/ Hannah McKay

visas and immigration for international talent. Explore the feasibility of a special bilateral visa deal between the United States and the UK for staff in financial services.

39 Address the disconnect between public statements about the Global Britain foreign policy and the often long queues and sometimes unfriendly reception at UK borders. This could involve developing a fast-track border system for frequent travelers and visa holders.

40 Nurture and develop a bigger pool of domestic talent by investing more in STEM education, reversing cuts in per capita education spending over the past fifteen years, widening financial literacy programs, continuing numeracy education for all pupils and students regardless of their specialism, and investing significantly more in early education (the biggest determinant of future attainment that also enables working parents to be more productive).

41 Encourage the industry to develop more collaboration with schools, particularly in more deprived areas to raise awareness among students of banking and finance and their career options, and to provide training and internships.

WIDER ECONOMIC AND BUSINESS ENVIRONMENT

The City of London and the international banking and finance industry do not exist in a vacuum. The wider economic and business environment is an important aspect of the competitiveness of the banking and finance industry and the attractiveness of a financial center. Issues such as the strong rule of law, high regulatory quality, human capital, high living standards as well as political, economic, and financial stability underpin a strong ecosystem around banking and finance and help the industry to flourish. While the UK has one of the best overall economic and business environments in the world, there are areas for improvement that will increase the competitiveness and attractiveness of the UK.

Enhancing the overall environment

42 Review the wider regulatory framework of company law, corporate taxation, and accounting to identify and reduce the practical barriers and obstacles for financial and professional services companies wanting to come to the UK.

43 Adopt a digital first approach across the wider framework including digital IDs for companies and individuals, and digital IDs for payments.

44 Establish a single access point for individuals and companies wanting to come to the UK, registering interest, providing all the information needed, and pointing to the relevant government departments. Create a dedicated arm for start-ups and growth companies, and simplify processes to make it easier for them to navigate through the different departments and requirements.

45 Explore the feasibility of building a "UK Edgar" platform like the US SEC's search tool that combines standardized company information and filings for listed and private companies. Such a platform could combine a regulatory news service with a beefed-up Companies House, the UK's companies registrar, including a centralized register of credit information for companies.

46 Identify and endeavor to address the areas where the UK falls below its international peers in measures of competitiveness as an international financial center, including poor transport infrastructure, poor air quality, the high cost of living and office space in London, and poor fiber-optic and mobile Internet connectivity.

INTERNATIONAL ALIGNMENT AND COOPERATION

In the post-Brexit world, the UK needs to strike the right balance between competitiveness, international alignment, and cooperation. On the one hand, the UK needs to increase the competitiveness of the banking and finance industry and to maintain and boost its role as a global financial center. On the other hand, the recent trends of deglobalization and geopolitical tensions have underlined the need for the UK to work closely with its allies to shape global standards and norms of behavior, and to help address common threats.

In this section we look at how the UK can build closer ties with the United States, the EU, and other countries around the world, and we assess some of the common challenges in global banking and finance that the UK can help address.

THE FUTURE RELATIONSHIP BETWEEN THE UK AND THE UNITED STATES

While the US and UK markets are already closely linked, there is scope for further engagement and further strengthening of this transatlantic relationship in banking and finance. In addition to the two countries' similar philosophy and approaches to markets, supervision, and regulation, there are other factors reinforcing the value of this close partnership: a shared history, common language, common foreign policy and security objectives, and the UK's geographic position.

The obvious differences in the regulatory and political structures and processes mean that neither side can legislate for a closer relationship: in the United States, the legal framework for banking and finance starts in Congress, whereas in the UK it starts in the Treasury, and the independence and accountability of supervisors and regulators in both markets is defined in law.

There are a number of areas where these allies can deepen their bilateral relationship and where they can work together more closely to project shared values, help shape global standards, and help address common threats on the global stage. Put bluntly, in areas where the United States and the UK work closely together, they will be able to define de facto global standards and shape the behavior of other markets.

People use an escalator during the morning rush hour from Canary Wharf underground station to the financial district of Canary Wharf amid the outbreak of the coronavirus disease (COVID-19) in London, Britain September 28, 2020. REUTERS/Toby Melville

Deepening the bilateral relationship

47 Work together to develop closer cooperation in markets where the United States and the UK already represent the majority of global activity between them such as derivatives, clearing, data, trading, fintech, and asset management. These sectors are inherently global and rely on common norms and principles.

48 The UK and the United States are more aligned philosophically on ESG and sustainable finance than either of them is with the EU. This provides an opportunity to work closely together to develop a more open and flexible ESG taxonomy that would build on existing initiatives on both sides of the Atlantic, bring together the huge pools of capital and financing expertise in the two nations, and provide an alternative global standard to the EU's taxonomy.

49 Explore the potential of launching an exchange and secondment program between US and UK supervisors, regulators, and other government staff, similar in style to the Rhodes Scholarship program for students.

50 Build on their existing FRWG to develop additional working groups in specific sectors to reduce barriers to trade and develop common positions in global supervisory and regulatory forums such as the Financial Stability Board, G20, and the International Organization of Securities Commissions (IOSCO).

51 Build on close defense and security cooperation to identify and address common economic and financial threats such as terrorist financing, money laundering, and cybersecurity, and potential financial threats from other countries such as China and Russia.

52 Establish a global alliance by expanding existing bilateral regulatory cooperation agreements to create a multilateral and informal forum between like-minded open economies such as Switzerland, Canada, Japan, South Korea, and Australia.

53 Address the ongoing asymmetry in market access in financial services between the United States and the UK. Understandably, there is more interest on the UK side; given that, the UK should demonstrate to the United States the changing nature of financial regulation, advocate on all fronts for stronger cooperation, explain the benefits, and highlight its commitment to reforms that would strike a balance between competitiveness and alignment with the United States.

THE FUTURE RELATIONSHIP BETWEEN THE UK AND THE REST OF THE WORLD

Post-Brexit, the UK has a once-in-a-generation opportunity to rethink and redefine its role in the global financial system, its relationship with the EU, and with the rest of the world. It is time for the UK to become more proactive and have a clear strategy on the sort of role it wants to play on the global stage and the sort of relationships it wants to develop in banking and finance with other countries.

After years of hard negotiations and often hostile rhetoric, the UK should focus on rebuilding its relationship with the EU at the political level and taking advantage of the already deep economic and financial ties, common history and shared values and interests with EU members. This would also enable supervisors and regulators in the UK and the EU to continue their good relationships and build on them.

From a global perspective, the UK should actively work with other countries to promote global standards, the benefits of global alignment for most sectors of banking and finance, and for responsible globalization. This would help address the rise of deglobalization, geopolitical tensions, supply chain disruptions, and competitive threats from rapidly growing markets.

The Global Britain policy provides an opportunity to develop closer bilateral relationships in banking and finance with markets around the world. The UK should be open to rapidly growing markets in Asia, strengthen existing relationships with countries that have a similar approach and philosophy, and form new partnerships with countries across the world. The government has already taken many initiatives on this front with like-minded countries around the world. It also has restarted the financial dialogue with China and has applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, but it should step up its efforts and take more initiatives.

Rebuilding its relationship with the EU

54 Set up a joint UK-EU financial regulatory committee to create MOUs and mirror existing arrangements with the United States and Japan. This would include separate working groups for each sector of banking and finance to improve regulatory coordination, sharing of expertise and best practices, and provide a dedicated mechanism for resolving disputes in banking and finance regulation.

55 Establish a more formal cooperation mechanism with the EU in areas of common interest and common threats such as ESG, fintech, cybersecurity, terrorist financing, and money laundering.

56 Offer supervisory, technical, and market expertise to the EU and to individual member states to help support the capital markets union initiative, an EU project to develop larger, more integrated capital markets.[23]

57 Seek to develop bilateral partnerships with individual EU countries and forums for dialogue with highly developed capital markets such as Sweden, the Netherlands, and Ireland, as well as with strategic partners such as France and Germany.

58 Continue to offer the Temporary Permissions Regime in the meantime,[24] to signal the UK's commitment to open markets and global cooperation and to build on the inherited EU-equivalence regimes to expand them and make them more dynamic and less politicized. At the same time, keep pushing to get equivalence from the EU in the areas the UK framework is and will remain equivalent, and focus the discussion on equivalence of outcomes.

Expanding and deepening relationships around the world

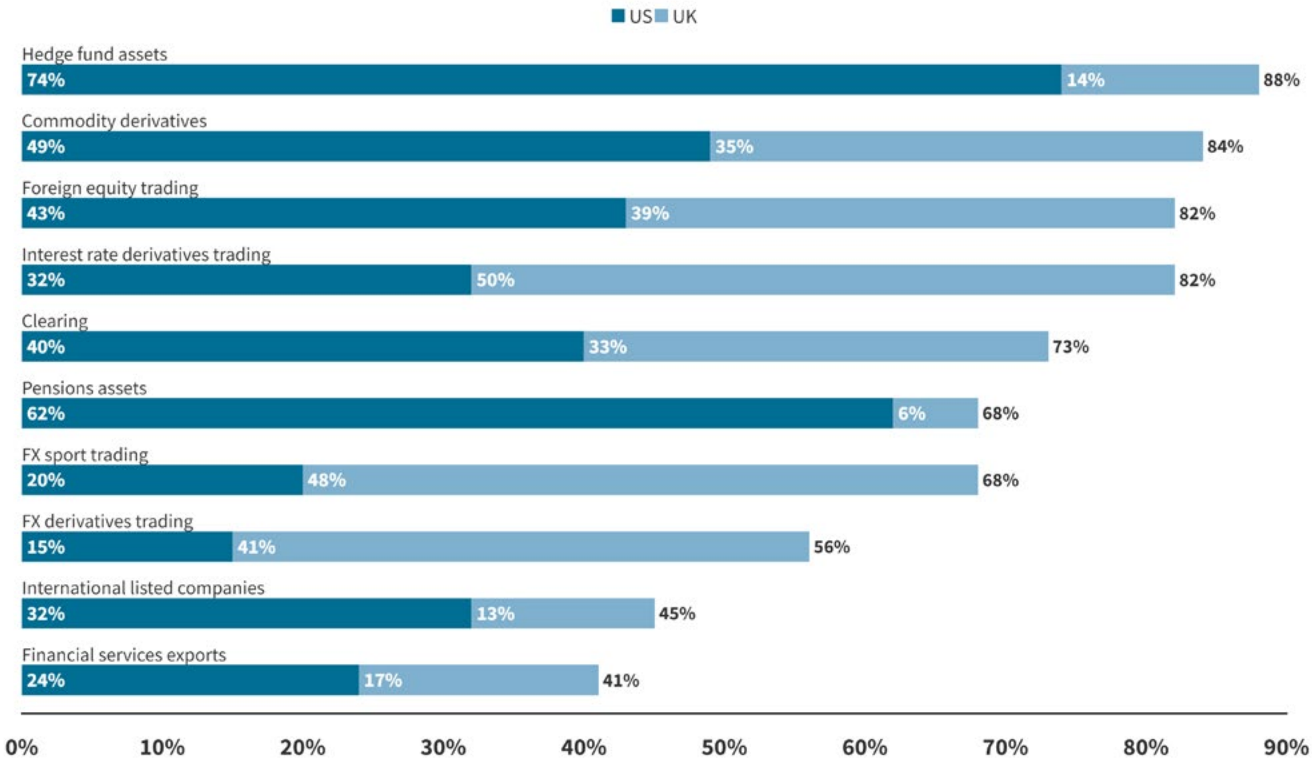
59 Strengthen financial diplomacy by beefing up expertise within UK embassies and increasing spending for financial and trade experts, trade

23 "Capital Markets Union 2020 Action Plan: A Capital Markets Union for People and Businesses," European Commission (website), Adopted September 24, 2020, https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan_en.

24 The FCA introduced the regime in 2019 to allow EU firms to continue to access the UK market for up to three years on the same basis that existed prior to Brexit.

US and UK Market Shares of Global Activity in Select Sectors

Sectors in which the US and UK are the largest and second largest markets



Source: New Financial

promotion, and roadshows in key markets in the United States, the EU, and Asia; by providing embassies and the international departments of supervisors and regulators with more resources and financial expertise; and developing a comprehensive financial regulatory diplomacy strategy.

60 Seek to deepen agreements and partnerships with non-EU countries that have a similar philosophy and open market approach such as Australia, Canada, Japan, and Singapore, perhaps by replicating its agreements with Switzerland or its free trade agreement with Australia that includes agreements on data.

61 Build on its existing strengths in several key areas to help shape new global standards through the Group of Seven, G20, Financial Stability Board, and IOSCO. For example, the UK should push for global alignment and standards in derivatives, actively promote the global delegation model for asset management, push for stronger cooperation on cybersecurity, and lead regulatory dialogues around fintech and open banking.

62 Help develop a global green taxonomy and ESG disclosures by creating a global standard for international issuers and corporations on sustainability-related disclosures to reduce the costs associated with compliance to different levels of disclosures across jurisdictions. For example, under the Corporate Sustainability Reporting Directive, a company has to make disclosures to list in an EU market even if it doesn't operate in the country. In addition, the UK is better positioned, compared with the EU, to drive the adoption of a set of principles on issues that are more related to the "S" and the "G" in ESG, such as modern slavery and diversity.

CONCLUSION

An enviable asset, the Banking and Finance Sector must be a key focus for any strategy for long-term economic prosperity and maintaining British influence in the world. The UK's financial markets continue to punch well above the country's economic weight but there are unmistakable indications that these advantages may wane. The high effective tax rate weighs on London's attractiveness, while a lack of strategy and direction has left the rest of the UK economy less well served in access to funding than it could or should be.

From taxation, to regulation, to accessing world-class talent there is much to do. For this reason, our report is unequivocal in calling for faster reform in three key areas: enabling domestic capital markets to better support the UK economy; striving for the international competitiveness of the UK as a financial hub; and embracing global cooperation and partnerships.

The "access" debate triggered by Brexit is over. The UK should take advantage of regulatory flexibility and set about creating a framework which is dynamic, agile, outcomes-based, and data-led. As the lines between financial services and information technology firms become more intertwined, the UK should seize the opportunity to take a global lead in these areas, from data sharing to digital IDs.

The new framework should enable the UK finance industry to better support the government's leveling up agenda to reduce inequalities among regions, and the transition to net-zero carbon emissions.

These steps will ensure London remains a hub for international finance which can deliver economic benefit both to the United Kingdom and the global economy.

The report was produced by New Financial in collaboration with the Atlantic Council GeoEconomics Center. The authors were Panagiotis Asimakopoulos, Christopher Breen, and William Wright.

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