

Speech: Chancellor's HSBC speech: financial services

It's great to be here in Canary Wharf, and I am grateful to HSBC for hosting me.

But I am conscious that holding this event in London risks feeding the prejudice that financial services is just a London business...

...when, in fact, of course it is a vibrant part of the economy across the length and breadth of Britain...

...with over two-thirds of financial services jobs outside London...

... and significant financial services hubs in Edinburgh, Leeds, Bristol, Belfast, Birmingham and Bournemouth, to name but a few.

On Friday, the Prime Minister set out the UK's vision for its future economic partnership with the European Union...

...in a speech which answered the call to set out "what we want"...

...while being clear that we understand this is a negotiation, where both sides will need to give and take.

As the PM said, our task, together with our European partners, is to deliver a Brexit that works...

...for the UK...

...and for the EU.

A partnership that protects supply chains and established trade relationships...

...that backs businesses, safeguards jobs...

...and promotes the shared European values that we all hold.

And the first step will be delivering on the Implementation Period which was agreed as a fundamental part of the deal on Withdrawal issues that we did in December...

...and which we expect to be formalised at the March European Council meeting.

This Implementation Period is essential if we – and by "we", I mean all of us, businesses and citizens, in all 28 countries – are to benefit from a smooth pathway to a future partnership between the UK and the EU.

Nowhere will this be more important than in Financial Services, where we must work together to avoid the potential risks to financial stability that could

arise if we faced a cliff-edge in March 2019.

But for the Implementation Period to deliver the smooth transition we all want to see, it needs to be effective.

That means our regulators working together so that businesses – especially regulated businesses – are able to plan on the basis of it.

Giving full and meaningful effect to what we agreed in December...

...delivering clarity and certainty to businesses and citizens across Europe.

The PM was clear in her speech that after we have left the EU, we'll be outside the Single Market and the Customs Union...

...but equally, we'll be free to cooperate closely with partners, including the EU, where it is in our mutual interest to do so.

Financial services is such an area where we can, and should, collaborate closely.

...recognising that a future economic partnership will always need to ensure a fair balance of the rights and obligations associated with market access.

Today I want to build on the vision the Prime Minister delivered on Friday.

I want to explain why it makes sense, for both the UK and the EU, that we continue to collaborate closely on cross-border financial services.

I want to challenge the assertion that Financial Services cannot be part of a free trade agreement...

...to set-out why it is in the interest of both the UK and the EU27 to ensure that EU businesses and citizens can continue to access the UK Financial Services hub...

...and how this is not a zero-sum game, where any loss of market share in London is automatically a gain to another EU Capital.

And I want to describe what a future financial services component of a comprehensive trade partnership agreement could look like.

The UK Financial Services hub is an engine that powers the real economy not just in the UK, but right across Europe...

Because the fact is that the UK financial services hub is not just a British asset...

...but a European asset too...

...supporting businesses, savers and citizens across the EU...

...serving the whole of our continent, as well as the world beyond.

And not just serving Europe...

...but powered by the talent of hundreds of thousands of Europeans who work in it.

And it is an asset unparalleled in its history, its scale, its complexity, its agility and its connectivity to the economies of Europe and the world.

A “global public good”, as the IMF described it.

EU passporting did not create the City of London.

...nor did some smart regulatory fix or government incentive.

It is a combination of intangibles: language, legal system, time zone, culture, networks, risk appetite, regulatory approach...

...all blending together to create an ecosystem...

...an immensely potent combination of factors...

...impossible to replicate...

...or perhaps even to map.

Of course, having such a significant financial services industry brings to the UK great benefits...

...but it is not cost free.

The UK economy bears the related risks and UK taxpayers stand behind those risks.

As we learned to our very real cost during the financial crisis...

...when those taxpayers provided support to financial sector firms to the tune of £136bn.

...and that is not a lesson we will forget.

So, even as a member of the EU, we have chosen to go higher and faster on regulatory standards at times to protect our taxpayers.

And because we understand the risks we are taking, our commitment to rigorous and robust regulation will remain undimmed...

...David Davis was right in Vienna when he said that Britain’s plan is for a race to the top in global standards.

And because those risks are so significant, it is vital that the citizens of any country bidding to take on a bigger share of Europe’s financial services market have a full and transparent understanding of them.

The deep pools of capital, specialist skill and regulatory competence in

London provide efficient, safe, and high quality services to the EU.

We manage EUR1.5 trillion of assets on behalf of EU clients;

Around two-thirds of debt and equity capital raised by EU corporates is facilitated by banks based in the UK.

78% of European Forex trading and 74% of European interest rate derivatives trading takes place in the UK. These are services that businesses rely on to run their operations efficiently, with the benefit passed on to consumers in all 28 EU countries.

And we should be under no illusion about the significant additional costs if this highly efficient market were to fragment.

Costs that would be borne by Europe's businesses and consumers...

...costs that industry bodies across Europe are beginning to recognise.

The consultancy, Oliver Wyman calculates that the wholesale banking industry would need to find USD 30–50bn of extra capital if new regulatory barriers forced fragmentation of firms' balance sheets.

And LSEG estimate that the EU's proposal on location of clearing houses, if implemented, would increase costs to EU27 firms by around \$25 billion a year...

...by fragmenting the market and losing the efficiency of "offsetting" between trades. Already evidence is emerging of market actors reassessing their commitment to Europe in the face of potential regulatory fragmentation.

For example, Intercontinental Exchange announced plans last month to launch daily gold futures contracts in the US next year, based on metal held in the UK.

Those who think that the major winners for any fragmentation of London's markets would be Paris or Frankfurt...

...Dublin or Luxembourg...

...should take note!

The real beneficiaries are more likely to be New York, Singapore, and Hong Kong...

...cutting Europe's market share.

And leaving Europe as a whole, less competitive...

...and more reliant on distant financial centres, operating under very different rules.

So it is time to address the sceptics who say a trade deal including financial services cannot be done because it has never been done before:

...to them I say: "every trade deal the EU has ever done has been unique".

The EU has never negotiated the same arrangement twice.

It has bespoke relationships with Turkey, Canada, Singapore, Korea.

Every FTA has varying degrees of market access depending on the countries involved...

...which is not surprising, given the different economies and the different interests reflected in those agreements.

In the last hour or so the EU has published its draft regulatory guidelines.

It is clear that a deal based wholly on precedent cannot deliver the depth and breadth of market access that these guidelines envisage.

Because any trade deal between the UK and the EU must start from the reality of today:

That our economies, including in Financial Services, are deeply interconnected;

That our regulatory frameworks are effectively identical;

That our supervisors and regulators work hand in glove to maintain the stability of our financial systems and have developed high levels of mutual trust;

And that our businesses and citizens depend on cross-border financial services trade in their day-to-day lives far more than most of them will ever know...

...when they buy a car...

...or take out a fixed rate loan...

...or hedge their fuel costs...

...or insure an aircraft.

The EU itself pursued ambitious financial services co-operation in its proposals for TTIP – which it described as a partnership that would be: "more than a traditional free trade agreement". And in its initial proposals for CETA.

We know because back then, British and French officials worked hand-in-hand on the proposals, with the Commission.

Both CETA and TTIP were intended to promote convergence between entirely separate markets... ...with different rules.

And low levels of interconnectedness.

We can do so much better...

...given our starting point..

At the time of the TTIP negotiations, people rightly argued that this was a challenging objective...

...but it need not be so in a partnership between the UK and the EU.

Our markets are already deeply interconnected.

If it could be done with Canada or the USA...

...it could certainly be done with the UK.

And there is another reason why it must be done:

A trade deal will only happen if it is fair and balances the interests of both sides.

Given the shape of the British economy, and our trade balance with the EU27, it is hard to see how any deal that did not include services could look like a fair and balanced settlement.

So I am clear not only that it IS possible to include Financial Services within a Trade Deal but that it is very much in our mutual interest to do so.

But in making that statement, I do not minimise the challenges.

I recognise that there will be many legitimate concerns...

...concerns about the policing of rules once we are separate legal jurisdictions...

...concerns about the legal framework for regulatory and supervisory cooperation...

...concerns about the implications for Financial Stability and for the operation of Eurozone monetary policy.

We stand ready to engage on all of these issues...

...and we have been giving a great deal of thought to how to address these concerns...

...to ensure that all our economies continue to benefit.

...rather than simply throwing in the towel and allowing the market to fragment...

...to everybody's cost.

I will set out our initial thoughts...

...but first, let me say a word or two about financial stability.

We have come a very long way since the autumn of 2008.

Working collaboratively across the EU and indeed, beyond with international partners...

...we have increased the capital requirements of our banks...

...we have tightened supervision of their operations ...

...and we have put in place resolution plans...

... to avoid contagion should the worst happen to an institution.

In the UK we have gone further and ring-fenced the retail banking operations of integrated groups from their wholesale market activities.

So the risk now to financial stability is not from continued close co-operation and integration...

...it is from the opposite: breaking up the intense co-operation that has developed between regulators across the EU and the UK.

Modern Europe is, quite literally, testament to the benefits of tearing down walls.

Let us not now propose new barriers where there need be none between our successfully collaborating financial services regulators.

So, building on the Prime Minister's speech last week...

...let us consider how we might structure a future partnership in financial services...

...in a world beyond the single market and passporting.

A partnership that enables the ongoing delivery of cross-border financial services in both directions...

...while protecting financial stability...

...and consumers, businesses, and taxpayers across the UK and EU.

In my Mansion House speech last June, I set out three principles for a future partnership in financial services:

A process for establishing regulatory requirements for cross-border trade between the UK and the EU; Cooperation arrangements that are reciprocal, reliable, and that prioritise financial stability; and

A legal framework that makes this structure durable and reliable for participants in the market and for businesses who use their services.

Today, I want to describe how the vision of the Prime Minister's speech could shape those principles into a framework that could be the basis of a future partnership in financial services...

...as part of a wide-ranging Free Trade Agreement.

We will start from a unique position...

...with full alignment on Day 1.

The challenge is what happens next.

So the way forward must surely be to bank our Day 1 defacto equivalence.

...and shape a regime to manage future regulatory change that ensures that...

...while our rule systems may evolve separately...

...we deliver fully equivalent regulatory outcomes...

...maintaining commitments to support open-markets and fair competition.

As these rules systems for financial services evolve, the United Kingdom cannot simply be an automatic 'rule taker'.

Let me explain why.

We have invested heavily in the current rulebook, and our industry is structured around it.

And we hope that from Day 1, good sense, sound economics, and a commitment to mutual benefit will be the guiding principle of future rulemaking on both sides...

...often within the framework of internationally agreed regulatory standards.

But, because of the size of the UK's financial services market...

...around 10 times our GDP...

...and the complexity of the products traded on it...

...and the consequent risks our taxpayers bear...

...we cannot sign up to automatically accept as-yet-unknown future rule changes.

We must have the ability, if necessary, to deliver an equivalent outcome by different means...

...maintaining our commitment to ensure access to each other's markets is on fair and non-discriminatory terms.

...while protecting UK taxpayers from potentially unacceptable risks.

At first glance, this may appear to point to a solution based on the EU's established third-country equivalence regime.

But that regime would be wholly inadequate for the scale and complexity of UK-EU financial services trade.

It was never meant to carry such a load.

The EU regime is unilateral and access can be withdrawn with little to no notice.

Clearly not a platform on which to base a multi-trillion pound trade relationship.

But the principle of mutual recognition and reciprocal regulatory equivalence, provided it is objectively assessed, with proper governance structures, dispute resolution mechanisms, and sensible notice periods to market participants clearly could provide an effective basis for such a partnership.

And although we will be separate jurisdictions, we would need to maintain a structured regulatory dialogue to discuss new rules proposed by either side...

...building on our current unparalleled regulatory relationships...

...to ensure we deliver equivalent regulatory outcomes...

...agreeing mutually acceptable rule-changes where possible.

And where rules do evolve differently we will need an objective process to determine whether they provide sufficiently equivalent regulatory outcomes...

...including not only the rules themselves, but also an assessment of the way in which they are enforced...

...drawing on international standards where they exist, or on additional principles for equivalence where the UK and EU have more developed rules.

Second, there would need to be continued close supervisory co-operation.

The EU itself noted in the context of TTIP discussions that "in too many instances, international standards have been implemented in a way that does not allow...the relevant regulators and supervisors to work together"...

...weakening the resilience of financial markets.

We must not risk exacerbating that tendency.

While the UK would cease to be a part of the EU's supervisory agencies, there is no reason why we could not maintain a very close working relationship.

Indeed it would be an essential part of supporting the regulatory equivalence that I have described...

...for instance, through proactive and extensive information exchange...

...authorised by the data-sharing agreements within the overarching FTA...

...going far beyond what is available in ordinary third-country relationships.

It could cover market abuse, transaction reporting, and stability monitoring, as well as prudential concerns about individual firms...

...and it could involve a version of today's college structures, covering both day-to-day supervision and resolution in crisis.

Of course how each party organises its internal governance would be a matter for it.

Neither party would have a role in the other's governance processes.

But we should be able to build on the extraordinary level of supervisory collaboration and trust that already exists between the EU and UK authorities...

...to establish the most comprehensive supervisory cooperation arrangements anywhere in the world...

...protecting our respective financial systems and our taxpayers from instability risks.

We recognise, also, that the supervision of major clearing houses conducting euro-denominated activity is a particularly important and sensitive subject for our EU partners...

...and we stand ready to discuss a mutually satisfactory way forward in this area.

The supervisory cooperation that I have described does not involve either party transferring any responsibility for its rules or ceding any sovereignty.

And that leads me to the third principle.

As the PM said on Friday, in certain circumstances we may choose not to maintain equivalent outcomes but we will know there may be consequences...

...we would have to address how this future partnership would work in such circumstances...

...with clear institutional processes to do so.

Our concern in a financial services partnership would be to ensure that any such consequences were reasonable and proportionate...

...applied in a predictable way that allows industry to plan with confidence...

...and that they were delivered through an independent arbitration mechanism

that has the confidence of both parties.

Such mechanisms already exist within FTAs, including CETA.

The Prime Minister was clear on Friday that we have decided to leave the EU..

...and we accept that there will be consequences.

We do not expect the same relationship we have today across all areas of activity in financial services...

...trade-offs should be expected...

...and the industry will change.

But we should ensure that the future partnership strengthens European stability and prosperity...

...rather than weakening it.

The ideas I have set out today suggest a way to move forward...

...to shape a potential partnership in Financial Services...

...based on the core concept of fair and non-discriminatory competition...

...recognising legitimate concerns where they exist...

...but drawing a distinction between those concerns, and protectionism or political expediency which would undermine that competition.

What I have set out today is a possible route to a future partnership grounded in logic, pragmatism, and compromise...

...a partnership that would protect Europe's financial stability and underpin one of its great competitive advantages.

And I look forward to constructive engagement with our friends and partners in the EU to take these ideas forward.

Thank you.