Brexit and financial services in Scotland

19 June 2020

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The size and shape of Scotland's financial services sector

Scotland is the UK's largest financial centre outside of the City of London. TheCityUK estimates that financial and related professional services account for 9.4% of the Scottish economy. Scotland’s strengths lie in banking, life assurance and pensions. It also has a large asset management sector and is emerging as a leading hub in Fintech.

Employment in financial services

Edinburgh and Glasgow are the major Scottish centres, employing collectively around 62,000 people in financial services, insurance and auxiliary activities (see table 1). Edinburgh has a long reputation for providing banking services, life insurance and investment management. The Royal Bank of Scotland and Scottish Widows have their global headquarters in Edinburgh. Glasgow on the other hand, specialises in finance and asset administration activities. CYBG, which owns Clydesdale Bank, Virgin Money and Yorkshire Bank has its European Headquarters in Glasgow.

Financial centres are ranked annually through the Global Financial Centre Index. The ranking is based on a number measures of financial centre competitiveness including the strength of the local labour market and the regulatory and legal environment. In the 2020 index, Edinburgh rose 12 places and now finds itself in the Top 20 with its ranking of 17. It is categorised within the report as an ‘Established International’ financial centre. This puts it in the second tier below ‘Established Global’ financial centres such as New York, London and Tokyo and on a par with San Francisco, Melbourne and Munich. Glasgow rose 5 places and is currently ranked 65th on the index.
Table 1: Financial Services Employment in Scotland (April 2019) by financial services activity and local authority

<table>
<thead>
<tr>
<th>Local Authority: county / unitary (as of April 2019)</th>
<th>64 : Financial service activities, except insurance and pension funding</th>
<th>65 : Insurance, reinsurance and pension funding, except compulsory social security</th>
<th>66 : Activities auxiliary to financial services and insurance activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Edinburgh</td>
<td>18,000</td>
<td>9,000</td>
<td>10,000</td>
<td>37,000</td>
</tr>
<tr>
<td>Glasgow City</td>
<td>11,000</td>
<td>2,500</td>
<td>11,000</td>
<td>24,500</td>
</tr>
<tr>
<td>Fife</td>
<td>2,500</td>
<td>150</td>
<td>400</td>
<td>3,050</td>
</tr>
<tr>
<td>South Lanarkshire</td>
<td>2,500</td>
<td>0</td>
<td>400</td>
<td>2,900</td>
</tr>
<tr>
<td>Stirling</td>
<td>225</td>
<td>1,500</td>
<td>600</td>
<td>2,325</td>
</tr>
<tr>
<td>West Dunbartonshire</td>
<td>2,000</td>
<td>0</td>
<td>125</td>
<td>2,125</td>
</tr>
<tr>
<td>Perth and Kinross</td>
<td>225</td>
<td>20</td>
<td>1,500</td>
<td>1,745</td>
</tr>
<tr>
<td>Aberdeen City</td>
<td>600</td>
<td>10</td>
<td>800</td>
<td>1,410</td>
</tr>
</tbody>
</table>

Source: NOMIS Business Register and Employment Survey

Beyond Edinburgh and Glasgow, West Dunbartonshire, Stirling and Inverclyde also have important financial services labour markets (see table 2). In the case of West Dunbartonshire, it is even more concentrated than Glasgow. However, Edinburgh stands out as the most significant centre for financial services activity within Scotland. Only the City of London and Tower Hamlets have a higher proportion of their workforce dedicated to financial services in the UK (see table 3).

Table 2: Financial Services as Proportion of Total Employment (%)

<table>
<thead>
<tr>
<th>Local Authority: county / unitary (as of April 2019)</th>
<th>64 : Financial service activities, except insurance and pension funding</th>
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<th>66 : Activities auxiliary to financial services and insurance activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Edinburgh</td>
<td>5.2</td>
<td>2.6</td>
<td>2.9</td>
<td>10.7</td>
</tr>
<tr>
<td>West Dunbartonshire</td>
<td>6.5</td>
<td>0.0</td>
<td>0.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Glasgow City</td>
<td>2.7</td>
<td>0.6</td>
<td>2.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Stirling</td>
<td>0.5</td>
<td>3.3</td>
<td>1.3</td>
<td>5.1</td>
</tr>
<tr>
<td>Inverclyde</td>
<td>3.3</td>
<td>0.2</td>
<td>0.9</td>
<td>4.4</td>
</tr>
<tr>
<td>Perth and Kinross</td>
<td>0.4</td>
<td>0.0</td>
<td>2.3</td>
<td>2.7</td>
</tr>
<tr>
<td>South Lanarkshire</td>
<td>2.2</td>
<td>0.0</td>
<td>0.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Fife</td>
<td>1.9</td>
<td>0.1</td>
<td>0.3</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: NOMIS Business Register and Employment Survey
Table 3: Local Authorities in Scotland with the highest concentration of financial services employment (%)

<table>
<thead>
<tr>
<th>Local Authority: county / unitary (as of April 2019)</th>
<th>64: Financial service activities, except insurance and pension funding</th>
<th>65: Insurance, reinsurance and pension funding, except compulsory social security</th>
<th>66: Activities auxiliary to financial services and insurance activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of London</td>
<td>16.0</td>
<td>3.0</td>
<td>16.0</td>
<td>35.0</td>
</tr>
<tr>
<td>Tower Hamlets</td>
<td>16.1</td>
<td>0.2</td>
<td>6.4</td>
<td>22.7</td>
</tr>
<tr>
<td>City of Edinburgh</td>
<td>5.2</td>
<td>2.6</td>
<td>2.9</td>
<td>10.7</td>
</tr>
<tr>
<td>Swindon</td>
<td>6.0</td>
<td>1.7</td>
<td>1.3</td>
<td>9.0</td>
</tr>
<tr>
<td>Calderdale</td>
<td>5.5</td>
<td>1.7</td>
<td>1.0</td>
<td>8.2</td>
</tr>
<tr>
<td>West Dunbartonshire</td>
<td>6.5</td>
<td>0.0</td>
<td>0.4</td>
<td>6.9</td>
</tr>
</tbody>
</table>

Financial services exports

Some financial services, like high street banking are not traded internationally. However, others are. This includes services such as private banking where a customer in Italy chooses to use the services of a private bank based in Edinburgh for example. Currently these exports can be undertaken as part of the UK’s membership of the single market which means that a bank can use a passport to serve customers in any other member state.

The single market also makes it easier to set up branches in other member states than is typical within free trade agreements. Once a bank or financial services firm is established and authorised in one member state, it can apply for to open branches in other member states with relatively little additional regulatory clearances required through a process called passporting.

Scottish based financial services firms have taken advantage of both of these ways of exporting into the EU. As chart 1 shows, financial and insurance activities were the largest source of exports in 2017, the latest full year for which this data is available. This was followed by professional, scientific and technical activities which includes legal services. This is important to note when considering Brexit and financial services because there are very close working relationship between financial and legal services in the delivery of wholesale financial products.

More of Scotland’s financial services were exported to the rest of the world than to the EU in 2017. However, financial services still represented the most important component of Scotland’s exports to the EU which shows how the EU is a more important export market for financial services than would be expected for the size of its economy compared to the rest of the World (see chart 2).
Chart 1: Scotland Service Exports by Industry (£ millions)

Financial and insurance activities: 6,271
Professional, scientific and technical activities: 3,561
Transportation and storage: 2,417
Manufacturing: 2,112
Other services: 1,855
Administrative and support service activities: 1,691
Accommodation and food service activities: 1,642
Information and communication: 1,043
Primary and utilities: 875
Retail (excluding motor trades): 189
Wholesale and motor trades: 126
Construction: 82
Real estate activities: 24

Source: ONS

Chart 2: Scottish Service Exports by Industry and Destination

Financial and insurance activities: 17.8% (EU) 10.8% (Rest of World)
Professional, scientific and technical activities: 8.3% (EU) 6.0% (Rest of World)
Manufacturing: 5.5% (EU) 4.3% (Rest of World)
Transportation and storage: 6.9% (EU)
Accommodation and food service activities: 3.9% (EU) 3.6% (Rest of World)
Administrative and support service activities: 4.3% (EU) 3.4% (Rest of World)
Other services: 5.3% (EU) 3.2% (Rest of World)
Information and communication: 3.1% (EU)
Retail (excluding motor trades): 0.3% (EU) 0.6% (Rest of World)
Primary and utilities: 3.5% (EU)
Wholesale and motor trades: 0.1% (EU) 0.2% (Rest of World)
Construction: 0.9% (EU) 0.2% (Rest of World)
Real estate activities: 0.1% (EU) 0.0% (Rest of World)

Source: ONS
Financial Services in Scotland

Scotland, and Edinburgh in particular has a long history in financial services dating back at least as far as the opening of the Bank of Scotland in 1695. Edinburgh also played an important part in the development of life insurance providing cover for soldiers during the Napoleonic Wars. This history has grown into a diverse set of activities.

Banking

Scotland is home to the headquarters of a number banks including The Royal Bank of Scotland, Clydesdale Bank, Tesco Bank, Virgin Money and The Bank of Scotland (part of Lloyds Banking Group). Many other UK and international banks have sizeable operations in Scotland, including HSBC and Barclays. Some of the services provided by these banks will be sold to domestic clients in Scotland and the rest of the UK and hence not effected by any additional non-tariff barriers at the end of the transition period. However, those that are exported will be.

Fund Management

Fund Management in Scotland is made up of both large institutional companies and smaller bespoke firms that provide investment services to institutional and personal clients around the world. Scotland Financial Enterprise estimates that funds under management in Scotland stand at over £800 billion or 8% of the total funds managed in the UK. Some of the major asset management providers based in Edinburgh include Aberdeen Asset Management, Baillie Gifford, Kames Capital, Blackrock and Standard Life Investments. Within the asset servicing side are HSBC, Citi Group, BNY and State Street.

The largest proportion of asset management-related jobs in Scotland relate to operations, fund administration and corporate finance. Around 7,500 people are employed directly in asset management in Scotland. Asset servicing is a key growth area in Scotland's financial services industry and Scotland is now a leading European centre for asset servicing offering a comprehensive range of services, including; custody, securities servicing, investment accounting, performance measurement, trustee administration, shareholder services, compliance, client management and retail fund administration.

Insurance, Life Assurance and Pensions

Scotland has a long history and strong international reputation in general insurance, life assurance and the pensions. Life insurance is particularly important, accounting for 24% of the UK’s employment in this sector. Notable life insurance companies in Scotland include Standard Life, Scottish Widows based in Edinburgh and Scottish Friendly, which is based in Glasgow. This focus on insurance in Scotland is important in the context of Brexit because insurance is typically more domestically focused and less reliant on EU exports than other parts of the financial services sector.
Fintech

Fintech Scotland counts 120 Fintech companies in Scotland and reports a rapidly growing sector. There is a strong enabling environment for Fintech. This is particularly true in Edinburgh, where the concentration of financial services, universities and public policy bodies is enabling the inter-firm linkages needed to design products for the market. Notable Fintech companies in Edinburgh include The ID Co., Money Dashboard, Nucleus, Float, FreeAgent, Zonefox, Symphonic Software, Wallet Services, The Lending Crowd and Payfont. There are also Fintech companies in Glasgow, Aberdeen, Stirling, Dundee and Perth.

Edinburgh has a higher concentration of Fintech jobs than in London. The fintech sector is a diverse blend of startups, global corporations, universities and the public sector. Deloitte summarised this in their assessment of Fintech hubs stating that:

Edinburgh has all the component parts to enable a thriving FinTech ecosystem and in an area roughly of one square mile across the city centre, one can access major Financial Services organisations, deeply experienced technologists, highly intelligent and practical academics and secure early stage funding. There are not many other cities that have an ecosystem concentration like Edinburgh!\(^1\)

The fintech sector is particularly reliant on EU nationals for labour. The salary threshold proposed by the government of £25,600 for migrants entering the UK, lower in the case of those holding PhDs – is unlikely to pose a significant barrier to entry for this sector under the government’s proposed post-Brexit migration regime that it intends to implement once freedom of movement ends. However, employers will still have to go through the bureaucracy of applying for visas and there will be significant extra costs to pay that do not apply now to EEA nationals coming to work in the UK.

Financial services in Edinburgh

Financial services are a significant part of Edinburgh’s economy. Indeed, outside of the City of London and Tower Hamlets, the City of Edinburgh has the highest concentration of financial service employment in the United Kingdom. Table 2 takes a conservative estimate of the proportion of people employed in financial services in Edinburgh and estimates that 10.7 percent or 37,000 employees work in the sector. Broader estimates of the number of people employed in financial services in Edinburgh put the figure close to 50,000 and contributing 25.2% in GVA to the economy of Edinburgh. Outside of London, Edinburgh has the UK’s largest centre for banking and is a major international location for fund management; and Glasgow and Edinburgh are the biggest insurance centres.

\(^1\) Deloitte: A tale of 44 cities Connecting Global FinTech: Interim Hub Review 2017
Financial services are the main service export Edinburgh accounting for close to half of all service exports (see chart 4). They are almost five times larger than Information and communication services, which is the next largest discreet category of service exports. Edinburgh remains a significant market for life assurance with one quarter of the UK’s life assurance employees based there. It’s the chosen headquarters for major financial institutions, such as the Royal Bank of Scotland Group, Standard Life and Scottish Widows. Multinationals also have a large presence in the city including JP Morgan Chase, BlackRock, HSBC, and The Bank of New York Mellon.
Brexit and financial services in Scotland

Full details of how different outcomes to the UK-EU trade negotiations may impact the financial services sector more generally can be found in our report Services and Brexit and in evidence previously submitted to the Committee.

Like financial services in the rest of Scotland, Edinburgh exports a higher value to the rest of the world than it does to the EU. This suggests that as a financial hub it may be less exposed to leaving the single market than London is. However, there are close interlinkages between different parts of financial services so any disruption in one area can impact other parts in terms of the attractiveness of Edinburgh as a financial centre.

It is important to note that because the EU’s single market goes further in supporting financial services trade than is common in free trade agreements, the ability to export from Scotland to the EU will most likely change with or without a trade agreement in place.

In the face of this uncertainty, some financial institutions in Scotland, in common with those in the UK have begun to initiate their Brexit plans by moving assets, and or employees, to European hubs including Amsterdam, Paris, Frankfurt, Dublin, Frankfurt and Luxembourg. They are doing this to maintain single market access when passporting rights end at the end of the transition period.

It is hard to provide definitive figures on this but below are some notable examples
1. Scottish Widows transferred its European portfolio to a new legal entity in Luxembourg called Scottish Widows Europe in March 2019. Policies mainly sold in Germany, Austria, Italy and Luxembourg under the Clerical Medical Brand which were sold through Scottish Widows’ European branch and broker networks were transferred which shows that Scotland's strengths in insurance have made corporate strategy changes in light of Brexit.

2. Standard Life Aberdeen has opened a portfolio management and distribution service in Dublin to service clients in the EU 27. This can be understood as a response to the end of passporting and the end of single market access that will bring for financial firms. Opening within the EU27 makes sense in terms of maintaining that market access. They have also expanded the size of their Luxembourg office.

3. Royal Bank of Scotland began operating a banking entity in the Netherlands, based in Amsterdam in March 2019. They are using this to serve from of their non UK EEA customers. They use this as a base for a network of branches (in London, Dublin, Frankfurt, Madrid, Milan, Paris and Stockholm). They have also established Natwest Bank Branch in Frankfurt to support Euro Payments and Euro Liquidity through the Bundesbank.

Summary

Scotland, and Edinburgh and Glasgow are significant financial services hubs. Their strength is reflected in the proportion of people employed in these sectors and in their strong export markets.

Access to EU labour, that is particularly important in some parts of financial services like fintech and EU export markets will change with or without a deal at the end of the transition period.

There is some evidence that because of Scotland’s strengths in insurance, it may be less exposed to the end of transition than London’s financial centre.

However, financial services are best thought of as an ecology and any potential risks to one part can have knock on consequences in other areas, particularly given the uncertainty surrounding what the UK’s future trading relationship with the EU will be.

In the face of this uncertainty, some high profile Scottish financial firms, including in insurance, have begun to move parts of their operations to other financial hubs within the EU.