

Retail and Corporate Banking Sector Report

1. This is a report for the House of Commons Committee on Exiting the European Union following the motion passed at the Opposition Day debate on 1 November, which called on the Government to provide the Committee with impact assessments arising from the sectoral analysis it has conducted with regards to the list of 58 sectors referred to in the answer of 26 June 2017 to Question 239.
2. As the Government has already made clear, it is not the case that 58 sectoral impact assessments exist. The Government's sectoral analysis is a wide mix of qualitative and quantitative analysis contained in a range of documents developed at different times since the referendum. This report brings together information about the sector in a way that is accessible and informative. Some reports aggregate some sectors in order to either avoid repetition of information or because of the strong interlinkages between some of these sectors.
3. This report covers: a description of the sector, the current EU regulatory regime, existing frameworks for how trade is facilitated between countries in this sector, and sector views. It does not contain commercially-, market- or negotiation-sensitive information.

Description of sector

1. The views in this section do not represent a Government position. Their inclusion should not be taken to imply any endorsement or otherwise by the Government of those views.
2. The banking sector provides essential day-to-day services to individuals, households and corporates, covering deposit-taking as well as finance and lending to consumers and businesses.
3. This subsector has a close interrelation with the broader wholesale capital markets sector – of which banking activity forms a key component – although capital markets are considered in a separate report. It also interconnects with the provision of payment services, which is similarly covered in more detail in a separate report.
4. For the purpose of this analysis, banking is split into three functions:
 - Retail banking – individual/consumer deposit taking and lending;
 - Business/Corporate banking – including lending and other banking services offered to large businesses; and

- Investment (or wholesale) banking – markets activity and other ancillary services.
5. This paper looks at the first two of these, and the Wholesale Capital Markets paper covers the third. This paper broadly covers the following activities:
 - Provision of banking services – including the ability to open/operate a bank account;
 - Deposit taking – holding money on behalf of consumers and businesses;
 - Lending to individuals – activities such as credit cards or mortgage lending;
 - Commercial lending – such as commercial property or a small business loan; and
 - Business/corporate banking, providing retail type services to large business clients including financing, trade and cash management/payment services.
 6. According to Oliver Wyman, the retail and corporate banking subsector accounts for up to £67bn and £39bn in annual revenue and annual GVA respectively, contributing £19bn in UK tax revenue and employs approximately 470,000 staff, across domestic, European and global activity.¹ The ONS is not able to separate out the retail and corporate banking sector's gross value added to the economy, as considerable commercial and investment activity is provided by non-banks that operate in the same market.
 7. Most firms have headquarters based in London, but banks and banking services are found all over the UK, largely in proportion to population density. In 2014, the industry estimated that it employed around 416,000 people in the UK (around 1.4% of the UK's total). Of these, around 70% were employed in retail and corporate banking.
 8. Breaking down the approximate split of all banking employment across the UK, 35% of banking employment were in London, 84% in England, 10% in Scotland, 3% in Wales and 3% in Northern Ireland.² As well as direct employment, there are many jobs that are indirectly related to banking through the provision of ancillary legal, accounting and professional services.
 9. The banking sector as a whole made up almost 5% of UK gross value added in 2014. Around 40% of this is generated by foreign banks.³

¹ ['The Impact of the UK's Exit from the EU on the UK-based Financial Services Sector'](#), Oliver Wyman, 2016.

² ONS, 2014 and Oliver Wyman proprietary data and analysis, 2013 in *Winning the Global Race: The Competitiveness of the UK as a centre for international banking*, BBA, 2015

³ BBA, *Winning the Global Race*, 2015

Retail banking

10. Retail banking is of importance to consumers and businesses and to the UK economy as a whole through the provision of credit, deposit taking, and associated services. 97% of adults have a personal current account; that product alone generated revenues of approximately £8.7 billion in 2014.⁴ There are 11.1 million mortgages outstanding in the UK, worth around £1.3 trillion⁵. The UK retail market is currently very concentrated: for example, five firms alone account for 60% of all outstanding mortgages.⁶
11. The macroeconomic environment, regulatory interventions (including structural changes to major banks and improvements in their stability), as well as the development of new business models and advances in technology, mean that the UK retail banking landscape has seen substantial change over the last 15 years. It is a resilient sector, and profits have been recovering since the financial crisis in 2008. Future prospects remain linked to the overall performance of the economy.
12. The majority of the UK retail sector is made up of banks and building societies.⁷ Most of these operate 'simple' business models which focus almost entirely on retail banking and business lending within the UK. For example, the vast majority of UK mortgage lending is done by domestic financial institutions.⁸
13. Local knowledge, country-specific rules and competition within Member States still limits the levels of cross-border EU activity in retail lending. A small number of EU-headquartered banks offer certain limited retail services in the UK on a branch basis, typically servicing expat communities.
14. However, the UK's largest banking groups are universal banks, offering retail services alongside full corporate and investment banking operations.

Corporate banking

15. In contrast to retail banking, there is a higher proportion of cross-border activity in corporate banking. The corporate and business banking services of UK-based banks are similar to those provided to retail clients and include deposit taking, credit facilities and payment services. This includes the use of UK banks by large corporates across the EU

⁴ 'CMA final report', August 2016

⁵ 'Council of Mortgage Lenders press release', January 2017

⁶ Bank of England – Bankstats – 2015; Council of Mortgage Lenders - [Lending by CML members 2015](#)

⁷ Building societies are a relatively uncommon structure outside the UK, existing in e.g. Australia and New Zealand, but not across the EU, where different models prevail. The UK also has around 500 credit unions offering deposit-taking, savings and lending to their members.

⁸ See: <https://www.cml.org.uk/news/news-and-views/largest-mortgage-lenders-2016/>

as the gateway to accessing finance – e.g. to help facilitate the issuance of securities for a client or to help a client access non-bank lending. A number of EU-headquartered banks also operate cross-border in the UK for their corporate banking operations, for example to access multinational businesses based in the UK or to pursue growth beyond their home market.

The current EU regulatory regime

16. There is a series of EU regulatory measures that deal with banking as a whole. The most significant of these is the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR).
17. CRD IV and CRR together provide that a bank authorised in one member state may establish a branch in another Member State or provide services remotely there, subject solely to its home state authorisation. The conditions necessary to make such mutual recognition feasible are detailed harmonised rules across the EU covering the safety and soundness of banks. CRD IV/CRR sets out 15 services which banks authorised in one Member State may provide under the passport. These cover most traditional banking activity: deposits; lending; finance leasing; payment services; other means of payment (e.g. travellers' cheques); guarantees and commitments; trading in certain instruments on own account or of customers; participation in and service provision for securities issues; advice to corporates on structure, strategy and mergers/acquisitions; money broking; portfolio management and advice; safekeeping and administration of securities; credit referencing; safe custody; and issuing electronic money. Banks may also provide investment services under their CRD IV authorisation, but are subject to the investment services rules contained in MiFID II.
18. Any authorised bank in the EU or the EEA is able to provide the above services across the EU/EEA either by establishing a branch, or remotely on a services basis. Many international banks choose to establish authorised subsidiaries in the UK, and then offer their services across the EU.
19. Other relevant EU legislation includes the Bank Recovery and Resolution Directive, which sets rules on how to resolve a bank, and the Deposit Guarantee Scheme Directive, which legislates to ensure that individual depositors are protected in the event of bank failure.
20. There are also a number of pieces of EU legislation focused on retail financial services offered by banks such as:
 - Payment Services Directive II - Setting out rules on the provision of payment services by banks, e-money issuers, and payment institutions;

- Consumer Credit Directive – Setting rules on the provision of consumer lending;
- Mortgage Credit Directive – Setting rules on the provision of mortgage lending;
- Payment Accounts Directive – Setting rules regarding switching between payment accounts, the comparability of fees and providing a right to a basic bank account;
- Interchange Fee Regulation – Capping card fees;
- MiFID II / MiFIR - Setting out rules on the provision of investment services for banks and investment firms; and
- Distance Marketing Directive - Minimum standards of disclosure and cancellation rights.

21. EU prudential, resolution and depositor rules are derived closely from international standards set by the Basel Committee on Banking Supervision and the Financial Stability Board (FSB), in which the UK has been an active participant. By contrast, issues relating to market structure, transparency and conduct are largely developed at the EU level. The EU has generally followed these international standards closely. Even in areas where the FSB has not set standards (e.g. consumer or mortgage credit), the EU has taken into consideration the FSB's analysis.

22. The UK has been a strong advocate internationally of robust capital standards for banks, and negotiated for flexibility within CRD IV to impose additional requirements on UK banks for macroprudential purposes. The UK is also implementing a domestic policy of ring-fencing retail banking from other banking activities.

Third country equivalence

23. CRD IV does not harmonise access to the EU for third country banks. The conditions, under which banks that are not headquartered in the EU or EEA may operate within the EEA, whether by establishing an authorised branch or a subsidiary, depend on the domestic law of each member state. EU law does, however, prevent a Member State offering a third country firm better access or better conditions for access than a firm from another Member State.

24. A branch is not a separate legal person. Therefore where a third country branch is authorised to operate in an EU Member State it does not enjoy passporting rights. A bank would therefore have to seek authorisation from every Member State in which it seeks to operate. The rules on third country branches are not harmonised in CRD IV either, so each branch would be subject to domestic requirements of that Member State. Conversely, a subsidiary of a third country bank is a legal person in its own right and so

may establish a branch or provide services under the EU's passporting regime, but is required to hold regulatory capital in accordance with CRD IV.

25. Rules designed to promote the effective mitigation of financial stability risk make it very difficult to set up a pure 'brass plate' operation in an EU Member State, under which the EU entity, for example, marketed its services to clients, formally routing the actual delivery through its marketing arm, but in reality upstreaming the service to the third country bank, which provided all the risk management. The EU bank will instead need to establish itself substantially in that country; to establish senior personnel with a relationship with the local regulator; and to ring-fence capital and liquidity.
26. Further, the rules that apply to the third country banks are also determined in part by whether the EU assesses that country's supervisory regime to be 'equivalent'. If the EU does consider that the third country's regime is equivalent (as it does with the US), then a third country conglomerate, will not have to restructure its EU operations so as to enable supplementary supervision. A finding of equivalence will also determine whether EU credit institutions may treat certain exposures to third country credit institutions in the same way as exposures to EU credit institutions.
27. The equivalence regime under CRR/CRD IV – unlike that of MiFID II – does not allow third country banks direct market access for banking services to EU clients. As such, third country equivalence would not support continued cross-border banking activity between the UK and EU. For investment banking services, MiFID II and CRR/CRD IV, activities are frequently combined and so the limitations of equivalence mean it cannot provide a mechanism by which mutual market access is maintained. The European Commission has said that the purpose of its equivalence regimes is not to open up international trade in financial services.⁹

Existing frameworks for how trade is facilitated between countries in this sector

28. The arrangements described in this section are examples of existing arrangements between countries. They should not be taken to represent the options being considered by the Government for the future economic relationship between the UK and the EU. The Government has been clear that it is seeking pragmatic and innovative solutions to issues related to the future deep and special partnership that we want with the EU.

⁹ See: https://ec.europa.eu/info/sites/info/files/eu-equivalence-decisions-assessment-27022017_en.pdf

29. With respect to international trade, WTO-GATS establishes the fundamentals for trade in services, including in relation to all financial services.
30. For financial services, only limited liberalisation has been achieved in the WTO context. Conventional Free Trade Agreements (FTAs) have not provided for either comprehensive market access or deep regulatory cooperation, even though there is no structural impediment that would prevent two contracting parties to agree a more comprehensive set of provisions if they so wished.
31. The EU's FTA with Canada (CETA) is a recent example of one such conventional FTA. CETA provides market access in "WTO terms" for financial services firms, meaning access cannot be subject to quantitative restrictions on size and form of investment or service provision. CETA provides investment protection for investors in financial services and includes some commitments relating to transfer of data, regulatory transparency, nationality requirements for senior managers, membership of self-regulatory organisations and operations of payment and clearing systems. However, CETA does not remove barriers related to regulatory requirements and provides only for limited dialogue mechanisms to discuss and manage these.
32. Across all of financial services, CETA does provide some clear commitments for provision of services in specific sub-sectors¹⁰ but this is partial. In practical terms under CETA, a European bank still requires a significant local presence in Canada to carry out extensive capital market operations and *vice versa*.
33. The EU has agreed similar provisions with respect to financial services in its free-trade agreements with Korea and Singapore.
34. More widely in financial services, there are well-developed principles at the international level which seek to support cross-border activity and avoid duplicative regulation and fragmentation. While these principles are not especially developed in relation to retail and corporate banking, they are familiar to financial services policymakers and regulators more widely and include concepts such as deference, regulatory coherence and regulatory convergence; mutual regulatory recognition; and supervisory cooperation.

¹⁰ For example, advisory on M&A, corporate restructuring, corporate strategy, investments, research, and credit rating; in asset management, investment advice and portfolio management services (excluding custodial, trustee or execution services); in insurance, insurance and insurance intermediation relating to Maritime, Aviation and Transit (MAT) and insurance of goods in international transit, retrocession, reinsurance as well a range of services auxiliary to insurance, including actuarial, consulting and claim settlement services.

Sector views

[This information was provided by the Government to the Committee, but the Committee has decided not to publish this section]

HOUSE OF COMMONS EXITING THE EUROPEAN UNION COMMITTEE