NEVER WASTE A GOOD CRISIS

USING BREXIT TO REFORM THE UK'S FINANCE SECTOR

A REPORT FOR MOLLY SCOTT CATO MEP

BY VICTOR ANDERSON

FOREWORD

Ten years on from the financial crisis it's time to take stock of our financial system. Weak regulation and untrammelled greed resulted in huge social and economic costs and yet the price was paid by the innocent while the guilty have returned to business as usual and very few have been held accountable and even fewer sent to gaol. The sense of injustice that the handling of the financial crisis fostered is a festering wound in society and we will not make social and economic progress until it is healed.

The extent of inequality and injustice in our society exposed by the financial crisis, and the responses to it, were key to creating a sense of disenfranchisement and disempowerment. People saw that the outcome of the 2008 crisis was for the rich to become richer while the poor paid the price. This sense of alienation from City financiers and the 'metropolitan elite' was a central driver of the decision of voters to choose to leave the European Union.

Questions are frequently raised about the precise volume of tax revenues derived from the activities of The City. There is no question that they are vital for funding our public services, but they are nowhere close to the amount of money that was poured into the banking system to save it from collapse in 2008. So, are we really gaining or losing because of having such a massively disproportionate banking sector based in London?

The unconventional policy of quantitative easing means that huge amounts of public money have been created. But this has been transferred directly to the very people who are responsible for the crisis and has increased the value of the assets of some of the richest people in our society. Meanwhile everyday working people have seen their wages stagnate and have not gained interest on their savings.

The UK's financial system is over-sized in proportion to our economy and almost uniquely private compared to other countries. A key lesson from the financial crisis is the need to challenge this self-serving, self-contained banking model and to learn from other national systems where public and cooperative banks play a significant role. One really encouraging sign is active proposals to establish a nationwide system of public banks that would be embedded in local communities and would insure that when money is created we all benefit.

Citizens across European have paid dearly to keep the banking system afloat; now it is time for finance to pay us back. The greatest threat facing humanity is the environmental crisis and particularly climate breakdown. We need the financial sector to lead in terms of sustainable finance and to rapidly shift its assets away from fossil fuels and towards the energy transition.

For the UK, Brexit is another crisis on the scale of the financial crisis. Two years on, people are becoming more and more aware that the 'EU bogeyman' is not actually the source of all our ills and are instead beginning to reflect on all aspects of our society and economy. Rethinking finance should be central to this process.

If Brexit goes ahead, any route out of the EU will mean the loss of passporting rights and hence the loss of some of the activity that currently takes place in The City. Given the power of London as a global financial centre it will not whither overnight but there is a risk that private finance companies will choose the Singapore model of finance, with increased risks for taxpayers and even greater contempt for financial institutions.

An alternative route is available: a route towards a financial system closer to the German model, where a significant proportion of the banking system is in public hands and the value generated by banking is a social good. This is a system where banks see their primary role as lending to businesses rather than increasing their own profits and earnings; a system where the power of finance is used to move us gradually towards a climate-safe and sustainable future.

This report explores how the economic and political crisis thrown up by the decision to leave the EU can be used to our advantage. Whether or not we leave the EU, we can respond positively to the Brexit crisis by ensuring that the long shadow of the financial crisis can be the catalyst for long-lasting and socially and environmentally beneficial changes to our financial system.

MOLLY SCOTT CATO MEP

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INTRODUCTION

It is ten years now since Lehman Brothers, the poster-child for the casino economy, spectacularly collapsed, sending shockwaves through the offices of the square mile and knocking the masters of the universe down from their pedestals. The cost of this calamity has fallen on working people while those who caused it have continued to profit. The question most frequently asked by everyday people is: 'Why has nobody gone to gaol?' This level of outrage against the establishment is part of the explanation for the political earthquake of Brexit, the revolt of the dispossessed. If there is any area of British life where the mantra 'take back control' can be usefully applied that area is the finance sector. And yet, having spent vast sums of public money on saving the banks, politicians failed to reorganise them so that they would serve the society that suffered to fund this bailout. Ten years on it is a political imperative to re-examine the way our financial system works and to bring about fundamental reform. Ironically, the crisis that Brexit will bring to our financial system offers an opportunity to do this. This report explores whether we can use the changes Brexit will bring to humanise and socialise the finance sector in the UK.

Withdrawing from the European Union will – if it happens – affect every aspect of life in the United Kingdom. This will also have international repercussions. The UK's finance sector will be on the most affected parts of the economy, with additional impacts overseas because of the City of London's long-standing and pivotal role in international finance.

This report considers the likely effects of Brexit on finance and, drawing on this, suggests how the sector could be reorganised not only to cope with these effects but also to better serve the interests of people and businesses. The main objective is to sketch out a positive picture of what finance in the UK could look like if the disruption caused by Brexit is taken as an opportunity for creating new systems and structures. The proposals set out here could not undo the impact of Brexit, which would be substantial, but they would help to limit the damage and rethink our finance structures.

At stake here is the future of all the different components of our finance sector: investment, pensions, insurance, mortgages, banking, accountancy, financial information and advice, each of which plays a significant role in the larger economy of the UK. While estimates vary, and the issue is itself a highly politically contested one, it is clear that the financial sector is the UK's biggest economic sector, and hence contributes significantly to our public finances. This can be an opportunity to grasp – to transform the UK's biggest economic from one that works for the few to one that works for the common good.

This report asks: if Brexit takes place, what will happen to the UK finance sector? And how could this opportunity be used to refashion the finance sector into the one that the UK needs, one that works for everyone, not just the few? In doing so, this report draws on speculation and forecasts about Brexit, and on analyses of the City of London as the hub of the UK's and the world's finance sector, particularly in the wake of the 2008 financial crisis. The report draws on reports and analyses from think-tanks and experts such as New Economics Foundation, the Federation of Small Businesses, The University of Birmingham, and the Bretton Woods Project.

This topic is urgent. In six months time, the UK could be outside the EU. If a transitional period is negotiated, the limited amount of time available would be well spent focusing on radically reforming our financial systems and structures.

THE IMPACT OF BREXIT ON THE UK FINANCIAL SECTOR AND WIDER ECONOMY

London is a financial centre in its own right but has also, over the centuries, secured its place as a global hub for financial activity. The UK's finance sector is also an important player in the national economy, with 'two-thirds of financial and related professional services jobs outside of London, in Scotland, Wales and Northern Ireland according to the Government's own 2017 Brexit White Paper.[i] 'The UK is a global leader in a range of activities, including complex insurance, wholesale markets and investment banking, the provision of market infrastructure, asset management and FinTech.' The City also supports a number of regional finance centres including Bristol and Bournemouth. According to the City UK, one job in every 15 in the South West England is related to finance.[ii]

The finance sector is particularly dependent on whatever future arrangements are negotiated with the EU 27 for two reasons: firstly, the rules because Brexit will affect the arrangements and conditions about how UK-based banks and financial companies can sell their services within the EU; and secondly because ability to keep and recruit international staff will be threatened if we leave the single market. One in four financial sector staff in London are non-UK citizens, and 12.2% across the UK (of which 7.5 are EU citizens and 4.7% are from non-EU countries.[iii]

The loss of 'passporting' will have a serious negative impact on activities in The City and is the reason some of the largest players are shifting jobs abroad. 'Passporting' allows financial services firms to operate in different EU countries (or countries which are part of the European Economic Area, the EEA, such as Norway) without needing new authorisation every time. If a certain firm is authorised to undertake certain activities by the regulator of one EU member country, it can apply for a 'passport', and can then do business throughout the EU without further authorisation. A British bank – or even a subsidiary of a bank from another country that is based in the UK – can do business in Berlin as easily as it could in Bristol.[iv]

If the UK stayed in the European Single Market by remaining a member of the European Economic Area, passporting rights could still be retained by using a Norway-style trade relationship. However, it appears increasingly clear that the Brexit deal will not involve staying in the Single Market, which as the EU's chief Brexit negotiator, Michel Barnier, confirmed in late 2017 would mean UK financial services firms losing their passporting rights.[v] Following a hard Brexit, UK financial services firms would have to establish subsidiaries inside the EU and apply for a local licence in order to continue enjoying these rights.

The less attractive alternative to passporting is a form of 'regulatory equivalence' meaning the UK maintains its current laws that are in compliance with the EU rulebook on financial services and seeks the EU's permission to keep operating as they are now within the EU. The disadvantage is that as EU laws on financial services change over time, the UK will have no power over them, and will either have to accept the changes or lose the ability to offer various financial services across the Union.

Without full passporting rights, the UK financial sector will be at a considerable disadvantage in trying to operate within the EU/EEA, which is a major market for its services. A recent European Parliament study showed that the UK exported £23 billion worth of financial services to the EU, as opposed to £4 billion of imports, meaning a huge knock-on effect to the UK economy

i The United Kingdom's Exit from, and New Partnership with, the European Union' (Department for Exiting the European Union 2017). Para 8.22.
https://www.gov.uk/government/publications/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union-white-paper/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union--2#ensuring-free-trade-with-european-markets

ii TheCityUK website:
https://www.thecityuk.com/about-us/uk-work-programme/new-u-k-interactive-map-page/south-west/

iii Source:
https://www.reuters.com/article/us-britain-eu-banks-immigration/uk-financial-sector-wants-global-talent-on-tap-after-brexit-idUSKCN1IL0WY

iv For an overview of passporting and related issues, see 'Brexit Brief 3' (British Banking Association 2016).
https://www.bba.org.uk/wp-content/uploads/2016/12/webversion-BQB-3-1.pdf

v https://www.independent.co.uk/news/business/analysis-and-features/brexit-passporting-rights-eea-explained-what-does-it-mean-for-banks-economy-pound-euro-a8065131.html

and the financial sector in particular. Financial services is the area where we make up for the balance of trade deficit in goods and food and so the undermining of this market will have serious repercussions for the UK economy.[vi]

The most direct consequence of Brexit's impact on the financial sector will be in terms of employment. According to a recent survey, 1.1 million people are employed directly in the finance sector, with the figure rising to 2.2 million when related services such as accountancy and management consultancy are taken into account.[vii] Professional services firm Ernst and Young (EY) calculates that Brexit has the potential to cause 83,000 redundancies in the finance sector.[viii] TheCityUK lobbying groups suggests more conservative but still highly significant loss of 35,000 finance jobs shed from UK finance firms and £5 billion worth of tax revenues.[ix] An official study for the European Parliament concluded: 'For the EU 27, the losses are found to be virtually insignificant, and hardly noticed in the aggregate. By contrast, for the UK, the losses could be highly significant, over ten times greater as a share of GDP.'[x] Employment that is indirectly related, such as office maintenance, cleaning, ICT support construction, catering, stationary, office equipment, will also be affected. Given that we are as yet unclear about the future relationship with the EU there is an understandably wide spread in these estimates.

There will also be a significant impact on government revenue, due to reduced economic activity and especially the tax yield from some of the country's highest earners. Although estimates by the industry itself cannot be considered entirely reliable, TheCityUK website estimates that 11.5% of all UK government revenue comes from the finance and related services sector.[xi] A reduction in job numbers and wider economic activity in the finance sector would thus lead to a loss of government revenue, with implications unknown but necessarily either an increase in government borrowing, an increase in tax rates, or a reduction in public spending (or perhaps a combination of all three).

The UK, standing on its own, instead of as part of the most powerful political bloc in the world, will have reduced political impact within the global finance sector and the institutions that govern it, such as the World Bank, the International Monetary Fund, and the Bank for Intentional Settlement, with economic effects. The role of the Bank of England has already been diminished, as seen in the absence of any UK members of the Commission's technical group on sustainable finance, an area where Mark Carney was acting as a leader.[xii]

Most studies of the potential economic impact of Brexit have focused on the wider economy, rather than just the financial sector. Ian Begg and Fabian Mushovel from the London School of Economics carried out a survey of nine different analyses of the economic impacts of Brexit.[xiii] The impact of Brexit on the UK's GDP (Gross Domestic Product) by 2030 was estimated to range between –9.5% to +4% compared to what would happen without Brexit. All the impact assessments except for that by 'Economists for Brexit' founder Patrick Minford (also a key architect of Thatcherite economics) projected a significant economic cost. A treasury report released just before the referendum predicted that, even with a bilateral deal with the EU, the UK economy would be 6.2% lower if Brexit went ahead 15 years after leaving the EU.[xiv]

What appears almost without doubt is that Brexit Britain will almost certainly be poorer, with the finance sector especially badly hit and with knock-on effects of that onto other sectors. But what of the impact on Europe?

vi Implications of Brexit on EU Financial Services (European Parliament 2017). Page 41. http://www.europarl.europa.eu/RegData/etudes/STUD/2017/602058/IPOL_STU(2017)602058_EN.pdf

vii William Turvill, City AM website 25.4.17. http://www.cityam.com/263446/financial-and-professional-services-industry-contributes

Statista website. https://www.statista.com/statistics/298370/uk-financial-sector-total-financial-services-employment/

'Key Facts' (TheCItyUK 2017). https://www.thecityuk.com/assets/2017/Reports-PDF/UK-Key-Facts-2017-updated.pdf

viii Djankov, S. (2017), 'The City of London after Brexit'. https://piie.com/system/files/documents/pb17-9.pdf Simeon Djankov February 2017

ix https://www.thecityuk.com/news/the-impact-of-the-uks-exit-from-the-eu-on-the-uk-based-financial-services-sector/

x Centre for European Policy Studies: 'An Assessment of Economic Impact of Brexit on the EU27' (European Parliament 2017). http://www.europarl.europa.eu/RegData/etudes/STUD/2017/595374/IPOL_STU(2017)595374_EN.pdf

xi 'Key Facts' (TheCItyUK 2017). https://www.thecityuk.com/assets/2017/Reports-PDF/UK-Key-Facts-2017-updated.pdf

xii https://www.ft.com/content/7b89b770-7a32-11e8-8e67-1e1a0846c475

xiii Iain Begg and Fabian Mushövel: 'The economic impact of Brexit: jobs, growth and the public finances' (European Institute, London School of Economics 2016). https://www.lse.ac.uk/europeanInstitute/LSE-Commission/Hearing-11---The-impact-of-Brexit-on-jobs-and-economic-growth-sumary.pdf

xiv 'HM Treasury analysis: the long-term economic impact of EU membership and the alternatives' (Treasury April 2016). https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517415/treasury_analysis_economic_impact_of_eu_membership_web.pdf

THE IMPACT ON THE EU27

The City of London is a global centre of finance, a history role that goes back to the late 17th Century, being tied to the growth of commodities trading such as wool and cotton, the expansion of the British Empire, and the spread of the English language across the world.

Despite losing ground to competitors in the period after the Second World War, London received a new boost from the 'Big Bang' reforms of the 1980s, such as the removal of rules that restricting foreign ownership in London. This history, together with the advantages of its time-zone (in between New York and Tokyo), its universities and its efficient legal system, has given London an entrenched role in finance which has become retained in a transformed form through EU membership, enabling London to extend its market while staying outside the Eurozone.[xv] In finance terms, this is something of a cake-and-eat-it-deal. Its importance can be seen in the fact that as Europe's leading financial centre, it is also the main centre for trading in Euros, despite being outside the Eurozone.

The final deal (or lack of deal) will determine how Brexit will affect European finance. The City of London has used its formidable lobbying power to argue for a bilateral negotiating position vis-a-vis the EU, a form of 'mutual recogntion' of financial regulations that breaks the unity of the single market and is thus highly unlikely to be accepted by former Financial Affairs Commission Barnier.[xvi] Inevitably, other European capitals such as Frankfurt, Berlin and Dublin are also seeing the opportunities offered by Brexit once the UK is a third country. They are already banking on increasing competitiveness and taking trade from London.

Given the emphasis on deregulation amongst proponents of Brexit, it is clear that there is a risk to the high regulatory standards of the single market in the area of finance as elsewhere. If the UK chooses to reduce standards we may see a race to the bottom, as European governments come under pressure from their financial sectors to weaken financial and transparency regulations in order to attract financial players.

Absence of the UK from the EU will also weaken the position of non-Eurozone countries within the EU, including Poland and Sweden, which are likely to come under greater pressure to join the Eurozone in order to avoid marginalisation within EU decision-making, especially if there are further moves towards Eurozone economic policy integration.[xvii]

Greater EU policy integration may well result from seeking to deal with the danger that Brexit will create an uncoordinated dispersion of Eurozone finance across many different cities and countries. It seems likely to be more efficient to reproduce the gathering together in one place which has given the City of London much of its success, either physically in a single location such as Paris or Frankfurt, or through introducing regulations to strengthen links between different financial centres in the Eurozone so that they can operate together in an integrated way.[xviii]

Brexit is creating major disruption for one current EU initiative in particular: the Capital Markets Union (CMU). The UK has the largest capital market in the EU and Brexit will remove it from direct involvement in the CMU. The aim of the Capital Markets Union is to more efficiently turn savings into productive investment, increasing access to funding opportunities, especially for small and new businesses, and making cross-border capital flows easier within the EU. This involves standardising relevant regulations across the EU, with increased powers for the European Securities and Markets Authority, located in Paris. The Commission intends to have the measures in place to establish the Capital Markets Union in 2019, the year the UK is scheduled to leave the EU.

xv See Maurice Glasman: The City of London's Strange History, Financial Times website, 29.9.14. https://www.ft.com/content/7c8f24fa-3aa5-11e4-bd08-00144feabdc0

City Timeline, City of London Corporation website (2012). https://www.cityoflondon.gov.uk/things-to-do/visit-the-city/our-history/Pages/timeline.aspx

xvi Finance UK, Towards a framework for financial services in an EU - UK trade agreement. https://www.ukfinance.org.uk/wp-content/uploads/2017/11/BQB10-Towards-a-framework-for-financial-services-in-an-EU-UK-Trade-Agreement.pdf

xvii This is argued from a Polish perspective in Sebastian Plociennik. 'A "Non-euro" Zone after a Possible Brexit' (Polish Institute of International Affairs 2016). http://www.pism.pl/publications/bulletin/no-41-891

xviii See André Sapir, Dirk Schoenmaker, and Nicolas Véron. 'Making the Best of Brexit for the EU-27 Financial System' (Peterson Institute for International Economics 2017). https://piie.com/system/files/documents/pb17-8.pdf

The European Commission Vice-President responsible for the CMU, Valdis Dombrovskis, was quoted in a Commission press release as saying: 'The CMU remains at the heart of our efforts to boost European investment and create jobs and growth. As we face the departure of the largest EU financial centre, we are committed to stepping up our efforts to further strengthen and integrate the EU capital markets.'[xix] This suggests an intention to create a strong rival financial centre outside of the UK, either in one place or dispersed across several different cities and held together by fast communications and standardised rules. If the EU's aims are achieved, it will be a centre more attractive to productive businesses and less focused on finance for its own sake.

What started out as an EU initiative with London at its centre – and led by UK Commissioner Jonathan Hill – is now being turned into a scheme for creating a rival financial centre to London. Support for the project, which was initially rather weak, has actually increased in the wake of Brexit as a financial centre for the Eurozone seems more vital to support the Euro and European lending to business.

xix European Commission press release 8.6.17. http://europa.eu/rapid/press-release_IP-17-1529_en.htm

REFORMING THE ROLE OF UK FINANCE

Every shock can also be an opportunity. The shock that UK finance will endure could be an opportunity to transform it into a sector that seeks to achieve.

Whilst the City has provided large amounts of tax revenue and a large number of jobs, it has been criticised for entrenching wealth inequality. The City of London has provided channels through which money has flowed out of the UK, both for legitimate overseas investment and into tax havens [2]. The peculiar legal status of the Crown Dependencies and Overseas Territories has enabled them to operate as centres for tax evasion

The financial sector as a whole has failed in its central role of transferring money from savers to businesses, following the longstanding criticism that the focus is on the highly lucrative commercial banking (the 'casino economy') rather than business lending. A recent study showed the percentage of UK bank lending going to non-financial corporations and for consumption (and therefore not for circulation within the finance sector or for mortgage lending) is only just over 20%, the lowest for any G7 country.[xx]

Another common critique of the financial interest is the way they have lobbied to protect their profits and against the wider social interest. The City has used its influence to lobby for deregulation, against bankers' bonuses, and against the introduction of even the lowest Financial Transaction Tax. In 2011, the British financial services industry spent more than £92 million on lobbying politicians and regulators in an 'economic war of attrition'[xxi] which garnered many victories, such as killing off government plans for a new corporate super-watchdog to police quoted companies and the slashing of UK corporation tax and taxes on banks' overseas subsidiaries. This lobbying power have made reforms hard to implement and the UK finance industry has continued to be an industry that concentrates wealth and takes huge risks with the knowledge that they will be bailed out by the state if need be.

The Brexit negotiations provide an important opportunity for the EU27 to require tighter regulation of the network of UK-linked tax havens as a condition for a favourable trade deal. Britain's withdrawal from the Union will also enable it to move ahead with its plans for tighter financial and corporate tax regulation, measures which were repeatedly blocked by the UK in Council.[xxii]

Brexit provides the opportunity for UK finance to have a fresh start – and a variety of proposals could ensure that it becomes a financial sector with the needs of the UK economy and the British people at its heart. The next part of the report will lay out some proposals that would ensure the financial sector is re-made to suit our needs, rather than working to maximise its own returns. We begin by laying out the principles these proposals should be based on.

We suggest an ideal finance system would:

- Provide funds for useful productive economic activity.
- Give priority to projects that are part of the transition towards a Green economy, such as renewable energy production, and limit funding for projects that contribute to climate change or biodiversity loss.
- Help local economies, especially neglected ones outside of London.
- Provide basic banking services to everyone who wants them.

xx 'Still Exposed' (New Economics Foundation 2017). Page 15 http://neweconomics.org/wp-content/uploads/2017/11/still-exposed.pdf

xxi https://www.theguardian.com/politics/2012/jul/09/finance-industry-lobbying-budget-revealed

xxii Clare Godfrey: 'Tax Justice Agenda for the Brexit Negotiations' (Green/EFA Group in the European Parliament 2017). http://extranet.greens-efa-service.eu/public/media/file/1/5414

- Sell products on an honest basis with full information and provide impartial advice to potential customers.
- Establish public control over the creation of money.
- Think long-term for forecasting and investment purposes, for example by taking climate change into account for pension funds .
- Contribute to overall financial stability and protect people's savings, by clamping down and not rewarding reckless risk-taking.

And an ideal finance system would NOT:

- Facilitate tax evasion and money laundering.
- Take unreasonable amounts of risk on the basis that taxpayers would pay up for any losses whilst finance companies take the profits if things go well.
- Charge exploitative interest rates to personal customers.
- Increase student debt beyond the amount initially borrowed.
- Charge excessive management fees to personal customers.
- Channel funds into activities that promote environmental damage and climate change.
- Encourage short-termism in company decision-making at the expense of the long term.
- Have undue influence on government economic policy and tax regulations.

Bearing these principles in mind we proceed to explore some of the central issues in more detail.

LENDING TO BUSINESS

Currently, UK banks – especially compared to other countries such as Germany – do not specialise in lending to UK businesses, tending instead to favour lending that can be backed up with an asset – such as a property or a car – that can then be sold if the debt cannot be repaid. The risks of lending to a small business are harder to evaluate thus requiring expert staff and better connections between bank managers and local areas and businesses, something which is being lost with the mass closure of high street banks. This has resulted in a built-in bias against business lending, especially to smaller businesses.[xxiii]

As well as the prioritisation of mortgage lending over lending to business, there is also a marked failure to take environmental and sustainability factors into account by banks when determining investment and lending.

Various proposals have been put forward to counter this in-built, anti-social bias guiding the direction of lending. Critics have noted in particular the wekaness of the public banking sector. A more resilient sector could also be created by having more smaller banks with less power and responsibility, and less impact when things go wrong. More public and co-operative banks, rooted in local and national communities, would also help make banking less about creating profit for shareholders and more about providing a service and supporting local and national economies.[xxiv] The plans for a system of regional public banks that are being led from London and the South West are a particularly encouraging development in this regard.[xxv]

The German banking system provides a useful example of banking success, and was one of the most resilient in the face of the financial crisis in 2008. Much of German baking is publicly

xxiii Ben Baruch: 'Locked Out' (Federation of Small Businesses 2016). Page 8. http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-bank-branch-closures-(final).pdf?sfvrsn=0

xxiv nef, A Local Banking System: A Local Banking System The urgent need to reinvigorate UK high street banking.

xxv 'Plymouth Could Soon Get Its Very Own Bank', Plymouth Live. https://www.plymouthherald.co.uk/news/business/plymouth-could-soon-very-bank-1819069

or co-operatively owned. German banking has developed in much closer relationship with manufacturing than banking in the UK, with some manufacturing companies even establishing their own banks.

The German banking system consists of almost 1,800 banks, as opposed to the UK's 300 banks and 45 buildings societies. In Germany each bank's share of responsibility and money is much more spread out. The top five banks together only have 44% of total amount on banks' balance sheets: compared to 76% in the UK. There are three distinct kinds of banks: private banks (200), publicly-owned savings banks (400), and member-owned local credit unions (1,100).[xxvi]

Germany's government-owned banking group, KfW, is a key part of this system. Its borrowing is mainly through bonds which are guaranteed by the federal government, thereby lowering the risk to lenders and the interest rate they charge. With an AAA credit rating and half a trillion Euros in assets, its emphasis on small and medium-sized enterprises have helped Germany's businesses and high streets. In recent years it has also given priority to lending money to increase efficiency in buildings.[xxvii]

In the UK, there has been a history of government investment banking, but with only limited scope. In 1974, the newly-elected Labour Government, with Tony Benn as the minister in charge, made an ambitious attempt to reform finance for business through setting up the National Enterprise Board. Opposition from some business interests led to it being restricted in various ways in 1975, along with the reshuffling of Benn to a different department.[xxviii]

2012 saw the creation of a Green Investment Bank, created in order to help finance Green transition, but it had limited powers and was privatised in 2017 (and renamed Green Investment Group).[xxix] As well as criticised for selling it at too low a price, the sale of the Green Investment Bank was criticised by the Public accounts committee, who said that 'the Green Investment Bank failed to live up to original ambitions and there is no guarantee it ever will'.[xxx] Although the British Business Bank was set up in 2014 as an investment bank for the purpose of investing in British businesses, it is tiny compared to such banks in other modern economies.

Part of the solution would be creating a public investment bank, together with a system of regional public or cooperative banks, all of them operating with a strong remit to support their local economies and clear social and ecological principles.

THE CURSE OF SHORT-TERMISM

A pervasive short-termism characterises the current financial system, with short-term gains being prioritised over long-term considering because of shareholder pressure for returns.[xxxi] Lack of long-term thinking is a particular problem for pension funds, which by their nature are future-facing. Whilst long-term trends are difficult to predict, as the conditions that lead to more extreme temperatures and a higher risk of extreme weather events continue to be reinforced by our activities, that climate change will continue to gather pace is a 100% safe prediction.

Actuaries – business professionals dealing with the measurement and management of risk and uncertainty – are failing to factor climate change and resource scarcity into their forecasts, as a recent study by the Institute and faculty of Actuaries' showed.[xxxii]

A reformed finance system that is realistic about its predictions and puts people before short-term profit would have stability and long-termism built in. Three types of reforms are necessary:

1 Corporate governance laws, such as those set out in the Companies Act 2006, should be changed to ensure that investors who are simply short-term gamblers have no say in future

xxvi Patrick Behr and Reinhard H. Schmidt (2015), The German Banking System: Caracteristics and Challenges, White Paper No. 32, Frankfurth, Goethe University.

xxvii Christopher Cermak: 'How Germany's three-tiered banking system works', Handelsblatt website 9.6.17. https://global.handelsblatt.com/finance/how-germanys-three-tiered-banking-system-works-779275

xxviii See Coventry, Liverpool, Newcastle and North Tyneside Trades Councils: 'State Intervention in Industry' (1980).

xxix See Damian Carrington, in 'The Guardian' 24.5.12. https://www.theguardian.com/environment/damian-carrington-blog/2012/may/24/green-investment-bank-energy-efficiency

See House of Commons Environmental Audit Committee inquiry report into the Green Investment Bank (2011). https://publications.parliament.uk/pa/cm201011/cmselect/cmenvaud/505/50502.htm

National Audit Office: 'The Green Investment Bank' (2017). Page 9. https://www.nao.org.uk/wp-content/uploads/2017/12/The-Green-Investment-Bank.pdf

xxx https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news-parliament-2017/sale-green-investment-bank-report-published-17-19/

xxxi See 'American Prosperity Project' (Aspen Institute 2017). https://assets.aspeninstitute.org/content/uploads/2017/01/American-Prosperity-Project_Policy-Framework_FINAL-1.3.17.pdf

xxxii Aled Jones et al.: 'Resource Constraints: sharing a finite world' (Institute and Faculty of Actuaries 2013).

in the running of a company and electing its board of directors. Votes should be restricted to those who keep their money in a firm's shares for more than two years, for example. They could either buy a type of share that cannot be resold within that time period, or simply have to have held their shares for more than that amount of time in order to qualify for a vote. There would still be market pressure from the changing share price, but taking power out of the hands of the speculators would be an important antidote to excessive short-termism and would enable firms to plan more sensibly.

2. Actuaries should be encouraged to factor climate change into their forecasts, and be prepared to acknowledge that the growth rates seen in recent decades may not be continued indefinitely (although exactly what will happen to GDP is difficult to forecast largely because of the shortcomings of GDP itself as a statistical indicator). This would not require any change in the law: it would simply be enough for pension funds and others who are advised by actuaries to take climate change into account when choosing who is to advise them and which advice to take notice of.

3. Insurance companies have an important role to play. Their businesses depend on accurate assessments of risk, which in turn depend on making an analysis of the underlying long-term situation and the trends and dangers which that is generating. There is a need for insurance companies themselves to think about the many different long-term threats deriving from climate change and ecosystem deterioration. They have an interest in reducing risks in order to reduce the amounts they are called on to pay out, and they also have an interest in factoring in all risks so that they don't lose out. Initiatives such as the Principles for Sustainable Insurance, organised by United Nations Environment's Finance Initiative begins to mainstream this thinking, as does the sustainable finance agenda of the European Commission.[xxxiii]

GREENING FINANCE

Short-termism and ignoring environmental factors is a particularly problem for the finance sector, which has played a role in funnelling resources towards companies and projects who work not only fail to take environmental factors into account but rather exacerbate pollution and ecological damage, fossil fuel companies being the paramount example.

Under the leadership of Commissioner Dombrovskis, the European Commission is giving global leadership on the sustainable finance agenda. This agenda builds on the advances made by the divestment movement – where universities or public bodies shift their money from fossil-fuel assets to renewables – and enhanced company reporting, so that we know much more about what the companies who have our pension savings are doing with them. The sustainable finance agenda is similar to this work but much, much deeper and wider and legally enforceable. Because the EU is a financial regulator, the European Supervisory Authorities can determine which assets are considered viable when determining whether banks are solvent or pension funds will be able to afford to pay out. So if regulators take the initiative to legislate that coal mines or intensive farms will not be viable assets after, say, 2030, we will ensure an orderly transition away from these assets and towards the assets of the future like windfarms and organic farms. This is the promise of the sustainable finance agenda: using finance as a lever on the whole economy. At present there are three legislative proposals under negotiation: defining a sustainability taxonomy; developing regulations on much stronger disclosure requirements for environmental and particularly climate risks; the creation of benchmarks for green investments. The ECB has also established a working group to explore how to operationalise the proposal for carbon stress tests for banks. While it

xxxiii See UN Environment Inquiry into the Design of a Sustainable Financial System. http://unepinquiry.org/

might seem that the Brexit we are heading towards would mean the UK financial sector failing to benefit from these legal changes, we are likely to continue to follow the single market rulebook on financial regulations.

We also need to see much firmer action by global financial institutions, such as the World Bank and the European Investment Bank, requiring them to abide by sustainability principles. Organisations such as the Bretton Woods project are pushing for institutions such as the IMF and the World Bank to stop funding socially and environmentally damaging projects.[xxxiv] In December 2017, World Bank Group (WBG) President Jim Yong Kim announced at the One Planet Summit in Paris that the Bank will cease project lending for 'upstream' oil and gas projects after 2019.[xxxv]

Green bond schemes: Companies and governments can also issue Green bonds to raise funds for projects which give a high priority to sustainability, such as renewable energy schemes. This reflects a widespread desire amongst many potential investors and contributors to pension funds to see their money put to good use.[xxxvi] Here again, the EU institutions are showing leadership, seeking to develop globally reliable green bond standards to remove the risk of greenwashing and stabilise the market. The EU is currently considering establishing a certification scheme for 'green bonds'. Since this would need to include the possibility where necessary of removing certification, this would influence the behaviour of credit-rating agencies as well as investors and lenders themselves. As a minimum, there would be an alignment with EU commitments under the Paris climate change agreement, and there are also additional proposals which have been put forward (e.g. ruling out nuclear power).[xxxvii]

The tragedy of Brexit is that the UK, which has a proud record of environmental expertise and activism as well as being a leading global financial centre, would otherwise be ideally placed to show global leadership in sustainable finance. This would bring huge social benefits but would also be good for business. Sadly, this is another area where the self-harm of Brexit is likely to damage the UK, the EU and in this case the planet too.

INDIVIDUALS ARE NOT SERVED BY THE CURRENT BANKING SYSTEM

One of the key functions of the finance system from the point of view of most members of the public is that (if they are fortunate) they can have a bank account and (if they are more fortunate) they can borrow money from a bank through having an overdraft.

The reality for many other people, however, is not so straightforward and convenient. A recent report on the problem of 'financial exclusion' found that there were around 800,000 people in households in which no-one had a bank account and 1.5 million individual adults without bank accounts. This obviously creates problems for these people with paying bills, receiving wages, and financial transactions generally.[xxxviii]

Credit ratings, carried out largely in secret and according to criteria not often made public, have a major impact not only on whether someone can borrow money from a bank in the form of an overdraft, but also on the interest rate they end up paying if they do get a loan, for instance from a 'payday lender'. Although the initial principle of 'payday loans' is that they are very short-term, and in fact around half are repaid within a month, the interest rates and fees charged can be extremely high when money is not repaid on time. This is something that happens to many people on low incomes and very few people on medium or high incomes.

There are also a number of other irritations with UK banking. Banks co-operate less than they used to, making them unwilling to accept cheques from other banks. Some banks have withdrawn

xxxiv For information on the World Bank's environmental record, see the Bretton Woods Project website. http://www.brettonwoodsproject.org/topics/environment/

xxxv http://www.worldbank.org/en/news/press-release/2017/12/12/world-bank-group-announcements-at-one-planet-summit?CID=ECR_FB_worldbank_EN_EXT_OnePlanet

xxxvi See Principles for Sustainable Insurance website. http://www.unepfi.org/psi/

xxxvii See Molly Scott Cato MEP: 'Draft Report on Sustainable Finance' (European Parliament 2018).

xxxviii Karen Rowlingson and Stephen McKay: 'Financial Inclusion Annual Monitoring Report (University of Birmingham 2017). Page 20. https://www.birmingham.ac.uk/Documents/news/15518-CHASM-Report-Stage-4.pdf

banking services of any complexity from many of their outlets and relabelled them as not being 'branches'. Personal connection between local bank managers and local people has declined. Bank closures can have a devastating effect on local economies in cases where there was previously only a single bank. There is very limited real competition between banks as to the services they provide. Telephone banking is often of very poor quality. Opening hours can be problematic where they coincide with usual working hours. Pushing people into internet banking doesn't meet the needs of many older people and people without internet access at home, and there is often poor internet connectivity in rural areas. Complaints, particularly about how banks have dealt with internet and telephone scams, are often not properly followed up. The mis-selling of payment protection insurance (PPI) was essentially a scam operated by the banks themselves.[xxxix]

This long list of criticisms of UK banking implies a need to look again at the structure and workings of this part of the finance sector.

The most obvious, but also in practice most ambitious, point is that the banks should serve those on low incomes as well as those on high incomes. Banks should serve all parts of the country, not simply larger towns and cities and should work as part of local communities and local economies. Profit-maximisation in the market inevitably militates against this, because the objective of making as much money as possible incentivises banks to give priority to high income customers in high density prosperous areas. The financial calculations made by the banks explain why customers have to queue for longer in poorer areas of the country: expenditure on staff salaries has to be matched against revenue from the customers those staff are dealing with, as is the practice with Swedish bank Handelsbanken.[xl]

Rather than completely change the whole banking system in line with a new set of priorities, the most practical approach in the short run would be for a publicly owned bank to fill in the gaps in personal banking left by the private sector banks. A publicly owned bank should set out to include everyone who currently does not have a bank account but would like one; exist particularly in areas where private sector bank branches have been closed down; and be prepared to lend to low income customers without charging exploitatively high rates of interest.

Fortunately there is already a national network which could play this role: the Post Office, which has more branches – 11,500 in fact – than any bank. Unfortunately, it has been sold into the private sector, where it is subject to the same profit-maximisation market pressures as the banks. This privatisation of a major public asset, completed in 2015, should as soon as possible be put into reverse, returning to the public the Post Office it used to own.[xli]

A reformed Post Office would become a sort of 'People's Bank', as well as retaining its links with the benefits system, its postal services, and its role in supplying customers with foreign currency. It would also provide competition to the existing banks, encouraging them to make better provision for smaller towns, older people, and lower income customers.

xxxix See Clear Barrett, 'Financial Times' website 27.3.17. https://www.ft.com/content/e1099b26-12c6-11e7-b0c1-37e417ee6c76

xl For examples of good banking practice, see: Handelsbanken customer satisfaction ratings. https://www.handelsbanken.co.uk/shb/inet/IStartRb.nsf/

xli See We Own It website: https://weownit.org.uk/public-ownership/royal-mail

RECOMMENDATIONS FOR ACTION

On the current UK Government timetable, the finance transition would need to be happening at the same time as, or slightly earlier than, the overall Brexit transition, or 'implementation', period. There is an urgent need for the civil service, as well as the legislatures, to also give attention to the future of the finance sector. This should be a major focus during the transition/ implementation period.

Creating a coherent transition for the UK finance sector will require the joint activity of many different organisations, with the co-ordination of many different measures and initiatives. This section sets out 14 specific recommendations for political action to enable the transition to the evolution of a socially and environmentally benign financial system.

PEOPLE

1. At the centre of all this is the people who currently work in UK finance: approximately 1.1 million, about 360,000 of whom are employed in London.[xlii] Most people in finance have useful specialist expertise which could help in the development of an improved finance system and plans should be put in place to explore their transferable skills and help them find employment in the reformed finance industry.

2. A Brexit finance transition strategy should prioritise the regional distribution of finance activity, reducing the dominance of London, encouraging the flow of high-quality jobs away from the capital, and helping to address accelerating financial inequality.

BUSINESS, ENERGY AND INDUSTRIAL STRATEGY DEPARTMENT (BEIS)

3. A government-owned Public Investment Bank should be established, to lend to companies and projects where privately owned banks are failing to lend. It should give priority to 'green investment' (so that it incorporates a new Green Investment Bank) and also to widely distributed regional and local investment, especially in less prosperous parts of the UK.

4. Corporate governance laws should be reformed to ensure that votes within companies, for example at AGMs, are restricted to those who keep their money in a firm's shares for more than a minimum of two years.

5. The UK should pioneer improved corporate disclosure. Corporate reporting requirements should require firms have to report fully on their environmental, social and governance performance. This should also apply to pension funds and those who handle investment funds on behalf of clients.

6. BEIS should develop a range of innovative savings bonds specifically linked to renewable energy infrastructure to allow small-scale investors to have a stake in the transition to sustainable energy.

TREASURY

7. The Treasury should establish a UK Financial Transition Agency to co-ordinate the transition process in a way that keeps pace with Brexit developments. The Agency would be concerned principally with the redeployment and retraining of finance staff, working with public bodies and private financial firms.

xlii Estimate for first half of 2015, on Statista website. https://www.statista.com/statistics/298370/uk-financial-sector-total-financial-services-employment/; Estimate for first half of 2015 https://www.statista.com/statistics/298354/uk-financial-sector-total-financial-services-employment-in-london/

8 The UK should use its legal authority to clamp down on tax evasion activities, and the laws and loopholes which facilitate them, in UK Crown Dependencies and Overseas Territories.

9 The UK should co-operate with the EU and other jurisdictions to combat tax evasion, joining in imposing economic sanctions on tax havens where necessary and where it lacks independent legal authority.

10 UK banking regulations should distinguish between banks on the basis of the risk level of their activities and require the high-risk banks to participate in a insurance scheme to avoid the need for future taxpayer bailouts. This should apply to the risk-taking involved in investing in fossil fuel companies, which carries with it the danger of large 'stranded assets' on the balance sheet.

11 Treasury should urgently overhaul consumer protection for the finance sector, with particular safeguards for low-income customers and those who are financially excluded through being denied bank accounts and loans.

12 Working with the FSB and other small business organisations, the government should review the current system of business lending with a view to facilitate smaller loans.

13 Government should give full support to the development of a system of regional public banks, ensuring that the FCA facilitates this new form of banking.

14 The Post Office should be brought back into public ownership, taking on the role of a 'People's Bank', operating across the whole country, including in areas where private sector banks have closed branches, and making a point of serving the needs of small businesses, older people, and lower income customers.

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