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Not with a Bang but a Whimper

Are we undermining the future of financial services in Britain?

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Executive Summary

There has been much discussion about whether new taxes and regulatory changes will undermine the UK's position as a financial centre. At the same time there has been a lot of media coverage of firms relocating, and of activity and prominent individuals moving abroad.

A range of new taxes have been imposed in the wake of the financial crisis: the new 50p top rate, restrictions on pensions relief, the bank bonus tax, higher rates for Capital Gains Tax, the non-doms levy, and plans for bank levies. A number of regulatory changes have been introduced or discussed: from the AIFM directive in Europe, to new capital and liquidity requirements, to proposals to separate banking activities. Several of these changes have prompted concern in the media.

Judging the scale of the threat is difficult. The City of London is essentially a labour market agglomeration. While the UK's time zone is useful for some types of activity, various other locations share this advantage. London's advantage is the depth of its markets and in particular the labour market for financial professionals. There is no good reason why this agglomeration should take place in the UK: indeed the modern revival of London was, amongst other factors, the product of a heavy handed regulatory regime in the US (one recent example being the Sarbanes-Oxley reforms) driving activity away. Such agglomerations are strongly self reinforcing: success sucks in ever more business, but a loss of momentum can quickly tip over into a rout as the agglomeration unravels.

Anecdotal evidence of departures abounds: firms which have either left, changed domicile, or moved activity out of the UK include: Amplitude Capital, Bluecrest Capital Management, Brevan Howard, Krom River, Henderson Group, Shore Capital, Tullett Prebon, HSBC, Brit Insurance, Kiln, Hiscox, Omega, Zurich Financial Services, Terra Firma, United Business Media, Wolseley, Ineos Capital, WPP, and Yahoo.

But how serious is the threat to UK competitiveness really? We commissioned market research to test whether there is a threat, if so, what its nature is, and what the main issues are.

Polling evidence

We polled two groups: senior managers of financial firms, and individual professionals who work in

financial services in the UK.

Senior managers

While some institutions will leave the UK, and a surprising number have considered it, the main threat is that activity within businesses will be redistributed out of the UK, and the UK will fail to attract new business in itself.

- **Some whole institutions will leave:** 23% have either considered or are currently considering whether to relocate their businesses out of the UK. Of this 2% of respondents are currently planning or consider themselves likely to relocate.
- **But the main threat is the loss of activity within business:** Some 25% of the senior managers polled thought it likely that over the next few years their organisation would move operational parts of teams out of the UK, with just 2% believing that their organisation would add to their UK operations in the same time frame.
- **Compared to ten years ago, the UK is less attractive for new business:** 21% believed the attractiveness of the UK for new business had deteriorated, whilst 7% believed the situation had improved.

Individuals

Individuals are much more likely to have thought about leaving or to actually be leaving. Strikingly, younger professionals in particular see their future outside the UK, suggesting the UK may miss out on the business of the future, and gradually lose momentum as a centre.

- 43% of the financial professionals surveyed have either considered or are currently considering whether to leave the UK. Additionally over a quarter of those (11% of the total respondents) have already considered their positions and are either definitely departing or are likely to do so.
- The number of those either leaving or likely to do so is just 7% in the 55 and over group, but 15% in the 25-34 age bracket.

What makes the UK more or less competitive?

- Leaders of firms cite a wide range of reasons why they might want to relocate out of the UK. Indeed, it is striking that so many different tax and regulatory issues are seen as relevant problems. Interestingly, this all adds up to a general perception of a problem: the "overall tax burden" and the "overall regulatory burden" were cited as the two most important reasons for leaving the UK (with 74% and 67% of respondents respectively citing these as factors).
- For individuals, the most important reasons on why they would depart from the UK are: high

living costs (86% of respondents), poor quality of life (69%), a weak economic outlook in the UK (67%) and the overall burden of tax (63%).

Where might business go?

For leaders of firms, the most attractive places to move domicile to are Switzerland or the Crown Dependencies, (both 59%). For individuals, the US is overwhelmingly seen as the most attractive alternative location. For both managers and individual companies, developed country destinations are seen as significantly more attractive than emerging centres like Dubai.

Recommendations

We recommend that the government should:

- **Monitor levels of activity, with an annual "City Health Check".** The Government should actively monitor and publish annual data of those inflows and outflows of businesses and employees into and from those industries which are internationally mobile and contribute a significant part of GDP and/or tax revenues

- **Monitor changing sentiment about the UK as a centre**. The Government should conduct annual surveys of those same industries to determine whether changes in sentiment over the UK as a domicile are occurring, in order to be proactive in ensuring the UK's competitiveness, whether in infrastructure provision, tax and regulatory burden, or other important factors

- **Produce data on the social value of financial services.** To ensure that the potential impacts of policy choices are well understood the government should conduct high-level annual appraisals as to the estimated net cost or benefit of these industries to the UK.

- **Signal a change of direction.** Our survey suggests current concerns and moves to relocate are not driven by one single regulatory or tax policy decision, but by the cumulative impact of a large number of different policies. It is important for the Government to signal a turning point in this trend, with a number of significant decisions which will boost the attractiveness of the UK as a financial centre.

Introduction

In recent months there have been many suggestions in the press that London's position as the world's leading international financial centre is under threat, and that a number of financial sector firms either have already relocated or are considering relocating. However, little of that discussion has progressed beyond anecdote. In this Research Note we attempt to apply survey evidence to address this question.

Less attractive London

As is well-known, the past three years have been difficult for the financial sector. Investment returns have been poor, jobs have been lost, and opprobrium has been extensive. In addition, there has been a plethora of new regulations and additional taxes.

Important regulatory changes have included:

a) Measures that had only recently been implemented prior to the financial crisis, and had probably not yet been fully absorbed into behaviour, prices, demand or market structure. These include in particular the Capital Requirements Directive (implementing Basel II) and the Markets in Financial Instruments Directive;

b) Measures that had been planned before the crisis but scheduled for introduction shortly afterwards. These include the Solvency II Directive and the new Clearing and Settlement framework;

c) Measures introduced at least partly in response to the crisis which affect the broader financial sector but are not directly aimed at banks themselves. This includes in particular the Alternative Investment Fund Managers Directive; and

d) Measures introduced, proposed or debated in response to the crisis affecting mainly the banking sector. These include measures requiring or effecting:

- New arrangements for cross-border supervision and crisis management.
- Changes to capital and liquidity requirements even under existing regulatory structures and new measures such as changes to trading book capital requirements.
- The Basel III capital requirements (forthcoming).
- New special administration regimes or other resolution mechanisms.
- The restriction or separation of activities.
- Restrictions on remuneration or dividend policy.

- Caps on size, connectedness, concentration or complexity.
- Accounting changes.
- Macroprudential oversight.

There have also been many new taxes (or “stability charges”) imposed on the sector and its employees. These include:

- Increased taxes on high earners, in particular the new 50p top rate, the loss of personal allowances, and restrictions on pensions relief.
- A special payroll tax applied to bank bonuses.
- Plans for bank levies.
- Increased contributions under the Financial Services Compensation Scheme.
- Tighter rules and higher rates for Capital Gains Tax.
- An annual levy on certain resident non-domiciled individuals.

History suggests that even quite subtle changes to tax and regulation can lead to significant shifts of business in the (very globally-mobile) financial sector. Notorious historical examples include the Eurobond market and Sarbanes-Oxley.

When the US imposed an “interest-equalisation tax” in 1963 on the purchase of overseas securities intending to incentivise domestic companies against exporting capital, it inadvertently caused the emergence of the ‘Eurobond’ market. Formerly firms would issue bonds in either their home market, or in an overseas market in order to tap into greater access to capital. The US, as by far the largest market for these ‘foreign bonds’, decided at the time to attempt to encourage investment to be retained domestically, and instituted the tax on these foreign bonds.

Overseas companies, as well as European and American multinationals were forced into seeking an alternative means by which they could access capital, which were the ‘Eurobond’ issues offered by large international syndicates of underwriters. Whilst denominated in one of the major currencies, the Eurobonds were outside of any national jurisdiction and allowed companies to avoid the US tax, and despite their weaker reputation, rapidly grew in size.

The tax was repealed in 1974, and the US no longer has any controls or taxes on exports of capital, however by this point the Eurobond market was firmly established, and has remained to this day. Particularly large bond issuances by multinationals are frequently now marketed on both the Eurobond market as well as in major domestic markets, clearly illustrating their acceptance.

A more recent piece of legislative reform from the US, the Sarbanes-Oxley Act, enacted in 2002 following a series of infamous incidents of corporate fraud including the Enron and Worldcom scandals, aimed to re-establish confidence in the US securities markets through increased transparency and risk management. However, in doing so legislators created significant additional compliance costs for US-listed corporations.

There has continued to be debate about the relative merits and costs of the Sarbanes-Oxley reforms, and particularly whether they had a negative impact on the exchange listing choice of companies. Firms from developed countries with well-regarded systems of regulation faced only additional costs by listing in the US, whereas those from less-developed countries received the benefits of greater credibility and lower borrowing costs in return for the additional costs of compliance.

One study by Piotroski and Srinavasan (2008)[1] used an exchange choice model to compare the listing preferences for companies between the US and the UK stock exchanges both pre and post the Sarbanes Oxley reforms. Their conclusion was that whilst there was no significant change in preference for major foreign firms between the LSE Main Market and the US exchanges, there was an increased preference between smaller foreign firms for the LSE's Alternative Investment Market (AIM) at the expense of the US's NASDAQ, consistent with those smaller firms being less able to absorb the incremental impact of the additional compliance costs. These findings fit quite clearly with the spectacular growth in the AIM that occurred around the time of the reforms.[2]

Thus, the lesson of history would appear to be that taxation and regulatory changes *can* lead to large and sustained movements of business. Of course, it does not follow that they always *do* so. History is littered with examples of regulatory changes that businesses warned at the time would lead to mass exodus but in practice drove very little change at all. So, although there have been significant changes in the environment the financial sector faces in the UK, the question is: will businesses actually leave?

Is there any evidence that firms or professionals are leaving?

Anecdotal evidence of departures abounds. An initiative by several Swiss cantonal governments has seen meetings held in London to attempt to lure hedge fund managers to their jurisdictions.[3] Switzerland has many of the same beneficial characteristics as London: a helpful geographical location close to the European markets and between the American and Asian markets, strong heritage (and

[1] Piotroski, Joseph D. and Srinivasan, Suraj, "Regulation and Bonding: The Sarbanes-Oxley Act and the Flow of International Listings". Journal of Accounting Research, Vol. 46, No. 2, pp. 383-425, 2008

[2] Further quantitative information on the impact of the Sarbanes-Oxley reforms can be found within Litvak, K. "The effect of the Sarbanes-Oxley Act on non-US companies cross-listed in the US". Journal of Corporate Finance, Vol. 13, Issues 2-3, pp. 195-228, 2007. and Kamar, E. "Going-private decisions and the Sarbanes-Oxley Act of 2002: A cross-country analysis". Journal of Law, Economics, & Organisation, Vol. 25, Issue 1, pp 107-133, 2008

[3] http://news.bbc.co.uk/1/hi/business/8518208.stm

hence credibility) in financial services, and excellent infrastructure, and the Swiss are not blind to the value of attracting more of such a profitable industry into their boundaries.

Several firms have responded already. Amplitude Capital, a hedge fund managing approximately $1 billion, moved its headquarters, Chairman and seven other colleagues to Zug in Switzerland.[4] Two other major UK asset managers, Bluecrest Capital Management and Brevan Howard, have both announced that they will assist any employees wishing to move to Switzerland. Bluecrest, the UK's third largest hedge fund, moved 50 of its staff to its new Geneva operation, before the 50% tax on incomes over £150,000 was introduced in April 2010. Brevan Howard has been consulting staff over a potential move, citing the EU's AIFM Directive as a central motivating factor.[5] Krom River, a smaller outfit, with approximately £500 million in assets, has also announced it will move to Swiss jurisdiction,[6] whilst Henderson Group has already created a new Jersey incorporated holding company which is tax-registered in Ireland.[7]

There is evidence that other financial service companies outside of the hedge fund sector have similarly been considering their position. Shore Capital announced in March 2010 that it will relocate to Guernsey, in order to benefit from the more stable tax and regulatory environment, although it would still pay UK tax on its stockbroking activities.[8] Tullett Prebon, have also said that they will expand their Swiss operations if necessary to accommodate any of their UK based staff who would like to move.[9]

HSBC, one of the few major banks to survive the financial crisis unscathed and employing 8,000 staff in Canary Wharf, has announced its intention to review the location of its headquarters in the "interests of competitiveness and its shareholders".[10] Whilst it might be unlikely that an institution of HSBC's stature will uproot to new pastures, given that HSBC moved from Hong Kong to London in 1993 it would be foolhardy of the Treasury to consider it impossible, particularly when the decision to move is becoming more and more attractive. The Chairman of Barclays also noted in August 2010 that he was sure "all banks are responsibly considering what their options might be", with the potential separation of retail and investment banking activities likely to be a primary motivating factor in any decision.[11]

Insurance is another area where firms have started to weigh up their options. Brit Insurance announced a move to the Netherlands in November 2009 via the creation of a new group holding entity (whilst

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[4] http://news.bbc.co.uk/1/hi/business/8518208.stm

[5] http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article6991038.ece

[6] http://www.thisismoney.co.uk/news/article.html?in_article_id=451706&in_page_id=2

[7] http://www.independent.co.uk/news/business/news/charter-joins-henderson-in-tax-exodus-to-ireland-912402.html

[8] http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article7056144.ece

[9] http://news.bbc.co.uk/1/hi/business/8518208.stm

[10] http://www.thisismoney.co.uk/news/article.html?in_article_id=451706&in_page_id=2

[11] http://www.guardian.co.uk/business/2010/aug/05/barclays-first-half-profits-smash-forecasts

remaining listed in London),[12] and Lloyds of London insurers Kiln, Hiscox and Omega have all moved their domicile and headquarters to Bermuda.[13] In addition Zurich Financial Services has been in negotiations with the FSA over its desire to centralise its European life assurance business in Ireland, with the UK office becoming a branch of the Dublin headquarters, following a similar move in 2009 of its general insurance business.[14] Aviva, the UK's second largest insurer also established a single holding company for its European operations in Ireland,[15] and whilst these latter two moves didn't involve a substantial movement of personnel (and in Aviva's case didn't even involve the UK operations), it illustrates that some businesses are seriously considering alternative domiciles for structuring themselves that might traditionally have preferred the UK.

Notable individuals within the financial services sector have also announced that they are leaving the UK. Guy Hands of Terra Firma has quit the UK for Guernsey over the higher taxes for high earners[16] whilst Stephen Hedgecock, a partner at Altis, a hedge fund with assets under management of over £1 billion that has announced a move to Jersey, has declared "The UK model is broken. It's not just the 50% rate - it's National Insurance, the treatment of pensions... everything. It's just a ridiculous amount of taxation".[17] Research by Philip Beresford, compiler of the Sunday Times Rich List has indicated that during 2009 at least 498 directors of UK companies changed their addresses to one of Jersey, Guernsey or the Isle of Man with an additional 91 UK companies similarly moving their registered address there.[18]

It is not just financial services firms that are finding the UK less appealing as a domicile within which to operate. United Business Media, a major media publishing group, moved its headquarters to Dublin in June 2008,[19] as did WPP, a FTSE 100 advertiser,[20] and Shire, a pharmaceuticals company, in the same year, whilst major publisher Informa switched its tax base to Switzerland in 2009.[21] One of the main reasons driving this relocation was the planned changes to the treatment of tax on foreign earnings, which eventually resulted in concessions by the Labour government, albeit too late to prevent the move of these corporations.

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[12] http://investor.britinsurance.com/phoenix.zhtml?c=133807&p=irol-newsArticle&ID=1354543&highlight=

[13] http://www.independent.co.uk/news/business/news/lloyds-insurer-kiln-joins-exodus-to-bermuda-440147.html

[14] http://www.independent.co.uk/news/business/news/zurich-in-talks-with-fsa-as-it-plans-assurance-base-in-dublin-1999809.html

[15] http://www.aviva.com/media/news/5507/

[16] http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/5300951/Income-tax-rise-forces-Guy-Hands-across-the-water.html

[17] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/6804908/Ten-entrepreneurs-a-week-quit-UK-to-avoid-50pc-tax-rate.html

[18] http://www.timesonline.co.uk/tol/news/politics/article6954613.ece

[19] http://www.guardian.co.uk/business/2008/apr/28/unitedbusinessmedia.taxavoidance

[20] http://www.independent.ie/business/irish/wpp-moves-hq-to-ireland-in-taxcut-bid-1485865.html

[21] http://www.guardian.co.uk/business/2009/may/01/informa-budget-tax-switch

Even so firms are still leaving, as Yahoo has announced that it is moving its headquarters from London to Switzerland in order reduce costs and remain competitive.[22] Ineos Capital, a pharmaceutical group that has recently moved to Switzerland, estimates that between 2010 and 2014 it will save around €450 million in cash taxes as a result of the move.[23] Wolseley, the world's largest plumbing and heating products supplier, is establishing a Jersey holding company for the group which will have tax residence in Switzerland, with the main reason cited as tax-efficiency.[24]

In an attempt to stem the tide the Chancellor has made pledges to reduce Corporation Tax and to further simplify the taxation regime through the Office for Tax Simplification, as well as to minimise regulatory hurdles for companies where possible and to make further changes to the tax treatment of foreign earnings. This has been a positive step, and was expected given that whilst in Opposition the Shadow Chancellor wrote a letter to Alastair Darling urging a quick response to the potential exodus of companies and criticising the uncertainty of the tax and regulatory regime in the UK. "With companies leaving Britain, weakening an already ailing British economy, I urge you to adopt proposals in order to restore our competitiveness and help prevent any more companies from deciding to leave the UK".[25]

Yet there is a concern in the City that some of these pledges made in Opposition may not survive in government. One of the main factors that encourages businesses to relocate is uncertainty over tax and regulation, as the difficulty in planning business decisions over the medium and longer-term makes it more attractive to move to stable regimes. Firms may well leave not as a result of specific regulatory or tax changes introduced, but simply due to the instability of regime and fears of what might be unexpectedly introduced.

Other sources such as the CBI and KPMG have produced reports outlining their fears over the recent changes to the UK's current tax and regulatory regime.[26,27] KPMG's survey particularly noted that complex rules and over-legislation were holding the UK back, placing Switzerland, Ireland and Cyprus towards the top of the most attractive places to do business in Europe due to the stability of their fiscal laws, low rates of taxation and straightforward rules. Even a report by HM Revenue & Customs commissioned in August 2010 believed that one in five UK businesses have considered relocating abroad

[22] http://www.guardian.co.uk/business/2008/mar/14/technology.yahoo
[23] http://business.timesonline.co.uk/tol/business/industry_sectors/industrials/article7049007.ece
[24] http://www.telegraph.co.uk/finance/newsbysector/constructionandproperty/8028633/Wolseley-moves-to-Switzerland-because-of-UK-tax.html
[25] http://www.telegraph.co.uk/finance/2795424/George-Osbornes-letter-to-Alistair-Darling.html
[26] *"CBI Annual Conference Survey 2010: The UK as a place to invest",* Deloitte/CBI, October 2010. http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/0d7a75c1365294a2802577bd0036ff2c/$FILE/CBI-Deloitte%20UK%20as%20a%20place%20to%20invest%20survey%20-%20Ipsos%20MORI%20report.PDF
[27] *"UK Tax Competitiveness Survey 2008: Riding the Storm",* KPMG, 2008. http://www.kpmg.co.uk/pubs/119784_Tax_Competitiveness_Survey_Access.pdf

for tax reasons.[28]

Such tales are common, and global financial sector businesses are highly mobile, with the vast majority of international relocations reflecting evolving business needs and new business ventures. Thus, though such anecdotes are interesting, can we identify any more robust evidence that there are indeed more departures going on, rather than the usual balance of inflow and outflow natural for any dynamic global centre?

Survey: Are more firms and professionals considering leaving?

As will be discussed later in this paper, there is an inherent difficulty with the attempts at scientifically comparing the relative merits of different tax and regulatory domiciles. An enormous array of factors affects the managerial decision of where to locate a business, far beyond the level of taxation or the regulatory hurdles that must be leaped. If this were not the case then every country would be forced to compete very aggressively on these technical issues to provide the most attractive location for fear of a wholesale departure of enterprise.

One method of circumventing this difficult comparison is simply to ask whether firms and individuals are either actually planning on leaving, or have at some point seriously considered leaving. The technical attractiveness of the relative merits of different financial centres is a secondary concern to the perceived attractiveness of those relative merits. Whilst the former will affect the latter, when your aim is to influence the decision to remain, then the most important consideration is the perception that those firms and individuals have of the UK *relative* to other domiciles, which can be discovered by asking them directly.

As a result we commissioned two surveys of the financial services sector by YouGov, in order to attempt to illuminate whether the media's suggestion of the potential for an 'exodus' is unjustified hyperbole, or whether in fact it is a very real and growing problem and that we are indeed on the cusp of a larger emigration of the sector.

The surveys were conducted independently by YouGov who used two separate online interviews, one targeted at senior managers within the financial services sector, seeking to find out their views on the companies they manage, and the other targeted at professionals in the financial services industry seeking to discover their views on their own individual positions.

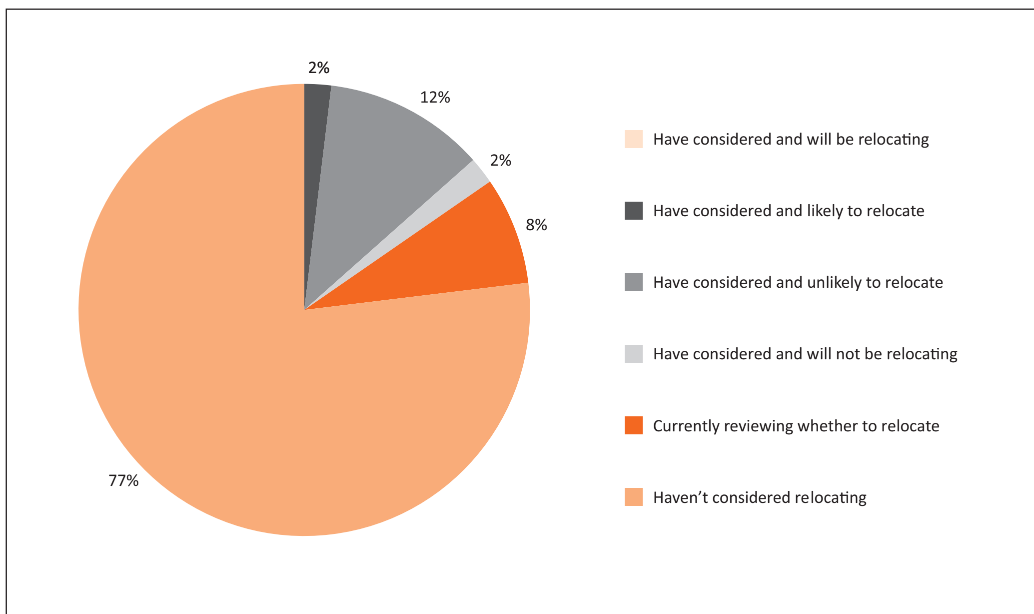
[28] http://www.telegraph.co.uk/finance/economics/7962524/Tax-regime-drives-20pc-of-big-businesses-to-consider-leaving-UK.html

Survey results: How many firms and individuals are relocating and when?

Survey results: Senior managers[29]

The headline result from the survey is that of those senior managers polled, 23% have either considered or are currently considering whether to relocate their businesses from the UK. 2% of respondents are currently planning or consider themselves likely to relocate, with 14% having considered their position and either staying or unlikely to move, and a further 8% still undecided as to their position.

Figure 1. Are you considering relocating your business from the UK?

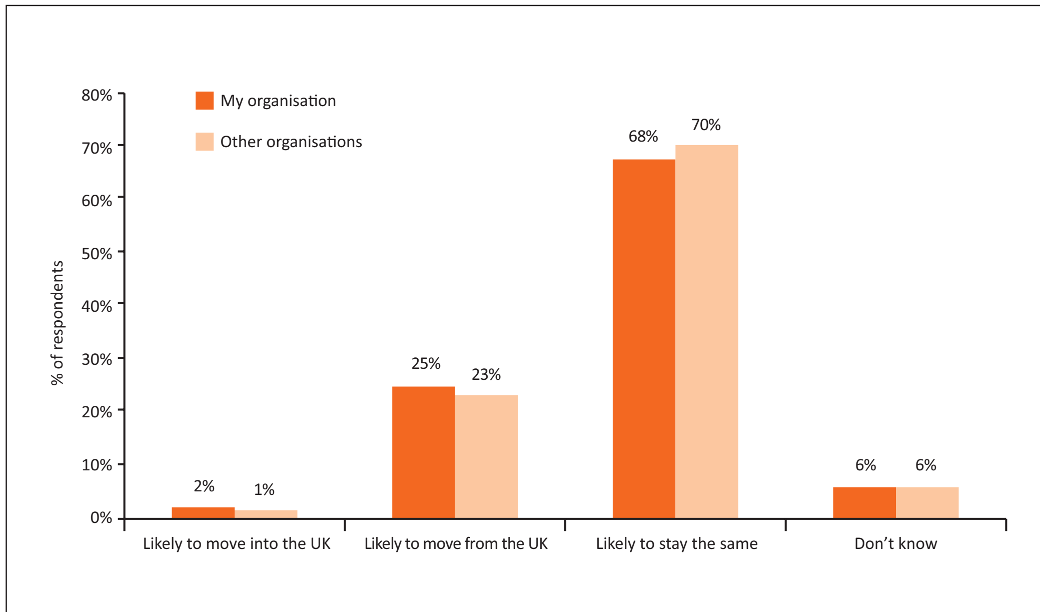


Source: YouGov, Policy Exchange

Some 25% of the senior managers polled thought it likely that over the next few years their organisation would move operational parts of teams out of the UK, with 2% believing that their organisation would add to their UK operations in the same time frame. In addition amongst respondents there was a similar proportion of expectation as to the likely organisational changes of their peers, with 23% expecting to see movements out of the UK and 1% expecting movements into the UK.

[29] All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 57 adults. Fieldwork was undertaken between 31st August 2010 and 2nd September 2010. The survey was carried out online and all figures are unweighted.

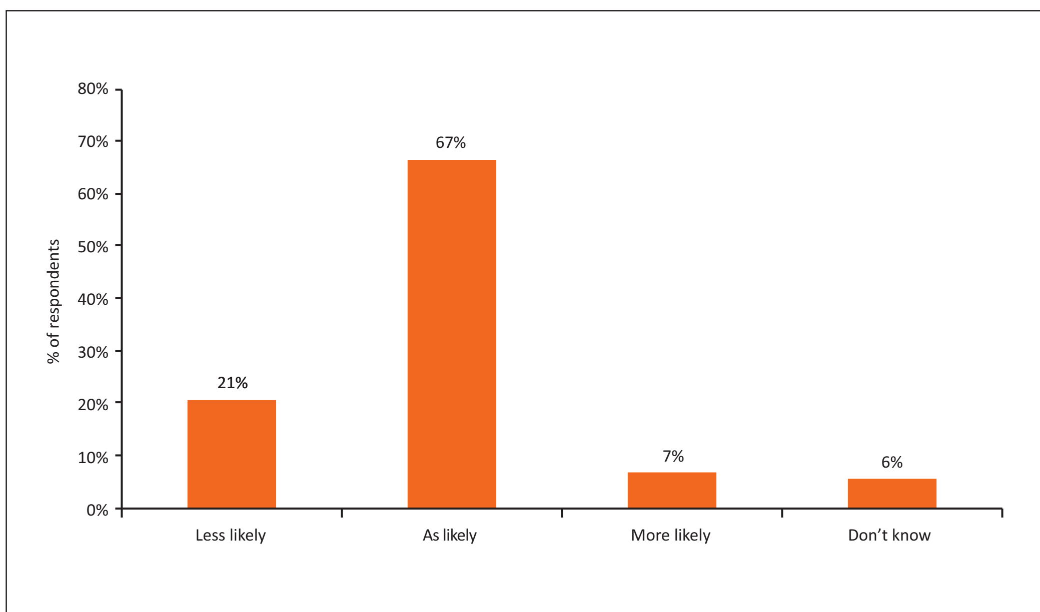
Figure 2. Over the next few years what movements of operational parts or teams into or from the UK do you expect?



Source: YouGov, Policy Exchange

When we asked the senior managers to consider whether relative to ten years prior the organisations in their sector (including their own) were more or less likely to move operational parts or teams into the UK, or to commence new UK operations, 21% believed the situation had deteriorated, whilst 7% believed the situation had improved. Two thirds of respondents believed that over the past ten years the situation had not changed sufficiently to alter the likelihood of firms moving to or leaving from the UK.

Figure 3. Relative to ten years ago, are organisations in your sector more likely to move into the UK or commence new operations?

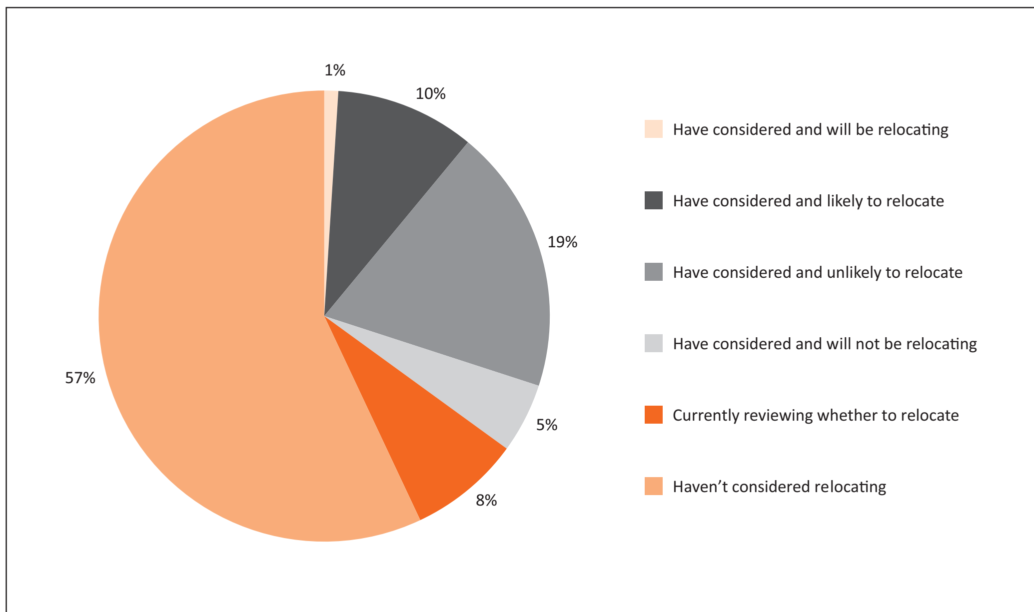


Source: YouGov, Policy Exchange

Survey results: Professionals[30]

From our survey of financial services professionals, the headline result is that of those polled, 43% have either considered or are currently considering whether to leave the UK. Additionally over a quarter of those (11% of the total respondents) have already considered their positions and are either definitely departing or are likely to do so in the near future. 24% of respondents reported that they had considered relocating but had either decided against it, or were unlikely to move.

Figure 4. Are you considering relocating from the UK?

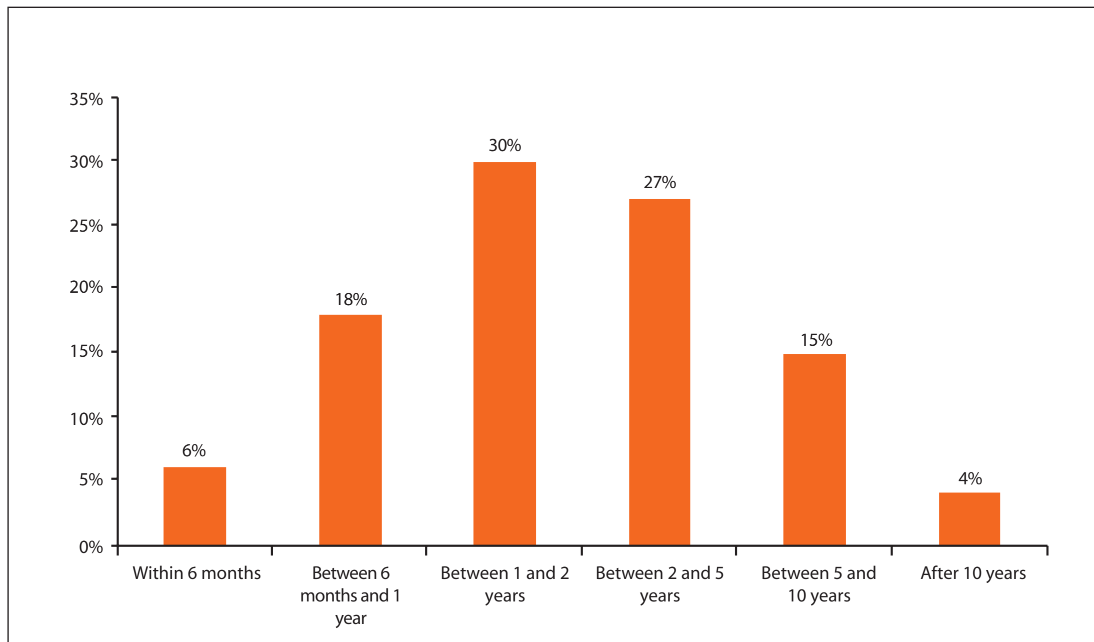


Source: YouGov, Policy Exchange

Of those intending or likely to move domicile, 24% are planning on leaving within one year, rising to 54% within two years and 81% within five years.

[30] All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 1,014 adults. Fieldwork was undertaken between 31st August 2010 and 6th September 2010. The survey was carried out online and all figures are unweighted.

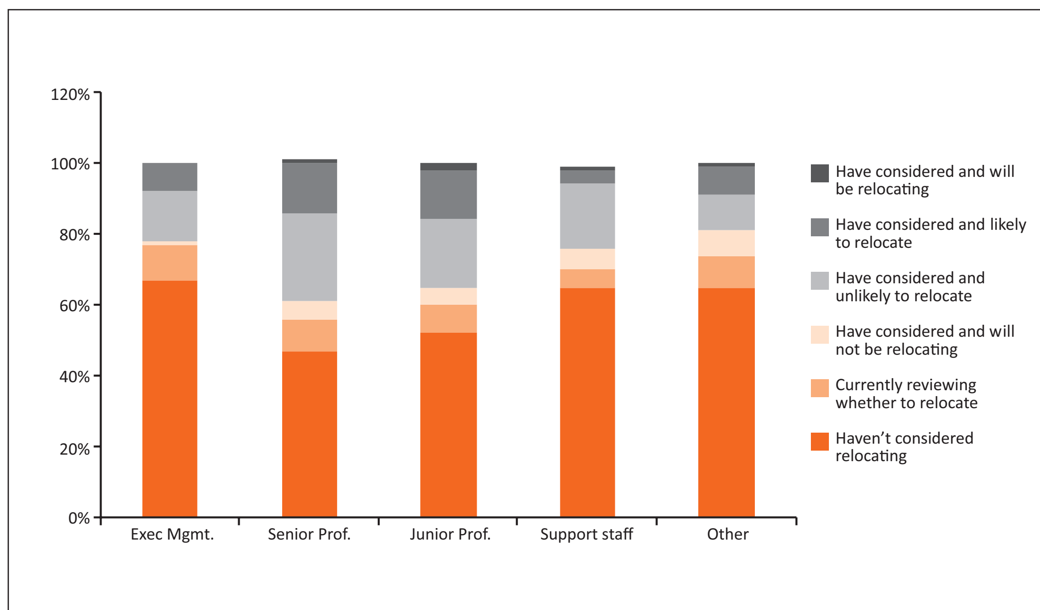
Figure 5. In what timeframe are you planning to relocate?



Source: YouGov, Policy Exchange

Looking more closely at the intentions of different levels of workers, we can see that amongst senior and junior professionals there is a sizable increase in both those who have considered or are considering changing their domicile, and those intending or like to move from the UK.

Figure 6. Are you considering relocating from the UK? (By worker type)

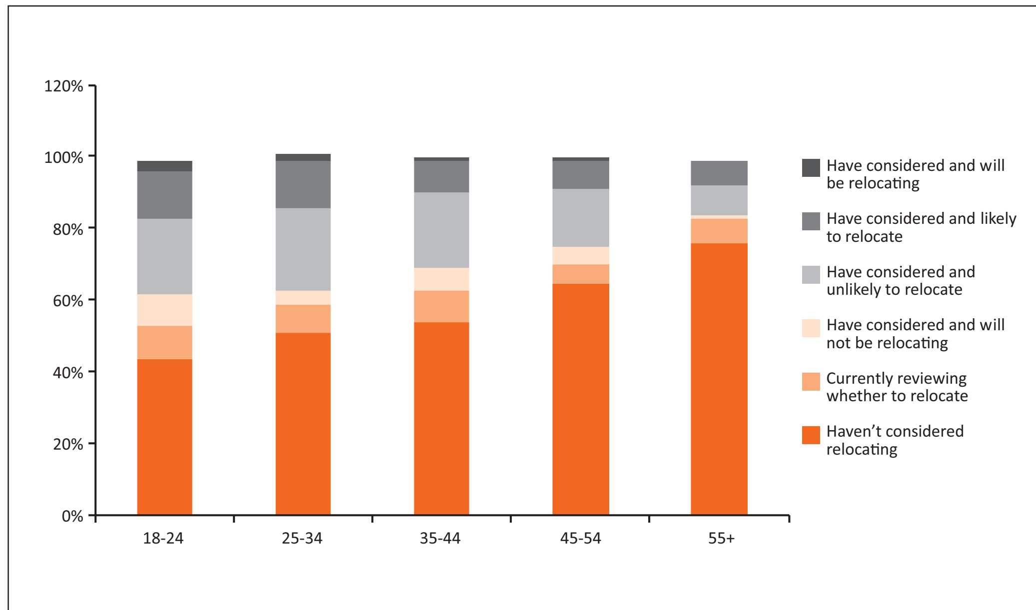


Source: YouGov, Policy Exchange

Additionally the evidence is clear (as one would expect due to increased familial commitments as well as

established social and professional networks) that as age increases there is a decline in the likelihood of relocation to a new domicile. The proportion of those who are either considering relocating or have considered falls steadily from 55% amongst the 18-24 age range, to 23% of those 55 and over. Similarly the number of those either leaving or likely to do so falls from 16% in the 18-24 age bracket and 15% in the 25-34 age bracket to 9% amongst 45-54 year olds and finally 7% in the 55 and over group.

Figure 7. Are you considering relocating from the UK? (By age group)



Source: YouGov, Policy Exchange

What creates an attractive environment in which to work or do business?

Obviously myriad factors are at play in determining what make a place better to work in and a domicile better to run companies in, from the tax and regulatory regime individuals and companies face, to the ease of access to markets and factors of production, as well as to families and friends. The City of London's biannual report on Global Financial Centres outlines five broad categories of factors influencing the attractiveness of a location for companies: people, the business environment, market access, infrastructure and general competitiveness. [31]

Whilst it is beyond the scope of this paper to attempt a direct comparison between the major financial centres (see the City of London's aforementioned report or the World Economic Forum's Global Competitiveness Report for efforts at statistically judging this), it is nonetheless instructive to unpick some of these categories in order to have a clearer idea of the individual factors at work, and to see which of them are within the scope (either in the short-term or the long-term) of government policy.

[31] *"Global Financial Centres 7"*, Z/Yen Group Limited/The City of London, March 2010. http://217.154.230.218/NR/rdonlyres/661216D8-AD60-486B-A96F-EE75BB61B28A/0/BC_RS_GFC7full.pdf

The business environment within which a company operates can have an enormous impact on that company’s success. Things we often take for granted in the UK (but are prized and difficult to secure elsewhere) such as the rule of law, enforceability of contracts, political stability, high levels of transparency and low levels of corruption, all significantly enhance stability and predictability for companies. This then enables them to attract financial backing and staff, as well as increasing the certainty that the expected fruits from labour will be received.

Beyond just increasing certainty of outcomes, the environment will also dictate how easy it is to conduct business through the regulatory hurdles that a government sets, and also the level of return that can be achieved on enterprise through the effective tax rates that are set both for companies and for individuals. Whilst the first set of factors within this category can take a considerable amount of time and effort to improve (as many developing nations continue to find), the second set are significantly influenced by the will of governments.

Moving onto the second factor, ideal geographic placing is a highly fortunate advantage the UK's financial services industry benefits from, conveniently situated between both the American and Asian markets and proximate to the European markets. This helpful location and the policy of deregulation which emerged in the 'Big Bang' reforms of 1986 converted a strong domestic banking industry, which had been founded in the UK's history as a major industrial power, into Europe's key financial centre as well as one of the world's most international financial centres. This helped to draw in an unprecedented amount of capital, further developing existing stock exchanges and markets in financial services such as foreign exchange, derivatives, and insurance, as well as establishing new ones.

It is this depth and strength that the UK's financial markets acquired that further encourages its development in preference to other financial centres, particularly in Europe. Firms based in other countries seek listing on UK exchanges as it gives them access to a considerably deeper pool from which to source the capital they need to operate, whether equity or bonds. The depth of capital, and the inherent liquidity and competition for returns that this provides, allows firms and individuals to benefit from the most competitive rates, whilst the ability of firms and individuals to access any and all of the most sophisticated financial tools available to them provides further incentive to do their financial services in a major financial centre like London.

The difficulty and the time required to develop such markets is a problem the aspiring financial centres of the future are all too aware of, many of whom are forced to offer incredibly low taxation rates and limited regulation in the hope that this will attract the markets they desire. However to assume that as the UK's leading position in financial services is established it is automatically secure in the long-term would be to ignore the many historical occasions when centres of production or trade have risen in global importance, and then subsequently declined.

The third factor of competitiveness we can consider is that of infrastructure, those foundations of an

economy without which it would struggle to function at all. Secure and reliable energy and water sources, advanced communications networks, high-quality transport links (both internally and internationally), as well as affordable and attractive business locations well-suited to the type of enterprise being undertaken, are all incredibly important in assisting companies in the smooth operation of their businesses. An additional benefit of good infrastructure is to improve the quality of life for a company's workers, and hence making it a more attractive place to live.

Whilst the quality of infrastructure is naturally determined by a government's spending decisions, the development of infrastructure is a long process requiring considerable planning, and hence a factor which is largely the product of the series of decisions taken by the current and prior governments. It also comes at a significant cost. In our paper *"Delivering a 21st Century Infrastructure for Britain"* Policy Exchange has estimated that the UK will need to invest at least £500 billion by 2020 in order to renew its infrastructure sufficiently to keep the UK competitive with its peers.[32]

Infrastructure is a *sine qua non* of a productive economy, and whilst it may not be changed or improved quickly, it is well worth noting that credible long-term plans for investment and regeneration in infrastructure send out a positive message to both businesses and individuals, and improve the long-term attractiveness of a location.

Another group of factors determining competitiveness simply consists of those assortment of factors not easy to collate, but still possessing attractive qualities for businesses, such as the cost of living, the underlying business confidence, the level of foreign direct investment flows, the general brand of London and other cities in the UK, as well as the amount of intellectual property held within the country. These can all be indirectly influenced by government policy, for example by encouraging property development or incentivising higher levels of research and development, but are far from simple to manipulate and represent the more blunt ways of becoming more attractive as a domicile.

Considering the final category of 'people'; for any firm to succeed in a competitive marketplace it must be able to source able and suitably skilled professionals and managers. In the long-term a government can thus pursue a variety of educational objectives, for instance by encouraging a higher general level of education through raising the school leaving age or targeting increased numbers of graduates.

However, whilst these educational objectives in the long-term improve the human resources that are already located in a country, this alone fails to grasp the need to provide the employees whom the businesses require with an attractive location in which to live. Those in whom you invest money in improving educationally may decide afterwards to move to places where they are taxed less, their

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[32] Helm, D., Wardlaw, J., and Caldecott, B. *Delivering a 21st Century Infrastructure for Britain*, Policy Exchange, 2009.
http://www.policyexchange.org.uk/images/publications/pdfs/Delivering_a_21st_Century_Infrastructure_for_Britain_-_Sep__09.pdf

quality of life is higher, their children can be better educated, or even somewhere with more days of sunshine. Those who have been developed elsewhere also need to be attracted if a government wishes to provide businesses the deepest pool of human capital from which to draw.

Some of these factors are inevitably beyond the government's control, whether they are positive (e.g. existing social networks and familial commitments) or negative (e.g. the notorious British weather), but many of them are not. Lower personal tax rates provide greater disposable income with which to improve lifestyles, whilst better infrastructure (for instance in transport by improving or shortening journeys, or in utilities by ensuring reliable and good value provision), and the provision of high quality education, healthcare and emergency services improve quality of life directly.

Similarly, world class restaurants, galleries, theatres and opera houses cannot be easily transplanted. The personal freedoms of religious belief, sexuality, lifestyle choice, and from racial hatred should not be underestimated in a cosmopolitan centre such as London. All of these things and others help make the decision to reside in the UK easier, assisting the staffing of businesses whilst having the important benefit of improving the lot of the electorate.

In recent times the UK has fallen down the rankings of competitiveness that have been published. The World Economic Forum's Global Competitiveness Index places it 12th, behind Scandinavia, Switzerland, Germany and the Netherlands in Europe, the US and Canada in North America, as well as Japan, Hong Kong and Singapore in Asia.[33] In the City of London's most recent report on Global Financial Centres, London has lost its advantage over New York, and is facing increasingly competitive propositions from Hong Kong and Singapore.[34] Zurich, Geneva and Frankfurt are no longer far behind and given the current policies are likely to narrow the gap in the short term.

Survey results: Why are financial services firms considering leaving the UK?

Beyond the headline results, we also asked senior managers what the main factors would be in their decision to move their organisation out of the UK’s domicile, what their preferred alternative domiciles were, and also what the main factors were which would keep them in the UK. The survey was carried out online by YouGov plc between the 31st August and the 2nd September in 2010, with a total sample size of 57 adults.

Considering first the main factors driving the decision process to leave, the most important reasons for businesses were the current tax and regulatory burdens (with 74% and 67% of respondents respectively citing this as factors). This was closely followed by the continuing uncertainty over changes to taxation

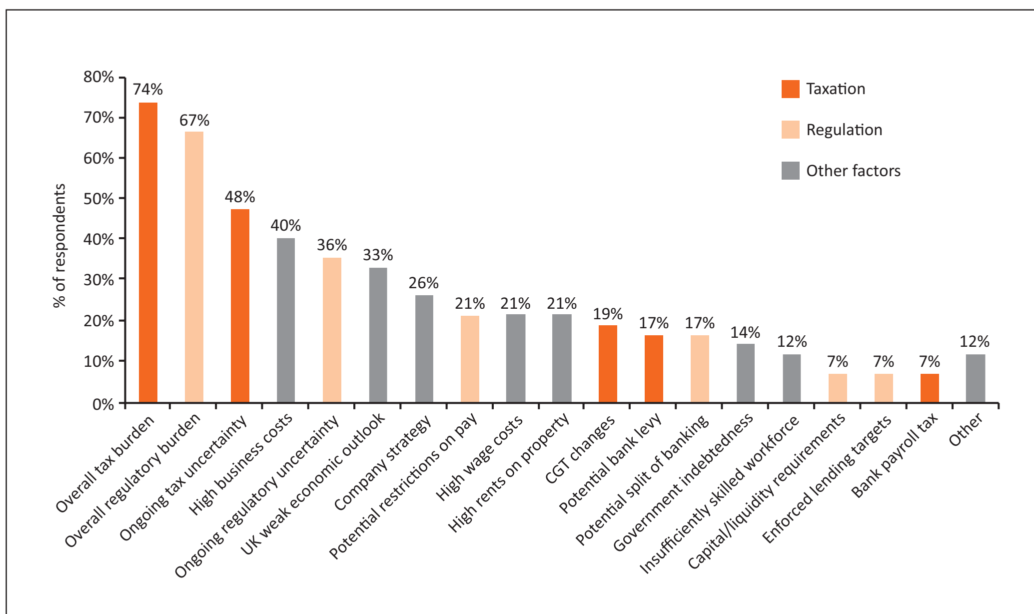
[33] *“The Global Competitiveness Report 2010-2011”,* World Economic Forum, 2010. http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf

[34] *“Global Financial Centres 7”,* Z/Yen Group Limited/The City of London, March 2010. http://217.154.230.218/NR/rdonlyres/661216D8-AD60-486B-A96F-EE75BB61B28A/0/BC_RS_GFC7full.pdf

and regulation (at 48% and 36%), as well as the high costs of operating in the UK (40% of respondents included general business costs, whilst 21% included high wage costs and another 21% included high property costs).

The current weak economic environment and outlook in the UK, also plays a significant role in the decision process as 33% noted this as a key reason, with another 26% seeing the move out of the UK as driven by corporate strategic needs. Individual regulatory and taxation changes were seen as less important collectively, although this does not necessarily mean that these individual factors would be insufficient in driving away specific subsectors of the financial services industry.

Figure 8. What would be the main reasons for moving your organisation from the UK?

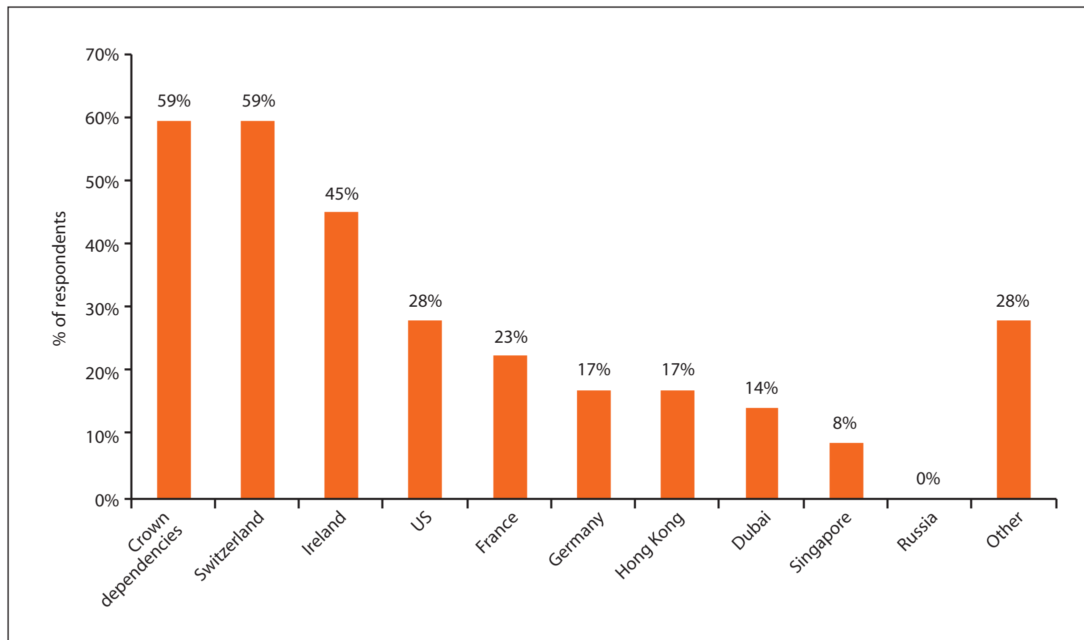


Source: YouGov, Policy Exchange

A cursory glance at the preferred alternative domiciles for these businesses is instructive. The majority of businesses in the financial services sector are not thinking of moving to the nascent Asian financial centres of Singapore, Dubai and Hong Kong (only 8%, 14% and 17% of respondents respectively placed them within their top three choices). Nor it would seem are they contemplating moves to the other major European nations like France or Germany, receiving votes from 23% and 17% of the respondents.

Even New York, the former global financial hub from which London assumed the mantle, remains less attractive relative to the low tax regimes and simple regulation of the Crown Dependencies (Jersey, Guernsey and the Isle of Man), Ireland and Switzerland, favoured by 28% of respondents compared to 59% for the Crown Dependencies, 59% for Switzerland, and finally 45% for Ireland in spite of its current woes.

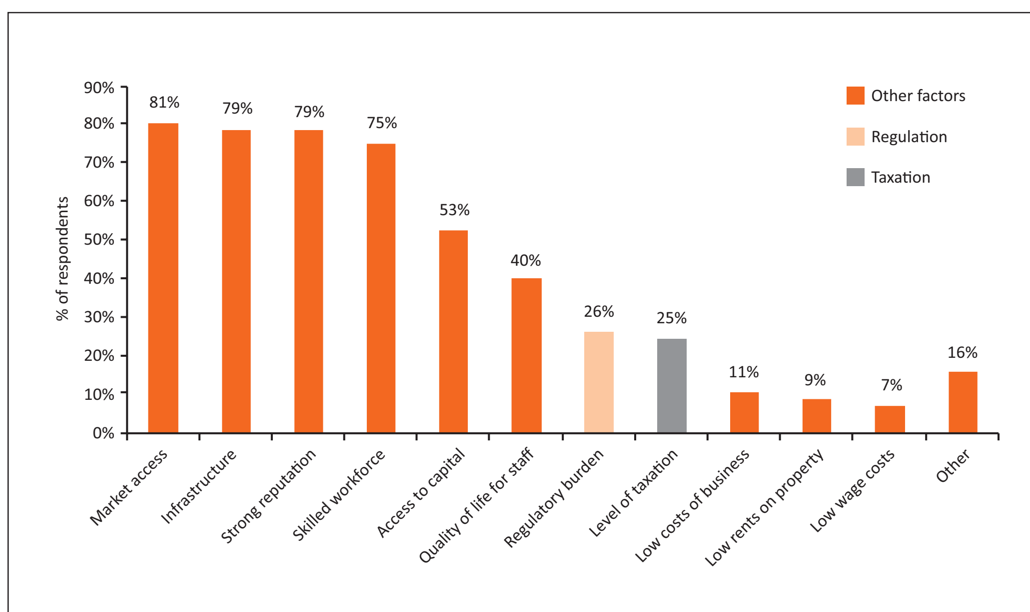
Figure 9. Which domiciles would you be most likely to move your organisation to?



Source: YouGov, Policy Exchange

When we ask those senior managers what the key factors that the UK has which helps retain their organisation, it is immediately clear that the UK relies heavily upon its strong foundations of an historic reputation, excellent access to markets and capital, reliable infrastructure and a well-developed and skilled workforce to maintain its crown. The weak points in the UK's armoury remain the high costs of living and operating, and the current tax and regulatory burdens, the latter of which once would have been a strong attraction for developing businesses.

Figure 10. Why is your organisation most likely to remain in the UK?



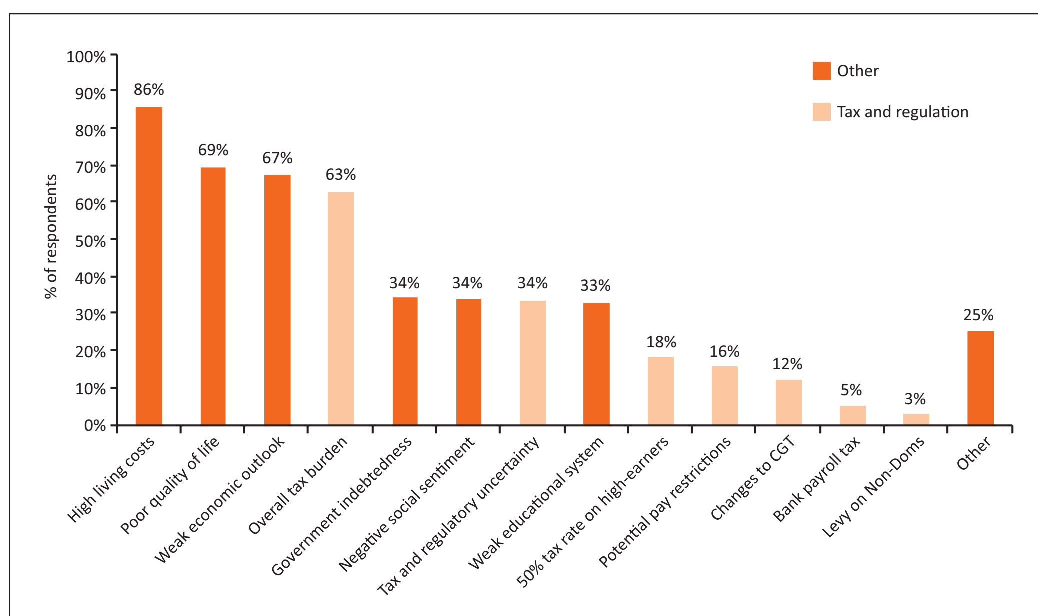
Source: YouGov, Policy Exchange

Survey results: Why are financial services professionals considering leaving the UK?

Turning to what the driving factors are in the decision making process for individuals in the financial sector when they consider moving to a different domicile, it is apparent that these are significantly different from the concerns of the firms they work for. The general strifes of life, such as living costs (86% of respondents), poor quality of life (69%), an uncertain economic outlook (67%) and the overall burden of tax (63%) are seen to be collectively by far the most important reasons why an individual would depart from the UK. The survey was carried out online by YouGov plc between the 31st August and the 6th September in 2010, with a total sample size of 1,014 adults.

Specific taxes and regulations appear to be overall of less concern, for instance the 50% tax rate on high earners (cited by 18%), the potential restrictions on remuneration (16%), changes to Capital Gains Tax (12%), as well as the bank payroll tax (5%) and the levy on non-domiciles individuals (3%). Again it is worth noting that, although our evidence suggests that overall these are not significant concerns, there may be cases (e.g. the annual levy on resident non-doms) where those rules are sufficient concerns in and of themselves for small but important groups of people.

Figure 11. What would be your main reasons for leaving the UK?

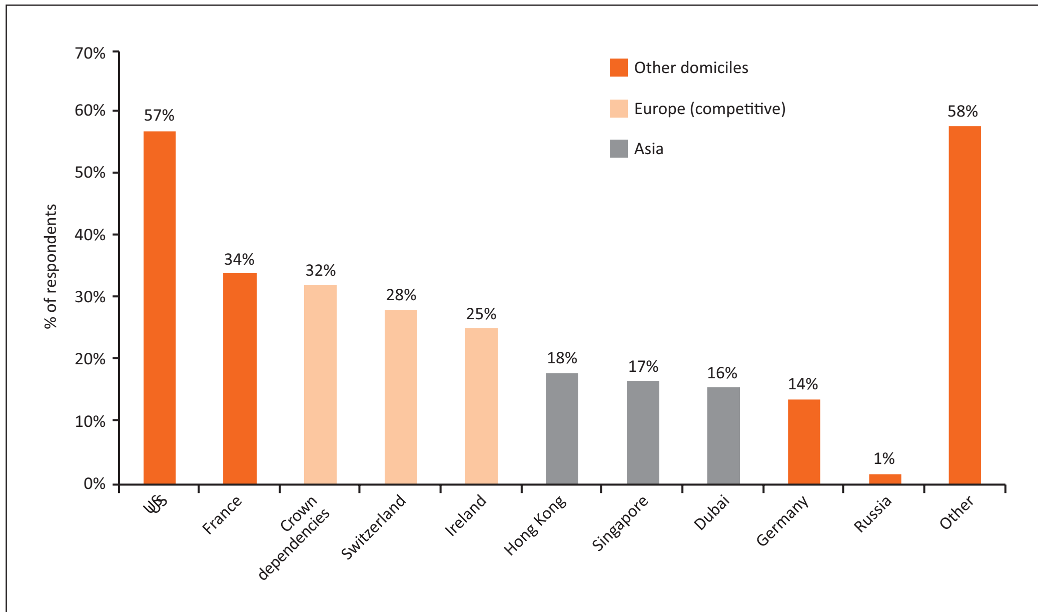


Source: YouGov, Policy Exchange

In contrast with the intentions of the firms that the professionals work for, there is a significant preference amongst individuals to move to the United States (57% of respondents), whilst France is also an attractive alternative (34%) amongst the more competitive European tax regimes like the Crown Dependencies (32%), Switzerland (28%) and Ireland (25%). Asia remains unattractive relative to Europe and North American alternatives in spite of its growth prospects.

The unusually high number of 'other' responses was split across a broad range of countries, but for the most part was represented by Australia, Canada, New Zealand, Spain, the Netherlands, Luxembourg and Cyprus.

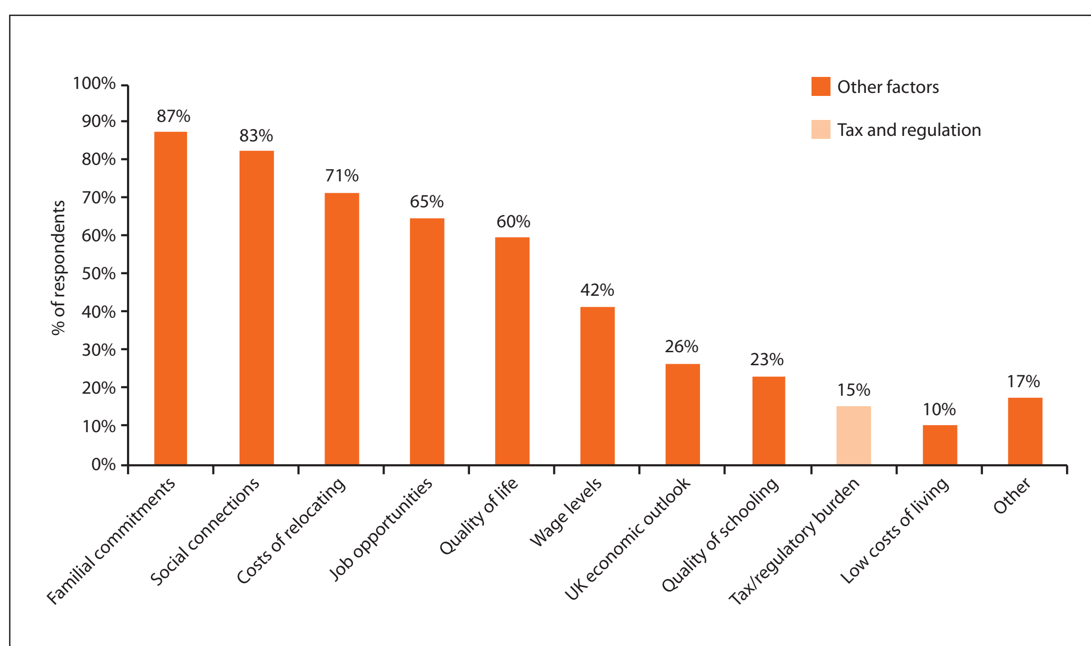
Figure 12. Which domiciles are you most likely to move to?



Source: YouGov, Policy Exchange

When asked why individual financial professionals would be most likely to stay, again most of them saw little attraction in the current tax and regulatory regimes (cited by 15% of respondents), and instead were driven by the personal concerns of family (87%), friends (83%), opportunities for employment (65%) and the general quality of life (60%), as well as the strong disincentive of the physical costs of a relocation (71%).

Figure 13. Why are you most likely to remain in the UK?



Source: YouGov, Policy Exchange

What do we lose when financial institutions or professionals leave?

Natural reactions to some of the evidence above might be: "who cares if they leave?" or "a good thing too!". Iceland and Ireland have been object lessons in the dangers of an economy becoming overly dependent on the financial sector. Huge bailouts of financial sector firms have imposed burdens on taxpayers. It is not perhaps as obvious to the public as professionals in the financial sector like to suppose that the very presence of the sector provides a net benefit to the economy.

Several reports have attempted to indicate how much the financial services sector contributes to the UK, though these rarely include the costs imposed, both actual and potential. A report by PwC in December 2009 estimated that the financial services industry contributed £61.4 billion[35] (12.1% of total tax revenues and 17.7% of total government Corporation Tax receipts) to UK government taxes in the 2008/09 financial year, in spite of the decline in financial services activity. Before the financial crisis these figures were even higher, at £67.8 billion (27.5% of total government corporation tax receipts).[36]

Regarding contribution to output, TheCityUK has estimated that financial services contributed 10% of GDP in 2009,[37] whilst CRA International has estimated that the associated professional services activity

[35] *"The Total Tax Contribution of UK Financial Services – 2nd Edition"*, PwC, December 2009
[36] Ibid
[37] *"Financial Markets in the UK",* TheCityUK, November 2010.
http://www.ifsl.org.uk/media/191876/financial_markets_in_the_uk%2011_2010.pdf

(law, accountancy, consulting) adds a further 3.9% of GDP.[38] Financial services also have major impacts on employment and the balance of trade, with over 1 million employed in 2008/09,[39] and £40 billion of trade surplus generated in 2009.[40]

These matters are complex, and it does not fall within the scope of this report to produce a robust cost-benefit balance sheet for the UK's financial sector. However, some brief remarks are relevant.

Amidst an atmosphere of austerity, with a substantial fiscal deficit to repair and considerable cuts to public spending and services as part of the fiscal consolidation, the easy assumption is that those with more should pay even more than they do already. If the money has to be recouped from somewhere then smaller net profits for successful firms (particularly highly profitable financial institutions) and less take-home pay for higher earning individuals is surely the least painful way of achieving the goal.

Yet this fails to confront the reality of the situation. We live in a world of choice where individuals can elect how hard to work, whether to establish enterprises, and where to locate themselves and the companies they control. These are not exogenous inputs to the model of the UK's economy. When regulatory changes are introduced or taxes raised these have direct consequences on those choices.

Leisure will become more valuable to individuals relative to work, moving to other domiciles will generate more reward for the same amount of effort, and the value of successfully evading taxation or regulations will rise (and hence the temptation to do so). Companies (or additional operations) that were profitable may no longer be, those that are still profitable may find that they can now generate more from the same inputs elsewhere.

For high-earning individuals the costs of relocation are small relative to their wealth and the benefits of relocation potentially extremely large. It is often only the social ties that keep an individual from departing, but when other colleagues and friends and their families begin to relocate, the ties to a particular domicile will decline and the advantages to moving increase. But why should we care?

Individuals

When an individual chooses to live somewhere else, we might not necessarily see this as a problem. If that person (and their family) was a net recipient of money from the state, then their departure will make the country richer, there will be less competition for public resources and they may do more harm than help to others. There would be a net social benefit to the country of their exit.

[38] *"The Taxation of the Financial Services in the UK: Predictability and Competitiveness"*, CRA International, October 2010. http://217.154.230.218/NR/rdonlyres/E3CEF4F7-479B-46B4-AB93-29DF5F673B53/0/TaxationofFinancialServices.pdf

[39] ONS Labour Force Survey (2008/09)

[40] *"The Taxation of the Financial Services in the UK: Predictability and Competitiveness"*, CRA International, October 2010

This is naturally a rather negative case. It is hard to conceive that the majority of people do not contribute something, whether financial, social or cultural, to their place of domicile. Yet it is very difficult to assess many of these factors. One factor we can be more certain of is the financial input provided by an individual. An individual receives the fruits of their labour, whether through income or profits from an enterprise they own a stake in. Of this money, a slice is paid directly in taxation to the government, and the rest will be saved, invested or spent, which will then be either earned by someone, capital to be employed by someone, and further indirect slices which will be taken by the government.

Without knowing an individual's exact financial circumstances, spending habits and so on it is difficult to make these calculations and derive the total financial input of a particular individual and their family, but nevertheless we should be able to make some sensible assumptions about their likely impact.

A high earner does not just pay more direct tax than low earners, but pays proportionally more direct tax. This is a feature of our progressive taxation system that seeks to ensure that those more able to pay, contribute more, and a function of the assumption that the same amount of money has greater utility for low earners, than it does for relatively higher earners. Hence we would expect wealthy and high income individuals to provide a substantially greater financial input to HM Customs & Revenue through direct taxation.

Whilst a high earner may choose to spend a smaller proportion of their income relative to low earners, due to a higher ratio of discretionary spending (luxuries) versus non discretionary spending (necessities), it is almost inevitable that they will spend more (and possibly substantially more) which generates higher indirect tax revenues and puts money back into the economy, as well as providing investment capital for other productive enterprises. Some of this will be spent or invested overseas, but even so some taxation will still be received.

Hence those most mobile individuals (i.e. the wealthiest), also provide a proportionally larger financial input to the country in which they choose to reside than other lower earners. When we consider financial services relative to other sectors in the UK, the earnings are certainly above average and hence many of the workers in that sector will fall into the above categories. There may well be a case that inequality has a social cost in itself, but we should be careful to note the substantial financial cost (and potential fall in living standards) to the country of a significant migration of high earning individuals. It is hard to view the equal sharing of miseries as preferable to an unequal sharing of blessings.

Companies

When a company chooses to locate itself elsewhere, again this might not necessarily be a bad thing. It could be exploiting workers, spilling toxic waste, causing dislocation of markets, or causing other forms of social, economic or environmental harm. The damage caused to the country could outweigh the employment generated and the tax revenues received. Yet that is the very purpose of regulation, to prevent the kind of harm from occurring which would outweigh (or could potentially outweigh) the

benefits of the enterprise.

First, however, let us consider what benefits a company can generate for the country where it is domiciled. In a similar vein to individuals, the state receives direct tax revenues from the profits generated, as well as from the income of the company's employees, and also from National Insurance contributions paid by both the employer and the employee. Any distributions to shareholders will also be subject to a further slice of taxation.

Even more important than taxation is the employment that businesses generate, organising and utilising labour resources. A greater number of employment opportunities and the consequent competition for workers will reduce unemployment (and hence the welfare burden), raise levels of pay, create better working conditions, and will increase the likelihood of an individual's financial independence from the state. These workers will then spend, save or invest their post-tax earnings, further adding to the economy.

The larger and more profitable a company is, the more tax revenue it will generate for its domicile, and if it pays its employees relatively high salaries then this will result in proportionally more tax income as well as higher levels of spending. All of which boosts GDP levels and consequently living standards as individuals become richer.

There are other additional benefits to enterprise locating in one's country. More firms will likely increase the level of competition in the market, providing better value goods and services, as well as increasing the range of choice available to consumers. The presence of firms, due to their supply chain needs, may also drive the creation of other business. The UK is not just a major centre for banking, but a variety of complementary services such as the provision of legal and accounting advice. There are often significant economies of scope when businesses locate near one another which should not be forgotten.

Conclusion

Financial services firms operating in this country benefit from a number of extremely valuable factors, amongst them the rule of law and enforceability of contracts, geographic positioning in the middle of the European, American and Asian markets, deep pools of capital, and a highly skilled workforce created by decades of London operating as one of the world's major financial centres.

Additional costs and burdens inevitably make the UK a less attractive place for individuals to work and for companies who provide financial services to operate, but have recent changes in tax and regulation actually been driving business and globally mobile individuals away from the UK?

It is always difficult in a study such as this, to ascertain whether the current level of those considering departing from the UK's shores is a meaningful amount. Without past statistical data of a similar type,

we are reliant on comparisons with the memories of those currently weighing up their options, which may well be unreliable, or arbitrary assumptions about what appears to be a large number of those considering their position.

Nevertheless it does seem to be the case that there has been some departure of the financial services sector already, and it is natural to suppose that over the next few years there will continue to be a modest net movement of financial services businesses (or operational parts and teams) away from the UK. How much of this is driven by the natural inflow and outflow of companies seeking new, more profitable, opportunities, and how much is driven by the current tax and regulatory regime, is very difficult to ascertain. However, a natural interpretation of the survey evidence we have gathered, in combination with the widespread anecdotal evidence in press reports, is that for a number of companies the ongoing uncertainty in the UK over the future path of taxation and regulation as well as their overall burden, have reached a threshold where they are significant issues for businesses considering their domicile.

We are not, however, as yet in the midst of a major exodus of firms or individuals from the financial sector, neither is it perhaps likely that we are on the precipice of one. However, the UK has become less attractive relative to other financial centres over recent years, with a consequent net movement of business away. Financial services institutions are most concerned over the tax and regulatory burden they face (and any uncertainty over how it will change), and are currently retained in the UK by the excellent access to markets, strong infrastructure and the worldwide reputation of the City.

For individuals, whilst there may be a greater proportion likely to (or indeed hoping to) move than the companies they work for, they are motivated by personal tax concerns, and see this as part of a broader problem in the UK with high living costs and the general quality of life they enjoy. They are generally bonded to their place of residence by their existing social contracts and networks, as well as the significant costs of relocating. The fact that their preferred alternative domiciles are somewhat at odds with those preferred by firms may yet be another balancing factor in the decision.

Additionally the evidence that it is the younger generations, and the professionals (as opposed to senior managers and support staff) who are more likely to reconsider their choice of domicile should sound a cautionary note about the current regulatory and tax regime. These workers are less constrained by the social ties that are the most important factor in retaining people, and whilst the decision to move is not one made easily, because of the costs involved it becomes all the more difficult to reverse.

London’s incumbency as the world’s pre-eminent financial centre creates many of these competitive advantages, but past success is no guarantee of future success, even if it helps. If we care about the value of the financial services industry to the UK then we should be concerned if the individuals who staff it are largely bound by social factors rather than attracted by the choice in and of itself. Rather than just relying upon a level of inertia, the key to retaining that pre-eminence in the long-term (which is, of

course, not an unalloyed good) and to avoid a slow drift away of business can only come from attracting more of those enterprising and globally-mobile businesses and individuals, not fewer.

Whilst it is beyond the scope of this paper to determine the net value of the financial services industry to the UK, we believe there is insufficient awareness of both the actual inward and outward flows to and from the UK of businesses and workers in key sectors, as well as the prevailing sentiment over their domicile. Hence we recommend that the government should:

- **Monitor levels of activity, with an annual "City Health Check".** Government should actively monitor and publish annual data of those inflows and outflows of businesses and employees into and from those industries which are internationally mobile and contribute a significant part of GDP and/or tax revenues

- **Monitor changing sentiment about the UK as a centre**. Government should conduct annual surveys of those same industries to determine whether changes in sentiment over the UK as a domicile are occurring, in order to be proactive in ensuring the UK's competitiveness, whether in infrastructure provision, tax and regulatory burden, or other important factors

- **Produce data on the social value of financial services.** To ensure that the potential impacts of policy choices are well understood the government should conduct high-level annual appraisals as to the estimated net cost or benefit of these industries to the UK.

- **Signal a change of direction.** Our survey suggests current concerns and moves to relocate are not driven by one single regulatory or tax policy decision, but by the cumulative impact of a large number of different policies. It is important for government to signal a turning point in this trend, with a number of significant decisions which will boost the attractiveness of the UK as a financial centre.

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The work of the Financial Services reform programme at Policy Exchange

For more information on the work of the Financial Services reform programme at Policy Exchange, please contact Ted Sumpster, Research Fellow at ted.sumpster@policyexchange.org.uk

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