Financial Services Sector Review

2016 starts with a whimper, uncertainty stalls growth

Q2 / 2016

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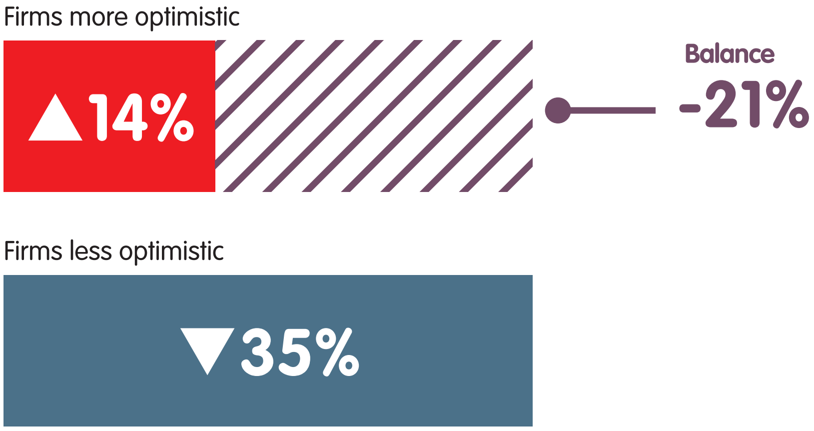

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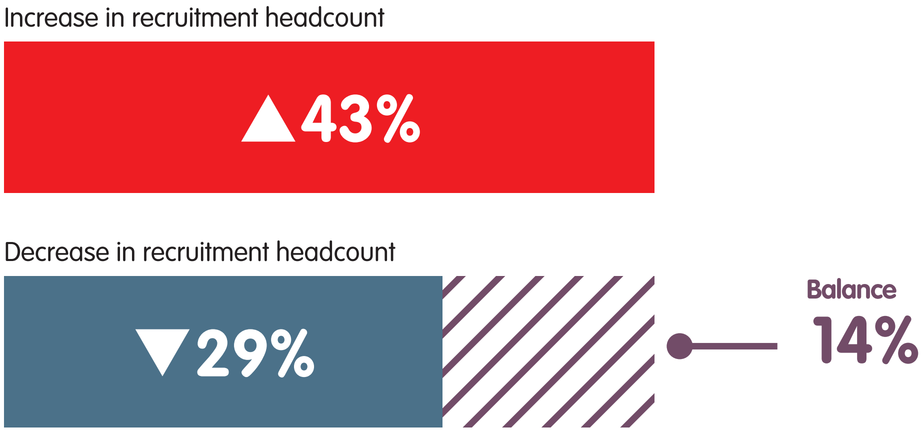


A worrying drop-off in economic confidence, against the backdrop of the EU referendum, has been the story of the UK during the first quarter of 2016, the financial services industry has proved no different.

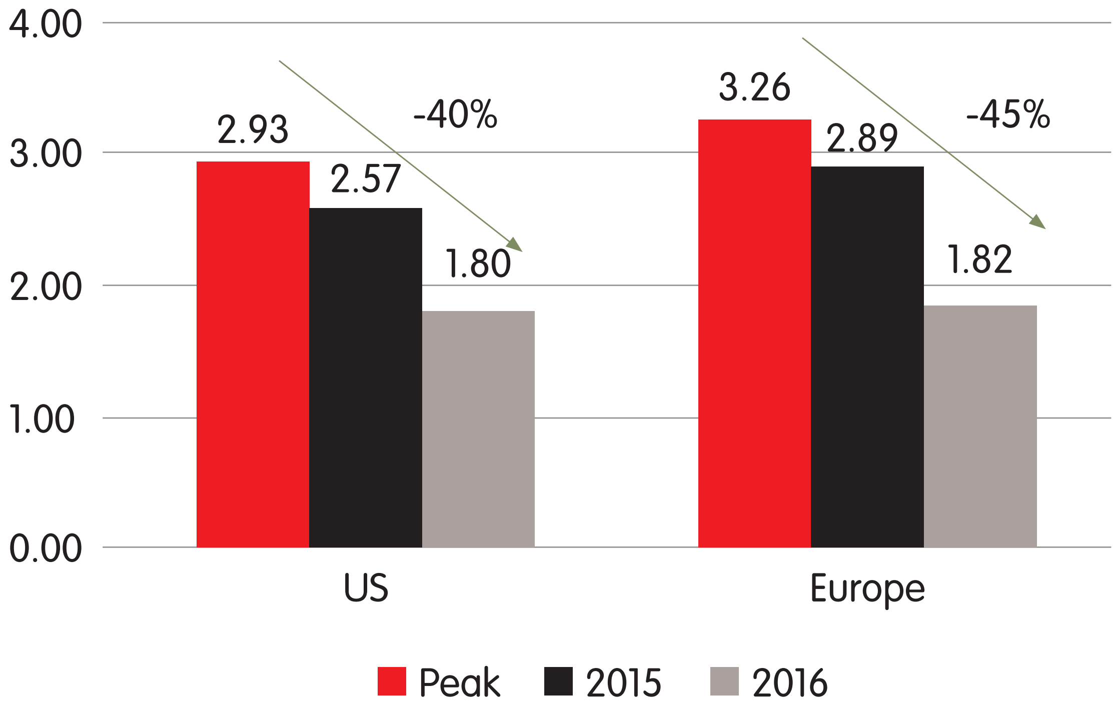
Confidence with the financial services sector fell at the fastest rate in five years during Q1 2016 according to the Financial Services Survey produced by the Confederation of British Industry (CBI) and PwC.

The survey showed that compared with three months earlier, 14% of financial services firms were more optimistic and 35% were less optimistic, giving a balance of -21%. Confidence was highest in building societies and insurance companies with banking and investment management at the other end of the scale. "Concerns over China and a volatile start to the year for markets, alongside uncertainty about a possible Brexit, have created a perfect storm to dampen optimism in financial services," said **Rain Newton-Smith, the Director for Economics at the CBI.**

Employment in financial services increased in the first quarter of 2016. It is expected to remain flat in the three months to June 2016, however, with increases in the insurance and building society sectors offset by another sharp fall in headcount in banking.

"We've seen a lot of signs of slowing down. There seems to be a general

At the tipping point of full time employment reduction (million)
(Source: ECB, United States Bureau of Labour Statistics, Citi Research estimates)



malaise about the health of financial services", **Vicky Pryce, Chief Economic adviser at the Centre for Economic and Business Research (CEBR).**

Job Cuts at the Bank

Job cuts in the banking sector continued in the first quarter of 2016 with Lloyds announcing the latest tranche of the 9,000 job cuts that are part of their three-year turnaround. More than 1,750 were confirmed along with the closure of 29 branches.

According to a survey by EY 56% of workers in the banking sector are expecting job cuts this year, a rise of 50% compared to 2015. With this in mind EY are warning of the biggest net reduction in staff since 2012. A similar number are also predicting a drop in pay for 2016. Unsurprising then that banking displayed the sharpest drop in confidence since the global downturn in 2008/09, with a balance of -48% according to CBI/PwC.

"The challenge for banks at the moment is how they're going to become profitable again. In Europe, banks need to cut costs by around 30 per cent to reach the one per cent return on equity bankers are expecting in 2016," said **Karl Meekings, EY's Global Banking and Capital Markets Lead Analyst.**

The CEBR is also predicting job cuts along with the 'collapse' in bonuses for financial services workers in 2016. The weakest start to a year since the financial crisis in terms of IPO, according to IPO Monitor from PwC, won't help this feeling either.

This challenge may be more than a short term one as well with a report from Citigroup suggesting that the rise of fintech companies will mean traditional banks will be forced into reducing employee numbers by 30% across Europe and the US by 2025. According to Citi, there were 6.19m full-time employees working for traditional banks in the US and Europe at their peak. This figure has now reduced to 5.46m and is predicted to fall to 3.62m in 2025.

Not All Bad

Senior management within banks are more confident with 43% expecting greater recruitment compared to 29% who expect headcount to decrease over the next 12 months, a positive balance of +14%. This was according to PwCs 19th Annual Global CEO Survey.

The EY Item Club is also positive about the future of financial services in the UK with decent growth expected in the next few years.

Omar Ali, UK Financial Services Managing Partner at EY, said: "2015 was the first year for some time that the underlying economic fundamentals were good enough to support an across-the-board return to growth in borrowing by consumers, home buyers and firms."
"If we can plot a course through the policy and politics, 2016 looks set to be a better good year."

What this means

Businesses dislike uncertainty, so until the outcome of the referendum is known confidence will continue to drag. With that in mind a vote to leave may have the effect of prolonging uncertainty which may exacerbate some of the issues discussed above.

In the short term this will mean that businesses are likely to favour contact workers over permanent staff – until the referendum. This may present a useful opportunity for employers who are more positive about the future to place hard-to-fill roles more easily.

The City & Brexit

28%

of all finance graduates with less than four years' experience are born outside the UK

"The impact of a Brexit for the wider economy is uncertain, but a negative effect on the financial services sector is more likely" says **Stephanie Flanders, Chief Market Strategist for Europe, JP Morgan Asset Management.**

The financial services industry has been discussed in terms of the industries that might suffer most if Britain decided to exit the European Union. In fact, a report by Open Europe suggests it would be the single sector that was most exposed to risk.

"Major firms from across the world come to London to access Europe's single market, bringing with them jobs and investment," said **Chris Cummings, Chief Executive of TheCityUK.** "While Brexit may not be ruinous for the UK economy, it does risk damaging the UK-based financial services sector, particularly over the short-term, delaying investment decisions and reducing activity. It also threatens the overall competitiveness of the UK as a place to do business."

Andrew Sentance, Senior Economic Adviser at PwC, added: "In all the scenarios we have examined, the financial services industries will be less successful for at least a decade if the UK leaves the EU."

Rathbone wrote a report in which they claimed to 'dispel' five Brexit 'myths' which included the claim that the Swiss business model could be reproduced as a market that thrive outside of the EU. Rathbones believed such replication would not be possible.

This would explain why three out of four finance chiefs in the UK are in favour staying in the UK according to Deloitte.

Jobs

Without unrestricted access to the single market financial institutions based or headquartered in London may choose to move to a location that does offer that option such as Dublin or Frankfurt or to one of the other major world financial hubs such as New York, Hong Kong or Singapore. This would cost UK jobs.

TheCityUK believe this figure could be 100,000, by the year 2020. This would be significant for an industry that the Office for National Statistics (ONS) reports only employs just above 1.1 million – it would mean nearly 9% of the workforce.

That said the report, carried out by PwC, suggested that the sector would recover after that and only have 30,000 less employees by 2030 – but that is a long way in the future.

Skills

Those campaigning for the UK to leave to EU claim that London's position as the financial capital of the world would mean that businesses would want to remain here and jobs would not be lost. There is also a worry that without the free movement of labour the finance sector would be hit hard by skills gaps that while already in existence could be heavily exacerbated.

Skills Shortages are already the second highest concern for Chief Financial officers going into 2016, according a survey from the Institute of Chartered Accountants of Scotland (ICAS). "There's an elephant in the boardroom," **Icas Chief Executive Anton Colella** said. "The skills gap has been a frequent complaint from the boardroom for years. But the evidence from the nation's finance directors is that it has now become critical."

This is a sector that already relies heavily on foreign graduates, they currently account for more than a quarter (28%) of all finance graduates with less than four years' experience according to salary benchmarking site Emolument.

This supply which may dwindle if the UK were outside the EU. European graduates would have to apply for visas to work in the UK and those from outside the EU may choose educational institutions inside the Shengen Area.

While visas could be obtained for the kind of highly skilled workforce the financial services sector requires this would increase both time and cost of hire. This said research carried out for the Financial Times by Oxford University's Migration Observatory suggests that three-quarters of EU citizens working in the UK would not meet current visa requirements. This includes 66% in the banking and financial sector where employers would have to be concerned with more than just the financial skill sets but also all the ancillary staff that companies require.

What this means

Leaving the European Union may create problems in the financial services recruitment market in the short term, however in the longer term these would likely fade into the background and just become part of the business landscape. The financial services industry has long sought the best candidates and paid them well.