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Brexit – Let's go Frankfurt

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In a comparison of European financial centres, Frankfurt clearly ranks in second place behind London. With numerous qualities in its favour, the German banking centre is an attractive location for domestic and international players in the financial sector and has the potential of becoming the preferred destination for Brexit-related job relocations, which many London-based institutions are already making internal preparations for in the wake of the Brexit vote. But Paris, Dublin, Luxembourg or even Amsterdam are serious rivals in this restructuring process, which will take many years.

If Frankfurt is really to become the principal winner of Brexit, there will need to be more self-confidence and an emphasis on the particular character and high quality of life that the city offers. Furthermore, a concerted effort to promote the German financial centre by all the important players as well as a further improvement in the conditions is essential to ensure its success.

In our baseline scenario, the negotiations between the United Kingdom and the EU should eventually result in a compromise. Despite damage to its image and restrictions on its access to the single market, London would remain the leading financial centre in Europe. In view of its excellent position, though, Frankfurt would have good chances of picking up at least half of the jobs in the financial sector up for grabs. Based on very cautious assumptions, this would amount to a total of at least 8,000 employees over a multi-year period, which would compensate for the ongoing consolidation in Frankfurt. By the end of 2018, employment in the banking sector should not have fallen below its current level of just over 62,000 jobs.

Source: Helaba Research

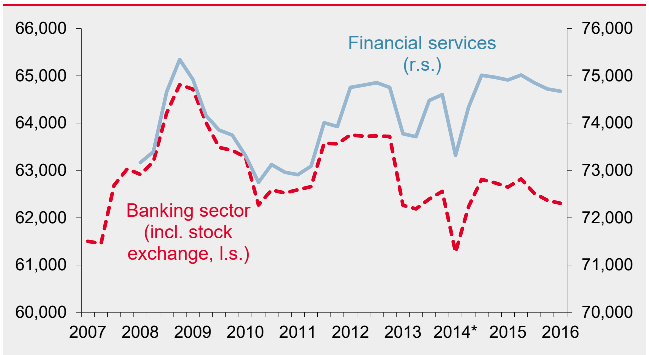
Numerous international players in financial centre

Status quo in the financial centre of Frankfurt…

The German financial centre is extremely attractive to international players. Numerous banks from a variety of countries maintain a presence here. Over the last ten years, an increasing number of foreign credit institutions have opened offices in Frankfurt. By the middle of 2016, for instance, around 160 foreign banks were operating from Frankfurt, accounting for 80 % of all banks with a head office located here. In addition, there were several representative offices. Furthermore, the community in the German financial centre is complemented by a myriad of other financial service providers from Germany and abroad, which ensures bustling activity in the city.

Moderate staffing adjustments in Frankfurt

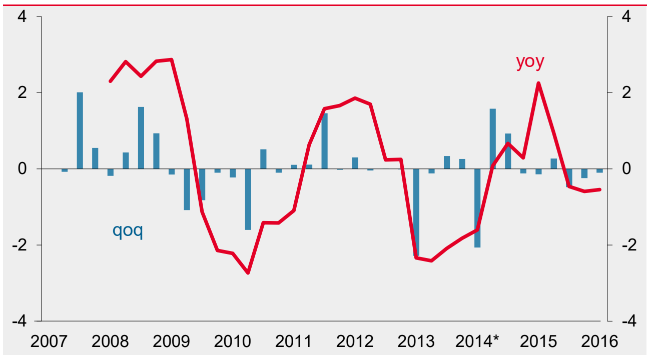
Number of employees in the city



* statistical break; Sources: Federal Employment Agency, Helaba Research

Wave movement in Frankfurt's banking employment

%



* statistical break; Sources: Federal Employment Agency, Helaba Research

Frankfurt employs a total of around 74,700 people in its financial services industry, with the banking sector – the pulsating heart of this industry – accounting for 62,300 of these jobs (as of spring 2016). In a Europe-wide comparison, the German financial centre boasts a very solid employment trend. Since the outbreak of the financial market crisis in 2008, there have been waves of adjustments to staffing levels in the city's banks. The small number of cutbacks until the middle of 2010 were followed by a period of extensive recruitment before rebounding again in the first half of 2013, albeit once again only temporarily. Extrapolated from a one-off statistical effect at the beginning of 2014, employment in Frankfurt's banking sector then remained stable before a tendency towards consolidation developed.

So much for the sound performance of the German banking centre – but how does the location measure up for financial players willing to make the switch from London? Frankfurt is tactfully signalling its interest in potential newcomers and is promoting its qualities in various ways: Immediately after the Brexit vote at the end of June, a homepage was specially launched for this purpose about Frankfurt as a location (https://welcometofrm.com/). The inward investment agency FrankfurtRheinMain GmbH, which co-ordinates marketing activities for the local financial centre, recently opened an office on the Thames. The Hessian Ministry of Economics, Energy, Transport and Regional Development as well as Frankfurt Main Finance e.V. and Hessen Trade & Invest GmbH are also involved in promoting the region of Frankfurt. In August, the Hessian Minister of Economics, travelled to London with a wide-ranging delegation made up of various different representatives from the financial centre in order to enter into a dialogue with banks there. The Mayor of Frankfurt followed up on this marketing drive with a roadshow also consisting of high-ranking VIPs, whose primary focus was on companies from outside the financial sector.

Frankfurt in dialogue with companies in London

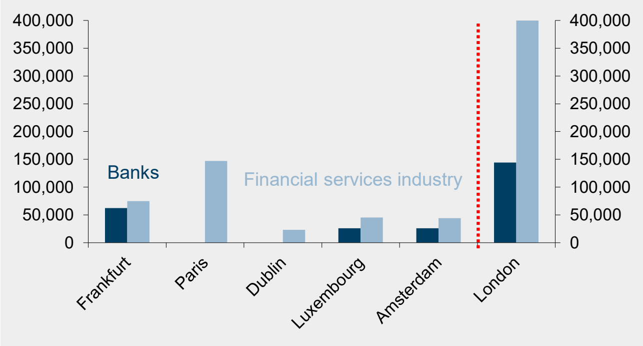
…and in London

In terms of staff numbers, the City of London is undoubtedly the largest financial centre in Europe, albeit various definitions of sectors and geographic delineations exist that must be taken into account. In 2015, the financial services industry in London employed approximately 400,000 people (including an estimated 144,000 in the banking sector). In contrast, there were 147,000 employees in the Parisian and almost 75,000 in Frankfurt's financial sector. These were followed, much further behind, by other continental European locations. In Luxembourg and Amsterdam, the financial sector employed around 45,000 and 44,000 people, respectively, with about 23,000 in Dublin. These differences in scale alone underline the fact that even moderate job losses in London would provide the smaller financial centres with an impressive boost to their employment figures in percentage terms.

Banks in London have changed their communication policy: In the run-up to the referendum, many institutions had threatened to withdraw staff from London in case of a vote for Brexit. Frankfurt or Dublin were usually mentioned as potential destinations in this context, which has been confirmed by various surveys. In the meantime, although many banks have doubtlessly firmed up their relocation plans, very little information about them has made it into the public domain. Despite internal discussions exploring options of alternative financial centres, the vast majority of London-based banks currently maintain a wait-and-see stance.

London has by far the biggest financial sector

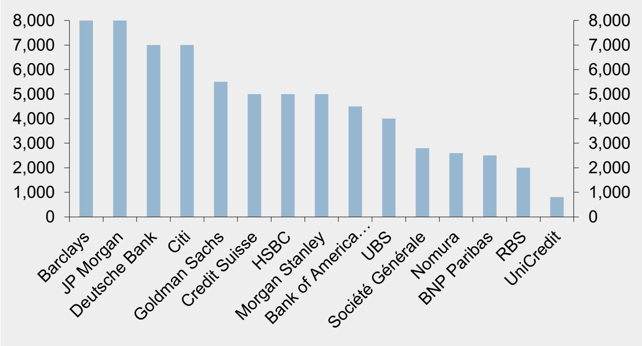
Number of employees in 2015*



* Paris 2014; Sources: Federal Employment Agency, Deutsche Bundesbank, INSEE, ONS, Stationery Office, Statec, Helaba Research

London-based banks exploring job relocations

Employees in London's investment banks



Sources: Financial Times, Helaba Research

The main factor determining the real extent of job relocations will be the degree to which banks will be able to conduct their European business operations from London in future. Up to now, many non-British banks with offices in London have operated using so-called passporting rights within the area of the European single market. According to British financial supervisory authorities, there are around 5,500 institutions registered in the United Kingdom that take advantage of a total of more than 336,000 passporting rules for their different activities in the individual member states. However, it is likely that unrestricted access by the British to the EU single market, and consequently the privileges associated with EU passporting rights, will be lost due to Brexit. What would an outline of the time span and results of negotiations between the United Kingdom and the EU look like?

Compromise solution for Brexit expected in spring 2019

If the British trigger Article 50 (of the Treaty on European Union) by the end of March 2017, the full two-year period for the negotiations laid out in the EU treaty will probably be used. Therefore, no de facto Brexit can be expected before the spring of 2019. Ultimately, it will probably end up in a compromise agreement, in which the political and economic fallout will be limited and the financial centre of London, in spite of some restrictions in terms of access to the EU single market, will retain its leading role in Europe (Helaba forecast: 60 % probability). In a conflict scenario (30 %), the British financial centre would sustain considerable damage because cross-border traffic, especially as far as financial services are concerned, would be severely impeded by new regulations. The least probable, albeit not inconceivable scenario of cherry picking would involve the British negotiating significant advantages for themselves in a "divorce settlement" to the detriment of the EU (10 %). Until the negotiations are completed, the United Kingdom will remain in the EU and regulatory uncertainty will continue.

Global investment banks may begin relocating jobs soon

However, London's banks cannot wait that long and want to fully and seamlessly continue their activities. In order to receive EU passporting rights in another member state, such as Germany, a firm has to allow for a period of at least one year from submitting the documentation to the regulatory authority to receiving official approval. Thus, the relocation of offices to or their expansion in other financial centres could take place during the two-year transition period, including any regulatory procedures that may be necessary for this. Accordingly, in the foreseeable future, many institutions will probably look for a second location in addition to London, push ahead with their relocation plans and transfer individual business units. In the first instance, this primarily concerns global investment banks, while it is likely that most smaller institutions will not follow suit until a later date. Many a player in the financial centre is even already considering setting up their European headquarters on the continent.

Overall, we are talking about a process of reorganisation at the institutions concerned and in the entire community of financial centres that will take many years. In this regard, not only do regulatory requirements have to be fulfilled but there will also be challenges to be met, for example in the areas of compliance and data protection or with securities and payment systems. However, after an initial withdrawal of activities from London, there may be a certain shift back to the largest financial centre in the medium to long term. This is because the United Kingdom will make an effort, through deregulation, to optimise the attractiveness of its own financial sector location and boost its appeal again. Although London will remain the most significant European financial centre in this whole Brexit-induced process, its image will suffer either way.

Opportunities for European financial sector locations thanks to Brexit

Frankfurt the clear number 2 in Europe behind London

Frankfurt is the foremost financial centre in Continental Europe and has fared well in these difficult times for the financial sector. Our anniversary study, which was published shortly before the Brexit vote, demonstrates the relative significance of the three large financial centres of Europe: London before Frankfurt, Frankfurt before Paris.[1] In this wide-ranging comparative financial centre analysis, the focus was on five core criteria that we considered indispensable for a location to position itself successfully in the competitive international environment (cf. chart below). In a ten-year comparison, it is clear that the German financial centre has made progress in numerous respects and, in particular, has gained a significant amount of ground on Paris.

Anniversary study 2016: Location assessment of three largest financial centres in Europe

	Frankfurt		Paris		London	
	2006	2016	2006	2016	2006	2016
Banks	😐	😐	☺	😐	☺	😐
Stock exchanges	☺	😐	☺	😐	☺	☺
Fin. sector teaching & research	😐	☺	☺	☺	☺	☺
Trends in the financial sector	😐	😐	😐	☹	☺	☺
Location-specific qualities	☺	☺	😐	😐	😐	😐

☺ indicates that the financial centre is well positioned in terms of its international competitiveness; ☹ points to deficits; 😐 represents a midrange position.
Source: Helaba Research

Frankfurt scores points with certain qualities for banks willing to relocate

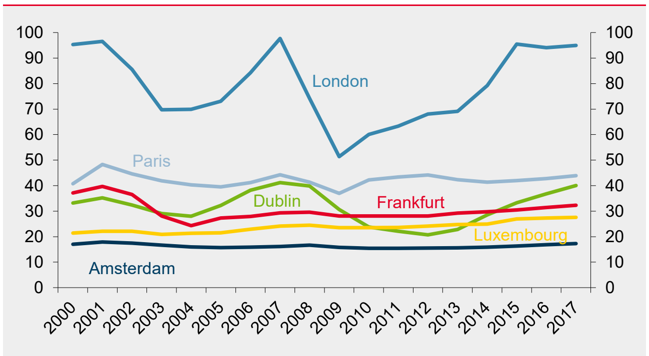
With its excellent position in the framework of financial centres, Frankfurt enjoys a strong appeal among players both from Germany and abroad. In the current debate over an exodus from the City of London, the following assets that Frankfurt possesses are of particular benefit: The stability and strength of the German economy, the headquarters of the ECB in its dual function, a transportation hub with a good level of infrastructure, relatively low office rents as well as a high quality of life and a diverse range of leisure activities in the city and its green surroundings.

[1] cf. Helaba Research (June 2016): "Financial Centre of Frankfurt: Making further Headway".

The fact that office space in Frankfurt is cheaper and easier to find than in London or Paris is obvious and undisputed among London's bankers. In terms of quality of living, however, the German financial centre is far better than its reputation would suggest, which should be apparent to anyone who is open to Frankfurt and is also verified by two recent studies. In comparisons of the most liveable cities by both the global recruitment consultant Mercer and the British Economist Intelligence Unit (EIU), Frankfurt ranks considerably ahead of its financial centre rivals. In these quality of living assessments, London ranks a long way behind Frankfurt.

Frankfurt attracts companies with affordable office space

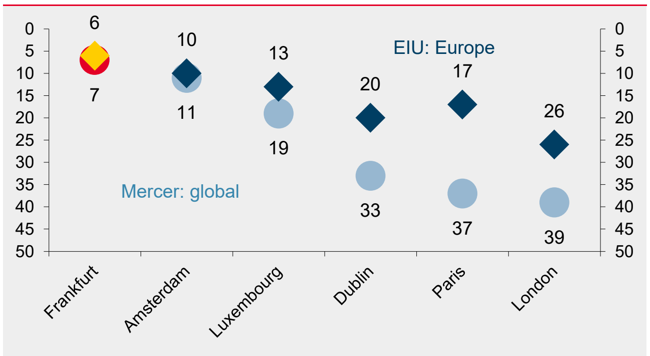
Average office rents in good locations, €/m²



Sources: Feri, Helaba Research

Unbeatable high quality of living in Frankfurt

Ranking of liveable cities



Sources: Mercer, EIU, Helaba Research

Frankfurt has different character to London – attractive in another way

On top of that, Frankfurt, which is considered to be a staid city, simply has a different character to that of the hip City of London and is primarily of interest to a different target group of bankers. While London attracts many young professionals with its pulsating nightlife, Frankfurt has more to offer those looking to shift down a gear from life in the fast lane to settled family life and who have extensive experience to show for, which is a factor that should not be underestimated in the aftermath of the financial crisis. In this respect, the numerous bars, restaurants, discos and the broad range of cultural activities Frankfurt has to offer are more than sufficient. Furthermore, over the years Frankfurt has been radically transformed and offers a number of trendy scene locations. Its broad range of venues includes the renowned English Theatre, the largest of its kind in Continental Europe, located directly in the banking district. After all, English is meanwhile very widely spoken in Frankfurt. Incidentally, childcare and children's education, which is more affordable than in London, is a considerable factor in Frankfurt's attractiveness. There are more and more international kindergartens and schools in the region. Last but not least, in general the cost of living is relatively low.

What outsiders often ridicule as provincialism turns out to be a clear advantage in the local community: In this compact city with an outstanding transport network, the daily commute to the office is still manageable, even for commuters from outlying regions. Office workers can enjoy countless quick and uncomplicated lunch meetings on or near the "Fressgass", a cobblestoned pedestrian area known for its cafés and restaurants, so that the proximity of the various players to each other in the financial centre is a significant factor contributing to their business success.

Frankfurt already capital of European supervisory mechanism

Moreover, Frankfurt is the preordained location for the cross-border EBA (European Banking Authority), which can no longer stay in London after Brexit. Substantial efficiency gains could be generated by concentrating the European supervisory system in a central location such as Frankfurt. In this way, the German financial centre, which is already the location of several supervisory bodies, would be strengthened as the capital of the European supervisory mechanism.[2] Furthermore, Frankfurt has potential in terms of the megatrend of digitalisation. The technology centre near the banking district that is soon to open its doors as well as increasingly lively activity in Frankfurt's innovative fintech scene show that things are going in the right direction.

[2] cf. Helaba Research: "Frankfurt: Hub of Finance and Supervision" (March 2014).

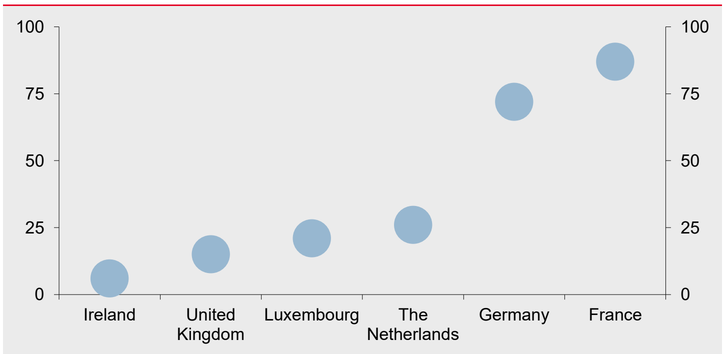
Competition among financial centres for London's banks

All of this is pointing to Frankfurt becoming the principal beneficiary of Brexit. However, despite its many qualities as a location, it is not a foregone conclusion. After all, it has many competitors that have to be taken seriously and that are also hoping for an influx of workers from London. Paris, Dublin and Luxembourg or also Amsterdam are the cities that principally come to mind in this respect. Similarly, low-income locations in Eastern Europe, such as Warsaw or less significant financial centres in Europe, could get a slice of the cake – albeit a much smaller one (e.g. Madrid or Milan). In addition, individual institutions may even relocate activities to other continents in the scope of their group strategies, such as to global financial centres, for instance New York or Hong Kong. Thus, there seems to be an endless list of potential winners from Brexit. But the focus is clear: Apart from Frankfurt, what makes Paris, Dublin, Luxembourg or Amsterdam attractive for London's banks?

Paris is the third most important financial centre in Europe, behind London and Frankfurt, and simultaneously a global city with many cultural attractions. The other three locations at the focus of attention are considerably smaller but have their own specific advantages. Dublin, culturally close to London, scores points with its language bonus and low taxes. Luxembourg styles itself as a centre for investment funds with many EU organisations and Amsterdam as a traditional, cosmopolitan mercantile city, although both can offer tax incentives as well. According to a ranking by the World Bank, the burden of taxation in Ireland is lower than in the United Kingdom, followed by Luxembourg and the Netherlands. They are followed, much lower down, by Germany and finally France.

Tax burden in European countries

Index (sub-components of Doing Business), 2015



Sources: World Bank, Helaba Research

Factors such as these form part of the selection process of London's financial institutions, so that it is important for a financial centre to carry out a targeted marketing campaign to stress these qualities. At the end of the day, though, what will be decisive will be compatibility with the institutions' respective business strategies and previous, specific branch structures. On top of that, if many banks relocate a significant number of jobs at a similar point in time to the same financial centre, a certain "pull" effect may result. In this case, Frankfurt would be the first place to come under consideration as the clear number 2 behind London in the framework of European financial centres.

Recommendations for action for the German financial centre

Self-confidence and an emphasis on high quality of living are important

Compared to its rivals in Europe, the German financial centre is well positioned. With the exit of the United Kingdom from the EU, Frankfurt has a real chance of achieving an even better position and, at the same time, of reducing the gap between itself and London. For Frankfurt to really become the principal winner from the process that has been triggered by Brexit, it will need to emphatically demonstrate more self-confidence. The facts that militate in favour of Frankfurt will not have the desired outcome by themselves if they are not shifted into the focus of international attention and if financial players in London do not permanently become aware of them. If Frankfurt's financial centre region does not assertively promote itself, nobody will. Modesty is not what is called for in the increasingly tough competition between locations. At the same time, a co-operative tone should be maintained, which could already be heard during trips by delegations in the late summer. With its head held high, Frankfurt must finally shake off its image as a boring provincial town, which it is still unfairly saddled with. After all, Frankfurt has a lot to offer that makes it attractive, especially in the financial sector. In today's context, emphasising the different character of Frankfurt in combination with its high quality of life compared to London (cf. page 5) would be particularly conducive to a successful marketing strategy for the city as a location for financial services.

Consistent political support, even from the federal government

Furthermore, a concerted effort to promote the German financial centre by all the important stakeholders is important for the German financial centre. Ultimately, a strong financial centre in Frankfurt is not just a local issue. In this respect, the German federal government should be a powerful advocate for the interests of the only German financial centre of any relevance, in addition to representatives of the city, the state government, locally-based financial institutions and marketing organisations. It would make sense to bundle the various forces in order to present a focussed, united front when going to the outside world and, in particular, to London. It would be especially desirable if there was a clear and consistent position on central issues regarding the location.

Otherwise, Frankfurt will not be a serious option for institutions such as the EBA or for the headquarters of a potential Anglo-German stock exchange. This, despite the fact that it is the predestined location in both cases, because Frankfurt already serves as the European capital of regulation and supervision and the European "super exchange" – in terms of market capitalisation of the two companies to be merged – should naturally be located here. Decisive support from all levels of politics would send out a strong signal in respect of the influence and self-image of the German financial centre. New players would not only be an asset for the local community but the reputation of Germany with an international financial centre would gain in the long term.

A culture of welcoming bankers in Frankfurt

A culture of welcoming new bankers would contribute to this. A good platform has already been created in the shape of the special Frankfurt homepage, which has already been implemented and which could be further expanded and cross-linked (cf. page 2). In relation to the important issue of financial supervision, this would mean conducting promotional activities at London-based institutions through a central contact point in Frankfurt which, with customary German efficiency, would be willing to communicate in English and would be prepared to support them with transparent processes. A relaxation of labour and taxation laws have already been suggested by the Hessian state government. In addition, to make Frankfurt even more interesting for banks considering relocation, it would make sense to mobilise attractive office space as well as expand residential accommodation, also in the centrally-located premium segment. Likewise, the range of international childcare and educational establishments should be increased in the foreseeable future. All these measures have the potential to increase Frankfurt's already good chances of becoming the preferred place for relocation.

Employment prospects for Frankfurt

In view of the large degree of uncertainty that continues to exist with respect to the outcome of the two-year Brexit negotiations between the United Kingdom and the EU, which will most likely kick off in spring 2017, most London-based financial institutions are still being cautious for the time being in making any firm pronouncements about their relocation plans. Accordingly, it is difficult to estimate the overall extent and speed of job relocations. However, this restructuring process in the framework of European financial centres, which will take many years, can be outlined based on cautious assumptions as follows:

Cautious baseline forecast: at least 16,000 jobs would leave London

Of the approximately 400,000 employees in London's financial industry, a moderate loss of 5 % would mean about 20,000 jobs would be affected. In an environment that remains difficult for banks, some would presumably be permanently cut, possibly around 20 %. Therefore, in this baseline forecast, which relates to our compromise scenario (cf. page 3), at least 16,000 employees would have to move from the City of London to alternative locations over the next few years. If the negotiations result in a more restrictive outcome (conflict scenario), there may be substantially more than twice as many job relocations – subject to any positions being shifted back to London due to regulatory arbitrage. It is worth noting that the uncertain situation in the United Kingdom, which persists for many years, leads to a preference of new players for establishing offices in other European financial centres. This is already becoming apparent with many a company. As a result of official scrutiny by regulatory authorities, which will not be completed for months, to date the effects of the planned Anglo-German stock exchange merger are still unclear; because many details, including the question of where the headquarters should be located, an aspect that is relevant to local labour markets, are still unresolved.

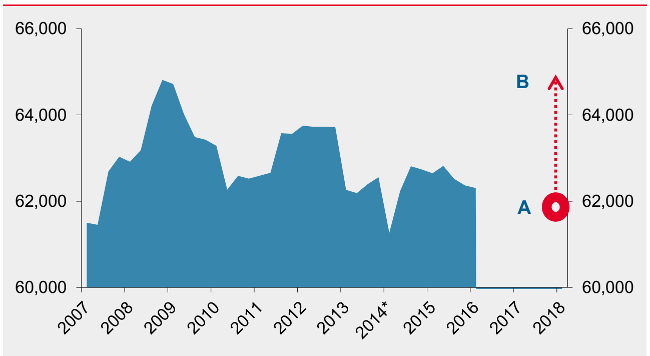
Baseline scenario compromise: Estimated job relocation from London to Frankfurt

Financial sector employment

Source: Helaba Research

Forecast for bank employment in Frankfurt by end of 2018: Same level as at start of 2016

Number of bank employees in the city



* Statistical break; Sources: Federal Employment Agency, Helaba Research

Considering Frankfurt's outstanding position in the framework of European financial centres, the chances are high that at least half of the available jobs will be moved from the British to the German financial centre if the latter markets its qualities as a location in an appropriately self-confident manner and manages to complete all the other tasks on its to-do list (cf. page 6f). This relocation process of an estimated at least 8,000 jobs will probably commence gradually over the course of 2017 and will not be really noticeable until 2018; when the results of negotiations are announced, it is likely to continue to accelerate. Accordingly, until the forecast horizon of the end of 2018, considerably more than 2,000 new employees could relocate to Frankfurt. This Brexit-induced effect on the labour market will act as a counterbalance to the trend towards consolidation in local banks.

Effects of Brexit and consolidation to cancel each other out in Frankfurt

Altogether, it is likely that these two effects will more or less cancel each other out within our forecasting window until the end of 2018. Then, expected banking employment in the German financial centre would be at a level of just over 62,000 jobs (cf. point A in the chart above). However, should relocation by some prominent institutions lead to a certain pull effect from London to Frankfurt occurring or should the outcome of negotiations point to conflict between the United Kingdom and the EU, there would be more extensive job relocations. By the end of 2018, it is conceivable that there would be considerably more than double the number of relocations to the German financial centre than the minimum of more than 2,000 jobs estimated in the cautious baseline scenario (cf. B). This "quantum leap" in Frankfurt's banking employment would pose enormous challenges for the location, especially in the residential property market. Even in our baseline scenario, the consequences will be clearly noticeable in Frankfurt. At the same time, however, Frankfurt should take advantage of the opportunities that Brexit presents to improve its position in the framework of European financial centres. Let's go Frankfurt! ■