Helaba

Focus on: The Financial Centre of Frankfurt
28 June 2021

→ Exceptional times for the financial centre of Frankfurt
→ The EU's financial market regulation in relation to the UK
→ The status quo for Frankfurt's banking sector employment
→ Forecast for Brexit banks and banking sector employment

The impact of Brexit on Germany's banking hub

Ulrike Bischoff
phone +49 69 9132 5256

Summary

These are exceptional times for Germany's financial powerhouse, Frankfurt am Main, which faces challenges such as persistently low interest rates, advancing digitisation and the Covid-19 pandemic. At the same time, Brexit has led to an inevitable restructuring process among many London-based institutions and this presents opportunities for Germany's banking sector. After all, no sooner was the referendum over than Brexit banks singled out Frankfurt as their preferred destination and began relocating their activities from the River Thames to the River Main. Meanwhile, several foreign banks have established their EU headquarters here and their significance is growing thanks to large-scale transfers of assets. With the easing of pandemic restrictions and continued pressure from the ECB, multiannual restructuring programmes are leading to a renewed increase in staffing levels. Some of these new staff are being transferred from London, while others are being recruited locally.

We adhere to our previous forecast that Brexit will lead to the creation of 3,500 additional jobs in the German banking centre overall. Given its unique role for Brexit banks, Frankfurt can expect to gain around 1,500 additional jobs in 2021/2022. In the medium term, there are likely to be some further adjustments to staffing capacities, depending on how specific institutions' business strategies develop and on the way the regulatory framework evolves.

Regulating financial services between the EU and the UK is proving to be a similarly arduous process as Brexit itself, with little likelihood of a comprehensive equivalence regime for the UK in the near future and uncertainty over individual equivalence decisions. This would mean that British regulations would be recognised as equivalent to those in the EU. Instead, going forward there is a danger of regulatory arbitrage – after all, Brexit presents a chance to change regulations that have long been considered unsuitable for each side’s respective market. In the medium to long term, the architecture of Europe's financial centres is set to undergo a fundamental shift. This will depend on regulatory adjustments by London and Brussels, which should be carried out with a sense of proportion in order to avoid a damaging race to the bottom for both sides.

Despite the boost that Brexit provides, employment levels in the German banking centre will decline over the next few years due to ongoing consolidation that has been exacerbated by the Covid-19 crisis. The environment continues to be challenging and this points to a significant reduction in banking employment in the years ahead. By the end of 2023, we anticipate a headcount of around 62,200 in Frankfurt's banks, which would translate to 3,300 fewer jobs – a drop of 5 % – compared to the latest available data of autumn 2020. In this regard, it is important to note that, in the course of 2020, there was an unexpected rise in staffing levels at banks in Frankfurt, despite their announced cost-cutting programmes. Now, it is time for the German financial centre to meet the challenges it faces and seize the opportunities available with determination. In order to succeed in competition with other global financial centres, it is vital that it promotes itself in a self-confident and concerted manner and drives the key trends in the financial sector, the most important one being sustainable finance.

Exceptional times for the financial centre of Frankfurt

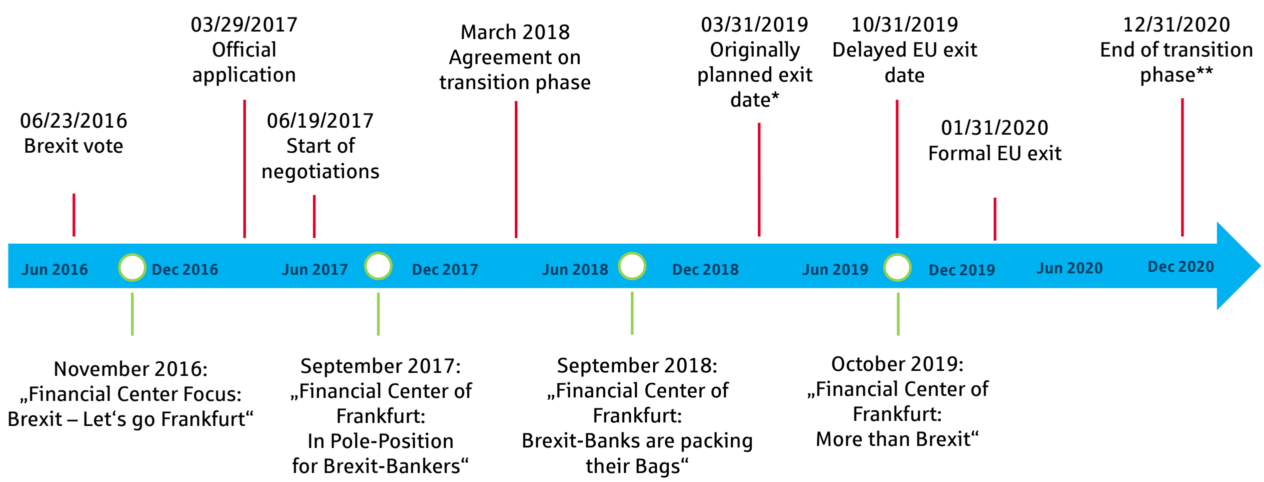
Helaba has been conducting financial centre research for the last 15 years and, in this time, we have devoted our studies to a variety of key issues, thereby actively supporting the ongoing development of Germany's financial hub. Our financial centre criteria, surveys of foreign banks and, in particular, the forecast for Frankfurt's banking sector employment are core elements of this research.

For the last year and half, the Covid-19 pandemic has created an exceptional situation and this has had a profound impact on the economy and the financial centre. Even without the pandemic, the German banking industry is undergoing a period of enormous change as it faces both stiff competition in an increasingly digital marketplace as well as a sustained phase of ultra-low interest rates. The macroeconomic effects of the pandemic represent an additional strain on banks' profitability and are likely to be felt for some time to come. While the government's vaccination drive will hopefully lead to Covid-19 being permanently contained, the pandemic's overall economic impact will leave its mark on Germany's financial centre.

According to the latest assessment by Germany's Financial Stability Committee, which was established in the wake of the global financial crisis and is made up of representatives from the Federal Ministry of Finance, the Bundesbank and the Federal Financial Supervisory Authority (BaFin), Germany's financial sector has so far managed to weather the Covid-19 crisis in good shape thanks to improved capital buffers. However, uncertainty about the real scale of losses in the corporate sector, and hence the need for German banks to increase their loan loss provisions, remains high. In this respect, significant risks exist in the German and the international financial system.

Beyond Covid-19, another extraordinary factor is affecting Europe's financial centre landscape – Brexit. Although a lot of people have grown weary of the issue after years of back and forth, in many ways Brexit will continue to reverberate for some time to come. It is set to generate a constant stream of new topics for discussion, such as the regulation of financial services currently being debated, and that is why this study once again focuses on Brexit and its impact on Germany's banking hub. [1]

Helaba's financial centre studies have been tracking the Brexit process over many years



*plus additional exit date planned for April 2019, **signing of post-Brexit EU-UK Trade and Cooperation Agreement (applied provisionally until it entered into force on 1 May 2021)
Source: Helaba Research & Advisory

After all, the post-Brexit agreement that was signed just as the transition period expired at the end of 2020 and was provisionally applicable for several months before finally coming into force on 1 May 2021 does not cover financial services. As a result, the UK's withdrawal from the EU without an EU passport became a reality for London's financial institutions. Although not entirely surprising, no provision was made for an alternative arrangement at all. The response to the UK's de facto departure from the EU at the turn of 2021 was swift in coming, with a major

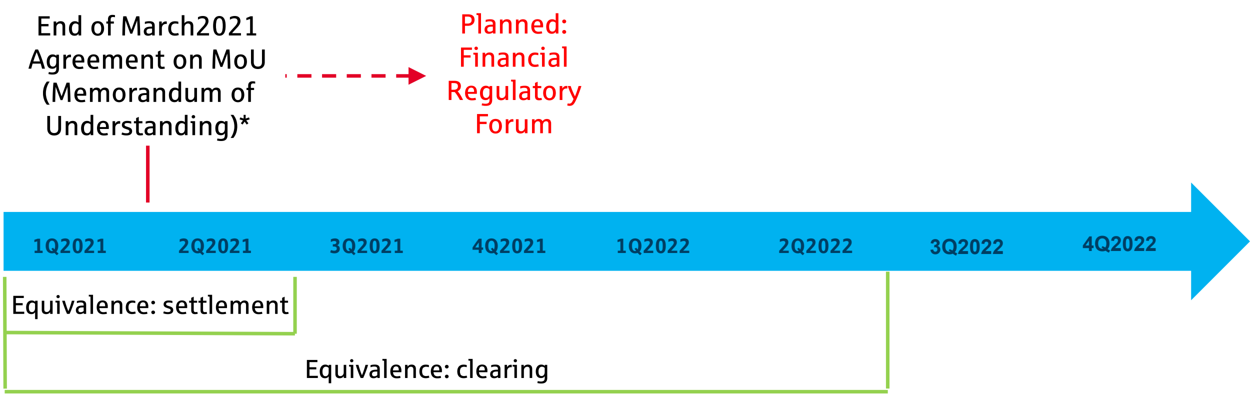
[1] cf. also previous Brexit studies by Helaba Research & Advisory: "**Brexit – Let's go Frankfurt**" (2016), "**Financial Centre of Frankfurt: In Pole Position for Brexit Bankers**" (2017), "**Financial Centre of Frankfurt: Brexit Banks are packing their Bags**" (2018), "**Financial Centre of Frankfurt: More than Brexit**" (2019)

chunk of equity trading, for instance, migrating from London to various EU locations (mainly Amsterdam). Likewise, a number of banks continue to transfer substantial volumes of capital market-related assets to locations such as Frankfurt, which is now handling an increasing share of business with EU-based clients. The costs of maintaining these twin structures for many institutions as well as Brexit-related losses in the financial services industry are colossal. However, it is impossible to gauge the ultimate extent of these costs as long as the cross-border regulatory regime has not been fully ironed out.

The EU's financial market regulation in relation to the UK

Regulating financial services between the EU and the United Kingdom is proving to be a similarly drawn-out, uncertain process as Brexit itself. After months of talks, the EU and the UK reached a basic agreement on financial regulation (Memorandum of Understanding, MoU) just in time for the deadline at the end of March 2021. The MoU provides for voluntary cooperation in regulating financial services while aiming to create transparency on both sides regarding possible regulatory adjustments and reducing uncertainty for market participants. Cross-border issues could also be addressed in this way with a view to ensuring the stability of financial markets. A twice-yearly "Joint UK-EU Financial Regulatory Forum" is planned that will facilitate discussion on regulatory issues. However, the MoU is still awaiting signature and no date has yet been officially announced.

Post-Brexit era: Financial market regulation between the EU and the UK



*date for signing unknown; source: Helaba Research & Advisory

This agreement could form the basis for regulating various aspects of the financial sector individually by means of specific equivalence decisions; for clearing and settlement activities, temporary equivalence rules have already been adopted. This means that British regulations would be recognised as having the same legal force as those of the EU, although the EU could unilaterally terminate these decisions at short notice. Equivalence decisions have at least been made for the two market segments of clearing and settlement, which are important in terms of stability considerations; however, these are temporary and will need to be re-examined when they expire at the end of June 2022 and June 2021, respectively. So far, however, nothing has been formally announced about the future of settlement. According to press reports, the EU is preparing European banks to relocate their euro-denominated derivative business from London to the euro area by next summer, with a view to establishing direct supervision over this market segment, in which enormous volumes are traded, and thus gaining more autonomy in Europe's financial services industry.

For Frankfurt as a major financial trading hub, this holds out exciting prospects. In autumn 2017, Frankfurt-based Eurex Clearing successfully launched a partnership programme with leading banks in order to expand its position in this key market segment. Despite London's dominance, the role of Eurex Clearing in the euro-denominated OTC interest rate swap business has grown sharply in recent years. This is illustrated by the fact that the Deutsche Börse subsidiary now has a share of 20 % in the market for euro interest rate swap clearing (outstanding volume in spring 2021 of over EUR 20 trillion). This is an area in which Frankfurt is becoming more and more popular as a location and is well on the way to gaining a stronger position in relation to its competitors. The expiry of the temporary EU equivalence rules in the middle of 2022 would accelerate this trend.

So, what does the future hold in terms of market access for financial services between the EU and the UK? Are we likely to see further equivalence arrangements? Well, in relation to direct market access for London, the EU is in "no rush" as it seeks greater autonomy for and an expansion of its financial markets. The EU Commissioner for Financial Services, Mairead McGuiness, stressed in early summer that any further decisions on equivalence would not be made until the MoU comes into force and that they would be made on a case-by-case basis, especially in light of the UK's regulatory intentions. Should the UK diverge too far from the EU's regulatory regime, it would not be granted any regulatory equivalence. At the recent City Week in London, the EU Commissioner for Financial Services made it clear that financial services should not be viewed in isolation from the political relationship as a whole. She added that the EU is now waiting to see whether the UK fully complies with the post-Brexit agreement or opts for unilateral action. Only when the MoU has been formally adopted would the EU consider whether to resume its deliberations on equivalence.

The UK is also self-confidently forging its own path and wants to take advantage of its new-found independence to expand its financial centre. The Financial Conduct Authority (FCA) recently stressed that the UK is not pursuing equivalence at any price and is also taking the opportunity costs into account that would arise if regulatory autonomy were not exploited to benefit its own financial market. The Financial Services Bill, passed at the end of April 2021, is regarded as an important first step on the way to modifying the regulatory framework in favour of maintaining an open, dynamic and globally competitive financial centre. In addition, a task force set up by the UK government put forward proposals for regulatory reforms that also specifically target the financial services industry when it presented its findings in mid-June, with recommendations for action in various fast-growing sectors of the economy. It is likely that the UK will publish more detailed proposals for reforms to financial market regulation later this year. London is stepping up its efforts to boost key drivers of growth (e.g., fintechs, listings, digital currency, green finance) on the back of London's pre-eminent position in global finance. This new strategic focus for the British financial centre is also intended to compensate for the limited opportunities it now has to do business in the EU.

Given how sluggish things have progressed so far as well as the current stance of both sides, it is unlikely that the EU will grant full equivalence to the UK in the near future; even the prospect of individual equivalence decisions remains in doubt for the time being. This stalemate poses the risk of regulatory arbitrage, as Brexit provides both sides with the opportunity to change regulations that they have long considered unsuitable for their own respective markets. However, this should be undertaken with a sense of proportion in order to limit regulatory competition and the inevitable damage that would do to everyone involved. Moreover, it is also vital to avoid an exodus of certain business lines to other attractive financial centres in the United States or Asia. Over the next few years, the financial centres are expected to find a new balance between autonomy and interdependence and, to some degree, develop their own specialisms depending on regulatory modifications, both in London and in Brussels. Consequently, it remains to be seen how the architecture of Europe's financial centres will develop over the medium to long term.

The status quo for Frankfurt's banking sector employment

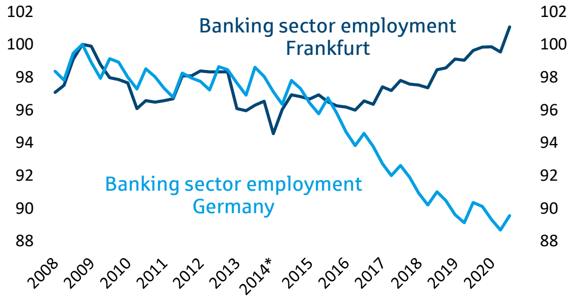
The number of people employed by banks in Germany as a whole has been falling for many years. But this has not been the case in Frankfurt. While staffing levels in the banking sector across Germany declined by 11 % between the end of 2008 and autumn 2020 to around 632,000, the number of employees in Frankfurt's banks rose over the same period to approx. 65,500. In recent years, the workforce in Frankfurt-based banks has been steadily creeping up, increasing by a total of 7 % between the beginning of 2014 and autumn 2020 (the latest available data and a one-off statistical effect at the beginning of 2014). This means that Frankfurt now accounts for well over 10 % of German banking sector employment, which is primarily a result of the consolidation process within the local banking industry. Although there has been an increasing trend towards branch cutbacks, it has had a limited impact on Frankfurt. At the end of 2020, there were 24,100 bank branches in Germany, almost 60 % fewer than in the year 2000. The structural transformation in the banking industry, which Covid-19 has accelerated, has led to the relevance of branches declining even further. People's professional and day-to-day lives have become increasingly digitised as they make greater use of remote forms of communication and the pandemic has spurred on this trend considerably.

In spite of the extraordinary Covid-19 situation last year, by the autumn of 2020 Frankfurt's banks registered a net rise of 800 employees – an astonishing figure in view of the cost-cutting programmes that many institutions had previously announced. Beside the unstoppable pace of digitisation, Brexit is another key factor determining the number of jobs in Germany's banking centre. As part of a restructuring process over many years, a number of

Brexit banks have started to establish and expand their workforces in Frankfurt. However, due to the Covid-19 crisis, some London-based institutions have postponed their relocation process somewhat, while there was probably a temporary halt to consolidation among German banks during the lockdown in 2020. Taken together, Brexit-related recruitment has so far more than compensated for any consolidation within Germany.

Banks concentrating activities on Frankfurt

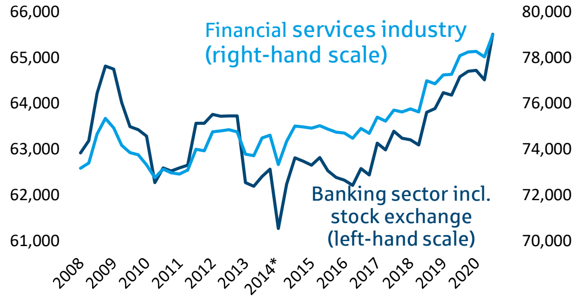
2008 = 100



*statistical break
Sources: Federal Employment Agency, Helaba Research & Advisory

Banks as a key part of the financial sector

Employees subject to social security contributions in the city of Frankfurt

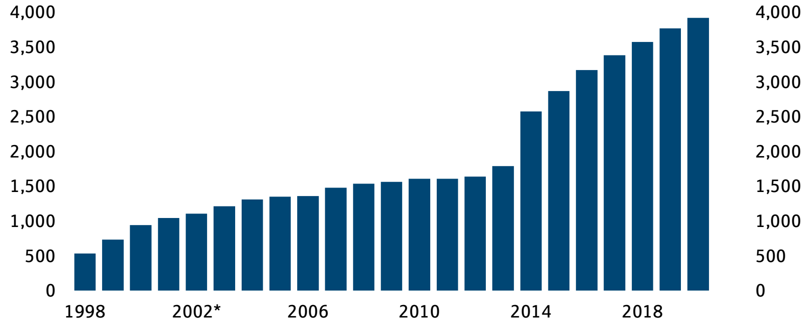


*statistical break
Sources: Federal Employment Agency, Helaba Research & Advisory

Our preferred aggregate of banking sector employment in Frankfurt comprises a number of sectors of the city's economy. This represents all jobs in the banking industry, including the stock exchange, that are subject to social security contributions. The aggregate figure of 65,500 is smaller than that of the entire financial services industry (around 79,000), but the two have been moving in tandem for many years. In view of the paramount importance of banks in the financial centre, our forecast is based on the aggregate for banking employment in Frankfurt. It is important to keep in mind that this figure is not for the whole region, as is sometimes the case for other financial centres.

ECB as a vital driver for employment in Frankfurt

Employees (at year end)



*full-time equivalents
Sources: EZB (annual reports), Helaba Research & Advisory

Furthermore, it should be noted that employees of the ECB are not included in this aggregate. This is because staff of EU institutions are not subject to national tax and social security contributions (this falls under the EU's own jurisdiction). At the end of 2020, there were approximately 3,900 members of staff at the ECB's headquarters in Frankfurt. As the eurozone's monetary policy and supervisory authority, it is extremely important for Frankfurt as a financial centre and acts as a powerful magnet for a range of financial sector players. Having the ECB in Frankfurt tends to result in a higher demand for staff at local institutions under its direct supervision. What is more, other commercial and central banks from other countries look to enter into a close dialogue with this leading institution within the Eurosystem. In this way, the ECB serves as a vital driver for employment in the German banking centre.

Forecast for Brexit banks and banking sector employment

So, what are the next steps for Brexit banks? Many of them started the year on a solid footing and are now doing business with EU clients through units they have successively established or expanded at alternative locations. Brexit banks, in particular, have selected Frankfurt as their preferred location and this is fuelling competition in Germany's financial centre. Meanwhile, many foreign banks have relocated their EU headquarters to the River Main and these offices are increasingly growing in importance as a result of large-scale transfers of assets. With the easing of pandemic restrictions and continued pressure from the ECB, Brexit banks are once again boosting their workforces. Some of these new staff are being transferred from London, while others are being recruited locally.

European supervisory authorities have been adamant from the outset that Brexit banks must ensure that their alternative locations to London are adequately staffed with local personnel and have reiterated this point recently. This includes managerial staff in business with EU clients as well as specialists for risk management and compliance in addition to traders and sales staff. Needless to say, staff were not exactly thrilled when banks announced a relocation to the continent and a city they could not choose for themselves. It follows, then, that the willingness among London-based bankers to relocate is not particularly high. That applies to any location in general and not just to Frankfurt, while family considerations are also a factor.

Yet, thanks to its numerous qualities as a location, many Brexit bankers who have since settled here are pleasantly surprised by Frankfurt. From outside, scepticism about Frankfurt is often due to the fact that the German financial centre could well take a leaf out of the book of its British counterpart when it comes to self-confidence. The self-assured air of the City just keeps on growing, seemingly in defiance of dramatic events such as the financial crisis or Brexit. Instead of letting the prejudice about Frankfurt as a provincial backwater persist – an outdated image propagated by London – the city can be proud of the enormous transformation it has undergone over the years and of its distinctive, multifaceted character.

New recruitment in Frankfurt's Brexit banks

Source: Helaba Research & Advisory

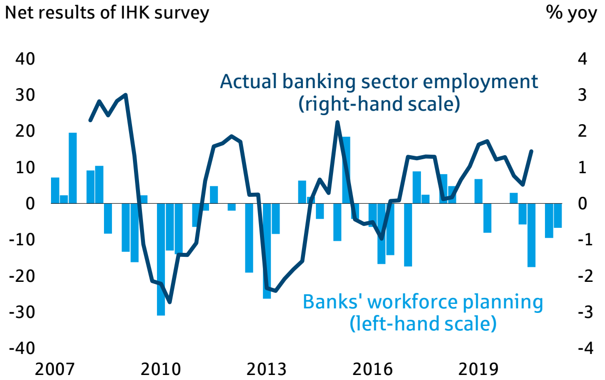
We adhere to our previous forecast that Brexit will lead to the creation of 3,500 additional jobs in the German banking centre overall. Due to the particular challenges and uncertainties that the Covid-19 pandemic has created, many institutions have temporarily delayed their business relocation process. Meanwhile, Brexit-related restructuring is gathering pace in order to meet regulatory requirements, especially since the ECB recently drew attention to this issue once again. Given its unique role for Brexit banks, Frankfurt can expect to gain around 1,500 additional jobs in 2021/ 2022. In the medium term, there are likely to be some further adjustments to local staffing capacities, depending on how specific institutions' business strategies develop and on the way the regulatory framework for financial services between the EU and the UK evolves.

However, we forecast that the positive effect on employment as a result of Brexit will be not sufficient to compensate for consolidation within the German banking sector, which has been exacerbated by the fallout of Covid-19. Ultimately, the pandemic constitutes yet another factor placing major strain on the banking industry in Germany, which already has to contend with fierce competition and persistently low interest rates in an increasingly digital business world. As credit defaults rise in the wake of the Covid-19 crisis, there is likely to be a need for higher loan loss provisions while institutions' profitability will come under increasing pressure. For the years ahead, we expect a significant decline in local banking employment as the business environment for banks remains challenging.

A survey carried out three times a year by the Chamber of Commerce and Industry (IHK) on local financial institutions' workforce planning only partially reflects the continuing high level of uncertainty in the face of medium-term risks in the German and international banking sector. In fact, this indicator is closely correlated with actual employment trends in Frankfurt. Currently, it has not reached the lows seen during the financial crisis of 2008/2009 and, on this basis, the results of the survey to date point to more modest staff cutbacks in the German financial centre than some press reports have suggested.

Sentiment in Frankfurt's banks indicates…

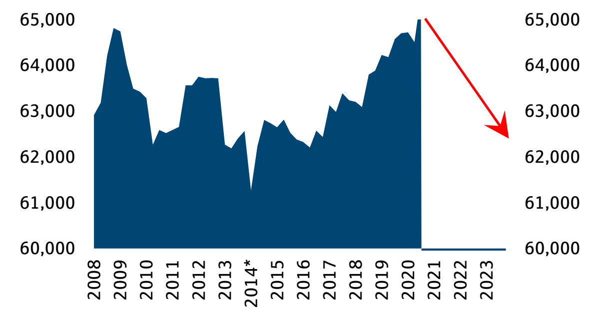
Net results of IHK survey



Sources: IHK Frankfurt, Federal Employment Agency, Helaba Research & Advisory

…impending decline in staffing levels

Bank staff subject to social security contributions in the city of Frankfurt



*statistical break

Sources: Federal Employment Agency, Helaba Research & Advisory

Over the period of our forecast, we expect to see a significant decline in the number of employees in Frankfurt's banking sector. It is important to note that, despite many institutions having announced cost-cutting, the total number of employees actually rose in 2020 and that therefore the baseline for our forecast is somewhat higher than originally assumed. Consequently, by the end of 2023, we anticipate a headcount of around 62,200 in Frankfurt's banks, which would translate to 3,300 fewer jobs – a drop of 5 % – compared to the latest available data of autumn 2020. However, should losses at German companies turn out to be higher than the impact of Covid-19 has indicated so far, this would put additional pressure on German banks and have a knock-on effect in terms of greater consolidation. In any case, the pandemic is an extraordinary situation with far-reaching consequences for many areas of our lives and work and is also leaving its mark on the German banking centre.

For the time being, there is no end in sight for these unique times of change in the financial centre of Frankfurt. Although they throw up a multitude of challenges, they also present opportunities due to the large-scale relocation of business by numerous Brexit banks. In order to develop successfully, the German financial centre should market itself in a self-confident and concerted manner while actively harnessing its potential for innovation and embracing key trends. Most importantly, it must adopt a systematic approach to the issues of sustainability and climate change because sustainable finance is an essential factor in the transition of the global economy and will therefore become an increasingly significant driver for the competitiveness of global financial centres. As the centrepiece of Germany's banking and financial system, Frankfurt boasts numerous qualities and, with determination and self-confidence, will be able to forge a sustainable path forward.

Sign up for our newsletter here:
https://news.helaba.de/research/

Publisher and Editor

Helaba Research & Advisory
Editor Marion Dezenter
Publisher
Dr. Gertrud R. Traud
Chief Economist / Head of Research & Advisory
Neue Mainzer Str. 52-58
60311 Frankfurt am Main
phone +49 69 9132 2024
Internet: http://www.helaba.com

Disclaimer

This publication was very carefully researched and prepared. However, it contains analyses and forecasts regarding current and future market conditions that are for informational purposes only. The data are based on sources that we consider reliable, though we cannot assume any responsibility for the sources being accurate, complete, and up to date. All statements in this publication are for informational purposes. They must not be taken as an offer or recommendation for investment decisions.