SCOTTISH-IRISH FINANCE INITIATIVE

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Counterparties:
a common financial industry strategy for Scotland and Ireland

Policy insight

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The opportunity afforded by Brexit

Change creates opportunities, and there is no doubt that the world is in flux – last year's vote in the UK to leave European Union (EU) has led to uncertainties for both Britain and other members of the bloc. In these islands it has created stresses both within the UK, where Scotland voted strongly to remain in the EU, and in Ireland, where a close trading relationship with the UK and delicate peace process is put at risk by the plebiscite. As if this uncertainty wasn't enough, the accession of Donald Trump as President of the United States has amplified the economic volatility that individuals and businesses face in these islands. Whatever the rhetoric, will the new administration help or hinder the UK in its search for new trading relationships? Will Donald Trump's plans for lower US corporation tax levels threaten the business model that Ireland has embraced in recent years?

The finance industry, in Ireland, Scotland and internationally, is susceptible to these challenges, not least in the resulting roiling of markets, but the sector also faces its very own issues. Overall, the finance industry is still subject to deep suspicion after the economic quagmire that followed the credit crunch. Investment banks have struggled to explain their contribution to the common good, while Europe's retail banking industry is yet to find its feet amid increasing regulatory capital restraints. The fund management and wealth advisory industry is facing greater scrutiny over its ability to deliver returns for clients, while overall the finance industry is looking at a tsunami of regulation, such as Solvency II, PRIIPs and MiFid II.

That's not to say that all upheaval is negative – rapid changes in technology are creating opportunities for new entrants in financial markets. At the same time, existing players are looking at technological innovation to help them deliver their services more efficiently and invest more securely with greater returns.

A common focus

Ireland and Scotland have a head start over others to take advantage of any realignment, with substantially developed financial industries existing already. Scotland brings a tradition of finance going back hundreds of years, and is the birthplace of investment funds while it played a key role in the development of the UK's insurance industry. Nowadays it's home to a range of larger investment managers, smaller boutique and hedge funds and fund servicing. Ireland is a European hub for fund administration, custody and for some of the key operations for international investment banks. Innovation in attracting business has been a hallmark of Ireland's success in recent years, building up a thriving finance industry in under three decades. Both countries can tap well-respected academic structures, are English-speaking and have well-developed legal systems similar to London, the region's, and possibly the world's, financial capital. In short they are well placed to take advantage of any political and technological changes and win new business.

The importance of the finance industry to both nations cannot be overemphasised. Ireland has more than €3.7 trillion of assets under administration, a figure that has increased almost 8 times since 2003. There are more than 500 firms operating in Dublin's International Financial Services Centre, with an average salary of more than €60,000. The centre accounts for 10% of multinational employment in Ireland and provides 13.5% of corporation tax revenues collected in the country.

For Scotland the financial services industry employs 100,000 people directly, and a similar amount indirectly, generating £8 billion for the Scottish economy. Assets under management stand at £800 billion, while Scotland is home to almost a quarter of the UK's life assurance workforce.

But why work in tandem? The main answer is that both nations have skills, expertise and experience that would be useful to the other. Obviously there has to be the incentive of both countries bringing in more business working together than they would individually. And for this the countries need to exploit both their shared and complementary attributes, outlined in general terms above and in specific cases below.

In the next section this paper sets out some broad categories where cooperation could be advantageous, along with some initial examples. It is important to note that any cooperation should be politically neutral – the benefits should be about protecting and enhancing the ability of the respective finance industries to thrive whatever macro-economic and political situation arises.

Possible areas for cooperation

Established industries – asset management

Ireland is a centre for fund listing, administration and custody. While Scotland does indeed have a well-developed asset servicing industry as well, it has a competitive advantage in frontline asset management. This is an area that's difficult to develop quickly and deliberately through public policy because it requires a critical mass of investors in order to make it worthwhile for companies to visit a location to meet with fund managers. Ireland and Scotland should therefore exploit the common interest in this industry and their differing areas of expertise.

The uncertainty as to whether UK will remain in the single market for financial services creates a situation for companies to future-proof their activities by exploiting links between Scotland and Ireland. A considerable number of Scottish, and indeed British, fund managers already base their offshore funds in Dublin (rather than Luxembourg because of the appeal of the similar legal system) and this business is growing. Many Scottish fund companies are already internationally focused in their sales activities, there is no denying the potential in the European market. Thus, they will need to keep a way of selling to 450 million Europeans, the continent's wealth managers and substantial sovereign wealth and pension funds (Norway's $885 billion fund is the world's largest, while Europe has a quarter of the world's pension fund assets) if Brexit results in a closing down of market access.

A system of fast tracking fund listing in Dublin could be attractive for both countries in terms of encouraging funds to be listed in Dublin, and finding a way for Scottish fund managers to continue to sell into the EU. Should European authorities make it more difficult for Scottish-based companies to use this route, perhaps requiring more evidence of a foothold in Dublin than just a letter box in order to gain a MiFid licence, Scotland could also help facilitate the establishment of satellite fund management offices in Dublin, with the necessary number of staff and expertise to pass any substance test. The benefit for Scottish companies would be a continuation of their business in Europe, while Dublin benefits from the development of its frontline fund management industry, a higher value proposition than administration that remains relatively small in Ireland at present.

Further, there are some companies who base their funds in Ireland in order to sell into Europe as a whole (PIMCO for example), and will also suffer with UK transactions should trade barriers be erected. Converse to the suggestion above, Scotland could cooperate with those companies in Dublin to facilitate the listing of funds in Scotland and potentially establishing fund management footholds in Scotland so as to meet any substance hurdles in the granting of licences to sell funds the UK.

Were Scotland to decide to leave the UK, this obviously sets up complementary relationships for Ireland and Scotland to facilitate financial trade between the remainder of the UK and the EU.

New technologies – Fintech/blockchains

For policy makers, it's always going to be easier to focus on shaping the future rather than remoulding the past. Blockchain and distributed ledger technologies are fast-growing in the finance industry. Designed to facilitate confidence in financial transactions through recording the history of a security in any trades related to that security, the technology was key in the development of Bitcoin as a trusted currency independent of guarantees from sovereign states. The technology is likely to become increasingly prevalent in financial trading in coming years. It also has the potential to allow financial transactions and development to occur away from traditional financial hubs such as New York and London.

While Scotland and Ireland are both home to companies involved in this technology (over £10 billion was invested in Fintech start-ups globally last year), the different specialisations in both countries offer the potential for shared benefits. In other words, Scotland could focus on developing the application of blockchain technology to frontline asset management and trades in this area, while Ireland could focus on developing the technology as it applies to custody, administration and listing. The two countries could then build cooperation in the linking of blockchain expertise across all of these areas so as to create a unique proposition to financial markets and participants.

Education – Fintech

While Ireland and Scotland are both rightly known for traditional education in finance, with a proud history training accountants, actuaries and bankers, there is now a realisation of the potential of Fintech in the development of finance in both countries and how this should be progress through education. Scotland, in the University of Strathclyde, has the UK's first MSc in Fintech, a third-level qualification, while Ireland's NCI also provides an MSc in the subject.

Education provision, of course, is an area that can be directly influenced through public policy. The governments of both countries could encourage third-level institutions to cooperate in this area, perhaps in the specialisation suggested in the previous section. A programme of cooperation could also attract the best brains, both at an academic staff level and for those students with the most potential in this area.

Political contingencies – stock listing

The political questions that arise from Brexit are various and significant. Whatever arrangements eventually occur, there is potential for Ireland and Scotland to share responsibilities in the short term at least so as to ensure continuity in financial services and administration. For example, should Scotland find itself more detached from the UK, Ireland, with an existing stock exchange structure and expertise, could be used in the short term at least as a place for secondary trading of Scottish securities.

Conclusion

The above suggestions are a selected few examples – this paper should prompt discussion from interested parties as to how cooperation should develop. There is no doubt that both Scotland and Ireland have strong existing financial industries with great potential in the future. The ability of similarly sized nations – with much in common, but enough difference to make cooperation useful – to work together in certain areas of finance is something that should be explored urgently in terms of public policy. This will ensure both nations can continue to thrive and punch above their weight in this important global industry.

About the authors:

David Clarke CFA is a writer, commentator and consultant. His focus on finance and investment developed while working for Bloomberg, the world's preeminent financial data and news service. There he was the main fund management reporter, while latterly he served as an editor-at-large, dealing with newspapers around Europe, and as an editor on bonds and foreign exchange. In recent years he has helped fund managers and related parts of the industry with their communications and marketing. He is a CFA charterholder and takes a strong interest in the future of fund management, and jointly wrote the CFA Society of the UK's recent report on the value of the investment industry.

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Daniel Broby has enjoyed a successful career in both academia and practice. He is Director of the Centre for Financial Regulation at the University of Strathclyde. His knowledge of financial theory and markets have had important practical application. He has also held a number of senior executive positions in the fund management industry, including chief executive, chief investment officer and chief portfolio manager. His practical skill set includes financial modelling, portfolio construction, accounting analytics, and investment process.

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