HOUSE OF LORDS

# European Affairs Committee

## Corrected oral evidence: UK-EU financial services

Tuesday 29 March 2022

4 pm

Watch the meeting

Members present: The Earl of Kinnoull (The Chair); Baroness Couttie; Lord Faulkner of Worcester; Lord Foulkes of Cumnock; Lord Hannay of Chiswick; Lord Jay of Ewelme; Lord Lamont of Lerwick; Lord Liddle; Lord Purvis of Tweed; Baroness Scott of Needham Market; Viscount Trenchard; Lord Tugendhat; Lord Wood of Anfield.

Evidence Session No. 5 Heard in Public Questions 63 - 78

### Witness

I: Lord Hill of Oareford CBE, former European Commissioner for Financial Stability, Financial Services and Capital Markets Union.

# Examination of witness

Lord Hill of Oareford.

Q63 **The Chair:** Welcome to this hybrid House of Lords and the European Affairs Committee. We welcome this afternoon our witness, Lord Hill, Jonathan Hill, who, apart from being a colleague here in the House, is a former European Commissioner and was Commissioner for Financial Stability, Financial Services and the Capital Markets Union, and more recently has been the editor of the recent UK Listings Review, which is very much something we have been considering in our current inquiry on the future of trade in financial services between the UK and the European Union.

This is the fifth evidence session. There will be a transcript taken and we will send that on to you in due course. If there is anything you would like to correct, could you let us know and we will correct it? It is the basis, of course, on which we will write our report. I will ask that members keep their questions to you crisp so that we have the maximum time. I think that we will be here for just over an hour or so this afternoon.

I will begin. Could you start with your overall assessment of the changes that have taken place in the UK-EU financial services relationship since the moment of Brexit and how you think that the sector has adapted to those changes?

***Lord Hill of Oareford:*** In a way, I am more struck by the similarities and the continuities over the last six years rather than the changes. Many of us thought that after 2016 things would change quite quickly. My former officials in Brussels certainly thought they would. If I look at it, I am more struck by the fact that London is still Europe's largest financial centre. The capital markets union is pretty stalled where it was as we left the EU. Without Britain in there, it is harder for CMU to make the progress that it might have made. No other single financial centre in Europe has so far supplanted London's place as Europe's biggest financial centre.

Behind the scenes, instead of a stark and sudden change, I think that there is much more, on both sides of the channel on financial services, of regulators, politicians and business looking over each other's shoulders and seeing where they are getting to, not so much in a conflictual way but from the point of view of where might they also want to change. An obvious example is probably Solvency II, where the UK is looking at that but French insurers will be very keen to look at it as well. It is more nuanced, I think, behind the scenes than one might think from the politics, but overall I think that things have shifted less than I thought they would have.

To the second part of your question, after 2016 the City, however you define it, got on with doing what it needed to do to carry on being able to trade. It did that quite quietly, quickly and efficiently. I think that the position from the beginning with the City was, "We will try to do the least we have to do." I think that its preference was always to try to keep the bulk of its business in the UK and, broadly speaking, so far that is what has happened.

**The Chair:** That is very helpful. Thank you very much. I wondered whether you felt that there was anything in the suggestion that there is, in fact, a symbiotic relationship between a capital market and a commerce market that is making things. A manufacturing market needs to have a good capital market because it needs capital and a capital market needs clients. Are we in a symbiotic relationship where London provides services that are required for European business?

***Lord Hill of Oareford:*** Yes, I think that is broadly how it works. You need deep capital markets to provide capital to businesses around the world, not just in the UK or in Europe. Over time, European corporates, whether they are manufacturing things or selling things, have become dependent, or more dependent, on London as a source of capital. Because of the concentration of capital, it means that their costs of borrowing money are lower than they otherwise would be. To your point, the real-world ramifications of not having strong and effective capital markets is that the cost of doing business for all types of business goes up. You also have, which was always the issue in Europe with its traditional heavy dependence on the banking sector, more risk concentrated in the banking sector. So, having deeper capital markets was a way of increasing financial stability and spreading risk, which was the other main motivation for wanting to try to build a capital markets union in the EU.

Q64 **Lord Tugendhat:** What you said was very interesting, Lord Hill. You were talking about London on the one hand and the EU centres on the other. Can you say a word about New York? Do you feel that within the perspective you were talking about New York might have gained and that decisions that might have come to London have gone to New York or that New York is playing a bigger role in European institutions?

***Lord Hill of Oareford:*** Yes, I do. The issue, going back to 2016—and some of that was driven by politics on both sides of the channel—was about who would do better between the UK and the EU 27. I think that the real exam question is the one that you imply, which is while we are both kicking bits out of each other and cutting off our nose to spite our face, the United States is opening up a bigger lead, as is Asia. For London, when it thinks about itself as a global financial centre, I think that we should be concentrating on the US and what is happening in other global financial centres and not spending so much time obsessing—that is quite a strong word—about what is going on in the EU. The international competition is not coming from within the EU, it is coming from the rest of the world.

**Lord Tugendhat:** Is there any particular area you would single out to illustrate your answer?

***Lord Hill of Oareford:*** An obvious one, which we may come on to talk about, would be the question of why businesses choose to list in New

York rather than choosing to list in London or elsewhere in Europe, where the lead in that and attracting tech companies listing in the United States is opening up.

**Lord Tugendhat:** We will, so I will not pursue that.

Q65 **Lord Jay of Ewelme:** I was going to ask whether you thought the reality of Brexit compared to expectations, but in fact you have already rather answered that by talking about being struck more by the similarities and continuities than the differences. I have one specific point. We have been told by some earlier witnesses in this inquiry that there have been fewer job losses, for example, or fewer jobs moving from the UK to the EU than had been expected. Are you struck by that, too? Is that something that you would agree with?

***Lord Hill of Oareford:*** I am sure you saw that EY does a regular Brexit tracker, which it published yesterday. I think that it has said 7,000 is the figure for jobs. Obviously, it is not just jobs, it is assets and capital moving, but I cannot now remember what some of the figures were, going back six years, that people were projecting—100,000 to 200,000—so 7,000 is obviously at the low end of that range. But that is not a reason to conclude that everything is fine and it has all settled down and we do not need to worry or try to make ourselves more competitive.

A lot of this is about people's expectations of the future direction of travel, what the sentiment is and who has momentum. Certainly, from 2016 to 2019 everything was rather frozen politically in the UK and in the City they felt that. It had gone through a period of being abused and then ignored, and I think that had an effect on sentiment and morale. I think that has shifted and there is more of a sense that the Government are trying to do things to address the question of London's competitiveness, but all these other centres we have talked about do not stand still.

The number of jobs is lower than one might have thought but I do not think that is the whole picture. I still think that there is a lot one needs to do about the overall regulatory environment.

**Lord Jay of Ewelme:** If you try to project yourself forward—you have talked about things having been a bit frozen between 2016 and 2019 and now perhaps being slightly unfrozen—will that process of unfreezing continue over the next three, four or five years? Do you feel reasonably confident about London maintaining a competitive edge in different ways as it adapts, as the City of London has traditionally done, to new circumstances in the years ahead?

***Lord Hill of Oareford:*** I do. I feel more confident than I did. Again, we might come back to talk about this. One reason that I recommended what we called in our review an annual state of the City report was to try to put some scaffolding in place whereby the Government and the City and the regulators, all in one place, would have to ask themselves once a year, "How have we done? Have the changes we have made over the last year worked? What has worked? What has not worked? What can we do better?" to try to keep the feet of government and regulators to the fire so that it is an iterative thing.

When you think about regulation, people often talk about it in a static way, and then people want to defend the state that it has arrived at. I think we should be striving for something more dynamic. I am more confident than I was, but I think that you have to keep going at it over the next five years. You cannot disassociate what is happening in the City from the broader economic policy framework for the rest of the country: tax, attitudes towards foreign investment, attitudes towards subsidy, market intervention, and so on. All those I think help create the picture one wants to paint of being an open economy with regulatory flexibility and predictability.

**The Chair:** Thank you very much. Lord Hannay wanted to come in here.

**Lord Hannay of Chiswick:** Yes, not on jobs that may or may not have gone but on revenue to the Exchequer that may or may not have risen, fallen or stayed much the same. We have been completely unable to get any indication on that out of the previous witnesses. Do you have a feel for that rather important element, since, as you know, the proportion of the Government's revenue that comes out of "financial services" and the City is pretty big?

***Lord Hill of Oareford:*** It is. I do not, I am afraid. I guess only the Treasury would be able to tell you that.

Q66 **Lord Foulkes of Cumnock:** Good afternoon, Jonathan. Returning to the jobs that have moved, we have been told that they have moved to different centres throughout the European Union. What effect does that fragmentation have, good or bad, as far as the EU is concerned and, indeed, as far as the UK is concerned?

***Lord Hill of Oareford:*** I think that it has a bad effect. If you start with the big picture about what seems to be going on generally with the reversal away from globalisation, where supply chains got longer, where payment systems and financial services became more integrated, more efficient and cheaper to use, we are clearly reversing out of that and we do not yet know how far back along that line we will go. The consequence of that greater fragmentation is that, crudely, the cost of raising capital increases. That means Europe's businesses find it harder to fund the recovery that the European economy needs to have. I think that it is a retrograde step.

It also goes to the point that was made earlier by Lord Tugendhat about the United States. It means that when people are looking around for funding they will often look outside the EU to try to raise it. From an economic point of view, it makes the whole process more costly and I think that what you describe has happened. It has tended to go into penny packets around the EU, some more than others. In that EY survey, I think that it was saying Dublin has done quite well, Luxembourg has done quite well. People say that Amsterdam is making a push in making itself an attractive place to go and list. Cumulatively, I do not think that it leads to a stronger system.

**Lord Foulkes of Cumnock:** The jobs that have moved, have most of them or all of them been from the City of London or have some of them been from the other financial centres such as Edinburgh, Glasgow and Leeds?

***Lord Hill of Oareford:*** Again, I think TheCityUK or one of those bodies would give you a better answer than I can. My sense is that it is mostly London since quite a lot of the jobs outside London in the UK were—it is not true to say they were back-office jobs, but I think they are more likely to have stuck. I do not know. Someone will do a better answer than me.

**Lord Foulkes of Cumnock:** Does that fragmentation illustrate anything about the relative strengths and weaknesses of the European Union sector and the UK?

***Lord Hill of Oareford:*** I think that it says that no single European centre has the critical mass that we have. It says that London is still pretty sticky, I mean in the sense of resilient. If you flip it on its head and say to yourself, given what happened to the City, particularly from 2016 to 2019, we created conditions that were perfect for the Europeans to be able to take business from London and it has not happened on a big scale. I think it tells you that just the sheer concentration of people and scale in London who still want to be in London gives us an advantage, but again we have to work at it. There is quite a lot to do to shore up that position and to try to equip ourselves to compete in new areas that are not yet regulated.

Q67 **Baroness Couttie:** Good afternoon. I would like to hear a little bit about what you feel the primary opportunities are for the UK financial services sector post-Brexit and what the Government can do to support achieving those aims. You talked a little bit when you were responding to Lord Jay about a dynamic regulatory environment and I would like to hear a little bit more about that. We are also, I hope, signing more and more trade deals. What would you like to see in those that would support the financial services sector its trade more broadly than with Europe?

***Lord Hill of Oareford:*** The narrow answer to the question about what the opportunity is after Brexit is that from a regulatory point of view, constructing rules, particularly in areas that have not yet been regulated—so in the whole area of fintech more generally, of crypto, of green finance, where we will have to work out how to regulate that—being able to regulate for one is a hell of a lot easier than trying to do it for 27. It is a consequence of a consensus-based system. It makes it extremely slow and laborious to put in place. Because of all the compromises entailed, between different bits of legislation across wide fields, amending regulation is quite difficult.

My view is that you are more likely to compete successfully if you have a flexible regulatory system. I think that there is an opportunity to move more quickly, but consistent with global standards. This is an obvious point to labour—it does not make any sense if you want to be a global financial centre to construct regulatory standards that will apply in a market of 68 million. Can you crack on more easily in a more focused way in one jurisdiction? Yes, I think that you can. That would be the narrow point about where the regulatory opportunity is after Brexit.

The broader point is that it is not a direct consequence of Brexit other than in the sense that a big national moment like this gives one the opportunity to regroup and think about things and the opportunity for us to think more intelligently about how we approach regulation overall and how our regulators behave. I draw a distinction between what the rules are and then how the rules are applied. We have an opportunity to think about that afresh just because we have had to pull the drains up and have a good look.

In particular, I would say look for those opportunities in the areas where we are not struggling through a set of rules that are already in existence. I mean all the acquis that we have brought across. A lot of those, if we think about it, are from traditional financial service sectors. Many of them I think will be disintermediated by technological change. In the areas where we will have to draw up new rules—what we will do about crypto or whatever else it might be, how you get a balanced approach to green finance—I think that we do have a chance to be world leaders. Our regulators also need to be outward looking and engaged in all the global regulatory fora. That is where I think that it is best for us to look.

**Baroness Couttie:** You see the opportunity being about the way that we regulate within the UK rather than having perhaps easier or better access to other markets through trade deals? You think that the access we have is sufficient?

***Lord Hill of Oareford:*** I think that there is a practical problem and many of the people on this Committee will know more than I do about trade deals. Getting access for financial services into trade deals has not traditionally been very straightforward or yielded a huge amount and I do not think that there are massive signs that that will change any time soon. There is, obviously, an opportunity for us to do some thinking on some bilateral arrangements with countries, maybe specifically on financial services, not as part of some great big trade deal. I do not know. I know that there has been work done with the Swiss and people talk about the possibility of us trying to do more regulatory co-operation with other jurisdictions. I think that there should be some opportunities in there, but that is slightly different from a full-on trade deal where progress so far has not been massively encouraging.

**Baroness Couttie:** I think that it is largely about recognition of professional qualifications, movement of people, data sharing, those sorts of things around financial services that could potentially open up new markets if they were negotiated. Thank you very much.

**The Chair:** The message is the importance of being consistently flexible rather than flexibly consistent, I suppose. Thank you very much.

Q68 **Lord Lamont of Lerwick:** Good afternoon. You chaired the UK Listings Review and came up with a lot of liberalisation measures about free floats, SPACs, dual-class shares, and so on. I noticed in your letter to the Chancellor accompanying the review that you referred to the poor status that the FTSE 100 now had because it has a lot of old economy companies, and despite the UK's insistence that we are very good at modern technology and innovation we have very few big technological listed companies. Do you think that the specific recommendations that you put forward will encourage more large technology companies to list in London?

***Lord Hill of Oareford:*** I always felt this about the listing review; that it was a subset of issues that needed to be addressed but it was not a complete answer. In and of themselves, if the recommendations were implemented would everything magically flow and bring large technology companies with it? I think the answer to that is no. The specific issues that we were asked to look at had produced a set of obstacles and restraints and reasons why people thought they did not want to come to London. If you were a founder, you could go to a different jurisdiction and have more discretion for longer over your shares or you could raise and hold on to a greater amount of capital.

I think the Review will take away some of the criticisms that tech founders were making about London. It levels the playing field between us and other jurisdictions. I do not think that there was anything in our review that you could not find in another jurisdiction. It was not that we were consciously trying to open up a gap by lowering standards. We were trying to close a gap that had opened up between us and other jurisdictions.

I think that it is part of the picture and the regulator and the Government have moved quickly to implement it, but it is not the total picture. I cannot say because of that it will follow because there are lots of other issues to do with the availability of funds, the rules for pension funds, research analysis on tech companies, the general culture towards founders' success, and the way our media might make people think that they did not want to become prominent business figures. All those are factors. I think our review just helped remove a subset of obstacles.

**Lord Lamont of Lerwick:** It is good to know that you think that the Government are implementing it quickly. Does Brexit have any relevance to what you did? Did it make it easier or is it of no consequence to the policies you put forward?

***Lord Hill of Oareford:*** It is a bit of both and it is an illustration of the point I tried to make earlier. All the rules you talked about are FCA rules that we could have chosen to change at any time we wanted to, in or out of the EU, and we had not. The bit of the recommendations that was clearly Brexit-related was around the Prospectus Regulation, which we could not have changed, and we are now going to change. The

Government have said they will bring forward regulation on that as soon as they can, which I think will be this year. We will go back, I think, to a regime on the prospectus much closer to what we had before we were in the EU, which will be, I hope, lighter-touch, more principles-based and so on.

Q69 **Lord Lamont of Lerwick:** You said earlier that the capital markets union was further away. Of course, if you will forgive me saying, I remember very well you were a great supporter of the capital markets union. Why do you think that it is now further away? Do you think that there is any prospect, or would this be cloud-cuckoo-land, that you might get a market-driven capital markets union even including non-EU countries in it?

***Lord Hill of Oareford:*** A lot of the issues you had to address to make a capital markets union work were already extremely difficult to do. How do you harmonise solvency rules across, then, 28 countries? It is an incredibly difficult practical thing that you need to do.

It was always difficult. I think it was easier to build some momentum around the idea that it might be achievable when you had a big capital market centre such as London in the EU because it was Europe's capital market centre, or the EU's capital market centre, and, of course, now it is not. I think that shifts the way that people in the EU think about it.

Has it gone further away without us in? I think for that reason, just from a practical point of view, from a critical mass point of view, yes, it has. Is some broader alliance possible? That is the really interesting big picture policy question that Ukraine has brought into relief: could you have, should we want to have, an alliance of like-minded people with similar values uniting around a range of things, including defence and security? I would argue that what we have seen during the current crisis is that the financial system, the payment system, is part of defence and security. Could we lift our gaze and think, "Here is an opportunity to try to overcome some of our small differences and concentrate on what we have in common" and do what you suggest, or will we revert to small differences, Europe first? Will we on our side make the most of this opportunity politically and diplomatically? I do not know, but I think that yours is exactly the right question. I do think that there is potential for it. I think it is the sensible thing to do. I am not sure, though, that politics and some of the personalities will make it happen, but I would be going for it if I could.

Q70 **Lord Faulkner of Worcester:** Good afternoon, Lord Hill. We have covered some of this area that I want to talk to you about. That is the question of strong competition from other financial centres, not just in Europe but in the US and Asia. What particular centres do you think are London's biggest competitors when it comes to listings?

***Lord Hill of Oareford:*** The US and, more recently, in some areas, Amsterdam. I am told from friends in the market that Amsterdam has made efforts to make itself more open.

**Lord Faulkner of Worcester:** Are you prepared to say whether challenges that we have had in attracting companies to list in London are in any way attributed to Brexit or not?

***Lord Hill of Oareford:*** What are hard to disaggregate are hard factors to do with particular pieces of regulation and softer factors to do with sentiment. On the harder factors—what are the rules?—I do not think that Brexit has played a part in that at all. On the softer side of sentiment, given that people are making judgments for some time on where they might want to float their business, clearly in that period after Brexit people were asking more questions about what kind of economy the UK would be, what kind of attitudes it would have towards the City, than they were before.

I do not think that you can say it has zero effect, but when during the review I was talking to founders no one said, "I have been put off because of Brexit". It was more to do with some of the specific issues that we managed to address and some to do with general British cultural attitudes towards success, wealth and control. I think that they felt, crudely, in New York you can float yourself, be celebrated and you will be under the radar, and in the UK, because of the robust nature of our system, which has many benefits, you do not have that same thing. Your downside risk, either if you are very successful or very unsuccessful, is greater in the UK.

**Lord Faulkner of Worcester:** Because you are likely to be the subject of media speculation and comment?

***Lord Hill of Oareford:*** Yes.

Q71 **Lord Faulkner of Worcester:** You mentioned Amsterdam as a particular competitor. I wanted to ask you about two contrasting decisions, one by CVC Capital Partners, which has announced that it is planning to list in Amsterdam rather than in London, whereas Shell said last year it was going to scrap its dual listing structure and move its headquarters from Amsterdam to London. Obviously, we know which one we would prefer to be the model for the future, but what do you think is, in fact, the more representative of the two and what is what we can perhaps call the general direction of travel?

***Lord Hill of Oareford:*** I do not know enough about those individual cases and what the reasons were behind them or, indeed, what people have said publicly. One has to be a little careful of extrapolating a trend from a couple of pieces. We all tend to do it. About a year ago, after the review came out and there was suddenly a number of companies saying that they wanted to IPO in London, that was probably overinterpreted as a trend saying, "Aha! Everyone now wants to come to London". I think that one has to guard against that.

I do not feel I can say that one is a trend more than the other. Looking at it, the significance of the CVC decision, if it is indeed a decision, I would say has a greater weight than the other one. As I said right at the beginning, I think that these are all signs as to why we have to keep our eyes open and keep working at things and not believe that because there has been a listing review everything is now done. Clearly, it is not and companies are making decisions in real time to go to other places.

**Lord Faulkner of Worcester:** Thank you. I follow that. Do you have any tips on what we should do to make Shell more the model than CVC?

***Lord Hill of Oareford:*** I am not sure that I do usefully at the moment to help the Committee, I am afraid.

**The Chair:** Can I ask one follow-up question on that? It is to do with very small things. These would be corporate bonds, catastrophe bonds, preference shares, things that generally have a listing but maybe have a limited life. There are quite a lot of these sorts of things; they are small but beautiful and tend to head off to small exchanges. Did your listing review look at that as a class of business and did it form a view about whether that should be something that London should go after again?

***Lord Hill of Oareford:*** We were not asked to look at that. The brief we were given was quite narrow and specific to do with the main market.

**The Chair:** Principal equity listing, yes.

***Lord Hill of Oareford:*** Yes.

Q72 **Viscount Trenchard:** Good afternoon, Lord Hill. I would like to ask you what you think about the objectives of the regulators. At present I think that the FCA has an objective to promote competition in consumers' interests, which I always thought was slightly strangely worded. It is one of the primary objectives but not the first listed. The PRA has what is described as a secondary competitiveness objective, but if you look at its drafting, it is exactly the same as the "have regard to" so I do not think that it is considered a leading priority. In your review, you recommended that the Government consider adding a growth or competitiveness requirement—I do not think that they are quite the same thing—to the remit of the FCA but not to the PRA, as part of the future regulatory framework review. Could you say a little bit more about what exactly you want to achieve and whether you think that is a good idea?

Perhaps you could also comment on what we heard from the regulators when they talked to us last week. They drew a distinction between having competitiveness as a secondary objective that would be subordinate in the FCA's case to the consumer protection objective and competitiveness as a primary objective. They seem more supportive of the secondary objective approach. Do you recognise that distinction and do you have a view on the relative merits of the two approaches?

***Lord Hill of Oareford:*** We recommended that there should be a competitiveness requirement—not to get hung up on words, obligation requirement, whatever—for two reasons. The first is I do not accept that high standards and thinking about your place in the world are incompatible, conflictual concepts. I think that it is perfectly possible to be committed to high standards, very high standards, and then to think, "I would like to get businesses coming into my very well-regulated space". To be a regulator responsible for regulating something that no one wants to transact business in does not seem to me a very good case, for all sorts of reasons.

I have a lot of sympathy for the regulators, the job that they are asked to do, having been a quasi-regulator sort of person in Brussels. I think that the pressures they are under politically make the job very difficult. However, I do not accept their argument that if you have a competitiveness objective of some sort, it will suddenly mean we are going to be forced to sacrifice high standards. That is one reason why I am in favour of it.

The second reason I am in favour of it is to do with the changed regulatory framework that we now have. If you look back, what has happened, it seems to me, over the last 20 to 30 years is that politicians have surrendered to regulators huge amounts of responsibility that, 30 years ago, we thought were matters for political debate. For better or worse, they have given those over to people who exercise their best judgment but have huge amounts of power and responsibility. A lot of those are to do with things that I think one would consider to be political in nature.

As the debate goes on, the regulators are asking for more power to be able to amend regulation more quickly without having to come back for primary legislation. I understand that argument and have a lot of sympathy with it but it seems to me that the political system needs a process holding them somehow to account, and the competitiveness requirement seems one possible way into having a conversation with regulators about how they are getting on.

I also think that there is a sense in which—I was told this by a member of staff within one of the regulators, so I do not have first-hand experience of this and they may want to correct me—the whole organisation is run stems from the core, primary objective that it has. That then leads budget, leads staffing and defines resources. Something that requires the organisation to be thinking about how what it is doing fits into the broader world, I think, would also help to make sure that the organisation is run and resourced taking those things into account.

**Viscount Trenchard:** If I could ask you to be crystal clear on that, would you agree that that means that in the cases of both regulators, the competitiveness or competition-related objective should rank equally with the other primary objectives? If that were done, would the UK's regulators then be fully equipped to apply the UK's framework in a way that strengthens the UK's position as a global financial centre?

***Lord Hill of Oareford:*** Personally, I would go for a primary objective. It seems to me that if it is the wrong objective you should not have it as an objective or you might as well make it a primary objective, if you see what I mean. I would go that way.

In answer to the question, "Do they have what they need to do their job?" I do not know enough about the resourcing. I read the same things that we all read about making sure that they have the people they need.

There is this crucial point that I do not think we are all yet clear on, that if you give them—which makes sense in principle—more ability to flex their regulatory decisions, it seems to me we need an accountability mechanism. That is not a comment to do with any of the people currently in the job but if we are setting up a framework for a long period of time—and these are very powerful organisations—you need a way for Parliament to be able to express a view and to make sure that we have not created a very powerful body beyond some form of parliamentary accountability apart from being hauled in front of the TSC once a year.

**The Chair:** Thank you.

**Lord Hannay of Chiswick:** What you have said is extremely interesting. It contrasts rather sharply with the views we have had from regulators, who told us that it was a jolly good thing that they were being given more flexibility and more authority. They contrasted that with the time when we were within the European Union, when a great deal of this was done in primary legislation in negotiations in Brussels. They told us that very firmly. However, what they were not able to say was where the accountability was going to come from. Indeed, they rather gave the impression that they would rather it did not come from anywhere.

Leaving that on one side, you mentioned in your reply just now—very helpfully, I thought—that you thought Parliament ought to play a role in this. There are basically, I suppose, two ways in which the issue of accountability of the regulators could be handled: one is by giving more powers to the Government and the other is by giving more powers to Parliament. Could you express a view on that? I think it is a missing piece at the moment.

***Lord Hill of Oareford:*** Yes. You sum the dilemma up extremely well. I completely understand why the regulators say what they say, and from the point of view of technically being able to do their job swiftly, flexibly and adaptably, that is no doubt true. However, as you say, there is a hole in the argument about accountability.

There is a question that we have not answered collectively yet. As you know very well, the European Parliament, for all its many faults, does have people in it who know the files and the detail of the financial regulation extremely well. We do not have anything comparable in our system among parliamentarians because we are not set up like that and we have not been set up like that. The way that the Commons works is not to have people who have that kind of detailed knowledge on the intricate ins and outs of a financial file. I do not think we have yet answered the question as to who is going to replace that. Because it is so detailed but the detail can have billions of pounds of consequence, you must try to find a way in which someone knows enough to be able to ask the regulators the right question.

To your question, "Government or Parliament?", if I am allowed a cop-out answer, I would say that we need both. But I do not think the Executive on their own is satisfactory because of the nature of what I have just argued, that the regulators have huge power over the lives of people and, down the line, the wealth of people. I think you need some connection to the voter and that comes through Parliament.

Q73 **Lord Hannay of Chiswick:** Thank you. That is very interesting and helpful.

We switch now to what is called the Memorandum of Understanding between the EU and Britain outside the EU, which was referred to in the Trade and Cooperation Agreement, which said that the two should "agree to establish structured regulatory co-operation on financial services".

The memorandum, of course, was negotiated reasonably expeditiously and has now disappeared into the same oubliette as quite a lot of other things, namely Horizon and a few others, which are all stuck. I think you would agree that seems to be the story but perhaps you will confirm that that is the story, that they are stuck while mud wrestling on the Northern Ireland protocol is conducted.

***Lord Hill of Oareford:*** I am not close to it, obviously—I am not part of the Government—but that would be my understanding for the reason that, again, you know very well, which is that all of these things are subset issues of the big issue. Particularly on things such as financial services, the European side from the beginning was always going to make that one of the last areas that it would move on and I think that remains true.

**Lord Hannay of Chiswick:** You confirm what others have said. Most of our witnesses have taken the view that finalising the MoU, bringing it into operation, as it were, and having that structured regulatory co-operation would be useful, would be something that we could make use of and value. No doubt, the European Union ditto because of London being such a very large part of geographical Europe's financial markets. Where on the spectrum do you rate bringing it into life, not tomorrow or the next day but as part of an overall approach for our future? Is it essential? Desirable? Where do you rate it on the spectrum?

***Lord Hill of Oareford:*** I think we are seeing so far—if I am to try to be consistent with what I argued at the beginning—that it is not essential because life has carried on without it. It is the kind of thing that can help. If we can normalise relations and you have bits of architecture that you can hang relationships off, that is generally a helpful way to improve co-operation.

It is the kind of thing that would be useful to have as part of a broader reset but it fits into the conversation I had with Lord Lamont earlier, in that I think there is a broader opportunity now for us, not just UK–EU but broadly across the West, however you define "the West", including Japan and other countries, to build a broader grouping. That could also be around financial services.

**Lord Hannay of Chiswick:** We did hear that the Bank, for example, found the existence of a structured relationship with the United States pretty valuable, and felt that we could exchange views on areas we in which might be having difficulties with each other more freely and effectively through such a structure. Presumably, that argument does more or less cut with the European Union too.

***Lord Hill of Oareford:*** Yes. From my domain, when I was Commissioner one of the things that we were keen to do with the US—the US was a bit resistant but ultimately said it would—was to set up a financial dialogue between me and the Treasury Secretary twice a year. That suggests that people see the utility in this.

Q74 **Lord Liddle:** Some of this ground has already been covered by Baroness Couttie. It is the Brexit opportunities question. Where do you think they are? Do you think that the Government are doing what they could be doing to take advantage of these opportunities? Do you see any downsides in this?

***Lord Hill of Oareford:*** As we have touched on, I see that there is some opportunity in working through some of the inherited financial regulation and working out whether there are ways we can do some of that a bit better. There is opportunity in the areas of, broadly, fintech and green finance, where we have the chance to set global regulatory standards, although on green finance the Europeans are getting a crack on. They are, again, fairly predictably, going down a heavy and convoluted route that is going a long way away from green finance.

Then, as I argued before, broadly, there is a chance for us to construct an overall approach to regulation, not just the rules but how the rules are applied and the regulatory culture, whereby people can think we welcome them to our regulatory space. There is quite a lot of criticism from businesses, which they do not ever want to put their name to, about some of the processes of our regulators. You do not often hear criticism about the quality of our regulators or the rules, so much, but when it comes to processes further down in the system you often hear people saying, "Elsewhere in Europe we get a better service from some of the domestic regulators than we sometimes get in the UK". The culture of regulation is an important subject, separate from what the actual rules are.

**Lord Liddle:** You refer to that in your letter to the Chancellor, do you not, where you say that you cannot automatically assume that UK regulation will be more proportionate, adaptable and fleet of foot? I would have thought that was absolutely right. We have not in the past always made a great success of these things when we have had a chance to do them ourselves.

***Lord Hill of Oareford:*** Again, I have struggled and so far succeeded not to get drawn into the whole Brexit thing but the idea that all the problems we have from regulation stem from European regulation is patently not true. My basic view is that over a period of time we have enormously reduced our risk appetite across the British economy and society. Most of that we have done to ourselves of our own free will. Thinking about the overall regulatory burden simply in terms of Brexit makes us miss the big picture and the opportunity. We obsess over relatively small things and miss the bigger things.

**Lord Liddle:** Thank you, that is very helpful.

Q75 **Lord Tugendhat:** You mentioned a few moments ago fintech and green finance, and you also mentioned how difficult it is to get agreement between 27. In the light of those two remarks, do you think there is scope for us to become the first movers, the trendsetters, the precedent creators, in areas of that sort?

***Lord Hill of Oareford:*** I think there is. Again, though, as I argued before, it goes broader than just the regulations that we set because, as we discussed a moment ago, quite a lot of what persuades a founder or a company to go into a particular market is to do with sentiment and emotion. We can be thinking about the specific regulation but there are also those broader points about tax culture, regulatory predictability and how likely the Government are to intervene. At the moment, for example, there is the possible effect on investment of the National Security and Investment Act. We all know why it is there but it introduces a new uncertainty into the system as it is not completely clear whether a foreign investment needs to be referred to this new piece of machinery.

There are a range of things that one ought to look at in the round to try to create a sentiment and a direction of travel, so that people can see overall that the UK is welcoming to business in a coherent and consistent way. Then, in particular areas, there is work one can do to regulate to make that as attractive as possible.

**Lord Tugendhat:** The rest of my question has been largely covered.

**The Chair:** Thank you very much indeed. Our member who is in Iraq at the moment is Lord Purvis. Over to you. We will give Lord Purvis a minute, but if he is not there then we will move on.

Q76 **Lord Purvis of Tweed:** The connection is not great, I am afraid.

Good afternoon, Lord Hill. I wanted to pick up on the reply you gave to Lord Liddle, I think, which was on the future of regulatory reforms. Are there areas where you think that regulatory alignment would be consistent with the process now post Brexit? We received previous witness evidence that suggested that the future areas of regulation for the UK are likely to be in similar areas as the future areas of regulation for the EU, such as green and fintech, as you mentioned. If so, do you think that the alignment should be on the details or more just on the outcomes?

***Lord Hill of Oareford:*** First of all, for all the areas that you mention, the task is to try to set them at a global level. UK regulators—I know they do—will want to remain very active in all the global regulatory bodies.

You need to take a whole array of people with you at the top level to try to get ahead in setting standards in the world.

In terms then of how they are implemented at a detailed level, the truth is that all jurisdictions approach things in detail differently because we have different histories and cultures and different shapes to our societies. I do not think one should try to iron out all detailed differences because I do not think you will ever get there and you will drive yourself mad. To your question, outcomes and principles are the best way to go.

**Lord Purvis of Tweed:** You referred before to some of the concern that you had about adding more quasi-statutory powers, if I put it that way in my own words, to the regulators. Is there a concern that with the process that is now under way there will be even more power to the regulators, away from primary and secondary legislation, and at the same time perhaps the accountability structure remains within the European system? There is potentially a growing democratic deficit in the regulation of our financial services, even while the outcomes are likely to be aligned.

***Lord Hill of Oareford:*** I do think that. That was the point I was trying to make to Lord Hannay. Giving the regulator more discretion is a rational thing to do—I have seen in the European system the difficulty of changing things flexibly because it is a highly politicised system and I understand why, in principle, you want the regulator to have more flex—but I do not believe, from an accountability point of view, that we should be relaxed about creating a system whereby that greater discretion is passed over. In itself, that tends to be behaviour forming and enhancing; it is just the beginning of a process. I think your summary is correct and that is why we must try to put some greater accountability mechanism in at the beginning.

Q77 **Baroness Scott of Needham Market:** I wanted to go back to the discussion that you were having, particularly in response to Lord Lamont, about the extent to which the EU's direction of travel may be changing because of our departure. You gave the capital markets union as an example. Could you say any more about that, or whether there are any other examples or other evidence that the EU's direction of travel is changing as a result of our departure?

***Lord Hill of Oareford:*** I think we started with this. One of the outcomes that I and all my former European colleagues were surprised by—they indeed believed that the purpose of Brexit was to make London Singapore-on-Thames and I think they are quite surprised that in a number of respects, the shape of our economy feels more like Brussels-on-Thames in recent years.

It has weakened the European capital markets but I do not think it has sent them in a different direction. I thought it might have. I thought at the beginning that you would imagine that without the UK they might become less interested in capital markets, keener to get on with integration and a bit more heavy-handed on regulation, because the UK used to spend a lot of time in the European Parliament and the Council arguing for lighter-touch regulation. I do not think that is, in practice, what has happened. There has been some modest progress on banking union but overall I do not think they have been taking an enormously divergent approach.

Somewhere in here, the interesting question might be what the Germans end up doing. There are some people close to Scholz who are very interested in capital markets and who are, I think, supportive of the broader, alliance-type approach that I talked about to Lord Lamont rather than a Europe-first, greater integration kind of approach. Overall, I do not think there has been an enormous lurch in a new direction in the EU.

**Baroness Scott of Needham Market:** Thank you. I was also going to ask you to say a little about the Russia–Ukraine crisis but you have already touched on that. Therefore, in the interests of time, I will allow us to move on and perhaps the Chair can come back to you if there is time at the end.

**The Chair:** Thank you very much indeed. In fact, another retired Commissioner would like to ask a supplementary here. Lord Tugendhat.

**Lord Tugendhat:** I noted your comment about the Germans, but to what extent do you think the probability of this high inflation coming down the track and the differences of view within the European Central Bank over quantitative easing, that combination of issues, is going to create difficulties for not just the capital markets union but for plans in this sector altogether?

***Lord Hill of Oareford:*** Like all of us, they have a big economic problem coming extremely quickly. Obviously, like you, I have seen that the ECB is taking, so far, a different approach towards quantitative easing from the decisions that are being taken in the United States and over here on interest rates. I do not know whether it will be able to sustain that.

However, I think the main consequence of what is happening is that the emphasis everywhere on security and resilience is likely to increase. The process that had been going on in financial services of global integration and the internationalisation of finance, I think is going to go into reverse. In the same way that we all woke up and thought, "We have been overly dependent on other parts of the world for our energy supplies", other parts of the world, when they saw what happened with SWIFT and sanctions, have woken up and thought, "We have become overly dependent on bits of the West for our financial system and our funding". I suspect that there will be a process of more fragmentation or consolidation but as to how that will work through in the European economy, Lord Lamont would have a better answer than I would, I think.

**The Chair:** Our most patient member is Lord Wood and he has the last substantive question.

Q78 **Lord Wood of Anfield:** I wanted to ask you about equivalence decisions, which were the holy grail for many parts of the City in the immediate aftermath of Brexit. We only so far have one, compared with the US having 15 and Singapore some as well. What is the reason for that, do you think? Is it a punishment strategy or is it something else going on?

***Lord Hill of Oareford:*** I am not sure it is a punishment. I used to be responsible for equivalence decisions and I naively started off thinking there must be some kind of technical process, that you would go through a technical process and it would give an answer. Then you realise very quickly, of course, that it is just a political process and the answer fits the politics. I do not think it is a technical problem.

I would not use the word "punishment" because I do not think that is a terribly helpful way of thinking about what has been going on, but it is a version of what we discussed earlier, which is: like all systems but the European system in particular, you do things only when it is in your interest to do them. They think that an equivalence decision is a plum to give, and why would you give that before you know you want to give it and in exchange for something else? That is tied up with the much bigger picture of our overall relationship.

I spent a lot of time after 2016 saying to people in the City, "I promise you, you are not going to get equivalence". They did not believe me because they did not want to believe me and they had optimism bias, but it was completely clear that the Commission was not going to do it. They are quite hard things to get done. I do not think it is punishment but it is tied up with the bigger diplomatic relationship, which is still uncertain. Until that is certain, why would they move on that?

**Lord Wood of Anfield:** Are you saying that you think, for example, the Northern Ireland protocol deal would unlock more equivalence decisions, or that hard-headed self-interest on the part of our former EU partners will mean that we will not get equivalence decisions even after that?

***Lord Hill of Oareford:*** I think it is more likely that you would get them. So much of the system—and there are many people on this Committee who know this better than I do—stems from trust and human relationships. With the European system, it is completely impossible and inflexible until it decides it is not going to be, and then it is incredibly flexible. That is where we are. If you can get to a position where trust starts to rebuild, all sorts of things can start to move. If you cannot, then not very much is going to move.

**The Chair:** Thank you very much, Lord Hill. We have gone, in the end, just over 80 minutes, I am afraid, but it has been utterly thought-provoking and a very different if in fact consistent window on the difficult problems that we have been examining as a Committee. With our great gratitude, I declare the evidence session over.