HOUSE OF COMMONS

Treasury Committee

Oral evidence: UK's economic and trading relationship with the EU, HC 1140

Monday 11 January 2021

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Harriett Baldwin; Anthony Browne; Felicity Buchan; Dame Angela Eagle; Mike Hill; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 65

Witnesses

I: George Peretz QC, Monckton Chambers; Elizabeth De Jong, Director of Policy, Logistics UK; Barney Reynolds, Global Head, Financial Services Industry Group, Shearman and Sterling; and Conor Lawlor, Director for Brexit, Capital Markets and Wholesale, UK Finance.

Examination of witnesses

Witnesses: George Peretz, Elizabeth De Jong, Barney Reynolds and Conor Lawlor.

Q1 **Chair:** Good afternoon and welcome to the Treasury Committee's inquiry session on the UK's economic and trading relationship with the European Union. I am delighted to be joined by witnesses covering a wide variety of areas of expertise relevant to this very important agreement.

We will, I hope, ultimately be joined by four witnesses, but unfortunately, due to technical problems, one witness is having trouble joining us. That is Elizabeth De Jong, the director of policy at Logistics UK. Hopefully she will be joining the session and answering questions fairly shortly. Can I start by asking the remaining three witnesses to very briefly introduce themselves to the Committee?

George Peretz: I am George Peretz QC. I am a barrister at Monckton Chambers, specialising in what we now must learn to call EU relations law, including in particular what used to be called state aid and we now must learn to call subsidy control.

Barney Reynolds: I am Barney Reynolds. I am a partner at the law firm Shearman and Sterling, which is a global law firm headquartered in New York. I operate out of London and I practise UK and EU financial regulation. I head the financial institutions group globally.

Conor Lawlor: Good afternoon, all. My name is Conor Lawlor. I work at UK Finance, the banking, finance and payments trade association. I run our Brexit, capital markets and wholesale policy unit.

Q2 **Chair:** Welcome to all of you. Thank you very much for joining us. We will be asking questions. Questions will generally be directed to one or more on the panel, but if you are not asked to contribute, and you would really like to do so, please raise your hand and I will endeavour to bring you in at that point.

My first question is to George. You said we must not call it state aid, but there is a lot in the agreement about what most people would perhaps call state aid, even if that is slightly out of date as a term. I wonder if you could set the scene for us by explaining what has been agreed around subsidies and distortions on trade, and how the mechanisms will work around that.

Specifically, if it is possible, give us a sense of how flexible those arrangements are going to be in terms of the Government being able to push forward on their levelling-up agenda, albeit that we do not know precisely what that will entail, but particularly things like special economic areas, where you might have no or low-tax arrangements within them.

George Peretz: Essentially, in the TCA you have a framework that sets out the skeleton of a subsidy control regime—the basic features. Those

basic features are drawn so as to be, principally, compatible with the EU state aid regime, which plainly satisfies all the criteria laid down. The envelope within which the subsidy control regime of the UK has to be created bears more than a passing similarity to the basic structure of the EU state aid regime. That is somewhat disguised by a somewhat obsessive relabelling of every single concept, so as to make clear the basic concepts of what more exactly counts as a recipient of a subsidy. You have "subsidy" instead of "state aid". Instead of talking about undertakings, you have economic actors, the recipients of subsidies. One of my favourites is the substitution of "an ailing economic actor" for "undertaking in difficulty".

These are all concepts that one is familiar with in the state aid context. A bit like the Académie Française insisting on rewriting every English term in common use in French into something else, a different term is used throughout, but the basic structure is very similar, as far as one can tell. You have a basic concept of a subsidy, which looks fairly similar to the concept of state aid. Indeed, the specific provisions dealing with tax measures, without expressly referring to ECJ case law, restate the basic principles of ECJ case law about when a tax measure counts as a subsidy. One knows the ECJ case law and can recognise quite a lot of what is in those provisions.

Very importantly for where we are in the UK at this precise moment, you have a requirement that courts can review decisions, both of granting authorities and of an independent authority, to ensure that the basic principles of the regime are complied with. The basic principles of the regime are these: there is a list of prohibitions, all of which, when one reads them, are things that in the EU state aid law regime would be simply forbidden—you would not be able to get the Commission to clear that type of subsidy. There is then a list of principles to be applied in other cases, which broadly resemble the sorts of things that the European Commission tends to think about when deciding whether to clear a subsidy.

You have a requirement that there be a court, which is able to review decisions of granting authorities at the instance of third parties, most obviously affected competitors. Then there is a requirement to set up an independent authority. That final requirement is left very vague, because the only requirement is that it plays an appropriate role. We probably want to discuss what that might mean, but those are the outline features of what one has. One has a sort of outline framework, with quite a lot to be filled in.

The rather peculiar position we are in is that that framework, because of section 29 of the European Union (Future Relationship) Act, is now law in the United Kingdom. The problem with it as law is that it is not written as law; it is written as a framework. There are a whole lot of gaps to fill in. For example, there is no independent authority at the moment in the UK and no definition of what appropriate role it is going to play. If we got

into litigation, it is highly uncertain what would happen and how a court would deal with trying to apply and turn into law what is currently just written as a framework.

Q3 **Chair:** What kind of timescale might we be looking at for moving from the framework you have described, albeit that it is in law now, to the body of law that would fill in the gaps, as you put it? How long might that take? It is an extremely difficult question, and certainly not just a legal one, but you must have a view on it.

George Peretz: It is difficult to know what work BEIS, which will be the responsible Department, has done on this. We were told back in June that it was working at pace on a new subsidy control regime. Then we were told in September that it was not in a position to say much about it until well into this year. The simplest answer is "ask BEIS". At the moment, the position is extremely unsatisfactory: you have what is designed as a framework, which is supposed at the moment to be operational as law. No one really knows what will happen if and when this ever hits the court, so there is a certain urgency.

There is also, it seems to me, a fairly clear breach of the trade and co-operation agreement as we currently stand, in that the United Kingdom simply has not set up an independent authority. The TCA is clear that there has to be an independent authority, albeit that it does not say precisely what its role should be. When you are in a situation of being in clear breach of a contract, agreement or treaty, the usual sensible advice is to get on as quickly as possible with getting yourself out of the breach. For both those two reasons—first that we are in clear breach, and secondly that the current regime is almost intolerably unclear—we need to be getting on with it.

How long it will take, I do not know. What one really would not want to see is a regime that came fully formed out of BEIS's head like Athena out of Zeus. There are a lot of complexities. It would be very sensible to have some time, notwithstanding the urgency, for consultation with industry, granting authorities, public authorities and those of us in the legal profession who specialise in this area, to make sure that the regime works. It is not something that can be done in a week.

Q4 **Chair:** Athena out of Zeus, if memory serves me right, was due to an enormous headache. It sounds like we might have one. What does the agreement say in terms of when this independent authority should have been set up, given that it has only just been concluded as an agreement?

George Peretz: It does not say anything. The requirement would apply from 1 January. It might be worth asking the Government about this, but one assumes that the Government have informed the EU that there is no independent authority, at least for the moment, and the EU has agreed to give the Government time to do it. Creating an independent authority is not something that one could ever hope to have done in the space between Christmas eve and 1 January. A lot of us assume that the

Competition and Markets Authority will be given this job one way or another, and it has recruited staff who are experts in the area of subsidies to do this job. Even then, one cannot really expect it to be up and running within a week, particularly when the week is over the Christmas period. One assumes that the EU has agreed to wait and see what happens and to give the UK some room for manoeuvre before taking any action.

Q5 **Chair:** That would seem to be logical, but technically not the position. What might the Government be doing that could end up being in breach of these arrangements if the detail has not been worked through? Would it be, for example, announcements about tax breaks and subsidies that they intend to bring in? At what point does the agreement as such bite, in that sense?

George Peretz: There are different types of breach. One breach would be to have a regime that did not meet the criteria for remedies, for example if the Government tried to prevent courts having the responsibilities that they have to have under the TCA, which are the power to review decisions and the power to order recovery. If the Government tried to cut back on that, that would be a breach of the TCA.

That said, it is not entirely clear how a court is supposed to go about reviewing the decision of a granting authority. When looking at the review of a public authority decision, lawyers often distinguish between what is referred to as merits review—where the court asks itself, "Is this decision right? Would we apply the test in the same way as this authority has done?" and, if the answer is no, strikes it down—and standard judicial review, where the court asks itself, very broadly, "Has the public authority respected the law? Has it been fair in the way it has gone about taking the decision? Has it applied the law in a way that makes sense, even if it is not the decision that we would have taken ourselves?" It is not clear what the court is supposed to do about that.

That is at one level. Has the regime been structured rightly? Have the right bodies been given the right powers? Then there is a separate question about what happens in relation to particular decisions that an independent body or court might take in relation to the decision of a granting authority. That is about the application of the prohibitions, because some subsidies are prohibited, and then the application of the principles that are to apply to other types of subsidy.

Those principles are worded in quite an open-textured way. There is quite a lot of scope for judgment about how they would apply in particular cases. In the context of state aid law, there is often a balance between a subsidy that may distort competition and may help a business vis-à-vis its competitors, on the one hand, and achieving public policy objectives on the other. One will ask oneself questions like, "Is this the most efficient way of achieving the public policy objective? Is far more money being spent than needs to be? Are there ways of doing this that would distort competition rather less than has been done? Is the business being

overcompensated for what it is actually being asked to do?" Those are questions on which lawyers, economists and specialists can legitimately reach different views.

We will have to see in practice what happens in a case where the EU simply takes a different view of the way in which those principles have been applied than is taken at the UK side. There are various questions one can ask about the dispute settlement mechanism. It is not entirely clear how often that will be used in practice. There are quite a few questions about how it would work as a matter of law. The basic structure is that the regime requires the UK to think about subsidies in a certain way and within a certain framework. The thousand million dollar question is what happens when the two sides, while they may agree on the framework, disagree about what it means in particular cases.

Q6 **Chair:** There is quite a lack of clarity here, clearly. There is a lot of detail to be provided. From where you are sitting at the moment, would you say that the UK has gained the ability to introduce greater flexibility in the way it handles subsidies to particular sectors, for example as part of the levelling-up agenda, albeit that that is going to be subject to these mechanisms hitherto undetailed? There is definitely scope for greater flexibility and manoeuvre than there was before, as part of the European Union. While the devil is in the detail, would that be broadly correct?

George Peretz: Yes, I would agree with that. Those of us who have practised in the field of state aid for years know well that the state aid rules can be maddeningly constraining. There are sets of block exemptions. Most aid is granted pursuant to block exemptions rather than going through the mechanism of being cleared by the Commission, but those block exemptions are often quite narrow and formalistic. There will certainly be scope to do better there.

You could also have a much quicker clearance process. In most cases, granting authorities do not welcome the advice that such and such a grant or subsidy is likely to be state aid, particularly if it falls outside a block exemption, because the consequence of that is notification to the European Commission, which can occasionally happen very quickly, but generally takes quite a long time. Obviously, quite often public authorities want to get on with a project, rather than hang around waiting for clearance. We can probably do better on that.

An interesting feature of the new regime is that the UK will probably have a much freer hand to decide which areas benefit from regional aid and precisely what sorts of aid economically left behind regions are entitled to get than was available under the state aid rules. The question will be how much latitude the EU is happy with. At one level, the EU probably would not wear a situation where the UK tried to say that every single region other than the two or three most prosperous in the country were entitled to benefit from regional aid. One could probably include regions within the definition of areas that were entitled to the equivalent of a regional aid exemption going beyond what the EU would allow, without that

irritating the EU too much. The answer is yes: there is a whole lot more flexibility, particularly in the area of regional aid.

Q7 **Chair:** That is very helpful indeed, thank you. Elizabeth De Jong has now joined us. Welcome and profuse apologies from the Committee that, at no fault of your own, you were not able to join us earlier. I wondered if you could very briefly—name, organisation and position—introduce yourself to the Committee.

Elizabeth De Jong: I am Elizabeth De Jong. I am director of policy at Logistics UK.

Q8 **Felicity Buchan:** Good afternoon, everyone. My questions are on the enforcement of disputes within the agreement. That is not limited to state aid; it is across the board. When I look at the agreement, there appear to be many different dispute resolution routes. There is talk of the partnership council, reciprocal mechanisms, rebalancing mechanisms and panels of experts. George, can you give us and the public at home a broad overview of how you see this agreement being enforced?

George Peretz: It is extremely complicated; that is the only headline one can put on that. There is a basic dispute resolution structure, which involves arbitration, and that applies to large parts of the agreement. Other large parts of the agreement are carved out from that. Then, somewhat confusingly, those parts are often put back into the arbitration mechanism, albeit that it works a bit differently with some qualifications.

It is probably not helpful to think about the partnership council as a form of dispute resolution, save in a very loose sense. The partnership council is essentially there to smooth the operation of the agreement and think about ways in which it may be improved, again at a very broad brush level. The field of state aid or subsidy control is the bit I have looked at most carefully, because it is one of my principal areas of practice. To go back to what I was just saying, that is one of the areas that are taken out of the dispute settlement mechanism, and then to some extent put back in.

What one sees there is a system that allows each side to take immediate swift action, within certain parameters. It can only be of certain kinds within the framework of the agreement. It has to be proportionate. That can be done quickly and without having gone through an arbitration procedure first. The party that is on the wrong end of that sort of measure can then go to arbitration and do so quite quickly—there are specific provisions designed to speed things up, and that happens—to challenge the other party's decision to retaliate, on the ground that the basis for it did not arise in law, or that it was not proportionate or fell outside what is permitted within the scope of the agreement.

That is just an example of the sort of complication you get into. Books are going to be written on this and are probably being written now.

Q9 **Felicity Buchan:** Yes, I am sure. Just so that I understand, the

partnership council you see as an overarching umbrella organisation, more setting strategic direction going forward, as opposed to a legal mechanism. In terms of the actual legal disputes, you see it being that you can unilaterally impose tariffs, but it would be subject to arbitration after the event. Is that a fair summary?

George Peretz: That second bit is true in the area of subsidy. It is not true in other areas, where you would have to go to arbitration first.

Q10 **Felicity Buchan:** That is clear. I saw the reference to the panel of experts for chapters 6 to 8, and their recommendations were not binding. What is the rationale for having a panel of experts and not having the recommendations binding? I am assuming arbitration is binding.

George Peretz: Yes, arbitration is binding, and there are then provisions that allow the party that won the arbitration to complain if the other party is not moving quickly enough to implement the judgment. Ultimately, it can then take retaliatory measures.

In relation to the panel of experts in articles 6 to 8, as I understand it, the rationale for having them rather than the traditional cast of arbitrators, who are usually distinguished lawyers, judges and so on, is that these are areas where, for various reasons, it might be thought that lawyers should not have the last word; it should be people with perhaps a wider view of the world. In areas of environmental policy, whether labour standards have diverged and so on, lawyers can contribute a certain amount to these discussions, but I do not think any lawyer would suggest that only lawyers can opine sensibly about what the answer to those questions may be in a particular case.

Q11 **Felicity Buchan:** Can I ask you about the rebalancing mechanism and its four-year review period? How do you see that aligning with the partnership council? I would have thought that it would be quite a big strategic decision if you were to activate that four-year review. Would that sit more under the partnership council?

George Peretz: We will have to wait and see how this works, but one would expect that, if either party was in two or three years' time beginning to feel that the agreement needed rebalancing, it would have made its concerns known in the partnership council. The partnership council has a certain amount of leeway to do things. It has pretty wide powers to amend the agreement. Presumably, if one party felt that the agreement had become out of balance, it could make its case in the partnership council. This would be a question of political negotiation, but it might persuade the partnership council—i.e. the other side—to act.

If, for example, the EU felt that the agreement had got out of balance, one would expect that the UK Government would have been on notice of that for some time before the EU instituted the formal four-year review. We will just have to see how that works. As you say, there is then the question of how that relates to the five-year look at the relationship. All of this, in the end, reflects the reality that this is going to be an ongoing

and dynamic relationship that is going to be adjusted and, one would hope, improved over time, as the parties feel their way towards a new way of living next to each other, which is what geography requires us to do.

It is a commonplace observation, which I am sure you are all aware of, but none the less worth repeating: the experience of European countries that are outside the EU, in particular Switzerland, is one of constant renegotiation with the EU. The EU is not something that goes away. One can make a comparison with Canada and the United States. Canada's relationship with the United States is almost an ongoing process. It is bound to be, given where it is.

Q12 **Felicity Buchan:** That is an important point: this is a work in progress. Clearly it is very complicated. Can I ask you one final question? Even though it is complicated, do you think it is coherent? Do all the pieces make sense when put next to each other?

George Peretz: I am afraid I am going to dodge that. It is too early to tell. It has been very difficult even for me, who is a bit of a nerd on these issues, to get myself a complete picture of how it works. The lesson of all these things, and of a complex Act of Parliament, is that one does not often know whether it is going to be a success until one has tried to work it for a bit. All sorts of things, as any lawyer will tell you, crop out of a text that nobody had thought of or foreseen at the time, and turn out to be significant issues.

Q13 **Dame Angela Eagle:** I want to ask about the way in which the agreement will impact on labour and social standards, and environmental protections. The Government summary has stated that both sides have committed not to lower the overall level of labour and social protection in a way that impacts on trade or investment. Mr Peretz, how do you think that could be enforced? There is a mechanism.

George Peretz: Again, that is a complicated topic and one, to be frank, that I am not sure I am the best qualified on this panel to talk about.

Q14 **Dame Angela Eagle:** Is there anyone else on the panel who feels qualified to talk about it? No, nobody.

George Peretz: We touched on the basic structure of this before, which is that there is a special arbitration mechanism involving the experts to test whether there has been divergence. The practical question is going to be about the extent to which either party decides to use this mechanism. The EU has entered into similar, analogous, although significantly different, types of provisions with other partners. It has tended not to, at least publicly, enforce them; one never knows quite what happens behind the scenes. Quite how the EU will operate this remains to be seen.

Q15 **Dame Angela Eagle:** Does the agreement not allow one side to take what it says are countermeasures if it believes that some change in

regulations on environmental or labour and social standards has been made that impacts on that? Does it not allow that to be done ahead of any arbitration? That might mean, for example, that they could introduce duties or costs to compensate.

George Peretz: Yes, that is right.

Q16 **Dame Angela Eagle:** We do not know how long the dispute mechanism is going to take to work its way through, but these things tend to be quite slow. Meanwhile, you would have a situation, would you not, where there would be extra duties put on to trade between the two?

George Peretz: Yes, that is right.

Q17 **Dame Angela Eagle:** There is no way of knowing how long that situation might persist.

George Peretz: One does not know. You get some guidance in the institutional provisions in the agreement as to what the timetable will look like, but, yes, these disputes are capable of going on for some time.

Q18 **Dame Angela Eagle:** Say the Government decided they were going to make some change in employment law or environmental law that the EU felt impacted on the fairness of trade between the two. Would the Government have to provide information when they make changes in these areas routinely to argue that they had not done that? Will there be an extra layer of stuff that has to be gone through every time a law is passed in the UK so that we can continue to have this zero tariff, zero duty trade with the EU?

George Peretz: How that is going to work diplomatically I do not know. One would expect that both parties will be keeping an eye on each other's moves in these areas and that there will be diplomatic channels. One of the difficulties here is that, if one thinks about something like environmental protection or labour rights, it is probably unlikely that there would be, on either side, a huge and dramatic divergence done as a single stroke of the axe. What is more likely is a slow divergence. I am no employment lawyer but, if one looks at the sorts of things that the current Government might have in mind in terms of employment rights, it is probably fair to say that they are not at this stage minded to take a root-and-branch axe to the structure of employment rights that exist. There will be some tweaking round the edges. The EU may well be entirely comfortable with the tweaking round the edges because it takes the view that these differences do not matter very much.

The difficulty is if that process continues, like slicing a salami. At what point does the EU, or the UK if it is the other way round, say, "This has just gone too far now"? It is very difficult to get a sense of that, but it seems to me that it will be a difficulty in practice.

Q19 **Dame Angela Eagle:** Will there be the right for each side to go and check the enforcement of labour standards or environmental standards

on either side? Will there be inspections? How convoluted and costly might these mechanisms get?

George Peretz: I am afraid that I cannot remember off the top of my head what, if anything, the agreement says about specific powers to go in and check the extent of enforcement. In a lot of international trade disputes, one finds WTO disputes, where the issue between the parties is not what the law of the other party actually says; it is what the other party does in practice that is the problem. One gets a whole lot of discussion about what happens in practice in that party.

In that context, that will not be because either party has any particular privilege in terms of doing investigations on the ground. There will be a litigation process in which generally parties are asked questions and normally feel required to answer those reasonably fully and honestly in the context of litigation or threatened litigation. There will not be EU inspectors going round individual factories to check how enthusiastically the UK enforces its health and safety legislation. As far as I am aware, there is no provision for that.

If the EU has serious concern that UK legislation in a particular area has simply become a dead letter and is not being enforced at all, or is not being enforced adequately, that could be the subject of a dispute and it would presumably be decided on the basis of such material as the EU has been able to get hold of, either through the litigation process or just by using the ability to do research that any of us has.

Q20 **Dame Angela Eagle:** Do you read the agreement in the way that it allows a dispute to be going on, but in the meantime, if one party or the other thinks there is detriment, there can be duties put on before it is resolved, to prevent that detriment? With the sanctions or the duties, is there capacity in the agreement for them to come first, or are they a last resort?

George Peretz: It depends, rather inconveniently, on which bits of the agreement you are talking about, because the rules are different for the different bits. In the area of subsidies and certain other ones, there is certainly room for the parties to act first unilaterally and then argue about the extent of the reaction later.

Q21 **Dame Angela Eagle:** In that case, it is quite important how streamlined and fast the dispute resolution process is.

George Peretz: Yes.

Q22 **Dame Angela Eagle:** Otherwise it could be damaging and detrimental almost as a tactic.

George Peretz: Yes, and one notes that in the subsidies context there are specific provisions that say effectively that the timetable should be speeded up so that they are dealt with much more quickly, presumably for precisely that reason.

Q23 **Mr Baker:** Thank you all very much indeed for being here. To try to cast some light, for the benefit of the public and companies that have perhaps have not read the whole agreement, or for people like me who have read the whole agreement but are not experts in comparative international law, could you explain what has been agreed in relation to competition policy? George, I hope you will not mind if I give you a rest. Barney, perhaps you might explain that.

Barney Reynolds: This is George's specialist area.

Mr Baker: I will come to him in a moment.

Barney Reynolds: I think the answer is these level playing field provisions of the true-ups that George has just gone through, so the ability to impose tariffs if someone is unfairly subsidising their businesses to your detriment, then ultimately the rebalancing. You then have to have a domestic regime dealing with subsidisations in the way that George says.

Q24 **Mr Baker:** If I were running a company and I felt I was suffering detriment from a distortion being practised in the EU, what would you expect the process to be that I would go through?

Barney Reynolds: George should correct me if I get this wrong. As I say, it is his specialism. I think you would raise it with the Government and they would then look into it. If there is proof of a material impact on trade, that would then go through the processes under the agreement and there would be recompense, with the ability to immediately impose tariffs, or there could be a dispute.

Q25 **Mr Baker:** Barney, I feel I am pressing you too hard when you have George here supervising you. George, tell me about what a company would go through, please, if it felt it was suffering detriment under the competition provisions.

George Peretz: There are two things a company could do, and this would apply either way round. The first is to go to the Government of its own side, so either the EU or the UK, and say, "This is happening. Please think about taking some action."

The other thing you can do, which would be true on either side, is to go to court. On the EU's side, it is an established feature of the EU state aid rules that, if you are the competitor of a company that has been given an unlawful subsidy—one that has not been approved in advance by the European Commission—you can go to the national court of whichever country it is and order that subsidy to be stopped or, if it has been paid over, to be paid back. If your complaint is with the Commission because you say that the Commission has approved it but it should not have, then you can take the Commission to court, in the General Court of the EU and ultimately the European Court of Justice. That is something a UK company would still have the right to do. It is an entity and would have rights under the EU system.

Conversely, if it is an EU company or indeed a UK company complaining about a subsidy that has been given by, let us say, a local authority to its competitor, it could go to the EU—that is probably not plausible if it is a UK company, but an EU company might go to the Commission and say, "Do something about it"—or it might go to the courts in this country. As I was saying right at the beginning of the session, it is now indisputable that, in the UK, the right to go to court to complain about a granting authority's subsidy decision is there; it is to be found in section 29 of the European Union (Future Relationship) Act when read with what the TCA says about subsidies. You would have a right to go to court, presumably the Administrative Court in England and Wales or the Court of Session in Scotland, and complain about that decision. There are a lot of uncertainties about it, but the basic right is clearly there.

Q26 **Mr Baker:** Can I put to you a quote from the Institute for Government? It said, "Unlike other areas of the level playing field, the commitments are not enforceable through any kind of arbitration". That was in relation to the competition element. Do you agree with the Institute for Government? Is it right that the competition commitments are not enforceable through arbitration?

George Peretz: That is right about the commitments to have a competition regime distinct from the subsidy regime. Those are commitments essentially to have a regime that stops cartels and anti-competitive agreements, and that controls abuses of a dominant position. Those are relatively non-controversial areas, it has to be said. Neither side is in any real doubt that the other intends to maintain a reasonably robust system of competition policy in those areas. That is why the agreement does not actually do very much in those areas. There is no real need for enforcement because both parties are pretty confident that the other will run a policy in those areas.

Q27 **Mr Baker:** That is great. I was going to reflect it back, just to make sure that I have understood. Precisely because we are going to have competition regimes of our own—it is inconceivable that we would not—it is not necessary for those provisions to be enforceable.

George Peretz: Yes.

Q28 **Harriett Baldwin:** I am going to move on to the subject of taxation and what is covered by taxation in the agreement. I am not sure which one of you I will invite to go first. It is probably still George, but I would welcome comments from others on taxation. My understanding of the taxation section in the agreement is that it basically mirrors the work we have already led at the OECD, particularly on base erosion and profit shifting. It is a nod to that. It does not appear to be an enforceable commitment. Does anyone want to dispute that way of framing it?

George Peretz: I will say that I think that is right, but with a huge caveat that those are not bits of the agreement I have studied in any detail.

Q29 **Harriett Baldwin:** There do not seem to be any restrictions whatsoever now in terms of the rate of tax that the UK sets on anything, or any VAT items or anything along those lines, where we have previously found ourselves restricted. Is that correct?

George Peretz: I would agree. There are two caveats. One is that one has to remember the position of Northern Ireland. Northern Ireland is still within the scope, for example, of the VAT directive. The extent to which the UK will want to do things that are different in VAT terms between Great Britain and Northern Ireland remains to be seen, but that will be the issue.

Q30 **Harriett Baldwin:** Can I ask specifically about that? The Chancellor reduced the tampon tax to zero on 1 January. Did that not apply in Northern Ireland.

George Peretz: I am afraid that off the top of my head I do not know the answer to that question. Northern Ireland remains within the scheme of the VAT directive. That is an issue in Northern Ireland.

The other caveat, which goes back to my pet area of subsidies and is a point I made right at the beginning, is that, as you know—it has been quite a controversial area in the last few years—the EU has been applying the state aid regime to tax measures of various kinds. At a fundamental level that is not controversial, because any system of subsidy control has to deal with tax measures. One way in which a Government can effectively write a cheque to any company is to waive tax that would otherwise be due, so any subsidy control regime has to say something about tax.

It gets difficult in situations where you have tax rules that treat different types of transaction differently and often have certain reasons for doing so. The question then is in what circumstances you regard that as a subsidy. That is quite a tricky area. As I made the point at the front, one finds, quite interestingly, in the subsidy provisions of the TCA a setting out, without referring to it as such, of the sorts of tests that the European Court of Justice has laid down for how you distinguish between a subsidy and an acceptable form of treating different taxpayers differently.

Q31 **Harriett Baldwin:** Specifically, the wording says that we have both agreed to work towards countering harmful tax regimes. Can you give an example of what in case law has been classified as a harmful tax regime? For example, would the British Overseas Territories be considered a harmful regime potentially?

George Peretz: I am not sure to what extent the British Overseas Territories are within the scope of this agreement. It is important not to overstate the subsidies issue. The caveat I was making was to the proposition that we have a free hand on tax under this agreement. Quite how the subsidies control provision would work in practice remains to be seen, but one will have issues. Take, for example, a corporation tax measure that is deliberately designed to give a tax break to a particular

type of industry. In that situation, you have something that looks quite like a subsidy, and probably one would have to look at it within the framework of the subsidy control regime.

When people talk about tax harm, one is talking less about that sort of issue, which is about discrimination, and more about levels of tax rates. It is important to make the point that state aid rules never covered a decision to set corporation tax, for example, at 15% rather than 35%. Ireland has a low corporation tax rate, as everyone knows. That has never been the subject of state aid challenge, directly at any rate, because it is accepted that Ireland has a free hand to do that. That sort of thing can fall within the tax harm agenda in situations where people are concerned, for example, that a country's income tax regime is unduly favourable or that its corporation tax regime has been structured in such a way as to effectively make it difficult for other countries to collect corporation tax.

Q32 **Harriett Baldwin:** Can I just ask a question? You mentioned Ireland. There has been the case with Apple there, Starbucks in the Netherlands and Amazon in Luxembourg. Does HMRC now have the ability to raise more revenue from companies that use low-tax EU bases for some of their activity that actually ends up in the UK?

George Peretz: HMRC has always had some ability to deal with that. As you probably know, Apple won its case against the Commission decision, but other cases have gone the other way. Those cases are really about the way in which different countries have used tax rulings.

Q33 **Harriett Baldwin:** What would we do if we felt that a company that was doing business in the UK was using a low-tax EU country to book that business? As the UK now, what are our ways of dealing with that?

George Peretz: I am not sure they are much different now to what they always have been. EU law did not impose that many constraints. There were cases on free movement and so on that were certainly constraints on what HMRC could do, which stopped the tax regime treating companies differently depending on whether, for example, profits came from elsewhere in the EU as opposed to from the UK, but in a broad sense HMRC could always do quite a lot in principle to deal with that sort of issue.

Q34 **Mike Hill:** Thank you, everybody; it has been fascinating so far. My questions are about the robustness of borders and some of the projects that the Government have stated are up and running, and fit for purpose. I have a couple of questions for Elizabeth, but I do not really know who would like to answer the first question. It is in relation to a letter that Lord Agnew wrote to our Committee. In that, he was basically alluding to the fact that the HMRC-operated goods vehicle movement service would go live on 23 December, and that all was well and everything was working as expected. The quick question there is whether they are up and running as expected. Are there any problems?

Elizabeth De Jong: GVMS is the new UK border system control for roll-on roll-off traffic. It needed to be ready specifically for GB-Northern Ireland movements by the end of the year. As you say, it launched on 23 December, although some technical specifications for it had been available earlier. The delay to that date was due to fixing a significant specification issue that we had highlighted; there was too low a limit on the number of consignments per entry, restricting how many consignments per lorry. We were very pleased, in fact, that that was fixed before it was launched.

We have daily calls with the Border and Protocol Delivery Group, which has been monitoring and sharing with industry stakeholders the systems issues, so we have an understanding of the problems covering GVMS and other systems. They are quite small at the moment, in the late teens or low twenties. I do not have all the details on the errors. I remember them mentioning that some codes were missing for a particular port. One company is struggling to link it with its third-party software.

Generally, our member advice centre has not had concern raised about the technical resilience of GVMS or indeed other systems. It has been around difficulties understanding the end-to-end processes, around using it, around the controls and around all the different types of paperwork that you need to be able to produce. Particularly for Great Britain-Northern Ireland, rather than receiving information in piecemeal fashion, getting that end-to-end operating manual would really have made a difference. We are needing to get more guidance published at pace all the time at the moment, to help trade flow.

Q35 **Mike Hill:** Even with some of the publicised issues we have had around Northern Ireland deliveries and things like that, you would describe things as working but with teething troubles. I was specifically going to ask about your members' satisfaction with the permit system for getting into Kent, for example. I notice that those permits are called Kermits, wherever that came from. Is that new system working to your members' satisfaction?

Elizabeth De Jong: I am not quite saying that there are no problems with trade at the moment, but the technical systems issues themselves are quite small. It is about understanding of processes. In terms of the Kent access permit, again, we are not hearing about technical issues with it. At the moment, we are in a trial period for systems and processes, and also checking our understanding with businesses, haulage companies and Government officials here and in the EU. We suspect the Kent access permit is working quite well in that it was designed partly to reduce flows into Kent where paperwork for the border was not yet ready. People are accessing Kent when they have self-declared they have the paperwork. That has been ready.

We are not having queues in Kent at the moment because flows are much lower than expected, but we have another issue in Kent, which is Covid tests. Currently the biggest reason for not being able to make your

crossing is not having a negative Covid test and being sent away to get one.

Q36 **Mike Hill:** I was going to move on to resources in respect of that. I know we have not seen the volume that we would expect to see through Kent at this time of the new year. We have had the experience of the lorries backing up and Covid has had an influence. From your members' perspective, are there sufficient staff at the export and import locations? Are those locations fully operational to the expectations of your members to at least have that side of it correct? Have the Government fully resourced the operation?

Elizabeth De Jong: We are going to need to give it another couple of weeks in order to answer that. Because the volumes are so low, possibly last week 40% less than we would normally have at this time of year, we have not really been able to test those systems. Currently, there are enough staff, although it is mainly ferry staff who are helping people at the port, but there are also the HMRC sites and the inland border locations. Currently, with low volumes, we are not having issues reported to us.

Q37 **Mike Hill:** There does not appear to be a lot of turning back and turning around, when people do not have the right documentation and they get sent to the big lorry parks. There is no real evidence of a lot of that happening.

Elizabeth De Jong: At the moment, of those arriving at the port of Dover and Eurotunnel, less than 3% are not border ready. Part of that is about needing to have a Kent access permit, so needing to self-declare that you are border-ready. It does not mean that there are not difficulties in getting paperwork together. It is such a big process and big change in business procedures in order to do so. We are hearing anecdotally that there are more delays back at the depot as people arrive to pick up their loads and the paperwork is not ready. You will have heard a number of those cases in the media. The turn-aways from the port in Dover are quite low, but in Northern Ireland they have been higher where there has not been that access permit before you travel to the port.

Q38 **Mike Hill:** Finally, on the Northern Ireland issue, has there been any technical issue or lack of clarity over the North Sea border? Has that caused complications?

Elizabeth De Jong: Yes, we were hearing today that the software in the trader support service is running slowly at the moment. I know people are on it and I am expecting it to be fixed. The problems with paperwork are more prevalent. We were hearing reports that, at least last week, they had improved over the last day. This is moving all the time. About 25% of lorries arriving at Holyhead and slightly more at Stranraer did not have the correct documentation.

Information was received late and in piecemeal form, but these are not systems issues, although there has been generally a higher lack of

awareness in businesses, the exporters and importers, that border-like administration is required for Great Britain-Northern Ireland even though a border does not officially exist. The main messages were about there not being a border, but in fact you still need to do border-like administration.

Mike Hill: That is fascinating. Thank you very much.

Q39 **Alison Thewliss:** I have some more questions that will also be directed to Elizabeth, to follow up on the issues raised by Mike. There has been a huge amount spoken and raised in the press about the impact on hauliers in Scotland, particularly on the fishing industry in Scotland. I was just wondering if I could have your views on the generality, and then I have some further questions on that.

Elizabeth De Jong: In terms of the specific question, it is about the issues in Scotland at the moment.

Q40 **Alison Thewliss:** Yes. We have issues with people trying to ship langoustines from Loch Fyne and those are being held up to the point where it is not even worth their while sending boats out to fish. It would be useful to get your views on the reasons for these delays and what more could be done to improve this situation.

Elizabeth De Jong: This is absolutely live. I have my Scottish policy manager working on these things today. There are some issues about groupage, which we have been looking at, and today the Government said they are going to give more information on that. That is about having lots of different loads in one consignment and an understanding that you cannot do that, so we are trying to find a way through as a live issue today.

I am really hopeful for the Scottish industry. There is also DEFRA, which is prioritising seafood through the short straits. The groupage issue is being worked on now, if that gives you some hope. Industry wants to solve it; Government want to solve it.

Q41 **Alison Thewliss:** On the groupage issue, how can that practically be done? If you have fish coming from different places to be put on to one lorryload, how does that work in practice? That is going to make it incredibly difficult if you have to not use large lorries to move things and you are being asked, perhaps, to use smaller lorries. It is not going to be cost-efficient for hauliers to move things in smaller lots.

Elizabeth De Jong: I almost have to send you our email trail today, which highlighted quite clearly what we understood from the guidance, where the areas were not clear in the guidance and different workarounds. Maybe that is something you and I can take up afterwards, but I know there are meetings going on now to sort that. I am really hopeful that we will have got clearer guidance and be able to mix those loads in a safe and secure way by re-examining that guidance.

Q42 **Alison Thewliss:** It has been reported that transport companies are refusing to take stock at the moment. Is it this groupage issue that is causing that or is it something else?

Elizabeth De Jong: There have been different reports. The ones in the media are the ones we tend to talk about and look at. A number of companies have paused, because they have realised that their understanding of the systems, their preparation for the systems or what they thought they would need to do has not allowed them to transport things as easily as they might otherwise have done it. Our member advice centre, for example, talks to us about understanding what a customs agent will do, but still realising that as an individual business you need to do an awful lot of data and processes yourself, even if you are using a customs agent.

Pre-Christmas, we were very concerned about images of lorry drivers stuck in ports. If we can keep, as everybody is wanting to do, the queues down, there is no reason why EU hauliers will not want to come here. I was checking the inbound and outbound flows and they look broadly equal at the moment, so at the moment I am not feeling that issue, but we need to be really mindful of it.

Q43 **Alison Thewliss:** In terms of the knock-on effects on the industry down the line, fisheries representatives have been saying they are now at the point where they are not going to send boats out, so those crews that are out fishing on those boats will not be going out and getting paid to catch fish in the first place, and langoustines and other high-quality Scottish seafood products, because they have no faith that it is going to be processed down the line and that they will not be losing money on everything they catch. How long would you foresee this situation going on and what can be done to give the industry some confidence?

Elizabeth De Jong: It is really in the hands of DEFRA and Government. We are working on this. The groupage issue is one of our No. 1 issues at the moment. I am hoping new guidance is just days away, if not less.

Q44 **Alison Thewliss:** We are all hoping that, because it is absolutely heart-breaking to see the videos of folk whose livelihoods are on the line and they do not know what is going to be happening here, particularly with the wastage of these products as well. By the time things are arriving at their destination, the food is either spoiled or the person who has ordered it does not want it because it has taken so long to get there.

I was wondering if you can tell me a wee bit more about your expectation of the length of time it will take once things are up and running to process that. Seafood exporters are saying they need things to be moved in 24 hours from it leaving them to getting to the customer, yet an example has been given that goods due in Northern Ireland on a Friday might not get there now until Tuesday morning and that is too late. What would your expectation be of where this goes back to? Will we get back to 24-hour processing of food?

Elizabeth De Jong: I have absolute faith in the industry. We are able to use a lot of the processes around borders, customs, safety and security checks and environmental health certificates elsewhere in the world. It does not have to be used as quickly, because the flows and types of goods are different.

There will be friction. We know that it is going to be an operational border with improvements to come, but there is concerted effort at the moment to use this test period for getting things to work. I believe it is just a matter of weeks. We are seeing improvements already in Northern Ireland. Various supermarkets are reporting improvements to us already, after a week or so of this trial period where we get to see things in action. We have read them and now we need to test them, but everyone wants it to work for all freight wherever.

Q45 **Alison Thewliss:** I have seen on these websites where you can order a range of produce that companies based in either the EU or the UK are not now shipping things to Northern Ireland. For example, I was on a website looking at some trainers earlier on and they said, "We are not shipping anything to Northern Ireland". What is your expectation for getting things like that for individual businesses that just want to send goods across to their customers in Northern Ireland as they always have done?

Elizabeth De Jong: I am hoping they will soon become confident. We may need a little more of this trial period before they do. One of the concerns, if we are to address the friction, is that Great British companies will lose out, if we do not address this and do not get everything working quickly, to Republic of Ireland companies or more locally sourced produce. As well as clearer guidance, because we are finding issues with that, we want the different working groups under the protocol to start working. We know we have some cliff edges coming up shortly on a number of mitigations and that group really needs to be working and finding out what further mitigations are needed for freight to be as frictionless as possible, as soon as possible.

Q46 **Alison Thewliss:** Do you have an idea in mind of how soon before those mitigations end you need to know something? A concern that I have raised at various points is that we are just going to use these mitigations to kick the can down the road, rather than fixing what needs to be fixed, and we will be up against a deadline before we know it.

Elizabeth De Jong: I would like the Northern Ireland protocol committees to start working now, because we have had lots of late information. Some of the mitigations are stopping in three months, so we need it now.

Q47 **Alison Thewliss:** How much of this is a symptom of things being agreed very last minute and over the Christmas period?

Elizabeth De Jong: Some elements are. There were some fundamentals for our industry that were linked to the free trade agreement, but we have known since February there will be some form of customs, safety

and security declarations and SPS checks required, so it is not about that in principle. It is about the information being quite late and the information was latest around Great Britain-Northern Ireland flows, so some of that is catch-up.

Q48 **Alison Thewliss:** That is helpful, thank you. I have an issue in my constituency, and I am sure lots of other Members have the same, of touring professionals who work with music companies or orchestras having issues about moving their goods to and from Europe. Are there specific mitigations put in place for touring professionals and their crews?

Elizabeth De Jong: Again, your finger is absolutely on the button. This was our meeting on Friday. The trade agreement was really important to us about market access. However, UK hauliers have lost some of their operational flexibilities and market access rights, particularly, for instance, affecting touring companies. They had had unlimited rights to collect and deliver loads between EU countries, and these opportunities have now been curtailed to a maximum of two such journeys before having to return.

As you rightly identify, that restricted number of journeys is incompatible with certain business models, in particular when that same load needs to be moved to successive locations across Europe; returning to the UK between these deliveries is unnecessary and inefficient. The UK has unparalleled expertise in this specialised type of transport. There are other types of business models that are affected too, so objects of art for multilocation exhibitions or equipment for sports. We have raised this with the DfT, and the DfT, DIT, DCMS and BEIS are all keen to look at this issue with the EU, but at the present the free trade agreement does not offer a solution.

Q49 **Alison Thewliss:** Lastly, it has been reported on Twitter that some lorry drivers have had their sandwiches seized at the Hook of Holland. Is there any advice that you can give to lorry drivers about what they should put in their packed lunches?

Elizabeth De Jong: We did look into this and it was not quite true, but it was an interesting story. We have to really be mindful of what we are carrying and know what is in our sandwiches. Perhaps that is the moral in that story.

Q50 **Siobhain McDonagh:** I want to look at what the trade and co-operation agreement provides for financial services, so probably most of these questions are directed at Barney and Conor. The Government summary of the trade and co-operation agreement with the EU states that the agreement includes provisions to support trade in services, including financial services. How far do these provisions go?

Conor Lawlor: In many ways, it is a conventional modern free trade agreement that has been agreed by the UK and the EU. It provides preferential treatment for the trade of goods between the UK and the EU. We are hearing some quarters saying it does bits and pieces for FS and

others saying it does not. It does lock in a set of basic commitments between the UK and the EU that would ordinarily be available to different third-country jurisdictions doing business with each other. The benefit of the TCA is that these basic commitments are now agreed and codified in this treaty, so it is difficult to retract or take away.

To give you an example of what you can do because of this trade and co-operation agreement, you can set up a subsidiary in the EU from the UK to do business without any undue competition impacts. You should be allowed the ability to hire the correct staff and run your business within the laws and regulations of the EU without being put to any disadvantage.

What the TCA does not do for financial services is to try to synthesise or recreate passporting for the single market. It does not give you any of the gifts of remaining in the UK, having your business and providing investment services to corporates, businesses, consumers or clients across the EU. That is not unusual for free trade agreements. You can do quite a lot for financial service market access in recognition outside of a free trade agreement. That is effectively what the memorandum of understanding that is currently being agreed by the two sides is set out to achieve by building a new form of regulatory co-operation and supervisory dialogue between both sides.

That mechanism itself should effectively re-foster trust between both sides. It should enable conversations to take place about how equivalence determinations might work. You might have a conversation about divergence and alignment of your rules, and what the consequential result of respective alignment or divergence might be. That at its heart will be an important tool for financial services.

Success for financial services is not generally measured by the free trade agreement. We are delighted to see it. It will be important for the customers and consumers of our members, financial service providers, but there is still quite a lot to play for in the formation of this regulatory co-operation mechanism, the agreement of potentially further equivalence determinations and, equally, UK domestic policy for financial services and how we make sure the UK maintains its destination as an attractive place to remain and do business from.

Barney Reynolds: I agree with all of that. The reason it is valid to say it is CETA-plus is that there are some commitments on services that go further than CETA, for instance for legal services with the ability to practise under home country qualifications in the EU. In financial services and across services generally, there is a general commitment not to require a local presence and to permit cross-border services.

The way financial services regulation works is that, on top of that beneficial commitment, one also needs to navigate the authorisation perimeter and requirements of the EU and the member states. The perimeter of EU regulation requires certain types of financial services to

be licensed—it is very complicated which ones, but there are certain ones that require a licence, even if cross-border—when they are provided to local customers. If you want to have a presence, you need to have a licensed branch or to seek authorisation.

There is a commitment to treat that application for a licence pari passu with local applications. It is not nothing, but it is not a full suite of recognitions. Where the EU stands at the moment in financial services around the world is that it has a concept for equivalence in numerous of its laws, including most recently, although it has not been fully activated yet, for investment banking, which would cover an awful lot of what would be cross-border. It has declared equivalent status for various countries around the world, including the US, Mexico, Singapore and so on.

It is to be hoped that it will do the same for the UK. The framework in the MoU that has to be agreed by March, as per the trade and co-operation agreement, should provide the packing for that. It remains within the EU's discretion as to whether to grant each and every one of those equivalence determinations and we will have to see how things play out.

Q51 **Siobhain McDonagh:** As a layperson, with financial services accounting for about 79% of GDP in 2019, are you not surprised that there is not a fuller agreement, given how important this is to the UK?

Barney Reynolds: You could say that that would have been a big ask for the UK, and I suspect it was. It is clear that France at the very least, and possibly Germany, wanted financial services carved out of the agreement, so you get into a trade-off discussion. Not having been in the room, I do not know whether this outcome was essential, but I would imagine the EU would not move on that.

Equivalence determinations made by the EU for financial services around the world are unilateral. They are not subject to commitments to make them, so this would have been a first to get it. It would have been possible to enhance the equivalence arrangements in theory and create a framework around granting equivalence declarations in either direction, but we did not do that.

Q52 **Siobhain McDonagh:** Would it be reasonable to say we got fish and they got financial services?

Barney Reynolds: No, because fish is a matter of UK sovereignty anyway and it is UK waters, so the question is access to the EU. The ask for financial services is for something that has not been done by the EU with anyone. The ask, which may still be forthcoming, and there may be an arrangement in due course on this, is for a unique layering on in relation to equivalence. To do that, one would have to apply leverage over the EU negotiations. There may be that leverage through the eurozone structure and the fact that they need London to manage their risk for the eurozone, but it is that kind of analysis, which may still play

out over the next few months as financial services starts to be dealt with. We will have to see.

Q53 **Siobhain McDonagh:** It sounds scary to me. What is the position as of right now if a British bank wants to give a mortgage for the purchase of a property in the EU, sell a pension within the EU or sell an ISA?

Barney Reynolds: Those are retail financial services. Retail financial services within the EU itself are pretty domestic. There is a passporting regime where authorisations in one member state are recognised in others, but an awful lot of those sorts of products are quite difficult to provide cross-border within other EU countries. It is really in the wholesale markets, business to business, that the passport, which is what you are talking about, has the most benefit. There are equivalence arrangements, in fact, for wholesale and retail that could, in theory, be triggered. We will have to see how that plays out.

Otherwise, you would offer those products from a local presence and that has been done by businesses from all over the world for ages. There are businesses with branches in numerous EU member states offering those sorts of things locally.

Conor Lawlor: I agree with what Barney has said. I would add a more general point, thinking about financial services and what you can now do from the UK with respect to your EU counterparties, or your customers, clients or businesses. This was not a surprise to the industry; we were preparing for this. The political red lines were set many years ago. UK institutions will now be navigating a bunch of different rules and regulations, depending on where their customer is based in the EU and on what the product or service is. What is available to UK-based firms is the individual market access regimes of specific EU member states. The national access regime for Germany, for example, is different to those of France, Ireland and the Netherlands. That optionality may be eroded over time if member states want to change those rules.

The other option that UK-based firms will have is dependency on the equivalence provisions that Barney noted a couple of moments ago. As we have seen so far, only two of those determinations have been put in place by the EU. Those two determinations have been in its interest, to protect financial stability of clearing and settlement of key products and services. We have no evidence to suggest or believe that the EU is going to give away any further of those determinations. We will certainly be watching how the UK domestic regime for financial services evolves, but on day one, in theory, you would expect many of these equivalence determinations to come into place, because we do effectively have the same rulebook.

We only need to look at the overarching political direction and strategy of a jurisdiction like the European Union. They have not been shy about this. You can look at Mairead McGuinness' comments from 16 December. She is now the Financial Services Commissioner for the European Union.

They have been very clear about the need to reduce dependency on capital liquidity in markets outside the single market. That means reducing dependency on the United Kingdom, and if that is your objective it is unlikely you would give any unnecessary market access away, as it goes against the grain of what you are trying to do. This was not a surprise to us or the industry, and we have been preparing for it for quite some time.

Barney Reynolds: I just want to add one point that is relevant in understanding where we are, though. There is something pretty unusual also going on here, which is a mercantilist attempt to control business in financial services. Generally, that is pretty difficult and often has not succeeded historically.

In EU law, in recognition of provisions in the treaties that allow EU citizens and businesses access to global capital flows, there is a general concept of reverse solicitation, where businesses and systems are entitled to reach outside the EU regulatory regime and buy financial services and products from abroad, with some exceptions, from businesses that are selling under their own home state regime, protected only by the seller's regulations. That is going to be a key part of the jigsaw puzzle going forward. It would be a very significant thing indeed if the EU was to close that down because of the provisions in the treaty and the general way in which the EU works.

Siobhain McDonagh: An awful lot of hospitals would close.

Barney Reynolds: Quite possibly.

Q54 **Rushanara Ali:** I am going to focus my questions also primarily on Conor and Barney but, if others want to come in, please raise your hand. Conor, picking up on some of the things you have said, could you talk us through what your members are saying to you in terms of the implications of the deal, recognising that people are glad there is a deal, lots of preparations have been made and this is within the realm of what was expected? Are they talking about fragmentation of the financial services sector? You talked about market access. How does it feel on the ground in terms of members, what they are grappling with and what they want to see going forward?

Conor Lawlor: The first point I would reiterate is the benefit of not being surprised by this deal and understanding what would and would not be covered in the TCA. Because we landed in a spot that we had generally predicted for financial services, it meant that since 2016 or 2017 financial services and entities based in the UK could plan effectively a worst-case scenario on a basis where there was not any further provision given for market access or equivalence. To a large extent, that is what they have done.

There are a couple of points on top of that. I am quoting words from Andrew Bailey in a similar Committee hearing last week. The measures

put in place by both sides, effectively the equivalence determinations for clearing and settlement, were put in place to ensure there was not any consequential financial instability as a result of the UK leaving the single market. We can say job well done on that particular component.

What will not be covered and has not been covered by separate or ancillary provisions are measures to stop market fragmentation or market instability. That has effectively begun to happen. We have seen some EU shares that would have naturally had a home in the UK now being moved to EU venues. This has been reported in the *FT* over the last 48 hours. About 6 billion of EU shares have moved back to the EU. Is that likely to flow back to the UK? We do not know. Was it predictable and were these firms prepared for it? Yes, to a large extent they were.

Q55 **Rushanara Ali:** You mentioned 6 billion. Going forward, do you see that as a continuing trend or do you see things settling down once we get to clarity around the MoU, which I will come on to, the evolution of agreements and so on?

Conor Lawlor: It is a tricky question for a number of reasons. I do not see the particular movement of shares that have left the UK returning. I say that coming back to my point about the overarching objective of the EU, which is to onshore financial services activity to the EU. Your rules and regulations would stem from that particular objective and, therefore, make it more difficult for UK entities to house EU shares on a UK venue. Therefore, you have to move your ancillary business to the EU to conduct that.

It will be largely dependent on the rules and requirements from both the UK and the EU that will dictate what our firms need to do and whether they need to move more business from the UK to the EU. We can commend the UK regulatory authorities and the measures that they have made in the final weeks and months alleviating some of the stress for derivative and share trading that we would have ordinarily seen in the absence of those measures.

Q56 **Rushanara Ali:** Do you see more going outward? You mentioned not coming back. I might have missed that.

Conor Lawlor: Yes, potentially. If you were trading shares of corporates with EU identification numbers, you would be required to trade them on EU venues. As an overall consequence of that, if this is the beginning of market fragmentation, and if you reduce the optionality of firms and counterparties, reduce liquidity and reduce their ability to get the best price, it does not necessarily mean the service cannot be provided. It may well be provided from a different jurisdiction, but because they have less liquidity and optionality it may be a little slower.

Q57 **Rushanara Ali:** How do you and your members see this in terms of the overarching numbers, in terms of both jobs and what is lost to the UK economy in relation to the financial services sector?

Conor Lawlor: It remains to be seen. The movement of jobs has settled from the original numbers that were quoted 18 months or two years ago from 100,000 to 7,000. Many firms hired organically in the EU rather than lift and shift EU staff. There may be different requirements in the EU, six, 12 or 18 months from now, that require you, if you have a substantial presence based in the EU, to move some of your board, further operations and further capital and liquidity. That increases the costs of operating for these large institutions.

We are now seeing the beginning of market fragmentation. If you increase the costs of doing business, it is economics 101. Where do those additional costs begin to land over time? Again, this increases the importance of making sure our regime here in the UK is equally attractive and competitive and it maintains UK business.

Q58 **Rushanara Ali:** Barney, do you want to comment on this point about fragmentation and how you see things evolving? Do you share Conor's analysis or do you have a very different take on this?

Barney Reynolds: I broadly share it. I would add a couple of extra points. The reason why the UK is a global financial centre, along with New York, is because of the synergistic benefits of the various services and products offered here, the quality of those services and products, and their pricing and liquidity. In fact, the capital markets shift around to where they get those benefits. The US drove Eurodollar business into London in the 1960s through legal and regulatory measures.

As a general matter, yes, there will potentially be an element of additional cost for service delivery into the EU, depending on EU behaviours, but it will largely involve incurring cost within the EU by EU businesses and consumers. That cost, ultimately, will be resisted by people, because people will want the cheapest services and they will find ways around it. We should not stand still. The EU regulatory regime has itself imposed huge unnecessary cost on business.

Q59 **Rushanara Ali:** I am going to move you on to the MoU, because that is the key opportunity through which we can try to build on the trade agreement. Can you talk us through what you would like to see in that MoU, which needs to be agreed by March? Talk through what is vital for members and the wider financial services sector, and what would be nice to have. We have lost passporting. We are going to have to rebuild those things that are missing now in some way. Could you reflect on those?

Barney Reynolds: There will be arrangements anyway for regulatory co-operation. I believe there are good relations already between the regulators. What then is in question is whether we can have more clarity, notice periods, predictability and so on around equivalence determinations. That is the most important thing. There is a political tussle going on at the moment, because the EU is dangling those determinations and saying, "I will only give them if you commit to certain

rules in the shape of your future regime," which the Governor of the Bank has rightly rejected. There is something to play out.

What I would layer into the analysis is this. I mentioned eurozone risk earlier. The UK is the only place in the world where the regulators—and the Bank of England, in fact—mitigate eurozone risk and have the expertise to do that. The EU creates that risk through a whole swathe of rules, and then does not manage or mitigate it. I do not actually think it can; the costs would be extraordinary. It is mitigated in London, where the EU market meets the global market. A key part of this discussion is going to be how we mitigate that risk going forward. The safest way to do it for the world, and the cheapest way for EU consumers and businesses, would be through an enhanced equivalence deal. We should look to put back in—

Q60 **Rushanara Ali:** Do you think we are going to get it or do you think it is going to be difficult, given the points Conor raised? How optimistic do you feel about that happening?

Barney Reynolds: It is the direction of travel. There will be a tussle in the first instance, because I do not know yet that the EU is reconciled to the gravitational forces of financial business, so there will be a period where it tries to see what it can get. Whether they are all behind that, I do not know. That policy, driven by one or possibly two states, is at the cost of businesses and consumers across the EU, so whether the other countries go along with it remains to be seen. That may not happen and they may do it. I am pretty optimistic that ultimately we will get it.

Q61 **Rushanara Ali:** Conor, can you pick up on those points? Earlier, George Peretz was talking about the state of constant negotiation that non-EU members have to be in. Is that not the state of our future now, even if we get the optimistic version of that future for financial services vis-à-vis the MoU?

Conor Lawlor: The relationship between the UK and the EU for financial services will continue to evolve, not only because there may be political differences between the mechanisms for market access, but the UK and the EU work at an international and global level as well to set standards. If you can get it right at a global level, and you can agree generally the output and direction of travel as to how you regulate and supervise international wholesale markets, that is a fantastic start. Doing that at a UK-EU level through this regulatory framework that would be codified by the MoU would, again, be a fantastic start.

You end up having discussions about equivalence determinations as opposed to having it pulled from underneath your feet at the last minute, because you have re-fostered trust, discussions and dialogue between regulatory authorities. You can talk about rules you are making or evolving at their conception, as opposed to doing it in two completely different contexts and then arriving at very different end zones. As a result of having different rules, the more you differ, the higher your risk

of not being able to access each other's markets because you are operating in a very different way.

You asked a moment ago about what matters for our members. Ensuring that we are aligned to international and global standards as much as we can is incredibly important. The MoU is not trivial. It is not in itself a new deal for financial services. It is simply a mechanism that codifies how regulators communicate and speak to each other. For financial services, that is incredibly important.

You can delegate as much power to your regulatory authorities as possible and they can work with each other within the powers they have been given, but both sides really need political will to integrate markets and work together. This comes back to my point from a moment ago. If one party has a very different objective, which might be to move or shift business and to have less of a dependence on the UK, that is going to weigh into your ability to have a fruitful financial services relationship.

Barney Reynolds: I agree with all that. The extra thing to layer into that understanding is that this was going on within the EU and the passporting regime, and increasingly so. There were those who introduced the passport in order to take business from London. There have been all sorts of other attempts to take business from London. There was a constant tussle within the EU on rules.

Finally, there was the David Cameron negotiation, where there was a carve-out, because the whole position of the eurozone is an ongoing problem for the UK as to how it relates to the eurozone and how we mitigate that risk. That led to a right to renegotiate, which was in flux. The counterfactual is not that different from where we are now. The fact is that the UK, in fact with more power, needs to recut this relationship.

Rushanara Ali: Thank you very much. That is really interesting. I am very grateful.

Q62 **Anthony Browne:** I am going to carry on the theme of financial services. At the outset, I should declare an interest that I once employed Conor Lawlor when I was chief executive of the British Bankers' Association, and a very impressive employee he was too. I put him in charge of this Brexit work; I see he is still doing that.

Supposedly, one of the reasons for Brexit was taking back control and few areas does that apply to more than wholesale financial services, where almost all our regulation came from the EU. If you were a financial services official in the Treasury, the City Minister or the Chancellor, what would you do with these new powers to improve British financial services?

I have noticed two things that have happened already. The Government have granted equivalence to Switzerland, which the EU had been blocking as part of negotiations. When we had Andrew Bailey last week, he mentioned that the EU under the capital requirements directive was

putting the capital expenditure of software as part of the capital stack of banks. He said they would not do that. I doubt the industry actually likes that, but it is a divergence, even if it is a small one. Conor, as the industry, are there things you would like to see done that we can do now and could not do before, or do you want to do everything exactly the same?

Conor Lawlor: It is an excellent question. It feeds into what the Treasury, and the Chancellor specifically, had begun to announce before the transition period expired at the end of the year. We have seen a number of initiatives published by the Treasury. One of those is an area in which, yes, we will be looking to engage with the Government to see how rules might change to attract further businesses to the UK, to list on UK venues, to deliver and drive capital, and to grow their businesses in the form of the UK's listings regime review, which is being led by Lord Hill and is currently live. Getting that right would be incredibly important.

We have seen the Treasury also open the door in how it regulates inward international financial services business. Getting the measures there right to ensure that, wherever you are in the globe, if you need a service or a product from the UK, you can access this market credibly and appropriately is incredibly important. More domestically, we have been speaking for many years now about proportional regulation. Building societies are unique to the United Kingdom. Should they be subject to the same capital charges as major institutions? Probably not, so let us look at making sure that we have the right regulation for the right firms.

With the energy behind the initiatives that the Treasury and the regulatory authorities have released, and the financial regulatory mechanisms that will be going through Parliament, now is a good time to put all our ideas together, be innovative and think how we can make the UK an incredibly exciting place to continue to do business and enhance the world-leading standards of regulation and co-operation that the UK has always been known for. If there is one thing this country does very, very well, it is services and financial services. It is a key strength and we should look to lead on that and maintain our ability to do business from the UK.

Q63 **Anthony Browne:** I want to follow up on the building societies point, because the discussion has also been had about making sure that challenger banks have proportionate capital regimes, so they can compete in the prime mortgage market. What difference would having a proportionate capital regime for building societies and challenger banks make?

Conor Lawlor: Overall, you are reducing resource, energy and cost in building capital stacks that you may not ordinarily need, and redirecting that energy, cost and capital into the wider economy, so you can make more investments, take on more customers and invest into your local and regional economies with capital that would have been tied up. I am not going to use the word "redundant", but it could definitely be used for

better purposes. We would like to see the ability given to our challenger banks and building societies to do exactly that: invest in the United Kingdom.

Q64 **Anthony Browne:** Barney, if you were the Chancellor, just to promote you temporarily, what would you do, now you have control of financial services regulation in the UK?

Barney Reynolds: I would start by understanding the full implications of the current EU law system that we have inherited. There is a blanket of regulation far more prescriptive than anything the UK would have done on its own, because we have a different way of regulating and making laws.

The whole purpose of financial regulation is to manage and mitigate risk, and it does not actually do that. It creates risk for the eurozone and then does nothing about it. That is where we are now and EU financial regulation operates across the entire sector. That process started basically in 1989 and it has taken 20 years, but we are basically subject to an entire EU law infrastructure.

Scots law is similar to common law, in that neither of them is codified. They are very different from the EU way of legislating and regulating. The EU model basically originates from Franco-German thinking, where you make a rule for everything. You create a code that covers everything and deals with every eventuality, and when you have something new come along, like fintech, you make another rule. You therefore have a permanent staff in the Commission making rules.

We need to go back to our method. Our method is that everyone is presumptively free to do business and do whatever they wish. Then you create laws and regulations for things that need to be restrained, either with liabilities attached or, if something really should not happen, you create rules to say, "You cannot do this particular thing". It is focused on risk.

We need to go back to the common law approach. It is a big shift, but it is intrinsically superior. Economic research shows the superiority of the common law to countries that use it for growth. That has been modelled across the whole of the Commonwealth, the US and so on. It also is better in this context, most importantly, for financial services. Notably, all the main financial centres where people come and do business, rather than being forced to by the local mercantilist-type regime, are common law-based. That is London, New York, Singapore and Hong Kong.

We need to go back to our roots on that and we need to do it very quickly. It is easy to do, but one needs to understand the big difference between how we do things and how the EU does things. Strip away all the unnecessary red tape. Focus in on what we actually need to regulate. Rewrite the rules. EU law is unclear, partly deliberately and partly because of the political processes in making it and the way it is written,

and that chills business. People do not quite know where they stand and they go and ask officials whether they are able to do something, applying a purposive method: "Did the law intend me to do it?"

Common law does not work like that. It is self-executing. You write things in a very clear way and then market participants are able to evaluate whether they can do something. If it is tricky, they ask a lawyer and that is it. Then, if you are challenged, you end up in a court process. We need to go back to that. It will mean a little more legalism around a much more limited rulebook, but that legalism is key.

The regulators themselves need to be overseen. There is a process within the EU system as to how the regulators operate, with the ESAs and so on, across the EU. That process is highly unsatisfactory. We need to look across the Atlantic at how the Americans do things because there are lessons to be learned there, but the regulators themselves need to be operating under the rule of law in a way that is challengeable and predictable. Otherwise, you get what we have under the EU system, which is regulatory challenge in one direction only, where the regulators challenge the industry, as they have done since the 2007-08 crisis. This is hugely cramping on business activity and there is nothing pushing back in the other direction.

There are two ways of doing that. The most important one, in fact, is your Committee. The Treasury Committee oversees the regulators and it needs to do so on a more US model than we currently have, because we have been operating in the EU architecture with ESAs, the Commission and so on. There now needs to be far more check and balance on the regulators, which they should welcome. They should be writing clear rules. They should be consulting on them and doing cost-benefit analysis.

The other people who come into play are the courts, the judges and the independent judges, which are not found in civil law systems to the same degree. They will then evaluate whether proper processes have been followed and the principles of judicial review should be applied. You and the courts will provide the check that makes the regulatory system operate in a predictable, self-executed way on the common law model; then we will get the economic and financial market benefits for businesses of our traditional system, which we know works.

We did not get caught up in the Wall Street crash in the way that the Americans did. We have a very sophisticated pedigree of rulemaking, law-making and expertise in that, which is second to none. That is what we need to deploy, but it does mean a big shift.

Q65 **Anthony Browne:** That is a very interesting point you make about the role of the Treasury Committee. As it happens, we are going to do a hearing about our role in future financial services regulation. I was just wondering if you could set out how you think we should change our role with regard to regulation. If you could send us a letter setting that out, that would be very helpful.

Finally, I have one very last question. I am running out of time, I know. A delegation of UK financial services people went to Brussels recently and met one of the top officials, who said that, in his analysis, it is a race between the EU trying to get more of London's market business and London trying to get more of the world business, and we all know who is going to win that race. Do you share that analysis?

Barney Reynolds: I think I know who said it. No, I do not. We should not get caught up in thinking about this as a battle with continental EU financial centres. In fact, in the last edition of the Global Financial Centres Index, Paris and Frankfurt went down three places in each case, whereas London has solidified its role as equal top. Really, we need to think about financial services differently. We are not a G5 power in financial services; we are a G2 power.

There is a global element. There is an element of truth in what your interlocutor said there, but it is not right that we are racing with the EU. In my view, we are racing back to how we do things very well, on the tried and tested basis that we gave up as the price of the passports. One can debate whether that was a price worth paying, but we did give it up. The way we do things works for financial business and we need to get back to that as soon as possible. That is not a race with France or Germany because they cannot do it. Their system does not support that and the EU one does not either.

Anthony Browne: I agree with that. Thank you very much.

Chair: We have reached the end of our session. Can I thank our witnesses very much indeed for those very detailed and insightful answers to our questions, which were quite testing questions in part? The only person who was slightly distressed was Conor, when Anthony suggested to him that he might be promoted to Chancellor, which is something nobody would wish for at the moment. You have done a fantastic job for us.

One of the overarching messages is that so much is unknown. If we look at the legalities around the agreement, a lot of that needs to be fleshed out. If we look at the way the borders are operating, it is a quiet time of year. It is just 11 January. We will know a bit more in time. There is a huge amount of uncertainty, I guess, around where we end up with financial services and the memorandum of understanding, with the various motivations that the EU may have in that context. You have given us an excellent basis on which to build our knowledge, understanding, thoughts and deliberations in the weeks and months ahead. Thank you all very much indeed for spending time with us today.