HOUSE OF LORDS

European Affairs Committee

Corrected oral evidence: UK-EU relationship in financial services

Tuesday 8 February 2022

4 pm

Watch the meeting

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

Evidence Session No. 1 Heard in Public Questions 1 - 16

Witnesses

I: Miles Celic, Chief Executive Officer, TheCityUK; Dr Gerard Lyons, Senior Fellow at Policy Exchange and Chief Economic Strategist at Netwealth Investments; Rachel Kent, Partner, Head of Financial Institutions Group, Hogan Lovells.

Examination of witnesses

Miles Celic, Dr Gerard Lyons and Rachel Kent.

Q1 **The Chair:** Good afternoon and welcome, everybody, to this hybrid House of Lords and to the European Affairs Committee. We are here for the first evidence session of a new inquiry of ours on financial services and the future relationship between the European Union and the UK financial services landscape. We have three heavyweight witnesses with us this afternoon. We have Miles Celic, who is with TheCityUK, Dr Gerard Lyons, who is with Policy Exchange, and online and joining us virtually is Rachel Kent of Hogan Lovells.

As this is a public session, a transcript will be taken and we will send that to you. I would be very grateful if the witnesses could check it and notify us of anything that needs to be corrected. Then it will be published on our website and it will form part of the evidence that we will use for a report that we expect to produce in April or so.

We have a lot to get through and quite a wide-ranging question set, so I would be grateful if you could keep your answers relatively crisp and to the point as we go through, and we will get to all the issues over the course of our session today.

I will start with rather a general question and with Miles. At the time the EU-UK Trade and Co-operation Agreement was finally concluded at the end of the transition period, there was a feeling of general optimism that the provisions of the Trade and Co-operation Agreement and associated other agreements at the same time would provide for a good and strong continuation of the trade in financial services between the United Kingdom and the European Union. How has that panned out?

Miles Celic: First, thank you to you and your colleagues for the opportunity to present to this Committee. This is clearly an important point in the relationship between the UK and the EU, not least in financial and related professional services, so we welcome the opportunity to be part of this.

The industry always took a view that we would hope for the best but plan for the worst. There was a lot of work done between regulators, Governments and industry on both sides of the channel, and indeed both sides of the Irish Sea, to minimise disruption. We were very pleased at the end of the transition period that there was no effective disruption in the service being provided to clients or customers. I think that both the Prime Minister and the Chancellor are on record as saying that they had hoped that more could have been done for financial services, and I include the rest of the services-based economy in that characterisation. Some 70% of the EU’s economic activity is in services, 80% of the UK’s economic activity is in services, but the focus during the talks was very much on the goods side of the economy.

On how the industry has adapted and what we have seen, first, we have welcomed the approach that the Treasury has taken in the UK in providing for most of the equivalence determinations that could have been provided. We had hoped that the EU would reciprocate that; it has not done so yet. We were very pleased to see the commitment to a memorandum of understanding on financial regulatory co-operation. That was due to have been signed, sealed and delivered by the end of March last year. We continue to await that going through its European stages; I understand that it has gone through all the relevant UK elements. We have also been pleased to see that there has been no deregulatory agenda on the UK side and no regulatory tit-for-tat process. Unfortunately, we feel that more could have been done. It was not, but the foundations are in place to build on for the future.

Dr Gerard Lyons: Good afternoon. Thank you for the invitation to be here. If I may explain my background, in addition to being at Policy Exchange, the relevance for this committee is that I have a number of roles in the City. Three in particular are important. I am a stakeholder and a strategist at Netwealth, which is a discretionary wealth manager—we started five years ago—so I have insights into the market from that side. I am on the board of the Bank of China as an independent non-executive director, and last summer I became a board member of the BGC, which is one of the biggest interdealer brokers in the world. I have insight into the financial services from a number of different perspectives. I would also like to draw the Committee's attention to a report I produced for Policy Exchange last May looking at the City and financial services in some detail.

In answer to your question, rather than repeat what Miles has said, since 2016 a number of things stand out. First and foremost, the misplaced, widespread pessimism that prevailed before 2016 has proved ill-founded. There was a lot of fear about how the City would be impacted. That being said, and Miles touched on this in some respects, the uncertainty linked with the political crisis and the lack of a deal did not help the backdrop for London or, indeed, a global perspective of London.

Beyond that, though, much of what has happened was largely predictable in the sense that firms have had to take action based on their own business model. Firms that have a presence in London but previously served EU-based clients from London have had to move some of their staff to the continent, which in many respects was expected. The general perception across the City is that that move has now taken place. On the other side, in a very positive respect, there are many different aspects, but London has retained its position as Europe's leading financial centre and a major global centre.

The last thing to draw attention to in particular is the temporary permissions regime that was set up by the UK, which has had close to 1,500 firms take advantage of it. That expires at the end of this year and there is already evidence across the City that many firms have taken advantage of the temporary permissions regime to set up a permanent presence in London. It is difficult to quantify fully, but that is a positive.

In answer to your question, there was a lot of uncertainty, a lot of fear. The fears have not proved justified. The uncertainty did not help. We have seen firms, because of their business model, take some action to move assets or people to the continent—that was largely expected before the referendum—but at the same time we have seen other factors that have cemented London's strong position as Europe's leading financial centre.

The Chair: Thank you very much. A number of questions spring to mind about that, but I would like to go to Rachel Kent now and we will come back to metrics.

Rachel Kent: Thank you for the invitation. I should say at the outset that I am not sure my optimism lasted quite as long as the end of the transition period. It might certainly have been reduced prior to that.

When looking at free trade agreements, which of course is essentially what the TCA is, I always think of two aspects: first, protect me against something happening, do not discriminate against me; secondly, give me something additive, something I do not have at the moment. On the former, the Trade and Co-operation Agreement contains anti-discriminatory measures—for example, prohibiting quotas on the number of firms that can access the EU and prohibiting the less favourable treatment of UK firms. Those protect the status quo rather than give us something that was an additive.

What would that additive thing have been? From my perspective, the key ask was something that would operate in a similar way to passporting, allowing access to the EU. To what extent has that been developed after the TCA? At the moment, it could still be replaced by some equivalence determinations on the part of the EU in relation to the UK. The TCA sets out governance arrangements for formalised meetings, dialogues and so on that might have facilitated such a thing, but that has not happened so far. The other thing that was hoped for was discussions about our joint ability to influence global standard setters and to discuss areas where our respective regulatory regimes should continue to be aligned.

Q2 **The Chair:** Thank you very much. We will come on to quite a number of those things later on in the session.

Dr Lyons, what you were saying about increases and decreases in business was very interesting. Are there any metrics that you can draw the Committee's attention to where we can look at real statistics of what has been going up and what has been going down? Are you able to point to any particular success stories or any particular problem areas that have hit the City?

Dr Gerard Lyons: Lots of statistics are quoted, but often the data needs to be put in context in order to draw the right conclusions from it. One that was often quoted and has been repeated is that London has lost its prime position in share trading to Amsterdam. That tells only part of the story. Amsterdam has seen an increase in share trading, but there are about 17 exchanges in western Europe. Euronext in Amsterdam is number three, Deutsche Börse is number two and the LSE—the London Stock Exchange—is number one.

However, the London Stock Exchange is only part of the London story. In fact, many of the shares that are traded do not make it on to the exchanges because of things called systematic internalisers. Big trading firms in the City of London match their share trading internally; customer A here might be buying, customer B here might be selling, and they are matched up internally. They do not make it on to the exchanges. Lots of other acronyms are used, reflecting the fact that not all trades make it on to the exchange. Big institutions in particular might want to trade off the exchange in order not to move the share price in advance of or as they are executing. The point is that the data needs to be looked at in context.

Incentives do matter. When you change something and leave something that you have been in for over four decades, naturally that will have an impact on how firms behave. Firms that previously were selling financial services from London to the continent or to the EU may well now have moved their presence from London to the EU, as I touched on earlier, or may carry out that activity within the EU itself. That would be reflected, for instance, in the decline of exports of UK financial services to the EU area, and that is down in the headlines. In contrast, TheCityUK has pointed out that we have seen an increase in activity to the US. Incentives matter, but the point is that there are many things that are not always caught, because London’s ecosystem is vast.

Maybe the final point, therefore, is that people often look at the jobs data. The jobs data shows that there has been an increase in employment in the City. In many respects, the cake has become bigger, and one would assume that London’s share of that bigger cake is getting bigger. In relative terms, some other centres—Amsterdam, Paris, Dublin—have gained, but it is a relative change. There is an overall change reflected in the jobs data, but a relative change—I think the figure quoted last year was that 7,600 jobs that might otherwise have been in London have moved.

The Chair: Thank you very much. I want to pose the same question. Are there any particular metrics that you could point the committee to? Please write to us if you think there are after the meeting. Are there any particular success stories, on the upside, or problems, on the downside, that you could mention briefly?

Miles Celic: Sure. We issue an international key facts report each year, which Gerard has already alluded to. That shows that financial services trade with the EU has declined since the end of the transition period and since the transition period, but, as Gerard says, it is important to look at these things in context. The share of financial services trade with the EU that the UK conducts has been declining for some years, and that is reflective of growth being predominantly elsewhere in the global economy.

In 2020, the United States overtook the European Union as our largest single financial services export market. It is now 34.2% of all UK financial services exports. The EU in total is 30%. If you look at the Z/Yen survey of leading global financial centres, the UK remains clearly Europe's leading financial centre, with London and Edinburgh in the top seven. It is also worth pointing out, to further make the point, that four of the top seven European financial centres are now outside the European Union, if you include Zürich and Geneva. I think Gerard's figures were from the EY Brexit tracker, which shows that 7,400 jobs have moved to the EU since Brexit.

One caveat on all this is the impact of Covid. I think that has complicated the statistical picture to a degree, particularly on job moves. It is also difficult to completely separate out how many jobs have moved from the regular churn, even when the UK was in the European Union, of jobs moving between the various different financial centres in the EU28 as it was at that time.

The Chair: Thank you very much.

Q3 **Lord Liddle:** A lot of the ground was covered there that I was going to ask about, but let us just probe a bit further this question of what has happened. I remember, Miles, that you or the City of London Corporation—I cannot remember which—published a very detailed consultancy study of what was likely to happen on Brexit, which said that something of the order of 70,000 jobs would be lost. You are now saying 7,400 or 7,600. What explains the difference? That is a question to you.

Gerard, you said that firms that based their business models on EU clients were where there had been some shift to the continent. However, EU business is 30% of the City's. Why has this not had a bigger impact that you might have expected when you constitute such a large section of City business? Where have the problems been for the different sectors in the City and where has the least impact been felt?

Miles Celic: Thank you for your question. I am very happy to explain what you characterise as a discrepancy, which I would argue is not yet, or at least potentially not yet.

The report that you referred to is the Oliver Wyman report, which was done on our behalf in 2016. It originally identified 75,000 jobs as leaving the UK in the instance of a very hard Brexit. What was also clear at that time—this perhaps was not always picked up in some of the media coverage—was that would be over five years following the end of a transition period, and clearly we have not gone through that process. Oliver Wyman ran the model again 12 months later in the light of further information, and from recollection they came up with 40,000 jobs at that point. The EY tracker, which is certainly the most comprehensive of the ones I have seen, has identified somewhere between 7,400 and 7,600 that have moved. Obviously, we had not been able to take account of things like Covid when the Oliver Wyman report took place. I think that the right time to judge how accurate Oliver Wyman has or has not been will be in about three and a half years' time.

Dr Gerard Lyons: If I may slightly push back on that last point, I think that the adjustment has occurred. Indeed, if I quote from New Financial, which did a detailed analysis, "Most firms in the UK that need continued access to clients and markets"—in the EU—"now have it". Notwithstanding the fact that some of the projections were over a four or five-year period, if your business model necessitates change, the reality is that you make the change as soon as you can. We did see a change, hence that figure of 7,500 or thereabouts.

I think it would be wrong to suggest that the City has seen job losses. There has been a net employment increase in the City. When the temporary permissions regime fully plays out—in other words, when it ends at the end of this year—in all likelihood, many of the firms that have asked for temporary permission to be based in the City or in the UK and stay will have to set up a meaningful presence. That would include boards as well as one or two senior representatives. Firms in London have been recruiting people, notwithstanding Covid. I think it would be unfair and maybe potentially wrong to suggest that we have seen net job losses. Certainly, in some areas jobs have had to move, but in other areas there have been increases.

Coming on to the second point about the EU, the 30% is a strange figure. Professor Tim Congdon did a very detailed analysis a couple of years ago suggesting that the figure was far smaller. One or two other economists have questioned that, but I have not seen detailed analysis apart from Tim's. There are many parts of the City, because its ecosystem is so vast, where the depth of markets and the concentration of businesses is in London. For instance, the Bank for International Settlements points out the high number of interest rate derivatives—43% globally, I think—that takes place in London. Some of those you might say are linked to EU-type activities, but they effectively take place in London because that is where the market is.

Coming back to your second question about why we have not seen a bigger impact, it might be because that 30% figure overstates the importance of the EU. The EU is certainly very important for London, but London is a global centre. At the same time, some of the business related to the EU by its very nature, because of the depth and breadth of markets, will remain in London. As Miles touched on earlier, time will tell.

Miles Celic: I will very briefly add to what Gerard said. I think it is important to bear in mind that the number of jobs in financial services has increased since 2016, so it is now over 1.1 million. I think it was just under 1.1 million at the time of the referendum.

The other thing is that, to a certain degree, the number of jobs that have gone to the EU is a little bit of a red herring, because what we have seen—the data needs to be pulled together—through conversations with financial services members, law firms, accountancy firms and others is that the jobs that have moved have not predominantly gone to the European Union. The jobs that we have seen move have predominantly gone to New York and Asia.

Lord Liddle: Could I ask for a bit more clarity on this? Basically, there is a difference of view between you. Miles is saying that we do not yet know the full impact and Gerard is saying that we do. Is that fair? I do not know whether Rachel has a comment to make on that. That is one point.

The second point is that you have not given us much flavour—this is not meant to be critical—of which sectors, which parts of the City, are least affected and which are most affected. It would be very helpful to get that.

Rachel Kent: Can I comment on your first point? We need to look at both sides of the equation, which perhaps is a bit like saying that both are right. I do not think we should forget the point Miles made about the UK being a global financial services centre. To give two very simple examples, or the same examples from two firms, we know that the US investment banks have established two retail banks in the UK within this recent period. That is nothing to do with the EU, for the reasons we have mentioned. Certainly the UK is still attracting business, which no doubt is having an upward or a stabilising effect on figures.

I also think that Miles or Oliver Wyman are correct to say that we need to keep a bit of a forward-looking eye on this, because the position is not static. The position is very dynamic, and the EU's policy develops, sometimes daily. Gerard mentioned the UK's TPR—temporary permissions regime. There were and remain as I understand it, some, temporary permissions regimes in the EU, so we could also see some issues arising when those run out.

Secondly, there are proposals pursuant to CRD6 whereby some of the exemptions that UK firms are currently relying on to conduct business in the EU without authorisation may be tightened up. Of course, those firms will have a choice: either to cease doing that business or to move that business to the EU. Finally, of course, there is the ever-present substance test, which again I am not sure has stopped moving. There are some practical factors that may play out over the forthcoming period that might affect that.

The Chair: Thank you very much.

Q4 **Lord Faulkner of Worcester:** I want to pick up something that Dr Lyons said in his first answer. He said that London has retained its position as the leading financial centre. Is that in spite of efforts by the EU to pursue a strategy that supplants the United Kingdom in that role?

Dr Gerard Lyons: Thank you for your question. As my colleagues have touched on, there are many different moving parts here. Even though the focus today is on the UK-EU relationship, there are many other factors globally. Miles quoted the Z/Yen survey. So that people are aware, every half-year there is a comprehensive survey, but it is subjective in some respects. There lots of data there, but it is not always based on hard numbers; it is sometimes based on perceptions and how people respond to answers. That is widely seen globally as the best barometer of the league table of financial centres. London, as Miles touched on, or the UK, has retained—sorry, it is London. London has retained the number two slot. It was number one a couple of years ago, but if we go back over time it was either London or New York.

The thing that is very evident from that survey is the rising role of Asian financial centres. The other thing that is very evident is the, shall we say, fragmented nature of financial centres across western Europe. Miles touched on the main ones being outside the EU, but if one looks at the EU ones, obviously Dublin is important, Luxembourg is naturally important given the size of its overall economy, but none of these has the broad-based strength or depth to challenge London.

In answer to your question, London has retained its position, in spite of the EU approach. In my personal opinion, and others in the City say this, the EU approach has at times been very political. One of the issues is reverse solicitation, which is not always at the top of people's lips. This is a legitimate way of EU citizens being able to do business in the UK. Post-EU, a UK firm cannot solicit business from an EU customer, but legitimately an EU-based customer, client, institution or firm could contact a firm in London to do business. That is now being frowned upon, so there are a number of people in the City who think that we should use the phrase "legitimise the legitimate". That is just one example.

Without going into the detail, I think one of the challenges was that we had a political crisis from 2016 to 2019 and at the same time there was no cheerleader within the square mile in that period. I do not think that helped at a time when the EU quite clearly saw this as a big prize to gain more of the market share from the UK. The important thing is what we do from here, and I am sure that, rather than answer it all now, we will come to this later. I hope that covered the question.

Lord Faulkner of Worcester: It is very helpful. Would you say that the EU approach was therefore fragmented? There is no EU view that a new financial centre should be Paris or Amsterdam or Dublin, or are they all having a go at it?

Miles Celic: I very much agree with what Gerard said, and I point to the New Financial survey as well, which is more quantitatively based rather than qualitatively based. Absolutely, Z/Yen is to a degree sentiment-based. New Financial's work, which I commend to the Committee, again identifies the UK rather than London as the second largest financial centre; the US is in number one position, and China is in third position and rapidly rising.

On what we have seen in the EU, I think the question you have asked is absolutely the right one. We were told by somebody in the European Council in 2016 that one of its priorities for the Brexit negotiations—I quote what he said—was, "Preventing a number of Member States fighting like rats in a sack over the crumbs that would fall from London's table in financial services". There was certainly an attempt by one or two centres—I am thinking here particularly of Paris—to try to build themselves up as a single alternative European financial centre. However, the EU has moved to what is quite clearly a market location policy rather than a market efficiency policy, and I think that touches on your initial question. There will continue to be attempts to move activity from London and from the UK into the European Union. Rachel has already touched upon the substance tests. I think we will see the ECB and others trying to ratchet this up over time.

One of the other things that the European Union seems to have adopted, at least for now, is a multicentre financial centre approach. There will be activity particularly in asset management, say, in Luxembourg. There will be investment banking in Frankfurt. There will be activity taking place in banking in Ireland, exchange activity in Amsterdam, work in Paris and so on. I would argue that one of the many big advantages that the UK and London have is the cluster effect. It is the agglomeration effect that you get in a centre like London. There is the rule of law, English law, common law—a huge advantage—commercial dispute resolution, time zone, language, high-quality regulators that are well regarded globally. All this comes together. If the EU were successful in creating a multicentre approach—to a degree this is politically driven rather than economically driven—that would be historically and economically unusual.

Lord Tugendhat: I am sure the point you have just made about the whole infrastructure in London and the network of supporting suppliers of every sort is very important, by the way.

We talk about the EU, but what the Commission thinks and what the German banks, the Dutch banks and the Italian banks think is by no means necessarily the same. My impression, but I put this as a question, is that the big banks, especially the Dutch and the Germans, do not necessarily have the same view as the Commission on these matters. I am not sure to what extent there is uniformity among Governments either.

Miles Celic: We have a series of dialogues with our counterparts in Europe. In fact, Lord Wood spoke at our Anglo-German financial services dialogue in 2019, and many thanks for that. We have found in conversations with commercial counterparts a substantial focus on areas where there are shared commercial interests and shared policy interests. There has been a reluctance to engage on Brexit, and there have been very politicised Brexit-related issues, but when we think about the growth of fintech, ESG issues, green and sustainable finance, there is clearly a commonality of position there. As Rachel has already touched upon, many of these rules, particularly in banking, are set at international level; they are international standards. Therefore, having alignment between where British institutions and European institutions might be is not unhelpful.

Lord Foulkes of Cumnock: You keep talking about London. At one point, Dr Lyons, you said the UK and then you corrected yourself and said London. Mr Celic said earlier that Edinburgh is still one of the top seven.

Miles Celic: That is right.

Lord Foulkes of Cumnock: Why are you not mentioning Edinburgh? Where is it in the top seven? How has it managed to stay there? What sectors have ensured that it does stay there? Should you not be talking a bit more about Edinburgh as well as London?

Miles Celic: To be honest, I think we should be talking about Edinburgh, Manchester, Leeds, Birmingham, Cardiff, Belfast and so on. Two-thirds of the jobs in this industry are outside the M25, which often gets forgotten. People then assume that most of those jobs are back-office jobs. The reality is that half the exports of the UK's most successful exporting industry come from outside the M25. This is a national success story. We absolutely talk about that. I am certainly not answering on Gerard's behalf, but I think the difference between the Z/Yen survey, which is of cities, and the New Financial survey, which is of countries, would explain the difference there.

Edinburgh is a massive centre for asset management, for pension management, increasingly for fintech, as is Glasgow. We work very closely with Sandy Begbie and the team at Scottish Financial Enterprise to promote not just the UK, London and the other centres but Scotland's industry.

Lord Foulkes of Cumnock: Brilliant. I hope you will mention not just Edinburgh but Glasgow and the other cities more frequently. I know that London is very important, but other cities are too.

Dr Gerard Lyons: Absolutely. I corrected the UK to London, because that survey covers London. In fact, in addition to building up the financial sector in the UK to better serve UK Inc, which would point to more jobs outside London and across the regions, there is an international opportunity in regional centres for onshoring more financial sector jobs. Given the skill base across the UK, whether it is Glasgow, Edinburgh as you mentioned, or Manchester, we could do more with that.

Best practice internationally has been in London, Dublin, Singapore. Basically, it is wholesale fund hubs, where you try to bring onshore not just the back office but a whole raft of areas that serve your front-office financial centres—research, custody, administration. The UK has a skills base such that, if we focus more of our attention, it is not just about the major centres of London or Edinburgh, as you correctly say; it is about broad-based job opportunities that are well paid relative to the job opportunities in the rest of the economy.

Q5 **Lord Faulkner of Worcester:** Does Rachel Kent share the optimism of her two colleagues for the prospects for the United Kingdom? I shall be very careful not to refer to London any more. Will the UK not lose out and any ambitions that the EU has to move business from the UK are likely to fail?

Rachel Kent: As I said earlier, I still think there is a chance of some additional leakage because of some of the forthcoming implementation of EU proposals. I would not say that part is over, but I absolutely share their optimism.

Miles mentioned some of the areas that are real opportunities for the UK, and that includes fintech. I was lucky enough to participate in the Kalifa review, which had some very specific proposals about cross-UK growth and ESG, to take two examples. I am very optimistic about it, because I think we have the skills, resources, experience and commitment to innovation that those things require, but it is not a foregone conclusion. We have to look at our place in the world and whether fragmentation is good and whether divergence, although perhaps superficially very attractive, is the right thing.

To give you an example, on ESG we have all heard a lot of talk about taxonomy. What do we actually mean by some of these new key terms? Five taxonomies across the globe is not helpful. How does the UK participate in that to make sure that we do our part and help to maintain a leading financial centre but at the same time do not cause unnecessary fragmentation? That it will certainly be a challenge.

Lord Faulkner of Worcester: Will the challenge be particularly from outside the EU, non-European countries, New York perhaps?

Rachel Kent: In some of the key areas I mentioned, the challenge will come from a number of different places, including the EU, the US, China, and possibly India. I could go on. Those are very hot topics and are key. They could bring huge benefits not just to the UK but internationally. Another example is central bank digital currency, which is no good at all if it only operates domestically. We have to consider interoperability. It is a complex task.

The Chair: Thank you very much.

Q6 **Lord Purvis of Tweed:** This is a factual question, and nothing to do with optimism or pessimism. Reading from a House of Commons Library research paper, financial services exports to the EU have continued to fall in 2021, falling by 5% between quarter four 2020 and quarter one 2022, and a further 5% between quarter one and quarter two 2021. This was the area that I wanted to ask about. Compared to 2019 and pre-Covid levels of trade, financial services exports to the EU were 31% lower in quarter two in 2021 than quarter two in 2019. Perhaps Mr Celic can answer this: what makes up that 31%?

Miles Celic: Without seeing the particular research paper that you are talking about, I would struggle to say precisely what it is referring to.

Lord Purvis of Tweed: Do you recognise that ONS data?

Miles Celic: In broad terms, I recognise that. It is not the same as the stats that I have in front of me on the changes that we see year on year or the stats that I think that we have used in our international key facts report, although we draw on ONS data together with data from the OECD, the World Bank and the IMF, from recollection. Some of that will be reflective of the fact that if you look at the other side of this equation, UK trade with the rest of the world has continued to grow.

Lord Purvis of Tweed: Sorry, I am asking for your best judgment, regardless of the 31% or otherwise. What is the analysis of what aspects of financial services exports have fallen?

Miles Celic: Without seeing that paper I would be hard pressed to address that. We have looked across the piece, whether it is in banking, asset management or insurance. Banking has become less international since the crisis, partly because of the regulatory rules that have been put in place, but a large driver of that is a shift in export activity towards high-growth areas of the global economy, which is partly the United States and largely Asia.

The Chair: Thank you.

Q7 **Lord Hannay of Chiswick:** Good afternoon. I will begin by declaring my interest as a member of various European-oriented think tanks.

Moving on to the issue of equivalence, could you confirm that for current EU recognition of third-country financial services equivalences the scorecard for sectors is roughly as follows: US 21, Singapore 15, China 14, Switzerland and Mexico 13, UK one? Does this imbalance not already create some kind of a competitive disadvantage for the UK? Is that not a disadvantage that will continue as long as the imbalance lasts? Does it not also demonstrate that there we have a long list of independent, sovereign third countries that see benefit in receiving EU-granted equivalence, which does not, in their eyes at least, raise fundamental issues of principle?

Miles Celic: I recognise the scorecard, and that would certainly seem to fit. Part of the problem here is that the UK has onboarded the EU acquis. We helped to draft the EU legislation. At the point at which we left the European Union and the transitional period, the UK's rules were effectively identical, bar what were termed the inoperables—for instance, where a piece of legislation referred to the ECB it was changed to the Bank of England. On that basis, there was no technical reason, I would argue, why the UK should not be deemed equivalent, given that the rules were absolutely identical on both sides of the channel.

We have been told by the Commission and others—and I have to say that in my experience this represents a departure from the way in which equivalence was handled—that they now see equivalence as a process of managing future and ongoing alignment with another country, a third country. My expectation and my guess is that this was in part a lack of clarity about what the UK was going to do with its financial services rules. Certainly, in some of the conversations we had in Brussels and other

Member States there was, in my view, an unrealistic expectation that the UK would embark on some regulatory bonfire and some race to the bottom. We never saw or expected that; it certainly was not something that our industry called for.

Finally, equivalence differs from directive to directive. The EU has no single mechanism, no overarching mechanism, of equivalence. Most equivalence decisions are not relevant for market access. Only about a third of available equivalences deal with market access. What they are normally about is forms of preferential prudential regulatory treatment.

Lord Hannay of Chiswick: You have not answered the point about this putting us at a competitive disadvantage.

Miles Celic: Obviously, if only a third of those are relevant for market access, there will be an impact. Does it put us at a disadvantage? My view is that as long as the UK remains open and provides equivalences itself, that goes some way to maintaining the UK's openness.

On the engagement with the EU, of course it would be preferable to have a form of equivalence in many of these areas, although, as time goes on, the way that equivalence is being operated by the EU, and as we see parallel development between the UK and the EU—we are already seeing this with the back book of regulation, Solvency II being a case in point—the UK will need to determine whether it makes sense to change its rules to fit the European Union or, indeed, whether the European Union wants to change its rules to fit the UK as the leading financial centre in Europe, or whether there is a process of ongoing parallel development with the consequences that brings for both sides.

Lord Hannay of Chiswick: In the last year, we have merely moved from two to one.

Miles Celic: Two to one?

Lord Hannay of Chiswick: We have moved from having two equivalences to one, so it cannot be said to be moving in that direction.

Miles Celic: Over time, I expect that that area of parallel development will continue, however. As I have identified, and as I think Rachel has also touched on, much of the UK's growth over the years and the decades ahead will be in areas such as fintech, data, digitalisation, green and sustainable finance. Those are areas where the rules are less well developed in the UK and in the EU. The EU will develop the regulation and the equivalence mechanisms that it requires for its market, and the UK will do the same for its market.

Dr Gerard Lyons: In answer, I have two points. The first is a general point, but it is probably the most important point I will make today. To judge a financial centre as globally competitive, there are three key aspects. One is inherent characteristics, of which London has a whole host of inherent characteristics, the English common law being the most important. The second is the regulatory environment, and within that equivalence has an important role to play. The third is where clients want to do business, and that depends effectively on the breadth and the depth of the markets. London has inherent characteristics, the regulatory environment and the place where clients want to do business.

Equivalence matters, because it very much comes into that whole regulatory side. Your question was: is it a disadvantage? It comes back to the previous question about how just over 30% of exports fall based on the broad data. If your business model prior to 2016 was dependent on equivalence giving you access to the EU market, it will have an impact on you. That has led to some firms deciding to move staff. It is not only people who interact with clients. You cannot service them from London unless reverse solicitation is prompted: that is, they come to you first. If you are building a business, you cannot rely on that. Therefore, firms have been impacted.

One area that is interesting where we were granted equivalence is linked to clearing houses. This is a key area at the centre of the system.

The Chair: We will come to that a bit later.

Dr Gerard Lyons: I see, sorry. There is some impact, yes. The question is: why did the EU do this? My colleagues might have different views, but Miles touched on it; it is because of the political agenda. However, there are also different countries on the continent competing for the cake. Some firms have been impacted, but where we go from here goes to the wider regulatory issue, which is the key issue of whether we are a rule taker or a rule maker.

Equivalence matters. Some might say that it is a nice to have, but regulatory independence is a must have. We should not be complacent about the equivalence issue, because when you go into it, it is about the detail. Often we have discussions about equivalence that are broad-based, but you need to drill down into the nuts and bolts, the legal part, to know whether it will have an impact and whether ultimately we say that we want equivalence. You need to look at what is under the bonnet before you say, yes, we want equivalence.

Lord Hannay of Chiswick: Neither of you—and I hope that Rachel will come in on this, too—have said anything about the fact that some of the non-EU financial centres with which we compete have a much higher degree of equivalence than we do. Is that not what I have described as an imbalance?

Dr Gerard Lyons: That is an imbalance, because ahead of 2016 one would have argued that as a third country where, as Miles touched on, our picture was exactly the same as the EU on the day of the referendum, there would be complete justification for being granted equivalence. The political angle comes in. Does it put us at a disadvantage relative to others? London has a major global financial centre, so one might put London—I would say London as opposed to other parts of the UK—in a different box compared to some of the other cities or countries you have mentioned. The US-EU is an interesting one, and may be a challenge for the UK as well. I hope that answers the question.

The Chair: Thank you very much. I wondered whether you were posing the same questions to Rachel Kent, Lord Hannay.

Lord Hannay of Chiswick: Yes, indeed.

Rachel Kent: I agree with the proposition that it puts a UK firm at a competitive disadvantage. Imagine for a moment two firms, one a UK firm and one a US firm, both prior to Brexit taking advantage of some kind of equivalence or passporting regime. The US firm remains able to do that. The UK firm is no longer able to do that; either it has had to cease its business or it has had to undergo costly reorganisations involving an additional licence, additional capital and all the things that go with that. I fail to see how that cannot be a competitive disadvantage at that level.

Nevertheless, I also agree with Dr Lyons that, again, it is a bit of an equation. The price of equivalence is alignment, and if not being equivalent means that not only can we make many more of our own decisions but we can make them quickly in response to key market opportunities, that certainly might be a compensating advantage that partly or wholly makes up for it.

I flag whether the other jurisdictions that you mentioned really are more equivalent than we hope to become. I am not sure that is a question for me. I am not sure we are being judged by the same yardstick.

The Chair: Thank you very much.

Q8 **Lord Foulkes of Cumnock:** Dr Lyons, I think you were going to move on to talk about central counterparties. Perhaps you could explain why they are the exception and why the EU has made them an exception. Do you think that it will continue beyond the three years?

Dr Gerard Lyons: Yes. Back in 2017, the governor, Mark Carney, talked about how bringing euro clearing into the euro area would lead to a fragmented market and to wider bid/ask spreads because the volume of business would be lower and would require more capital to be allocated against that and would, therefore, reduce the ability of EU-based banks or euro-based banks to lend in the wider economy. I do not know why, is the answer to your question, so it is conjecture. One might be that, linked to that argument, there may be an economic cost as a result of fragmenting the market.

The other is the underlying legal aspect, and my colleague will be better placed to answer this. For bankruptcy, if someone fails, centre clearing parties, the clearing houses, take the settlement risk and sort things out if someone defaults at the end. The legal structure in the UK, it is said, is much clearer. People often cite the example post 2008 where the problems associated with Lehman were able to be solved relatively quickly, whereas the problems linked to it in Germany or France took longer to be resolved. The other argument is the capability on the legal side. The EU has not explained fully, as far as I am aware, and one can conjecture that those sensibly look like the two reasons for it. Therefore, there is a need for a key role as a clearing house, and the UK has a strong presence there.

Lord Foulkes of Cumnock: Can any of you explain whether the lack of equivalence, particularly in banking and insurance, is causing any problems for the European Union institutions?

Miles Celic: Do you mean the regulatory institutions or companies and so on?

Lord Foulkes of Cumnock: Any of the European Union entities.

Miles Celic: London remains Europe’s international financial centre, so you often find that a German business goes to its local Sparkassen or its bank in Hamburg or wherever and conducts a transaction, and as far as it is concerned that transaction takes place in Germany. What it might not see is that the back end of that deal goes through London or Edinburgh or another UK centre. I cannot say that I have seen lack of access to finance in the European Union as yet. Obviously, there is a degree of waiting for the statistics to catch up with the reality, but I have not seen that as currently stands.

I will add to what Gerard said about the CCP decision. Today, I think, Commissioner Mairead McGuinness said that they will extend the temporary regime for a further three years, but as far as they are concerned that is it. There is clearly a move, and it has been an ambition for some time, to move that activity into the European Union. That could be a retrograde step. Ultimately, clients want to do business where it is cheapest and most efficient to do business, and the size of the activity in the UK and in the United States makes that cheaper and more economic. I am sure that Rachel will have views on that from a legal perspective.

Rachel Kent: I am possibly in the unique position of having established two clearing houses in the UK, so I am very well placed to explain how complex it is. It is probably one of the most complex legal tasks there is. That means that any process for establishing clearing houses anywhere will take time. I also agree entirely with Dr Lyons’s view about the usefulness and practicality of UK law in solving some of the complex issues that arise. One of the issues that is caused, not necessarily because of a difference in EU law but because of fragmentation across the EU and between the EU and the UK, is the inability to net transactions. That gives rise to increased capital costs and other costs, so that will also be quite a challenge to overcome.

Lord Foulkes of Cumnock: Thank you very much. I think that in the interests of time we should move on now.

The Chair: Thank you very much.

Q9 **Lord Lamont of Lerwick:** I will refer first to the register of interests and my interests as a director of various investment companies and advisory investment companies.

Is it not the case that equivalence is a highly political matter, that it is unpredictable and can be taken away—as was evidenced in the case of Switzerland, when some equivalence was taken away after its referendum on mobility of labour—and that its unpredictability perhaps means that one should not wish for it too strongly? Having said that, how have UK providers adapted to the lack of equivalence? Could I ask Dr Lyons to comment on the point made by Rachel about the disadvantage for a UK firm compared with a US firm with the lack of equivalence?

Dr Gerard Lyons: Yes. In some respects I thought I had touched on it in answer to an earlier question. Basically, the fall in measured financial services exports to the EU is because some firms based in London have had to change their business model. If they have not changed their business model, their business model has led to them having to make changes, some of them as a result of the change in the regulatory/equivalence environment where they could not service some of their EU customers directly from London as they were previously able to do. In that respect, I agree with Rachel's comment.

I also agree with your opening statement about what one wishes for. Equivalence is a relatively recent concept in some respects, and there may be other substitutable ideas. The key issue is the wider one of the regulatory agenda and whether you can set the rules. The argument at the moment or in recent years in the City has been whether, on the terms under which equivalence has been offered, that would make the UK a rule taker as opposed to a rule setter, in which case it might adversely impact the competitiveness of London overall in the longer term.

In some respects, you might argue that there might be a short-term gain just because there is a natural bias—"gain" might be the wrong word to use. There is often a bias towards the status quo, because to make any change you must do things differently, and sometimes there is a cost involved. I think that covers the point.

Miles Celic: If I can briefly add to Gerard's comments, I think there has always been a degree of politicisation to equivalence. A former EU Commissioner for Financial Services tells the story of how he would be approached and told, "We are negotiating a particular FTA", or something else, "with a third country. We want to use equivalence as part of the sweetener, so could you look at equivalence at this point, or could you withhold equivalence at this point until we get it to where we need to be in the broader relationship?"

You have touched on the withdrawal of equivalence. That differs from the equivalence-to-equivalence element. As I said, there is no single framework of equivalence. It is a patchwork, which is one of the problems with it. Some forms of equivalence can be withdrawn at 30 days' notice. As we have seen, it took at least two years in some cases, as I am sure you will know from your own experience, to prepare for the UK's withdrawal from the European Union—30 days is no basis for dealing with that sort of withdrawal of approval. In other cases, there are forms of equivalence that have no mechanism for withdrawal and theoretically could be taken away at the drop of a hat.

In fairness, the European Union has recognised that and there is an attempt to reform equivalence, which again means that we need to be careful about the conversations we have about equivalence, because we often find that these conversations are almost about a moment in time. Equivalence is a moving target; it is an evolving concept and an evolving set of standards and rules.

Lord Lamont of Lerwick: Rachel, would you like to comment? Could you also enlarge a little on what you said about ESG earlier?

Rachel Kent: I am happy to. Were I to be asked to defend the European Union in court against a claim that its equivalence decisions were political, I would be tempted to focus on the statements by many members of the UK Government to the effect that we are now going to go our own way and will look at our own laws and necessarily diverge—not, it has been clearly stated, to lower standards but to standards that are better tailored to our market. I do not know whether that is a substantive reason, but it seems to be a factor to be considered.

On the subject of politicisation, it also seems to me, without commenting on whether the politicisation of financial services decisions is a good or a bad thing, that we have the current position in the EU that you have identified. In the UK, of course, we have a system where, it is my view, we are about to depoliticise—not wholly, but some way down the line we will depoliticise—decisions because of the future regulatory framework and the transfer of increasing powers to regulators, rather than to the Government. I make no comment on it other than to say that there is a potential mismatch between those two things. There are, of course, protections in our system because of the objectives that have been given to regulators.

On your point about ESG, climate change, and social issues, the UK has a huge opportunity here. As I said in my opening remarks, it has a justifiably enviable reputation for innovation, and there is a view, which I agree with, that the financial services sector is an accelerator. It is capable of being an accelerator of ESG issues, because they are not just large firms that have ESG issues in their own right; they also lend money. They invest in equity and so on in other businesses, and via their policies they can drive through change. We have a huge financial services sector, which I believe can be a huge driver of change in that area. We should not forget fintech. I believe that the fintech community is hugely engaged as we speak in finding solutions to some of these difficulties. I will not elaborate, because I know we are short on time. ESG is a huge opportunity for us.

Lord Lamont of Lerwick: A final question to Dr Lyons. You said earlier that between 2016 and 2019 there was no cheerleader for the City. What did you mean?

Dr Gerard Lyons: I meant that one of the concerns in the City was that financial services did not figure in the Withdrawal Agreement, and the impression was that, across the City, people had not pushed in a united way for what they wanted or had a cheerleader, which I think is the best way to say it.

I think there was a real feeling post 2016 that many institutions in the City might have preferred to retain the status quo. Therefore, they were waiting to see how the politics played out, but while the politics were playing out there was already a dynamism underneath in the work being done for the Withdrawal Agreement, and, as we have touched on, the EU was already pursuing its own agenda.

In some respects, that helped to explain why, when we came to the withdrawal agreement, financial services were not given the prominent position, despite their scale in the economy. Since then, as we have seen from TheCityUK and others, there has been a proactive approach.

Lord Lamont of Lerwick: Some people in the City, though, argued quite positively that they did not want an agreement on financial services of any kind.

Dr Gerard Lyons: Yes. I argued quite strongly about different aspects of that, but it might be fair to pass to Miles, given that he represents TheCityUK.

Miles Celic: The mood, the perspective, within the industry at the moment is that there is no point trying to navigate by looking in the rear-view mirror. We have left the European Union. The challenge now is to make the best of that, and, in my view and certainly in the view of the companies that we represent, that will require a concerted and ideally co-ordinated effort between industry, government and the regulators. There are opportunities that we can seize here, and the challenge now is to make the absolute best of those opportunities.

Q10 **Lord Wood of Anfield:** I must declare an interest as a director of an investment trust. We have had a good run-around on equivalence, but I have one question about the future. We have talked a lot about autonomy and the balance between freedom on the one hand and co-ordination equivalence on the other. I am interested in your views about whether the Government have the balance right in their current approach to equivalence, which is to press for equivalence where it is in the interests of the City and not where it is not.

Secondly, is there any embryonic shape of institutions emerging by which future partnership decisions about equivalence or non-equivalence will be taken? Is there any hope of something more regularised emerging that might make the sorts of decisions that we are talking about?

Rachel Kent: Where the balance should ultimately be is still very much a work in progress, not just for the Government, who I think are working very hard at it, but for firms and representatives of firms in the City, like me. We are looking at the areas. If we had complete freedom, what would we do? I have mentioned ESG, and fintech has also been mentioned, but what are the areas? What would we do? Can those be accommodated within a world where we are seeking equivalence or not, and, if not, which gives us the better situation?

On hope, again leaving aside the politics, on which I do not have a view, the memorandum of understanding that is attached to the TCA has of course been technically agreed, just not implemented. That, so far as it goes, will be helpful. I referred to it earlier as giving governance, so it does not require substance; it requires meetings and discussions, including on the key issues of alignment with and joint influence on global standards.

If you are not talking, you cannot achieve anything so, yes, I think that is helpful, and I hope that provides a forum for sensible discussions on mutual equivalence.

Miles Celic: I draw attention to one of the points in your question, which is the idea of equivalence being a mutual process. That is absolutely not the way the EU sees it. In fact, in the early days—Rachel will remember this, because she was on a number of delegations to Brussels with me—even suggesting that there could be some form of mutual equivalence was guaranteed to affect the tone, tenor and friendliness of any meeting in Brussels. Usually, at that point, somebody would say that this would be an appalling infringement of European sovereignty, that they would have to pull together their equivalence decisions in consultation with a third country. Equivalence is not something that is done jointly. That is certainly not the way the EU sees it.

Lord Wood of Anfield: But, then, it is alignment rather than equivalence?

Miles Celic: You have to align with the European Union, and that is increasingly the way it is seen. I draw the committee's attention to a speech that Bruno Le Maire, the French Finance Minister, gave in Helsinki in, I think, September 2019 where he talked about the future of European equivalence. It is on the French Trésor website, and I commend it. Towards the end of the speech he talks quite openly about further politicising what are technical decisions.

For the future, a lot of work has been done by TheCityUK, the individual trade associations, the City of London Corporation, and Gerard's terrific work for Policy Exchange. There are lots of ideas out there about what the UK can do, and they do not need, nor can they be solely dependent on, equivalence. As I have said, the approach that the industry has always taken has been to hope for the best but plan for the worst.

Lord Hannay of Chiswick: Can I ask why in all these questions on equivalence, which have been going on for quite a time now, none of you has explained why countries like the United States, not absolutely renowned for keeling over and lying there for its tummy to be tickled by the Commission, should have reached so many equivalence situations, or China or Singapore? It is odd, is it not?

Miles Celic: Part of that is historical. I cannot give the statistics off the top of my head, but I am very happy to write to the committee with them. Many of these represent a different time in regulatory dialogue between the European Union and its partners. I cannot recall the last time a major equivalence determination was granted between the EU and a major alternative financial centre.

The Chair: Bermuda and Japan, 2015.

Miles Celic: Thank you very much, Chair.

Q11 **Baroness Scott of Needham Market:** The underpinning of all this was to be the memorandum of understanding, which you referred to in your introductory remarks. The understanding was that a text had been agreed almost a year ago. What is the delay and, to an extent, how much does it matter? How disadvantaged are we, if at all? Are third countries being advantaged? What is the assessment of the absence of it?

Miles Celic: The honest answer is that I cannot explain the delay. I could speculate on what the delay might be. I suspect—this may be unfair—that it might have something to do with issues that are nothing to do with financial services. Certainly, as we understand it, the UK has been ready to go on this for almost a year. The original intention, as you say, was that it would be done by March. We have good relationships, as we see it, between regulators and supervisors on both sides of the channel and both sides of the Irish Sea. To a certain degree, rather like the way we all moved on to Zoom as a result of the pandemic, people are depending on pre-existing social and professional capital and relationships.

The intention was always that the UK-EU forum would be based on the relationship that existed between the EU and the US, which we thought was a very useful forum. We absolutely advocated for the creation of this, because it creates structures for these discussions and, hopefully, minimises the possibility of people being surprised or blindsided by discussions taking place, so it formalises and creates structure. So far, it seems to be working reasonably well without that structure in place, but our sense is that it would be better to have the structure and almost not need it, rather than not have it.

Dr Gerard Lyons: I would answer your question, which in some respects touches on Lord Wood's question, by looking at this from a global, a regional and a national perspective. Globally in financial services the UK still plays a very important role, and in many respects that is the key. There is the Financial Stability Board and the four international supervisory organisations. I think we currently chair two of them, but whether we chair them or not we always play an important role. That is vital, as we saw in the global approach to things, particularly in the aftermath of the global financial crisis.

I will come back to the regional level in a second. At the national level, we need to control our own controllables, regardless of what the EU or the US does. While we are agreeing with them at the global level, we need to try to make the UK as competitive as possible. It is important that, even though we are talking here about London and Edinburgh as global financial centres, our principles—maybe we should spend more time on this—are about making sure that the financial sectors help the domestic economy to become stronger. We then have the financial centres becoming competitive, and regulation and financial stability are very important here. That is what we are trying to do, and we must keep changing and updating that all the time.

Then we come to the regional approach, and here it depends on the other side. We co-operate with the EU, it seems to me, on anything to do with financial stability. This also comes back to the question about clearing houses. But in other areas it is very competitive. Some people suggest that we might seek equivalence with the US. Last summer, I think, we signed a substituted compliance form with the United States that is a minor, lower version, and we would not want to necessarily go down that route. In answer to your question about whether we suffer as a result, coming back to what I said earlier about where business models may have been impacted by equivalence, firms have had to already make changes to those business plans. Goodness, it is a few years on.

In other areas, people are now assuming, or some might be, that if it happens, it happens, and if it does not happen, we cannot do anything about it, so we must continue to do business. It will, by implication, impact the type of business that you can do—for instance, whether you can service EU-based clients out of London or whether instead you continue to build up your presence in Madrid or wherever else it is. It reiterates the point that if we go down the route of equivalence, we need to go into the detail. Whether we are suffering very much depends on what the equivalence relates to, so we need to go into the detail to come out with a clear answer. Hopefully, that helps.

Rachel Kent: I would like to add a slightly different dimension to this. When we all looked at the MoU, we were not in quite the position we are in today. Equivalence certainly seems not to have happened so far and there seem to be rather gloomy prospects in the short term. When we looked at the MoU, I think we were still hopeful of having equivalence decisions. If memory serves me correctly, part of what was in the MoU was governance, dialogue and process around equivalence decisions, in particular alignment. It may, for example, say something along the lines of somebody who has received an equivalence decision prior to changing its law having to notify the giver of the equivalence decision. At a time when we thought we would have had and have given equivalence decisions, that made sense. I think we would want to look at how that impacted us in the new dynamic.

Q12 **Viscount Trenchard:** I should declare my interest as chairman of a Guernsey-based protected cell company and a director of a Hong Kong-managed, London-listed investment company.

The British Government, as you know, have undertaken and are undertaking a number of reviews into the regulatory framework underpinning the financial services sector, such as the Taskforce on Innovation, Growth and Regulatory Reform review and the Future Regulatory Framework review. These reviews are designed to maximise or to identify where the benefits of Brexit can be derived. Which areas do you see as being most likely to benefit from regulatory reform?

In answering that, could you also say what kind of regulatory approach would likely maximise the potential benefits? Also, should the existing transposed EU regulations such as MiFID II, bits of which were very unpopular when they were introduced—the whole of AIFMD was very unpopular with the asset management companies—now be abolished or changed substantially to the benefit of the UK financial services sector?

Overall, do you agree with the Government's current approach to post-Brexit regulation and divergence on financial services, and is it making it more attractive to international investors?

Miles Celic: Our view has been that ultimately there are two approaches that you can take in financial services and in trade deals generally. You can have scale, which the EU absolutely has, or you can be nimble and innovative. This is almost a variant of Ursula von der Leyen's characterisation of the vaccinations programme and the difference between the EU and the UK. Her argument was that the EU was a huge super-tanker that has scale and mass but is not very manoeuvrable and does not move very quickly, whereas the UK was a speedboat that does not have the same scale as the super-tanker but is nimble and fast and manoeuvrable. We would like to see that approach to innovation—being able to seize the opportunities and to lean into some of the issues that we have already talked about in this session, such as fintech, green and sustainable finance, helping to deal with the consequences of an ageing population, infrastructure renewal, climate change and so on.

We have been very encouraged by the Government's approach and the Financial Regulatory Framework review proposal for a secondary duty on the regulators of international competitiveness and growth. We think that is absolutely heading in the right direction. We think, and this has been touched on in the discussion so far, that it is important that democratic accountability and oversight is built into that process. We certainly would not want to try to repeat the ECON Committee. I do not think the UK Parliament is built for that sort of thing, but equally we think that there may well be an opportunity for a group of Members of this House and Members of the other place to come together to provide a degree of scrutiny for the activities of the regulators and the approach that Government are taking.

We would like to see—and we touched on this in my answer to Lord Lamont earlier—some form of partnership group that brings industry, government and regulators together to that end. You can put as many structures and as many strategies and objectives in place as you want, but ultimately a lot of this will come down to the cultural approach that we as a country and the regulators take.

Dr Gerard Lyons: Thank you for the question. Do I agree with the Government's approach? For the economy, there needs to be a clear, longer-term economic vision, but for the financial sector there needs to be a vision, without the Government micromanaging but recognising, regardless of where one sits on the political fence, that incentives matter, and that will drive what happens in the financial sector.

On MiFID and Solvency II, you did not mention, but it was implicit, that the UK played an important role in helping to set many of these rules when we were in the EU. Lots of people in the City would have a cold shiver at the idea of redoing MiFID and Solvency, but the important thing to note is that we do not need to change every part. We now have the flexibility to change some parts of them, and we should do that.

Although we played an important role in the EU, there were 28 countries and there was a lowest common denominator, so many parts of these bulky regulatory areas are not very relevant and are costly for many firms in the UK. For instance, regulatory disclosure is an important part of MiFID II, as is openness on fees. Certainly, we should revisit both those key areas.

On regulation in the future, the Bank of England's *Future of Finance* report a couple of years ago made reference to the monetary authority of Singapore's best practice, where it tried to have a new strategy for modern regulation. It had four components to it: regulation fit for the fintech age, data sharing, international collaboration and using enhanced analytics for suptech and regtech—supervisory technology and regulatory technology.

Our approach to regulation should supersede our concerns over equivalence, and in that respect it is important to promote global standards while retaining our own regulatory independence. There need to be clear principles linked to the competitiveness of London, to the wider economy and to financial stability. It is also about taking regulation to the next level, as they are trying to do in Singapore, and keeping the costs of regulation down and having clear oversight. Now that we are outside the EU, if we look at the size of the regulatory groups in Brussels that provide support to the Commission, I would suggest that here in the Lords, as well as in the Commons, there needs to be greater help and support to provide the oversight.

At the end of the day, it is not about micromanaging. We must set the right parameters and then let business get on with it. It is about allowing the markets to drive the agenda and trusting the markets in some respect.

Rachel Kent: I hope to add to it in 30 seconds. I agree with Miles on the future regulatory framework and with Dr Lyons in particular on the strategy point. On the particularities, there is a huge number of opportunities for us to look at. I would split them into the domestic and call out in particular our retail financial services, especially consumer credit. There is a huge scope for simplification there. I would look outwards to areas where the reason for change might be to be the global leader. I mentioned cryptocurrencies and DLT generally in that space. It cannot be effectively regulated, in my view, by a number of disparate approaches among different jurisdictions. There are opportunities aplenty to look at the way in which the UK can drive improvement in regulation.

Q13 **Lord Purvis of Tweed:** I should have said this before when I asked a question, but rather depressingly I do not have any interests to declare. Quite a few of the answers already have basically addressed the question about the benefits or otherwise of maintaining alignment and so on. I will start by turning that on its head. What changes, from your knowledge, is the EU probably looking at that it would consider improvements but which we may consider retrograde or whatever, and that we must address, respond to or accommodate?

Rachel Kent: It probably will not surprise you to know that we are driving down parallel tracks here. I will take as examples ESG and digital, which are my two broadest areas. As you know, the EU has distinct packages in both those areas, as do we. I think we are all identifying similar opportunities.

Miles Celic: If we take insurance, the UK is looking at a review of Solvency II regulation, and the EU is doing the same. That will be a point of obvious divergence, and more likely divergence, in the short term. On the approach to data localisation, for example, there are many similarities between the UK-Japan FTA and its EU equivalent, because one draws from the other, but what was notable there was that the Japanese were very happy to agree to the UK suggestion of carving out data localisation for financial services, so there is no data localisation requirement for financial services in the UK-Japan FTA, whereas it is explicitly a part of the EU-Japan FTA.

When you look at the UK's aspirations with regard to Switzerland in financial services, the digital economy agreement that has been agreed between the UK and Singapore, and the progress that we are likely to see, hopefully, between the UK and the US on the CPTPP, you can see that those are obvious areas where the historical experience and the political drive on areas such as data are very different in the UK versus that in the EU, partly due to the common-law experience in the UK and partly due to the historical experience. Data is increasingly as important for our members as capital, if not more so, and, as we have discussed, it will be one of the drivers of innovation and success for this industry in the future.

Dr Gerard Lyons: There are three areas. Data is very important. The area that we cannot be complacent about and that does not get enough attention is the infrastructure that serves the UK very well. We had two match centres, Slough and Basildon, which many people used to say were critical to the City. We lost the match centre in Basildon, which is going to Bergamo. Interestingly, many people in the City do not think this is an issue. I tend to be more of an exception; I do not think we should be complacent about it. Also, investment is taking place in Frankfurt, Paris and elsewhere in data back office, and that investment is now taking place here, but land is incredibly expensive. We cannot be complacent about the whole infrastructure that is key in the back.

The third area is research, but it is in America, not the EU. I do not know what the EU is doing on this. As a by-product or a consequence of MiFID—this was picked up in the Hill report—the UK has seen its excellence in research, hopefully not economic research, take a dive in equities and other areas. Some figures have suggested that investment has fallen by 70%, because firms could pay for that before in a way that they cannot pay for it now. That needs to be corrected, coming back to the earlier question about the benefits. Those are the three key areas: data, the whole back-office infrastructure—more than the back-office infrastructure, actually; all the nuts, bolts and pipes—and research.

Q14 **Lord Purvis of Tweed:** When we scrutinised the Japan agreement, the data aspect was not universally welcomed, as far as moving away from the EU on the consumer and privacy side was concerned. These are not zero sum when we come to scrutinising the firms.

My final question is to Rachel from the legal point of view. I understand that the Paris courts are now able to use English law in some of the trade beyond the EU. Is that a minor aspect or is that a growth area for them, and how unique is the common law as far as the international work is concerned? Can it just be done here or can others simply adopt and use it? I think they can, but I do not know whether that is a tiny thing that will stay tiny or whether it will grow. Ultimately—this is linked, in a way—are there areas of common ground? The two rail lines that you talked about may come together in some areas so that there is common ground between the UK and the EU on some areas, given that, as Miles said, the UK is still the continent's largest centre for financial services.

Rachel Kent: Certainly on the choice of English law, unless somebody has contracted out in some kind of international agreement, for example, which I do not believe is the case, they can choose it. It would not surprise me. I would have thought that there would be a clamouring from users of financial markets for the choice of English law, but I do not know the extent to which that is possible in the current political climate. I think that would be welcome.

On the question about whether there are areas of similarity between us, I would say that there are more areas of similarity than divergence. I refer to those two packages. I have not done a precise side-by-side analysis, but certainly upwards of 50%, probably significantly more than that, is at least pointing in the same direction, if not substantially similar. There are some key differences emerging. Some of the detail we already know and other of the detail is still a work in progress. I mentioned taxonomy earlier and the fact that I struggle to see that there is a benefit in multiple taxonomies, but certainly the EU and the UK are looking at differences. There is a lot of crossover, but equally there are a lot of differences.

Miles Celic: I think Rachel has covered the legal point. We all realised that Paris was very serious about taking British business when they agreed to do their regulatory forms in English, which felt like a pretty major step from a French perspective.

I agree with Rachel about the areas of common ground. I think there are areas of common ground. My concern is that, over time, those will become fewer and fewer as the process of parallel development or divergence—pick your term—unfolds. I think that the areas of common interest that we see in our conversations with industry counterparts—I alluded to this earlier—are the shared interests in the opportunities relating to data, to ESG issues, and to financing the transition to net zero. There is a huge commercial opportunity there; it is both an area of co-operation and an area of substantial competition, not just with the EU but with the Americans, the Chinese and others.

We have talked about fintech. I worry about what open strategic autonomy means for the EU, because if you take at face value what some people talk about, this is about making sure that the EU develops, as we are doing, rules that fit its own market. Some of the conversations that we have had make me concerned that in the EU it is more about protectionism. What appears to have been a misstep on CRD6, which it appears has raised barriers to cross-border activity—or at least has raised the possibility that those barriers will be raised—concerns me, because I do not think that is in the EU's interests or in our interests.

Dr Gerard Lyons: On the point about protectionism, it will be interesting to see the route that the EU goes down. In the 1960s, the US went down the route of imposing severe regularity constraints, which led to the growth of the euro-dollar market in London. In those days, "euro" meant international. There is a feeling in the City that if the EU tries to create a walled garden, as long as London ensures that it is competitive you could see a euro-euro market, an offshore euro market, being developed here in London. A lot depends on the route the EU goes down.

If we look at this from a customer perspective, we need to differentiate between retail versus non-retail. The reality is that most retail business takes place within the country. Even when we were in the EU, the data showed that the single market in financial services did not work that well for retail. What we are talking about is the non-retail area, and the performance in London in the last few years suggests that there are lots of areas where the EU needs London. The question is whether they can replicate what we have in London. I think there is an overlap.

When things settle down and we see where businesses have moved and start to do things, I think there will naturally be co-operation as well as competition, if that makes sense.

The Chair: Thank you very much indeed. We come to the very patient Lord Tugendhat.

Q15 **Lord Tugendhat:** My question moves away from the EU. We are aware that the UK Government are trying to secure free trade agreements in different parts of the world with countries and trading blocs and so forth. To what extent do you think this will have any significant impact? London already does business with every conceivable country in the world, and every conceivable country in the world has institutions based in London. To what extent do you think the Government's drive for free trade agreements and so forth will have an impact?

Secondly, among the various tools that are talked about—mutual recognition agreements, temporary permissions, economic and financial dialogues and all the rest of it—which do you think might be the most promising line of attack?

Miles Celic: The nature of free trade agreements, as you will know, is that they are pretty underweight on services and have been for a very long time. This is a problem for 80% of the UK economy, not just the 10% that financial and related professional services represent. I think there is progress on that. There has been progress at the WTO level, and the dial is shifting in some of the FTAs that are being negotiated, because each FTA raises all boats.

I think the DIT has done a very good job on this and HMT is making progress on this. Often there was a hook in an FTA that would allow for regulators to speak to each other afterwards, and there would not be a great deal on financial services; it would be about the regulatory conversation that it unlocked. Each FTA probably does not move the dial substantially by itself; it is the opportunity that it subsequently opens. I think we will see over time—and not just in the UK; I hope this is a wider issue—that those elements in an FTA become more fundamental and more substantial when they relate to financial and professional services.

On the areas of potential interest or benefit, the more we can hardwire in mobility, mutual recognition of professional qualifications, data, which we have touched on already, regulatory co-operation and so on—Gerard touched on substituted compliance—the better. That segues into your final point about which of these mechanisms or tools offers the most benefit and the greatest promise. It is honestly different from market to market.

With the Swiss we are taking absolutely the right approach in trying to go for a mutual regulatory recognition arrangement. As a senior Swiss Government figure said to us, if you cannot have mutual regulatory recognition between the UK and Switzerland, it is very hard to think of two countries where it is possible at all. There is political will, and you have two highly sophisticated, well developed and in many ways very similar financial services and ecosystems that should be able to interlock pretty well, with two very high-class regulators that work well together.

That will not always be the case in other countries. That is not a criticism. It is just that they will be at a different stage of development, or their regulatory approach will be different, and an EFD may offer an opportunity. In an ideal world, I would like to see a ramp and you develop from mechanism to mechanism until eventually you reach the sort of relationship that I hope will be possible between the UK and Switzerland and, conceivably over time—the ambition is certainly there—between the UK and the United States.

Dr Gerard Lyons: I agree. One very important point is that the UK now has its own seat at the WTO, and, particularly given how the WTO has evolved in recent meetings, there is potentially an important opportunity there.

Rachel Kent: I agree very much with Miles that free trade agreements are at the top of the tree. I was perhaps mildly disparaging earlier about their ability to deliver proactive change, as opposed to defensive national treatment-type fair mechanisms, but I also agree with Miles that all eyes are on the Swiss agreement to see whether we can move the market there and get something. Whether we call it mutual recognition or something more akin to equivalence, such as deference, whatever we call it, that would move the needle.

The other mechanisms that you mentioned tend to be less about legally binding obligations and more about discussions. Of course, sometimes, depending on the circumstances, it can be easier to have something that is an informal discussion than very prescriptive processes. Horses for courses is my answer.

The Chair: We come to our most patient colleague and our final question, Baroness Couttie.

Q16 **Baroness Couttie:** Thank you. Much of what I was going to ask about has been covered in answer to the question about the opportunities that we can take advantage of post Brexit. I would like to delve a bit into what the Government can do to make sure that we take advantage of those opportunities. Also, looking ahead a few years, do you think there will be any overall structural change to the financial services sector in the UK as, hopefully, we take advantage of these opportunities and, indeed, as perhaps some of the threats come to roost? I must declare an interest; I am deputy chairman of the Guernsey Financial Services Commission.

Miles Celic: On what Government can do, first, they could continue to make the targeted changes that they are making to the regulatory regime here in the UK. I think they have taken absolutely the right approach by being open. They have granted almost all equivalences to the EU. They have avoided taking a regulatory tit-for-tat approach with the EU. They have avoided a bonfire of regulations, but they are being very forward thinking, as we have seen with the Hill review, the Kalifa review, the review that is going on to carbon market trading and so on.

I would like to see the Chancellor continue to build on the vision that he set out at the Mansion House in June last year. That was very welcome. It was something we had called for for some time, and the Hill review's proposal for a state of the City speech and report will, over time, hopefully become a very helpful, regular drumbeat of what is happening in the industry.

What was very notable in conversations that we had in Singapore, Switzerland, the United States and so on was that, for a certain amount of time after we left the transition period, people were asking, "What is the vision for this part of your economy? It is your critical path, it is your national competitive advantage, and we are very unclear about what direction you will go in". Some of that, as I understand it, was a reluctance to get too far into the detail as a result of the potential consequences for the EU-UK Brexit negotiations, but we are now beginning to unfold that. As I have already touched on in this session, that is a huge lift, a huge amount of change. We think that industry should play its part in delivering that, as should the regulators.

This is, as I say, a shared national asset, so we would like to see a financial and related professional services council, on the same basis that there is a Life Sciences Council, that brings government, other parts of the public sector, and the private sector together. That is not just about Treasury; we already have touched on the importance of DIT, DCMS when it comes to data, the Home Office when it comes to visas and mobility, BEIS for the role that it plays in relation to the wider economy as well as the accounting elements, and the MoJ for the legal elements. This is a cross-cutting industry with responsibility across the breadth of government, and that needs to be reflected.

I expect substantial structural change. Mark Hoban, the former City Minister, who I think you are familiar with, chaired a piece of work for us, which PwC did in 2017, on the vision for the industry post Brexit. The reality, I fully expect, is that that this industry will at least continue to be 10% of UK GDP and to be the most successful exporter of its type in the UK and the world, but it will look different. I think that ESG, the infrastructure around fintech rather than necessarily fintech itself, data and the role of the centres elsewhere in the UK outside London are all up for change, and it is exciting.

Rachel Kent: I agree very enthusiastically with everything that Miles just said, with the possible exception of structural change, which I cannot say will not happen. There will be lots of innovation, but I do not know whether that will amount to structural change.

The only thing I will add is that work is already going on in the Treasury to look at the international access regime. We have spoken a lot about our domestic regulatory regime once you are here, but it is also important to look at whether we could make more equivalence decisions, what our perimeter looks like, what our exemptions look like, how easy it is if you are an overseas firm wishing to establish a business in the UK, and that work is already under way.

Dr Gerard Lyons: I echo what has been said. The Hill report calls for the Chancellor to make an annual statement to the City. I agree with that and would take it further. The Chancellor and other senior politicians meet regularly with City people, and TheCityUK and other organisations represent themselves and their view. I argue that there needs to be an annual meeting, or maybe more regularly, which produces a report that is made public, a barriers to business report, where there is a discussion from the business side—"These are the barriers"— there is a government response as to how things will move forward, to make sure that we are on the front foot and to continue to be ahead of competition.

There are many areas where the City can do well, but we need to push the global message, which does not always convey very clearly. One area that we have not talked about today is how the world economy is changing. The strategic review last year, which was not to do with the City, talked about the Indo-Pacific—that is, right from India in the west to America in the east—digital data revolution. All that matters for the City, but the Commonwealth is also very important, and the Commonwealth has the same legal system. If one looks at growth opportunities and demographic changes, London is in a very strong position—the UK is in a very strong position, I should say—to leverage more off those connections. It is basically about taking advantage of things that we already have in place but do not leverage enough of, and we can contribute naturally to those countries' domestic development as well as global development.

Miles Celic: I agree. We should not lose sight of international comparators. The UK is falling behind on competitiveness, on tax, on banks in particular. For instance, we need to make sure that we have the right regulation in place and are continuing to attract people, which is the single biggest issue for most of our members—getting the right talent, both domestically and internationally, into the UK.

Baroness Couttie: Thank you very much.

The Chair: I add my thanks to all three of you on behalf of the whole Committee. You have given us a lot of very interesting evidence for nearly two hours. Thank you very much.

Miles, you promised to write to us on the timing of the equivalence decisions. We would be very grateful for that. We would also be very grateful for some metrics. It is not that we do not, through our staff, have access to an awful lot of metrics, but it is interesting for us, given the points that you were making about the context of metrics, to see which ones you think are interesting. If you are able to give us metrics particularly on what has been a success and what has been less of a success since Brexit, and the various growth figures that came through it, that would be very much appreciated by us. In the meantime—

Lord Tugendhat: Could I go right back to the beginning when you talked about jobs moving away? Is it possible that the pandemic has made a difference? Business practices have moved a long way on Zoom and Teams and all the rest of it. Might some jobs have moved, if you follow me, because people have changed business practices as a result of Zoom and so forth?

Miles Celic: Covid is certainly a factor. It may have paused some moves from the UK to the EU, or indeed from the EU to the UK. Something that has not come up is the number of European companies that have applied for licences here in the UK. The thing that would give me pause would be if, ultimately, for activities that are regulated activities, the regulation remained national or, in the case of the EU, within the EU. I expect that the UK regulators would be very uncomfortable with people who they have no regulatory sight over operating for UK companies, and vice versa for European companies.

The Chair: Thank you very much. We will take the nod from Rachel as saying the same thing. I repeat my thanks, and with that I declare the session formally over.