



The Select Committee on the European Union

Financial Affairs Sub-Committee

Corrected oral evidence: Brexit: Financial Services

Wednesday 7 September 2016

9.55 am

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Members present: Lord Butler of Brockwell (The Chairman); Lord Desai; Lord Haskins; Earl of Lindsay; Lord Shutt of Greetland; Lord Skidelsky; Lord Woolmer of Leeds

Evidence Session No. 1

Heard in Public

Questions 1-9

Witnesses

I: Professor Eilís Ferran, Professor of Company & Securities Law, University of Cambridge, and Professor Sir Charles Bean, Professor of Economics, London School of Economics.

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Examination of witnesses

Professor Eilís Ferran and Professor Sir Charles Bean.

Q1 The Chairman: May I welcome Professor Ferran and Professor Bean on behalf of the Committee? This is a formal evidence session. You have in front of you the declarations of interest of members of the Committee just so that you should be aware of them. A full transcript will be produced and put on the public record and on the parliamentary website. You will be sent a transcript and will be able to revise it in terms of any minor errors. The session is on the record and is being broadcast, and it will be accessible subsequently via the parliamentary website. Would either of you like to make any—brief, preferably—opening remarks?

Professor Sir Charles Bean: As far as I am concerned, let us go into questions. I do not have an opening statement that I want to make. I do not know whether my colleague does.

Professor Eilís Ferran: I do. I have a few remarks to tell you where I am at on this. For me, although there is a lot of uncertainty, the future, is outside the European Economic Area, not for reasons of free movement of persons but because I think that that is the best way of ensuring a degree of regulatory flexibility in the longer term. It is a bespoke model that we need to look at. The existing alternative models do not really work for financial services in my view, and there needs to be a distinct arrangement. We can talk about the details of that, I am sure.

My second point is that, although there is a great deal of attention on the need to ensure that the industry is able to continue to thrive, I would like also to emphasise the importance of ensuring that supervision continues as seamlessly as possible. The UK will have to step outside the EU system of financial supervision, but the reasons that made that system necessary are still there and we have to ensure that we preserve as much as possible of that and not turn the clock back in that respect.

The Chairman: Thank you very much. That is very helpful. Could we start, as it were, on the general question of what your expectations are for investment and the economic climate over the short to medium term? Do you foresee a prolonged period of uncertainty, and, if so, how do you expect it to affect the day-to-day running of the industry? Professor Bean, perhaps particularly addressed to you, what impact do you think Brexit will have on the UK public finances and the overall economic environment of the country? The effects so far seem to have been rather less than the doomsayers said before the referendum. Professor Bean, would you like to start on that?

Professor Sir Charles Bean: On that last point, as I will explain in a moment, I think some of the recent indicators have been greeted a little too enthusiastically. The picture is a bit more mixed. Certainly what most, if not all, economists expected was that—at least in the short term—there was likely to be a slowdown in growth, essentially because the heightened



HOUSE OF LORDS

uncertainty was likely to lead businesses to put investment spending on hold. There is plenty of evidence from past experiences where there has been heightened uncertainty of that happening. Clearly, particularly for foreign businesses that might be expecting possibly to locate to the UK, while the nature of our relationship with the rest of the European Union is unclear, they might want to hold off on that—and similarly for businesses that might be expanding. So most economists expected to see a weakness in business investment going forward.

Investment intentions have been weakening through the year. The question is what that maps into in reality. To give you some numbers, the central expectation from the Bank of England was that business investment for this year would contract by a bit over 3%, a further 2% next year, and then recover in 2018. That compares with a pre-referendum viewpoint of reasonably robust growth in business investment. It translates across into GDP growth of about 1.75% for this year, about 0.8% for next year and then picking back up to a little under 2% in 2018. Most City forecasters and most independent forecasters are in pretty much the same ballpark. The pre-crisis Treasury document is not so far away from where the Bank forecast is; the Bank's forecast has GDP two years out from where we are about 2.5% below where it would otherwise have been. The Treasury's document, which it released during the campaign, had 3.5%, and half of that difference can be accounted for by the monetary actions that have been taken by the Bank of England. The Treasury had a slightly faster slowdown in the near term.

That is where the economic forecasters are. The one thing I want to stress is that there is a huge amount of uncertainty here. There is uncertainty in the world and that extrapolates across into uncertainty about economic forecasts. We are only two months on from the referendum. We have next to no hard information about what is going on—some business surveys, and really that is about it. A lot of the consequences of the uncertainty, particularly for business investment, will show up only over time.

I said that I think some people have overreacted to some of the recent indicators, particularly if you look at the purchasing managers' indices. They fell very sharply in the first release after the referendum, implying contraction. Only the ones released in the past few days have bounced back into expansionary territory. A lot of people make the mistake of thinking of those as telling us about the level of activity, whereas they really tell us about the growth. If you have a sharp contraction in one period, you need an equally strong expansion the following period to offset that. So it is better to look at the two months together, and they are averaging round about 50, which corresponds to broadly flat output, whereas before the referendum campaign got going, if we go back into last year, the economy was growing at round about 0.5%, or a little bit more, per quarter. That corresponds for the purchasing managers' index to numbers like 55 or 56. So the underlying picture at the moment does not suggest that the economy has just shrugged off the Brexit result. The real issue is that it is too early to draw a firm conclusion. We will learn



HOUSE OF LORDS

over the course of the coming months and quarters, as we get GDP releases, firmer information about what is going on, and about how much of a drag the uncertainty created by the result will exert. Clearly, the sooner the uncertainty is resolved, the faster that will go away.

The Chairman: Thank you very much. Professor Ferran, do you want to add to that?

Professor Eilís Ferran: I want to stress the critical importance and risk of legal uncertainty in this respect. One thing that has made the UK, and London, such an important hub is the fact that its legal system is certain and predictable, and so the shadow of what comes next hanging over us is a critical risk, in my view. So the sooner the shape of the exit terms becomes clear, the better that has to be. That has to be a priority so that industry can start to plan ahead. The prospect of a cliff edge and that cliff edge getting closer and closer is one that we should be very concerned about.

The Chairman: Can the Government do anything about that—for example, by declaring that EU regulation, as it is, will continue until there is a change so that a period of stability can be forecast?

Professor Eilís Ferran: At one level, it will continue until it changes—we remain a member of the EU and we continue to have those rights and obligations—but what is needed is a clear sense of what the change is going to be like. So the Government could—and I think this would be a wise course—indicate that, in the short term, we will be keeping the body of EU financial regulation effectively intact, and will be bringing home pieces of legislation that are currently in the form of EU directly applicable requirements and taking steps to turn them into domestic legislation. So there is a way of providing predictability for the period post the exit that will provide very important reassurance.

Q2 **Lord Skidelsky:** I am going to ask a question about the revenue implications of not just the period of uncertainty in which growth may well slow down, but on the expected profitability of the financial services sector, which has been a large revenue source for Governments. That is not just because of the uncertainty but because of the shape, as Professor Ferran said, of the exit terms when they are known. The implication of that is that, on given policies, there will be a widening of the budget deficit. Do you think that that is a reasonable conclusion to draw? I do not know whether you would like to venture an opinion on what the response to that by the Treasury should be.

Professor Sir Charles Bean: Certainly, if we confine ourselves to the shorter term, if there is a slowdown, and let us say it is of the order of the Bank of England's central projection, with output a couple of percentage points lower than it would otherwise be, broadly speaking that translates into about £15 billion less in tax revenues. The exact numbers depend upon the precise mix of demand and all those sorts of things, but that is the order of magnitude. As one goes further out, of course, the crucial



HOUSE OF LORDS

thing is the nature of the settlement with the European Union. If we minimise the trading costs associated with Brexit and maximise the opportunities that are made possible by leaving, clearly the impact on GDP and tax revenues would be less than otherwise.

The one thing that might be worth adding in here—you mentioned the profitability of financial services—is that, if you are putting more grit into trading with European markets, that is going to have an adverse effect on profitability and you may lose some business and so forth. But there are lots of other challenges out there in financial services. There is the shift in economic activity towards Asia. We are in a world of sustained lower interest rates than we were, reflecting the lower world real interest rate that is consistent with a reasonable level of activity. As you will certainly be aware, there has been a lot of discussion of this in the academic literature. The so-called 'secular stagnation' thesis suggests that we might be in this world of very low real interest rates for a long time.

That has implications for the sustainability of lots of different business models. It includes banks but also asset managers, pension funds and so forth. It is easy to think that handling Brexit is the only thing that really matters, but there are a lot of other challenges out there to the financial services sector. There are also opportunities and, when it comes to ensuring adequate profitability, the key thing is seizing the new opportunities, some of which might be associated with increased trade with Asia, increased financial services there, and new developments such as fintech. The prospects for the profitability of the financial services sector are going to depend as much, if not more, on those things as on exactly what the Brexit deal is. Having said that, the better the deal the UK can get, obviously the better it is.

Q3 Lord Desai: Assuming that we will have our passporting rights withdrawn, how would that affect the market, with firms moving out, as well as other things the firms will do to compensate for loss of access to the EU?

Professor Sir Charles Bean: The key thing about the current set-up is that clearly with the passport you can either sell services into, or you have the right to establish a branch in, another EU member state. Removal of that right removes the right to establish a branch, but MiFID still allows you to sell cross-border financial services provided that the regulatory regime is regarded as equivalent. A key thing will be whether that equivalence is satisfied.

Secondly, it will matter a lot where the firm in question is mainly operating in wholesale financial services where it can sell its services cross-border or whether it needs to connect with retail consumers. If you need to connect with retail consumers, you basically need to physically operate in the member state, and the loss of passporting rights will essentially mean that firms will need to set up subsidiaries over there.



HOUSE OF LORDS

If you look at the major banks—the non-EU banks that are headquartered in London at the moment—many of them also have subsidiaries already in other parts of the European Union, so they can still retain the access that they need; but then the question will become to what extent they need to transfer activities that are currently undertaken in London across to the member state. This is partly about what makes economic sense for the business itself and it will partly depend on the home state regulator. It may well insist that the subsidiary has lots of supporting services.

To make this concrete, to show that this is not something that is peripheral, I can remember discussions at the Bank when Santander was generating a presence in the UK but there were concerns about the stability of the Spanish banking system. The Santander operations in the UK relied for their back-office functions on an entity in Spain. A key question for us was whether, if the parent back in Spain got into trouble, even if the operation in London was fine, it would still have access to all the necessary back-office functions. There is a natural tendency for supervisors and regulators to want ancillary services to be there supporting the subsidiary to ensure that, even if the parent got into trouble, the subsidiary would still be able to function well. So how much gets transferred out of London into member states will depend both on the economics as far as the business is concerned and the response of home state regulators.

Professor Eilís Ferran: Without getting into the detail of it, I think we should be careful about assuming that there will be equivalence solutions across the board. There are not. There are key areas that are not covered by equivalence. For example, the area of payment systems is one that is critically important and not covered. If we look at MiFID and MiFIR, yes, it is true that wholesale services will be covered under the new regime, but retail will not, and indeed that will depend on a member state by state permission to provide retail services. Another area that I would pick out as being hit in a significant way will be the asset management industry. All the European fund brands, UCITS and the like, will no longer be available to UK funds and fund managers; so we will then be in the very complex world of being a third country under the notorious alternative investment fund managers directive—AIFMD. The third-country provisions of that stand out as one of the most complicated and unsatisfactory sets of EU post-crisis law. The passport under that regime for third countries comes at a heavy price, namely, having to comply with EU law in that respect. So the world will be significantly different there.

One obvious problem on the horizon is with respect to clearing houses that do euro trades. We saw that when we were a member state the UK was able to resist the ECB's attempt at location policy, using its right as a member state to challenge that in court, and using its protections from discrimination as a member state with respect to currency or location. It is very likely, it seems to me, that the ECB will reopen that issue and want to have an extended competence in that regard. Although there has been some suggestion that this may be a problem that is disappearing because



HOUSE OF LORDS

new technology is going to change the way that clearing and settlement is done, I am not convinced by that. I think that what will happen is that the existing clearing houses will probably incorporate that new technology into their business operations but they will continue as they are. So there is a major problem there that will not be covered under a passporting regime. That would be my sense of where things are in a number of areas.

Professor Sir Charles Bean: Can I endorse that? It is very easy to think that we can get equivalence in lots of areas. By definition, we are equivalent at the moment since we are part of the single market, but, in practice, proving equivalence and maintaining it is quite challenging. So the notion of it being across the board I do not think is plausible. In selected areas it may be perfectly viable. On the issue of euro clearing, I will not say it is likely that we will lose it: I will say it is certain that we will lose it. Independently of the economics of whether it needs to be in the eurozone or not, I have absolutely no doubt that it will be mandated to be taken back into the European Union.

Q4 **Lord Shutt of Greetland:** What are the most important priorities for the UK financial services sector, both in withdrawal negotiations and in negotiating a fresh future relationship, and where does free movement of people come in this?

Professor Sir Charles Bean: To start with the last question, part of the City's strength comes from access to a deep pool of skilled labour, and a lot of that labour comes from overseas. Something like 11% of the 360,000 people who work in the City are from other EU member states. Of course, there are also plenty from non-EU countries. That is clearly one of the several attractions of London as a place for business. Were access to that skilled labour to be seriously impaired, it would impinge on London's attractions. So a lot depends on the nature of the controls on migration that are put in place. Clearly, there is a debate going on at the moment on different models. We do not know what it is going to look like, but I would have thought, from the financial institutions' perspective—and that of many other employers, for that matter—the key is that whatever is there enables them to get the specialised labour that they need in a relatively efficient and smooth way. My worry is that some heavy bureaucratic process is put in place that takes a very long time to operate and becomes very cumbersome. Certainly, the more efficient whatever is put in place is, and with sufficient flexibility, if you like, for the City and other employers' needs, the better.

Professor Eilís Ferran: I agree completely with that. I will say three things on the broader priorities. The first is replicating as far as possible the current arrangements that we have with the EU, partly through equivalence, partly through bespoke provisions in the exit terms, and doing that as soon as possible so that we can avoid that cliff edge and businesses can start to plan. The second is thinking about the UK and the rest of the world. To the extent that the UK has access to international markets by reason of EU-brokered access arrangements, we need to ensure that those access terms are preserved and protected. The third is



HOUSE OF LORDS

thinking about where the UK repositions itself in international financial regulation. In the design of that it is important for the industry that the UK continues to play a very influential role. It is losing some levers of influence by not being part of the EU but gaining by being more independent and more able to form different coalitions. Figuring out how all that is going to work is very important for the industry and for the UK's interests as a whole.

Q5 Earl of Lindsay: Can I go back to the issue of equivalence, which you both touched on? You have both mentioned already some of the shortcomings and difficulties that would emerge if, as a third-country regime, we were hoping for equivalence to be, as it were, the saviour of financial services and the means by which they could continue to access the single market. Are there any other shortcomings or difficulties associated with equivalence that you have not mentioned that we should be aware of? If that is the destination that we end up heading for, how can we mitigate those shortcomings and difficulties to make the best fist of an equivalence scenario for our financial services?

Professor Eilís Ferran: Equivalence can take a long time. We saw that with clearing houses—more than three years between the US and the EU. That should not be a problem in the short term in the sense that we are, as Charles said, equivalent now, so we should be able to have that agreed pretty efficiently, provided that politics does not get in the way. I am reasonably confident on that. We do need also to think about future-proofing. As to the Swiss relationship with the EU and its special bilateral treaties, one of the big problems there has been the need for renegotiation every time something changes. Because financial services move very fast, there will be new issues and we will start to diverge, so we need to think about what the mechanisms will be in the future so that we do not have to keep going back and doing an equivalence check every time there is a change. We need a streamlined process and a degree of certainty over when that will be triggered so that there is room for manoeuvre on both sides. For me, it is very important that we think about that.

Professor Sir Charles Bean: To be honest, the only way I could see equivalence operating on a long-term basis is that, if we want to sell services under an equivalence basis, we would just have to accept that we would be adopting whatever regulations the European Union decides to adopt.

Professor Eilís Ferran: Can I disagree with that?

Professor Sir Charles Bean: You can certainly disagree with it, but it will be quite difficult for us to think about this as a negotiation every time. There may be some small areas where there is some flexibility, but I think that we will see ourselves as predominantly being driven by decisions by the other European member states.

The Chairman: Professor Ferran, this is your chance to negotiate.



HOUSE OF LORDS

Professor Eilís Ferran: I agree in the short term that we are the ones trying to disturb the status quo, and that is a weak hand, but over the longer term—equivalence is not about being identical; it is about getting to the same outcome, and that has been very clear in our negotiations within the EU with the US and the like. There will be new issues and new problems. The UK has a very good record of being an effective first mover. It was ahead of the EU on bank resolution and other areas as well. So there is plenty of room, I think, for the UK to take the lead in solving new problems, and, in a sense, that first-mover advantage will allow it to set the agenda in equivalence negotiations. So I am more optimistic.

Earl of Lindsay: Can I check your optimism, when you said that there should not be delays in negotiating and agreeing equivalence because you do not think politics will get in the way? I am interested to hear you say that, because there seemed to be political signals from some players on the European stage that suggest that politics might get in the way. Can I raise one other point, Professor Bean, that your colleague Professor Moloney at the LSE has raised: that equivalence is not just about regulatory equivalence but about supervisory and enforcement equivalence, and that making judgments about supervisory and enforcement equivalence is much more difficult? Is that a real issue that we should be wary of?

Professor Sir Charles Bean: It certainly is a real issue, yes.

Earl of Lindsay: Can I go back to the first question, then?

Professor Eilís Ferran: Yes. Why I am relatively optimistic about politics not getting in the way is that, one, the EU needs us as much as we need it. If we look at, for example, the flagship Capital Markets Union plan, it is about opening up new sources of finance and new investment opportunities. Cutting out the UK as a market, both for us to provide services there and for the EU firms to provide services into the UK, is not wise in that respect. Secondly, both the UK and the EU are committed to open markets. We saw that again this week in the G20 communiqué—there was a reaffirmation of that—and they both care about their international profiles and being able to influence the international agenda. Erecting fortress Europe would cut across that. My third point is one that picks up on a recent paper by Niamh Moloney, who is a close colleague of mine as well—we work together a lot. She has made the point that the rise of the European supervisory authorities and the role that they play in determining equivalence is one that brings a very strong technical expertise to it. I would hope from that that there is a buffer zone in these processes that will act as a shield against political interference.

Q6 **Lord Skidelsky:** How would financial regulatory co-operation between the UK and the EU change or be affected under different models of EU membership—the Norway, Switzerland, WTO options? What motivates my question is that the reform of the banking system since 2008 is work in progress. Under any of these regimes, we would lose our influence over that work as it is undertaken by the EU. We have reservations about



HOUSE OF LORDS

many of the macroprudential instruments that have been put in place. We have great reservations about tax on bonuses, just to take one example. Would not the effect of that loss of influence be quite serious, because much of the work is really directed to the particular problems of the eurozone and we would just lose our input into that?

Professor Sir Charles Bean: First of all, there are some areas where we will be just as influential as we are now, if not more so—most obviously in things like bank capital requirements. The Basel Committee is the key body there, and things like the Capital Requirements Directive, and so forth, are just implementing agreements that are made at Basel and have the imprimatur of the G20. So that sphere I would not be too concerned about, and a lot of what goes on there is building alliances with the Americans, with Asian countries and so forth. There are, though, other areas. You raised the bankers' bonuses issue. That is not something that we have been particularly in favour of, not because we like people having big bonuses, but if you restrict the size of bonuses you restrict the elasticity of remuneration with respect to performance, and, particularly if you want to penalise people for bad performance, you need potentially quite a chunky area there. So it seemed to us that that was not helpful.

It certainly is true that some of the initiatives in Europe have been focused on issues that are not primary. There has been quite a lot of attention from some countries on reining back hedge funds. Hedge funds were not the source of the financial crisis: they were bit-part players at most, but they are often the messenger; they are the people who are betting against unsustainable positions, and in the case of the eurozone debt crisis, of course, they looked like the villains. But it is a case of shooting the messenger if you are trying to rein them back, in my view. Certainly, quite a lot of the initiatives taken in Europe are focused on the particular issues as seen within Europe. Europe is a very bank-centric financial system. They are starting to get more concerned about diversifying forms of corporate finance. So starting to move into other areas of regulation and the like. Certainly, there will be some areas where we will not have much influence on what they do other than where supervisors meet in fora where they can discuss these issues and we can pass on our views. But it is not the same as being around the table in the relevant fora, whether it is ESMA, EIOPA, the EBA or discussions between Governments at Ecofin and so forth. We have to accept that we will be on the sidelines of some of those discussions.

Professor Eilís Ferran: I agree on the importance of international standard-setting fora. That was one of my priorities earlier, and the UK's influence in that will still be significant. I accept that if we went for the Norway model we would still be an observer in EU processes, but the drawback of that model is that it then ties us in to following the EU. Having said earlier that I think there are opportunities for us to lead in regulation in the future, the trade-off there for me comes out as being in favour of giving up that influence as an observer within EU processes for other things.



HOUSE OF LORDS

If I could just add one point on bankers' bonuses, having said that I was optimistic, relatively speaking, about coming to a sensible deal on equivalence, if we want to scupper that possibility, the best way of doing that would be to start picking a fight over bankers' bonuses. We should leave that for now and move on to other things.

Lord Skidelsky: But we are in a stronger position than Norway to influence the shape of our settlement.

Professor Eilís Ferran: That is true. We are in a stronger position now, and in the future I think we can influence in other ways, notwithstanding that we are not around the table in the EBA, for example. We will still be in the supervisory colleges. We will be there as an observer rather than a member, but my expectation would be that those discussions will be ones that are fully open to the UK's participation.

Lord Skidelsky: Can I ask one other supplementary? It seems to me that the trend of financial services reform, or the mood, I should say, is one of repressing the scope of financial services to some extent, which goes directly against the philosophy of the City of London and the position of the City in our economy. Is there a tension there that will become more acute from the fact of our leaving?

Professor Sir Charles Bean: It is a fair statement of the facts that there is, shall we say, suspicion of Anglo-Saxon financial markets in many other EU member states, and at a superficial level they think that it was that model that led to the financial crisis and that is a huge real-economy cost, so it needs to be reined back. London is the only big global financial centre in the European Union. Most of the other financial centres are really focused on their domestic markets, and it is about providing finance for consumers and businesses and so forth in a relatively straightforward way. They have a very different perspective on the matter that they are dealing with. It is fair to say that, while we have been in, we have been able to put the other side of the case and to try to make the case for more liberal markets, or whatever it might be. That will be harder on the outside. We do not have to stay silent, obviously; we can try to make our case in the relevant fora, but we will have less traction. We have to accept that.

The Chairman: May I ask one supplementary under this heading? Switzerland is a country with a strong financial services tradition and industry. Has its financial services industry suffered by it not being a member of the EU?

Professor Sir Charles Bean: There is always a question about what the counterfactual looks like—what it would have looked like if it had been in. Of course, if you have arrangements like Switzerland, you are outside but you have some dealings with the European Union and you find ways to work with whatever the set-up is. People in financial institutions are very good at working out how to deal with whatever the set-up is and what is the profitable way around obstacles and so forth, whether that is having correspondent banks within the European Union or whatever it might be.



HOUSE OF LORDS

It is very difficult to answer the question in the way you put it: would Switzerland have been much better off had it been a member of the EU with full access to the European Union financial markets instead of the arrangement that it has, which really just has equivalence on insurance, but nothing special on the banking side?

Lord Desai: I have one supplementary, which is a sort of counterfactual. The resentment of financial markets is as much in the UK as outside. They may not like Anglo-Saxon capitalism, but some of the people who voted for Brexit actually did not like the way banks worked.

Professor Sir Charles Bean: Yes, absolutely.

Lord Desai: Do you think that the Government will be able to take a stance in negotiations that would be really protective of City interests or will they let go? I know that that is a political question.

Professor Sir Charles Bean: It is a political question and I am an economist. So my view here is just like that of any other punter, if you like, but I think you are right that it would be quite difficult for the Government to have a negotiating stance that said they are going to prioritise the interests of the City ahead of, say, migration control or any of the other myriad issues that will be involved in this. I do not think that that would go down well domestically. Clearly, they can make the case that it is important, as a big foreign revenue earner for us; it is getting on for 10% of GDP, with something like £60 billion net earnings from it and so forth. So they can make the case that it is important that there are arrangements that allow the City to prosper. But something that looked like it was prioritising the interests of the City ahead of other things would be quite difficult to sustain. But as I say, that is politics; it is not my sphere.

Professor Eilís Ferran: I would say that it is very much in everybody's interests that we have a safe, secure and resilient financial system. We need our payment systems to work. We need settlement finality. A lot of things are currently up in the air as to how they will operate, and I think it is a priority, not for the profitability of the City of London in itself but for the well-being of society, that we ensure that the system that we have with all of those checks that are in place at the moment is continued and that the checks are not disturbed by any kind of fragmentation post Brexit.

Q7 **Lord Woolmer of Leeds:** Professor Ferran, you started with an opening statement that mentioned the advantage of a bespoke arrangement. Could you set out the main features of a bespoke trade agreement that would best maintain the position of the UK's financial sector? Which arrangements within that bespoke deal are most likely to be acceptable to EU negotiators and which would be the most difficult to achieve, because a lot of our discussions in the UK seem to assume that the EU members have no views about this and are just waiting to know what we are demanding? It would be helpful to know what the EU would want out of these negotiations.



HOUSE OF LORDS

Professor Eilís Ferran: I would suggest that we have an early agreement on a badge of equivalence in areas where there is an equivalence regime currently in the EU framework; that we come up with something similar in each of those different areas where there is equivalence regime in the current EU framework; that we agree on issues of legal certainty, for example around settlement finality; and that we do all of that as quickly as possible, recognising that politics will come into the timing of things. There are some relatively easy wins on some of the technicalities. For example, there should be an easy win with respect to how the treatment of exposures to the UK held by European banks will be worked out for capital adequacy purposes. Those exposures currently benefit from a favourable treatment because they are EU. We need a quick equivalence agreement in relation to those. That is for the benefit of European banks and is an area where we can perhaps easily sort things out and get rid of politics in equivalence.

There are potential easy wins, too, in ensuring supervisory co-operation. We can use the fact, if we come back to MiFID, that the UK currently has a really rather generous overseas person exemption allowing third-country firms to provide investment advice and services in the UK without a local authorisation. That is not replicated across the EU. I think we have a bargaining chip there in what we are able to offer to firms coming in. As to where the greatest difficulties are, it is hard for me to pick out one area and say that it is likely to be the absolute sticking point. It is the volume more than anything else that worries me and how you work through each of the issues. At the operational level, if in future our MiFID trading depends on our firms being registered with ESMA, which it will under the current regime, and we want to have an equivalent type of registration regime, we need to get going quite quickly on those operational things as well. ESMA is not a well-resourced institution. We do not want to find ourselves having a very nice framework but operationally things getting gummed up in the system because there is just an overwhelming body of applications to process. I would look at that as well.

The Chairman: Professor Bean, do you want to add anything?

Professor Sir Charles Bean: I do not have much on the specifics. I would just make a more general observation that what we want to give is, if you like, a quid pro quo in the negotiations, is something that our European partners will want. Going back to what I said earlier about London being really the only global financial centre in the European time zone, clearly for financial companies in Europe there are advantages to them in being able to operate relatively freely in the London market. London is partly built on the idea of welcoming outsiders to operate—the “Wimbledonisation”, as it is sometimes referred to, of the City.

Professor Eilís Ferran: That was before Andy Murray started winning.

Professor Sir Charles Bean: That is true, yes. The other thing is that when it comes to corporate finance, because corporate finance is relatively underdeveloped relative to bank finance in a lot of the European markets,



HOUSE OF LORDS

the European corporates often, when they are looking to raise finance other than through banks, will come to the London market. They want access. Looking to exploit the things that we can offer in return for things that we want makes some sense. But that is a rather general, high-level observation.

- Q8 **Lord Haskins:** I want to raise the issue of uncertainty and the degree and the length of the uncertainty. My background is in dealing with the manufacturing side and dealing with foreign direct investors in the north of England. Their position on this is, basically, to sit tight, wait and see. They can do that for quite a period of time. Saying nothing is happening is absolutely right—nothing is happening—and that is a worry; but in our discussions with the City just before the break I got the impression that things were already happening and that people could not hang around. It is much easier to make a decision to move people from one place to another than it is to build a new car factory in one place rather than another. These things take a long time to come. The worry I picked up from that was that the City was already walking, and we indeed talked to two or three people there who were already moving. During that period of prolonged uncertainty—and it is likely to be prolonged—how can the Government maintain the confidence of the City such that it does not do rash things too quickly?

Professor Sir Charles Bean: One thing that might be advantageous would be to try to have a reasonable transition period. If you are going to relocate activities to another EU member state, particularly if you have to set up a subsidiary from scratch, getting the authorisations and so forth, takes time; it can take as long as a year. You have to set up associated systems; then you have to move your staff across. It can take quite a long time to plan it, execute it and go through all the process. If you think, okay, the button is going to be pressed on Article 50 on such and such a date and two years after that to the day, whatever happens, we will have whatever deal that has been agreed, whether it is WTO or some bespoke agreement, that does not leave you that much time to execute it.

Certainly, it would help firms if they knew that, even if the negotiations were going to be concluded within two years, there might well be some transition period afterwards. That would mean that they would not need to worry so much about starting to move now. I am sure that they will already be planning what they might do under certain models, but, until you know exactly what the model is, it is a bit precipitate to take hard decisions to start moving. The more that you think that there will be a transition period after the actual implementation of Brexit, the less need you will have to move now. That is one thing that might be useful. It may not quite be in the Government's gift to say, "Yes, you will have it", because it may depend also on our partners, but they could at least indicate that it would be something they would go for. Frankly, as far as our partners in the negotiation are concerned, they do not want to see disruption in financial markets. That does not help them. They would want the process to be executed smoothly too.



HOUSE OF LORDS

Lord Haskins: You do not think people are going to make precipitate decisions in the short term.

Professor Sir Charles Bean: Some might. Frankly, if you are a business where it does not really matter too much where you are, you might as well move now.

Lord Haskins: Like the big American banks, for example. They could move. They do not take a year. They do not have to carry out all the set-up that you are talking about.

Professor Sir Charles Bean: The thing is, if it is very easy for them to move, you do not need to move so precipitously. You do the planning. I am sure that there is lots of planning and I assume in your inquiry you will talk to people from institutions who will be able to tell you exactly where they are. I think a bank or any other financial institution, for that matter, would be very remiss if it was not doing all sorts of contingency planning. Unless it is either pretty irrelevant where you are, or you are really worried that it will take you a long time to execute a switch, it does seem to me unwise to be moving before you have to. There is an option value to waiting. That is why firms hold off investing—there is a value to them to waiting—and, equally, there is an option value to not moving yet.

Q9 **Lord Shutt of Greetland:** Can I put this to you? I think that all your answers this morning are there or thereabouts where I had expected them to be, and I am not unhappy in one sense, but it seems that what you are really saying is that we should hug the existing arrangements and the EU as much as we can. Let us hug it. How does all that fit with this “Brexit means Brexit” rhetoric? Is this what these Brexiteers want and what so many of the British people said—“Yes, this is what we want; we want out of all this lot”? What you are saying is, “Hug it”.

Professor Eilís Ferran: I do not think that financial services were perhaps the driver for many people’s decision to vote in the way they did. As to hugging, I am saying that we should hug in the short term. In the longer term, there will be opportunities to do things differently while remaining equivalent and while remaining within the bounds of international financial regulation. We can more easily be super-equivalent, for example, and we can be a first mover in solving new problems that come along. We can also, I think, look at developing parallel regimes—EU compliant and non-EU compliant—to cater for different groups of market participants as well. “We can start to release the bear-hug over time” would be my view of things.

Professor Sir Charles Bean: My picture on this is that it is a case of wanting to minimise the costs and maximise the extent to which you take advantage of the opportunities, but of course the interesting question is when there is a trade-off between those two. If preserving access to the EU under some equivalence arrangement or whatever involves having an adverse impact on your competitiveness in a way that it impacts your



HOUSE OF LORDS

ability to compete on the global scale, you are faced with a trade-off and you have to decide where you want to be on that.

As I said earlier, it is very easy to get focused on the problems of extricating ourselves from the European Union and the adverse consequences that might flow from it, but there are also an awful lot of opportunities out there. There are big challenges in financial services because of the changes that I mentioned earlier and the rise of Asia and the low-interest-rate world, but there are lots of opportunities, too. The key challenge for the City collectively is to try to seize those opportunities and make a success of them. In the past we had a good record, when the world changed, of actually embracing and taking advantage of it, instead of pushing back. The central issue, when it comes to thinking about what the new regulatory environment is and so forth, is how you balance the two objectives of minimising the costs of withdrawal and maximising the extent to which you can take advantage of the opportunities. And there will be times that they conflict, I have no doubt about that.

The Chairman: May I thank you for your admirably clear answers? Is there any further thing that either of you would like to say without which the evidence you have given to us this morning would not be complete? Ladies first.

Professor Eilís Ferran: Not me.

Professor Sir Charles Bean: Not from me.

The Chairman: We are very grateful indeed. Thank you very much. That ends our first public session.