



The Select Committee on the European Union

Financial Affairs Sub-Committee

Corrected oral evidence: Brexit: Financial Services

Wednesday 7 September 2016

11.05 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. 2

Heard in Public

Questions 10 - 17

Witnesses

I: Andrew Gray, Global Financial Services Brexit Leader, PwC, Anthony Browne, Chief Executive, British Bankers' Association, and George Hay, European Financial Editor, Breakingviews, Reuters.

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Examination of witnesses

Andrew Gray, Anthony Browne and George Hay.

Q10 The Chairman: May I start our second session today? I welcome Mr Andrew Gray, Global Financial Services Brexit Leader of Pricewaterhouse, Mr Anthony Browne, chief executive of the British Bankers' Association, and Mr George Hay, European financial editor of Breakingviews for Reuters.

Again, this is a broadcast session—a formal evidence session of the Committee. A full transcript will be taken. It will be put on the public record in printed form and on the parliamentary website. You will be sent a copy of the transcript and will be able to revise it by correcting any minor errors. The session is on the record; it is being webcast and will be accessible subsequently via the parliamentary website. You have a general statement of the declaration of interests of members of the Committee before you. Would any of you like to make an opening statement?

Anthony Browne: Can I make a very brief one? The UK banking industry—both UK banks and UK-based international banks, which we represent—clearly accepts the verdict of the British public in the referendum. We are committed to working with the Government and with Ministers to make sure that Brexit is a success. We are talking to the Government about that.

We think that it is important that we approach this in a way that minimises disruption, maintains financial stability and ensures continuity for customers, both in the UK and in the EU. It is important that it is seen in both ways. Customers in the UK are often served by EU banks that operate here, but customers in the EU 27 are also served by UK banks. It is important that they continue to get those services.

The Chairman: Mr Hay or Mr Gray, do you want to make an opening statement?

George Hay: No.

Andrew Gray: I will add to and reinforce the point that Anthony made. This is a complex issue that is not just about the UK versus the EU. Financial services are a global industry. Changes to the current environment will have implications across both the UK and the EU, as well as more widely in the international community.

The Chairman: Thank you very much. Could I start by asking you a general question? The value of your panel is that you cover specific sectors. It will be very interesting to know your answer in relation to each of the sectors. What are your projections for the investment and economic climate in the short to medium term? Will what is likely to be a prolonged period of uncertainty affect the day-to-day running of the industry? Would you like to take those questions? Who would like to go first?



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Andrew Gray: I am happy to start. We have been doing work with a number of clients across the sectors of banking, insurance, asset management and the financial market infrastructure, both in London and the rest of the UK and also internationally. There are several issues that our clients face.

There is a particular point around uncertainty as regards the timeline over which agreements may be reached. There is also uncertainty about what those agreements may be. That requires firms to look at options that they have and, potentially, to start to develop plans that enable them to have contingency arrangements in place that can be implemented within the timeframe that they have available. Clearly, firms are looking at the range of business activities that they perform and the extent to which they use various passporting arrangements.

There are questions around immigration. The UK financial services industry relies extremely heavily on overseas talent coming into the UK and London. Finally, the issue of the speed at which firms need to move relative to the speed at which the negotiations move provides a very complex situation. While a degree of certainty would be welcome, there is nevertheless a sense of realism that that may not come for some time.

George Hay: I echo those thoughts. Probably the key thing that investment banks, in particular, are worried about at the moment is that, as and when Article 50 is triggered, the clock starts ticking and you have two years. They are hyperaware that, if the answer at the end of that two-year period is not very positive as regards our equivalence with the rest of the European Union, they probably need to start doing whatever they are going to do in response to that now. The people I am talking to say that it takes a number of years to move a large number of people to various bits of the EU or to make big carve-ups of your business, in the way that may be required if we do not get a good deal. There is a lot of uncertainty. That will have some impact on business activity, I would say.

The Chairman: Is there any way in which the Government can minimise that by giving indications of what their negotiating parameters are at an early stage?

George Hay: The problem is that we are about to go into a negotiation that will potentially be a hard-nosed one. The issue is how much of our hand we want to reveal early doors, as it were. Clearly, from the bankers' point of view, it would be really helpful to have some idea of what the UK Government's position is—what kind of equivalence regime we want to shoot for. But, from a negotiation point of view, it may not be the best idea to show Europe exactly what we want, working on the assumption that we probably will not get what we go in and ask for originally.

The Chairman: Mr Browne, do you want to add to that?

Anthony Browne: Yes. What we would like, which we believe is in the interests of both the UK and the EU 27, would be to have the fullest



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possible bilateral access to the European market—as close as possible to what we have at the moment. That is in the interests of customers on both sides of the channel.

You raised the point about uncertainty. No businesses in any sector like uncertainty. It is very difficult to plan for that. The red line for the banks is being able to serve their customers. That is what they really do not want to put at risk. What they need is as much reassurance as the Government can give them about the road map towards an end deal. As George said, we totally accept that neither the Government nor we as an industry can try to negotiate in public. But if you are making big decisions about where and how you can serve your customers, against a background of triggering the Article 50 negotiations and potentially, at the end of two years, ending up with no agreement, and as it takes years to relocate activities from the UK to elsewhere—if that is what you decide that you need to do—clearly you need to start making decisions about this quite soon in the process.

As your previous witness, Charlie Bean, said, there is an optionality to waiting. There is a “wait and see” situation at the moment. But the more certainty the Government are able to give—we totally accept that this is a bilateral thing and that it depends on their discussions with other European countries—the less risk there will be of disruption to financial services and to customers across the EU.

Lord Skidelsky: What do you think the macroeconomic impact of the Brexit decision will be over the next two years? Obviously there will be a lot of uncertainty, but what will be the impact in concrete terms? Most of the central projections are for some decline in the growth rate. That will have an impact on public finances. What steps do you think the Government might take to mitigate that, assuming that the central projections are right and that this does not depend primarily on the shape of the settlement? In your view, what steps should the Government take to minimise the adverse macroeconomic effect of the Brexit decision?

Anthony Browne: We think that there are three different economic effects of the Brexit referendum result. First, there is the immediate market reaction. The banks planned for that immediately—there was obviously a big drop in sterling—and weathered the storm, largely, with the support of the Bank of England, which injected a lot of liquidity. There is then the longer-term macroeconomic impact, which is what you are referring to. As representatives of the banks, we do not do macroeconomic forecasts and do not advise the Government on what we think they ought to do. I note that so far it has not been quite as bad as some projections—

Lord Skidelsky: Did I understand you right? Did you say that you do not do macroeconomic forecasting?

Anthony Browne: There are lots of people in the industry who do macroeconomic forecasting, but we as a trade association do not do that. The industry does—banks do. However, as the British Bankers’



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Association, we do not do forecasts on behalf of our members. They do it themselves.

Lord Skidelsky: I understand.

Anthony Browne: The one thing that is a concern for the future goes back to the point about uncertainty and the shape of the deal that we have. That could have an impact. As I said at the beginning, what we really want to avoid is disruption to our financial markets. If you end up with cliff-edge effects and disrupting London's access to capital from Europe and vice versa, that could be quite disruptive. That is why we need certainty and want to have as much access to financial markets as we have at the moment across the EU. That would be the way to minimise the macroeconomic impact.

George Hay: The Bank of England has already given its monetary response to the Brexit shock. The obvious thing for the Government to do is some kind of fiscal stimulus, if that is deemed to be needed. What that is will be revealed if it comes out in the next year or so. There are plenty of things that you could do on infrastructure in this country, especially with borrowing rates at such low levels. The counter to that is that in the last couple of days the actual economic data has come out and was an improvement on what you saw last month. What you say is definitely true—there will definitely be slower growth. The question that some people are now asking is whether there will be a recession in the way that a lot of people were expecting a couple of months back.

Andrew Gray: One of the difficulties—pointing to the recent upturn in economic indicators—is that it is far too early to tell, I would argue, what many of the real economic consequences will be. Our analysis was very much that there would be lower growth relative to what there would have been had Brexit not occurred. The combination of the exchange rate, the interest rate and the fiscal environment from the Government will play a significant part, as will the openness with which the Government feel they are able to express their views of the negotiations as they unfold, and their position regarding the UK and the rest of the world outside the EU.

Q11 **Lord Desai:** Given how important passport rights are, what would be the effect on different sorts of firms in the City of losing passport rights? Does it depend on the legal structure, what product they are selling and so on? What can the UK do if we cannot arrange access? It is the worst-case scenario. If so, do we diversify and go somewhere else?

Anthony Browne: It is no exaggeration to say that London's role as Europe's financial centre has been very dependent on access to passporting rights. Both UK banks and, perhaps more significantly, the international banks based in London serve customers across Europe using the passports that are granted by the various European treaties—whether it is to sell securities or to do corporate lending, trade finance, hedging et cetera.



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In the worst-case scenario to which you referred, we would end up without an agreement with the EU and with an agreement based on World Trade Organization rules—the so-called “naked exit” of the EU. There is very little provision for financial services under World Trade Organization rules and agreements. There are limited business lines that UK-based banks could carry on offering European clients and the other way around.

As you know and as your previous witnesses said, there are various equivalence regimes that exist under existing regulations. They are relatively untried and untested. They are uncertain and limited in scope, in the sense that a lot of activities are not covered by them. Classic corporate banking—deposit-taking and lending to companies—is not covered by them. There is also uncertainty and unpredictability about them. They can be removed at relatively short notice and could be subject to change in future, if there are changes to regulation on either side of the channel.

I can give you one concrete example, just to bring it to life. If a German company was trying to raise €500 million for an investment to build a factory, it might do so by raising a bond with, in addition, a syndicated loan, and then hedge that in respect of foreign exchange payments, currency risk and interest rate risk. Those are three different products. The company would come to London for that. All of that is based on passporting rights. If passporting rights were lost, the company would not be able to come to London for bonds, for a syndicated debt or for hedging foreign exchange or interest rate risk. If we got equivalence, under MiFID and EMIR, it might be able to come for the bond and to get some hedging, under EMIR, but it would not be able to get the syndicated debt, because there is no provision for lending under any of the existing regulations. So banks based in London would only be able to provide a narrower range of services. They would not be able to be the sort of one-stop shop that they are at the moment.

George Hay: The way to think about passporting is that you have to have it in order to have the automatic right to do cross-border business on the continent. That is what we have at the moment. How badly it affects individual firms will depend on how much cross-border business they want to do and where they are starting from. A company like Lloyds Bank does most of its business here. It wants the current system to continue, but it would not necessarily be hit too badly if it did not, because most of its business is in the UK.

The other issue is whether you have a subsidiary in continental Europe. Provided that we get equivalence, having a subsidiary would allow you to continue doing business there, but it depends critically on the equivalence that we get. That is all in the lap of Europe, when we do the negotiations.

Andrew Gray: I will add a few points. Across the sector—in banking, insurance and asset management—by and large, retail businesses providing retail products are conducted across Europe by local subsidiaries that are locally capitalised and locally regulated. On the whole, the impact



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on those businesses would be minimal—which is not to say that it would not have some impact.

When you come to corporate banking, corporate insurance and arrangements like that, as well as Lloyd's of London, the institutional nature of the business means that, typically, it is international and cross-border in nature. The impact of losing passporting would be that you would not be able to conduct business on a cross-border basis with certainty, at this stage. While there is talk of equivalence, there are no equivalent arrangements set up to enable firms to do that. It is possible that there will be in the future.

That is why many firms are looking to set up new subsidiary structures in one or more European locations. But doing so increases the cost of financial services and industry. It requires additional capital and a fragmentation of liquidity, as well as a number of additional incremental investments to support a more complex business model. Ultimately, those costs would be borne by the users or shareholders of financial services.

Q12 Lord Woolmer of Leeds: Could I turn away from the corporate sector? What are the risks facing UK and EU retail customers and investors if final access arrangements affect the operations of private wealth management firms and European payment systems? Mr Browne, you may have an interest in that.

Anthony Browne: Absolutely. I echo the point that Andrew has just made. If you are a UK-only retail bank whose customers are in the UK, obviously you will be far less affected than if you are a cross-border, international bank. There are aspects of retail banking that might be affected. There is EU regulation that affects retail banking. One area that you mentioned is payments, particularly cross-border payments. We are members of the single euro payments area, which reduces the cost of international payments and makes them easier to do in euros. If we left that, transferring money in euros to mainland Europe would become more expensive.

You mentioned private banking for high net worth individuals. They are often serviced internationally. They are customers across Europe of private banks based in the UK. They use a wide range of services—not just payments, lending and deposit-taking but more sophisticated investment services. A lot of those would not be covered by any equivalence regime, even if we got such a regime, because they are classified as retail customers and, basically, the equivalence regime covers only corporate and institutional customers. Things like UCITS, for example, are covered by the equivalence regime, but only for corporate customers. High net worth individuals from Germany, France or Italy who are customers of private banks based in the UK would no longer be able to access those services—so it would definitely be more limited.

George Hay: That is certainly right. They count as retail clients. Equivalence is quite complex. Even if there is a third-country equivalence



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regime, which Anthony was talking about, for all the more corporate, wholesale clients, it will take some time for Europeans to work out whether they want to give us that equivalence. For retail, there is not even that regime in place, so you would have to create one. It is not impossible to do that, but it would probably take time, which feeds into the lack of certainty about where we go for both clients and businesses.

Anthony Browne: There is also a lack of clarity about what private banks will be able to say to their customers in other EU countries. There is a view that they would only be able to do marketing. Private banks in London could market to customers in Germany, France or Italy, but could not actually sell to them. That is the problem.

You asked the previous witnesses about Switzerland. Clearly, there is a big private banking industry in Switzerland. There are very many constraints on what those banks can and cannot say to their customers when their customers are in the EU—either when they physically visit them or when they speak to them over the telephone. I know that from some meetings that I had recently in Geneva. Obviously, Geneva has a border with France. If they are speaking on the phone to a customer who is driving along, as soon as the customer crosses the border into Switzerland, they are allowed to say and do different things. They can actually sell things, which they cannot do if the customer crosses the border back into France, where they are in the EU. Depending on the sort of arrangement that we have, there could end up being similar sorts of constraints here.

Andrew Gray: I will add one specific thing. We have focused on private banking and wealth management, but my point relates to payment systems. The payment services directive is a new piece of legislation that is coming in. It will enable certain aspects of new technologies to be deployed across Europe to make payments. Some of that initiative has been driven by the fintech industry in the UK. The UK would not be able to participate in some of the opportunities that that will provide in the future to have a more seamless payments infrastructure across Europe.

Q13 Lord Shutt of Greetland: What do you believe to be the most important priorities for the UK financial services sector in both the withdrawal negotiations and in negotiating a fresh future relationship for the UK with the EU? Where does free movement of people fit in with this?

Andrew Gray: The key thing we have already touched on—I know that it was discussed with the previous panel as well—is, effectively, a right of access to European markets that is of equivalent standing to the current passporting arrangements, without which there would be major disruption to the way in which financial services could be provided. That looks remarkably like we are saying that it is business as usual. To be honest, the financial services industry has grown up in London over many years, is a very complex environment and has adapted very well to the current regulatory arrangements by which it gains access. So removing that access right will increase costs and provide disruption to the financial services industry.



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In addition to access directly to customers, access to clearing systems and other market infrastructure is a fundamentally important part of the way in which the industry operates. Fragmenting that infrastructure will also result in incremental costs to the industry.

There is an additional point about immigration. It is an international industry and one that uses talent from across Europe and, indeed, more widely. It is also an industry that is used to moving its people internationally and doing so quickly. Again, there would be impediments to that movement.

Finally, on the certainty and speed of transition, it is recognised that a two-year period for the Article 50 process is an unrealistic timeframe for the financial services industry to be able to plan and migrate to a future model without knowing what that future model is.

George Hay: That is definitely true. Something has changed since the immediate aftermath of the referendum. At that point, a lot of people in the financial sector were saying, "We need an EEA model. We need a Norway model. Basically, we need freedom of movement, which would allow us to keep access to the single market and pretty much to keep the passport that we have". Now there is probably a bit more realism that that is not going to be possible. There will have to be some kind of action on restricting on freedom of movement.

That takes you immediately into the equivalence conversation. That is more of an unknown quantity. Bluntly, we do not really know Europe's position. You can certainly make the argument that European corporates use London as a place to do their financial services and to get cheap financial services, so you could say that we have some kind of leverage over them, but I would not push that too far. The dynamics of it will inevitably have some repercussions for the kind of deal that we get.

Anthony Browne: As I said earlier, the priority as regards the end state is to have the fullest possible two-way access between the UK and the EU markets, similar to what we have now. On the journey there, the priorities have to be having an orderly transition, avoiding financial instability and avoiding cliff-edge effects. Our concern about entering the Article 50 negotiations without any political framework or agreement is that you then enter a two-year period at the end of which we face losing pretty much all access rights if we do not get agreement. Businesses need to be able to plan. As we said earlier, that planning takes a lot of time. If they end up needing to move operations, it can take two, three or more years. We certainly think that there should be some form of transitional arrangements that would enable them to plan and to ensure that they could continue providing services to their customers.

George Hay: I can provide one detail on equivalence and how long it takes to get anywhere. The US and the EU were negotiating on equivalence for things called CCPs, which are big clearing houses. That took three years, at least, and there were no fundamental political



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disagreements between the US and the EU about whether there should be equivalence in that case. So you have to start with that and potentially add a bit more to reflect the political uncertainties and the fact that the EU may want to teach us a lesson for leaving.

Anthony Browne: The process of negotiation is absolutely critical here, to ensure that there is an orderly transition. There is a view, which you sometimes hear, that there will be no negotiation before the UK triggers Article 50—Article 50 is the divorce agreement, as it were—and that only when we have left the EU can we start negotiating the future arrangement. The trouble with that for the UK—and, indeed, the EU—is that it would mean that at the end of the Article 50 negotiation we would fall back to World Trade Organization rules. As I said, that would mean dislocation between the European economy and its financial centre, which would be incredibly disruptive. So we certainly think that you need to be able to negotiate in parallel what the arrangements should be for the new partnership between the UK and the EU at the same time as the Article 50 negotiations, to make sure that you do not have that extreme cliff-edge effect at the end.

Andrew Gray: One thing that would be helpful is a strong and better mutual understanding of some of the economic benefits that are shared by both the UK and the rest of Europe around having a single global financial centre within the European area. As Anthony said earlier, the failure of an investment bank in London to provide a German corporate with the right financial structuring would inevitably be a direct cost on the German corporate, as well as a loss of revenue for the English subsidiary of the particular institution. Some of the wider costs that would impact on both the UK and Europe should be more fully understood before negotiating positions get too hard.

Lord Haskins: In your position, there is a contradiction. On the one hand, you are saying that prolonged uncertainty is very unhealthy. I agree. On the other hand, you are saying that prolonged transition is very necessary. There is a contradiction there.

Anthony Browne: Having transitional arrangements should help to remove the uncertainty. We are not saying that the negotiation should necessarily take longer; it is just that you need some sort of framework so that banks and their customers know that they can continue operating throughout the negotiation process and between when the negotiations end and when the new partnership comes into play. The whole point of that is to reduce uncertainty rather than to prolong it.

George Hay: Your point relates to the propensity of the Europeans to give us a long transition. The longer the transition we have, the better it is for our negotiating position, I suppose. If the Europeans know that we have a hard stop and we have to cobble something together by then, it helps them in forcing through whatever their agenda is. So, yes, there is a bit of a tension.



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Lord Haskins: Our colleagues in Europe will be keen to avoid that long transition.

Andrew Gray: Except for my previous point, which we have mentioned a few times. The cost of disruption to financial services will be borne by both the UK and Europe. It is in nobody's interests for financial services to be artificially fragmented in a way that has not been fully thought through, so that institutions that actually provide the financial services cannot plan in a reasonable timeframe to be able to deliver the solutions in a cost-effective way that will service the ultimate consumers of financial services in the right way.

George Hay: That is definitely true. If everything was rational, that would be exactly right. Unfortunately, I am not particularly confident that this will be a massively rational process. With the French and German elections next year, there will be a lot of grandstanding and positioning. That will affect this process as well.

Lord Skidelsky: You mentioned the German and French elections. Are you not avoiding domestic political repercussions of these different options? After all, there was a vote in favour of leaving. If you do not invoke Article 50, nothing happens. Will people not feel that the vote means absolutely nothing and that everything is the same? Everything is going to be negotiated now. Who knows what the results of the negotiations will be? Maybe we will go to the electorate again and say, "Look, we have these terms. What is the point of leaving?" I would have thought that there would be a huge amount of political opposition to that approach. What people who voted to leave will probably expect is a rapid triggering of Article 50, as a sign that something has changed. That is all.

Anthony Browne: I totally accept that. I go back to my opening statement, where I said that we completely accept the verdict of the British electorate and we want to make Brexit a success. However, it is better to take your time and make sure that we get it right, so that it is a success, than to rush and get it wrong. Even the most committed Brexiteers would accept that.

We want to work with the Government to make this work. But saying that you need a negotiating plan in place before triggering the negotiations does not in any way mean that we do not leave the EU. In the referendum debate a lot of issues were raised, but I do not think that there were many people who said, "We want restrictions or barriers put up to the trade in financial services between the UK and the EU". That was not a political commitment from anyone on any side.

George Hay: As we have touched on, it is a given that there will be restrictions on freedom of movement. Increasingly, that seems to be part of the dynamic. That speaks to what the majority of people may have voted for on 23 June. The interesting question is how you manage what that means for the City. As I said, the difference between now and two



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months ago is that fewer people seem to think that the EEA option, where not much changes on freedom of movement, is going to happen.

Lord Skidelsky: Do you think that the restrictions on movement that people are expecting will take place without our triggering Article 50?

Anthony Browne: To clarify, we are not arguing against triggering Article 50.

Lord Skidelsky: I mean a rapid triggering of Article 50.

Lord Desai: One difficulty here is that people say, "Of course, Brexit is Brexit", but they want nothing to change. That is not what the British public voted for. Does the financial industry realise that it is not the most popular thing in the whole world? Some of the Brexiteers resented very much the behaviour of banks and the way they had to be rescued. I do not think that the banks' interests will necessarily be prioritised unless something is done.

Anthony Browne: Absolutely. I am fully aware of the politics of all of this. You say that the banks and financial services are not necessarily the most popular section of the economy. What I said earlier is that people voted for a lot of different reasons, but during the referendum campaign I do not remember there being a big campaign about putting up barriers to the trade in financial services. That is the only thing. I am speaking only for financial services. We totally accept that the UK is leaving the EU and that there will need to be changes in other areas. You talk about freedom of movement of labour, for example. Obviously there are concerns in the industry about that, but we accept the verdict of the British public.

Andrew Gray: We are not advocating a speedy or a not-speedy invoking of Article 50—or, indeed, the quantum of change that may be negotiated. The key thing at this point is to highlight some of the consequences of different scenarios that may be possible. One of those is the speed at which Article 50 is triggered, without the provision of measures to defer the implementation of new rules that are not yet clear. That is a risk. We need to highlight it as a risk.

Q14 **Earl of Lindsay:** Can I take you back to what might be achieved through the third-country equivalence regime, to which you referred in other answers? Do you think that it might be possible to have a very satisfactory outcome from equivalence negotiations? I want to quote from a BBA document, which states: "The EU and the UK should build on the precedent established by existing third-country frameworks to develop a uniquely ambitious, broad and far-reaching new form of bilateral agreement". Might it be possible to achieve that? How realistic do you think that aspiration is for the outcome of third-country equivalence negotiations with Europe?

How much do you think politics may get in the way of negotiating satisfactory, desirable objectives through equivalence regime negotiations? You have already mentioned that retail products and



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services are not covered by current equivalence regime arrangements. Are there other areas, shortcomings and difficulties that you think may emerge and remain a problem if we rely very much on equivalence regime negotiations to achieve a new arrangement for financial services?

Anthony Browne: One thing that I think is certain is that the future partnership between the UK and the EU will be unique. It will be a British solution. It is a fact of history that what is happening is unprecedented. We had a territory agreement, but a country has never left the EU before. Never before has a country and economy as integrated with the EU 27 as the UK separated.

We have had discussions about equivalence. It is a matter of fact that, in a practical sense, we are completely equivalent at the moment, because we have the same financial services regulation as the rest of the EU—certainly as regards EU regulation. It is unprecedented, and I think that the future partnership between the UK and the EU will be unprecedented.

The important thing is to make sure that it works in a way that is of interest to both sides—both the UK and the EU. We should not look at all of this as being about what is in our own national interests. It has to be in their interests as well. The point that I made earlier was that we believe that it is in the interests of a lot of customers across Europe to be able to continue to have access to the services that London offers. It is not in the interests of either side to sever that in some way and to put up barriers.

There is one really fundamental difference between what we are doing now and normal trade negotiations. Normally, in trade negotiations, you have barriers that already exist—largely, tariff barriers—and you are talking about reducing them to create trade that did not exist before. What we have now is in fact the direct opposite of that. We have virtually no barriers between the UK and the EU at the moment. There is a lot of trade there—£20 billion a year of service exports from the UK to the EU 27 in 2014. We have the trade and do not have barriers. We are now talking about what barriers go up. We would urge that we should minimise the number of barriers that go up and the number of restrictions that are put on trade.

George Hay: If you wanted to be optimistic, in technical terms, there is no reason why Europe should not grant us equivalence. In many cases, our financial regulation is tougher than theirs. We are super-equivalent to them in quite a few bits of City regulation.

To your point, though, the problem is politics. We have talked about the political situation next year, with the elections. That will act as a check on being too generous to the UK. The only way to make it potentially more positive, perhaps, is if the political situation in France and Germany supports some kind of restriction on freedom of movement. That might change the dynamic in some way—but that is hoping a bit.



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Andrew Gray: On equivalence, specifically, as was mentioned, at this point we are already equivalent—indeed, more than equivalent. In a number of cases, either the European regulation has been driven by requirements that originated from the UK or, when the UK has come to implement the regulations, it has implemented them to a higher standard. An example is the senior management regime, where requirements exist within the UK regulatory environment that are additional to those that exist in many other European countries.

That is one key aspect. There is also a question mark about remaining equivalent. Once we leave the EU, the direction in which future EU regulations move may well be inconsistent with what the UK wants, because we do not have a seat at that table. So there are some question marks about looking into the future and how you preserve an equivalence regime without necessarily having to implement everything that the Europeans want to come up with in the future, which may suit their business environment in ways that are not suited to the UK environment.

Q15 **Lord Skidelsky:** I would like to raise again an issue that I raised last time—the question of what influence we will have on the future of the financial system as it develops in Europe. It seems to me that there are a couple of contradictory pressures here. On the one hand, there is quite strong opposition within the EU, in some countries, to what was called by one of the last witnesses the liberal Anglo-American financial system. It may be that, as a result of Brexit, the City will lose influence on financial supervision and regulation within Europe.

On the other hand, there is the long-standing historical debate within the UK on what the role of the financial system should be—the old debate between finance and industry. I am a historian by training. I remember Churchill's famous remark when he was Chancellor of the Exchequer in 1925. He said, "I would rather see finance less proud and industry more content". The two things interweave. Basically, how do you think those tensions will be resolved, both vis-à-vis Europe and vis-à-vis the internal debate in this country? I am sorry. It is a large question.

Anthony Browne: It comes back to the issue we touched on several times earlier—the influence that we may have on future regulation, once we have a new arrangement between the UK and the EU. There certainly are concerns, both among regulators—they have said it very publicly—and in the industry about having to accept regulation we have no influence over as a result of leaving the EU.

That can happen in various forms. You heard from previous witnesses that one consideration about the existing equivalence regimes is whether that means that we simply have to adopt new EU regulations in order to maintain equivalence—regulations over which we had no influence and that may be very uncomfortable for us in different ways. Whatever the new arrangements for the partnership that the UK has with the EU, we will want to make sure that the UK maintains some sort of influence on its financial services regulation. There is no doubt about that.



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Andrew Gray: On the point about the UK's role, the UK is a member of the FSB, the G20, the Basel Committee on Banking Supervision and CPMI-IOSCO for market infrastructure, which are the bodies that set the highest level of direction for the regulation of the financial services industry. Our participation there is very important and will continue. Clearly, there are risks around the UK providing input into European regulation and the way in which the European regulatory authorities take down the guidance from the FSB, for example, and translate it into specific regulation. The future of how we provide an influence when we do not have a full seat at the table is an open question and one that needs to be thought through very carefully.

Anthony Browne: It is worth adding that we have been quite public in saying that we do not want a bonfire of regulations. We are not looking to repeal this, that and the other because we do not like it—for various reasons, but for two in particular. If we go down that route—which I know some people are pushing—it could potentially threaten our access to equivalence and to providing services to the EU market. Also, we are committed as a country to implementing the global standards that Andrew mentioned, through the Financial Stability Board, the G20, Basel et cetera. We would implement them—quite rightly—anyway. At the moment they are implemented largely through EU regulation. So even if we did not have EU regulations we would want to do it nationally in a very similar way. We tend to be super-equivalent and to have the most advanced and safest regulation, compared with the EU.

George Hay: On your point, if the UK wanted to pivot towards a more manufacturing-focused economy, it would be good for the UK's democratically elected Government to say, "Let us do this", and for people to agree with it, rather than for the financial part of the economy just to collapse in on itself because we had got a really rubbish deal from the EU. The financial sector provides £60-odd billion in tax. That helps the UK. If that is chipped away at, the money will have to come from somewhere else. It could, but it should come from a democratically elected Government saying, "Let us do this", rather than the opposite.

Anthony Browne: It is worth noting that financial and related professional services pay over £60 billion a year in tax. Of that, banks pay about £31 billion. Of that £31 billion, slightly over half—about £15 billion a year in tax, in the last year for which we provided the figures—is paid by foreign banks based here. It is worth noting that that is bigger than the entire UK net contribution to the EU budget.

George Hay: A key point is that a big part of that £30 billion is bankers paying tax, rather than banks. So even if you still have a lot of banks based here, but they move thousands and thousands of people to subsidiaries in Ireland, France or wherever, that will probably have an effect on us. It would be better if it did not happen.

The Chairman: The more they earn, the more tax they pay.



George Hay: Yes.

Q16 **Lord Woolmer of Leeds:** A previous witness, Professor Ferran, talked of a bespoke free trade agreement. Mr Browne, you talked about a unique trading arrangement—I think that was the expression that you used—between the EU and the UK. I have two or three questions. Could you spell out the main features of such a unique arrangement between the EU and the UK? Secondly, which elements of that arrangement would be the most difficult to achieve with what are currently our EU partners and which would be the most likely to be acceptable to them?

Anthony Browne: Presumably—we do not know—the agreement would cover a whole range of different things: manufacturing, agriculture, fisheries, security, defence et cetera. I would not presume to comment on the rest of those. I will stick to my little financial services brief.

As I said, what we want is basically some version of the passporting regime that we have—in the sense that, bilaterally, banks based in the UK can serve customers in Europe and vice versa—as well as some influence over future rule-making, and some predictability. One of the downsides of the equivalence regime that exists under current regulations, is that it can be withdrawn unilaterally at fairly short notice, without much warning. That is not a good basis for planning for businesses.

Lord Woolmer of Leeds: So that would be your statement of the unique trading arrangement between the UK and the EU. This is not a political point, but I do not think that the public would understand that. They were talking about taking back control and so on. What are the key features of an arrangement?

Anthony Browne: I am talking only about the narrow area of banking—from my point of view—not about fisheries policy, agricultural policy or, indeed, freedom of movement of labour, although obviously we have an interest in that.

Andrew Gray: One point about taking control is that the regulation that would actually apply to UK banks would need to come from UK regulatory authorities—or, indeed, the Government. To that extent, it would be local control within the UK of the extent to which we regulated our own financial services industry. The challenge comes where you want to export part of that financial services industry and to earn export earnings. Then you will need to play in a way that your trade counterparties recognise is acceptable to them as well. It is a difficult balance to achieve. While you nevertheless control, you also need to recognise the global nature of financial services.

George Hay: I realise that the “taking back control” thing probably applies to everything, but it would seem to me to apply particularly to freedom of movement. What we want from these negotiations appears to be restrictions on freedom of movement. We will have to give up something in return for that. That something is access to the single



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market—passporting and what we have just been talking about. I imagine that we will get some kind of restriction on freedom of movement, which will be enough to make people think that we have taken back control. In my view, the success of the negotiation will be whether we get a workable, bespoke equivalence regime. If we can get that, we will have succeeded.

Andrew Gray: There is an interesting observation about the way in which UK financial services firms access US financial markets. As part of that, the US imposes what are called extraterritorial requirements—for example, Dodd-Frank. If you want to participate in the US market, you need to comply with US regulations. We do not set those in the UK. Individual institutions that want to trade in the US markets will do so, but only on the basis that they implement those US regulations.

Q17 **Lord Haskins:** You have answered my question about uncertainty, but I would like to ask another. The City seems to be accepting the result of the referendum. You have said that. I am not hearing anything except that your objective must be to minimise the damage as a result of the referendum. I am not hearing anything serious about any benefits arising from Brexit.

Secondly, what worries me about the debate is that the City has a very strong influence on what is happening. I live in Yorkshire. There are huge problems there, too, which have to be balanced. There is a danger, if we are not careful, that there will be a trade-off, to the disadvantage of one or the other. How do you see us avoiding that?

Anthony Browne: To your first point, clearly there will be a new arrangement for the UK. We will have a new trade policy. We have a Department for International Trade. Trade agreements historically have not covered financial services in any great depth. There is a reason for that. It is a very heavily regulated industry, to ensure financial stability and consumer protection. You get trade in financial services across borders only if you have very equivalent standards and trust between regulators. There are hurdles that do not apply to exporting manufactured products to quite the same extent. Now that the UK has left the EU, clearly there will be opportunities—I know that the Government are looking at that—and ways in which we could promote exports of financial services to the rest of the world, not just the EU.

Lord Haskins: It will be a long haul.

Anthony Browne: Absolutely; it will. There is no doubt about that. There are lots of very big barriers. But historically we have been a global trading nation. We should explore all opportunities for that. We fully support that, and financial services will be part of it.

It is worth remembering that London is a global financial centre as well. We do not serve just the UK and the EU. Banks and other businesses operating out of London serve economies and businesses around the



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world. There are certain barriers to that. There may be ways to make it easier, but it is a very complex industry. It will be a long haul, as you say.

However, there are opportunities. As a country, we have been exploring renminbi trading, for example. I know that there has been a certain amount of progress in that area. Fintech is an absolutely fascinating area that is growing very rapidly and where London has a lot of comparative advantages. We could see that grow quite rapidly in the years to come. We fully support and endorse that. Maybe there are other opportunities. We are absolutely open to that. But the direction of questions has been about the relationship between the UK and the EU.

George Hay: Some people have talked about the opportunity for a bonfire of regulation and more regulatory openness. I do not really see that as a thing at all. As I said, we are super-equivalent in most regulations. There is an opportunity, if we are not in the EU and not in the single market, to reduce the bonus cap, but I do not think that that will be a vote-winner for anyone to roll out. So from a regulatory perspective, certainly, it is minimal.

Lord Haskins: It is very likely that in a lot of EU regulation we will just knock out "EU" and put in "UK" instead.

Anthony Browne: One of the huge programmes of work—not just in financial services but elsewhere—will be the transposition of EU regulations into UK law. That is an absolutely enormous project. Clearly, the Government are having to think about how we do that. There are various options. You can just transpose the whole lot, or you can proceed on a regulation-by-regulation basis. As we said earlier, we are not looking for a bonfire of regulations. We accept and fully support the high global standards the UK is signed up to, for both financial stability reasons and consumer protection reasons. We are not seeking to change that.

The Chairman: Would not the simple way to deal with that be to follow what the 1972 Act did? You say, "The EU regulations are UK law, except for the ones that we remove". Then you start from the other end, as it were, and make the task simpler.

Anthony Browne: That is absolutely one of the options. I am sure that the Government are considering that.

The Chairman: Thank you very much for your very interesting answers this morning. Is there anything that any of you would like to say without which your evidence would not be complete?

Andrew Gray: One final point—it has already been raised a bit, but I want to reinforce it—is not to forget the interconnectedness of financial services. It is not just about banking in isolation or asset management in isolation. You need to look at financial services holistically and to recognise that its existing holistic nature is of a global nature and that any forms of fragmentation of the existing way in which financial services are structured



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will have implications. You need to be clear about what those implications are before decisions are made.

The Chairman: Mr Gray, Mr Browne and Mr Hay, thank you very much for your evidence today. That concludes today's public evidence sessions. The Committee will now continue its meeting in private.