HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on the European Union Financial Affairs Sub-Committee

Inquiry on Brexit and financial services in the UK

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Watch the meeting

Members present: Baroness Falkner of Margravine (Chairman), Lord Butler of Brockwell, Lord Desai, Lord Haskins, Earl of Lindsay, Lord Shutt of Greetland

Evidence Session No. 3 Heard in Public Questions 18 - 26

Witnesses:

Elizabeth Corley, Douglas Flint and Alex Wilmot-Sitwell

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Examination of Witnesses

Elizabeth Corley, Vice Chair, Allianz Global Investors, Douglas Flint, Group Chairman, HSBC, and Alex Wilmot-Sitwell, EMEA President, Bank of America Merrill Lynch

Q18 **The Chairman**: Good morning. I welcome you to the inquiry of the EU Financial Affairs Sub-Committee into the impact of Brexit on the financial services sector. You have a list of interests that have been declared by the Members of the Committee. This is a formal evidence session of the Committee. A transcript will be taken which will be put on the public record both in printed form and on the parliamentary website. You will be sent a copy of the transcript to revise any minor errors. This session is being webcast live and subsequently will be accessible via the parliamentary website for those of you who make that your late-night viewing. I warmly welcome Elizabeth Corley, the vice-chair of Allianz Global Investors Great Britain, Mr Douglas Flint, the group chairman of HSBC Holdings and Alex Wilmot-Sitwell, President, EMEA, Bank of America Merrill Lynch. We are very pleased to have you with us and you have indicated that you can stay on if our session runs for a little more than an hour.

Perhaps I may kick off by asking each of you to give a brief response to the overall question of how your particular firms and others that you know of—we recognise that you represent different sectors—are planning for the outcome of Brexit and how the political uncertainty that that has created is affecting your day-to-day operations. How are you planning for the new and existing challenges in the areas you operate in?

Elizabeth Corley: Thank you very much, and I am grateful for the opportunity to speak to the Committee. As an asset management company, essentially we do what our clients need us to do. On planning, following on what I would say was a rather shocked and surprised reaction, which was short lived, many of our clients are calm. They are waiting to see what the process, the timetable and the outcome might be. So in terms of how we are looking after their portfolios and how we are talking to them about services, it is business as usual. Many asset management firms have well-developed structures globally; it is a global business. Europe is obviously an important part of that, but as I say it is a global business. So the specifics of how one plans vary depending on how well established one already is between the UK, the rest of Europe and the rest of the world.

For us specifically, many years ago we took steps to create what is a well-established legal structure in Europe that provides us with tremendous versatility to locate people and services wherever we want. The most important thing is that the global conventions which apply to asset management that allow you to run money quite freely do not change because you can delegate portfolio management around the world. If it were to change as a result of the negotiations on exit, that would be a change to the global convention, not necessarily just between the UK and the EU. At the moment, we are treating that as a lower probability. If there were any indication that that might change, we would have to make significant changes to how we plan for the future.

Douglas Flint: Thank you very much for this opportunity. The response is multifaceted. The initial reaction was around reassuring our staff in terms of their position and what we would say about the importance of being able to attract and retain talent. It was about working with customers to help them understand how their business models and operations might change depending on the variety of arrangements that could be negotiated in the future. Then in relation to banking services, again the dimensions are multiple. We are very international so we are present in most of the major countries of the world. In terms of our own ability to do business, we have choices. The critical thing for us is trying to understand what a change in arrangements in the world's most international financial centre and ecosystem might have on the aggregate ecosystem of finance around the world. If we think about the last seven years post-crisis, the principal priorities of our regulators and public policymakers has been to eliminate risk through consolidation, central counterparties and more transparent arrangements. That has led to an ever greater concentration of financial activity into the major centres of the world. What takes place in the ecosystem, the cluster that operates in London as one of the world's greatest financial ecosystems—it happens to be in the UK as opposed to being a UK asset; it is an international asset based here—means that our biggest concern is to understand whether financial stability in the ecosystem can be preserved if you start playing with the range of activities that can be conducted from a single location.

On a day-to-day basis, there is a huge amount of planning around what could be disruptions to the activities that we make available to our clients and how they might affect our own model in terms of where we do business. As I say, a huge amount of planning is involved in going through the options, but our biggest area of focus is on what happens to the ecosystem, because it is incredibly broad and deep with tremendous elements in it in terms of the supply chain that supports a huge number of multinational, domestic and regional companies which have consolidated their financial affairs into the time zone financial system that exists in the United Kingdom today and which services the world.

Alex Wilmot-Sitwell: I will try not to be too repetitive because I agree wholeheartedly with the comments made by Douglas and Elizabeth. The initial reaction for us to was ensure that our staff were reassured that we were open for business and to reassure our clients that we remain open for business. Regaining a sense of "business as usual" was the immediate priority. I would say that the preparation undertaken by regulators here and by market operators meant that the market did return to normality extraordinarily quickly and behaved effectively through what had been a difficult period which could have led to great volatility. As the head of an American bank based in London which is entirely focused on the wholesale markets, I would echo the comments made by Douglas in terms of what we are looking at now. We are trying to ensure that client activity is maintained in a way that supports clients' needs, that financial stability is protected because that is absolutely critical, and that we are able to explain the complex nature of the interconnected ecosystem. It is not a Lego set in which little pieces can be built up and put somewhere else. The interconnectedness is very significant and therefore the complexity of the ecosystem is something that we need to be assured that whatever happens from this point forward, the consequences and implications of any steps are understood.

The Chairman: You are almost directing me to think about chaos theory, but I will not go there. Have you found that there has been a chilling effect? Last night I spoke to someone from a major US investment banking firm who said that depending on the sector, they do think there is a chilling effect. Have you detected that across the different sectors? For example, has there been a reduction in M&A activity?

Alex Wilmot-Sitwell: No, I do not think there has been a fundamental chilling effect from our point of view. In fact, market activity has recovered to the levels that would be consistent with a normal market environment. There are clearly a lot of factors at the geopolitical and macro level that are of concern—a lot of political processes on the horizon that are of concern—and of course the Brexit process is a matter of concern because it is uncertain. Until we know what the direction of travel and the destination are going to be, it is difficult for us to position ourselves from a strategic point of view. But I would not say that I have seen any fundamental change in market activity.

Douglas Flint: I pretty much echo that. Clearly, a huge amount of work is being done across all sectors to understand what the changes might mean. There might be projects that are taking more time to get off the drawing board and execute, mostly in the commercial property space. In other activity the comparative advantages of a weaker sterling are promoting investment into this country for those who see it as better value than it was before, and supporting the export sector. There are businesses that are winning from that. I think there will be a lag effect and those that are faced with higher import costs on whatever they bring in from outside will start to see that towards the second half of the year. I agree with Alex that so far there has not been a dramatic impact on activity, but a huge amount of preparation work is being done.

Elizabeth Corley: I would just add that there is a difference between capital market activity, which, as you say, is around M&A or capital raising and the use of existing cash flow. Anecdotally—because it is still very early—we find in some sectors a hesitation to commit capital expenditure to inward investment in capital that is already there and a caution in deploying free cash flow, which would not come through in the activities of the capital markets per se. As we roll forward and start to see company announcements, we will see the extent to which major investments, innovations and R&D are continuing at that level. I am sure it is something that the CBI will be tracking closely. Anecdotally, when we speak to some of the companies in which we invest, there is definitely more caution.

Q19 **Lord Desai**: You referred to different players: the UK, the EU 27 and non-EU players. There are different sectors: asset managers, investment banks and retail banks. How will they be affected differentially by the passporting rights? How much do they depend on passporting rights for their operations?

Douglas Flint: Everyone is affected by passporting rights to a greater or lesser degree. The system has two major priorities. Some businesses rely on passporting rights in order to sell their services to or attract business from the EU 27. But it is also hugely important that the ecosystem that exists in the UK is largely because of the quality of regulation, the legal system, historical reputation, and so on, and the fact that the system built up to serve a global community. London dominates foreign exchange trading, including in the US dollar and the RMB. That has nothing to do with Europe but the cluster has attracted those services because they want a single point of contact to cover the world in terms of financial needs, currencies, and so on.

There are two aspects. For those who sell on their reliance on the passport, that is a challenge. But more important to the global financial system is the possibility that if the benefits that come from consolidation allowing people to bring all the risk into one place and get the compression effects of risk management and offsets were fragmented, we would risk an element of financial stability as it adjusts, we would make the system more expensive and we probably do not know where the system ends up if it gets fragmented. Does it get split over a number of centres or does it find some other place in the world that can offer the consolidated benefits that come from the system that exists today in the UK?

It is relevant to say that what we have today is not because we built it and then said to people, "Look how clever we are". We built it because our clients wanted the services and therefore they were added piece by piece to create this huge network of international and domestic firms that offer international services through London. The thing we are trying to work out, along with everyone else, is not so much how it impacts us but where our clients will want to do business and how those who compete with the UK ecosystem will seek to attract business away by promoting the fact that they can offer a greater degree of certainty as to how they will transact, as Europe and the UK transition to a different model of co-operation.

Elizabeth Corley: In the asset management sector, passporting is only part of the equation. I am sure we will get on to equivalence and other things in a moment. Obviously, it is very varied, as you rightly say, by different sectors even within asset management. This is a simplistic answer and the devil is a bit in the detail but simplistically, if one is dealing with professional, institutional clients the ability to do that is far greater than if one is dealing with retail clients. Europe has been one of the innovators in creating a single market for retail asset management—the UCITS directive. That is a very rare phenomenon in the world. Certainly, the ability of individual European retail savers to buy product from the best supplier in the market—which might be British, American or from somewhere else—is controlled through that UCITS regulation.

Therefore, it will be a question of how that gets promulgated in the separation arrangements.

Alex Wilmot-Sitwell: Again, we are in danger of repeating ourselves but passporting is a bit of a simplistic way of looking at the challenge. The challenge is actually ease of access to markets more broadly in order to provide clients with the solutions, capital support and strategic support that they are looking for. It is around efficiencies of scale, market infrastructure and the ecosystem that exists. You pull pieces out and it is difficult to know how that will impair or affect the efficiency of scale. But we do not operate in a world where there are very significant margins of doing business. Adding complexity and capital charges makes that ecosystem less healthy. That is the risk that we need to focus on.

Q20 **Lord Haskins**: You are putting a difficult proposition to Mr Davis. On the one hand you say, understandably, that the London ecosystem must not be messed around with or fragmented; on the other hand, Mr Davis has his political people behind him saying that that does not matter, the issues are much more important than how London fits in. How will he reconcile these two very different positions?

Alex Wilmot-Sitwell: I absolutely understand how difficult it is. We must be very clear that there is no one size fits all; we all have slightly different business models and we all represent slightly different aspects of the industry. We all benefit from being able to operate in an environment where you get real scale of capital, skills and infrastructure. That has real benefits as an ecosystem. To the extent that that cannot remain together for political reasons, we will obviously need to adjust to those different circumstances; and we will because that is our job—we need to service our clients. The important thing then is to ensure that a sufficient period of time and transitioning is put in place to allow that process to be undertaken safely. Financial stability, the efficient working of markets and the ability to provide access to capital and services to those clients are of fundamental importance. Even if there is a short-term interruption or damage is done to the system, that could have very wide ramifications for the whole economy, not just the UK but the EU and indeed the global economy. My greatest concern is to ensure that financial stability is maintained, that market access and infrastructure can operate effectively and efficiently, and that any process of change requires an appropriate period of transition so that it can be managed safely. We will adapt our business models to whatever that outcome is. We are not here—I am certainly not here—to preach or to influence the political process but rather to make sure that there is an understanding of the consequences of market efficiency and effectiveness if that process is managed poorly, hastily or in a way that is not well co-ordinated.

Douglas Flint: It is not just European businesses that benefit from the ecosystem; global businesses do so as well. For reasons of efficiency, European businesses have chosen to consolidate their capital raising, cash management, equity market activities and risk management activities within a single ecosystem that happens to be based in the UK along with, as I said, a whole bunch of international as well as domestic firms. I am sure that part of the discussion will be that you probably could not ever replicate that in one place. You could not replicate the individual pieces in multiple places other than in a fragmented way over a long period of time. How does Europe ensure that the economy continues to receive the financial support it needs during a period of transition to a new model? I am sure that that will be just as important to our European counterparts as it will be to the UK. We need to do more on capital markets union, but that is based on what happens in the ecosystem that is based in the UK. There is nothing that immediately replaces it. Can we envisage a time when there might be? That is possible, but it will take a very long time to build up, license and operate. If it is critically important to ensure that employment and economic activity in Europe, and in a broader sense the world, is maintained and not disrupted; and to ensure that we do not have events that contribute to financial instability, there has to be an open conversation about maintaining economic activity and avoiding financial instability during a transition.

Lord Desai: I have a supplementary question. As an economist, I understand that the City has certain advantages over anywhere else in terms of efficiency. Anything that happens with or without equivalence will add to transaction costs. Have you been working on what extra transaction costs you can bear and remain ahead of the competition?

The Chairman: Not all three of you need to answer. I am keeping an eye on the clock.

Elizabeth Corley: Perhaps I may add something in response to the previous question. One of the things that we have not been very good at—I say this from my own sector—is that we are actually one of the leading international centres of the world. Two-fifths of the assets and the activity we run here are for external clients, half of which is with Europe and half with the rest of the world. We have created a sort of national champion industry that we do not talk about much. We are also a critically important crossroads for capital flowing into investment in companies. What we need to think about as we move forward as an international trading centre is where we have an international and competitive advantage and where we wish to see that growing our businesses and our imprint on the world. Asset management is undoubtedly one of the leading international centres. The money that we run here is greater than the three largest European asset management centres and we are second only to the United States in terms of scale. Even more important is the fact that we are a significant contributor to equity issuance, equity risk capital which is obviously essential for growth. We need to work closely on what we need to see as the seeds of future international expansion when moving forward.

The Chairman: I think that we can pick up on those points later. Perhaps Mr Flint would like to deal with Lord Desai's question.

Douglas Flint: Very briefly, the question is not the competitiveness or the profitability of the industry, it is what our customers choose to do. First, at the moment they derive huge benefits from consolidating in one place because they get all the offsets. If you start to dismantle and fragment, it becomes less efficient for them. They then have the choice either to accept a less-efficient system or to go somewhere else where they can get everything in one place. The most obvious place would be the United States. Secondly, partly because of low interest rates and a weak economy, the European banking system is not recovering its costs of capital at the moment. It trades at less than 50% of book, so can it absorb more costs? Not without making itself less attractive as an investment proposition. Having folk going back to their head offices saying, "We are going to have to restructure and take our returns to a level even lower than they are today when the sector is trading at roughly half book", is not an attractive proposition.

Lord Butler of Brockwell: You have emphasised that London is a unique ecosystem which, taking Mr Flint's words, cannot be replicated. It sounds to me, and indeed it has been suggested by others, that in this negotiation as far as business is concerned, the EU partners will be *demandeurs*; in other words, they are going to want very much their access to London not to be inhibited by any outcome of the negotiations. Is that your view, and is there a possibility that business in Europe will be putting pressure on one way whereas the politicians may be putting pressure on in a different direction?

Alex Wilmot-Sitwell: I would say that there is a very real risk of that, and indeed there is some evidence that it is already happening. It is quite clear that corporate clients, institutional clients and other market participants want the most efficient access to products and services at the most effective cost. At the moment, having that hubbed substantially in one place, which happens to be London, is a great benefit to those clients and the users of such services. Clearly there is a potentially different political agenda. It is important that as the political agenda develops, there is an understanding of the consequences of certain outcomes. The consequences of those outcomes could well be that the cost of doing business goes up or indeed that the breadth and diversity of products and services that are made available to the markets shrink. As Douglas has just said, currently the European banking sector does not cover its costs of capital, so it is difficult to see how creating additional complexity and adding costs is going to be of benefit to the broader economy. I am talking about the whole European economy, not just that of the UK. That political agenda and the business imperatives could potentially drift apart. We should be careful about that and monitor it because it could have a significant negative impact on the broader macro environment.

Douglas Flint: If I could just add one thing to that. It is worth recognising that for the largest part of the financial infrastructure the major players in all the sectors are already responding to the Financial Stability Board, Basel, IOSCO and Dodd-Frank given that we all have interests in the United States. To a large extent, regulation of the sector has gone beyond national boundaries in any event. We are globally regulated although it is implemented by national regulators. The framework of regulation is a globally negotiated one.

Lord Butler of Brockwell: Do you think that you and your clients can play a useful part that is helpful to the British Government in putting pressure on for the maintenance of the stability of this ecosystem and try to prevent politicians complicating it or putting obstacles in its way? I mean this as a serious question. Great institutions such as the ones you lead could well be very important in this negotiation.

Douglas Flint: The most important voices are those of our clients, not us. We exist to give them what they want and I hope that they will speak up. I hope also that those who make the decisions understand the implications of what those clients say.

The Chairman: You are being quite modest. I think your announcement about HSBC's location was relevant to the argumentation.

Elizabeth Corley: It is about the benefit to all the underlying clients, and to an extent asset managers are clients of the large banks here. We are very respectful of the democratic and political process and frankly would not wish to do something that goes beyond our brief. But if suggestions were to come through that would be seriously damaging to employment, to the stability of the markets and to growth, we would undoubtedly make sure that we commented on them. But it would be on those points of substance rather than on the process itself, which we have to be very respectful of.

The Chairman: Thank you. I will bring in Lord Shutt on the legal and organisational structures.

Q21 **Lord Shutt of Greetland**: Can I get a greater understanding of the legal and organisational structures and how Brexit might affect them? You can speak from your own personal experiences, but it seems to me that you may have branches in different parts of Europe or you may even now have subsidiaries in various parts of Europe. Under passporting, perhaps regulation is simpler if you have branches rather than subsidiaries, because the subsidiaries may then be involved in other forms of regulation. How important is all this? Indeed, do any of you have neither, because you do not need a branch or a subsidiary?

Elizabeth Corley: We are a relatively lowly capitalised business versus the banking sector, which will be very different. You are absolutely right. At the moment, choices driven by client and cultural preferences, country by country, are being made as to whether one has a subsidiary, a branch or nothing at all and just flies in. I anticipate that institutional and professional business could well continue unless deliberately protectionist elements were introduced in a negotiation. For retail business, at the moment we are clearly benefiting from a harmonisation of client protection and marketing rules, which undoubtedly helps the retail customer. At the moment, the UK is equivalent to that in a full sense. In that area it would really depend on the detail of the legislation that came through after any exit.

Where we would certainly start to struggle would be if there were a physical restriction on what could be done outside the European market. For example, on the delegation point, if someone tried to say that you could not run European money if you sat in London, that would be quite an extraordinary reversal of the last 40 years of a global trend. It would certainly cause us a lot of thinking and would be very difficult. In the

United Kingdom we look after about £630 billion of European equities on behalf of global, not just European and UK, clients. So you would be talking about a reversal of the way that capital markets have evolved in the last 30 years since exchange controls were removed.

Douglas Flint: First, no free trade agreement outside what exists in Europe today allows free access to services, and particularly financial services. Therefore, even on a simple basis, whether it is a branch or a subsidiary, it is important to be part of a single payments system and to be able to sell risk management or foreign exchange services into a global market through a consolidated hub, as you will have heard in other testimonies. The UK does 90% of the world's OTC derivatives markets and it is the largest foreign exchange centre in the world. It has everything to do with being able to consolidate everything in one place, including the dollar, the renminbi, the Swiss franc, the Saudi riyal and everything else—it is the fact that people can do things in one place. If you say, "Euro activities cannot be done from a base outside Europe, and the UK is now outside Europe", then the benefit of being able to do everything in one place is fragmented. Could the business be done? Yes, it could, in the same way in which we deal with other countries through correspondent banks and the like or set up subsidiaries, but it adds another layer of engagement, which adds to cost and complexity and potentially to risk.

There is a whole ecosystem in terms of our customers, our regulators and our policymakers, and we have to ask how we can bring as much as possible together in a place that is transparent and well regulated so that we can eliminate risk. Dismantling that is completely counterintuitive to everything that people have tried to do over the last eight years post-crisis.

The Chairman: Mr Wilmot, did you want to say anything on that?

Alex Wilmot-Sitwell: The trouble is that I keep agreeing with Douglas.

The Chairman: That is perfectly fine and excellent.

Alex Wilmot-Sitwell: And I do not intend to disagree with him now. I will add one point, because we are all slightly different. As I said, we are a US bank and we service only the wholesale markets. There is an advantage in doing that in London for all the reasons that Douglas has just very well articulated. To the extent that we need to access the markets in the EU from within the EU, that will just add to the cost and complexity of how we run our business. The chances are that that cost and complexity will be passed on to clients to a certain extent, and the complexity will add to the risk. Eight years post the financial crisis, that is not a very good outcome from creating a much safer environment where capitalisation is clearly hubbed around operating subsidiaries that carry the appropriate liquidity. If you start dismantling that, it will create inefficiencies and add to risk and complexity, and that is not good for any of our clients.

The Chairman: I think that Lord Butler wanted to come in on this.

Lord Butler of Brockwell: To take a specific example, in evidence to us last week, Professor Charlie Bean said that he was certain that we would lose the capacity to do euro clearing in London. I do not know whether you agree with that view, but would that be a serious blow to London's financial services?

Alex Wilmot-Sitwell: I am not going to give a view on the political debate around what comes out of what will be a complex series of negotiations and discussions, but foreign exchange clearing is an ecosystem in itself; it is not something that you can dismantle and pull pieces out of without the risk of it increasing costs and complexities. Of course you can clear euros—you can clear any currency from any trading venue you choose. To the extent that it is all packaged together and interconnected and enjoys the benefits of efficiencies of scale, it is the supermarket effect, if I can call it that. Foreign exchange is essentially like Walmart; it is a question of pushing as much product through pipes as cheaply and efficiently as possible. If you move those pipes somewhere else, you will probably create some additional frictional costs and lose some of the benefits of compression that you get from having it all sitting on a single trading venue. But that may well be what we are faced with and it will obviously need to be factored into the strategy of CCPs and other trading venues.

Douglas Flint: I think it would be very bad for the ecosystem. Effectively, you would create the need for collateral in more than one place. It would become less efficient. The infrastructure is at the heart of the financial system, and you can get the compression benefits by offsetting all the pluses and minuses across every currency. As I said, we have Saudi riyals, dollars and renminbi, as well as euros, but to take every one of the major currencies from that offset arrangement would have a seriously damaging effect. It is inefficient, but you also invite people to ask where they can do it all in one place. No doubt other jurisdictions would leap at the opportunity to try to create something that competed with the ecosystem that dominated.

Q22 **Earl of Lindsay**: I turn to equivalence. Do you think it is very important that we establish equivalency rights going forward and maintain them thereafter? Is this going to be the vital means by which UK financial services or UK-based financial services retain access to the EU single market? Or do you see equivalence of disciplines and requirements of establishing and maintaining equivalence rights acting perhaps as a constraint, stifling new opportunities and perhaps introducing new risks?

Elizabeth Corley: As Douglas said very well, we are in an international world. It is a global world. There have definitely been a lot of attempts in the last eight years to see more convergence of regulation and standards. When we talk about equivalence with Europe, we are also talking about the way in which we work with other jurisdictions, particularly the United States and parts of Asia. There is no doubt that in financial services one needs a dynamic and agile means of regulation and supervision. The challenge with straightforward equivalence is that it is static. You are given an equivalent status at a certain point in time, and then, as you say, markets change and innovate, and regulation might shift. So anything that assumes a static status quo will not work in practice. Something that is beyond equivalence in regulatory co-operation and joint working and is consistent with an international framework of convergence on regulation will probably be key.

Douglas Flint: I completely agree. The great thing about equivalence for the UK is that we start off on day one as equivalent because we have EU law. The challenge then is the process to agree that equivalence remains, and whether it is absolute equivalence or you get an equivalent outcome from slightly different regulation. Are you a follower of someone else who says, "You have to be equivalent to us and therefore if we change, you have to change"? It is quite challenging to see what the arrangements would be in order to adjudicate on continuing equivalence and whether a business model could accommodate the risk of someone saying, "Sorry, I do not think that you are equivalent anymore." That would mean that you are out of business. It is a challenging concept without some line of sight on how changes would be accommodated, negotiated and agreed.

Earl of Lindsay: So if equivalence as a means of maintaining access for UK-based financial services in the European markets is not the most satisfactory or desirable pathway to go down in terms of the disciplines and constraints it might introduce, how else do you think that the access could be negotiated or created to provide some certainty going forward for the UK financial services sector?

Elizabeth Corley: Obviously this is something that from a regulatory and public authority point of view should be front and centre of the thinking. However, from the practitioner point of view, there is no doubt that the United Kingdom has in many instances worked very co-operatively with the rest of Europe on raising standards of regulation and supervision. We have been very influential on many of the financial services regulations. That in turn has helped Europe to have a degree more influence and status in global discussions around regulatory convergence. It would seem to be very sensible for both sides to view this not as a tit-for-tat negotiation but more about how to continue on the pathway that has been set out for the past eight years of raising standards, improving market stability and protecting customers without it becoming a political counter. This goes to the heart of looking after clients' interests. I do not know how the process will work, but as a pure practitioner I would love to feel that certain elements are viewed more in terms of market stability and consumer protection than they are as political counters in part of the negotiation.

Alex Wilmot-Sitwell: I think that equivalency can work, but it would need to be a different form of equivalency from what currently exists. That is because in its current form it can be withdrawn at very short notice, which does not give anyone the ability to look forward or to have any long-term confidence that it would remain. Some form of equivalence regime potentially could work, but it needs to go hand in hand with some form of shared regulatory response and harmonisation. That can be achieved, but it will take time and will require a lot of thought. This again goes back to a point I made earlier, which is that equivalency is quite possibly the right framework to be thinking about, but it needs to be long term and must be embedded and aligned with a harmonised approach to regulation. By the way, that is also achievable in the context of regulators from the UK and the EU that have worked completely hand in glove. We are equivalent today. We start this process being completely equivalent, so we are starting with the right perspective and from the right departure point. Equivalency is a regime that could possibly work, but as I say, it needs to be aligned with regulatory harmonisation and to be thought through on a long-term basis.

The Chairman: Do you take comfort from the Trade in Services Agreement for 23 member states? It is the new agreement that has been negotiated. Are you optimistic about it?

Alex Wilmot-Sitwell: I cannot comment; I do not know the details of the agreement so I would not want to jump into an area that I do not know.

The Chairman: Do either of the others know anything about it?

Elizabeth Corley: No, I am afraid not.

Q23 **Lord Desai**: One merit of a place like London is that you can always find new markets. The Brexiters are asking us why we should get stuck in the EU area. Is there any scope for the City to go into non-EU markets?

Elizabeth Corley: We may be the wrong people to ask because we are already global firms. I am sure that there are many opportunities given the reputation of the United Kingdom for its regulatory and legislative basis as well as the innovations that are happening here in fintech and other areas. I am absolutely sure that there are markets that have yet to be opened up. Purely in asset management we tend to roam the global stage already. Here in the United Kingdom, two-fifths of our asset management activity is for international clients, half of whom are in Europe and half elsewhere. I am sure that it will grow, but one thing that will help it is a better line of sight on what the transitional arrangements will be and on the process for getting us from A to B and then to the ultimate destination. It is a very competitive world and the more certainty we can give to our clients, the better that will improve our competitiveness.

Douglas Flint: We are already subject to global roles. We absolutely agree that there can be no backtracking on the very high standards that have been put in place; the UK is clear on that. There is no desire to loosen and lessen the regulatory. If anything, one wants to make it even more internationally respected in order to retain business in the ecosystem. There may be bits and pieces we can do where the EU is unable to agree a deal with a foreign country that the UK might have less concern about, but for the major firms the regulation that we face and the standards we apply are global rather than regional or national.

Alex Wilmot-Sitwell: I am definitely the wrong person to ask because as the head of a global firm we look at the business on a global basis. This is one of the big challenges that Europe faces. We are competing with other global markets, so creating and maintaining market efficiency, capacity and attractiveness are obviously critical. Whether it is in the UK or the EU, we operate close together. We are competing with Shanghai, New York and other big centres of commerce, although within our industry it is primarily those two centres. Business can move very easily if the framework for doing business becomes more expensive or less attractive.

Douglas Flint: We should not lose sight of the fact that over the last 40 years we have attracted many international firms into the ecosystem that has been built up by offering them not only fantastic rule of law and access to the cluster, but also access to the European markets. The Japanese among others are very cogently around. We have built up our infrastructure in the UK because it has given us access as well. There is a flipside to the question of whether other markets are more available because we have brought people in on the basis of giving them access to a bigger market than may be available in the future.

The Chairman: Am I correct in inferring that the regulatory fragmentation that will come out of this is not something that you would welcome? Do you see it as a challenge even though it might improve the competitive environment for some players in the marketplace?

Elizabeth Corley: For the international and wholesale markets, that is undoubtedly true. Douglas is better placed to talk about this, but where there is potentially some scope is in purely domestic opportunities and in retail. One could argue that a one-size-fits-all approach could possibly be rethought. But internationally and for wholesale reasons, we are going to be dependent on international standards.

Douglas Flint: It is possible that there is an opportunity at the middle and lower level of financial firms which are purely domestic. The one size fits all of international regulation which is articulated through European directives could be moderated for challenger banks and smaller institutions to improve competition. It is something that I am sure people will look at, and it could be a good thing. But at the wholesale level, as we have all said, we are subject to global standards and global rules.

Q24 **Lord Haskins**: We have come to the nub of the thing. David Davis MP is coming this afternoon to talk to Cross-Benchers. One thing that we know is that we will learn nothing from him. He has explicitly said that everything will be done confidentially and Parliament will not be aware of what is happening. But we must try. Despite knowing nothing, we are getting the feeling that the Norwegian option is not on the table and that the Swiss option is not on the table. In the view of Lord Lawson, Mr Fox and Patrick Minford, there is the WTO option of just walking away and everything will be okay. But we come back to the bespoke deal, which is almost a clean-sheet-of-paper approach. It seems that a tension is developing between the political aspirations on the one hand and the economic realities on the other. At the end of it, how will it work out? What sort of deal will be remotely acceptable to the financial services? I should add that my background is in Yorkshire manufacturing. I am very concerned that the manufacturing problems take second place to the problems of the financial services and that there may be a deal where

Minford would say, "Let manufacturing go to hell and we'll let the financial services run". You probably will not say anything about it, but how is that all going to work through?

Elizabeth Corley: The challenge that we face is that trade deals for services are a substantially underdeveloped area globally. There is no WTO option for services. I do not think that it detracts from the importance of trade deals. The challenge is that there is a clean sheet of paper on how one would do a services negotiation. Given the United Kingdom's location as a centre for a huge amount of financial services, we probably have no choice but to think about it carefully. This is again practitioner naivety, but one would hope that certain elements of financial stability, such as capital flowing round the world and looking after customers, are not viewed as tokens and do not get in the way of the more substantial conversations about manufacturing and other areas. One would hope that they could somehow be dealt with in a way that reflects the importance of capital markets to our jobs and growth. But that is me being very logical and practical and I completely understand that that is why I would never make a politician. I could not argue it fully.

Douglas Flint: You explained the uncertainty very well. In and of itself, it is another challenge. Firms today, particularly international firms based in London, are faced with the challenge that in two, three or however many years' time the UK could have left the European Union and they will have to make a decision as to how they configure themselves to be able to do what they need to do for their customers at that point of exit. That means that, in an ideal world, they need two pieces of information: where are the Government aiming to get to in their fresh relationship with Europe and what is the bridge arrangement between leaving and getting to that arrangement—how long will it be and what will it encompass? Without knowing where you are trying to get to and what happens from the point of exit to that point, if anything, how do you make a decision? Given the time that it would take to establish a different model and to set up subsidiaries or branches elsewhere or to repatriate activities back to your home location, these things need to be known sooner rather than later. It is taking us three years to move 1,000 people to Birmingham. Contemplating as a firm moving any number of people outside your own country, setting up arrangements and getting licensed is a non-trivial task.

Alex Wilmot-Sitwell: The bridge to the ultimate destination is absolutely fundamental. If that bridge is not long enough or, indeed, if it is not even built in time, it is impossible to make that journey without incurring huge risks and harm to the participants. That does not mean us; it means the markets and our clients. These are very complex processes. Migrating huge businesses from one jurisdiction to another requires an enormous amount of work. It requires a huge amount of regulatory approvals; it requires an enormous amount of co-ordination with other participants, clients, counterparties and clearing houses. That process is very dangerous; it is fraught with risks. The materials that are being moved are risky. You do not move nuclear waste in a race; you do it in a carefully co-ordinated and managed process. The materials are perfectly safe so long as they are properly handled and the period of time in which to move them is suitable. So the bridge—both the building of it and its length—is critically important. An important factor in this process goes back to your point: we are probably not going to know the destination for some time. There is clearly a lot of uncertainty and a lack of clarity in that approach and it is quite clear that the Government are not going to let us know the destination until they are ready. But then we have to be careful that, once the approach and the destination are understood, the time for completing the journey is long enough. That transitioning period is critical.

Q25 **The Chairman**: That bridge analogy is quite compelling. From where you sit, looking at your own sectors but also at the UK interest—it is in your interest that the UK should do well, as your business is located in the UK—what sort of transitional arrangements would you wish to see? You must have given quite a lot of thought to planning for that. How do you see the architecture of that bridge, Mr Wilmot-Sitwell?

Alex Wilmot-Sitwell: It is difficult to be definitive at this stage because this will obviously depend on the detail of the outcome, but it is multiyear. The danger of this potential two-year window from the point of triggering Article 50 to the point of completing negotiations and implementing the outcome is that it is simply not long enough. If you wind the clock 24 months from a period probably in the first part of next year, we need to start those plans now, because the process is multiyear. That is the danger. It has to be a multiyear process from whenever the point of destination is understood if it is going to be completed safely, done in a way that will not risk financial instability and done in a highly co-ordinated fashion. It is a multiyear process, but it is difficult to be precise, because the devil is in the detail.

The Chairman: But once negotiations are concluded and we know what they are, you would like to see a reasonable period—would you like to put a figure on it?—for transitional arrangements on both sides to bed in.

Alex Wilmot-Sitwell: Yes, I would. I suspect the period is two to three years.

Elizabeth Corley: Perhaps I could add that it is a bridge but it is a bridge with spans, as we have periods of transition. We have from now until we trigger Article 50. We then have the period during the process of negotiation. We then have the concluded negotiation and a transition to the end state. So we have spans on this bridge and multiple transition periods. Alex is absolutely right. It is very complicated and you cannot detail it, but one theme will clearly be around continuity of service and continuity of risk management and controls. That is vital. What does it take to be able to continue to service clients in a way that gives you risk management and controls? That, for me, would be the first test. In the second span of the bridge, we are talking about passporting, future business growth and growing from the status quo, but the first part of the bridge has to be around looking after client interests so that they are not harmed or fractured.

The Chairman: I was more interested in the end state. How long do you think you need between when you know what is on offer and the end state?

Douglas Flint: This is going to be the big challenge. Defining and agreeing at the point of departure with our European partners where we all think we are trying to get to will dictate how long the bridge is. How long will it take to set up infrastructure somewhere else and to license the institutions to do business in a different way? Transitioning the licensing, the supervision and the regulation of an ecosystem that today exists in one place and is regulated and supervised by the regulatory authorities of the UK to somewhere else, piecemeal or in whatever way, is an enormous task. Likewise, the UK will have to relicense the 76 European institutions that are here. The more ambitious people are about taking things away from where they are today, the longer the bridge will be because it will take a very long time to build it. If we go to our clients and say that we will not know for seven years or whatever what it is going to look like, they will say, "Well, good luck. We'll go somewhere where we can do it all today because we can't run our business by waiting to see what it looks like in that period of time". So there is a trade-off, which I think will be a political discussion.

Lord Haskins: In a way, is that not a strength for the British negotiation? We can say to the other parts of Europe, "Don't rush this because it's not in your interests to rush it". Mr Juncker made some rather emotive comments yesterday about wanting this all to be tied up very quickly. It is very important to get the pace of this agreed but we do not even have that. If the pace were agreed, we could start dealing with it, and I think that that has to be done.

Elizabeth Corley: That is a very good point. Is it one race that we are running or are there multiple races? Certain parts could perhaps be done more quickly than others. Certainly, it is not just about our own competence in relicensing. If things moved into the European jurisdiction for regulatory purposes, there would be a need to build up regulatory and supervisory resources, which, in turn, would also take time.

Douglas Flint: There is an analogy that I like to make. Everyone talks about financial services being difficult and automobiles being easy, but automobiles are sold on a finance basis. You do not sell a bit of metal; you sell a financial contract which is secured by cars. So the auto manufacturers of Europe and the heavy equipment manufacturers are all going to require financial service access to the UK. There is a huge mutuality of interest in preserving access to finance to make the underlying business work.

Q26 **Earl of Lindsay**: I want to ask a question flowing on from that. Clearly the design of the endpoint will be critical for you—the design of the bridge and the spans within that bridge. I assume that that design being based on the realities of your sector, rather than on the politics that are flowing around the whole Brexit agenda, will be a key issue. You were somewhat reticent earlier when you were asked whether you were engaging directly with the senior Minister and officials involved. You rather sidestepped that question, saying, I think, that you rather hoped that your clients were doing that. Are you confident that in this process there will be the right quantity and quality of dialogue between the financial services sector and the Ministers and officials who will be taking forward the negotiations? Do you already have reason to believe that that dialogue will be there and that you will be listened to, or are you yet to be convinced that that opportunity will be properly created?

Elizabeth Corley: I would say that we have no reason not to believe that. I think there is a genuine recognition that this is a very important part of the economy—both directly and what it supports. These are very early days but—again, perhaps I am looking naive and optimistic—there is no reason not to believe that that should be the case.

Douglas Flint: I think that our role is not to lobby but to inform. We have had very good engagement so far in helping us to understand what the implications are. I think that that is our role. We have set up a number of groups that have interfaced with the political system to make it aware of the issues that are on our mind. It is going to be a political challenge to accommodate them all against all the competing interests but I think that our job is to inform.

Alex Wilmot-Sitwell: I agree. I would also point out that the industry as a whole is working together closely to try to create an environment of providing good information and access to advice. It is very important that we continue to work together, despite the fact that we all have slightly differing business models and interests.

Lord Butler of Brockwell: Do you have any confidence that similar links are in place on the other side of the channel?

Douglas Flint: Yes, they are.

The Chairman: That concludes today’s first public evidence session. The Committee will now adjourn for a few moments while we bring in the second panel. Again, I thank you, Ms Elizabeth Corley, Mr Douglas Flint and Mr Wilmot-Sitwell, for giving us your time today. Thank you.