



Select Committee on the European Union

Financial Affairs Sub-Committee

Corrected oral evidence: Brexit and Financial Services in the UK

Wednesday 2 November 2016

12 noon

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Members present: Baroness Falkner of Margravine (The Chairman); Lord Callanan; Lord De Mauley; Earl of Lindsay; Lord Shutt of Greetland; Lord Skidelsky; Lord Woolmer of Leeds.

Evidence Session No. 9

Heard in Public

Questions 75 - 80

Witnesses

I: Mr Daniel Morgan, Head of Policy and Regulation, Innovate Finance; Mr Bruce Davis, Managing Director, Abundance Investment and Mr Giles Andrews, Chairman, Zopa.

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Examination of witnesses

Mr Daniel Morgan, Mr Bruce Davis and Mr Giles Andrews.

Q75 The Chairman: Good morning. Welcome to the Committee's inquiry on the implications of Brexit for the financial services sector, Mr Daniel Morgan from Innovate Finance, Mr Bruce Davis from Abundance Investment, and Mr Giles Andrews from Zopa. Before I kick off, I will read you some housekeeping points. You have a list of interests that have been declared by the Members of the Committee. This is a formal evidence-taking session of the Committee and a full transcript will be taken. This will be put on the public record in printed form and will be on the Parliament website. You will be sent a copy of the transcript and you will be able to revise any minor errors. The session is on the record. It is being webcast live and will be accessible subsequently via the Parliament website.

Do you have opening statements or shall we go immediately into our discussion? I take it that we can go immediately into the discussion. Perhaps you could briefly tell us the main ways that you think the Brexit vote will impact your industry and what you think the Government's negotiating priorities should be in respect of the UK FinTech industry, given how it is being wooed across the world, it sometimes seems. Mr Andrews, would you like to kick off?

Giles Andrews: We are in the credit business: we lend money. Credit businesses tend to suffer in periods of economic downturn: the performance of credit businesses is linked to economic prosperity generally. If the prevailing view is that Brexit is likely to lead to less economic activity in the UK, that is bad for credit businesses, at a very general level. There is a specific point in financial services around passporting, which I know is one of the questions, so perhaps you want me to come back to that at the right time, and there is also a specific point around talent. Again, I do not know whether you want to come back to that in the question on talent.

The Chairman: We will.

Giles Andrews: Then there is a third point, which is pretty unique to my industry, the peer-to-peer lending industry. It has the benefit of its own regulatory order—RAO 36H—which is a marvellous thing and very good for the industry, and something we worked hard with both the Treasury and the regulator to enact. There is a piece of misdrafting in it, which is acknowledged as a piece of misdrafting, and it is the first sign we have seen of a lack of bandwidth, if I may use that word, in the Treasury and the FCA in resolving something. We found, before Brexit, that considerable time and energy was put into working with our industry and we have noticed a fall-off in that, which is perhaps not surprising given the stretch in resources that is being taken up by activities such as this.

The Chairman: Are there direct implications that you are facing?

Giles Andrews: There are. It is just a piece of misdrafting that could be resolved. I think all parties acknowledge that it is not as intended. The Treasury is on record as saying, "Yes, we acknowledge that that is not what we meant", and of course the FCA is bound to take some words on a form and say, "Well, that is what it says so that is what we have to do". For the first time in our experience of working with the regulator and the Treasury, we have found a logjam, where everyone acknowledges that there is a problem to be solved, which is actually not trivial to resolve because the redrafting will require some thought. It is not just a question of crossing a "t" or dotting an "i". It is that lack of time to put the thought into it that is stopping it happening.

The Chairman: That is very interesting. Mr Morgan?

Daniel Morgan: You use the term "industry"; we represent FinTech as a whole. There is no industry code or SIC code for FinTech so it is quite an amorphous space and Brexit will hit each sector differently. There has been FinTech a lot longer than the term has been widely used and it has arisen around the same time as the disruptor or particularly B2C—business to consumer—propositions. Most of the investment in the US and the UK, particularly on what has been described as the last mile—payments, peer-to-peer, crowdfunding—in areas where there are high margins is increasingly underserved or there is light regulatory friction. The vast bulk of the activity in this area in the UK over the past few years has been on the consumer side but increasingly there is activity in FinTech, cap markets, regtech and other areas, which again will have different implications.

The areas that have already been touched on are still important. Obviously, talent is hugely important. Of our start-up member base—non-institutional—30% of the founders of those companies were born overseas. It is inherently an international sector so access to that talent is really important. The Government commissioned EY to do a report on FinTech, which identified three types of talent within FinTech: technical talent—STEM, et cetera—financial services talent and entrepreneurial talent. That third one is quite difficult to define within a visa system. In a very large labour market of 500 million people, it is easy for people to come here and start a business.

Obviously, there are single market issues, including passporting. Some sectors, such as peer-to-peer, do not benefit from passporting. Others do, especially in the payments area, regulated under SEPA or the PSD. There is a huge sector of growth in payments, which will be directly impacted. Of our start-up members, 20% are authorised to passport but not all of them do so at this stage. It is very much seen as a growth potential for future activity for investors.

Obviously, access to capital is an issue—the attractiveness of the UK as a place to invest but also European funds are important. The European Investment Fund is a key cornerstone investor in a lot of venture capital in the UK, so the role of the British Business Bank will be critical in stepping in to fill that void.

Another key area, which has been a huge success for the UK, has been progressive regulation—some of the stuff the FCA did. The bespoke regime in both P2P and crowdfunding had been widely recognised as a global success and a world-leading sector. Other areas, such as the sandbox approach, Project Innovate and the competition mandate, have been widely seen as positive—something that is obviously in domestic hands and can be taken forward.

Bruce Davis: I can speak both as a platform that is regulated under MiFID as a crowdfunding platform and as a director of the UK Crowdfunding Association, so there are another 40 or so platforms that all have different regulations. The first thing to say is that there is no single market in financial services. What we are working with is basically a series of overlapping agreements that are incredibly complex and quite often rub up against each other in interesting ways that make our lives difficult. There is no harmonisation; it is not feasible in certain areas. You have many national interests represented in the way that legislation works. What we have found immediately, particularly since Lord Hill's departure from his role in the Commission, is that we have been shut out of those discussions, particularly around the development of the prospectus directive. That will have a direct impact on the way that our businesses run, specifically looking at raising the cap on the exemption from the prospectus directive, which will allow small and medium enterprises to raise money more cost-effectively from investors. That was an immediate impact within a week of the vote.

More broadly, as Giles said, we have had very strong support for our industry across a number of different areas, including the development of a tax system that incentivises investment, incentivises people to take risks and gives rewards for doing that. There are two sides to it, one of which is how we respond to the negotiations, but we must not take our eye off the ball. The UK market still needs that development to carry on. Each time we do something, we have an impact.

On the third area, which is around skills, it is not just about bringing people into businesses; it is also about how we fund research into both the development and the impact of our innovations, and helping to guide policy in that way. We welcome the fact that the FCA is using the Cambridge Centre for Alternative Finance to improve its evidence base for making policy, but that will need to be supported more strongly if we are going to grow it; the more we do, the better we do.

The Chairman: It has been suggested that prior to Brexit the FinTech industry was living in its own comfort zone because out of all the EU countries the United Kingdom was the most innovative in that regard. Do you think that one positive that may come out of this move is that you might go out and look at other markets where the future growth potential really lies? The next billion internet users are expected not to use bank accounts and to be far away from London.

Bruce Davis: The EU market is underdeveloped in terms of financial services and has huge potential. It delivers different opportunities from

the emerging markets. I think that the emerging markets are really about what might be considered to be leapfrog technologies. We have seen that in mobile phones and solar generation, and we will see it in financial services. I do not think that the emerging markets are going to go down the same cul-de-sacs that we did in terms of financial institutions and developing them when there are new technologies available to them. Yes, it is an opportunity, but I would say that it needs support. It comes with a huge amount of risk. We are a growing industry but we are not huge, so the question then is how we are being supported into those markets.

The Chairman: Could any of you put a number on the size of the industry?

Daniel Morgan: Obviously there is no industry code, so it depends on how you cut it. In revenues, according to the HM Treasury report it is worth around £6.6 billion, but if we take the larger figure, which is institutional investment in FinTech, it is around £20 billion. But again, because there is no industry code it is very hard to define the broader FinTech industry.

Bruce Davis: In terms of the EU, I would say that we are seen as the leader, but the catch-up rate is remarkably swift. Before the Brexit vote we had Ministers coming to the UK to talk directly to FinTech firms—I am talking about Finance Ministers from Ireland and from Germany in particular, and that was not just a sort of sales pitch for Berlin. They really wanted to understand not only how they could develop their regulations to attract businesses but also how to keep them. So they were slightly bemused when they were met by three or four German entrepreneurs who had set up in London and told them why they had not stayed in Germany. They were given a very clear reason why. I think that they will set about making themselves attractive.

Giles Andrews: In terms of scale, my industry piloted this because we were the first people in the world to do it. That gave us an advantage in terms of time. The industry will lend approximately £2 billion this year, which represents probably about 75% of all European activity. The rest of Europe is a fraction of our size but, as Bruce says, they are catching up fast and probably growing more quickly than the market here.

Lord Shutt of Greetland: Mr Davis, you said that you had been shut out of discussions in the EU. How did that come to pass? As I understand it, we are in until we are out. Did you think, "Oh well, we are on our way out so we won't bother troubling them" or have you been pushing?

Bruce Davis: We are still in discussions because we happen to have strong allies in Germany. The MEPs were shut out of the conversation in the trilogue process.

Q76 **Earl of Lindsay:** Mr Morgan, in your earlier comments you referred to the relative importance of passporting to some parts of your FinTech membership. Can I ask all three of you to be a little more specific about exactly how important, and where that importance may be, in terms of

achieving passporting post-Brexit? Also, do you have any comments to make about whether the third-country equivalence arrangements, which are already defined and designed, and to an extent operating in some EU directives and regimes, are also, as it were, a desirable objective in terms of what the post-Brexit landscape might look like?

Daniel Morgan: As I said, it is quite a diverse sector so it impacts on different parts of FinTech quite distinctly. The largest sector is around the payments under the PSD and e-money directive in terms of operating and utilising the passport in terms of FinTech and the 1,500 registered PSPs in the UK. They will be directly impacted. Again, with money transfer you are outside the single European payments area, so you will be impacted directly and there will be an extra layer of friction. In terms of MiFID and things like crowdfunding and robo-advice, I hear that it does not work as well in practice. There are many different national regulations around prospecting and so on. Like Bruce, I do not think that it is necessarily the best example and it is not fully utilised. The important thing to take away in terms of what is happening in the sector at the moment is that many who are passported, which is not all of FinTech, are not all utilising it yet. It was seen very much to be a part of something of a term sheet for investors, an opportunity to scale with relatively less friction up to a much larger consumer market at some future point. So many are utilising it, particularly in payments or money transfer, but others are not utilising it yet.

Bruce Davis: I run a passport business and I passport to the EEA. I know that other businesses trying to do that have found that responses from the local jurisdictions have become tortoise-like. We are at the bottom of the pile. An FCA request will not now be dealt with at the same speed as it was before. We can definitely see that as an impact right now. Even in the next two years, if we are still trying to establish businesses that we may then want to deal with post negotiation and post some form of resolution of what is happening, we are already seeing a slowdown in the engagement of bureaucracy on that side because it is not seen as a priority for them. That is being communicated strongly. There are an awful lot of other things that we touch on—the unfair terms directives and the alternative investment fund managers directive. Payments is a particularly important issue. A lot of us are on payment systems that are regulated out of Europe and based in Europe. The last one, which is perhaps the biggest one, is data.

The Chairman: We will come to data a bit later

Giles Andrews: For us, passporting is a desirable hypothetical because you cannot passport an activity unless it is similarly recognised as an activity in the other member state. Peer-to-peer lending is uniquely regulated in the UK and therefore we cannot passport it to a jurisdiction where there is no regulatory activity called peer-to-peer lending. I was hopeful that over time, as the European states catch up in terms of their volumes, they would inevitably be regulated. I have spoken to a number of country regulators who have all said that they admire the approach of the FCA to regulating our industry. It appeared that the direction of travel

was that other European states would regulate similarly to the FCA, so I was looking forward to being able to passport as and when they did. But I cannot grieve the loss of something I never had other than as an opportunity that I perceived I would have in the future.

Daniel Morgan: Earl Lindsay, you raised one more point about third-country regimes. Currently, as it stands, it would take payments and PSD; there is no third-country regime for that, so anything we moved for would be a bespoke option.

Earl of Lindsay: I want to pick up on the point Mr Andrews made. Some of the witnesses have commented on the merits and possible drawbacks of seeking third-country equivalence within the EU definition of how that process works. They have expressed a concern that the requirement to maintain regulatory equivalence could be unhelpful to the innovation of the financial services sector—of course FinTech is a good example—the UK's leading role with regard to innovating within the financial services and, equally, its reputation for seeking to innovate regulation alongside new products. Do any of you have any views as to why FinTech might suffer if we ended up with a Brexit deal that was heavily committed to retaining a regulatory equivalence to achieve that third-country equivalence in EU terms?

Bruce Davis: Obviously, the key areas are now hugely important for the business model, and payments is one. If you are outside the European Union, you do not have any say in how the regulation impacts on you as a nation. Given the size of the UK's financial services sector, I find it difficult to see how that situation would be palatable for long. On freedom to innovate, key things will have to be compliant with data. If you have a 500 million person block on your doorstep and you want to interact with that, you will have to be compliant with how you process that data and be equivalent. In other areas, there are opportunities as regards how we are looking at regtech now, especially capital markets; for example, blockchain, KYC and so on. There are huge opportunities, but at this stage it is a bit further down the line and it is not where our members are currently looking.

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

Giles Andrews: Forgive me, but I do not entirely understand the question. If you are asking whether third-country equivalence would be a similar result to passporting, I feel that it would be more difficult. The regulation has to be identically matched, whereas under the passporting regime, if there is deemed to be sufficient overlap that allows for more compromise, it allows for individual countries to have subtly different regulations that broadly get to the same place, and that allows for passporting. That feels like an easier solution than—if I understand you correctly—the more bureaucratic one you discussed.

Daniel Morgan: On FinTech regulation, the UK has already exported a model. The US, for instance—all eight federal regulators—is looking at a sandboxing approach, as are places such as Singapore, Australia, and so

on. Therefore the approach to regulating innovation in financial services is a model which is being taken on around the world. For instance, Australia has a very similar code of conduct handbook and it has taken a similar approach. We must not forget that the UK within the European Union has already started to set the agenda with regard to regulating FinTech.

Bruce Davis: It is really about the direction of travel. We had a direction of travel that was around encouraging cross-border retail money in particular, because that does not really happen at the moment in Europe, for lots of political reasons, which relate to some of the issues around the Brexit vote that also occur in other countries: a desire to protect the capital inside your own economy and not to have it flow somewhere else. Therefore we have to look at some of the political motivations behind the way the financial services market works within Europe and be realistic about that. It is not a small task to renegotiate commercial terms with large providers of services which are in a different regulatory environment. I am thinking specifically about data, which we can pick up later, but there are a lot of different places where that process will become more complex. Culturally we will be on a divergent path again, when previously we were on a convergent path as regards the way people thought about how financial services worked and the best way to operate at a European level. We are going back in time, and that has reduced opportunities for expanding businesses.

Q77 **Lord Woolmer of Leeds:** The use of and access to regulation of data is clearly very important to you. What use does the FinTech industry make of UK data-sharing arrangements and EU-US arrangements and agreements on those matters? How do you think those issues might be affected by the Brexit scenarios?

Bruce Davis: The EU-US question is interesting. Personally, I do not do business with the US, for that reason. Data is important, and there are two issues here: where it is stored and how it is shared. Currently, you will find that a lot of the industry uses certain providers. We had a long conversation with the FCA about how providing access to those facilities would work; that has to be looked at again, as lot of those facilities are in Ireland. It is therefore not straightforward to unravel all those different commercial agreements and what commercial providers are prepared to take in terms of risk within those agreements, as well as the political ones. You therefore have two levels of complexity: what the companies are prepared to do and what someone might have agreed at a policy level. I would not like to unpick that at this point, as we are still trying to work it out.

Daniel Morgan: The UK will implement GDPR—that was confirmed by DCLG very recently—and once we leave the European Union it is essential that we that we comply with the third-country equivalence regime. Given the size of the market and the business models involved, any extra layer of friction will have an impact on investment and business models, so it is critical that we do not go down our own path in terms of data processing given the size of the neighbour next to us. Obviously, a huge amount of

business models in FinTech are based in the Cloud and so will be impacted disproportionately. PSD2 will also be important as a driver for FinTech in the coming years which opens up consumers' data to third parties across Europe, supporting the FinTech industry. Again, open banking and open APIs in the UK will be critical to see who can operate within that market, which will all interact with GDPR. So it is essential to maintain a little less friction and that we try to aim for equivalence within GDPR.

Giles Andrews: EU data sharing and things like PSD2 have been long negotiated, and we urge a commitment to continuing with those. If there is a difference in approach, it is more between Europe and the UK together, and America. We are better off aligning ourselves with a big entity if we are going to have disagreements about data sharing with the US.

The Chairman: To align ourselves with the US, or with the EU?

Giles Andrews: With the EU.

The Chairman: Because we are closer to them?

Giles Andrews: We are closer to them philosophically and geographically on the matter of data sharing, therefore if we have a disagreement with the US, it is better to have that disagreement together.

Lord Woolmer of Leeds: As I understand it, the European Union's data protection directive is likely to be replaced by a more stringent directive in 2018. In that event, in or out of the EU, presumably you would want the UK to ensure that the way it protects data is very much in line with the way the EU has devised, which, as I understand it, will be more stringent.

Giles Andrews: Correct.

Lord Woolmer of Leeds: I could put that simply: it means that the idea that freedom to do what we want if we are not in the EU does not mean that we can ignore what the EU is doing, from your point of view. You would still want the UK, even with Brexit, to make sure that we are in line with European directives.

Giles Andrews: Correct, particularly in the area of data.

Daniel Morgan: It is not even just the UK being on the doorstep of the European Union; other countries are undertaking a third-country regime through the current EU rules and will do on a GDPR so that they can do business with the European Union and be seen as equivalent, so it is essential for business to do that.

Lord Woolmer of Leeds: How confident are you, going forward, that out of the EU, the Government on your behalf will be able to negotiate, and you yourselves with your relationship with Europe will be able to

maintain, sufficient equivalence so that you find ease of access to the EU markets?

Daniel Morgan: I do not know.

Lord Woolmer of Leeds: So really it is up in the air and you will wait and see what happens.

Q78 **Lord Callanan:** I want to ask you about the potential impact on your business of any post-Brexit immigration controls. How might that affect the ability of the FinTech industry to attract and retain talent?

Giles Andrews: Just under half our workforce is non-UK, and they come from a wide variety of sources.

Lord Callanan: EU or non-EU?

Giles Andrews: Mainly EU—not exclusively, but mainly EU. I happen to think that unfortunately the UK is underdeveloped in terms of its STEM education. That is something that successive Governments have tried to address, and perhaps we are on the route to addressing it, but as of today our graduates are underrepresented in those subjects, and therefore there is a need to look elsewhere. I also think there is a benefit culturally within our businesses from having the melting pot of a variety of different nationalities and attitudes. We met with our workforce the day after the referendum. There were a number of people who were very confused—adults saying, “Do I have to leave now?” We were able to give a degree of reassurance but we cannot give the ultimate reassurance. We could give our opinion that it is highly likely they will be able to stay, but we could not guarantee that. We are continually recruiting technical talent—I am particularly focused on that—but we are already finding less desire among bright eastern Europeans, Germans and French people to come and work in the UK.

Daniel Morgan: We have institutions and start-ups in our membership base. The start-up section goes up to quite large companies, and 30% of the founders of these companies were born overseas. It is an inherently international market, and that is not unique to the UK: this is a global sector and a globally competitive sector. It is a similar story around the world. The Government’s own figures, from a report commissioned from EY on the FinTech sector, highlight that 40% of all tech workers in Silicon Valley were born overseas, and the US has a large domestic labour force—larger obviously than the UK’s. There are three elements to it: technical, FS talent and entrepreneurial. As we said, the flexibility around technical is still difficult. The definitions and the hoops which start-ups have to go through are quite tough. The wage level that is set does not always fit, although sometimes, obviously, equity is offered in lieu of a wage. How long it takes to hire new workers is potentially going to be an issue—you may want to hire someone quite quickly, maybe after a funding round, and obviously some of the criteria on a tech nation visa can be quite stringent, and not many people qualify for it. The numbers and awareness are not great.

One of the key things with technical, FS and entrepreneurial talent is that entrepreneurial talent does not have a definition—you cannot define someone who wants to come here and set up a business. Obviously there is an entrepreneurial visa, but you have to have a huge amount of capital already in place behind you or prove that you are about to set up a business. Many of our founders came here just with an idea, and with a smaller labour pool that talent will no longer gravitate here. I might also add that many of our members have not been enthused by some of the language around immigration and skills. This is a highly international sector. Investment was the number one concern immediately following the vote, and this has shifted somewhat to attractiveness to international talent and skills, before we even try and attract them.

Bruce Davis: I would just add two things. First, I think it is about looking beyond recruitment into the companies and into the universities that we then recruit from. Similarly, about one-third to one-half of my workforce comes mainly from the EU, but for lots of different skills, not just tech. A lot of them came through our university system, so it is turning out good people, but we need more of them.

The other thing is that one of the reasons why those entrepreneurs come here is because of a positive circle: we have an effective crowdfunding system, so we can raise money for companies more easily, and so if you have a good idea, we are a good place to come and create it and then export it to the world. There are later questions about being a FinTech hub; part of being a hub is about being connected to spokes. At the moment those spokes have to be two-way, and people have to feel they can come and go within that environment because that is what creates new ideas. These things do not come out of thin air, but out of the interactions that we have with industry. We are very collaborative, and that is what is producing the good stuff that is happening. Maintaining that momentum is very important, and it can disappear quite quickly—as quickly as people’s confidence. We really need to work to ask what we are doing to support that ecosystem.

Lord Callanan: Do you think there is a good opportunity post-Brexit, if we frame immigration policy properly, to increase the supply of talent from across the world rather than just concentrating on the EU? The consequence of free movement has effectively been that the Government have imposed much stricter immigration controls on non-EU nationals, so it is much more difficult to hire people from outside the EU, as a consequence of it being relatively easy from within it. If we structure immigration controls properly we could attract talent from the EU and outside it, while possibly restricting non-skilled immigration.

Bruce Davis: I could not comment on that as it is something of a hypothetical as to what graduates are bringing in. When you look at the numbers of foreign students who are using our universities, the biggest number is Chinese—90,000, I think. What we do not know, and what would be a good thing for the Government to find out, is exactly what they are studying.

Giles Andrews: And whether they stay.

Bruce Davis: And whether they stay. Within the European area, there is a degree to which the idea is you come here and stay. There are different views elsewhere, more about acquiring those skills and then taking them back. Some of that is a cultural desire to deliver your success in an environment where you are recognised for that success. It is a more complex cultural problem than simply turning off a tap and then turning on a different one. I do not think that would be the case.

Daniel Morgan: What is clear is that if you take away the access to a labour pool of more than 500 million people, there will have to be a radical overhaul and assessment of all levels of visas and what we are looking to achieve through that. Obviously, at the SME, entrepreneurial start-up level, they do not often fit into the boxes or definitions of what would fall within certain skill sets or qualifications or within certain access to capital around the entrepreneurial side of the well. We would need to drastically increase the numbers, or keep them open to review on a constant basis. We would have to be a lot more flexible in trying to address some of the skills shortages if we were going to do that.

The Chairman: Mr Morgan, would you be able to provide us with a line of vision—a list of the things that, when recruiting from outside the EU, a company in FinTech would have to go through, for example to get a visa for an Indian, an Australian or one of the other nationalities to come to the United Kingdom? Would you be able to give us a short list of what your company would have to do? We want to get a picture, or brief overview, of the bureaucracy involved and the timelines.

Daniel Morgan: I have never been involved in the process, because I am in a trade body, but—

The Chairman: Would any of you be able to provide that?

Daniel Morgan: I can attempt to run through what I understand to be the process. Obviously there would have to be a period where the role has to be out internally, under a number of guises. There is often a certain salary level which needs to be achieved at tier 2, which is obviously not exceptional.

The Chairman: Would you be able to send this to us?

Daniel Morgan: Absolutely.

The Chairman: That is great. It will help us to illuminate the extent of the issue if they do not negotiate the kind of deal that Lord Callanan just referred to.

Giles Andrews: To pick up on your point, in a pre-Brexit environment we are naturally competitive within Europe as a place where people want to come and work. It is not impossible but it is harder to imagine that competitive advantage being extended greatly geographically. The US is seen as a very appealing prospect for people who are prepared to travel

half-way round the world, and it would be hard for us to compete with that.

Q79 Lord Skidelsky: I want to get an idea of what FinTech really is. It is always quite useful to have that in one's head before talking too much about it. Is it simply a supplementary electronic form of intermediation, such as traditional banking provides, with services to retail services and investment services? Is it regarded as a sort of supplementary electronic form of intermediation, or do you have in mind the potential to replace traditional banking in some sense? To finish that question, you have talked about credit creation. To what extent is this a source of credit? Can it be a source of credit creation? If so, it will obviously impinge on monetary policy. There are huge implications for this industry, so how do you see its development?

Giles Andrews: We do not create credit. Banks create credit. We intermediate directly between providers of credit—who, in our case, are predominantly retail consumers—and the people who want to borrow it. So we provide a different sort of electronic intermediation.

I would characterise FinTech as being not about technology per se but about the use of technology. Innovations in FinTech are seldom innovations in technology. They are usually innovations in business models that are enabled by the use of technology. Although we are technology-rich and employ lots of technology specialists, those specialists are more involved in implementing technologies that already exist so as to do a different form of intermediation.

Lord Skidelsky: So you are in the interstices of an intermediation system, and you are not thinking of replacing banks as sources of credit.

Giles Andrews: No, but we could replace banks as intermediaries of certain types of credit, if that is clear.

Lord Skidelsky: No.

Giles Andrews: We take a source of capital—which in many cases is not very different from a bank's source of capital in that banks take retail deposits and we take investment from our lenders—and we do a different type of intermediation that does not involve the creation of money; it simply involves transferring money from one place to another. Banks do the same intermediation, plus they have the ability to create money.

Lord Skidelsky: In so far as you grow, the regulatory environment will have to change to accommodate that growth.

Giles Andrews: It would have to change were we to seek to create money, but I do not think there is any fundamental need to create money. The UK economy is not short of money, so I would postulate that the money does not need to be created.

Lord Skidelsky: One last thing: one of the triggers of the development of FinTech was disappointment at the failure of banks to create enough

credit in the aftermath of the 2008 crash.

Giles Andrews: I think that that was coincidental, not causal. In our company's case, we have never lent money to consumers to whom banks would not lend money. So we were not responding to a funding gap; we were responding to a disenchantment with the industry. We were introducing some efficiency and a better service that meant that people were happy to use the new, alternative service, but we were not stepping into a gap.

Daniel Morgan: Fintech is pretty broad and it is evolving all the time, along with technology and the regulatory and policy environments. Obviously the vast bulk of the investment has gone in in the last mile—the consumer experience on top of the rails of the existing financial system. How you experience payments is ultimately still administered by the banks. The PSR—the new Payment Systems Regulator—is obviously working towards opening up the access of real-time gross settlement to electronic challenges, which could potentially change some of that relationship.

Another area is robo-advice, which is delivering automated investment based around algorithms. It offers automated execution, only cheaper than an investment manager would do it, the average cost of advice being about £140 an hour. It enables people to step into an underserved area. For example, the Retail Distribution Review created an underserved area with the advice gap, and technology can deliver it in a cheaper and more transparent fashion. It is a changing and emerging area of activity, which so far has been primarily on the consumer side, but a whole new range of technologies are looking to change the way that capital markets and regulation work, based on the better use of data. It is a moveable feast, so to speak.

Then there is the rise of neo-banks and challenger banks with full banking licences. You can have a digital-only bank based on an app on your phone, but they are fully licensed banks and can create credit. So FinTech is a pretty broad spectrum.

Bruce Davis: There is also the investment side. My main competitors are not the high-street banks; they are the international merchant banks on the local infrastructure projects that I fund. We are looking at introducing the opportunity to take risks again with people's money, which had largely been taken away. On the other side, when I have talked to the larger high-street banks, I have been told that their regulation is driving them towards very high-volume, very low-risk and low-margin business. That is vital in the economy—they need to provide that extremely liquid credit to very low-risk businesses and individuals—but we need to maintain the momentum of rebuilding the financial system that was largely wiped out in 2008 and, post that, with the unwinding of those businesses. That needs to be replaced. At the moment, it is not so much about replacing banks as about replacing a vacuum. If we lose focus on that, in some respects it will have a bigger impact on some of the detailed negotiations around our relationship with the EU.

We also need to look at the resilience of our own financial system. The fact that we have an alternative finance industry, as opposed to just a blip, will support us in maintaining our economy. On your point about why people voted in the way that they did, where large amounts of cash arrived from the EU, interestingly people voted against the EU because they did not feel that they had a stake in it. One thing that alternative finance does through this mechanism is that it gives people a stake in the way that these financial institutions work. They are part of the system: it is not done to them; they are it—we are networks. That enablement and engagement is incredibly important.

Swindon has today launched its own ISA. Why has it done that? It is because it a pretty self-starting kind of town and they want to do it for themselves. Now, you can invest in stuff that is happening in Swindon through an ISA. That is the innovation. There is a load of technology and thinking behind it but, in that case, the innovation is self-reliance. I think you will see that coming through in lots of places, whether in alternative currencies, new forms of lending or new forms of investment. That is where we can generate innovation

The missed opportunity is our ability to export those ideas easily to new markets. We are going to keep innovating in the UK and we need support. We have had good support but more can be done, particularly around social investment. Once you go beyond that, we can take it out to new places, but that is risky for us. We would have to raise capital and we have to have confidence that we can operate in those sectors. We would need a lot of legal advice and there would be a lot of cost in doing things, and help would be needed with that. The more we create barriers to that, the harder it is to do. That does not mean that it is impossible but it is harder.

Q80 Lord De Mauley: You mentioned Berlin. We have heard in the course of our inquiry that Amsterdam, Frankfurt and Paris are also busily trying to persuade companies and services to relocate. We have also heard how important the financial and related professional services ecosystem—a word you recently mentioned—is in London, and it has been suggested that it would be difficult to replicate this elsewhere. So could the close proximity of regulation, legislation, funding, research and advice contribute to supporting London's continued position as a leading FinTech hub?

Giles Andrews: Yes, it could help. It is why London is the leading FinTech hub, for all the reasons that you mentioned. What we are concerned about is the diminution of that leading status. The ecosystem you described is the reason why the hub is as strong as it is.

Lord De Mauley: It is difficult to get a feeling for the relative importance of that against some of the other issues that you have been raising.

Giles Andrews: It is very difficult to give you a detailed answer on its exact importance, but it comes from an emotional perspective. Mr Morgan made the point that where entrepreneurs choose to set up

businesses is for a wide variety of reasons. That is the central decision: it is the entrepreneur who has an idea deciding where to go. We are concerned that they are less likely to pick London. The point I made earlier about the regulator having less time and attention may be relevant as well. Having the proximity of the regulator in London is a great thing, as is the fact that it has been forward-thinking to date. The fact that they may have less time to devote because they are otherwise engaged is a bad thing.

Daniel Morgan: We are really at early doors in the FinTech story. It obviously gets a lot of headlines but I think that only 1% of banking revenues in the US have been disrupted, according to a report from Citi. This is the start of the journey; it is not that we have a well-established industry. It is early in this fledgling industry, so let us not forget there is a long way to go. We have used the term "ecosystem", which is very popular in FinTech more broadly, but it is the same as a natural ecosystem. If you take one vital part out of it, you do not know what the effect will be. Taking one part of the food chain out could be benign. It could readapt or it could crumble. We are in a place now where we will see how it reacts and what we need to do to respond to that.

In terms of other centres in Europe, London is a FinTech centre more broadly because of its huge financial services base. Berlin is a huge tech centre but at the moment it does not have what we would describe as a FinTech sector, primarily because there are not the banks investing huge amounts in accelerators, et cetera. There is a venture capital community that fed off a wider and older financial services ecosystem, which has meant that London is more of a natural home. But that does not mean to say that it will stay; they are obviously under pressure as well. Even if we look to the US, where a lot of the big B2C FinTechs grew out of California and the venture capital there, they are increasingly located in a huge base in New York, because that is the financial centre. That is the reason why it is a FinTech hub.

Giles Andrews: I would argue that New York is the dominant FinTech hub in the US, not California.

Bruce Davis: I have experience of both the FSA and the FCA. I caught the dying embers of the FSA and, in the space of two years, you had significant cultural change.

The Chairman: For better or worse?

Bruce Davis: For better. In other words, it is not difficult. The FSA was a horrible place to deal with. Trying to get a new thing done was like dealing with something from a Kafka novel. It took two years of my life to get through that process; that is why we have things such as Project Innovate. Abundance and Seedrs were the two which broke the ground, if you like. They bear the scars and the risk, and I think that the FCA responded to that. It is not beyond the wit of man for the BaFin in Germany to do the same.

One barrier to innovation in the European markets is their regulators being slow to wake up to their role. Regulation should promote innovation and protect consumers. That is not a big philosophical shift but it has huge ramifications. Austria did it in six months; I think that Finland did it in under a year. Do not underestimate how quickly they can change the environment in which we could innovate. That is probably a bigger thing than whether or not law firms have offices in certain places or are able to recruit, for example, German-speaking lawyers to produce German documents. I cannot sell my products in Germany under full passport unless I am able to operate fully in that local language, to make sure that consumers understand the risks. We are slowing down that process. Every barrier that you create in that adds in costs. Cost ultimately stops us doing things; that is why we are pushing for the exemption cap to go up on prospectus directives to €10 million or €20 million. It is because money is not being raised not because of regulatory or consumer risk, but just because it is not economical. It is those sort of barriers that we are sitting against. Placing economic barriers when we need to bring growth back into an economy seems counterintuitive.

The Chairman: Thank you very much. Are there any other questions that members of the Committee might have? Thank you, it was a really illuminating discussion and we are very glad that we had you in. Thank you very much for coming at such short notice. This concludes today's public evidence session and the Committee will now continue its meeting in private.