HOUSE OF COMMONS

Treasury Committee

Oral evidence: The UK's future economic relationship with the EU, HC 483

Tuesday 10 January 2017

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Watch the meeting

Members present: Mr Andrew Tyrie (Chair); Mr Steve Baker; Helen Goodman; George Kerevan; Kit Malthouse; Chris Philp; Mr Jacob Rees-Mogg; Rachel Reeves; Wes Streeting.

Questions 247-391

Witnesses

I: Douglas Flint CBE, Group Chairman, HSBC, Elizabeth Corley CBE, Vice Chair, Allianz Global Investors, and Xavier Rolet KBE, Chief Executive, London Stock Exchange.

Examination of witnesses

Witnesses: Douglas Flint, Elizabeth Corley and Xavier Rolet.

Q247 **Chair:** Thank you all very much for coming to give evidence to us this morning. We have plenty to discuss, so we will get under way immediately. Could I begin with you, Mr Flint? If no agreement is in place at the end of the article 50 process—the two-year negotiating period envisaged—as I understand it, HSBC would lose regulatory authorisation to conduct certain types of business in the EU. What would be the impact of that on HSBC and on your clients?

Douglas Flint: The impact would start to be seen far before the end of the article 50 process, because there would be a period of time necessary to adjust our service propositions to ensure that, at the end of article 50, we have the capacity and capability to continue to deliver seamlessly at that point in time that which we give to clients today.

Q248 **Chair:** So you would take pre-emptive action?

Douglas Flint: We would take pre-emptive action in order to ensure that we have the capacity in place to continue to deliver what we deliver today from a different set of arrangements. Having a full service bank already in France, we are perhaps in a better position than many. We therefore already have an operation within the European Union from which we can service EU business that is currently done in London. That would require us to move CRD IV activities, if we would lose passporting rights, to France, or indeed to Ireland, Holland or any other place within Europe that we have operations.

Q249 **Chair:** Can you give us some indication of the scale of that? Do you think you must be doing contingency planning for now? What is the scale of the move to Paris going to be, which I think you were hinting at there?

Douglas Flint: Much of it would go to Paris because that is where we have the largest banking operation. We said right up front that we thought that, if we look at the businesses that could be impacted by loss of passporting, it would be something like 1,000 jobs; that continues to be what we think. About a third are probably in the front office and two thirds are in the middle and back office, depending on how the negotiations go. It is still around about 1,000 jobs across our wholesale and custody businesses that potentially would have to move to a different jurisdiction within Europe.

Again, because we have the operation in France, we can take a little bit more of a wait and see approach than possibly some others, because we already have the licences in place. So it is not a question of having to set up and get the licences, but we would have to think about how to move the appropriate number of people, which means moving people and families and making sure they have schools and all that kind of thing sorted out.

For our clients, I think it splits into two main categories. For the large multinational or even large national companies, this is not something that is at the top of their mind at the moment. They simply believe that the financial system will adjust to give them what they want; it is really our challenge to give them what they continue to want. Effectively, in order to prepare for that, we are creating optionality, in a sense. Some of them are saying, "We think we'll do business out of Ireland," some of them are saying, "We're going to put a treasury centre in Amsterdam," some of them are saying, "We already have operations in Paris or Frankfurt. Will you be able to hook us into whatever settlement operations we need to access?" We are effectively creating capacity to the extent needed be able to make the multiplicity of arrangements that our clients say they will put in place. The big guys, therefore, see it as the industry's problem.

The smaller companies do not really have the planning or financial resource to see what happens. So there is an element of wait and see and that is what we are seeing at the moment. Cash balances are rising as people effectively wait and see how the arrangements might be negotiated in relation both to the single market and the customs union, because that will impact how they configure their businesses.

So it is more problematic for the smaller businesses. I am not sure that they can do too much pre-emptively, except that we are spending a huge amount of our time talking to our customers about the possible range of scenarios and ensuring that they have thought about the financial aspects of planning that we can help them with in relation to creating more debt capacity availability for them, so that if their supply chains become longer, their debts take longer to collect or things just get a bit more expensive and clunkier than they have been up until the point we leave Europe, they have the financial wherewithal to manage through until we get into the new arrangements.

Q250 **Chair:** As has been discussed by a number of people, there are two quite distinct types of transitional arrangement that might mitigate these effects. One is the prolongation of the negotiations, which requires unanimity to obtain. The other, which is obtainable under qualified majority voting—and therefore it is quite reasonable to suppose agreement could be reached—is the idea that at the end of the negotiation there is then a period of standstill before implementation of the agreement that has already been concluded as the negotiation has been concluded. Would such a standstill offer you or the middling-sized clients you have just described some protection and calm things, or not?

Douglas Flint: It clearly would be helpful, but in my view it would need to be accompanied by a clear indication of the direction of travel and where we were aiming for as a destination. A standstill agreement, without clarity as to what we want the endgame to be and the likelihood of getting agreement to it, would continue the uncertainty.

Q251 **Chair:** So you are saying that, in order to mitigate the economic consequences, as you see them, of falling off a cliff at the end of the two-year period without any agreement, there should be: one, a standstill; and two, agreement of some sort—agreed at the beginning of the negotiations or early on; that's as I understand it—and clarity about the main objectives in the negotiations. Is that correct?

Douglas Flint: Broadly, yes. I think there are four periods. There is the period between now and triggering article 50, when it would be helpful to get an idea of the policy objectives of the negotiation. There is the period during article 50, when there is the possibility of having a discussion with our counterparts in Europe as to the likelihood of finding common ground in relation to where we might get to.

Then there is the period from the end of article 50 to the new world, for however long that takes—the standstill that you described. Then there is the implementation period for whatever is agreed for the future relationship, because it will take time to configure financial systems and operations and, indeed, our customers' systems and operations, to whatever is ultimately agreed as the going-forward position. So I think there are four periods that need to be looked at separately.

Q252 **Chair:** Okay. Xavier Rolet, with no agreement in place at the end of the article 50 process, UK-based central counterparties, such as London Stock Exchange, would no longer be able to clear euro-denominated transactions. How would your firm respond to that? What plans do you have at the moment to prepare for that pre-emptively?

Xavier Rolet: The decisions would be made by our customers, and without a clear path to continued operation of our global businesses, which are not just euro-denominated or sterling-denominated—in 2015, and the numbers have grown even larger in 2016, the London Stock Exchange Group subsidiary London Clearing House cleared over 90% of the world's over-the-counter derivatives last year, which was in excess of $655 trillion or equivalent in the world's leading 18 currencies—our customers simply would not wait for that outcome to materialise or not. So early on, perhaps almost immediately on the filing of the article 50 notice—the beginning of the process leading to an exit from the European Union—customers would ask us the same questions that you have just asked me: "What are your plans? What are the alternatives to current arrangements that you can offer us today or in the coming months so that in 18 or 24 months, whatever the period may be, we are not faced with a necessity to migrate, novate enormous amounts of notional risks?"

I would characterise the impact of a lack of certainty or of something close to certainty—as Douglas said, a very strong direction of travel—as having three major impacts. First of all, there is client/customer behaviour. London has achieved true global leadership in areas that in the post-2008 crisis world were G20 mandated and regulatory mandated as needing and requiring the financial infrastructure services to take over: the previously non-transparent world of transactions, where enormous amounts of balance sheets were skipped by financial services intermediaries, moving on to clearing houses. That global leadership would be at risk.

Secondly, there is no doubt that an economic impact in terms of the jobs that power the industry—I am talking about not just the clearing jobs themselves, which number in the few thousands, but the very large array of ancillary functions, whether syndications, trading, treasury management, middle office, back office, risk management or software, which range into far more than just a few thousands or tens of thousands of jobs—which would then start migrating.

Last but not least, we are talking here about the largest financial asset classes in the world. We are talking about numbers that are almost unimaginably large—hundreds of trillions—that would have to be quickly novated, migrated. The potential systemic impact would normally have reverberations if mishandled—if handled too quickly, without the benefit of anticipation and preparation—and would have reverberations on a global basis.

I think the best we could hope, which is what we heard from our customers almost immediately, in the hours and days after the outcome of the referendum in the United Kingdom were known, is: what are the arrangements? How quickly can you put them in place? And the regulators as well, including in the UK, of course legitimately demand to know what preparations were made. The systemic impact of handling such transitions requires that, of course, we do not wait until certainty is achieved, if indeed it is not at the time of filing article 50.

Q253 **Chair:** You have described massive migration of jobs, more than just a few tens of thousands.

Xavier Rolet: That is correct.

Chair: That is a lot of tens of thousands, which sounds a very large number. You have also said that there is an increase in systemic risk that will accompany arriving at the end of the article 50 process without a clear agreement, as I understand it—I think that is what you said. So what about the second part of the question? What kind of protection now can be provided at the beginning, or even prior to the beginning of negotiations? Is it the same or is it different from the points made by Douglas Flint? Is it a clear sense of direction and much more clarity about the objectives in the negotiations, plus agreement to a standstill for this period of adjustment on completion of the negotiations or after the period of completion?

Xavier Rolet: What is required to maintain stability—to maintain customer behaviour in the knowledge that no immediate disruptive changes are likely to happen—is nothing less than a grandfathering of the existing conditions of trade and clearing. Again, this was mandated at G20 by the political authorities. This was not invented by the London Stock Exchange or the London Clearing House. So a grandfathering of these existing conditions for a limited period of time.

I would add that we certainly believe that, in parallel to the actual Brexit negotiations, a stable framework of grandfathering for a limited time, to be determined in advance of course, is likely to strongly support a positive outcome for these negotiations, because it is clear that massive migration or changes in customer behaviour—systemic events—would be no good to anyone in the context of very complex negotiations. They would reverberate globally.

There are technologies that have been invented here, like the compression service in the London Clearing House. I will spare you the technical details, but a vast amount of supporting evidence shows the benefits of a clearing industry and that what London has achieved is because it has achieved it on a global basis. In 2015, $320 trillion or equivalent of interest rate swaps were compressed in the London clearing house, leading to the physical elimination of $110 trillion of risk. That saved the large banks, investment managers and corporate issuers that power the real economy—

Q254 **Chair:** This is the netting off, the compression—for people who are unfamiliar with the term.

Xavier Rolet: That is correct. That saved $25 billion of regulatory capital. The separation that is sometimes alluded to by some—for example, the euro-dominated portion of the businesses we clear here—would obviate or eliminate these compression benefits, which is why the point I was making is important. If it moves, given the compression benefits and the global need of our wholesale investment management and corporate customers, the whole thing moves because the compression benefits otherwise disappear.

Q255 **Chair:** Colleagues may come back and examine in more detail the core points that both of you have made, but I want to turn to you now, Elizabeth Corley, to give us some solace. My impression is that your industry is not affected in this way because firms can delegate under current rules—that is, they have an ability to delegate the day-to-day management of funds to a country of their choice, to outside the EU from inside the EU. Therefore, you and your clients should not be affected much by this and you should not be too concerned. Have I got that right?

Elizabeth Corley: Good morning everybody. It is certainly true that for the core activity, which is looking after our clients' money—that is, selecting investments and managing them, buying, selling and looking at foreign exchange and things like that—there are delegation protocols around the world. That global transition has been happening for a lot of time now. Certain countries do not allow you to delegate—these tend to be more emerging markets. Most countries allow you to buy and sell their stocks and bonds wherever you are in the world, provided that you are well regulated.

The United Kingdom has probably been the most successful international hub for asset management. We are the second largest international trading centre and we have over £5.7 trillion under management here. It has been a real global success story. Even after the financial crisis, it continued to grow and prosper. That is because we have a very robust regulatory regime, we have a tradition of co-operating with international regulators wherever we can, and we have a respected judiciary, so essentially we can run from this country assets in many parts of the world. Provided that those delegations continue, then yes, we are a source of solace. However, we need to be able to trade and we need to be able to enter into derivatives contracts, so we are dependent on the services that Douglas and Xavier described.

We need to make sure, so what we would be doing as we approached the date on which our membership of the Union finishes is sending questionnaires to our counterparts and to our banks, saying "These are the questions you need to answer for us." They are very pragmatic questions: for example, can we still rely on the contract we negotiated to do a particular derivatives transaction, which might be under UK law? Can we make sure the segregation of client assets and that they are going to be held in a place that is recognised? There are levels of activity beneath the actual management that can be delegated, which we need to be able to continue to be sure of. That is what we would be doing: we would be asking our counterparts and our service providers to reassure us that they can provide what we need.

Chair: Thank you very much. Again, I think those points will be explored in more detail later in the hearing.

Q256 **Kit Malthouse:** Can I draw the Committee's attention to the fact that I am an HSBC retail customer and that Xavier Rolet and I know each other, having collaborated on a number of projects when I was at City Hall?

I want to push you a little on the relocation issues, if I may. Obviously there has been a lot of flak in the air about who is moving and who is not moving. My rather excitable former colleague Anthony Browne at the BBA said that banks' fingers are "quivering over the relocate button". Is that actually the case, Mr Flint, or are you saying that you will wait and see and take a measured view? In the great scale of HSBC's presence in the UK—you have about 50,000 employees in the UK, and I think a year ago you announced 8,000 job losses anyway because of restructuring—is 1,000 moving significant from your point of view?

Douglas Flint: It is significant for the services that we provide through those 1,000 people. It is essentially a wholesale market issue. I think the quivering over the button is dependent on business model and what you use the UK for. If you are a foreign institution hubbing into Europe from London, you really have no choice other than to think very quickly and carefully how to replicate the access to Europe that you would lose once the UK leaves the European Union. If you have already established operations in Europe, you can take your time to decide whether you need to move quickly or more leisurely, depending on how the negotiations flow. If you are a bank like us with operations all over Europe, including a very significant full service bank in France, you can take even longer to decide when to push the button, because actually nobody wants to push the button; the best outcome for everybody is the preservation of the status quo, so far as that is possible within the framework of the discussions that will take place.

Having said that, our regulators, and indeed our customers, expect us to plan for the worst, because essentially what we are being required to do and what we want to do is ensure continuity of service. We need to assume what might happen if we end up with a break after the two years of the article 50 process with no vision of where we are going to and no transitional arrangement.

Q257 **Kit Malthouse:** This is what I do not understand. You say that you have to prepare for the worst. The 1,000 people who you say might move are people effectively making payments in euros.

Douglas Flint: No, they are people doing debt capital markets, doing debt raising for European companies, doing custody for European institutions—

Q258 **Kit Malthouse:** So what would the EU have to impose to make that job impossible from London? It would have to be some kind of restriction on capital.

Douglas Flint: No. We do not have a licence to deliver debt—to make a loan to a European company—other than through the passport that we have today. If we lost the passport to do that, we would need to make that loan from within the European Union.

Q259 **Chair:** Just for clarification, that is the CRD IV passport, which is the one that firms are telling us that they need to negotiate.

Douglas Flint: Correct. So in the first instance what people are thinking about is that you need to move your relationship managers into the European Union for the products that would need to be licensed within the

European Union. The question that then follows is whether the middle and back offices need to be co-located with the front office, or whether you could continue to service the flows in an outsourcing arrangement, the way that many of us do to other parts of the country, not in the EU.

Q260 **Kit Malthouse:** But say, for instance, you are raising debt for European companies, where are you raising that debt?

Douglas Flint: Through the London markets.

Q261 **Kit Malthouse:** Globally, so you would have to be licensed in both places.

Douglas Flint: Yes.

Q262 **Kit Malthouse:** So it would be perfectly possible, if they refused to license people operating from London in Europe, for us to do the same and refuse to license people operating from Paris in London.

Douglas Flint: It would be a pretty extraordinary thing to do, considering that today we have the most international, open financial market in the world. That is what has built London and the UK to—

Q263 **Kit Malthouse:** It would be extraordinary on both sides, though, right?

Douglas Flint: Yes. From the perspective of our customers, broadly speaking, the status quo is the best answer. To make the point that Xavier has made extraordinarily well, what the policy makers in the G20 required of the regulatory system post the crisis was to consolidate and make transparent risk, in so far as that was possible: move as much as possible on to exchanges, bring in central counterparties, consolidate risk, make it transparent, improve consolidated regulation and regulatory co-operation and enhance supervision, so that in case of events leading to another financial crisis, there would be clarity on where the risk was, who the ultimate beneficiaries of the assets were and who the liabilities were owed to, and so that the regulatory authorities, in extremis, could manage the wind-down of a systemically important institution.

To fragment that regulatory system after 10 years of putting it in place would, in my view, be seen with hindsight as one of the worst actions that ever could have taken place. That is what we are most concerned about: the fragmentation of a system that has massively improved financial stability.

Q264 **Kit Malthouse:** I understand that. Essentially, what you are saying is that if the EU were to impose these restrictions or deny passporting to the UK which they have granted to the US, Japan and others—

Douglas Flint: No, they haven’t. For CRD IV, the US firms passport into Europe from London. They have equivalence in other areas, and the UK could hope to achieve similar—

Q265 **Kit Malthouse:** But at the moment, they passport into the EU.

Douglas Flint: From London.

Q266 **Kit Malthouse:** Yes, but we’re in the EU.

Douglas Flint: We are in the EU, yes.

Q267 **Kit Malthouse:** So they passport into the EU at the moment.

Douglas Flint: Yes, but they—

Q268 **Kit Malthouse:** All I am saying is that if the EU denied us the same passporting which they currently allow the Americans—

Douglas Flint: They allow everyone from the UK the passports.

Q269 **Kit Malthouse:** No, sorry. Maybe I am not being clear. At the moment, we form part of the EU.

Douglas Flint: Correct.

Q270 **Kit Malthouse:** And at the moment, the Americans are granted passporting into the EU, therefore—

Douglas Flint: From here. From their London office.

Q271 **Kit Malthouse:** No, from America.

Douglas Flint: No, from here. *[Interruption.]*

Chair: Hang on. Let Kit sort this out with Douglas.

Q272 **Kit Malthouse:** We are not separate from the EU at the moment. They operate from London in the whole of the EU.

Douglas Flint: Yes.

Q273 **Kit Malthouse:** Yes. All I am saying is that by that same process, once we leave and have the same status as the Americans, we could be granted the same to operate throughout the EU.

Douglas Flint: No.

Q274 **Kit Malthouse:** Why not?

Douglas Flint: We have that status because we are a member. They have that status because they have an operation in the UK that allows them to passport into Europe. If we were not in Europe, they would need to set up an operation within the EU.

Q275 **Chair:** I am sorry to interrupt, Kit, but I just want to clarify this very important point, because there has obviously been a misunderstanding among some colleagues. You are saying that if the Americans can't get into the EU market via London, they will then have to apply separately for a completely new arrangement with the EU, which currently does not exist?

Douglas Flint: Correct.

Q276 **Chair:** What is the likelihood of them obtaining that, and what is the likelihood of the UK being able to do something equivalent?

Kit Malthouse: That is the point I am making.

Douglas Flint: It's exactly where we started. In the event, what you would need to prepare for an end of article 50, without a standstill transition and without clarity on where you are going, would be to replicate the access you have today from London by establishing licensed operations within the EU 27. Some of the American banks do. For example, Citibank has a licensed bank in Ireland. Some of the other banks already have operations on the continent but the majority of them have their principal operation in London and passport into the whole of Europe from here. They are looking at how they would replace that by setting up regulated operations in Europe. The challenge they have, more than firms such as ours, that already have operations in Europe, is that they would need to go and get the licences that they do not have, because today they rely on passporting from their UK licence.

Q277 **Chair:** To clarify, your point is to do that they would leave London? They would need to relocate at least part of their activities in order to secure that licence?

Douglas Flint: That is exactly right. Part of the uncertainty and the planning, if you like, is how much you would have to move. Clearly, you would need to move the front part of the business, the relationship managers who talk to customers.

The question would be whether the negotiation would allow the middle and back office the settlement, the risk management, the accounting and so on to be done outside EU27 and whether EU27 as part of the negotiation says, "No, if we are going to give you a licence, we want everything in our country." That is a political negotiation as much as a technical negotiation, so firms are planning on being able to move the front end, and then may be some in the middle, or do they have to move everything?

Again, you worry about scale. The reason that the operations are hubbed in London—not just for Europe, but for the Middle East, Africa and much of the rest of the world—is you benefit from the scale. If you have a big operation in the central time zone that the UK occupies, you put enough other things around it too, because you can touch all parts of the world, apart from Australia and New Zealand, within the same working day, and therefore, for economies of scale, you have as much as possible.

If you start moving bits away, the consideration comes, do you start moving other things as well, to take advantage of a hub operation and take advantage of scale elsewhere? Again, that depends on individual firms' business models and the proportion of the business that they do in London that is European focused, as opposed to rest-of-the-world focused ex-US.

Q278 **Kit Malthouse:** I am conscious of the time. I want to move on to Xavier Rolet. I am slightly confused also about how the EU would stop you clearing euros. If it decided that you were not allowed to, how would it physically stop you doing it?

Xavier Rolet: This is a good question and at the heart of a set of legal complexities that have, in fact, been tested before. Remember, if you will allow me a quick historical review, about four and a half years ago I submitted on behalf of Her Majesty's Treasury evidence to the European Court of Justice in support of the British position in respect of an ECB policy proposal requiring that euro-denominated securities be physically cleared inside the eurozone. There was a whole debate at the time, so this is a very old question, nothing new. It has just been put in a broader and more urgent context by the current debate around what sort of treaty or secession will be negotiated with the EU.

In that context, the ECB was proposing effectively to prevent the clearing of euro-denominated securities outside the eurozone. That position was defeated, thanks basically to that sort of evidence. So there were several things the EU could do. At the time, the ECB position was defeated because it was found that the ECB actually does not have the power to regulate central counterparties—clearing houses. So the EU could seek to change via a treaty change the powers of the European Central Bank to give it the power to regulate clearing houses. If that were to happen—it is obviously a complex process that would take some time—in my judgment, as a technician in that area, it is pretty clear that they would almost instantly re-enact, not as a policy proposal but an actual regulation, the physical requirement to clear your denominated securities inside the EU.

I have been very vocal in various fora related to customers that it has long-term implications for the eurozone. If you prevent non-eurozone-based clearing houses from clearing euros—that could apply to the Japanese, for example, the point you made earlier, sir. There is equivalency right now between the EU, the US and Japan. You can today clear euro-denominated securities in the US with a US clearing licence, and in Japan and a few other countries. So if they were to decide that, they would effectively impose a sort of currency control, de facto—indirect—and of course they would most likely lose the right to clear RMBs, dollars, Japanese yen. So it is actually a fairly momentous decision, which is why I think—

Q279 **Kit Malthouse:** Sorry to interrupt, but this is the point I was trying to get at. They could single us out?

Xavier Rolet: They have definitely already started in the past six or seven months. There are other ways—

Kit Malthouse: No, but from a regulatory point of view—

Q280 **Chair:** Sorry, carry on that point. They have started what, exactly?

Xavier Rolet: Since the outcome of the referendum, we have seen calls made by continental regulators to customers, warning them of the risk that euro clearing would be mandated to leave the UK. That resulted in immediate commercial pressure on our businesses.

Q281 **Kit Malthouse:** Hold on—

Chair: You've got to let Xavier give the evidence.

Kit Malthouse: I just wanted to say: mandated to leave just the UK, or mandated just to take place inside the eurozone?

Xavier Rolet: Correct. If I may quickly go back, the ECB would potentially have the power, if the EU were determined to give them the power, to regulate CCPs. There are other ways. One, for example, is an EMIR review. EMIR is the set of European legislation that, among other things, legislates on the power of CCPs, their functions and the way they are managed. There is currently an EMIR review—as you know, three years after a directive goes through, it is reviewed—which may or may not include specific technical requirements geared towards isolating and actually making it impossible to clear euro-denominated securities in the UK while permitting them to continue to be cleared in the US and Japan, since the amount of euro-denominated securities cleared in those two countries is very small. So, effectively, it would be targeted. Those pesky, well targeted, seemingly minor regulations that actually have a major impact on customer behaviour are sometimes overlooked.

So there are various ways—through treaty change, regulatory framework change or minor rules—that in the case of EMIR would impact the thinking, for example, about putting caps on the amount of euro-denominated securities permitted to be cleared outside the eurozone. Last year—actually, in 2015; we haven't published the 2016 numbers yet—LCH cleared €327 trillion between various products. Clearly, that would be outside the cap. There are other things that they could do via intergovernmental conference that would be less strategically or structurally difficult than, for example, an ECB-related treaty change to effectively create a disabling environment specifically for the London Clearing House—this is what it is all about—that would start affecting client behaviour, hence the Chairman's question earlier, in the case of there being no deal or no clarity over a particular deal. Our view is that client behaviour today starts being impacted.

That question and its technical ramifications could of course take hours to cover, but the point we have been making publicly and will continue robustly to promote and defend is that it is to the advantage of UK but also European industry—not just the banks and the very large asset managers but corporate issuers: companies that create jobs and invest in plant and equipment—to continue to be able to rely on London's ability to offer huge economies of scale in clearing, asset management and trading. The EU at the moment seems motivated—and it is no surprise that just a few days after the outcome of the referendum was known, one of the leaders of one of the continental European countries out of the blue focused on not manufacturing, agricultural products, wine, cheese, the space industry, start-ups or FinTech, but clearing as a business that he thought basically should be claimed back for the European Union. This is a strategic business.

Q282 **Kit Malthouse:** So you are saying that you are already seeing manoeuvring to try to single the UK out on clearing, in a way that does not affect other countries?

Xavier Rolet: That is correct.

Q283 **Kit Malthouse:** So it is effectively political retaliatory action?

Xavier Rolet: It would not be for me to characterise it; we just see it happening at our humble commercial level.

Q284 **Kit Malthouse:** Right, but if the bulk of the clearing were to end up under the regulatory regime, you could not see the Americans, for instance, standing for that—could you?

Xavier Rolet: Sir, that is a very good question and a point that we have also made publicly whenever asked. Given the compression and netting benefits afforded by the London Clearing House to its global customers, not just UK and European but US and Asians—again, it is over 90% of the global market. It is really, really big. Economically, as an alternative—I have said so publicly—we would see New York, particularly under the existing equivalency framework between the CFTC and the European Commission, certainly as a very attractive, perhaps even the most attractive alternative, if the business were to move—if customers decided that the compliance and regulatory environment was no longer sufficient to support these activities being carried out in the UK.

Q285 **Kit Malthouse:** Ms Corley, I heard what you said about your desire to operate globally and looking for global regulation, effectively, or being satisfied that things are regulated globally as an important factor in the decision about where you do your business. Are there any scenarios after Brexit where you could expand your operation in London?

Elizabeth Corley: I think there are scenarios where the business can grow, certainly. Particularly given the attractiveness of the United Kingdom in which to do business, there is no reason why we would not do. We happen to be a German company, but we have a significantly growing business here in the UK because we can find talent and the right environment. So, there is no reason why that should not continue. The freedom of finding the right people, putting them in the right place, a good regulatory environment, predictable tax regime—all that makes the UK a very, very attractive place to do business.

There are two points I would like to build on, though. It is the complexity with which one has to do business that starts to chip away at the attractiveness of a place of business. For example, to build on Douglas' point about who moves, in the detail of European regulation at the moment in directives, it says that you have to have a custodian—or a depositary, as they call it—in the European Union to look after client assets. So the frustration for us would be where, say, HSBC is a custodian for us at the moment and it has this hub effect and economies of scale in a particular place, unfortunately we would start to see the cost and inconvenience of that and would have to find alternatives. I think it is very much at the level of detail and sand in the machine that things start to chip away, but there are definitely opportunities.

Q286 **Kit Malthouse:** At the moment you have custodians presumably in Germany and London as well, or is it all in one place?

Elizabeth Corley: No, we have custodians all around the world. It is just a question of where you can get the best service, the best economies of scale. That is just the little detail. Some of these things are headline points and a lot of the issues of attractiveness of doing business come down to second, third and fourth degree effects.

Q287 **Chair:** Xavier Rolet, I want to clarify one point. If the EU did act in the way you imply it is already gearing up to, it would be cutting off its nose to spite its face at a time when the eurozone is pretty fragile, and that would be likely to bring greater instability to the eurozone than it already has.

Xavier Rolet: Yes, sir.

Q288 **Chair:** So on a scale of likelihood between 0 and 100%, how likely is it that all this sabre-rattling is going to turn into action?

Xavier Rolet: That is a very good point, sir. I think this can be only a matter of opinion and conjecture. If one looks at the importance of economic competitiveness and attractiveness as part of the EU legislative process, and if one looks at, say, the last 20 years, it is not obvious that economic competitiveness always stands at the front of preoccupations in the EU process. I say that not as an opinionated comment, just as a matter of fact. There is at the moment a political agenda in the European Union, driven of course by a set of elections—very important ones—that has, regardless of the outcome, one practical set of consequences. The true negotiators on the other side of the aisle—on the European side—will obviously not be known or confirmed until after September 2017, so the reality of what the European position is likely to be, notwithstanding what comes out in the public domain today, may yet evolve in a fashion that hopefully can help to accommodate a sensible deal.

That is why I certainly believe some grandfathering environment, where for a specific period of time we can maintain a status quo, would be very helpful and constructive. It would help reduce the temptation to destabilise potentially a system that has worked and economically has proved itself to European and UK industry, while at the same time hopefully helping to promote some sensible approach to get to a good deal.

Q289 **Chair:** I personally had hoped we would not press article 50 until the autumn, because at that point we would find out who our counterparties were. In the absence of that, you seem to suggest that at the very least a standstill agreement is needed right at the start, in order to detoxify this whole process from politics. Have I got that right, as a summary of your evidence?

Xavier Rolet: That is correct.

Douglas Flint: Can I add a quick point to what Mr Malthouse was inquiring about? We are a very large custodian in London. That is one of the businesses that might have to move if we did not have a passport. We made the analogy that the ecosystem in London is a bit like a Jenga tower.

If you pull one small piece out, you don't know whether nothing happens or, indeed, it has a more dramatic impact.

The custody business is in London because the fund managers are in London, and they are proximate, but the custody business has a huge consumer repayment service, risk management services and foreign exchange services. Therefore, if it were to have to move, there is more than a small possibility that some of the related services it consumes would move to be proximate to their client.

Elizabeth Corley: I want to build on those points and on what Mr Malthouse was saying earlier. De facto, if we move to a prompt completion of the preliminary negotiations and we want to get to a prompt exit, we are going to have a period when there is a standstill anyway, because there are tens of thousands of contracts written under existing law. There are levels of detail in the regulations that, frankly, we would not know about, and our lawyers will only get to on day 100. So in practice, I think there will be some sort of agreement that you have to just grandfather the status quo until we have the alternative and the i's dotted and the t's crossed. These are legal contracts. Therefore, thinking about that in advance and thinking about a thoughtful, planned implementation period would make sense, because otherwise we are going to face it on the midnight hour.

Q290 **Chair:** At the start?

Elizabeth Corley: Right at the beginning, and to think about the reality that it is not delaying an implementation date; it is planning for the implementation.

Kit Malthouse: I merely wanted to point out that the denial of a passport to the UK, which is currently granted to other countries in the EU, where there are equivalents, would be vindictive. That is all.

Chair: We have been round that circuit with both the witnesses, and it is not quite the same picture for each.

Rachel Reeves: Thank you for coming to give evidence today. I want to pick up on a couple of things that the Chairman and Kit Malthouse touched upon, before moving on more specifically to the transition arrangements and timescales. One of the complaints by people who campaigned to leave the European Union was that legislation that came from the European Union was meddling and not good for our economy. A lot of the points you have made, Xavier Rolet, suggest that when we leave the European Union, there is a risk that we get more meddlesome and more cumbersome legislation, because we are not there at the table to influence things. Is it your belief that not being there to discuss and influence legislation means we might have things that are even less advantageous for the UK? Is there any way that outside the European Union we can seek to influence and have a say over regulation that ultimately will affect British jobs and British investment?

Xavier Rolet: That is indeed a broad question that possibly goes beyond the powers and expertise of either myself or my colleagues at the London Stock Exchange Group.

The fact we are dealing with, of course, is that the UK people have made a decision and that decision will be executed, so how can we optimise, keeping in mind the interests of the British economy? It is London and financial services but, you know, two thirds of financial services jobs in the United Kingdom are outside the Greater London area and they are designed, or should be designed, to power the real economy. So, in that sense, how can we ensure that that process does the least possible damage and maintains the best possible opportunities for the future, again, not just for the financial services economy but for the wider economy—SMEs for example? The power of having an innovative, entrepreneurial, science innovation based economy is critically important. The UK has 5.4 million SMEs: that is twice the number of small and mid-sized enterprises of, say, Germany or France.

In terms of legislation, I think there is no doubt that if you go round industry and services globally, Europe has achieved the creation of a global market in some areas—or at least a European market with global reach that has a scale attractiveness to some businesses—and in other areas has not. It hasn't, for example, as of yet created a single market, a true single market, for financial services, so it is work in progress. Some of the legislation has been good—supportive—some has been not so good and not so competitive.

In terms of negotiating the exit from the EU, for me the holy grail is how can you maintain, nurture and promote what has made the UK economy one of the best global performers, and certainly a better performer than most of our neighbours in the EU—with the possible exception of Germany and a few of the Nordic countries—whilst at the same time maintaining as much access as possible to the customers, as we heard from Elizabeth and Douglas who represent hundreds of millions of customers and eventually, if the European Union survives, will end up being a very large financial services market? How can we maintain that balance by promoting the set of legislation that is pro-business, helps nurture innovation, helps power SMEs forward in the UK, and also be a good economic partner to other European nations? I think there is a way to turn this process into a positive, going-forward process for both economies but it is really essential—I certainly believe and I know my colleagues do whether they are in clearing businesses, index businesses or capital formation businesses—that we find a way to buy ourselves a period of time of stability, of grandfathering, that needs to extend into several years—two years is just too short—so we can maintain those benefits.

Q291 **Rachel Reeves:** Thank you very much. Douglas Flint, in your discussion with Kit Malthouse, you made the point that many American banks set up operations in London because by being in London they then have a passport to operate round the European Union which they would not have if they were operating directly from America. That also exists for other countries, including countries like Switzerland that does not have a passporting arrangement, so Swiss banks have operations often in London to be able to take advantage of that passport that they have by being in London. Do you have any idea of how many jobs in total in London have come not just from US but other banks locating here to take advantage of the passport?

Douglas Flint: I will try to provide a figure after the meeting. I would be making a guess but it would be tens of thousands.

Q292 **Rachel Reeves:** And they take advantage of that fact that having operations, proper operations, in London then gives them access to the European Union. The risk you spoke about, Mr Flint, is that if you don't get access to that passport by being in London, US, Swiss, other banks would have to go to a country that remains inside the European Union to have that passport.

Douglas Flint: If they wanted to have a passport, they would need to hub outside, in a European country. They could, from their own country, decide to set up operations bilaterally in individual countries—in the way the Chinese have branches from Beijing into many of the major European countries—rather than having sub-hub from London or sub-hub from Luxembourg. Some just go directly to individual countries, but yes, a great number of operations came to the UK, partly for access to the European market, but partly also for the benefit of the legal and political system and the cluster effect of what was a very successful financial market in its own right in any event, and in the most attractive timezone in the world, in the sense that you can cover virtually all of the world within this timezone. There is a natural logic to being within Greenwich mean time.

Q293 **Rachel Reeves:** So passporting is just one reason to be in London, but it's a pretty good reason.

Douglas Flint: It is just one reason to be in London, but it brought another tranche of business into what was already a global hub and made the global hub even bigger.

Q294 **Rachel Reeves:** Thank you.

We have already started this morning to touch on how long it will take to get an agreement with the European Union on access for financial services and what sort of bridging or transition arrangements we will need. Michel Barnier, as well as our own Ministers—the Foreign Secretary and the Secretary of State for Exiting the European Union—has suggested that a deal could be negotiated within 18 months and that that time period would be needed to allow adjustment and planning to take place. Do you think that in the area that you all know about, financial services, it would be possible to get a comprehensive deal that touches, as you were saying, Elizabeth Corley, some of those things that we have not even thought about yet and that lawyers might think about on day 100? Do you think 18 months is a realistic timeframe for financial services?

Elizabeth Corley: I think that for hammering out a framework and also to give a way forward as to how you would then work going forward, one could do something in the period of time that is set. If that is 18 months or 24 months, one could do that. In terms of a framework, a clear map of the way forward and a clear process by which things would then get defined—with a lot of what we are talking about now, there is no process; there is no defined road map for it—I think some of that work could be done, and we could do some very thorough looking at how we would implement, but as part of that, we should be creating a situation in which we can have true regulatory co-operation on an enduring basis, because things will change, not just on that D-day but thereafter. So what we should be doing is having a framework for regulatory co-operation. We should be agreeing what continues on a grandfathered basis, what continues on a contingent basis and what may not continue. You could do that at a high level and then you would have to mandate working groups to work through to the level of detail. Unfortunately, in these and, I am sure, other markets, it is the level of detail that can trip you up, and you can find suddenly that the unintended consequence of what was agreed at a high level, at level 1 if you like, is that it becomes inoperable as you go through to levels 2, 3 and 4. So whatever the period is, whether it's 18 months, six months or 24 months, a timeframe will be needed for a thorough implementation process, with the regulators, with the technical experts, who can do this.

Q295 **Rachel Reeves:** In your view, Ms Corley, what time period would be needed to have a comprehensive deal whereby we are in the new system and not in any type of temporary system?

Elizabeth Corley: You would have to get a range of views on that; I would not be in a position to say what it would be. Until you start to look, we won't know, because we won't know where some of the complexities and some of the interdependencies lie. One thing that can be done, and we have been doing, is trying to map out just the sheer impact of 40 years of joint regulation and directives—looking at them and seeing what might be cross-cutting. It is not just the regulation for financial services; it is also on data protection, information security—other things like that. They interlock, and sometimes directives are not drafted in a consistent manner. Even a word can be used to mean one thing in one directive and another thing in another directive. So we would have to actually map that out. This is really important. The thing we have to do is work out what is the enduring way in which we work through this and, on your earlier question, how we ensure that the UK's significant regulatory competence continues to influence international and European regulation.

Q296 **Rachel Reeves:** Is it fair to say that you don't think that 24 or 26 months from now—March 2019—you would be able to have a comprehensive agreement, which we have moved to?

Elizabeth Corley: It depends what the definitions of "comprehensive" and "agreement" are.

Q297 **Rachel Reeves:** Do you think it would be possible to be operating under a totally new framework?

Elizabeth Corley: If there is an agreement, in principle, between the United Kingdom and the 27 that there is a grandfathering basis that enables it to work through these levels of detail bit by bit, so that we are able to have economic activity and customers working as we need them to in a period of implementation, I wouldn't say that we shouldn't get to a position where that could be achieved, but I am not a lawyer. We have 40 years of regulation, legislation and interconnectedness to work through. The reality is to go in open-minded, realise it is just practical hard work and to have a framework within which one can address it.

Q298 **Rachel Reeves:** So we might be able to do it if we have some of the bridging, grandfathering and so on?

Elizabeth Corley: And an agreement in principle that some of this is not actually a trade or services agreement; some of this is about market stability—particularly things that followed 2008. It is about looking after customers, protecting customers, looking after their money and making sure the financial system is robust. As Xavier said, we don't want to unpick that just to make it look like a negotiation. That would be very negative for the global financial markets.

Q299 **Rachel Reeves:** I realise that I probably don't have much more time. I am just thinking about what it might be that triggered the loss of jobs, which I think concerns us all. To all three of you, is it the uncertainty about where we're going, or is it the terms of the final agreement with the other countries within the European Union that could trigger relocation and job losses? Is it the uncertainty that may make businesses think, "Let's just get round this uncertainty by moving our operations to Paris or Frankfurt or Dublin or wherever", or is it going to be the terms of the final agreement that will make people decide, one way or another, whether they are going to relocate jobs?

Douglas Flint: I think it is both, in a different way. I think uncertainty as to where we are going to end up would trigger people into thinking earlier about moving jobs to give themselves access to the passport and the right to do business in Europe. If the final destination turned out to be an unattractive destination, in terms of the economics—Those making decisions to move are going to have to write off a considerable amount of investment in this country and re-establish it in another place, they are going to have to put a case to their board that that investment is a better use of capital than investing in Asia or elsewhere. Take an American firm, for example. The American economy is booming. The financial markets in the last three months, in relation to bank stocks, have gone up very dramatically; the US banking system looks incredibly profitable at the moment. You are going to have to persuade a board that you should divert capital resources from your own market, which is doing extraordinarily well, to invest in a marketplace and if you thought the destination was not a particularly attractive one, you wouldn't make the decision.

So there are two risks to jobs. One is that we move the jobs, and the second is that the jobs are simply eliminated because the market opportunity is unattractive. Today, in Europe—particularly continental

Europe—banking returns are significantly below the cost of capital that the investors that entrust their money to the asset management industry are hoping for.

Q300 **Rachel Reeves:** That is very useful and worrying, in many senses. Is there anything that the British Government could do—not on the latter point about returns on banking in Europe—to try to resolve some of this uncertainty, either around the negotiating position on financial services and passporting, or on some of the transition arrangements? Would the Government be able to say anything at this stage that would help to better protect jobs in financial services in this country?

Douglas Flint: In my view, there are two important things. First, I understand the complexity of the politics, but clearly the industry would love to broadly hear that the Government believe that there is a need for, and that they can negotiate, a transition. Secondly, it would be good to understand the ambition that exists as to where we would like to get to. We may not get there, but what are we aiming for? These are the two things I think people would like to hear.

Q301 **Rachel Reeves:** I would like to draw you out a little on that, Mr Flint, on the ambition of where they want to get to. For you, does that mean saying that our ambition, our aim, is to have passporting? We may not get there, but at least that is where the Government are intending to get to—would that be a helpful indication?

Douglas Flint: Passporting is such a simple, single word. I think it would be to say something like, "We intend to put in place arrangements that preserve as many as possible of the benefits that come from the international financial system that today is located within the UK". I regard the international financial system as an international asset that happens to be located in the UK through accidents of history and a huge amount of effort by policy makers, regulators and institutions and has grown up into this extraordinary hub for the benefit of not just the UK and Europe but the whole world. To preserve that for reasons of financial stability and efficiency for our customers would be an enormous ambition and a great challenge to give to our UK counterparts, that it is actually a public good to have a financial system that promotes financial stability and efficiency in allocation of capital. The European Union has embarked in the last two or three years on creating a capital markets union, which would need to effectively replicate or, indeed, build upon, what London already has, and that is really important for Europe in the broad sense of Europe, not in an EU sense.

Q302 **Rachel Reeves:** Thank you, Mr Flint. I will ask Xavier Rolet the same question really. What would you like to hear from the Government? We have heard your concerns about clearing moving away from London and the risk of some sort of retaliatory regulation from the EU after we leave. What would you like to hear from the Government, around both transitional bridging and its ambition for these negotiations with regards to financial services?

Xavier Rolet: Thank you for your question. We obviously work very closely with regulators as well as with the political authorities here and in many other countries around the world. What seems to us to be the most productive, on the point that Douglas and Elizabeth already made—it is about customers and the real economy—is that while the political negotiations are carried out on the European side, the political decision makers are going to be in place, either new or confirmed ones, basically, in October 2017, so that political negotiation can then start.

I concur with Douglas that the use of a single word can mean different things in different industries, but grandfathering existing dispositions to maintain stability as well as economic benefits to all the economies involved—the global economy, the UK economy, the SMEs and the blue chips, as well as Europe—is possibly the best possible way, certainly in my view, to get a successful Brexit negotiation.

Q303 **Chair:** Just to clarify, when you talk about grandfathering, you are not talking about the grandfathering of existing contracts, or you are not talking about only that. You are talking about grandfathering the existing regulatory framework for a specified period, aren't you?

Xavier Rolet: Correct.

Q304 **Chair:** So you are talking about what Douglas and others have called a standstill.

Xavier Rolet: What I am talking about is a transitional arrangement with a finite period of time agreed in advance. This is not something that goes on forever and defeats the actual intent to Brexit, but a finite, agreed-in-advance framework so that the regulatory framework maintains existing business the way it is and that will derive, on Douglas and Elizabeth's point, to maintenance of the legal framework, because you do not need to novate your accounts. For example, a big corporate issuer doing a 20-year interest rate swaps with Douglas's bank is not going to book that 20-year swap in a location that may be non-compliant in two years' time.

Q305 **Rachel Reeves:** This is my final point then. For the grandfathering and the length of that agreement, it is not going to be 20 years—

Xavier Rolet: Correct.

Q306 **Rachel Reeves:** Would you need it to be two years after we leave the European Union? Or do you have another timetable in mind?

Xavier Rolet: If I am permitted to make a suggestion, I would say five years from the time that the article 50 notice is served, but that is just a personal opinion.

Rachel Reeves: So three years after we leave the EU. Thank you.

Q307 **Mr Baker:** Thank you for coming. We live in interesting times, and you have definitely given fascinating evidence. I am grateful that the cameras will have put on the record your smiles, Mr Rolet, when you mentioned the EU's approach to competitiveness. It has been a very interesting session.

Xavier Rolet: It is not the first time I have made this comment in front of this Committee, Mr Baker.

Mr Baker: I want to talk about the withdrawal agreement and what could be possible about it and ask you some questions about that, but I want to pick up a couple of things. Mr Rolet, in the course of your evidence you said in an aside, "If the EU survives", which I think points to the legitimacy of that question. May I ask each of you, do you think the euro can survive?

Xavier Rolet: Yes. That is a question that takes me away from clearing businesses and financial infrastructures. I think if the euro does not survive, the EU can survive. I think if the EU does not survive, the euro, of course, will not survive. I think the survival of the euro is possible. It is quite remarkable technically on the one hand—I have said this before—for a number of countries of that scope to physically manage to create a single currency. But what is required for its continued success, for its survival, in my humble opinion—I have also said this in Brussels—is a pro-competitiveness economic agenda.

Yes, there are issues that are raised around fiscal integration, integrated banking supervision and a range of others—I would say macro-governance—that support the success of a single currency, but even those, in my humble opinion, would not succeed without a greater focus on economic competitiveness. I am not talking about driving labour costs to the bottom; I am talking about true competitiveness, innovation—entrepreneurial innovation—recalibrating, as I have said often, including here in the UK, the way we fund our economy away from leverage and debt and towards long-term patient capital that benefits entrepreneurs and SMEs. That recalibration and retooling I think could ensure the survival and success of almost any macro-political—

Chair: That has taken us a long way from the subject, which is transitional arrangements. I know you were asked that question. I will ask Steve to bring the conversation back to the subject matter of the hearing.

Q308 **Mr Baker:** I will, but I really appreciate you putting that evidence on the record; it is certainly something with which I agree. Could I ask the other two of you to give us just a flavour—

Chair: A very brief response to the question, and then we are going to get back to the subject of the hearing.

Mr Baker: —of whether this question is legitimate? Will the euro survive?

Elizabeth Corley: This is a personal view, not a house view, and I would say it is a non-expert view, so you can put what value on it you wish. I would say that there is an extraordinary determination for the currency to survive, that there are catalytic events happening across the whole of the region which mean that there are probabilities, if that tide is taken, that the circumstances Xavier described could happen and the currency will come through it very strongly.

Douglas Flint: I believe it will survive. I think the economic and political costs of it not surviving are a fraction of the costs that would be incurred if it were to fail.

Q309 **Mr Baker:** The point I am making by asking the question is that it is a legitimate question—we are not looking at a city on the hill. Mr Rolet, you made the point about the single market and its completeness. In some areas, great progress has been made, but it is not complete. In fact, a moment ago I was looking at the "Myths & Realities" document from the Legatum Institute Special Trade Commission, and they have made the point that the single market is not complete. Mr Flint, to what extent would you agree that the single market is not complete? What does that mean for your business?

Douglas Flint: It was one of the great opportunities that one could foresee: Britain working within Europe to complete the single market in services in particular. The single market in services is not complete; there is a huge opportunity to expand European growth through completing the market in services. I hope that will still happen—it would be good for all. So, no, it is not complete, and services is very much the missing piece. Within services—financial services—capital markets union was a huge opportunity for Europe, and within Europe; and even with Britain outside Europe it is a huge opportunity for the financial centre of the UK to contribute to capital markets union in a European context, with Europe being geography rather than the political union.

Q310 **Mr Baker:** There is a proposal from the Legatum Institute Special Trade Commission for the withdrawal agreement to conclude some arrangements. It is a 35-page document—I can hardly explain it all—but it goes through all of the four key areas of your businesses and works out how deemed equivalence, mutual recognition and existing third-country arrangements could be used in the withdrawal agreement, to deliver the grandfathering that you have been asking for. It just goes through those relatively limited areas where a bilateral would be needed—deposit taking, lending, insurance, insurance distributions, and aspects of use of its fund management.

Have you had an opportunity to have a look at the Legatum Institute's report and to consider whether these grandfathering arrangements could be delivered within 18 months? Because at the moment you are asking for five years and it seems to me that that just pushes out the timescale of uncertainty and leaves us with all the same problems for five years, when actually this set of proposals, through the withdrawal agreement, could give you what you want within the 18-month timescale. Have you had an opportunity to look at it, and, if not, would you consider meeting with them?

Xavier Rolet: I have not seen the report. I would be delighted to read it and meet with anyone who could take us through it. In my own area of expertise, in clearing, given the degree of complexity for clearing alone that it took, and the many years that it took, for example to achieve equivalence between the EU and the US, from which the UK benefits today—I am just giving you an example; the fact that LCH is now the global leader in OTC clearing is due not just to the services it provides, the compression service, access to the EU, but also access to the US, which we get via membership of the EU—I would be sceptical, again, only in my area, that 18 months, given the many years that it took for this limited but quite complex agreement to be achieved, will be sufficient. This is just in my area; but I would be delighted to meet the team that you refer to.

Q311 **Mr Baker:** Perhaps, Mr Flint, I might put it a slightly different way for you. If a commercially attractive way forward, in everybody's interests, were presented to you, would you want it?

Douglas Flint: Yes, of course.

Q312 **Mr Baker:** So have you had an opportunity to look at what Legatum are proposing?

Douglas Flint: I haven't. I will read it with interest. There have been a number of similar proposals. Barney Reynolds produced a whole series of possibilities. The challenge of equivalence is really two-fold. One: it ties you to whatever you are signing up to be equivalent to, without necessarily input to the formation of those rules and regulations and laws; secondly, it depends who determines what "equivalent" is, and how broad the equivalence is—whether it is the outcomes or whether it is the process through which the outcomes are achieved, and so on. So it is a little bit hazardous to rely on equivalence, particularly where the industry involved is such a significant part of the GDP as our financial industry is to the UK.

So I think it is helpful; and, indeed, there are many areas where equivalence works, where the equivalence is determined by, if you like, an independent body staffed by experts from both sides, as opposed by being imposed by one and saying "You have to follow us." I would make the point, in terms of the timescale, we are nearly 10 years after the beginning of the financial crisis—the middle of 2007. We still don't have a finalised capital framework. With the best will in the world the European Union has talked about "We must get the European securitisation markets open"; and they are still not open because European legislators cannot agree on the final structure of one single aspect of securitisation. So the thought that you could do a comprehensive soup-to-nuts kind of deal in 18 to 24 months would not be supported by the amount of time it is taking to revise regulation in the aftermath of—

Q313 **Mr Baker:** That is not quite what I am proposing, and it is not what they are proposing. What the report proposes is that grandfathering, in essence, could be achieved within 18 months, based on the elements in the report. Would you think that grandfathering—not the full soup-to-nuts perfect situation, but grandfathering—would be achieved in 18 months?

Douglas Flint: With good will on both sides yes, but I think it would also depend upon agreement as to grandfathering to what?

Q314 **Chair:** Sorry, could you just clarify what you mean by grandfathering so that we are all on all fours—

Douglas Flint: If you simply said that we are going to have a standstill, effectively. We are going to preserve the status quo for a period of time while we negotiate the new arrangements, at which point the grandfathering standstill will stop and then we will have a period of implementation of the new arrangements, I guess. Even in our regulatory world, we have between two and five years when new capital proposals or regulation comes in to embed the systems, to train—all that kind of stuff. It could be possible with good will on both sides, but there would need to be clarity on where it was a grandfathering towards.

Q315 **Mr Baker:** Are there commercial incentives on all sides to have that good will?

Douglas Flint: I think that there are commercial incentives for the industry and the regulators.

Q316 **Mr Baker:** Miss Corley, would you like to come in on that?

Elizabeth Corley: Yes. If one is talking about establishing a framework that would then enable an orderly and well-planned transition, that should be feasible and indeed we should focus on that. If that paper contributes to a framework and articulates how it might work, I will read it with interest as well. However, we cannot get to the level of detail in 18 months, even on individual directives. It is extremely difficult. It is not just the principle of the regulation or the legislation, it is then what they call the technical implementing measures. It is the detail of implementation that goes beyond the law into what a regulator would have to do, and that takes a heck of long time in these areas.

Q317 **Mr Baker:** You have made that point clear. The last point that I would like to raise is that it has been in the news that the Americans—the new Administration, it would be fair to say—seem to be impatient to reach a trade agreement with the UK. It is bound to include financial services. It is not too indiscreet to say that yesterday I met a Swiss delegation. They made it clear that Switzerland would want to have a very good quality financial services agreement with us. Suppose the United Kingdom found itself making rapid progress towards a broad and deep trade agreement with the United States of America and with Switzerland. What would that mean for your businesses and for our negotiating position with the European Union, when all we were asking for was good will, grandfathering and continuity? I think that it is entirely plausible for us to be in that position very quickly.

Elizabeth Corley: My comment would be that we are now into a realm of international politics that I do not feel competent to comment on, if I am honest. I think that a huge amount of good will and negotiation depends on the motivations and outcomes of all parties, and I really would not have an insight into all those parties.

Xavier Rolet: I am not a trade negotiation expert. I would make two comments and try to avoid any political overtones as I am equally as unqualified as Elizabeth just said she was. First, you can have a trade agreement with elements promoting the free flow of financial services, or some limited impact on financial services. We have seen that, for example, with the Canada-EU free trade agreement. However—again, this boils down to political decision—there is one element that I know would need to be resolved, which is that under EU law, if my information is correct, you are not allowed to negotiate a free trade agreement while a member of the EU.

Mr Baker: Yes, we need to have discussions, not negotiations.

Xavier Rolet: I am not an expert, but I know that that rule exists. So the difficulty, because there could perhaps be some accommodation, is not so much whether the US and the UK, or Switzerland or other nations, would be willing to negotiate even before the UK leaves the EU—that is the key point—and have preparatory discussions in order to strike a quick agreement. It is whether the EU, which is a very large single market that benefits Switzerland—we have seen the result of the recent negotiations between Switzerland and the US—would permit these other nations to engage in these activities. I do not have the answer to that. If that can be successfully handled with the concurrent opinion of the EU, things could indeed move very quickly. If not, again I'm not an expert, but—

Q318 **Mr Baker:** Last word to you, Mr Flint.

Douglas Flint: One of the most solid regulatory co-operation agreements in our industry is between the United States and the UK. The Bank of the England and the Fed and the other US regulators have great respect for each other. In our area, I am not sure what we would be looking for in a free trade agreement. UK firms have access to the US; US firms have access to the UK. Our regulations are in many ways very similar, as Xavier said earlier: we have reached equivalence between Europe—including the UK—and the US on complex areas like derivatives. For the major financial institutions of the world, we all follow the global standards that come out of Basel. So I am not quite sure what the opportunity is in extending free trade in financial services, beyond the market access arrangements that we have already.

Q319 **Mr Baker:** That is a fascinating statement, because you have just very plainly said that we have access to one another's markets in an environment within which there is no trade deal with the United States of America.

Douglas Flint: Yes.

Q320 **Chair:** To be clear, Xavier Rolet gave us a figure of five years for grandfathering. In a sentence, what is the perspective of your respective industries on the length of that period that would be appropriate as our initial negotiating stance?

Douglas Flint: I agree: I think it is two to three years after the end of article 50. If very little was changing, it could be shorter; if a lot was changing, it would need to be longer. I think the politics of making it longer would make it very difficult for both sides, so I would work with two to three years post-article 50.

Elizabeth Corley: There is a technical period that you could anticipate based on workload, which could be two to three years post-leaving, and then there is a political process of adoption, which is not within our control and not within the negotiation's control. I think that that political process of adoption is a piece of string: it is very hard to judge how long it is.

Chair: Thank you.

Q321 **Helen Goodman:** All three of you have given evidence on the challenges and risks to the financial sector, but I am interested in the feedback mechanisms to the rest of the economy. Mr Flint, how would this impact on your clients? I don't mean your retail clients; I mean your industrial clients.

Douglas Flint: I think that's a really good question, because it is down in the nuts and bolts, which really makes a difference. Three areas come to mind very quickly. One is that the extent to which we end up remaining in the customs union, or not, will have a big impact on businesses in terms of the systems they have to create, if they do not already have them and if their business is largely European-focused, to look at rules of origin and proportion of foreign—

Q322 **Helen Goodman:** I am not talking about the other problems that businesses will face. I am talking about the problems that you face and how they will impact on the rest of the economy.

Douglas Flint: Well, we are simply a mirror image of our clients. If our clients are having challenges, we as an industry will have challenges. If they find that the arrangements are accommodating to them, then it will be good for us.

I think that there are two things that people are focusing on at the moment. If supply chains are extended or become a bit clunkier than they are today, businesses will need more access to financial services because they will need more financing. If businesses do not have access to the single European payments area, they will need to set up correspondent banking relationships in a number of countries. The amount of time that it will take to go through the due diligence that is now required to set up a bank account in all the countries where they might want to do business is quite extended, and it will be an absorption of management focus.

It is the nitty-gritty of how supply chains could change if we are no longer part of the single market or the customs union that is the biggest concern to the small and mid-sized enterprises. For the larger companies, they deal in 150 countries around the world. They adjust; they can accommodate most things that can happen, and we will work with them and can accommodate that too. What I worry about is the impact on the small and mid-sized businesses that will have to make an adjustment within what, for them, is a timespan that is quite difficult to accommodate, with more limited financial resources and more limited planning capabilities.

Q323 **Helen Goodman:** In that scenario where they needed additional financial services, what would be the increase in the costs to them of doing trade with European partners?

Douglas Flint: Potentially, outside the derivative area that Xavier talked about, if we are not part of the single European payments area—which I would hope we would negotiate; there are arrangements for non-EU members to be part of it, but that is not certain—it would just mean that payments would be slower, and therefore you would need more working capital finance and you would be paying more banks to move the money around in what you do almost in a seamless way today. That is why it would be more expensive. Your supply chain would be extended and the amount of finance you would need and the cost of that finance, because there would be more players within the system, would be elevated. Today we can offer the same kind of compression that Xavier offers for cash management, where we can look at all the balances around the world and net them. Hopefully we will continue to be able to do that. But these are some of the risks—for smaller businesses it is a concern if they have to have pools of money that are not capable of being netted in quite the same way that they are today within Europe.

Q324 **Helen Goodman:** Okay. Do you know whether anybody has put any quantitative analysis onto that?

Douglas Flint: No.

Helen Goodman: Fine.

Q325 **Mr Rees-Mogg:** I want to come on to contingency plans and what plans you may already be beginning to put in place. As a declaration of interest I ought to say that I am chairman of Somerset Capital Management, an investment management company which has had business relations with all three of your businesses. It would be hard to avoid having a business connection with the London Stock Exchange with an investment management company.

Mr Flint, it has been suggested that it takes at least 18 months—and some said longer—to get contingency plans in place. With the article 50 process expected to end in 2019, what have you already started doing in terms of contingency planning?

Douglas Flint: We have started effectively doing scenario planning on a variety of arrangements that could be negotiated. As I said, because we have significant infrastructure in many European countries, we can defer putting those contingency plans into action, but there is a lead time, because you either have to recruit and train staff or move existing staff that are in London. We have 2,500 to 3,000 European nationals in the UK today working for us, many of which came from France because we bought a big bank in France and made the London trading operation the larger of the two. So it would be a question of negotiating and discussing over a period of time whether some of those individuals and the activities they do for European companies were going to relocate.

To some extent, they would be going home, so it might be somewhat easier for us, but you are still talking about disrupting families, giving them time to find places to live, coincide with school years and so on. Indeed, one of the challenges we have had to deal with is family circumstances—people saying, "If I am going to be asked to move in 18 months, I would rather go now, because the kids are at a certain stage"—and so on. That's real.

The contingency planning is looking at the scenarios, talking to our clients about where they think they would put their operations in Europe if they were having to make adjustments from where they are today and then building our capacity in those places. As I said, France is an obvious one, but there are also Dublin and Amsterdam for cash and possibly custody activities, and Luxembourg, to ensure that we have enhanced capacity as more of our clients move more of their operations there. That is what we are doing.

Q326 **Mr Rees-Mogg:** To what extent will this be client-led, rather than you feeling you have got to do this—

Douglas Flint: It is all client-led.

Q327 **Mr Rees-Mogg:** To the extent that it is client-led, where are the regulations? That is to say, if you are lending to a client in the European Union outside the UK who comes to you for a loan, are you as a lender regulated by the UK or the European Union?

Douglas Flint: There is a big discussion on this as to whether reverse inquiry addresses the need for a licence. Then you get into the complexity: if I already have a relationship with you, is it a reverse inquiry or am I dealing with a client that already exists? It is different in different countries. One of the uncertainties that we would have to deal with is whether our legal advice was robust on the route that you take that a reverse inquiry enables you to do business from the UK with an existing client who approaches you. But those conduct of business rules are quite fraught. "Did you really speak to me or did I hint to you that you should come and have a conversation?" We would be nervous about getting into a situation where we did not have clarity.

Q328 **Mr Rees-Mogg:** In the investment management business—I don't know whether you would agree with this, Ms Corley—the reverse solicitation is relatively straightforward, particularly for UK firms dealing with the United States.

Elizabeth Corley: There are currently clear-cut rules that enable one to do that with professional and institutional clients. As you know, there is a huge difference in investment management between the professional client and the retail client. If we are talking about institutional clients, there is certainly a process by which one can do business on a reverse inquiry basis. Having said that, we err on the side of caution. Not in the

United States, but looking more globally around the world, if there is any doubt that with hindsight a regulator might decide that they are not going to allow that interpretation, we err on the side of caution and avoid it, because it is an unstable framework on which to base a business expansion.

Q329 **Mr Rees-Mogg:** To come back to you, Mr Flint, the 1,000 people that you think you may move must be dealing with the larger more professional clients. They are not going to be dealing with a small retailer in a Paris street.

Douglas Flint: No. The vast majority of those people will be dealing with the larger clients.

Q330 **Mr Rees-Mogg:** Who may well have international treasury operations.

Douglas Flint: Indeed.

Q331 **Mr Rees-Mogg:** Therefore they are clients who are likely to want to continue doing business with HSBC in the current way. You say it is all client-driven, but your move of people seems to be HSBC-driven.

Douglas Flint: Well, for the larger clients, the client approach is to say, "We currently deal with you in our treasury operation, and in Frankfurt, Bonn, Amsterdam, Paris, we wish to continue do so. Make arrangements."

Q332 **Mr Rees-Mogg:** So that's the continuation of business as it is. That does not need anyone to move at all.

Douglas Flint: But at the moment we deal with them in those centres from London.

Q333 **Mr Rees-Mogg:** Yes, but if they are coming to you and they are the large clients, they would be the equivalent in fund management terms of the professional clients, the institutional clients.

Douglas Flint: But it's not clear that that reverse solicitation will be entirely effective. The coverage officers are reaching out to the clients all the time to discuss their affairs. We would need very, very clear guidance that that was the continuation of a reverse solicitation, as opposed to us outreaching and saying, "Have you thought about doing this to hedge your interest rate risk for a contract that is in the future?"

Q334 **Mr Rees-Mogg:** But that is a legal matter as to whether it is reverse solicitation. It becomes a definitional matter of how it is being done.

Douglas Flint: It is not legal; it is a regulatory interpretation.

Q335 **Mr Rees-Mogg:** Regulation is the law.

Douglas Flint: Well, it is, but if a regulator says, "Our interpretation is different from yours", you are in a very difficult position.

Q336 **Mr Rees-Mogg:** Yes, but it is fundamentally based on the law that has been passed, so there is a legal question as to what the regulations are based on. The fundamental point is that the 1,000 people relate to your larger clients who are dealing with international treasury issues, and therefore the regulation from the EU would have to say effectively that a large client could not deal with somebody who was operating out of the UK, otherwise you would be able to continue on the reverse solicitation principle.

Douglas Flint: Assuming you were confident that the reverse solicitation could be watertight.

Q337 **Mr Rees-Mogg:** So it becomes a legal question.

Douglas Flint: But it is more than the interpretation of the practice of dealing with the client as to whether the to and fro with the client is indeed responding to an issue of reverse solicitation, or whether you are now proposing something new. If it were that easy, I don't think we would be having the planning discussions that we are having at the moment because it is not that simple. If it were that simple, many other people could be dealing within Europe without having a European operation.

Chair: And we would not be having this hearing, either, Mr Flint.

Q338 **Mr Rees-Mogg:** That does not necessarily follow, Chairman. We have lots of hearings on many interesting subjects.

It is coming to the fundamental question, isn't it? Yes, there are potential difficulties, but they effectively require the European Union to impose capital controls, and to say that you, as a German citizen, cannot go to a British bank and ask to borrow money. Put it at its most extreme: somebody from Frankfurt gets on a plane, goes into HSBC's offices and says, "Can I borrow money?" That would happen under UK regulation, if you decided to lend to a German national who is physically in the UK. The EU, to stop that, would have to put on capital controls so that that German cannot take that money back to Germany.

Douglas Flint: The example you have given is a very clear-cut case, where someone gets on a plane and arrives in London and says, "Can you do something for me?"

Q339 **Mr Rees-Mogg:** And then you go to the next stage and say, "There you are." That's where, to prevent reverse solicitation, you have to have capital controls.

Douglas Flint: Both examples are very clear. In the ongoing relationship, the relationship managers are having ongoing discussions. Are you operating a business in a foreign country? Or are you simply servicing a reverse solicitation?

Q340 **Mr Rees-Mogg:** Yes, but that becomes a matter that you could put in place internal compliance for.

Douglas Flint: We have enough experience of the interpretation of when you are doing business in a foreign country that is uncomfortable in terms of a variety of interpretations. Some of the countries in Europe have much clearer interpretations than others. I think it would be a great deal less risky for us to have 300 relationship managers based in Europe servicing that business than to rely on reverse solicitation.

Q341 **Mr Rees-Mogg:** But you already have the operations there. So a firm that isn't there, that is just in the UK, could just carry on because they do not have a physical presence there and, therefore, the issue of reverse solicitation is broadly clearer.

Douglas Flint: I hope that it might be clear but I don't believe it is as clear as you suggest.

Mr Rees-Mogg: All right. We'll take that as a modicum of agreement.

Q342 **Chair:** Perhaps you could supply something because there is clearly a lot of imprecision on this and you are saying that there will always be imprecision until tested. That is what your evidence has just been. Perhaps you could write to us on this point and attach an assessment of the business risk, or the absence of business risk. Because, if Jacob's correct, quite a major concern is removed so we need to explore this.

Douglas Flint: Sure.

Q343 **Mr Rees-Mogg:** What I am trying to get at is the contingency planning and the fallback positions. Of course, if everything could continue and people could carry on with passports and so on, that's fine. But I wonder whether it is realistic to assume that happens and whether, whatever timescale is given, you can sensibly take that risk.

Because we won't know whether there is grandfathering, in whatever definition it has been given, probably until the end of the process but certainly not until some way through it. By which time, if there isn't grandfathering on 31 March 2019, there is a much bigger risk than putting in contingency planning, of which the most obvious seems reverse solicitation.

There is a follow-on question that perhaps I could ask you, Mr Rolet. You were talking about grandfathering for legal contracts. Most contracts put within them the country where the law will be applied. Is it realistic that any departure would overturn legal contracts that were based on a specific jurisdiction?

Xavier Rolet: What I think will happen is that the customers, who again will drive this, would seek a novation process. You are correct in stating that you cannot take a contract and move it physically into another jurisdiction without addressing the point of which underlying law regulates the contract. So if it turned out that the UK was expected to become non-compliant with EU regulation for euro-denominated securities and if a migration had to happen, there would have to be a novation. Obviously, new business could be carried in a different fashion.

Q344 **Mr Rees-Mogg:** New business is different, but if you have a derivative contract that starts today and ends in 2020, that contract will be unaffected.

Xavier Rolet: Well, you would have to novate to a new environment, potentially a new legal framework and new counterparts.

Q345 **Mr Rees-Mogg:** If you rolled it over, but not during its lifetime. If it is legal to sell something, I cannot think of any regulation that makes it illegal to continue to hold it, except in the event of sanctions.

Xavier Rolet: That is a real issue. If, for example, two parties were to transact an interest rate swap with a 20-year maturity—we have interest rate swaps all the way to 50 years—and book it here in the UK, even though that contract had been legally committed and legally transacted today, in two years' time, assuming the counterparties are using a London-based clearing house that was no longer compliant, they would basically have a set of non-compliant legal obligations. That would have certain impacts. For example, they would lose the regulatory capital benefit in terms of the balance sheet. As Douglas referred to earlier, their national regulator—let's say the company is in Germany—would likely say, "Sorry, your contract is no longer compliant with EU law. You need to novate it."

Q346 **Mr Rees-Mogg:** So the contract is robust, but the use of that contract for other purposes may not be.

Xavier Rolet: The contract is robust up until the time when a regulator might deem—

Q347 **Mr Rees-Mogg:** The contract remains robust, but you may not be able to use it for regulatory purposes. You would need your counterparty to accept a change in the contractual terms.

Xavier Rolet: What the regulators might say is, "The contract that was robust legally two years ago no longer is." It is in their power to say so. They would then require the counterparties basically to take steps ahead of time to move that to a compliant jurisdiction.

Q348 **Mr Rees-Mogg:** If you needed regulatory capital. If you didn't need regulatory capital—if you were a straight investor—

Xavier Rolet: An investor in the EU today—and in the US—in the area of over-the-counter derivatives has a mandate. They are mandated in both the US and the EU to clear, so if their transaction became uncleared, the regulatory capital cost to them at the time when the transaction became non-compliant would be very substantial.

Q349 **Mr Rees-Mogg:** Yes, but not all investors need regulatory capital. Banks need regulatory capital, but a hedge fund does not need regulatory capital. It needs to have margin, but that is a matter for the counterparty that it is with and therefore the clearing house.

Xavier Rolet: If an investment management customer had transacted an interest rate swap, foreign exchange or credit default swap contract in a fashion that complied with EMIR and Dodd-Frank in the US and it all of a sudden became non-compliant, the banks that executed that transaction for that particular investor would demand a very substantial amount of regulatory capital, and therefore the investor themselves would be hit.

Q350 **Mr Rees-Mogg:** So this is the way the European Union would be able to stop clearing—by changing the applicability of capital to EU banks. If they went back to what they did a few years ago and said—

Xavier Rolet: They tried.

Q351 **Mr Rees-Mogg:** They tried. At that point, the UK was subject to EU law and therefore, had it lost its case, would not have been able to continue to clear. In future, we will be outside EU law, so we will be allowed to clear under our regulations—

Xavier Rolet: Correct.

Q352 **Mr Rees-Mogg:** But there will be the question of whether anyone will want to clear with us because of EU regulations.

Xavier Rolet: That's correct, sir.

Q353 **Mr Rees-Mogg:** Therefore, we would be able to continue to clear euro transactions for people who were not dependent on a European regulatory base—US companies dealing in euros; HSBC dealing in euros—but we wouldn't be able to do it for Deutsche Bank.

Xavier Rolet: That is a very good question. That would actually exclude not only all EU-regulated entities but also US-regulated entities—that is 98% of the market—because the US has an equivalency agreement with the EU. As Douglas pointed out earlier, equivalencies are very important, but equally they can be fragile, because they can be reneged on or denounced by one of the parties.

Mr Rees-Mogg: But if we—

Q354 **Chair:** Can you carry on with this very important point—your description of equivalence in this context?

Xavier Rolet: As regard to clearing—I'm not talking about all aspects of financial services—there is currently between the Commodity Futures Trading Commission in the United States and the European Commission an equivalency agreement, as far as clearing houses are concerned, so clearing houses based in the EU and clearing houses based in the US can clear each other's products. But if there were an environment where euro-denominated, dollar-denominated and other activities that go beyond those activities were carried out by US and European institutions that were to become deemed non-compliant by their respective regulators, under the equivalency agreement they would lose the benefit of clearing. To your point, you lose the regulatory capital benefit—you have to put up more margin. But you can also be deemed to be non-compliant with your domestic law by your regulators, which can have another set of consequences, fines and other disciplinary action.

Q355 **Mr Rees-Mogg:** But that assumes that the US would decide that its equivalency with the EU was more important than being able to access the London Stock Exchange's clearing, which is doing 90% of OTC derivatives. I quite accept the point that the EU may want to take decisions that are not in its economic interest, but I don't think the US will do that to help them. Therefore, if the US gave the UK the inheritor of the equivalence, then actually the majority of business going on in the LSE would continue, and it would only be euro-based, eurozone-based, European-regulated people who would be cut out of the market. And then you begin to cut it down. It's a part of your business, but actually it's much worse for them than for you, because they lose the comingling benefit and all those savings, and they don't have a business up and running to take this load from them, and they would lose their equivalence with the US if the US keeps it with us, so they then wouldn't be able to do dollars or sterling.

Xavier Rolet: I think, sir, that in a few words you've just described the interconnected complexity and strategic value of this business. What the outcome will be is fundamentally uncertain. You pointed out a very important fact.

Mr Rees-Mogg: All I wanted to conclude with—

Chair: Can we possibly have Xavier Rolet's response?

Mr Rees-Mogg: I'm sorry. I think what you are saying is more interesting than what I am saying, so do continue.

Xavier Rolet: I wanted to offer a response, but please continue your point. I apologise.

Q356 **Mr Rees-Mogg:** All I was going to say at this point is that the cards are not all with them. For them to stop euro clearing would be economically damaging to them, but we have got a very significant workaround that would limit the effect. That doesn't mean it is a preferred outcome, but it means that it is not a disastrous outcome.

Xavier Rolet: That is a point we have been making all along—it's been in the public domain, so I'm not saying anything secret here—when facing these attacks by many in Europe who basically want to secure our euro-denominated clearing business and bring it back to the EU. We have always brought in the US.

It is the complexity—you are absolutely correct. There are in fact independent studies unrelated to the London Stock Exchange. I point out the Clarus Financial Technology report—I would be happy to provide a copy to this Committee if you so wish. It highlighted that, economically, the separation of the euro-denominated component from the LCH clearing engine—a default fund that handles the world's 18 largest currencies and comprises all those currencies in a single default fund, would cost the industry, banks, asset managers and hedge funds—€77 billion of additional margin. This is based on 2015 numbers; those for 2016 are vastly higher. That is a very substantial impact, of course, in terms of margin commitment. The negative economic impact on European industry and all other market participants using euro-denominated products is undeniable.

25% of our revenues come from the US. They regulate us; it is a very significant market. I would not in any way prejudge the position of the political and regulatory authorities in the United States. The position of the US authorities can be quite complex. It will be driven by the interest of the US economy, issuers, the interest of US investment banks and other intermediators of distribution of capital, but also the US clearing houses. So I think their willingness would depend on several things.

This is where transition is important. Potentially, if London found itself in the very short term faced with an immediate potentially systemic event, it would have no choice but to consider, because of the lack of clarity, whether it could be on the receiving end of the entire business, because the benefits of compressions only hold true, and the customers—intermediate, corporate issuers and asset managers—would insist on retaining these benefits. Could they potentially see a company like LCH moving to New York? That might colour their judgment and the way they might play this particular—

Q357 **Chair:** For clarification, you are saying they might help the eurozone because they conclude they could pick up the London market in one fell swoop. Is that what you are saying?

Xavier Rolet: The competitive tension between New York and London goes back many decades, based on the potential benefit of receiving the largest clearing house—

Q358 **Chair:** To bottom out Jacob Rees-Mogg's point, what probability do you attach to that?

Xavier Rolet: I would say it would be extremely attractive for the United States to handle 95% of the world's clearing over accountability.

Q359 **Chair:** So you attach a high probability.

Xavier Rolet: And I would say that for financial market participants that are based in the United States, not just investment banks, but investors, they would also be equally likely to be attractive. I am merely speculating. I think that is one element to answer your question.

Q360 **Chair:** So, to coin a phrase, American politics will trump American economic interests.

Xavier Rolet: This is an example where both of them may be aligned potentially. If that were not the case, if we look at all the potential, it would be important for US-based clearing houses, the very big ones, to retain access to euro-denominated securities. That is still subject to the continued existence of the euro market, of course. I concur with Douglas that ultimately, if I were a betting man, which I am not, the likelihood of the euro surviving subject to the right outcome of the next four major elections in the European Union over the next eight months, that is obviously a big subject, I would be betting on that side.

A US-based clearing house would clearly be incentivised and would certainly represent as would customers, corporate issuers and intermediaries the benefit of continuing to maintain through equivalency access to euro-denominated securities. It is rather large: in 2015, LCH cleared €327 trillion, to give you a sense of the size of this market. So it is another component that could bias their judgment one way or another.

Separately, if the UK in the context of the Brexit negotiation could seek to represent to both sides a halfway position, leaning one against the other, to bridge between the EU, frankly I think this is an outcome that would be beneficial to all, starting with the UK in London.

Many in the EU see this is clearly an issue, which is why they embraced it immediately after the referendum as a sovereignty issue. To encourage the EU to look at it as an economic competitiveness issue and then working with the EU and the US Administration, to try to get a grand bargain would be beneficial to all, because it preserves the competitive opportunities of US-based clearing houses and investment banks; it preserves the interests of European issuers, European-based banks and asset managers; and, in my humble opinion, increases the likelihood that this remains here.

So, to try to work jointly during that period of grandfathering—that protected safe harbour period—with the new US Administration, which seems to be very competitiveness and economically minded, at least that is the early impression, and the EU continues to have an economic competitive deficit, once the electoral issues are out of the way, you have newly installed Government, or confirmed Government, that can then focus on the economic agenda. That is the role that London and the UK Government could play, which would be beneficial to a successful Brexit.

Mr Rees-Mogg: Thank you.

Q361 **Wes Streeting:** Good morning. I want to focus on your role in informing the Government's approach to the renegotiation. In evidence to the Lords EU Committee, David Davis said that the Government's negotiating position would be informed through a two-stage process. In one stage, Departments would be charged with seeking the views of every single sector of British industry; secondly, the Department for Exiting the European Union would do a quantitative analysis, "so that before we get to the start of negotiations we will have an idea of what is big, what is small, what matters and what does not."

Could each of you begin by giving an overview of the sort of contact you have had with Government? In particular, tell us which Government Department has been your main point of contact or interlocutor and what information Government has asked you to supply to inform its negotiating strategy. We'll go down the panel.

Douglas Flint: We have had a number of conversations on an individual basis with the Treasury and the Department for Exiting the European Union. I think all of us are members of a variety of working parties, in many respects brought together under TheCityUK, which commissioned a great deal of work on the relative size of the revenue streams and value added that attach to each of the elements of retail, commercial and wholesale banking in the UK, the proportion of the revenues and value added that attach to European business and a broad assessment of the likely vulnerability of those flows, depending on a variety of scenarios. That has been supplied to all the relevant Departments in Government. Indeed, Ministers from the Department for Exiting the European Union and the Treasury have come and participated in meetings, and have had meetings with the trade associations and individual institutions. So all of that, really.

Q362 **Wes Streeting:** Of the two—the Treasury and the Department for Exiting the European Union—your primary point of contact is—

Douglas Flint: I think we are responding to inquiries by both. We are producing a fact package, if you like, and then to some extent an analysis of that fact package, which we are providing to both at the same time. We are effectively supplying and responding to outreach from both. I would say it is equivalent.

Elizabeth Corley: I completely support that. There has been interest from both.

Xavier Rolet: Sir, you will probably not be surprised if I give you the same answer. We do have frequent interaction with all Departments.

Q363 **Wes Streeting:** David Davis said he would be asking businesses to quantify the effects of different barriers to trade and put numbers on which barriers matter most. Have you been asked specifically to carry out and supply quantitative assessments of the impact of barriers to trade? Is that information you have been asked to supply, and have you provided it to Government?

Xavier Rolet: As I said, a very high-level assessment has been done of the revenue value added at risk in the various activities that are subject to licensing and passporting agreements within Europe, but it is very high-level. It has to be. Frankly, it is not possible to get down to a granular level and say, "Here are all the individual elements of revenues that might go, depending on scenarios." A high-level vulnerability analysis has been done, and that has been shared.

Elizabeth Corley: In asset management, because it is a global industry already and there are relatively fewer barriers to trade, we have identified where we think there are opportunities for the United Kingdom to differentiate itself going forward, as part of the industrial strategy, but we have not quantified those. In terms of removing barriers, frankly, for us, it is quite low, because outside the retail area, this is very much a global business.

Xavier Rolet: As regards our interaction with various Government officials—of course, also at the request of our own regulators; we are regulated by about 60 regulators around the world, but UK regulators are our home regulators—we have been asked about contingency planning, and detailed analysis including economic analysis in our own businesses. In some cases, it is quite granular in terms of economic impact, particularly as it relates to the clearing industry, which is about a third of our business.

The other two thirds are our intellectual property business. We compute about a million indices every day, including in China, Japan, emerging markets and the US—all over the world. There is the impact, for example, particularly of losing equivalency, and the impact that that would have on administrators and investment managers in terms of their own benchmark. There are $11 trillion of assets in the benchmark in those businesses, so it is quite a big business. There is capital formation as well, which as a business we are better known for, providing, basically, a match between those who have the capital and those who need it. This is more around contingency planning. So we have done some detailed analysis in years for which we could, with some potential economic impact, but this has been focused mostly, because this is where it is easiest for us, given the share of the market, on balance-sheet areas, collateral management and clearing.

Q364 **Wes Streeting:** It would certainly be very useful if you could share the analyses you are producing with the Committee, if you haven't already. Thinking about the information flow in the other direction, David Davis has said that his Department has now produced 57 studies on how different sectors of the economy will be affected by Brexit. Have any of these studies been shared with you during your direct interactions with the Government or through any of the working groups you have referenced?

Douglas Flint: No.

Elizabeth Corley: Not personally.

Xavier Rolet: Not that I am aware.

Q365 **Wes Streeting:** Okay, and in terms of the extent to which you think the key issues and messages are filtering through to Government, are you confident that the Government now have a detailed understanding of how the financial services industry will be affected by changes to their rights of access to EU markets? And if you are not confident, which of the particular areas do you think this Committee and parliamentarians ought to be flagging during the various debates on the Floor of the House of Commons or through the reports that this Committee and others will be producing?

Elizabeth Corley: First, I would say that there has been an incredibly rigorous and intensive request for information. I think we have felt that that information has been received at face value and with a lot of good questions and follow-up. So in terms of information provision and flow, that has been a very good process and we will certainly make sure that the Committee receives whatever you would like to receive. In terms of that initial level of understanding, I think there has been a huge learning curve for all of us. Where the complexity comes in is with the Jenga, which is the interconnectedness. It is not just within individual sectors; it is the cross-sector interconnectedness and the horizontal directives as well. There I think, frankly, that even in all our contingency planning we are still mining the data, so it would be remarkable if the Government and their Departments had got there ahead of us. It is really quite complex—we are talking about 40 years of accumulated detail.

That is the legislation piece. The regulation piece takes it to the next level of detail and then the individual contracts that we have with clients, which might inadvertently reference EU law or an EU directive, take it to another level of detail. I do not think it is feasible to expect, at this stage, the Government to have a comprehensive understanding of that. That would not be a realistic assessment.

Xavier Rolet: By and large, whether we do this through industry forums, associations, ad hoc committees or a very intense, as you can imagine, robust base of individual meetings with Ministers and their colleagues in all the branches of Government, a lot of information has been provided. I concur with Douglas and Elizabeth that with the broad framework, the major issues have been identified and commented on, and I am certain that the Government are fully on top of them. Elizabeth's point about the nitty-gritty, the sort of sequence sensitivities as you discover one point leading to another, will simply take more time for all parties to fully investigate.

Douglas Flint: I agree with everything. The only thing I would add is that a lot of our analysis is, of course, purely economically driven and we recognise that there will ultimately, on both sides of the negotiation, be trade-off with other centres and with political priorities that may be more important than the economic outcome.

Q366 **Wes Streeting:** That's right, and that was really the driver behind my questions. I have no doubt that the information flow is there. You have given us a great deal of reassurance about that. My question was really about the extent to which you feel that the key priorities for financial services, in terms of securing the future success of the industry in the UK, are properly understood and are at the heart of the Government's priorities around the negotiations. Frankly, the Chancellor comes in front of the Treasury Committee and I think he gets it, but I am not sure whether his colleagues around the Cabinet table do. So the question for us, as we look at the order of priorities and the trade-offs that you referenced, Mr Flint, is: do you feel, from an industry point of view, that your concerns are well understood, to the extent that they are properly reflected in the Government's priorities? Or let me put it another way: is Jeremy Corbyn right to be warning about a "bankers' Brexit"? Are you getting a good deal at all? Is that on your radar?

Douglas Flint: No—no. One of the things we should try and refocus on is the fact that we are simply a mirror of what is happening in the real economy. The focus should be on how this impacts the customers of all our businesses. Does it make it easier for them to do capital formation? Does it make it easier for them to raise credit? Does it make it easier to manage risk? Does it make it as easy as it has been to manage their trade and supply chain arrangements? At the end of the day, we are simply a reflection of the activity that they can do. It is not about whether the industry does better or worse; we are a reflection of our clients.

Q367 **Wes Streeting:** So, if Jeremy Corbyn can sleep easily tonight knowing there is no "bankers' Brexit", should the Chancellor be sleeping uneasily tonight, concerned that there will be a deal that does not properly reflect the interests of one of our leading industries? How worried are you at this stage about where you fit in the Government's scheme of priorities?

Douglas Flint: I think they have grown in their understanding and knowledge. Elizabeth put it extremely well, that we are all struggling with what we would call Jenga. That is, are there individual pieces that do not look particularly important, but which are crucial to the underpinning of the edifice of the cluster that exists today? Xavier would say, I am sure, that one of those major pieces is the infrastructure, the clearing, which is not the sexy piece of financial services but is effectively the most critical.

Elizabeth Corley: We want to see the United Kingdom economy—our customers—prospering and growing, so we need to see something coming out of this that is good for all, because that is where we get long-term business from. There may be trade-offs down the track. The idea that there is a trade-off—that one side wins within the economy and the other one doesn't—is just not how we are thinking. We see this as our contribution to the Government's strategy, and it is fact-based. We are trying, wherever we can, to talk about what the consequences might be. However, it is simply fact-based because, ultimately, our customers are the ones who have to come out of this very well. If they do not, our businesses will be a reflection of that.

Q368 **Wes Streeting:** Finally, to bring you in Mr Rolet, I know the London Stock Exchange is doing some work on this. It seems at the moment that in this era of new populist politics the financial services industry is seen as the establishment, that bashing the financial services industry plays into popular sentiment, yet the message we have heard this morning is that what is bad for the financial services industry will be bad for the economy and for every single taxpayer and citizen. As an industry, how do you grapple with that problem, while also informing the Government's negotiation, and also inform better public debate about the role of financial services in the future of the economy?

Xavier Rolet: If that question is a personal one, I think I am anything but an establishment figure. As regards the London Stock Exchange, its roots go back to 1698, to entrepreneurs who were not people from the establishment—certainly not the landed establishment—seeking to do business and establish neutral rules and a single place where neutrality and integrity could help them grow their trading businesses. Ultimately, this was about risk intermediation and transfer.

Many of the businesses that the modern emanation, the London Stock Exchange, promotes are businesses like our AIM market, which today has passed the £100 billion raising benchmark for small and innovative UK companies; our ELITE programme, which promotes private companies up and down the country; our "1000 Companies to Inspire Britain"; innovation entrepreneurs: this is what we do.

There is a big opportunity to continue to invest in these businesses, to recalibrate our fiscal system—not just Europe and our regulatory system, but also in the UK—which privileges leverage, risk-taking and debt over long-term patient capital equities. We are seeing a little rebalancing away from that at the moment, due to rate policies into equities. I also think, to answer your earlier question, that the advantage of a well-defined, clear, time-limited grandfathering transition system

I also think, to answer your earlier question, that the advantage of a well-defined, clear, time-limited grandfathering transition system is that it will enable all of us—not only Government and decision makers such as your good selves but also economic players—to highlight and dig deeper into what is really important versus what might be sacrificed. That extra time will help in terms of the quality of the process.

I certainly think that the idea of capital raising to power innovation, growth and job creation has relevance. It is not about financial services employing 2.2 million people in the UK and two thirds of those jobs being outside London—that is only one part of it. If we want to succeed, we have got to power the 5.4 million SMEs. They are the ones creating good, innovation-based jobs that effectively give you pricing power—innovation gives you pricing power—and the ability to pay good salaries. That is what we need to focus on. That is almost Brexit-independent, although Brexit perhaps gives it a sharper focus. If we can continue to focus on that, whether we are a bank, an asset manager, a corporation or an infrastructure company, we can make it a success.

What is really important in the transitional arrangement—this is the last point I will offer—is not only that business today is global but that it will continue to increase in its globalisation. It is not just about financial flows. It is about trade and the movement of innovation, including scientific innovation. It is essential that we keep the UK connected to the big centres where innovation, capital formation and wealth creation happen. That is not just Europe; it is the US and the rest of the world. It is China, which is a major opportunity. China is just getting started. In that respect, any focus given to these issues and areas will get our full endorsement and support.

Chair: We have two more colleagues who want to come in. We have been running for well over two hours, but this has been a fascinating session.

Q369 **Chris Philp:** Good afternoon, and thank you for your epic levels of endurance and patience over the last two and a half hours.

Chair: Are you not referring to your own?

Q370 **Chris Philp:** Not at all. Patience is one quality that I don't possess, Chairman. I want to return to some answers that the panel gave to the

Chairman at the beginning of the session. The panel all said that if the Government gave some form of guidance as to their intentions in the coming negotiations, that would be very helpful, particularly for planning. You said that if that guidance was not forthcoming, there was a risk that people would start implementing contingency plans. Can you just clarify for the Committee the likely timing of the implementation of those contingency plans were no guidance to be forthcoming? When would it start happening, practically? Mr Flint, you are running a large business.

Douglas Flint: For those businesses that do not have infrastructure already in place in Europe, it will start pretty much immediately on the triggering of article 50.

Xavier Rolet: Some of these contingency plans have already started. Regulators have asked, "What are your plans for customers and for infrastructure companies?" I concur with Douglas: in the absence of further clarity around a transitional agreement, the time of the filing of article 50 will no doubt trigger contingency plans, if they have not been started already.

Q371 **Chris Philp:** That is to be implemented, not simply considered. When will they begin to be implemented?

Xavier Rolet: Around article 50, what you are likely to see is a number of firms, if they have prepared for these contingencies, starting to apply for licences. That does not necessarily mean that they will start moving people, but from a fiduciary, regulatory, board dynamics, shareholder point of view, they will have to start filing for licences outside of the UK.

Elizabeth Corley: The same. The longer the lead time is, the more in advance one has to start doing some of the preparatory work, but that is not necessarily a decision trigger. Douglas made the point earlier that, with the returns on bank equity as they are at the moment, for the banking sector it is a very big decision to decide to deploy capital to relocate activities and then back those activities up with additional capital. That is a huge decision, but the less prepared people are for doing business and the fewer entities they have in Europe already, the longer the lead time is for them to establish.

Q372 **Chris Philp:** When is the decision point when the work is no longer simply preparatory, but becomes almost irrevocable? At what point in time would that be reached, in your opinion?

Douglas Flint: Again, it depends on individual firms. I have heard a number of leading firms say that everything is capable of being unwound right up until the last moment. The default position of our customers and, indeed, many of our peers is that we would love the status quo to continue. Even if we had made plans and put some infrastructure in on the ground, if we did not have to physically go ahead with it, I think people would unwind.

Q373 **Chris Philp:** I am hearing very clearly that this clarity really should be forthcoming prior to article 50 being triggered—that is, in the next eight to 10 weeks.

Douglas Flint: In an ideal world, prior to or at the time of.

Q374 **Chris Philp:** If that clarity were to be given by the UK Government—if the UK Government were to articulate their very broad vision and objectives—how useful would that be for business planning purposes, given that the European Union, on the other side of the table, has to agree to whatever that vision might be?

Xavier Rolet: In the short term, it would be extremely helpful in in terms of our commercial discussions with customers. We can highlight the very point that Douglas just made: by and large, they simply do not want to move. So in the context where the UK Government would support the point you just made and elaborate on it, that raises the bar on a potential cost for the customer to make an early move, which might turn out to be the wrong one, and therefore spend resources and make early decisions to spend money on things that end up being irrelevant.

Q375 **Chris Philp:** Would other panel members concur?

Douglas Flint: Yes.

Elizabeth Corley: Yes.

Q376 **Chris Philp:** So your very clear request to the United Kingdom Government is to provide some clarity over their broad intentions prior to triggering article 50, notwithstanding the final shape of the negotiation being uncertain, because of course, it takes two to tango. Is that your request?

Xavier Rolet: It is not within our power and privilege to make requests from any Government, including the UK Government, but I certainly say that I would not be surprised if many commercial financial services operating, including outside the UK, would certainly support that initiative.

Elizabeth Corley: It would be very welcome.

Douglas Flint: Very welcome.

Q377 **Chris Philp:** That is fairly emphatic. We have had a discussion over the past two and a half hours about the disadvantages that European Union countries would suffer if we fail to get a sensible agreement. We have heard about risks to market stability, because of fragmented clearing, and the disadvantages that UK-operating businesses would suffer if they did not have access to a deep capital market, which London presents. I think we are probably largely unanimous in that analysis, but do you think that the European Commission and European Governments understand and accept the dynamic that we have discussed over the last couple of hours?

Xavier Rolet: Yes, I do believe that they understand the economic dimension. The question is how high up the pecking order of priorities that figures. Again, I think that for the real negotiation to start, one needs the actors in the countries that fundamentally matter in the rest of the EU—

starting with Germany, which will have elections in September, then France, in April and May, and Italy, possibly Spain and the Netherlands. The key political actors either need to be appointed or reconfirmed before the real debate can start.

Q378 **Chris Philp:** Let me put to the panel a concern that I have. Even though it is in Europe's financial interests to come to what we might call a sensible mutual arrangement, political considerations may prevent that. In particular, the European Commission may seek to prevent such a deal, partly to punish the UK for leaving but partly, or particularly, to deter other countries from leaving the European Union. So they have a political imperative connected with the European project that might override the economic interests. I would cite two bits of evidence in support of my thesis. The first, as Mr Rolet said, is the fact that they are trying to get clearing back. They have tried it before and they have now been trying it again in the last few months, despite the fact that it arguably works against their interest. The second is on the timing of the negotiation. We have all agreed this morning that this negotiation is complicated, long and difficult, yet the European Commission have refused to engage in pre-discussions of any kind and Monsieur Barnier has said that discussions can last for only 18 months. They have deliberately shortened the time available for negotiations, and the only possible motivation I can see for that is a desire to make the outcome unsuccessful. Is that an analysis with which you concur? I am going to come again to Xavier Rolet, because he has an unusual insight into continental European thinking, owing to his heritage.

Xavier Rolet: I have been singled out.

Chris Philp: I will come to the other two panel members on this point.

Xavier Rolet: So you want me to answer that.

Chris Philp: I do indeed, yes.

Xavier Rolet: Sorry, I thought you wanted to keep me for last, given my conflicted position.

Chris Philp: No, you first—it gives you a better ability to comment.

Chair: This is the first reference we have had to the fact that you are not English, and I hope it is the last.

Chris Philp: He is therefore better qualified to comment.

Xavier Rolet: I would make several points in answer to your comment and question. First of all, I am not a political expert, but political priorities can change ahead of elections and after elections. Therefore, some of the statements that have been made and some of the positions that have been articulated are subject to evolution if a new political framework establishes itself in the EU in the coming months. I simply do not know what that will be. I would be surprised if the Commission itself were not reflective of a new political reality if one emerged in the European Union.

This goes back to the point, and I concur with your analysis: it is true that article 50 was essentially designed to mete out punishment—exemplary punishment, perhaps—on any country seeking to leave. That is why it is so short. That is why it does not provide for normal adjustment mechanisms and issues of financial stability and economic progress have not been figured in, although one could interpret some element of article 50 as extending the final agreement—giving time and ability to the parties to potentially extend the final time of secession. But that is true.

However, I would also say—this goes to the heart of the EU—that there are some political, economic and regulatory voices in the EU that do understand the need for the European Union to be economically more competitive and basically assess itself as a greater contributor in terms of wealth creation and distribution and job creation. There are 25.5 million unemployed workers in the European Union. Obviously, they are not here—the UK is a successful economy. There are 23 million SMEs. They are not being used to create those 25 million jobs. There are new voices in the EU that I believe may be able, post this electoral cycle, given the proper encouragement—that could include encouragement from this side of the channel and perhaps other countries outside of our area, such as the United States and others in Asia—to lean on the process to get to the right place. I think that is still possible. That is my answer to you. Greater focus on economic competitiveness could be the gift of the UK to the EU as it leaves.

Q379 **Chris Philp:** You have pre-empted my next question, which is: do you think the UK Government should actively seek to encourage interest groups within the EU—particularly industry interest groups, whether that is French wine makers or German auto manufacturers—to try to put pressure on their Governments and the European Commission to reach a sensible solution and lean against the tendency to take decisions in defence of the European political project rather than economic self-interest?

Xavier Rolet: Again, this is where the reconciliation of politics and the economy is so important. In countries that have market-driven economics, that process has already started. Manufacturers, exporters, investors and other participants have already told their Governments how important it is to get it right, and in fact they have heard it from outside the European Union. In countries where the economic model is driven by state control or state direction of the economy, that is unlikely to happen. Even if it does happen, it is unlikely to have the importance that it should. This is effectively a litmus test as to whether the EU, thinking through the challenge to its own survival—not just the survival of the eurozone but the survival of the Union itself, which today is not assured; you hear that in Brussels, not just here—is going to do a little bit of a deep dive in terms of the attention to be given to economic competitiveness. I think there is still hope and the UK can play a part. It is actually in the interests of the UK and the rest of the world to have Europe economically more competitive.

Elizabeth Corley: Thank you for the question, Mr Philp. I will try to keep the answer fairly succinct. In the absence of fact, supposition and tonality drive a lot of the way in which we interpret events in all parts of Europe at the moment, including the UK. I think it is possible to look at symptoms, as you say, and interpret a motive and cause for them.

Personally, I think one needs to take a big step back from that and try to find as neutral a canvas as possible to enter these discussions, because they are going to be complex and lengthy. Therefore, if one starts with a deficit of trust it is going to be very difficult to build it up.

Q380 **Chris Philp:** But they have already refused to have discussions. That is an action, not a supposition.

Elizabeth Corley: It is also whether they have the competence. It is not just "refuse", it is whether they have the political competence to do it and what the interpretation is. Again, one could interpret why as something that is deliberate or simply more process driven.

What we need to understand is that the No. 1 priority will be the EU27 and the long-term survival and success of the EU27, hopefully including economic revival and robust growth. The more we can position our engagement to look at win-wins as opposed to win-loses, the better we will get on.

That means trying to identify those areas where there is no disagreement, where it is an obvious win-win, such as trying to agree, for example, on things such as financial market stability, safety in pharmaceuticals and healthcare, defence and security. There are a number of areas where there should be a significant proportion of win-win that can come out of this, where we just don't need to destabilise things that are working well.

We can think about prioritising what really are the points of difference, while acknowledging that on the other side of the negotiation there will be a focus on the eurozone and the EU27 and also acknowledging that the Commission wants to get this done. If you look at Monsieur Barnier's track record, he is a man who likes to deliver. If he is given a mandate to do something, he likes to deliver.

Again, why 18 months? I don't know why 18 months is feasible. It depends again on what you are talking about as an agreement and how much detail one goes into. I think we can play a huge part in shaping the tonality of the discussions as they go forward. There is still a great opportunity for us in terms of how we trigger article 50 and how we engage, to end up with a very constructive and thoughtful discussion going forward, identifying the vast majority of areas where we actually have shared interests. I have mentioned security, stability and defence.

After that, there will be major points of difference but let's use the political and emotional capital on those points of difference and try to focus on those in a spirit of constructive engagement.

Douglas Flint: I think the European politicians do get the issues. There are obviously competing priorities for what is more important but they do get the importance.

To me, the most important issue in Europe is the preservation and building of more sustainable economic growth. That is inconsistent with making the cost of doing business more expensive. That is inconsistent with reducing the flow of financial resources into Europe. That is inconsistent, at a time when the political priority was to reduce dependence on the banking system and a banking system that is relatively weak, with denying access to the capital markets that currently serve Europe to a very large degree.

The final point has a huge political dimension to it and is one of the reasons that the UK has done better than many forecast over the past six months. The harder the Europeans make it look as if the UK is going to be in relation to its future position with Europe, the weaker sterling becomes which makes it more and more competitive for business to shift to the UK from other parts of Europe and, indeed, the rest of the world. That produces a signal to the rest of Europe about the benefits of a flexible exchange rate. There are an awful lot of moving parts in this that I think are fully appreciated by political parties in Europe.

Chair: I am going to move on, if that's all right, unless there is a burning question that can be answered briefly.

Chris Philp: My only burning and very topical question is whether the panel thinks a £150,000 pay cap, as proposed by the leader of the Labour party, will mean leaving the European Union is a good idea.

Chair: Can we save that uncontroversial question for another time?

Q381 **George Kerevan:** The panel will be glad to realise that I am the last up. I want to return to where we began, which is the derivatives clearing market. Mr Rolet, could you just reprise: what is the scale of the clearing market handled through London?

Xavier Rolet: These statistics are very, very fresh. In 2016, in interest rate swaps alone, which is the largest financial asset class globally, we cleared $655 trillion. Actually, it is dollars or equivalent in the world's largest 18 currencies. We are also the largest clearing house for foreign exchange. We have cleared more than all other clearing houses around the world in foreign exchange. We are the second largest in credit default swaps and a major clearer of listed products, whether they be derivatives, equities, fixed income corporate debt or Government debt. In interest rate swaps alone, that is slightly in excess of 90% of the global market.

Q382 **George Kerevan:** Suppose I put it to you that expressing the situation in that way, in terms of the gross amount of assets being traded, is misleading when it comes to evaluating the danger from loss of business to the rest of Europe, post-Brexit? If you look at London Clearing House's own business, surely what we should be looking at is the actual revenues that come from the trading, and the profits. I am just looking at your company accounts, and SwapClear, which does the over-the-counter clearing, had a revenue last year of £162 million and LCH's overall profits were very commendable, at something like £72 million. In the scheme of things, that is a small amount of business, so why, strategically, is the loss of that business to you dangerous?

Xavier Rolet: That is a good question. As many infrastructure companies, we derive a lot of pride from the fact that our clients appreciate that in pricing our services we do not abuse our central position, which others perhaps might. It is really not the revenue, or even the number of jobs created by that particular underlying activity that counts; it is the onwards, upstream and downstream, strategic relevance of the business for trading, syndication, distribution, risk management and IT, as well as, of course, treasury management of corporate insurers. There is an interesting report—I would be happy to send you a copy—that was recently published by Ernst & Young at our request. It analysed the economic impact, in terms of jobs, of losing the clearing business alone—the clearing business is just a few thousand jobs in the UK—and estimated that, as far as the entire United Kingdom was concerned, 232,000 jobs would be at risk and likely to be lost if that clearing activity left our shores. But besides jobs—

Q383 **George Kerevan:** I had better stop you there. Just repeat that figure. You think it is highly likely that we would lose that number of jobs up and down the country?

Xavier Rolet: That is correct. Two thirds of them are based outside of the Greater London area. There is, of course, the systemic relevance. We talked earlier about the major relief offered to our customers—the buy side, the sell side and corporate insurers—in terms of regulatory capital. What that means in practice is that in 2015 SwapClear saved its customers $25 billion or equivalent sterling, euros, yen in regulatory capital. That means that tens upon tens of billions of regulatory capital were freed up so that these customers could invest in the real economy.

Q384 **George Kerevan:** The Committee is obliged to test these numbers, because we are testing both sides of the argument. That is a stunningly large number of jobs that you are claiming would be lost. Can you give a timeframe, or does the report give a timeframe, over which period those jobs will be lost?

Xavier Rolet: There is no specific timeframe. It just looked in aggregate at the jobs that would be at risk. The timeframes would start from the moment that those clearing functions would leave. I will give you an example. A clearing house will basically call margin on its customers. There is an initial margin, when you transact the particular transactions for the first time, and there is a function of how the underlying financial instruments move in value—up or down—which is the maintenance margin. So there are several margin calls, perhaps a margin call early in the day, at 7 or 8 o'clock in the morning, and a margin call at the end of the day. Right now there are over $130 million of cash and high-grade Government securities sitting in the LCH and LSE group's CCBs margins, in the default fund.

If you have a margin call at 5 pm against products that you novated to your clearing house and you happen to be five hours away, because the clearing house is in New York, it is clear that you are not going to ask your staff to stay until 11, 12 or 1 o'clock in the morning in London. So you are going to move your treasury, collateral management people, your risk staff not just within the CCB but within the corporate issuers, within the banks, within the asset managers, compute the margin that they are going to owe.

Of course, the trading, syndication and the writing, the legal jumps, about defining all this environment, the regulatory compliance jobs, that is where the downstream impact comes in. It is not, obviously, the clearing jobs, per se.

Q385 **George Kerevan:** I appreciate that, but given that regulated clearing on this scale did not exist 10 years ago, are you telling me that this entire number of jobs has appeared in the last 10 years? Are you not referring to a whole panoply of city financial activities?

Xavier Rolet: You are correct in saying that the strategic relevance and the impact on jobs and economic activities is fairly recent. The seminal event was the crisis of 2008, through which the G20, the G8 regulators around the world and political authorities mandated a complete revamp of the old way of doing business, where people could trade with each other and maintain reciprocal balance sheet exposure to move it on to clearing houses.

But another perhaps even more significant factor has happened in the last two years, which is SwapClear's compression service. I would be happy to send you a copy, which has all the details. Across the world's 18 major currencies within the realm of OTC—over the counter—swaps, foreign exchange, and other products, offers compression relief. Because we have these currencies—sterling, euro, dollar, Canadian, Mexican pesos, Japanese yen, Australian dollars, Singapore dollars and so on—in the same default fund, we are able to offer regulatory capital relief across a multiplicity of currencies. This is the true nature of the global reach of London and the UK as a global financial services market. This is why extracting just the euro component to satisfy some in the EU, saying as a matter of national sovereignty we need this business to move back to the eurozone, would be so damaging and impactful on the overall global economies, issuers, asset managers and banks, because it would eliminate the benefits of cross-currency compression.

Q386 **George Kerevan:** You make a good case, but the danger is that you are arguing for your company. Can I ask Mr Flint whether he recognises that potential skill or job loss resulting solely from the diminution of the clearing activity in London?

Douglas Flint: I have not studied the report on job losses, but I absolutely buy into the impact of the connectivity of clearing. The infrastructure that exists is pivotal to the scale of activity that takes place. It is not just the physical movement through the clearing houses, which are largely automated; it is the risk management settlement, accounting, decision making around the information that comes out of those that are hugely important.

I worry equally about the financial stability aspects. We have taken 10 years to create this exchange trade in a centre counterparty environment with a better regulatory oversight than we have had in the past. The two things that you worry about are refragmentation, but also just the physical and logistical steps that would be needed to take this apart and put it into different places. If ever there is a time when things go wrong, it is when you take something from a system that works and move it to different places or on to different platforms. You are talking about $600 trillion or so equivalent of assets and the risk to move. That is the kind of finance project that you would not want to be in charge of the IT for. It really is—

Q387 **George Kerevan:** So you can read into that that HSBC has a bias against moving out of the UK?

Douglas Flint: It is a bias against taking a piece of infrastructure that serves the industry well—if you think of the analogy with some of the technology platforms that have come out of the United States, we have created a platform that is the world leader, because it works. That is not because of anything other than the fact that people have confidence in the technology, the management, the risk management, the supervision, the regulation and the legal framework in which it operates. That is an extraordinary achievement and to unwind it in the context of the financial stability that drove the creation of that framework is something that you would not do for anything other than extraordinarily big reasons.

Q388 **George Kerevan:** Going back to Mr Rolet, let me test one of those reasons. Arguably, one of the reasons why the ECB was interested in having some regulatory input into the London end of the clearing market was because it is so large that if anything goes wrong and liquidity problems arise, that is a systemic risk to the euro area. Does that not imply that there is a justification for the ECB being involved and for it wanting to be involved that goes beyond debates about whether it is particular EU countries trying to grab a share of the business?

Xavier Rolet: That is an argument that has often been heard before, but there is one little catch: as it stands, the European Central Bank does not have the power to regulate clearing houses. Not a single one.

Q389 **George Kerevan:** It may want it though.

Xavier Rolet: If a treaty change was proposed, saying, "In the UK, but also in the Netherlands, Germany, Italy, France, Portugal, Spain and all the other eurozone and non-eurozone countries that carry out clearing of euro-denominated securities, there is a need for us to become the regulator and it will no longer be the national central banks," I concur that that is a completely legitimate argument, but that is not how they framed it. They did not say, "We are worried by the fact that we are not in a position to regulate clearing houses inside the eurozone." They said, "We specifically want the clearing of euro-denominated securities in the UK to move back to the eurozone." They did not say they would like to regulate it; they said they wanted it to move. The way it was articulated in the policy proposal, it was about geographic placement, rather than them saying, "There is an inadequacy in the regulatory framework, and we think we should be running it, rather than the national central banks." I would frame it in that way.

Q390 **George Kerevan:** Is there a liquidity risk from concentrating so much of the derivatives clearing operation in London?

Xavier Rolet: This is perhaps a debate for another day, but when one looks at clearing houses, they are not the same as other financial institutions. I hear the too-big-to-fail argument and the "too large" argument. Clearing houses are circuit breakers; they are not lenders of last resort. They collect bilateral exposure between financial market participants, corporate insurers, banks and asset managers and then they net them. They look at matching risk and they compress it when it is notional or they net it when it is actual securities. They effectively take risk out of the financial services industry so that banks, asset managers and others can re-leverage their balance sheets to reinvest in the real economy.

We are not leveraged entities. The risk that we represent on netting and compression is an operational risk, but in the process we collect vast amounts of cash, and the CCPs are the first line of defence—there are others. They do not have to call on the public purse, but they collect vast amounts of cash in high-grade Government securities as a margin buffer, together with guaranteed funds and the skin in the game for capital operators. CCPs are not a lender of last resort; they are designed to operate as circuit breakers in case there is a failure, or possible multiple failures, in the financial services industry. As such, they are very highly regulated by central banks around the world, as you can imagine.

The last point I would make, if I may, is of course a fairly simple mathematical concept. If you wish to net and increase the risk reduction, or increase the compression benefit, you need more of that over-the-counter exposure to be netted in a single location. In response to Douglas's earlier point, if you fragment you are less effective and provide less relief.

CCPs—clearing houses—are effectively, from a risk standpoint, the opposite of their customers, whether they are banks or leveraged lenders. They take risk out. The more they see, the more they net and the more they are compressed.

At the LSE, even before we acquired a controlling interest in LCH three years ago, and when the regulatory framework did not give power to central banks to regulate clearing houses, as they do today—so this takes us back seven or eight years—I argued publicly in favour of central banks rather than securities regulators regulating CCPs.

Q391 **Chair:** You have sat very patiently listening to people either side of you in response to those questions. Is there anything you would like to add? Would you like the last word in this hearing?

Elizabeth Corley: Oh, my gosh! Maybe I could build on what was said. I can't confirm the FTEs, the number of people involved, but I can confirm that the role of derivatives in capital markets has grown exponentially over the past 10 to 15 years.

The reporting requirements to regulators and the consolidation of information have also grown. Building on what Douglas was saying about stability, one of the things we have achieved is broadly consistent information requirements on hundreds of thousands of transactions. If we start to fragment that—the ability for supervisors and regulators to see what these major transaction flows are looking like—that will be a serious risk and we go back to where we were in 2007 and 2008. That is something we really shouldn't give up on.

I would say one thing. This has been a wide-ranging discussion, but ultimately it is about the customers, whose questions we have to be able to answer. As time goes on, we will all start to get questions. As I get questions about my counterparties and the security and qualification of the people who are dealing with our transaction, that ripple effect will go into levels of confidence that business as usual can be guaranteed, and levels of certainty that where we transact business can continue unchanged, and that where we invest in future can continue unchanged.

Again, it is not for us to ask anything. We are very respectful of the fact that we are a small part of a very large treaty renegotiation, but the more certainty that can be given that we can then pass on to our customers, the more we have an opportunity to have a fairly benign way forward. That would be the one thing I would like to leave as my last word. Thank you.

Chair: I thank all three of you for giving evidence. It has been nearly three hours and has been extremely detailed—more than we had bargained for, but well worth it. We are very grateful to you for taking the care you clearly have to work out what to put to us this morning, now this afternoon.

Mr Flint, you very kindly agreed to send us a note on one specific point. I think it might be helpful, Mr Rolet, if you take a look at the exchanges that you had about capital controls and the whole issue related to regulation: there might be something that you feel you need to jot down on paper for us as well. We will draw to a close there. I think this will probably be one of a number of hearings in this area in the weeks ahead. Thank you very much indeed.