



Select Committee on the European Union

Financial Affairs Sub-Committee

Oral evidence: Financial regulation and supervision following Brexit

Wednesday 13 September 2017

10.10 am

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Members present: Baroness Falkner of Margravine (The Chairman); Lord Bruce of Bennachie; Lord Butler of Brockwell; Lord Desai; Lord Haskins; Baroness Liddell of Coatdyke; The Earl of Lindsay; Baroness Neville-Rolfe; Lord Skidelsky.

Evidence Session No. 1

Heard in Public

Questions 1 - 9

Witnesses

I: Professor Eilís Ferran, Professor of Company & Securities Law, University of Cambridge; Professor Niamh Moloney, Professor of Law, London School of Economics.

Examination of witnesses

Professor Eilís Ferran and Professor Niamh Moloney.

Q1 The Chairman: Good morning. We welcome to our inquiry into the regulatory environment of financial services Professor Eilís Ferran from the University of Cambridge and Professor Niamh Moloney from the London School of Economics. You have a list of interests declared by Committee members. You will be familiar with the members as I think both of you have given evidence to the Committee in the past. This is a formal evidence-taking session of the Committee and a full transcript will be taken. It will be put on the public record in printed form and on the parliamentary website. You will be sent a copy of the transcript and you will be able to revise it if there are minor errors. This session is on the record. It is being webcast live and will be subsequently accessible via the parliamentary website. Would either of you like to make opening remarks, or shall we go straight into questions?

Professor Niamh Moloney: I am happy to begin.

The Chairman: As you know, the Committee is trying to engage with what the regulatory environment for financial services might be like post Brexit, and to see where the UK might fit into the broader international regulatory environment. I want to start with international standards and alignment and decoupling. In your mind, what are the key differences between, on the one hand, international standards and, on the other hand, the regimes in place in the EU, and how might the UK implement either or both of those going forward?

Professor Eilís Ferran: International standards come in different flavours. Some are quite detailed and prescriptive, Basel standards being an example; some are much more high-level principles. What they all have in common is that they are non-binding. That enables them to be high level because they are not designed to be legally enforced. Increasingly, what they also have in common is that methodologies are developing in quite a detailed way at international level, for international bodies to assess whether there is implementation of those standards in domestic regimes.

Comparing international standards with EU regulation, the EU often takes international standards as its starting point for regulation and is a fully signed-up member of the post-crisis G20 agenda on international co-ordination, but they are a starting point and EU regulation often comes out in a rather different form. Of course, EU regulation is legally enforceable, so in many respects it has to be more concrete. It also has to do the difficult job of ensuring consistency across the EU with different supervisors, so the single rulebook agenda comes into play.

Sometimes the EU will adapt to local circumstances as the international framework allows. Sometimes it does not follow international standards exactly, and there is some adaptation in that respect. To take as an example financial benchmarks and the IOSCO standards, they are quite

high level and aim to be principles-based to set a standard that different jurisdictions can adhere to. If we compare that with the way in which the EU has imposed regulation on financial benchmarks, the EU has taken heed of international standards but has put in place a much more formalised regulatory regime requiring authorisation and registration, so there is quite a difference in the level of granularity between the two.

As to how that looks for the UK, so far the UK has been in line with and followed EU regulation in that respect. The UK also signed up for the G20 agenda and is very committed to international standards. As to whether in future there will be room for the UK to take a different path from the EU, I think we will get on to some of the detail of that, but by continuing to take international standards as the starting point we will, at least to that extent, be starting in the same place as the EU.

Professor Niamh Moloney: Building on Eilís's point about flavours, one point of distinction between the EU and the UK with the international world would be the broad coverage. The international standard-setting process tends to be concerned with stability, risk management and prudential matters. It is increasingly beginning to look at conduct and investor and client-related issues, but, more often than not, issues relating to investor protection, consumer protection and conduct tend to be located in the EU or the UK, so it is more developed in that space.

Building on Eilís's comment about granularity, there is a more general point about what regulation looks like now. Any regulatory system now is almost like a technical manual of how to do supervision, how to build an internal compliance system and how to do procedures. It is deeply granular in a very operational way, and that spills down from the international principles.

The Chairman: You both talked about how things are at the moment in relation to the status quo ante. Do you think that the United Kingdom's influence will continue? More importantly, in the very short term, with Governor Carney standing down as chair of the FSB in November, will that impact on our heft?

Professor Eilís Ferran: There is a question mark over whether the international standard-setting fora are losing their influence anyway, in particular as a result of the "America First" Trump presidency. There is a risk, if the US pulls out of serious commitment to those fora, of their becoming a talking shop without real bite. Having said that, we assume that they will continue to be important. We have already seen that Governor Carney will continue to chair some influential committees, so his position right in the centre of all of that, which is beneficial to the UK, looks secure.

In the longer term, if we take the view that you have influence in those fora because you have economic strength behind you, clearly there will be a question mark, but the City of London will not decline immediately. We are still the home location for systemically important banks globally. There is also the fact that the UK has a good reputation for being expert

in designing financial regulation. If you take the view that those fora are operated and influenced by communities of experts, we can feel reasonably comfortable about that, at least in the short term.

If the fora are declining in influence, the other place that pushes forward financial regulation at international level is bilaterals—major countries between themselves establishing the basis on which they will engage with one another. That can act as a kind of template for the rest of the world, so in that sense quite a lot is riding on how the UK fares in the negotiations ahead.

The Chairman: If the UK and the US were to align, it would create a de facto rule-setting environment for everyone else to follow.

Professor Eilís Ferran: It could, yes.

The Chairman: Do you agree with the broad thrust of that, Professor Moloney?

Professor Niamh Moloney: Yes, I do, assuming—because we are in a state of flux—that the standard-setters retain their current bite. I think that is right, because these days it is about technocratic influence; it is about a community of experts coming together, but those experts are responding to markets that they regulate. The UK market has very strong connections and similarities with some of the major EU markets, so that natural incentive alignment will always be there.

Having said that, it is important that the UK is mindful of the formal channels it will lose access to, because they matter. Those formal channels are the Commission, the European Central Bank and the European Supervisory Authorities that to a different extent sit on those bodies. There are also informal coalitions, sitting with France, Germany and so on. The UK has to be mindful of where in the past those coalitions have been critical and how they might need to be replicated in the future, whether through informal engagement with the ESAs or some other kind of dialogue. As in so many things, it comes down to resources.

Q2 **The Chairman:** Moving to Brexit and the direction of EU financial governance, where do you think regulatory divergence might happen between the UK and the EU, and what do you think will be its drivers?

Professor Niamh Moloney: When one thinks about regulatory divergence, one has to assume that something is driving it. Looking at where the EU and the UK are right now, it is hard to see the big directional push that will move the two systems apart. Since 2008, the UK and the EU have invested a huge amount, as have the global standard-setters, in rebuilding global regulation. There are difficulties and problems, but broadly it works and it is now in a steady state, so unless there are major competitive changes in the global economy, it is hard to see the push for that to change.

Looking specifically at the EU, I suggest that it is in a steady-state procedure, so it is hard to see where the big new ideas would come from.

The grand projects have been dealt with. We will see tinkering with banking union and finishing capital markets union, but we will not see a big project over which there would be political contestation. What we are going to see are technical changes, technical finessing and nuance in the EU, which could lead to technical divergence within the UK system. In the same way, we will not see directional pushes for change in the UK for a couple of reasons. The first is industry. It has invested very strongly in systems. It may not like regulation, but there is a cost to it, and it is now accustomed to certain forms of regulation. Secondly, there is very little sense of why the UK regulators would change their current position, and the UK has very strong credibility internationally. Just a couple of years ago, the IMF lauded the UK's regulatory system for responding to international standards.

The Chairman: Given President Juncker's State of the Union address today to the European Parliament, and the context of the Eurozone, which he talked about, do you not think that the impetus of Eurozone integration will impact on the regulatory environment in political contestation as well?

Professor Niamh Moloney: It is an interesting point. I am sceptical about it. There is very strong political rhetoric about euro area integration, but if you look at how financial regulation has developed over the past number of years, the euro area tends not to coalesce very strongly as a group on major financial regulation measures. Member states will coalesce and pull away, but they have very different interests. Some of the big euro area flashpoints—for example, the European deposit insurance scheme, the missing leg of banking union—are proving very difficult. It is also proving difficult to get the big resolution pot in place. There is political mood music about integration, but it has to harden into real supervisory risk-sharing, and I do not think the evidence suggests that we will see dramatic change.

Professor Eilís Ferran: I think we will see some of that hardening. There is a big credibility problem around banking union because of what has happened with the Italian banks and other issues. There will be a big impetus from the institutions to complete banking union and capital markets union as well. I completely agree with Niamh that, essentially, it will be an incremental change and there will be nothing very dramatically different, but it will inevitably come out in a different way, because it will reflect changing circumstances, including the fact that the UK—the investment banker of Europe—will not be there anymore.

Although I absolutely agree with Niamh that there will not be an immediate bonfire of the regulations on either side, we will start to see change. One interesting test case is what we do about foreign takeovers and the regulation of foreign ownership of companies. Both the UK and the EU say that is an area they need to look at, so there is common ground, but historically the UK has been very open in its market for corporate control, whereas other jurisdictions, in particular France, have always been associated with being more protectionist. The different way

in which that plays out in the UK and the EU might start to tell us something about what that divergence actually means and how far it goes.

Q3 Lord Desai: Continuing the same theme, we were told last week that, basically under EU law, likely outcomes are the principal things on which decisions will be built, but nobody can predict what the outcomes will be. There is a lot of difference of opinion on that. On the other hand, in theory we could agree on just concepts and logic. Clearly, there are two different cultures of regulation. Which way do you think we will go after Brexit? Will we be able to stick to concepts, or will it be detailed granularity?

Professor Eilís Ferran: That is an absolutely central question. What test are we going to use for regulatory parity? How do we check that we are more or less the same? It is hard not to bring the EU's current approach into that, because it is established and it works. It does not work brilliantly, but it does work. There is a political dimension, because it is the EU imposing its norms on others and seeking to export its way of doing things. The suggestion that we could move to higher-level international standards and benchmarks for checking parity is interesting. I could see it working in some areas where we have international standards that are reasonably well developed; in other areas, going back to the different flavours point, it is harder to see a standard that is fit for purpose in that respect.

My overarching point is that perhaps we spend too long thinking about checking whether our rules are the same. They could be perfectly aligned but work completely differently because there are other factors in play. If we could be less preoccupied with the literal checking, and think about the outcomes and delivery and whether the practicalities of supervision on the ground are working effectively, we might see things in a different way.

The Chairman: Do you broadly agree?

Professor Niamh Moloney: I do. The EU works on precedents and templates; it invests in a particular way of doing business. It is very difficult for it to move from that way of doing business. Having invested in an equivalence system that is predominantly rules-based, although it is moving more into outcomes, it is hard to see how it will shift away from that.

However, as the FSB and the IMF, for example, do more peer reviews, and as international governance moves into how to do supervision, we see the technology developing. It is developing slowly. There is a bit of a time lag as to when we need this technology, but it is out there. As Eilís said, it is about thinking differently about metrics. Monetary policy is more straightforward. You have an inflation target. With financial regulation it is harder to do that, because what you want are no failures, but how do you quantify that? It is right that we need to think differently

about this, but it will take time to get to the notion of what is good supervision.

Lord Skidelsky: I want to ask a more concrete question about the relationship between principles and regulations actually adopted. For example, the G20 said in 2009 that standardised OTC derivatives should be traded on exchanges and clearings by the end of 2012. The European Union adopted a regulation to do that at some time in 2012. Is that regime in place? The regulation of SPVs was at the core of it. Is that in place as well? Does the UK accept those principles? The question is motivated by the difficulty of working out how much progress has been made from principle to regulation.

Professor Niamh Moloney: That goes to the nub of the relationship between international standards and what is happening nationally. Specifically, the OTC derivatives project was possibly the most complex part of the whole G20 financial crisis programme. It is halfway done—the clearing part of it; these derivatives must move through the big powerhouses, the CCPs. That is pretty much under way.

The reason it is going slowly is the problem of empirical data. Regulation is procedural; it is technical, but it can have major market impacts. The way regulation is designed now is to ensure that we have the right group of derivatives trading on stock exchanges or being cleared through CCPs, and that requires a lot of data churning. It has been happening in the EU, and the UK is following that, so that part of it is broadly in place. The trading piece is much slower. That is just starting and it will go on for the next couple of years, because it is the same idea. Which derivatives are suitable to be forced on to trading? If they are not, it creates further difficulties.

The principles are agreed, but what is heartening is the awareness by regulators that action has consequences. It is very important to have the empirical evidence before those rules go live.

Lord Skidelsky: Have you noticed any divergence between the UK and the EU on the particular topic of regulating derivative instruments?

Professor Niamh Moloney: On that issue, the UK has been a strong influence because it is the major centre for derivatives trading in the EU. Strong UK influence is certainly coming through in the political negotiations and in the data used by the European Securities and Markets Authority to make empirical determinations. That draws heavily on UK data sources. In addition, the UK has been a useful friction. You will see in the UK process people saying, “That data is not correct; we need that data cleaned”, and the industry pushing back. There is a productive relationship between the UK and how the EU rules are developing.

Professor Eilís Ferran: If we look at the way in which the US and the EU have engaged with each other over many years since the initial G20 decision, we see that the problem arises when those principles are translated into different systems of law and different approaches are

taken, and we try to bring that back to something that can work in a global market.

Lord Haskins: Professor Ferran, you mentioned the cultural difference between the French and the British on certain matters—takeovers et cetera—and how they are reconciled at the moment. They are reconciled within an EU regulatory framework, including the ECJ, if it came to it. In this divergent Brexit situation, those cultural differences are almost certainly going to widen; it will be difficult to see. Because of that, who is going to bring them together again if, as it appears, we do not believe that the ECJ is relevant? In that case, if we do not have an acceptable dispute resolution mechanism, the whole thing falls apart.

Professor Eilís Ferran: We need to go back to an earlier stage and have an agreed benchmark against which we are both tested. Can we move away from saying that EU norms govern everything to a broader standards-based test for whether or not we match? You are absolutely right. Even if we get that, we need some tier of mechanisms to ensure we are both within the agreed space for divergence. I have a lot of faith in leaving considerable room for the experts, because relations between the supervisors in particular are strong and there is a cultural coming together. But you are right that in the end there has to be legal underpinning. A joint committee is useful but not enough, and a more developed dispute resolution mechanism, with teeth, will need to be in place, if only to focus the mind.

Q4 **Lord Butler of Brockwell:** When we talk about retaining harmonisation, will our regulators be following the EU, or will the EU be following our regulators? Who do you think will be in the lead?

Professor Eilís Ferran: It probably depends on the issue. In some areas, since the financial crisis period, the UK had its own resolution regime before the EU. To go back to the benchmarks example, the UK took some steps but the EU did a lot more in that area. I do not think there is a single answer. It is context-specific, and in some areas we will be looking at the same issues at the same time. In the capital markets union reboot, the EU wants to look at FinTech and we are looking at FinTech. We may be moving at a similar pace. It is probably easier for the UK to land the project more quickly, because the EU law-making process is more complex.

Professor Niamh Moloney: I agree. There is certainly economic logic in the UK following the EU in certain projects where there is a natural global dimension and natural synergies. They are simply more efficient. The legwork is done within the institutional apparatus at the EU where the UK's incentives will be closely aligned and we are seeing refreshments, refinements and nuancing of the current set of rules to which the UK is subject.

Eilís referenced the resolution side. The UK has developed independently very sophisticated rules on banking accountability, in the Banking Act, for example. All of those are distinct from what the EU has done, so you

would expect the ethical/accountability framework to be led at UK level, along with consumer protection.

Lord Butler of Brockwell: Do you think that will continue post Brexit? Will our regulators continue to be the standard that the EU is likely to follow?

Professor Niamh Moloney: In many respects, the UK has always been a laboratory for a lot of the issues the EU comes to examine; for example, the City will almost always be the laboratory for innovative financial products. One could see the EU following quite closely where the UK is the home for a new financial technique, say securitisation mark 2. There is logic to the EU following that, and it has done in the past. I definitely see the relationship going in that direction.

In other areas, probably following the international sense, the EU will probably be the standard bearer for major international projects or a big new initiative on, for example, how we think about an aspect of resolution. There, the UK might follow the EU.

Lord Butler of Brockwell: We tend to think of the UK as the *demandeur* in this: can we get equivalence and how will we replace passporting? Is that too UK-centric a view? Will we necessarily be the *demandeur* in standards in financial services?

Professor Niamh Moloney: That is a really important question about incentives and how all this is going to play out over the next few years. It is probably worth emphasising the investment that the EU has put into the technology of financial regulation. That is political investment. Different member states at various points have had to give up supervisory control; they have had to pool risk-sharing. On institutional issues, we have the European Supervisory Authorities and the European Central Bank. There has been a very big investment in technology, and it is hard to see the EU giving up that template and technology for some kind of customised relationship with the UK. That is an important regulatory reality in how the EU will interact with the UK.

There is also a pragmatic sense. Going to Eilís's point about expert deliberation, that is how regulation is done nowadays. Regulators understand one another's interests, concerns and risks. It is in the EU's interests to make sure there is a reasonably open channel back to the UK market, and that data is flowing properly and supervisory co-operation is working correctly, but it is important to keep in mind that the EU works from templates; it is uncomfortable building customised solutions.

Professor Eilís Ferran: I completely agree with Niamh that the equivalence regime is there. Why would the EU give it up entirely in favour of something else? That does not make sense. Indeed, it would be inefficient to rip up a working model and start again. At the same time, we know there are shortcomings in the equivalence regime and lots of gaps in it. Some of that will improve over time, because it will suit the EU to change it in the interests of the Union, but some of it will have

potentially adverse effects for the EU as well as for the UK. In areas where there may be no equivalence, or there are shortcomings in equivalence, there is incentive on both sides to make sure that we can replicate as much as possible of the existing access arrangements. There is scope for genuine negotiation on something bespoke, not to supplant the equivalence regime in its entirety—I do not think anybody would see great reason for that—but to work alongside in the interests of both the EU and the UK.

- Q5 **The Chairman:** We were told by other experts in the City that the United Kingdom had such deep technical and legal expertise that in bilaterals in Brussels with the Commission's people, and with other regulators in Frankfurt and so on, it was being asked to keep in mind the possibility of continuing to be in the room in some fashion, maybe by associate membership, or something like that, of the regulatory agencies. Do you see that as a runner? Is that a possibility?

Professor Eilís Ferran: Yes.

Professor Niamh Moloney: Yes. For example, in the European Securities and Markets Authority, and indeed the banking and insurance authorities, there is formal provision for observers on the boards of supervisors. Observers are non-voting. They are traditionally particular groups: for example, candidate accession countries to the EU and the EEA. There is that formal channel. Being in the room is the key part. Against that, you are in the room at the highest level; by the time something has got to the board of supervisors it is very much at the level of contestation on big principled points, so it is a matter of ensuring there is a way for it to trickle down.

The European Supervisory Authorities are entrepreneurial; they are dynamic. They respond very nimbly to changing circumstances. To turn to Eilís's point about experts, they have an interest in ensuring that they pull in technical expertise. Where there is a will, there is a way, but it is important to be mindful of the level at which influence would be exerted.

Professor Eilís Ferran: If you want to be a formal observer, you can participate in the European Supervisory Authorities. It comes with conditions, unsurprisingly. There are arrangements regarding staff and financial contribution and for the adoption or following of EU law; and you do not get a vote. It is the taxation without representation problem, mitigated, as Niamh said, by the reality of how the European Supervisory Authorities work. By being involved not just in the board of supervisors but in the more technical committees and working groups below, we can have soft power and influence, but it is a downgrade from where we are.

The Earl of Lindsay: You have both emphasised the importance of strong relationships between supervisory and expert players within the UK and the EU. Do you want to say anything more about how you see that supervisory co-operation working in future? Is there more that could be built on in relationships that currently exist, or are there relationships that need to exist and be developed? Do you have any insights into how

in the event of a crisis, such as difficulties in a central counterparty operating across borders, that would be handled in future by supervisory co-operation?

Professor Eilís Ferran: The existing ways for supervisors to co-operate, apart from sitting around the table in fora such as the ones we have mentioned, include supervisory colleges related to where they have joint interests in banking groups; memoranda of understanding and co-operation agreements. There is a full toolkit of ways in which supervisors can agree to co-operate with each other, but the litmus test is: how does all this work when there is stress and failure? There is a classic line about MoUs in a crisis: M is me and U is you, and never the twain shall meet.

Although there are resolution colleges and memoranda of understanding already in place between the EU, the US, Switzerland and other places, to make it really stick in a crisis would ultimately require a proper international agreement negotiated by the Commission, entered into through a formal process, for which there is provision in the resolution laws of the EU. You would want clear arrangements around who is in charge, and arrangements under which you formally commit to recognising the other countries' resolution procedures and to enforcing in your laws any steps that need to be taken in the other countries' laws, so that you have a legal underpinning; otherwise, the obvious problem is that everybody retreats to their own interests in a crisis.

Professor Niamh Moloney: I agree. It is not resolved even within the EU, which shows us how difficult it is. The banking union structure is now relatively sophisticated, albeit with gaps, but the single market as a whole is still struggling with resolution in a non-EU area country and how that interacts with the euro area. This is a really difficult matter, and it is not just a question of the UK and the EU. As Eilís mentioned, it is a global question, which has to be resolved through the international standard-setters or other fora.

The other point in this context is heading off the crisis, and that is all about data. Data is plumbing and it is tedious; it is housekeeping, but it is absolutely fundamental. One of the achievements of the EU since 2008 has been the huge pipeline of data now flowing relatively freely between the 28 supervisors, in and out of the national regulators. Replicating that housekeeping will be critical. As Eilís mentioned, it could be through a memorandum of understanding or some other kind of infrastructure, but it will be critical in heading off a difficult crisis.

The Earl of Lindsay: Can we assume for the moment that ESMA and the ECB will in due course be given greater or new powers? Can we assume that the European Supervisory Authorities might be given powers of supervision in parts of the financial services arena that they do not currently have? Would you speculate as to how that might impact on the UK as a third country, and whether, given the greater likelihood of experts, technical players and supervisory players being a part of those entities, that might be a welcome development in the UK?

Professor Eilís Ferran: Potentially, it is. I said earlier that we get hung up about checking whether our rules match. If we are to start talking about comparable compliance, which is the phrase that has been introduced in the proposals about clearing houses, it will still have to be authorised in both countries' regimes, but we will defer to each other at the supervisory level. That has the potential to be more agile and more focused on the practical outcomes than on something on paper.

Another example is the way the Bank of England already deals with international banks and whether they can come into the UK as branches. The bank says, "We will look at international standards to check whether there is enough comparability at that level, but what really matters is our experience of supervising in conjunction with this other jurisdiction, so that is what we are going to look at". Being optimistic, I think that over time that could be a supplement to equivalence that leads to favourable outcomes focused on things that really matter.

Professor Niamh Moloney: I very much agree, in that it is hopeful, and it is not necessarily seen as a threat that we end up with European supervisors. Some of the baby steps are very heartening. For example, ESMA does peer review of its member supervisors. It drills into what supervisors are doing, but there is sensitivity: for example, "Your market looks like this; you use risk-based supervision; you like doing face-to-face interviews, but are you getting to the right outcome?" It is drilling down to what is happening, but there is sensitivity in how it gets there because of the expert background.

The Chairman: Can we move to the legal aspects?

Q6 **Baroness Liddell of Coatdyke:** I want to look at where the difficulties are likely to emerge. The European Union (Withdrawal) Bill is starting its process through Parliament. It is quite difficult for us as parliamentarians, because we look at it through the prism of that piece of legislation. How do you see that interacting, and what do you see as the headline legal obstacles to getting to any kind of agreement?

Professor Niamh Moloney: One issue I would raise in the context of the withdrawal discussions is where the technical implementation changes will land. Specifically, where will the Financial Conduct Authority, the Bank of England and the Prudential Regulation Authority emerge at the end of this process as regards their regulatory powers to finesse and amend secondary legislation in a way that is nimble and gives the EU comfort, or gives some political comfort to the process, that the UK has the technology to change its rules as appropriate and necessary in an equivalence framework, whatever that may be? From my reading of the Bill, that detailed rule-making function and amending of technical rules and highly detailed legislation of European origin is not yet clear. The more nimbly and quickly that can be done, the easier it will be for the EU and the UK to come to accommodations on some of the more technical parts of the negotiations.

Baroness Liddell of Coatdyke: What is your gut reaction about how

quickly something like that could come to a conclusion, given that in the past negotiations on these issues within the EU have been sluggish, to say the least?

Professor Niamh Moloney: It might be overoptimistic to expect speedy responses. One of the reasons is simply the institutional apparatus in the EU. The Commission, the Parliament, ECOFIN and all sorts of stakeholders feed into the process and it goes at the pace of the slowest carriage, if you like. There is a sense that the EU governance system has loads of moving parts and they interact. It is a matter of being attuned to the fact that these things have an internal clock that runs at a particular pace.

Baroness Liddell of Coatdyke: I get the impression you are not hopeful that we would get it done by March 2019.

Professor Niamh Moloney: I would be pessimistic.

Professor Eilís Ferran: On the EU (Withdrawal) Bill, obviously, it is early days and the Bill will change a lot. We should not get too hung up at the moment, but it seems to me that there are major issues in relation to financial services. We do not know what exit day means. That is No. 1. We are going to convert EU law that is in force and applicable as at that date. Satisfying the law "in force and applicable" requirement is potentially problematic if we have staggered starts to EU regulation, and we have not already completed the process of writing all the technical rules. That will give rise to legal uncertainty.

It is not at all clear what happens to the non-binding guidance that is given by the European Supervisory Authorities at the moment. What status will that have, even though it is part of the ecosystem that informs EU financial regulation as it is at the moment? Niamh made the point about where the European Supervisory Authorities' powers will go. There are other functions that are performed at EU level, such as endorsing international financial reporting standards. Who is going to take on that responsibility?

We have had a lot of talk about it being easy to badge us as equivalent at exit day, because we match. I do not think we necessarily will match. In the withdrawal Bill, we are adopting powers to correct deficiencies in EU law, and presumably we start doing that from the time the Bill becomes an Act. We will already be doing surgery on the body of EU law at that point, so we are not necessarily going to match at exit day and we will continue to have the power to correct the deficiencies, by a variety of different bits of the Bill, for two years or so thereafter. The idea that it is easy and that we are going to match, at least at the beginning, does not seem quite right. Given the scope of those powers and the circumstances in which they can be used, and given that the safeguards are not yet in place, it is very likely that an EU institution looking at the withdrawal Bill at the moment would not feel assurance that the systems will stay reasonably the same.

Baroness Liddell of Coatdyke: We know where the Commission and the European Parliament will interact when we get nearer to endgame. How will the European Supervisory Authorities feed into that process? Do they have any clout in it? Do the different agencies all share the same priorities? In other words, are there tensions even within the European Supervisory Authorities?

Professor Niamh Moloney: They are very much a part of this, but they are careful as to how they position themselves. The ESAs are very entrepreneurial and dynamic; they have hugely developed since 2011, but they are deeply conscious that they are not political actors. Everything they do is mediated through that, so they present themselves such that they are not interfering with negotiations or with legislation, but they have very strong technical influence. How is that going to represent itself? It already is, in so far as they are producing guidelines on relocation. This is in the context of making sure the single market works correctly and that all 28 supervisors deal with relocation appropriately. One can see in that how they are thinking about Brexit issues.

They have different approaches. For example, the European Securities and Markets Authority—ESMA—potentially has a lot to gain, because of the City. It deals with markets and has every incentive to say, “Look, it is the political masters who will make the decision, but we are capable of supervising third-country actors and running equivalence assessments”. Indeed, if you look at its public remarks, it is positioning itself in that way.

It is a little different for something like the European Banking Authority. There, it is all about the relationship with banking union and how Brexit might disrupt that in some way. The EBA is there and is technically very influential, but its influence would be carefully handled.

Professor Eilís Ferran: At the level of the institutions, at the moment they are all holding the same ground. There is some noise in the system. If you look at reactions in the European Parliament on clearing houses, some MEPs are saying, “We should be going further on this”, while others are saying, “The disruption of moving this business out of London would be harmful to all, so there should be a more measured approach”. That noise is inevitable, and at this stage I would not read too much into it. We do not quite see yet what the different institutional priorities will be.

The Chairman: Professor Ferran, you mentioned that the landscape was not clear as to what the withdrawal Bill would say about where responsibilities would lie. What proposals do you expect the Government to come up with? Will there be a separate financial services Bill after the repeal Bill? What methodology do you expect the Government to use?

Professor Eilís Ferran: There is a provision somewhere in the Bill for delegated legislation for different agencies.

The Chairman: That is right; it is a very controversial aspect of the Bill.

Professor Eilís Ferran: Yes.

The Chairman: You expect those to be the areas where it will happen, rather than a separate Bill.

Professor Eilís Ferran: Yes.

Q7 **Lord Haskins:** We come to the issue of transition, which seems to pop up now and then. Many people think it is a way of putting off the evil day. I am interested in what happens during the transitional arrangements. What do you gain from transition? Are there certain legal contracts in transition that run their course? Where does insurance stand, for example? Above all else, does transition create certainty where uncertainty exists? Is it just that we do not have time to do what needs to be done? The whole thing seems to be that we are saying we will put it into transition and come back to it later.

Professor Eilís Ferran: I think you have gone to the nub of it. To me, the problem is that we are talking about transition doing two different things. There is the transition we need because we do not think two years is long enough, so we need some kind of way through that. Then there is transition in the ordinary sense in which we use the word, where we have one regime and we are moving to another and we need a bridge to get us there. The problem is that we have the bridge to the next stage, which could be relatively short, and ordinarily would be, and you would say, "In this transition period any contracts entered into under the old regime will run their course", so you will grandfather them in. Presumably, you also have a longer transition period, which is about working out the new arrangements.

The problem at the moment is that Article 50 and the withdrawal process envisage transition, or an orderly withdrawal. It is a transition to get you to the next place; it is a bridge in the sense of where you are going. It is a fairly limited set of transitional arrangements, whereas we need something else, which is bigger, to preserve as much as possible at the moment. That is the problem. That is what the UK says it needs; the EU is saying, "We see the Article 50 process as orderly withdrawal".

In terms of contracts, bringing all of that together, the problem, as I see it, is that it is easy in a transitional sense to think that it is necessary and appropriate to preserve legal rights that have already been acquired, and not disrupt them. I do not think that would be regarded as controversial, but allowing some open-ended contractual security and certainty for new contracts that are entered into gets you into a much more open-ended and rather difficult area.

Lord Haskins: Would new contracts not have to be based on the new rules from day one of transition?

Professor Eilís Ferran: That is the problem.

Lord Haskins: It is very complicated.

Professor Eilís Ferran: Yes.

Professor Niamh Moloney: The key issue is: transition to what? I was trying to think of an analogy in the area of financial regulation. The only thing I can think of are the implementation periods we are very accustomed to: for example, four years to implement MiFID and five years for Basel III. That is very clear. You are in system A and then you go to system B, and you run your shadow preparatory system in the meantime. It is troublesome.

The Chairman: Let us break it into two: the transition period and the implementation period. If you were to put a figure on it, how long would you expect both to last?

Professor Niamh Moloney: How does one even think about it? One way is to think about the interests and incentives at play and then try to get some middle way between all of them. The EU's interest, as we know from public statements, is in a time-limited transition that is as short as possible so that everybody is clear about where they are ending up. Industry has different views on this. On the one hand, it wants clean, sharp preparation: "We are relocating now to the extent we need to; we assume X and, if we get X-plus, so far so good". However, although it is comforting to think of the status quo continuing for four, five or six years, there is a reality about how business, boards and governance work, whereby decisions need to be made. In that case, particularly when we look at the EU's interests, is there a logic to a long transition period? The logic starts to look a bit weaker.

The Chairman: What would you define as long?

Professor Niamh Moloney: Five years. In examples of transitioning legal systems, Basel III is seen as a really long process, and that is five or six years. That is why I put it at the outer mark.

Professor Eilís Ferran: A lot of this is a political rather than a legal question. Article 50 is the legal basis for the withdrawal agreement. Built into that is recognition of an orderly withdrawal and some element of transition, but if you follow the logic that it is just about transition to the different regime, the legal basis is that the transition period should be relatively short. It should be based on where you are going and—

The Chairman: How do you define relatively short?

Professor Eilís Ferran: Given that the original negotiation period is two years, and that is the legal basis on which we are doing the exit bit, it would be hard to see a transition period that was longer than the negotiation period in the first place.

Lord Haskins: Here we are in September not having taken step 1. It is inconceivable that the deadline will be achieved.

Professor Eilís Ferran: Yes, but we might be able to do two years and then renew it. There is a real legal problem. If the withdrawal agreement

is on the basis of Article 50, and Article 50 does not have a mechanism for an open-ended transition—other than getting all member states to agree to extend it, which would be a clean and logical way of doing it—it is dealt with on a treaty basis. The EU will be very much aware of the potential risk of that agreement being challenged before the European court, so the idea that you need to fit within the confines of that legal basis is a very powerful one. In the end, the UK has to take heed of that, because, if there is a challenge before the European court to the validity of the withdrawal agreement, that is bad for everybody.

Lord Bruce of Bennachie: All your previous answers have been about the strength of the arrangements and current practice, and it is potentially optimistic, but we heard evidence from witnesses last week who said that, frankly, if they do not get clarity in the next two or three months they are just going to relocate. How much damage to its own interests do you think either side is prepared to accept? You indicated that the EU members would be damaged if there is not a decent financial services agreement with the UK. Looking at it from both sides, do you get to the point of saying, “We do not care how much damage there is. There is a political necessity to get a resolution, and that is going to override it”?

Professor Niamh Moloney: There are all sorts of overlapping interests that will play out. At a very high political level, there is an absolute awareness that no one wants a disruptive movement of capital between the UK and the EU, and that pipeline becoming blocked in some way. On the other hand, all the rhetoric we hear from the national regulators, the European Central Bank and the European Supervisory Authorities is that this is how relocation works. They are putting their systems in place and there is almost an apparatus or technological equipment being readied for relocation. They are assuming that relocation decisions are going to be made. We know from reading the newspapers the play France is making in this direction. It is very clear that, politically, there are incentives to bring business, and that is simply a reality.

Professor Eilís Ferran: Although not coming to an agreement is bad for everybody in the end, the incentives to prolong the uncertainty work more in favour of the EU than the UK, because they allow the relocation strategies to be played out.

Lord Desai: Is there a way of stopping the clock?

Professor Eilís Ferran: There is discussion about whether or not you can legally withdraw the Article 50 notice. If we were allowed to stop the clock and were thinking about how to move through the implementation and transition period, there are various options: the EEA, the WTO and all the rest of it. Logically and from a lawyer’s viewpoint, ignoring the politics, the best thing to do is to get the other member states to extend the negotiation period, but the divergence between the lawyer’s answer and the political answer will be big.

Q8 **Baroness Neville-Rolfe:** First, I should declare an interest as

Commercial Secretary to the Treasury until June.

I want to talk about innovation and technology. FinTech is an area where London has played a really important and leading role. How far has FinTech driven domestic regulatory concerns? Is there scope for the UK to innovate more on financial services when it leaves the EU, or indeed anyway? Where do you see the direction of strength in innovation?

Professor Niamh Moloney: It gives the UK absolutely a competitive advantage right now. The Financial Conduct Authority is emerging as a global leader on FinTech. For example, there is the work we are doing on robo advice; we have the innovation hub. The sandbox is being followed across Europe. People have different views on it, but it drives how regulators are thinking. This is one of the areas where we see depth of technological expertise and a degree of ambition and experience in dealing with very new forms of regulation coming through from the FCA. That is very clear. This is one of the areas where previously the UK would have been the laboratory. How the FCA approaches crowd-funding and robo advice is feeding back into the European system, so there is huge innovation here.

The other way we have a competitive advantage in the UK is experience with supervision. In some respects, although FinTech is new and shiny, it is not new at all; it is financial services being delivered in different ways, so it is all about functional regulation. Find what is being done and then apply your tools. Traditionally, the UK has been very good at proportionality in how outcomes-based regulation and risk-based supervision are done. There is a long tradition of using supervision in a nimble and flexible way. The FCA and PRA have that kind of technology, so you would expect that kind of advantage to be very much an interest for the UK.

In that space, the EU does not have a natural role because it is something happening very much at national level. It is responding to different industry structures and taxation incentives, so it does not have a natural pan-EU home. I do not think we will see a homogenous European response; it is going to be more national, and there will be a very strong role for the UK.

Professor Eilís Ferran: I have very little to add. As Niamh said, the FCA is an innovator. Its competition mandate and the use of competition to produce good consumer outcomes is distinctive and is not found in other European jurisdictions. It has already done a lot within that space, because it is not an area that the EU has gone into directly, and we may see more of that.

Specifically on FinTech, there is nothing new under the sun; it is a different form of delivery rather than something fundamentally new. I agree with Niamh that the UK has had a strong track record in this area, but it has also had failures. FinTech poses risks to consumer welfare as regards whether advice is given properly, and the like. There is a risk of its being misused for money laundering and terrorist financing; there is

risk to the stability of the system. It is a new context in which old questions come up yet again, and perhaps it is another chance to get them right—to get the right balance.

Baroness Neville-Rolfe: In an earlier reply, one of you said that both London and the EU were looking at FinTech because it is so important. As you were hinting, it is now changing all of banking, because FinTech is becoming part of the banking model. I am still not quite clear about whether regulation to date on FinTech has been limited. Have there been problems? Is there an opportunity to have a different system? I suspect the answer is no, but I would like you to confirm that. Do you think that the EU will develop in a different way on FinTech if we are not able to be as influential, albeit that you say we will continue to be influential, in the future?

Professor Niamh Moloney: It is absolutely a potential bellwether for how the systems develop. Globally, this is at the top of the agenda for all regulators. They are struggling with something we have seen many times before. Do we use our usual set of tools, or is it something different? I do not think people yet know. It is one of those issues percolating through the international standard-setters. There is almost a first mover advantage. The first regulator who figures this out will slightly run the table, because everybody wants a template they can take down from the shelf and use, because it has been road-tested to a certain extent. The UK is in the vanguard of that.

As to how the EU is likely to develop, there is potential for tension, because there is a competitive angle to FinTech, and the cross-border benefits are not as strong. There will be strong interest in grabbing FinTech and perhaps less concern about the cross-border dimension. Certainly, the policy and position papers from the ESAs and the Commission are very much on the basis, “Let us learn and experiment. What are you doing?”, rather than moving towards a directive on how to deal with FinTech.

Professor Eilís Ferran: This could be where not having the UK at the table could impair the progression of EU law in this area, because the UK has a depth of expertise in this field.

Q9

Baroness Neville-Rolfe: Can I ask a linked question about data sharing? One of the things that many people have told us about is the change to data protection and data sharing. You mentioned data earlier in your evidence as being critical, with a big change over the last 10 years. What are your comments on that?

Professor Eilís Ferran: In areas where the EU has agreed supervisory co-operation with other jurisdictions in banking and in resolution, the really difficult things have been confidentiality, privacy, secrecy and data sharing. That will be a major stumbling block in agreeing the standard by which we judge each other. It is an area where I wonder whether, on balance, simply applying EU norms might be the sensible, pragmatic way to go. I know that the GDPR is adding significantly to compliance issues;

speaking from a university perspective, a lot of time is being given over to GDPR. But it is an area where we should be very careful and measured about going down a different route. Across many different areas, we will find that going too far away from the EU system will make it difficult, whatever standard we use to compare ourselves with one another. In a sense, it is critically important for each of us. We are talking about personal data, so it is not an area where I can see us agreeing to some very high-level standard and leaving it at that.

Baroness Neville-Rolfe: Do you think that the Bill we are expecting in this House that implements various data protection changes will do what is needed, which is to create enough equivalence, or will we run into the same problem you described in relation to the withdrawal Bill?

Professor Eilís Ferran: I do not know, but I think it is an area that needs careful, close analysis.

Lord Haskins: The remit of the various reviews the House of Lords is doing is to identify the risks and opportunities arising from Brexit. We are having a bit of a job finding the opportunities. I was hoping that there was a glimmer of an opportunity in this area, and that Brexit might help, but would you say that FinTech will thrive just as well inside the EU as outside it? We are trying hard, despite our best efforts.

Professor Niamh Moloney: I think so. I preface my remarks with a standard comment about financial markets. They find a way. There is absolutely no doubt about that. The history of financial markets is that they find solutions to difficulties, and we know that. I take comfort from the fact that markets find ways around for doing things. It may be that in so doing they make better, more efficient pipelines, products and technologies, using more efficient ways and so on. That is a reality.

A second benefit from all of this in a more macro sense is probably a breakaway from groupthink about financial regulation. The EU is a monolith and it has big structures designed to produce compromise positions. That is not necessarily good for the global financial governance system. In the wider scheme of things, in the wider financial stability system, which is absolutely important for the UK, it is probably a good thing to have potentially slightly more friction in the relationship between the UK and the EU. That matters for how the City ultimately develops.

Thirdly, disruption is not necessarily a bad thing in financial markets. Big disruptions arise, either financial crises or new ways of thinking about financial regulation. We are in a period when the jigsaw has been shaken and it will fall down in a different way, but the history of financial markets suggests that there will be efficiencies through that process.

Lord Skidelsky: Is that what you call creative destruction?

Professor Niamh Moloney: One could interpret it like that.

Lord Skidelsky: Destruction as well as creation.

Professor Eilís Ferran: I am struggling to be very concrete in seeing opportunities. Of course, financial markets will adapt and change.

Lord Haskins: That is not an opportunity; that is the way it works.

Professor Eilís Ferran: Absolutely. As we said before, being at the table is a good thing. A lot of time is spent creating EU laws. There will be less resource going into that, which may, I suppose, be used by the FCA and PRA to think about the UK's interests, but whether that works out as beneficial overall, given what we lose by not being at the table, I am not in a position to judge.

Baroness Neville-Rolfe: Might overseas relationships open up, with India, China and so on, as a result of having more time available?

Professor Niamh Moloney: This is a political, almost an international trade issue. It is hard to get away from the reality of economies of scale. The EU 27 is a very big financial market with a set of rules. Everyone knows what they are and the expectations of how to interact with the EU. To get away from that one is tricky.

Lord Haskins: I would have thought that one of the benefits is that the European Parliament might be less able to mess us around than it is at the present time in this particular area.

The Chairman: You are both being very guarded about that. On that note of ambiguity, it falls to me to thank you very much, Professor Moloney and Professor Ferran, for having spoken to us today. This concludes today's public evidence.