



Select Committee on the European Union

Financial Affairs Sub-Committee

Oral evidence: Financial regulation and supervision following Brexit

Wednesday 11 October 2017

10.20 am

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

Evidence Session No. 2

Heard in Public

Questions 10 - 18

Witnesses

I: Mr Barnabas Reynolds, Head of Financial Institutions, Advisory and Financial Regulatory Group, Shearman & Sterling LLP; Mr Jonathan Herbst, Global Head of Financial Services, Norton Rose Fulbright; Mr Simon Gleeson, Financial Services, Clifford Chance.

Examination of witnesses

Mr Barnabas Reynolds, Mr Jonathan Herbst and Mr Simon Gleeson.

Q10 The Chairman: Good morning. I welcome Mr Simon Gleeson from Clifford Chance, Mr Jonathan Herbst, Global Head of Financial services at Norton Rose Fulbright, and Mr Barnabas Reynolds, Head of the Financial Institutions, Advisory and Financial Regulatory Group at Shearman & Sterling, to our inquiry into financial regulation and supervision following Brexit.

I need to do a couple of housekeeping things. You have a list of interests that have been declared by Committee members. This is a formal evidence-taking session of the Committee, and a full transcript is to be taken. It will be put on the public record in printed form and will be on the parliamentary website. You will be sent a copy of the transcript and will be able to revise it if there are minor errors. The session is on the record. It is being webcast live and will be accessible subsequently via the parliamentary website. Would any of you like to make an opening statement?

Mr Barnabas Reynolds: No.

Mr Jonathan Herbst: No.

Mr Simon Gleeson: No.

Q11 The Chairman: That is excellent, in the sense that we can go straight to the meat of the matter. All three of you are extremely eminent in your own fields. We have seen the written evidence from some of your institutions, which was extremely interesting for the Committee. Would you like briefly to outline for us the legal options for continued market access between the UK and the EU? Mr Reynolds, would you like to kick off?

Mr Barnabas Reynolds: Sure. The basic way of achieving access to a financial market in the financial regulatory context is through some form of mutual recognition, because there is an interest in a country, or a jurisdiction, in the case of the EU, ensuring that services coming in do not cause systemic risk in that jurisdiction, and that its consumers are protected. The existing way of achieving that, in the EU framework, is through the concept of equivalence, which the UK has been part of developing over the last 20 or so years.

At a high level, I see three ways in which we could achieve access. One is to take the EU's concept of equivalence—to take at face value all the statements that have been made in the past about how equivalence works in the law and in preambles to EU law—and to tweak it. That would be for the benefit of the EU, effectively, because it is still incomplete; there are gaps in it and some things that can be rationalised. We would then provide for two-way certainty between the EU and the UK. At a high level, that would involve taking equivalence and defining it as based on outcomes, which is in the preamble to MiFID II. When he was selling the

idea of CCP equivalence to the Americans, Monsieur Barnier himself said that it should be based on outcomes and on looking at whether, at a high level, you are polluting the EU market by way of systemic risk, which is a very high-level concept.

You can achieve those outcomes in multiple different ways. Where there are international standards, we would take those to be the defined outcomes. Both the EU and the UK would apply them anyway; we have been party to developing them in international fora. We would make it clear that, in the wholesale markets, neither of us would engage in conduct causing systemic risk to the other. In the retail market, we would say that we will comply with each other's consumer protection standards. Obviously, we need to define in an appropriate way who is retail and who is wholesale. For branches, we would largely replicate the status quo, where the home state regulates the head office and the host state regulates the branch.

That is an achievable situation. In fact, I drafted something in a book for Politeia in July this year that sets out a draft EU regulation that achieves just that. It would come into UK legislation through the great repeal Act, so we would both have a mirror framework that achieves exactly what I have described. There would then be a provision allowing for a bilateral deal between the UK and the EU that would be entered into on Brexit, and would provide for procedural certainty in March 2019. One of the complaints has been that equivalence can be withdrawn at a month's notice, that it is politicised and so on. That would be dealt with through a bilateral agreement, which I have included in my Politeia book. That is the first way. The second is to step back, to look at mutual recognition again and to create a new concept appropriate to the UK situation. That could be made to get to the same place, it could get to a better place or it could get to a worse place.

With each of the three solutions, the devil is in the detail. It is impossible at a high level to say that one is better than another—it depends on how you do it and what the ultimate wording is. It is almost a political choice, based on which is easiest to execute and what conversations you think you can navigate most easily by whichever route is chosen.

On the mutual recognition route, you would create a new concept that I suspect would again end up talking about outcomes, about not polluting the other market through systemic risk and about consumer protection. That would be for the UK only and it could be part of an FTA. By the way, the previous option could be part of either an FTA or a mutual recognition agreement under GATS; it is achievable either way. This could be the same.

The only danger to watch out for when comparing and contrasting those two options is that we do not reopen Pandora's box. There have been some French statements about fiscal dumping, by which they mean, effectively, the UK competing. What some people in the Administration are concerned about, according to some of the statements that they have made, is the UK competing on tax, perhaps on competition law, on state

aid or on employment laws. I do not think that the UK should fetter itself to, effectively, a quasi-EU body without a say in the rule-making. One of the key points is not to end up a rule-taker. If that whole Pandora's box is opened up by creating a new concept that, potentially, is no better than equivalence, we should go for equivalence. Having said that, if we go for equivalence and, through the process, the EU wants to add points that are not in the equivalence regime at the moment, that would be less good. It is really a question of how it is utilised.

The third option would be reverse solicitation, where the EU allows its companies and customers access to global financial services and markets on the basis that they reach out to the wider world to get access to those products. Within that concept is the existing UK concept of an overseas persons exclusion, where we do not regulate people, in so far as our marketing rules are respected, which in the wholesale markets is almost no threshold at all, coming into the UK from outside. If the EU were to agree to some sort of build-out of a concept like that along UK lines, that would also be very attractive. I note that it was considered and rejected as part of the MiFID II negotiations, but that is not to say that it could not be reopened.

Really, it is a question of which one you like. You could run each of them in parallel as options. The question is: what comes with it? In my view, we do not want to end up a rule-taker. In a way, the only reason that anyone will be keen to do a deal with us is that we remain a G1/G2 financial centre, which depends on very subtly crafted laws and regulations for financial services that facilitate dynamic enterprise and competition—the continuation of the City's success. Anything that fetters that would be a trade-off. There will be a tipping point where you would hit the fetters and it becomes very unattractive, given that, in any event, people can come to a financial centre from outside quite easily, as they have done historically to the City, Singapore, Hong Kong and New York. It is not the end of the world not to have a deal at all. We certainly do not want to be trapped in a gilded cage where we cannot change things that are material to competing and remaining competitive, particularly with New York.

Mr Jonathan Herbst: I will add a couple of brief points; I do not want to repeat what Barney said. It is very important that we do not end up with an all-or-nothing solution. Given the political mood music at the moment, the reality may be that one needs to look at suboptimal situations.

I offer a couple of ideas on that. One gloss on what Barney said concerns voluntarism. You can have opt-ins to the alternative regime—the EU regime, in our case. That is done already for clearing houses. It is something that could be done and does not really pose a threat to sovereignty.

That is one mechanism that could be looked at. The other point, which is implicit in what Barney said, is that there is an EU-level relationship, but member state discretion is also important. If you do not get a comprehensive deal at EU level, it is very important that the UK can forge

a relationship with individual member states, to the extent that it is not a maximum harmonised area. We already have an example of that. Germany has an equivalent of the overseas persons exclusion, which it has created specifically for proprietary trading. It is important that that sort of thing is not cut off. It is important to look at two levels—what is the optimal deal, and what are the rational fallbacks?—so that you do not end up looking at it as all or nothing.

The Chairman: I have a quick point on your suggestion about opt-ins. Where would the adjudication level, the supervisory level, sit?

Mr Jonathan Herbst: You will need mechanisms of some type to deal with that. No doubt we will come on to talk about what an FTA could look at.

Mr Simon Gleeson: I have a couple of quick points. It is important to avoid getting bogged down in legal technicalities. There is no practical difference between a mutual recognition agreement and a mutual equivalence arrangement; they are functionally identical. A unilateral equivalence agreement, which is what is in some of the European stuff at the moment, is different, but is based largely on supervisory co-operation. It is important to remember that you do not need legal underpinning for supervisory co-operation. The Bank of England will tell you, if you ask it, that its supervisory co-operation with the Federal Reserve is excellent, despite the complete absence of any legal underpinning. You can go quite a long way without formal arrangements.

Unilateral equivalence is where we will end up, of course, if there is no deal at all. Europe does not have an equivalence doctrine at the moment. It has a fragmented set of equivalence provisions put into different directives for different purposes. What we have at the moment is by no means coherent. We may have to use it, but that is another point.

There is an important point for the UK. If there is no agreement, one of the questions the UK will have to ask itself is: should we grant unilateral equivalence recognition to European banks operating in London? Is it in our interest to facilitate European banks continuing to operate in London without placing regulatory barriers in their way? Unilateral equivalence is a slightly more interesting thing. Of course, reverse solicitation, whatever else it is, is not a mechanism for market access. In reality, the policy choices boil down to a mutual arrangement and the possible use of unilateral arrangements.

The Chairman: To answer your own question, where would you be on granting unilateral equivalence to EU institutions?

Mr Simon Gleeson: Personally, I would be strongly in favour of it.

Baroness Neville-Rolfe: I am keen to tease out a little more about the no-deal option Mr Gleeson helpfully talked about. Mr Reynolds, you tried to develop an option that improved the existing regime, so that if there were no deal we would be able to have our main banking operations

continue. Can you talk a little more about that? Is there any way that you could do that in anticipation, so as to strengthen your negotiating hand?

Mr Barnabas Reynolds: Absolutely. There are a number of things that we need to do now to prepare for a no-deal outcome, because it is not necessarily worse, depending on how it is handled, than a deal outcome. I am not at all sure that it is possible to compare and contrast the two entirely accurately, but it could quite possibly be better.

Rolling the clock back, since 2007 we have had a passport for EU mutual access. It was not properly in place before then. It is not in place for Singapore and Hong Kong, and the City has done well without it. Really, what you are talking about is having an attractive and competitive financial centre. There are a number of ways of doing that. The problem to solve in this situation is EU customers and corporates having access to the City, and City providers having access to those corporates. There are two ways of tackling that issue. One, in which many of the institutions are currently engaged, is to move bits of plant, effectively, to the EU to carry on current methods of distribution. The other way of dealing with it is to flip the problem on its head and assist customers to come here.

First, in so far as EU customers have places of business here from which they receive the service and that are not a pure conduit—because they receive the service from a number of different providers, rather than just one—essentially there is no cross-border issue, under the way the regulatory architecture operates in the UK and Europe. We have a fabulous double-tax treaty network that allows EU customers and corporates to strip out the profits without stickiness and seepage along the way. Generally speaking, that is a tried and tested way for people internationally to access the markets.

There are a number of other ways under EU law to access the London markets, including through reverse solicitation. It all depends on how that is interpreted. The nub of the question on all the laws allowing EU people to reach out is whether, once they have established that they wish to come to the City for their services, you can put in place a framework to allow them to continue to access those services. Is it possible, when they have indicated that they want to receive a service from a particular institution, for them to sign up to something that says, “Please tell me about all your other services from time to time. I am instigating this relationship”? That is another example of how, with the right interpretation of the law, the EU would continue to have access to the global markets, including the City, without a framework.

The issue with a lot of this stuff is that there is some vagueness in existing laws in this context. It is a political instrument to some degree, or at least is seen as such by some. One of the key things that we need to do in order to compete as a financial centre is tune up—now—the reasons why people are here in the first place. Then we need to be very robust on how EU law, which we are fully entitled to opine on, should be interpreted. When tuning up our system, the two levers are regulation—being much more fine-tuned and focused on what really matters and

stripping out undue process, because the EU, through the federal system, has overregulated—and tax incentives.

The Chairman: Lord Skidelsky wants to come in on that point.

Lord Skidelsky: I want to clarify it. Are you saying that it is more important that they have access to us than that we have access to them?

Mr Barnabas Reynolds: I am not sure how many EU participants realise this yet, but the consequence of what people refer to as fragmentation—bits of business being relocated in the EU to provide the continuum of services without change to the customer-facing element—is that significant costs will be incurred. The reason why everything is in a global financial centre here at the moment is cost efficiencies. Inevitably, those will be unravelled to some degree by putting things in the EU. The cost inefficiencies thereby created will be put back on the customers.

I have not yet seen much analysis of what the real implications are. Obviously, incentives are such that institutions do not want to reveal to their customers that this is all going to cost them more, but the reality is that there will be more costs for financial services for people in the EU going forward if they insist on fragmentation. Gravitational pull always pulls things back to the efficiencies of being in this centre. We need to enhance the gravitational pull of the markets here. If we enhance that gravitational pull, everything will keep coming back here in reality, one way or the other. Customers will find the market.

Baroness Neville-Rolfe: Would the other witnesses like to comment on what you do pragmatically in the case of no deal? We have had one idea of how you might do it. It would be quite useful to get that on the table at this point.

Mr Simon Gleeson: Barney is perfectly right. Whatever happens involves significant extra cost. The core assumption is that between 10% and 15% of business will move. Europe has exactly the same view as the UK regulators on this. It will not allow brass plates; it wants to see real capital, real people and real business. All of that massively increases the cost. The issue, of course, is whether that means that execution becomes sufficiently expensive that it is cheaper to do it in New York or Singapore. There is really significant concern in the industry that, basically, the upshot of this process is to make European financial service provision, whether from London or from branch offices, uncompetitive globally.

Mr Jonathan Herbst: I do not disagree with the optimistic picture, but those are not the discussions that we are having. They are certainly not the discussions that I have been having in the last year with all the banks we act for. I am sure that that is also true for the other witnesses. The reality is that we are in a more dangerous position. The question was, should we be more concerned about their access to us, or vice versa? In theory, it should be the other way around. I do not quite share the optimism, mainly because I am not sure that it is inevitable that the infrastructure will remain here. That is my big concern.

That leads to a second point. There is a very important distinction between the existing equivalence mechanics that are in single market directives and regulations and a Brexit deal. For example, although it is not perfect, Article 46 of MiFIR would effectively give mutual access—not through a Brexit mechanism, but globally—to jurisdictions that are on the list in relation to the wholesale market for investment instruments. That would at least be a start. It is different from a Brexit deal. If we are faced with a no-deal situation, we need to look at all the legal mechanics—Barney is absolutely right about that—but it is clearly suboptimal. That is my personal view. I can only comment on the work we are doing, which reflects that.

The Chairman: Absolutely.

Lord De Mauley: Mr Herbst, could you expand on the opt-in concept?

Mr Jonathan Herbst: Obviously, there would have to be legal underpinnings. The concept would be that banks or other firms here could effectively say, “We wish to do business in the EU. In return for that, we will agree to comply with certain EU laws and regulations, and, potentially, to submit to the jurisdiction in various ways”. It is not as revolutionary a concept as it sounds. It has already been done with the clearing houses, which are obviously discrete and significant institutions. The question is whether it is a way, from a legal perspective, of getting over the sovereignty hump. You give something to the European regulators and politicians, but you also make it easier from the perspective of the UK.

There are problems with it. One problem, of course, is having a two-tier market and the concern in Europe that, effectively, the UK could cherry-pick. For the domestic and the global business, it could have a lighter-touch regime versus what it would be on a cross-border European basis. I am not saying that it is a perfect answer, but it is an example. Maybe our job as lawyers is to provide fresh thinking that can move the discussion forward. It is not just binary, with one or two options. We have to look beyond the existing mechanics to something new, at least to allow policymakers new tools. Perhaps that is the answer to the question.

Lord De Mauley: Can that work in a no-deal situation?

Mr Jonathan Herbst: No. There is an important point. When we say, “a no-deal situation”, that is at the level of the EU as a whole. Of course—Simon made this point earlier—you could have mechanics where, member state by member state, you had elements of a deal. For example, you could have MoUs between the Bank of England, the PRA or the FCA and domestic regulators in Europe. To the extent that that is not at maximum harmonised level and is not shut off by EU law, it could provide a very powerful mechanism for access between the most significant markets in Europe. Again, it is part of the theme of a bottom-up solution. The all-singing, all-dancing solution will be wonderful, if we can get it. Given the current mood music, one wonders about that.

Q12 Lord Woolmer of Leeds: You have already touched on some of the issues that I am going to raise. That will happen throughout the session, I think. Can we turn to the legal obstacles to an agreement? How will the EU withdrawal process interact with the negotiation of an agreement? It depends on what the negotiations are and what agreement is sought. What are the implications of the European Union (Withdrawal) Bill itself for financial services?

Mr Simon Gleeson: It is fair to say that the Bill in its current form has nothing to do with the potential solution, for the good and obvious reason that, since we do not know what it is, we cannot really embed it in the legislation. As an observation on the withdrawal Bill itself, the biggest thing it does not deal with—to go back to an existing point—is the position of European businesses in the UK. Although transporting European law into the UK is easy, working out what we do domestically is a whole new issue. At the moment, the withdrawal Bill does not and, rightly, should not address those issues.

The concern—a very live concern—is about what it will leave us with. An awful lot of European financial regulatory legislation is in the form of primary law. The reason for that is that the policy objective is to ensure consistency across the European Union. What has been discovered over time is that the only way you can do that is by putting rule-making into directly effective regulation. When we translate that into UK law, if we simply copy Europe and translate everything that it has in primary legislation into our primary legislation, we will be moving into our primary legislation stuff that properly belongs in regulators' rulebooks. The reason why it properly belongs in regulators' rulebooks is that changing primary legislation is not easy. If we take a bunch of regulatory material that, almost by its nature, should be reasonably dynamic, and hard-bake it into statutory instruments, we are creating a monstrous procedural problem for ourselves in how we regulate the market going forward. There is real concern about whether we are setting a regulatory system in aspic.

Lord Woolmer of Leeds: You would favour a lot being left to regulation and rulebooks. Your advice to the Government would be, "Do not try to put too much into the Bill. Leave matters to secondary legislation—even more, to rulebooks—to get flexibility".

Mr Simon Gleeson: Absolutely. On financial regulation as it stands—almost everything that is currently in MiFID, the CRR and all the rest of it—when we did the Financial Services and Markets Act 2000, the task given to the regulator was to write those rules and put them in its rulebook. I cannot see any reason why, in that case, as in many others, we should not revert to the status quo ante, rather than have a sort of ratchet effect whereby what was in our rulebooks then became European law and then becomes our law.

Lord Woolmer of Leeds: What impression do you have of the Treasury's acceptance of that view?

Mr Simon Gleeson: You would have to ask the Treasury.

Lord Woolmer of Leeds: You talk to clients and the industry. Is that a view that you think is likely to prevail?

Mr Simon Gleeson: The view that much of this should not be in primary legislation is widespread among clients.

Lord Woolmer of Leeds: Mr Reynolds, you talked about an equivalence framework as one of a number of options. What would that imply for the withdrawal Bill?

The Chairman: Forgive me, Lord Woolmer. Lord Butler wanted to come in on that point with Mr Gleeson. I do not want to lose the point.

Lord Butler of Brockwell: Can I clarify my understanding of one point, Mr Gleeson? Were you saying that it should not even be in secondary legislation—in statutory instruments—but that it should be in rulebooks? Were you drawing a distinction between rulebooks and statutory instruments?

Mr Simon Gleeson: Yes.

Baroness Neville-Rolfe: Would that be acceptable as equivalence under EU law? Normally the EU likes things to be in a regulation, in my experience.

Mr Simon Gleeson: It does, but there have been examples of situations where the EU has accepted UK regulatory rule-making as a basis for equivalence.

The Chairman: Mr Reynolds, would you like to deal with Lord Woolmer's question?

Mr Barnabas Reynolds: If we went down the enhanced equivalence route, it would involve the EU making a new regulation, which the UK could help to pilot through the Council, under QMV, and the European Parliament, where a majority is required, before Brexit. There would have to be a level of agreement, but on this method the UK's votes would be counted. It is the same threshold, but with the UK voting, as you would require under Article 50. As long as that was achieved by Brexit, it would come into the UK system automatically through the great repeal Bill, providing the same framework on both sides, effectively. Then all you need is for the bilateral agreement to be agreed. Under the proposed draft framework, that can be agreed to by the EU using QMV.

If we take a different route, the FTA, it would have to go through the Article 50 process. There is then a debate. The EU has taken what I regard as a politicised view on the limited scope of Article 50. My belief is that you could agree an FTA arrangement for an ongoing relationship under the Article 50 mechanics, but that is a point of debate. I think that the EU would find a way to do it, if it decided to. However, that is a

slightly different route. In that process, of course, the UK would not have a vote.

- Q13 Lord Bruce of Bennachie:** I want to look at what the transitional arrangement options would be. We have talked about no deal, equivalence and everything in between. In its submission, Clifford Chance says, "For financial services and some others who rely on single market passports, the impact of the loss of those passports is absolute. They can either do business in Europe or they cannot". That would imply that a transitional deal is a transitional deal to oblivion. Could you explain what the value of a transitional arrangement is in that context? In which other sectors in financial services would there be legitimate transitional arrangements? How might they work, and how long should they last?

Mr Simon Gleeson: To some extent, this is to do with the fundamental difference between service businesses that rely on permissions and commercial businesses that are interested primarily in tariffs. The impact of tariffs on commercial businesses is that they throw a bucket of sand into the works. Permissions are absolute—either you can do business or you cannot. For financial services, the only interim arrangement that makes any sense is one whereby those permissions continue fully in force until the end of the interim period. That is difficult, because if you have a permission you must be subject to the rules that go with that permission, and all the rest of it. It makes the fundamental point that, for this industry, this is like an on-off switch: either you have your passport through the interim period or you do not.

The other important point about interim periods is that it matters whether the interim period is deemed in until you are out or deemed out on day 1. If it is deemed out on day 1, you do not just need an interim period with Europe; you also need an interim period with all the third countries that currently have equivalence and similar arrangements with Europe, so that they can put those in place with the UK before you get to the end. There is an "in until you are out" interim and an "out immediately" interim. They have very different characteristics.

The Chairman: Mr Herbst, do you have a view on that?

Mr Jonathan Herbst: I agree. The challenge of the transitional period is just the commercial reality, apart from anything else. All of us are talking to banks and others almost every day. Given March 2019, the logic of commercial planning is that you look at the worst case. You do not think about whether it is technically accurate or the right answer. One should not overplay the transition period concept. It does not solve the problem. In my view, all it does is allow a bit more time for mature thought.

Lord Bruce of Bennachie: What are people doing during this transitional period? Are they planning to find business elsewhere, because they are going to lose business, or are they relocating to put themselves inside the market? Is it a combination of the two?

Mr Jonathan Herbst: A lot of it is the latter. You have all sorts of different solutions. Sometimes the global business will remain here. Sometimes the business that needs to access either the European markets or European clients is at least putting a hedge in place. Different banks and other firms have different solutions. The logic of the transitional argument is just to allow more time, from both ends—the EU coming in and outwards—for a rational solution. Let us face it: the amount of technical legal work to be done is enormous—never mind the politics—and it has barely started.

Lord Haskins: I want to follow up your point about the difference between other sectors and the financial services sector. In your submission, you talk about the impact on other sectors being frictional. In other words, if we are buying 60,000 tonnes of cheddar cheese from Ireland, we will not be buying none afterwards—we will be buying 40,000; whereas your argument is that in financial services it is black or white—in or out. Is that right?

Mr Simon Gleeson: Yes. It is not absolutely black or white. You have to set up a new entity in the country concerned, and get it approved and authorised, which is similar, but not identical, to moving the business out of this country to the other country. There is no such thing as a kind of passport; you either have a passport or you do not.

Lord Haskins: Do the Government appreciate that?

Mr Simon Gleeson: I would hope so.

Mr Barnabas Reynolds: I agree, although I have a little note of caution on the transitional concept. It rather depends on what the arrangement is and what its terms are. Simon has mentioned one important aspect, which is whether we need to replicate the arrangements with third countries. There are others. If we are in a period when we are subject to rules that could be made at our expense, with no say in those rules, and we are hoping on a wing and a prayer that that does not happen, it strikes me as pretty dangerous. We need to think carefully about that point. That goes to the length of the period, potentially.

Another thing to be careful about is regulatory action within that period of two years or so. In June this year, the ECB asked for rules to make provision for euro clearing. The absence of those powers was the reason why the UK won its case on CCP location policy for euro clearing. It looks like that position will be rectified. As it stands, absent any protections, which, for member states, apply under the EU treaty with regard to non-discrimination between member states and give us room for argument, we would lose all that at the moment of Brexit. What is more, we could be subject to having to apply and comply with, effectively, land grabs from the EU to our detriment. That could be very damaging indeed. It really depends on the terms of the transition.

I am a little less convinced than some others of how essential the transition is. First, I do not necessarily agree with the analysis in some

quarters that there is a cliff edge at the moment of Brexit for contracts, because of the way European law, human rights law and so on apply to continuing entitlements at the point of Brexit. Nor do I agree that it is impossible, necessity being the mother of invention, for EU customer business to continue to be serviced from London after Brexit without moving things to the EU. Getting people to think differently would facilitate that. The question is whether it is best to rip off the Band-Aid, as the Americans say, and go for it, and get everyone to try to innovate, or whether we should buy time. But at what price? I am not worried about the financial price for the country—that is a political decision for the country—but I am worried about the arrangements we might lock ourselves into. We could easily end up in a worse position through a transition. That is my note of caution.

Lord Bruce of Bennachie: Unsurprisingly, I do not get the impression that you all agree about that. There are different sectors in financial services. People in insurance have said that contracts could become invalid. Those people say, “We need a transition period, on the basis that we have a positive agreement that there will be a continuing relationship, but we do not have the details. The transition is to work from that point to a position where we know what is what”. If it is a transition to a no-deal situation or we stop, you may as well start with a no-deal situation and try to rebuild it from the bottom, although it seems to me that the house will have fallen in on top of you in the meantime. I am just trying to tease from you where the centre of gravity lies.

Mr Simon Gleeson: That is exactly right. If business thinks that it is heading for no deal and no transition, it will be under enormous pressure to move to Europe, and will do so. If at the end of the process we discover that we had a transition after all, that transition will be completely useless.

The Chairman: What timeframe are you thinking of, Mr Gleeson?

Mr Simon Gleeson: Any manager in London is pretty much going to be sacked if he does not have a contingency plan that will have been completely effected by the date of departure.

The Chairman: Are the UK regulators asking you for contingency plans in that regard? They are, are they not?

Mr Simon Gleeson: Yes.

The Chairman: What are their timelines?

Mr Simon Gleeson: They are exactly the same. They have been saying what everyone else has been saying: hope for the best; prepare for the worst. The worst is hard Brexit on departure date.

The Chairman: Mr Herbst, do you want to come in on that?

Mr Jonathan Herbst: I want to come in on the contractual point, so that we are all on the same page. There are two different issues. One is, can

you lawfully continue to provide business cross-border? That is quite a complicated question; we do not have to go there. The second is: are pre-existing contracts still binding and valid? It does not automatically follow from a lack of the first that the second is the case. Take our own example. First, there is the question of whether a pre-existing contract, even if it is still extant, involves the continuing provision of service. Even if it does, it is not automatically voidable. It depends on the particular circumstances. The court can order it to be enforced.

Barney is right; there is a subtler analysis. This is a great example of the clash of law and politics. It is very easy for us to sit here and say, "Actually, it is more complicated". The reality is that, if you say to a CEO that there is any possibility whatsoever that their contracts could be void, there is general panic. That is the problem that we face in so much of the technical work that we are doing.

Mr Barnabas Reynolds: I agree. This is the time when lawyers need to be clear and robust on some of the definition of the playing field. There are entitlements under EU law, under the ECHR, which will apply to the EU and to us after Brexit regardless, and under public international law. Those exist. Rather like the debate about whether there is a payment due under Article 50 and so on, there are different sides, but the UK needs to be publicly robust on what we expect the EU to hold itself to as a matter of law. If it decides not to honour those commitments for political reasons, there will be consequences. It is important to get that laid out.

If we are transitioning to no deal, that is a troubling situation. The whole thing about the transition needs to be seen in a wider context. What are we transitioning to and on what basis, and what are we getting out of it? Those are key points.

Lord Bruce of Bennachie: The Government would say, "A bespoke deal that is in our mutual interest"—whatever that is.

Mr Barnabas Reynolds: That would be ideal; we are all agreed on that. If we can get that, it will be super.

Lord Woolmer of Leeds: Mr Reynolds, very early on you said that it is not the end of the world to have no deal at all. Everything that has been said in the last five minutes gives a rather different impression.

Mr Barnabas Reynolds: I believe that, if we enhance the competitive nature of the City, business will gravitationally migrate back here, even if there is transitional friction. The sooner we declare what the world will look like on a no-deal scenario, so that international businesses can make up their minds, the quicker we will get a proper understanding of the amount of migration we are talking about. At the moment, businesses are comparing EU-lite in the UK with being in the EU, and obviously they prefer the latter. I am not advocating this—it is our plan B—but if they were comparing continued market access with a highly competitive, refocused UK, with regulation and tax absolutely refocused on being very competitive, the trade-off would become more apparent. The EU's

passport, as it stands, is not cost free; it comes at the price of overregulation, overprescription and some quite prohibitive rules that the industry has been complaining about for years. We are not highlighting that at the moment, because the presumption is that we do nothing.

Mr Simon Gleeson: The industry collectively is absolutely terrified of that sort of language. In New York, there is already the lovely phrase “the London loophole”. The UK is slightly less regulated than the United States and is therefore perceived by the US as being some sort of lightweight place where people should not really be allowed to do business. The collective perception is that, if the UK were to adopt a deregulatory stance, business would flood out of London, not into it.

Mr Barnabas Reynolds: Can I clarify—

The Chairman: Before you respond, Mr Reynolds, I want to throw in one other point in relation to what you have just said. In your conception of what I would describe as Singapore on steroids, you imply that it is entirely within the gift of government to deregulate—bonfire of the vanities—and to set a different strategic direction for the UK on regulation. In our previous reports, we have taken quite a lot of evidence on that. The consensus that we got from your colleagues in financial services was that they were very proud of the fact that the UK had reasonable standards—in fact, high international standards—and was a rule-setter. They wanted to see that continue and did not want a regulatory bonfire.

In light of what you have just said, my question to you is this: if we were in a transition period, accepting EU supervisory frameworks, how do you imagine that we could do that during that period? If it were to happen after that period, would there not be quite a gap before it happened, even if it were desirable? In the meantime, we have heard a lot about how businesses are taking decisions here and now about their futures, and how the regulators are making them do it. How do you square those different visions?

Mr Barnabas Reynolds: If we started work on it now and engaged the industry, we could quickly come up with an attractive framework that was safe for UK taxpayers and was highly attractive and credible. That framework would be relevant to any discussions on equivalence, because equivalence is not identical. We should go into the room now, as we start to talk about this, making quite clear what we have in mind by equivalence. We should talk about specifics, so that we do not have arguments for ever and a day, where we come back and say, “We have in mind to change this rule”, and so on.

Afterwards, under an equivalence-type or mutual recognition framework, we would be in a position to make some adjustments that were beneficial to everyone and would actually make the market safer here, because they would be more focused on the market. If there was no deal, we would be in a position to bring it in immediately, or very quickly thereafter.

To go back to the whole idea of deregulation, which is the term being thrown around, we are now treading in a very subtle area. I am not advocating deregulation in the way the term is often used, which is removal of standards. Traditionally, in financial regulation, the UK has operated higher standards with fewer rules. I am advocating that we go back to that. What the EU has done, effectively—for a number of reasons, but principally because rule-making is federal and supervision is local—is to construct instruction manuals for regulators, because of mistrust of what regulators do, to try to iron out any discretion or judgment at the regulatory level. Therefore, there is massive prescription in the rules, which I believe is unnecessary and renders the market less safe than it would otherwise be.

The other factor is that a lot of rule-making in recent times has been focused on propping up the euro project, which is not relevant for the UK. In addition, a lot of the rules are focused on member state points that are not relevant to the London market. Increasingly, as people have developed a so-called single rulebook for the EU, we have had a rulebook that has morphed away from something that fits here. In some ways, it is overregulated, which people say is wonderful, but we have had to gold-plate in other areas. I am saying that we should not get rid of the gold-plating. We developed the large exposure regime in the UK. We actually pushed back on the EU's idea to stop us having a discretionary ability, under the Basel pillar 2 arrangement, to impose discretionary capital buffers where we thought that capital buffers were insufficient. Why did the EU want us to get rid of that? It was to level the playing field down and to stop London competing, because it perceives that we compete by having higher standards. This is not to do with removal of standards.

Q14 Lord Skidelsky: Some of my questions have already been answered, but that is never a deterrent to repeating them. I want to raise the issue of international regulatory standards and the problem of aligning them. What motivates the question is something Mr Reynolds has already touched on, which is that the regulatory dynamism of the EU is largely aimed at strengthening the institutional foundations of the eurozone. That was already a problem before Brexit, and it will be even more of a problem afterwards. What it means is that access by financial services to the EU will be conditional on accepting the EU's interpretation of what in 2009 the G20 said was necessary to establish a stable financial system.

As one of our written statements pointed out, "The view that the UK will be free to decide unilaterally how to regulate or supervise the markets in a post-Brexit world where it has access to the single market is by and large a red herring". The implication is that we are bound to be a rule-taker, not a rule-maker. Obviously, that gives us a choice. The EU will want a regulatory framework that is embedded in primary legislation, because it is part of an institutional move to make the eurozone viable. The eurozone was set up without many of the rules and regulations necessary to make it work. What is our choice in that situation? Mr Reynolds, I understand you to say, "In that case, we opt for the

deregulating route”—using that word subtly, as you said. It is a choice we face, is it not?

Mr Barnabas Reynolds: At a very high level, yes, but where we will have to make the choice is much narrower than might first appear. Objectively, under an equivalence recognition framework, internal single market rules and eurozone rules should not—subject to euro clearing, which I will come to in a second—be imposed on third countries. We are not the only third country in the world under that framework, by the way. We should be in the room with the Americans and others, working out a framework for mutual access going forward that works for us and the world.

Competition law rules within the EU should not be imposed on third countries. If we are uncompetitive, that is our own lookout. People will not want to do business with us if we are too expensive, and vice versa. Under the proposal for mutual recognition, that is two way. They will not want other people's competition laws and internal market rules imposed on them, either.

The sorts of topics where the rubber hits the road revolve around euro clearing and propping up the euro, as you said. The EU prohibits short selling.¹ It likes to regulate rating agencies, so that it can withdraw approval if they downgrade euro credits. The third thing it now wants to do is to regulate euro clearing in order to control the margining and haircutting of euro exposures, in case it precipitates a run on the euro. The latter one is explosively dangerous. The idea that the issuer of a currency, effectively, has control over the private markets' assessment of what is valid margining is astonishing and needs public discussion. I know from talking privately to various regulators around the world that that concern is shared. We are not on our own on this topic. This is not just about the UK having to agree something in order to get access to the EU; it is relevant to the US's interactions with the EU and the eurozone market, and relevant to other countries in the world.

At a headline level, there is a trade-off to be decided. In a way, you cannot decide that until you see the ink on the page, but there are points where we need to start engaging in a discussion with interested parties. Those include parties who are not in the euro area, such as the US, which have a strong interest in not being overly exposed to a currency that is half built and very dangerous.

Mr Jonathan Herbst: Can I come in with a gloss on your direct question, which was about the relevance of international standards? We are talking about three different situations. There is what we will dub the extreme deregulatory approach; there is complete conformity, on a literal basis, with EU law; and there is conformity with international standards for some time, which leads to the outcomes-based equivalence approach. The significance of the international standards, for which there is clearly enthusiasm in this country, is to try to get a proportionate and sensible

¹ Note by the witness: Of eurozone sovereign bonds in certain circumstances.

outcomes-based approach to equivalence. That is the answer to the question.

Lord Skidelsky: Mr Gleeson, is there anything that you would like to add?

Mr Simon Gleeson: On international standards, there is a terrible danger of viewing the whole of the financial services sector through the prism of banking. At the moment, Europe and the UK are commonly rule-takers from Basel. Everybody is perfectly happy about that. The fact that there is a global standard-setter and, therefore, that there are identifiable global standards is not only a good thing for each of us individually, but will be a good thing when determining in the future who is compatible with what.

That is very much less the case in securities. IOSCO is not a standard-setter; it is a writer-down of existing consensus. It is even less true for insurance supervision, because we are at very early stages with the IAIS. For large chunks of the sector, there are no international standards. The sorts of common agreed outcomes that we would have to crystallise do not exist. In practice, the first task between the UK and the EU will be to identify which standards we accept as global standards that we will all try to meet.

To some extent, that is the smaller part of the problem. You have to remember that European financial regulation as it stands was almost entirely written by the UK. These are our rules. We wrote them. On the point of how legitimate it is for Europe to use the rules to achieve its legitimate objectives, and I do not think that anybody would doubt that it is a legitimate objective for Europe to seek to protect the euro, the issue becomes, how do you do that in the extraordinary and unique factual situation that we are about to create of an enormous economy whose financial centre is outside its territory and not subject to its regulation? For the EU and for us, that creates an almost completely unprecedented problem. How do you regulate that? How should the regulators interact? How should government interact? The argument that Europe should have no say at all in the regulation of its primary financial centre strikes me as completely unsustainable. How do we build something that satisfies everyone?

Lord Skidelsky: Are you in danger of underestimating the European Union's commitment to the success of the eurozone? It is its only project. It is a project it hopes all members will eventually be part of. It is trying to get a regulatory framework in place to fill the gaps in the possibility of the eurozone surviving. That is a dynamic we are not part of. We are not even interested in it, primarily.

Mr Simon Gleeson: The UK Government have made it quite clear that the success of the eurozone is in the UK's interest. The UK should be actively seeking to work out how we stop the euro collapsing.

Lord Skidelsky: But it is not in the UK's interest as much as it is in

Germany's interest, for obvious reasons.

Mr Simon Gleeson: No, but it is massively in the UK's interest. The collapse of the eurozone would be disastrous for this economy.

Mr Barnabas Reynolds: Can I add just one sentence? The way to make the euro safe is to engage in the fiscal transfers that Monsieur Macron is seeking. That does not seem likely to be on the cards politically, because Germany does not seem willing to open its cheque book and share any cash, and is now looking at creating new sovereign bonds, which are not sovereign at all because you can write them down and they are not backed by a proper sovereign.

Yes, that is a big concern of theirs. We need to try to get them to focus on the only way of solving it properly, rather than on pretend solutions that, effectively, will create a phoney market in the euro by clamping down on free speech, which is effectively exercised by the financial markets voting with their wallets on what they think euro credits are worth. All these exercises of regulatory control are displacing and preventing free choice. It is explosive, because people will put their bets—their assessments—elsewhere. At some point, it will cause absolute global mayhem, much bigger than Californian subprime. There is only one way for the EU to solve this. We need to encourage it to do it in the proper way.

The Chairman: Mr Herbst, we have had two diametrically opposed positions. Do you want to come in on them?

Mr Jonathan Herbst: I come back to the matter in hand—the international standards. It seems to me quite clear that the UK has a strong interest in doing its best to enhance IOSCO's standards. To take one practical example, coming into our financial services sphere, the benchmark regulation incorporates an equivalence concept based on compliance by the third country with IOSCO standards. That is specifically built in. We could build on that.

Basically, it comes back to what I said at the beginning. We have to be realistic. Whatever the politics, from a lawyer's perspective, if we can build up piece by piece, look at the mechanisms that already exist in EU and UK law and the possible meeting points, and take out the politics, to some degree, to make it a more technical, outcomes-based discussion, an enormous amount could be achieved. That is not to say that it will be the perfect answer, but this country has always been very good at pragmatism. From a legal perspective, that is not a bad way of looking at it.

The Chairman: This is your building blocks paper.

Mr Jonathan Herbst: Yes, among other things. Life has moved on since then, but conceptually that is the idea.

Q15 **Lord Desai:** I think we have gone over quite a bit of what I am going to ask, but this question goes the other way. When we exit, will EU financial

regulations be affected? As has already been said, we have somewhat higher standards and have been the rule-makers. We have distinguished ourselves in that respect, so when we go what happens to EU regulation? Will it try to measure up to us or go its own way?

Mr Simon Gleeson: That is a big and worrying question. There is a wonderful factoid, the truth of which I have never managed to establish, that the UK has as many financial regulators as the rest of Europe put together. As an order of magnitude that is probably not too far wrong. The UK has been the engine and the motor of European financial regulation certainly since the late 1980s and for as long as I have been in practice.

What happens to Europe when you take that engine out of the machine? My concern, particularly if we get some sort of exit deal that permits business to remain in London, is the risk that Europe simply loses interest in financial regulation. The reason why that is a problem is the chained to a corpse issue. If we find ourselves in a position where we have to maintain equivalence with the regulations of a place that thinks it has more important things to regulate, the danger is that that inhibits the UK's ability to respond to market developments. One of the most important things about financial regulation is that it absolutely is not static; it has to develop, because the market develops. Whether Europe can keep up with the UK in a post-Brexit world is a matter of real concern.

Mr Jonathan Herbst: The popular perception is that the institutions of the EU will go in a more statist direction. I am not sure that is necessarily true. If we look at the history of many of the regulations, taking MiFID II as an example, much of it has copied our own domestic regime. In some respects, not in all areas, we have a tougher regime, for example in product governance, so that slightly simplistic assumption needs a bit of examination. I agree that one of the big questions on this side of the channel and in the EU as it will be is whether there will be enough expertise and market knowledge to do the job. To some degree, there is a common interest in continuing to share knowledge and thinking. Let us see how that works out, but it is a very strong point.

Mr Barnabas Reynolds: I agree with all of that. That is why in any mutual recognition equivalence-type arrangement we want joint working parties on new initiatives, essentially a continual process of refinement, improvement and discussion not far from the status quo. We need to create mechanisms that allow for continuing discussion at EU level so we are party to that. We help them; they help us. That is quite a key element in all of this. The only difference between the status quo and the new world is that we will technically have the ability to walk away from the table, whereas at the moment we do not. I do not see us exercising that much, if ever, in practice anyway. We have a long history of collaborative working with the EU. We want to get back to a very close working relationship.

Lord Desai: Will we diverge from the EU's prevailing system, making

ourselves tougher and innovative? Will we change our rules in such a way that the EU drifts away from us and we become a different regime?

Mr Simon Gleeson: That is potentially correct. If you look at some of the direction of travel in the UK today in things such as payment for research, the UK is creating its own policy that is significantly tougher than Europe's. The problem in this area is that one man's tougher is another man's loophole. The risk is that you get divergence for good reasons with good faith on all sides, which ends up with each side accusing the other of having different standards. As Barney says, the important thing is that if policy-making on future issues can be done jointly between the UK and the EU, with an attempt to create common standards, we will not get divergence, but if that does not happen and we have separate policy-making, divergence is almost inevitable.

Mr Jonathan Herbst: It will be challenging. If one can come to some core standards that are recognised as the basis for equivalence, it is fine if there is then divergence to a higher standard. There is the example of research. The other great example in this country is the senior managers regime, which is an entirely UK-created regime. Other countries have not followed it. No one seems to have a problem with that. It arises only if you diverge in a "downward direction", and the core of the equivalence debate is how that assessment takes place on both sides. That leads back to the need for shared knowledge and co-operation, which hopefully will lead to some sort of shared understanding. It is a big ask.

Lord Haskins: Over the last nine years, many of us have spent a great deal of time looking at EU financial governance. At the beginning, certainly when I was involved in 2010, there was a lot to be done. Our view is that, overall, probably some good progress has been made, but there is still a lot to be done and the road is not complete. Will Brexit in any way materially change the EU or the UK Government approach to the issue, or is it in the interests of both to work very closely together on the same basis as they have in the past?

Mr Simon Gleeson: To some extent, you have to subdivide the word "government". If you start at the bottom with the supervisors, they are absolutely certain that close co-operation is the only way forward and anything less than that will render the entire system significantly less safe. That is at the day-to-day level. At the rule-making level, there is greater scope for divergence, but it is my view that at government level on both sides there is very high agreement that divergence benefits nobody. There is strong awareness that we must not kid ourselves that we have seen the last ever financial crisis. There are real issues out there. One day we will have another one. When we get to that point, the degree of co-operation may well be the difference between a minor and a major problem. The further you go up the Government the less clear that is, but certainly at the day-to-day level it is absolutely the case. If we do not do that, we place ourselves, our taxpayers and everybody at significantly greater risk.

Lord Haskins: What bothers me about it are the three themes that

support Brexit: economic progress—we have not seen too much of that; the ECJ, which has not been mentioned at all today and is the cornerstone of the whole argument; and less regulation.

Mr Barnabas Reynolds: I agree. There are topics—the main one is the euro—on which it will be tricky to navigate the situation and come up with a regime here and one there that dovetails and is satisfactory to both. That was a job that needed doing anyway, even if the referendum had gone the other way, because the idea was that we would be in the outer circle and not in the euro. That navigation and thinking as to how the euro works—which rules are needed for that and which rules the City needs to apply to facilitate it—is a very fiddly task and there will not be identical rules in both places. There are some other topics like that, but that is the main one.

Mr Jonathan Herbst: There is shared consensus, certainly among the legal community here and generally among policymakers, that there is no desire to go back to the pre-2008 world, given the reforms that were made. It is not just a European question. If you look at how banks are now regulated, they have global colleges of supervisors. It is not just an EU issue. There is a very strong argument for the UK to play as full a role as possible in that, and indeed to enhance supervisory and rule-making co-operation, because we are not the only power in town. To adopt a phrase, it really is a no brainer.

The Chairman: Do you believe that United Kingdom regulators have sufficient expertise and sufficient heft to play that role at an international level?

Mr Jonathan Herbst: They are very well regarded and well resourced, and there is an argument for enhancing that. How you do it is a different question. Clearly, there is concern about loss of influence. One of the issues, frankly, is how much financial support and resource you put into the exercise. For the costs involved, which will be tiny relative to any kind of budgetary perspective, surely it is a very strong argument. To take a practical example, there was concern that after the vote the FCA would lose its role on ESMA. That did not happen, and one of the main reasons was that ESMA wanted the technical expertise. Obviously, things will be different after exit, but you can build something. To some degree, the UK plays a role as a bridge between the US, the EU and the Asian countries, so there is a role to be played if one can design it the right way.

Mr Simon Gleeson: It is absolutely critical now, almost more than ever before or since, that UK regulators are as visible and active as they can possibly be in international fora. There is a slight perception that the amount of effort they have to put in internally is detracting from their ability to be present externally. If that is true, it is a very bad development.

The Chairman: The Committee will see them as we go on with our inquiry, so we will be sure to pick up that point.

Q16 The Earl of Lindsay: I want to raise the question of supervisory co-operation. A moment ago, Mr Gleeson said there was currently a real commitment among supervisors to co-operate. Do you see that commitment and practice continuing post Brexit? The question is to all three witnesses. There are currently relationships between the supervisory bodies that will survive and continue post Brexit. If post Brexit there was a major crisis, with a cross-border player such as a central counterparty having a problem, would that joint supervision function effectively and successfully?

Mr Simon Gleeson: On co-operation, as Jonathan said earlier, there has been a sea change since the crisis. It is now absolutely clear that the G-SIBs—the globally systemically important banks—are not just the problem of the supervisor in the country where they are incorporated; they are everybody’s problem. The Federal Reserve accepts that we have a legitimate interest in how Citibank is regulated, in the same way that they have a legitimate interest in how Deutsche Bank is regulated and so on. It is very clear to the supervisors that one man’s problem is everyone’s problem. At that level, there is a strong commitment to co-operation, and I am quite confident that that commitment will continue almost regardless of the legal settlement that is reached, because the practical problem on the ground is unlikely to change very much.

CCPs are an extreme form of the problem, or, to be more specific, LCH and Chicago are an extreme form of the problem. The eurozone example is a perfect one. In a situation where the regulator of the CCP thinks, “If this goes wrong, I could blow up the entire financial system”, he has quite a lot to worry about. If the regulators of some of the major users of that CCP think, “If the CCP is saved by doing this, our financial system blows up”, that gives them a problem. If you do not try to resolve that co-operatively, you will not get to a better outcome and, almost unquestionably, will come to a worse one.

The curious aspect is that, in the event of a really bad crisis, everybody will be in the room agreeing what needs to be done because they will be terrified. Legal architectures are splendid up to a point, but they tend not to be terribly relevant in real crises. In real crises everybody is on the phone to everybody, and I am highly confident that that is what will happen.

Mr Barnabas Reynolds: I agree. To echo earlier statements, our supervisors have very good relationships and are seen as highly credible globally. We have super people in our regulators.

Shared supervision and joint supervision is another very fiddly topic. Essentially, sovereignty issues come in. Ultimately, someone needs to be able to call the shots. That is very important. There needs to be co-operation, collaboration and information sharing, with people in the room having access to one another and so on, but ultimately someone has to be in charge and responsible. To my mind, if the central counterparty is located here, that has to be our regulators.

Mr Jonathan Herbst: To go back to the first part of the question—whether life will carry on—we are talking about two different things. There is the international supervisory co-operation that happens already between EU jurisdictions and those outside. That will and should carry on. Then there is what we might be talking about in a free trade agreement, which will be much deeper and more legally based because there will be real sharing of power. They are two quite different things. The first can be achieved through supervisory relationships and MoUs; the second will need something more hard coded in law.

Mr Barnabas Reynolds: There is a difference between sharing of power in rule-making and sharing of power in supervision. The latter topic is particularly thorny and we need to be very careful about it.

The Earl of Lindsay: Mr Gleeson, can I ask you about the bail-in concept? I know you had some involvement in developing it. Do you see Brexit having an impact on how that might apply?

Mr Simon Gleeson: No. Bail-in is one of the things that was developed at FSB level. The UK and the EU have followed the FSB almost exactly in their implementation of that particular technique. In principle, bail-in issues between the UK and Europe post Brexit should be no different from bail-in issues between the UK and the US post Brexit. We are fairly confident that at least the UK-US position works.

Mr Barnabas Reynolds: I agree, although it is an example of a pretty sensitive topic. Within the EU framework—I anticipate that we will replicate that to a large degree—there is an autonomous decision-making power to affect debt entitlements that are held predominantly in the London market. There is a question of whether or not there needs to be some sort of gateway or protection to ensure there is not politicised write-down of debt that affects the international markets here to their political detriment, in order to do something slightly improper in Europe. I do not think that would happen. The current arrangements are definitely fine now, but it is something to watch and to be careful about.

The Earl of Lindsay: I have one further question on this theme. What additional powers do you think the ECB and ESMA might gain as a result of the EMIR review, and what implications might that have for the United Kingdom as a third country post Brexit? More broadly, do you see ESAs inevitably being granted additional powers in other parts of the financial services sector in future? From the UK's point of view, might that be a welcome trend, or not?

Mr Simon Gleeson: If we could wrap Omnibus III into the EMIR review, because they are all going in the same direction, it is unquestionably right that the ultimate aim of European policy-making is a single securities regulator. The EU would like to go past that and get a single securities supervisor as well, to match the Single Supervisory Mechanism in securities. It is generally accepted that you could not get there immediately without treaty change, so we are looking at an incremental process.

I am in very little doubt that after Omnibus III there will be Omnibus IV. Each of those will transfer a few more powers from national supervisors to ESMA with the aim of trying to turn ESMA into a single European securities supervisor. That will be a 10-year project at least, but it is undoubtedly the direction of travel. It seems to me to be a very good thing for the UK, and I wish it was happening faster. If our securities regulator had a single European securities regulator to talk to, the dialogue would be much more efficient than where we will end up if the securities regulator in the UK has to maintain dialogue with 27 different European securities regulators, ESMA and the Commission. At the moment, the fragmented nature of supervision in Europe in that direction is an obstacle to the development of sensible relationships between the UK and the EU.

Mr Jonathan Herbst: That may be right, but a slight note of caution is that it will depend on how ESMA uses its powers. If it is, essentially, to lock out the UK, a degree of member state discretion could be very beneficial. We are already seeing examples of that, with different member states taking slightly different approaches. I am not entirely convinced that the federal solution is good for us. Whether or not it will happen is a political question. We will see. Clearly, there are member state forces that do not wish to go too far in that direction, but from a UK perspective we will have to look at it very carefully.

Mr Barnabas Reynolds: The EMIR review introduces de facto joint sovereignty over systemically important CCPs in this country. That is a very thorny issue as regards their co-supervision, if it ends up going through and institutions here decide to opt in to that regime—they could decide not to. There are some very thorny issues about collaboration between our regulators and the EU or member state ones, and the sooner we start getting into the thick of it, the better.

Q17 **Baroness Neville-Rolfe:** We have been discussing an awful lot of complexities and uncertainties, but it seems right to ask you about the scope for innovation, as regards both how much we have achieved in London historically and whether we can ensure that it continues. Are there international examples that can help? Do you have ideas about how, in the future, we can continue to strengthen things such as the FinTech sector, which has relied a lot on passporting?

Mr Simon Gleeson: Financial innovation does not happen as a result of regulation. We start with the innovation, and the regulation has to move to catch up with it. The important thing is that it does so. The reason why the global derivatives market is largely in London is that the Americans did not amend their regulation fast enough to get rid of some provisions that practically prevented it, and to some extent still have not.

The question is how efficiently the UK can respond to innovation by accommodating it within the regulatory framework. To be fair, the UK is doing sterling stuff today. The FCA sandbox for FinTech start-ups is working well. I would not dream of asking whether it is entirely compatible with European law because that is not a useful question to

ask, but at the moment a good job is being done and one hopes that it will continue.

If the UK continues to remain a centre for financial innovation, which should not be taken as a given, it will be very important for us not only to change our own rules but to become a kind of missionary, at least to the EU, to say, "If you want these benefits, you need to change your rules as well".

Mr Jonathan Herbst: To respond to the question and pick up what Simon said, what are the successful examples? They are examples where the different bits of the regulatory and tax structure work together: the tax authorities, the regulatory authorities, the Government and possibly a form of investment authority. Those are the examples we should be looking at. The danger is when different bits of the regulatory system speak with different voices and give a confused message, and we see examples of that in this country.

Mr Barnabas Reynolds: Generally speaking, the UK has been rather good at this, as evidenced by the results. The EU has an instinct to regulate a priori before a market is fully developed. The e-money directive is a good example of a solution without a problem. We need to avoid that, and we need to try to encourage the EU not to do it again.

We need to look at whether our regulatory powers or framework should be tuned up again to the new environment by giving them an international competitiveness objective, obviously subject to the overall systemic risk objective, as a secondary one. Secondly, we need to remove competition-based regulatory rule-making where a whole group of very good people are trying to come up with rules to ensure a competitive market, sometimes before it exists. That is a mistake. You might end up with short-term things that look somewhat monopoly-like in the innovative sector. Let it run. If there is a real monopoly issue, you deal with it through the CMA through a quasi-judicial process on the evidence, but we should not allow people to start trying to regulate things at birth or near inception. That is not a sensible way of allowing markets to develop.

Baroness Neville-Rolfe: I agree. Having a culture of innovation is important. I particularly like the point Mr Herbst made that having the tax and regulatory regimes all pointing in the same direction is very important to innovation. One final question we want to ask is about data protection and data sharing, so that it is on the record. Is there anything you would like to say about that before any final questions?

Mr Simon Gleeson: It will be a blessed relief for the UK not to be part of a negotiating position where some members believe in data localisation as the solution to data protection.

Mr Jonathan Herbst: The only concern, with which I think we are all familiar—it goes back to the equivalence debate—is that we will not be viewed here as equivalent. It does not make a lot of sense, because

obviously we conform to all the standards, but there are concerns that institutions will need to keep their data within the EU. Going back to the beginning of this discussion, that is a very good example of people, whether it is logical or not, sometimes leaping to the worst scenario, even if in practice, since we have the same regime, there ought to be with very minimal political will an equivalence assessment, but that does not always follow.

Baroness Neville-Rolfe: You agree that it is an important area that we need to get right.

Mr Jonathan Herbst: Absolutely.

Q18 **Lord Butler of Brockwell:** I have two questions, one of which is about timetabling. Early in our conversation, you referred to the outcome of negotiations being incorporated in the great repeal Bill, but is there not a problem about that? The great repeal Bill is going through now and will not come into effect until March 2019. Is that a practicable way forward?

Mr Barnabas Reynolds: If we go down the enhanced equivalence route, where we work with the EU to enhance the concept of equivalence through a new EU regulation and it is enacted effectively before Brexit, it will automatically come into UK law through the great repeal Bill. Nothing needs to happen, because we adopt the entire *acquis* as it stands as at March 2019.

Lord Butler of Brockwell: No amendment is needed to the great repeal Bill.

Mr Barnabas Reynolds: No.

Lord Butler of Brockwell: Under the general provisions, the *acquis* will come in and will cover it.

Mr Barnabas Reynolds: Correct.

Lord Butler of Brockwell: When we were asking whether the Government were aware of something, you said we would have to ask the Treasury. The response to another question was, "I hope so". You have given us a great deal of wisdom this morning. Are you confident that it is getting through to the Government and they are listening to the sort of expertise you have contributed to us this morning, and that it is having an effect on their stance?

The Chairman: Who wants to go first?

Mr Simon Gleeson: Let us distinguish different meanings of the word government. I, and I suspect all of us, have spent considerable time talking to civil servants, regulators and those charged with working through the detail. I am in absolutely no doubt that they get all of this. The feedback I get is that the issues are not caused by lack of understanding; they are caused by political debate, and that is not something the likes of me can engage in.

Mr Barnabas Reynolds: I absolutely agree. We have some very good officials and I believe they understand what we have individually been telling them. There are some political judgment calls to be made that are extremely difficult and a lot of them are wrapped up together. They are all to do with tone, approach and so on. Whether those making the judgment calls ultimately are sufficiently in the weeds to be apprised of all the nuances, I do not know. There is a question mark in my mind as to that. This is a very complicated area with lots of jigsaw pieces, and the people making those judgment calls need to have directly understood those pieces and what the options are. Whether they are getting that, I do not know; I cannot speak to that.

Mr Jonathan Herbst: I have two brief points. First, I agree with my colleagues that the officials are very able and understand the issues. I am very confident about that. What is less clear—maybe this is something to consider—is whether there is an institutional mechanism for all of this to be shared or transmitted; it is very much a long series of bilateral meetings, all of which are valuable. Clearly, we are at the very beginning of what will be a hugely complicated 18 months, two years or whatever it turns out to be. As a personal view, there is a question about whether the institutional structures are quite fit for purpose, given the need to share industry knowledge, legal knowledge and Civil Service knowledge. We are in a significant national change. It is unique.

Lord Butler of Brockwell: You are referring to institutional structures within the UK Government.

Mr Jonathan Herbst: Yes. I think your question is whether the industry expertise is getting through to the Government. The answer is that there are a lot of bilateral meetings taking place with trade bodies, with us and whatever, but is it quite organised enough? Is there a need for some centralisation? I do not know. Whether the normal structures are capable of dealing with that is more for others than for me, but it is a real question.

The Chairman: I have a quick-fire question requiring only a one-sentence reply from each of you. When would you like agreement on a transition?

Mr Simon Gleeson: Before Christmas.

Mr Jonathan Herbst: The sooner the better.

Mr Barnabas Reynolds: The same.

The Chairman: Thank you very much for coming to our evidence session. We have learned a lot from you, and it has been very useful. That concludes today's public evidence session.