



Select Committee on the European Union

Financial Affairs Sub-Committee

Oral evidence: Financial regulation and supervision following Brexit

Wednesday 18 October 2017

10.20 am

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Members present: Baroness Falkner of Margravine (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 Woolmer of Leeds.

Evidence Session No. 3

Heard in Public

Questions 19 - 45

Witnesses

[I:](#) Mark Hoban, Chairman, Flood Re, and Chairman, IRSG; Rachel Kent, Partner, Head of Financial Institutions Group, Hogan Lovells; Catherine McGuinness, City of London Corporation.

[II:](#) Simon Lewis, Chief Executive, Association for the Financial Markets in Europe (AFME); Stephen Jones, Chief Executive Officer, UK Finance

Examination of witnesses

Mark Hoban, Rachel Kent and Catherine McGuinness

Q19 The Chairman: Good morning. I would like to welcome Mr Mark Hoban, Ms Rachel Kent and Catherine McGuinness to the EU Financial Affairs Select Committee's evidence session on financial regulation and supervision following Brexit. I will do a bit of housekeeping very briefly. You have a list of interests declared by the Committee members. This is a formal evidence-taking session of the Committee. A full transcript will be taken, which 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 you will be able to revise any minor errors. The session is on the record. It is being webcast live and will subsequently be accessible via the parliamentary website. Would any of you like to make any opening remarks?

Mark Hoban: Perhaps by way of introduction, I chair the International Regulatory Strategy Group, which is sponsored by the City of London Corporation and TheCityUK. It has spent the last year looking at the post-Brexit arrangements for access to EU markets and the impact on international regulatory engagement for financial services post Brexit. It has also just commenced some work looking at the engagement between UK businesses and UK regulators post Brexit.

Rachel Kent: I lead the global financial institutions sector at law firm Hogan Lovells. I have been involved either in chairing the working group or, in the main, in scribing the three reports that the IRSG has produced on Brexit but with a particular focus on market access.

Catherine McGuinness: I am the policy chairman at the City of London Corporation, and we come at the Brexit question from two main angles: first, through the work that we do to support and promote the financial and related professional services sector and, secondly, as curator of the square mile and as a significant property investor in both the square mile and central London. We help to provide the infrastructure for the sector, and we have a particular interest in how the sector fares. What I will be saying today is what we are hearing from the sector.

Q20 The Chairman: Thank you. I will kick off with a rather general question. Briefly, what are the key priorities post Brexit for financial supervision as well as regulation, and do you think your priorities diverge on where the regulators may wish to be and where you wish to be?

Mark Hoban: I am sure we will come on to the agreement that we are talking about, the free trade agreement, but the financial services sector is very interested in ensuring that post Brexit we have well-regulated financial markets in the UK and that it continues to be attractive as a venue for businesses from across the world to locate themselves. It is very clear from talking to members of the IRSG and to City businesses that they are not looking for a bonfire of regulations post Brexit. They believe that strong regulation is an asset for London post Brexit and would expect the regulators to continue in that vein.

One of the challenges for the regulator and the sector post Brexit is international engagement and ensuring that there is a strong framework of global standards into which the UK and the EU 27 standards come to fit in the future. At the moment, I see no divergence between the views of UK financial services businesses and the regulators. There is one point of detail that I would flag, and that is the position of the branches of EU 27 institutions that are based in London. There is quite a lot of concern from those institutions about their future regulatory supervision and an appetite to continue with the existing arrangements that are in place.

Catherine McGuinness: I completely agree with everything that Mark has said. What people are looking for post Brexit is certainty, stability and proportionality. We have to remember that it is 10 years since the financial crash, and they have accommodated a large amount of new regulation that was brought in in response to the crisis. People are definitely not looking to see that rolled back, and they are not looking to see any lessening of standards, because one of our USPs as a sector is prudence and good regulation.

When people look to the future after Brexit, they are looking for a framework that is fit for purpose, and there are questions that we may need to ask, such as whether the current regulatory structure will operate effectively post Brexit when it is untied from the strong links that it has had for all these years with the Brussels arrangements. Part of that, of course, goes to the question of global co-operation, and part goes to looking at how our system is set up and how it will operate, which is a future work strand that the IRSG will look at. There are also issues relating to the withdrawal Bill that we need to look at very carefully to make sure that we are not hardwiring into primary legislation issues that then become too unwieldy.

The Chairman: We will cover that a little later. Briefly, Mr Hoban, what do we expect the timings on that future work strand to be?

Mark Hoban: We hope to publish it later this year. This is quite an interesting piece of work. In my own experience, having been the City Minister for a couple of years engaged in Brussels, the rule-making process that we have been through in the post-crisis period has been very much a political and legal process in which UK Ministers, through the Council of Ministers, have had a voice and a position in the debates. MEPs have also had that voice through the co-decision making process.

As we revert back to pre-crisis mode with FISMA, clearly the role of Parliament is much less. It sets the perimeters and powers of the regulators, but it does not get involved in detailed rule-making unless there is a requirement to amend such instruments. That dynamic post Brexit looks quite interesting, particularly—I know we are going to touch on this later on—the model that we are proposing on access. A decision by the regulator to diverge materially from regulations made in the EU 27 could close off access to markets, so thinking about how those powers are exercised is quite important.

The Chairman: We are going to cover some of that later. I was trying to work out the chronology, and as our inquiry is proceeding apace we have to look at the evidence before us quite carefully. Are you able to indicate slightly more clearly when you think your next report might be available?

Mark Hoban: I have been as clear as I can be. If I explain how the IRSG functions, it will give you some clarity as to why I am not as clear as you might like me to be. The IRSG is cross-sectoral.

The Chairman: Yes. We know that.

Mark Hoban: It is UK, international and European-owned businesses. We work on a basis of consensus, and some of these challenges are quite difficult to resolve. Our aim is to complete it as quickly as possible, but that is why I cannot be clearer.

The Chairman: I think we have the flavour of your dilemmas.

Rachel Kent: Briefly, the main point is the consistency of agreement, both on the issues and on the models being proposed. Mark has just mentioned that the working groups looking at the proposals are cross-sectoral. They are also quite large. In a sense, it was very good to get a very good range of views. However, I cannot emphasise enough the degree of agreement on the end product from the industry.

Moving on from there, to answer your question, we have had excellent engagement with the UK Government and regulators, and both have been instrumental in feeding in at a more detailed level some new ideas that we might think about, so there has been very strong engagement there.

The Chairman: Do any of you have any views on the resilience of the financial services sector post Brexit in relation to regulation?

Catherine McGuinness: A great deal depends on the arrangement that we strike, and if we can reach the agreement that the IRSG proposal put forward, we would be in a very good place. A lot also depends on how we get there. We cannot stress enough the importance of agreeing fairly early on a transition period, and time is becoming very critical on that. We need it for two reasons. One is to ensure that people are not making suboptimal decisions that fragment the market unnecessarily. The second is so that we can move smoothly through to the next stage. The resilience depends entirely on what we finally agree.

Q21 **Baroness Liddell of Coatdyke:** I want to talk about the market access issues. We have heard from quite a lot of people, and it has also been in the media, that the equivalence regime is not enough for what is going to be needed in the future. I am anxious to know what would be a durable and appropriate basis for access, so it would be useful to start with where the current regime is deficient in relation to third countries and to get your view on how an enhanced regime could be built around the existing legal framework.

Mark Hoban: The equivalence regime as it stands now is very patchy. It does not cover all financial services or products, and there are gaps. For example, there is no equivalence regime for CRD IV or for UCITS. Even where there are equivalence regimes, they vary from directive to directive, so there is no consistent basis on which to access markets. They are unilateral in that equivalence decisions are made by the Commission and it is a process that they are in charge of; it is not a mutual process. Our concern is therefore—and it was set out in some detail in the first report that Rachel led on—that the equivalence regime does not provide the certainty or coverage that we need to enable continued high levels of cross-border business to flow between the UK and the EU 27 and vice versa.

Moving on to an enhanced equivalence model sounds attractive. I have spoken to a lot of people about it and there are some challenges with it. First, to create that model you need to have agreements through the co-decision-making process, which in itself is challenging. It is a model that would then become available to other third countries. It would not just be a bespoke UK model, so there would be some resistance perhaps to creating a model that would apply to the US, to China, to Japan et cetera. With enhanced equivalence, it would still be within the control of the Commission to determine equivalence, and it would be subject to the ECJ.

In the context of the red lines from the referendum result, the UK would still be a rule-taker in that model. You have people talking about building on enhanced equivalence, but that requires the enhanced equivalence process to happen and go through the European parliamentary decision-making process, and a separate agreement to be made with the UK as part of a free trade agreement. There are significant concerns across the sector that that is simply not going to be a workable basis, which is why we proposed the free trade agreement model in the paper that we published in September.

Rachel Kent: I would like to underline one point and perhaps add a second point on those red lines. Mark has already said that under the equivalence regime the development of EU law would operate exactly as it operates today but we would not be at the table. Therefore a decision on what that law is would be made, and in essence we would be told to apply it, so the sovereignty red line that Mark has indicated is one.

The second one that I would highlight is that at least the first part of that regime—the concept of enhanced equivalence via an expanded third-country regime—would, in my view, have to be implemented via EU law, and EU law can only be interpreted by the ECJ, which is of course a second red line for us. I would flag those two as the main issues. There are others.

Catherine McGuinness: The only point that I would add to my colleagues' is that I participated in a conference yesterday in Dublin. One of the central bankers from Ireland there said that in his view the existing

models would not be adequate for Europe either, because of the interconnectedness and the global nature of the sector.

Q22 Baroness Liddell of Coatdyke: I have seen your proposals for an FTA. That process of transition and implementation looks particularly complex before you get to an FTA. I take it you would envisage operating within the existing parameters of the regulatory regime?

Catherine McGuinness: What would be ideal for transition would be a two-phase transition. The first phase, in effect, would be a standstill, so that people are operating under the current system and the current regime while we find out what the next stage that we are moving towards is. The second would be a proper implementation phase moving smoothly towards that final stage.

Baroness Liddell of Coatdyke: The \$64,000 question is: how long do you think that would take? How long do you need?

Catherine McGuinness: That is a very difficult question. We need to focus on the end goal that we are trying to get to, and I understand, of course, that there are political issues surrounding how long that transition needs to be. It is very difficult, especially when negotiations are moving so slowly, to say, "Yes, of course we could achieve this within a set timeframe".

The Chairman: Mr Hoban, do you have anything to add on Lady Liddell's question on the FTA?

Mark Hoban: I was going to add in relation to the timescale of the transition that realistically we are not going to get more than two years. For a whole range of reasons, the process of creating the new set of arrangements should be completed by the end of March 2021.

Q23 Lord Desai: Would it be better for us to ask for a bespoke agreement rather than going down the equivalence route? Will it be feasible for us to get there, and will Brussels, the Commission, the EU 27 and so on like to offer us a bespoke agreement?

Rachel Kent: On your first point, we are absolutely of the view that a bespoke agreement would provide the most optimal outcome for financial institutions on both sides of the border. Critically, our proposal would provide mutual access, EU firms into the UK and the UK into Europe, continuing the existing regime. That would obviously avoid the relocation cost and the potential double hit on capital, which would be very inefficient, so critically it provides access.

In summary, the key characteristics that would need to go with the grant of access are regulatory alignment—I am happy to talk about any of these issues further—but a degree of regulatory alignment that is not the rule-taker concept that we spoke about a moment ago. It is principles-based but critically done by agreement. Therefore, it is regulatory alignment and, of course, on day one we would be aligned by virtue of the withdrawal Bill, so that should ease some of the transition-timing

concerns that were mentioned earlier. The focus would be on managing divergence via an outcomes and agreement approach.

We heard strongly from regulators on both sides that there is no point in having regulatory alignment without having supervisory co-operation. We are anticipating a bit of new infrastructure in the form of a regulatory alignment forum to oversee whether divergence is happening in an acceptable way or not and to collaborate on matters of supervision. These matters would be both at policy level, such as whether new policies need to be developed to accommodate new risks posed by FinTech, and at the level of individual member firms.

Finally, free trade agreements frequently have dispute resolution mechanisms. They are frequently an independent body. They are not normally the ECJ, which is entirely consistent with our proposal. That is a separate body, whose focus would only be on whether the terms of the free trade agreement had been breached by material divergence, but that would be judicial in nature and binding, and as Mark has already said the consequence of that breach would in extremis be the withdrawal of access, at least in relation to the part that the divergence affected.

Moving on to your second question as to whether the EU would like to give us this, maybe this has to be answered in two different ways—and my colleagues will undoubtedly have a view. I mentioned our engagement with the UK side earlier. We have already had engagement over a period of many months throughout these reports. It has been a journey, and I should flag that, like everyone, we are currently facing resistance from the EU to discuss anything in detail about the future relationship pending the completion of the phase one issues, so I cannot stress enough that nothing that has happened amounts to the negotiation of phase two. We have, however, had the chance to present our report and the ideas in it.

The Chairman: To whom?

Rachel Kent: To members of the EU 27, to the Brussels institutions and two members of Barnier's negotiating team on an information-provision basis. That has been welcomed on the basis that it is a piece of work on a potential solution that can be discussed at the appropriate time and taken forward or substituted as appropriate. I am feeling optimistic that it can be something of a sounding board or a starting point for discussion when the time comes.

Mark Hoban: The credibility that the IRSG brings to its membership adds weight to conversations in Brussels. This is seen as a very serious piece of work, but the credit for that is not with me but with Rachel and her colleagues, and you get very little push back. To go back to Baroness Liddell's other question on enhanced equivalence, it is quite interesting that no one says, "Why do you not do enhanced equivalence instead?" because they all recognise the flaws. This is filling the intellectual space, space very well.

There are two other points that I would make. First, while this is a financial-services driven approach, it applies potentially to other highly-regulated sectors, where access to markets is based on regulation, so there is a read across there. Secondly, the balance that we have struck is that the concepts that we use are very familiar to trade negotiators. As part of the journey that we have been on, moving from financial services regulation to trade, that trade language resonates. What is novel about this is its application to financial services, and that is where the challenge is in selling this to others.

Q24 **Baroness Neville-Rolfe:** I wanted to press a little more on how the UK Government persuade the Commission and other member states to agree to a bespoke agreement. Objectively, what do the other 27 need and want? You put forward a proposal, which is a good way forward, but you need two to tango, and I would like to press you on that.

Mark Hoban: It is a good question. This goes to the heart of articulating why London is Europe's global financial centre. London brings with it a whole series of benefits that come from having a comprehensive ecosystem. No other financial centre in Europe has the same ecosystem. A report by TheCityUK earlier this year demonstrates that, across the range of sectors and subsectors within financial services, the UK comes in the top three in all bar one of those sectors. We have to go out and sell London as a European asset. We are conscious from some of the conversations we have had that there are countries where businesses have quite sophisticated financial needs that are not met domestically, and they look to London to meet those needs. There is, therefore, a benefit to their corporates from accessing London, and those benefits would be lost to them if they did not have access to the same degree that they have at the moment.

It is really about trying to make the pitch that this is not about harming London, but the lack of a bespoke deal that guarantees a high level of access will harm their corporates and their consumers, and that has been a recurrent message that we have tried to get across. I know that AFME, which is going to give evidence later, also did a lot of work on this, which will help supplement that point.

Q25 **Lord Haskins:** I want to get on to the European Union (Withdrawal) Bill. My MP, David Davis, seems to suggest that this is a rubber-stamping exercise and that it will not create any excitement, but we are being led to believe from other sources that it is rather important to the financial services as to how this works through in various ways: first, the impact that it may have on a negotiated agreement further down; secondly, the relationship between legislation and rule-taking as to how that impacts. As part of that, do you have a view on whether Parliament is properly scrutinising the process and understands the state of the importance of this process? We have given the impression that it is of a high degree of urgency that this matter is resolved sooner rather than later, but I do not know that the Government entirely appreciate that.

Catherine McGuinness: Let me start by saying that I am not an expert on the detail of the withdrawal Bill, but I can come back to you on some of the detail. There are issues around it that we need to look at very carefully. As I said earlier, we need to look at the question of whether it is going to be hardwiring into primary legislation issues that should not be in primary legislation but should be in the rulebook or elsewhere and need a bit more flexibility. We may be untying ourselves from Europe but imposing a heavy hand of legislation on issues that should not be there.

On the question of scrutiny, there is a question of parliamentary scrutiny, and of course that is a big question, but there is also a question of engaging the sector in issues that might affect it. Often the expert advice that you will get will be when you consult the actual practitioners in the field. The process as it currently works does not appear to leave space for that, and that could do with exploration.

Rachel Kent: I believe it works very well with the model that we just outlined, for two reasons. The first is principally because it happens to provide very neatly the day-one alignment that I mentioned. Whether under the equivalence process or looking at other free trade agreements that exist, there has to be a heavy focus on how you bring laws into alignment. A great deal of the provisions are taken up with that concept. I believe this is a very neat way of dealing with that issue and getting us straight to that point. Those provisions for financial services would then stay in force unless we either agreed on a managed divergence process basis to make those changes, and then it would be a matter of normal EU and UK domestic law change, or we decided that we did want to diverge and change our law anyway and risk the access point I mentioned. I do not think, however, that the withdrawal Bill would cause a problem with our model.

Mark Hoban: The industry wants certainty and stability at the point of exit. It wants to make sure that EU law is transposed into UK law at the point of exit. It is very concerned about what was termed in a piece of work that we did with Linklaters earlier this year “inoperables”. There are references in EU law to EU institutions, so what replaces those? The sooner we have clarity on those, the more confidence the industry will have in the stability and certainty of regulation post-Brexit.

My concern would be that, while I understand the arguments about Henry VIII powers and things like that, if this Bill is used as an opportunity to unpick regulation, that would be to the detriment of that stability and certainty. The big principle arguments should be had, but this should not be an opportunity to make minor tweaks to policy that are not necessary in order to make sure that the legislation is implemented.

Lord Haskins: Is this an interim process? You mentioned that when we get into new trade agreements with others, all this will have to be looked at again.

Mark Hoban: Yes, it is. This gets us to the point when we depart.

Lord Haskins: But no further.

Mark Hoban: But no further, which is why we are doing work on the post-Brexit regulatory arrangements in the UK: to understand how those rules continue to evolve post Brexit.

Lord Haskins: Do you think that the process of this Bill will in any way clarify long-term positions as to where the Government stand, because we do not know where they stand on any of these issues at present? Will the process of this Bill help?

Mark Hoban: I hope it will entrench a status quo rather than be the forum for new policy-making. The Government need to think about some of these issues but in post-Brexit legislation rather than getting wrapped up in the transition Bill.

Lord Haskins: Do you think that you can almost overwhelmingly just replicate the status quo? Will it not, by the process, require further changes?

Mark Hoban: There are certain gaps, such as EU institutions regulating trade depositories and credit rating agencies, so we need to work out what the UK mechanism is for that. There are reporting limits on MiFID II, for example, that we will need a UK definition of, so there are lots of inoperables. I would not say that this is a small task, but with good engagement with the regulators, government and industry we will get a very satisfactory outcome that will create the right atmosphere for financial services to continue in the UK post Brexit.

Catherine McGuinness: Just replicating the status quo is in itself quite complicated, and I know issues have been raised by a number of people on whether the Bill as it currently stands would just replicate or whether it would have unforeseen consequences. That needs to be looked at carefully. That is one reason why, when we did the piece of work with Linklaters, we were proposing a rather more generic approach to the way the acquis would be domesticated. I accept that that has not been adopted and we are moving on, but the key concern that we hear from the sector is for clarity, certainty and stability, and just knowing that there are not going to be tweaks and changes—that we are going to be faced with where we are at the moment, and then we can move forward as we develop the new framework or the new goal.

Q26 **The Chairman:** Of course, the European Parliament plays a very active role in the formulation of regulation. Do any of you see what kind of role the United Kingdom's Parliament might play? Would there be space for scrutiny, or do you want transposition directly into rulebooks without parliamentary input? This is, of course, a point of some interest to us here.

Mark Hoban: That is one of the fundamental choices. Is there a direct read-across between directives and primary legislation, between regulation and secondary legislation, between some of the guidance that the various ESAs produced and then the rulebooks? At one level that all

sounds very logical, but it does not sit within the framework of the Financial Services and Markets Act, so it does not fit within the existing parliamentary process and it does not fit within the UK legislative process. That is why the direct read-across from EU structures of rulemaking into UK structures does not quite work.

In thinking about the transposition and nationalisation of the *acquis*, we need to think quite carefully about what is in the directives. If you were to implement that directive in the UK, what is for primary and secondary legislation properly in the FISMA framework and what would go into the rulebook? I would hate to burden your Lordships with more scrutiny of the thousands of pages of EU regulation on financial services.

Q27 Lord Woolmer of Leeds: You have all explained that you see the following process: there needs to be an agreement on something by March 2019—a heads of agreement, as it were—and then there would be up to two years maximum of what is being called a transition period in which an agreement would be fleshed out. The industry then wants a period of implementation, which could be another two years or so. My first question before I ask the more substantial one is: is that the picture that you are presenting to us?

Catherine McGuinness: It is difficult without knowing where the end goal is, but the key point about transition and knowing now—and I mean now, as soon as possible, such that there will be further time to work this through—is that if we do not have that, people will be implementing contingency plans. They may be doing that prematurely and sub-optimally in ways which will damage the sector, and the EU 27 as well as us, more than it needs to. In a sense, what we are really saying is that we need the certainty now that there will be that period. We are not then saying that it will then take four years or whatever to get to the end state, because that depends on the end state and how far we get with negotiating that. We do feel from all that we are hearing that the next few weeks are a critical time to get clarity around transition if we are not to see unnecessary moves.

Lord Woolmer of Leeds: But the transition is from an agreement on exit terms and the final detailed arrangements. What is it that you expect or want the Government and the EU to say with what legal force by the end of March next year?

Mark Hoban: Can I answer the question in a slightly different way? Transition has become a great word to cover lots of different things. We tend to use transition to cover two elements: one is a standstill period and one is a period of adaptation. The standstill period would be from the point at which we leave, in March 2019, to the point at which a bespoke deal is agreed. Then an adaptation period would be from the point where the bespoke deal has been agreed to a point where everyone is confident all the necessary legal processes have been completed.

The Prime Minister has been very clear that she believes that the bespoke deal will be concluded by March 2019. On that basis, the standstill

agreement would not be required; we would go straight into the implementation period. If the Prime Minister was not able to achieve her goal, we would need a standstill agreement from March 2019 to the point at which she agrees the bespoke agreement, and then the implementation happens. How soon we get the final deal determines how long the transition period is and whether the balance is with a standstill or with a standstill and an implementation period.

In terms of certainty, it is very clear when I talk to businesses across the City, the greater the certainty that there is about the transition and the nature of the transition, the less impactful the uncertainty will be on business. Businesses are starting now to move people. A lot of them have already bought leases on properties across Europe. Businesses already have their plans in place and they are starting to implement them. The value of transition diminishes over time. A transition agreement signed in March 2019 is of less value in terms of protecting jobs and access and benefitting consumers than a transition deal agreed by the end of this year. That is why you saw the pressure from the industry yesterday, with TheCityUK, the Governor of the Bank of England and Xavier Rolet, the chief executive of the London Stock Exchange, all weighing in about needing certainty as soon as possible to minimise the damage to London as a financial centre and to our customers both here and in the EU 27.

Lord Woolmer of Leeds: But anyone on the two sides can say, "If there is agreement on heads of terms by March 2019, there will be a transition period". That is easy to say, but difficult in practice. However, what do you want to be said by March 2019 that adds much more reassurance than that? To be meaningful, you have to agree what you are transitioning to. Are you saying that by March next year the industry wants the Government and the EU to have effectively agreed the principles that will lead to two years of negotiation to an FTA? Is that what the City wants? What can possibly be said by March next year?

Mark Hoban: There could be an agreement that there will be a standstill period up until the point where the free trade agreement is signed. That will give confidence. An agreement in principle from the EU 27 that there will be a transition period would be very helpful. There is a continuum from a planned statement in a communiqué to something that is legally watertight and, frankly, for the industry, the closer we are to legally watertight, the better—and the sooner, the better.

The Chairman: Your timeframe for your planned statement in the communiqué would therefore not be March 2018 but very soon. This side of Christmas perhaps.

Mark Hoban: The sooner it is, the better. That is the reality of it, and the later we leave it the greater the flow of jobs out of the UK and the greater the disruption to the clients of the financial services businesses wherever they are, so the sooner, the better, frankly.

Lord Butler of Brockwell: Is there a similar incentive for the people we are negotiating with? It might be thought that they would be very

pleased to see jobs going from the UK and, therefore, they will not be in a hurry to agree that there will be a standstill period after 2019.

Mark Hoban: There are two points I would make. The first is that there is no guarantee that the jobs will go to Europe. One of the messages that comes back from financial services businesses, given the pressures they are under, is whether they want to deploy the capital they have in Europe or whether they will go to the Far East or the US, where perhaps the returns might be better. There is no guarantee that there would be a straight shift from London to the EU 27.

The second thing, of course, is that we see this very much through a financial services lens. There will be other industries where there will equally be incentives on the other side for there to be transition. However, the people who are hurt the most by a lack of transition are the customers of businesses, and that is the argument that is important to make. This is not a self-serving protectionist argument for London; there is value to be had in providing stability and continuity of service for all our customers.

Q28 Lord Bruce of Bennachie: You have hinted at or answered some of the questions, but you have also raised some interesting ones. Mr Hoban, you have given a very powerful case for why the City is important to its customers, including EU customers, but the question then is, post Brexit, how do we engage internationally? Are we going to be in a good, close relationship with the EU when we are developing regulations? We have led them, we are told, or will we be looking for different arrangements, which could create divergence? We have had speeches from Government Ministers saying we want to be Singapore, which I guess does not assure our negotiating partners of our intentions. How do you think we should be presenting the future international engagement, and what is the role for the industry as opposed to just the regulators?

Mark Hoban: The UK plays a significant role in the shaping of global regulation as well as European regulation, and Mark Carney's chairmanship of the FSB is a sign of that. In a post-Brexit world, that global regulatory framework becomes more important for the UK. Post-crisis regulation in Europe has predominantly been through the implementation of the Pittsburgh G20 commitments, so we have had a chance to influence their implementation through that process in Brussels. Once we are outside the EU, we will not have that opportunity to shape what happens in Brussels to the same extent, so the coherence of the global framework becomes important. It is interesting that Andrew Bailey gave a very powerful speech in Berlin this year, which we reference in our reports, looking to the global architecture as a basis of mutual recognition of regulated standards, and that is a very good sign of where we should be.

The Singapore-on-Thames argument misunderstands the nature of the regime in Singapore. Businesses come to London because of the strength of the regulatory system. We have transparent, fair markets. We have well-qualified regulators, who are managing one of the world's most

sophisticated financial markets, and that gives businesses the confidence to come and trade here. We cannot afford to undermine that confidence if we are to continue to be a global financial centre. TheCityUK produced a report earlier this year in association with PwC that said we need to build our relationships with other financial centres outside the EU 27 to a much greater extent than we have now. This means recognising that London has a distinctive ecosystem—a distinct range of products and services that can be used to help foster development in other countries and as a means of allocating capital from surplus economies elsewhere in the world to those looking for investment. We need to emphasise the international side of London as well as the European side.

Catherine McGuinness: We will need to find our individual voice on the state of global regulation again. What is made clear to me when I talk with EU 27 counterparts, for example when we have the financial dialogues that the Corporation and TheCityUK help to run, is we are a very valued voice on the regulatory front because of the experience we bring, because of the connections with the sector. At the moment we need to look a little beyond the Brexit bubble that we have got ourselves in to. Of course, we spend a lot of time focusing on and talking about Brexit and perhaps not focusing on what the sector is doing for the ordinary customers that Mark was referring to a minute ago. I went to Bulgaria a couple of weeks ago, for example. Making the case of the importance of this sector for customers in Bulgaria is quite important, and important when it comes to the regulatory dialogue, because it establishes why what we are doing is an important factor to bear in mind in framing regulation. I would highlight the regulatory sandbox as an example of where we are ahead of a lot of the rest of the world and we have something to say very positively.

Lord Bruce of Bennachie: Can we present that in a positive way to the EU? To put it crudely, the message we get from the City is, “We are bloody good at what we do. People would be crazy not to deal with us, so it will be fine”, and some of us are not convinced that that is quite sound enough to get to where we want to be. We equally know the EU are saying, “There is an opportunity for us to steal stuff from London and we are going to go for it”. In reality, are we going to be able to create a space where, hopefully, we can be influencing international standards and they can become the basis for the agreements that we have with the EU, and where the EU will see that as beneficial and engage with us? We will not have the same influence that we had inside, but will we be able to continue to have a significant role and even persuade the EU that having that role through the UK is helpful to them? That is an optimistic statement, but do you think there is any possibility of that being achieved?

Mark Hoban: I do. I used to go to ECOFIN occasionally, representing the Chancellor, and you realise that the UK’s voice in ECOFIN on financial regulation was listened to because we have authority, expertise and a set of skills and experiences that others find it hard to replicate. From talking to member states now that we are leaving, particularly the smaller

member states, I know that they will miss that expertise. The contribution we make to the ESAs will be missed, so there is a continuing interest on both sides to find a mechanism or a vehicle that continues engagement. We will not have a vote, but we will have an opportunity to shape each other's thinking. The model that Rachel outlined earlier on about the alignment forum could help provide that way we can lock together.

Lord Bruce of Bennachie: Are we going to be able to continue to be leaders in influencing international standards as we have been in the EU? Given that the Government in the United States seem to have a slightly different agenda, will that make it more or less difficult to ensure that international standards can be the basis of our equivalence and that the UK continues to be an influential player in getting the right outcomes?

Mark Hoban: We are going through a period of significant change in global regulations, which is partly a consequence of the US regime and partly because of Brexit. Those who believe in the benefits that come from global markets need to continue to help support and shape the future global regulatory regime.

Catherine McGuinness: When we talk to our counterparts from the US—we spoke recently with Chris Giancarlo from the CFTC—we do not get the message that they want to move away from a sensible regulatory coherent framework. You have a point that the sector needs to prove its usefulness and it needs to prove its usefulness not only to the EU 27 but domestically, which is why making the case about the customer and what we are providing for the customer is important. In the next session you might also want to explore a capital markets union and what we might offer to that, even from outside.

Q29 **The Earl of Lindsay:** I wanted to move on to supervisory co-operation and ask you how you see joint supervisory activity in a post-Brexit scenario working if, for instance, there was a crisis with a central counterparty having a cross-border failure. You might also comment on the enthusiasm or otherwise of the industry for joint supervision in the future.

Rachel Kent: As I mentioned very briefly earlier, the concept of supervisory co-operation is absolutely built into our model. It was not built into our model at the outset. This was specifically something that arose from speaking to regulators on both sides, so there is acknowledgement that there is no point in having alignment if you do not implement and enforce those regulations in a consistent manner. That was certainly signed up to by the industry.

That is easy to say. It will still require a great deal of clarity over who is responsible for what precisely. We, of course, already have under our passporting regime—I am oversimplifying—but the concept of home-state responsibility for prudential supervision and host-state responsibility for conduct of business supervision. That is a simple way of putting something that is a bit more complicated, and so that would have to be

worked through to be clear about that, but I would say that is not a major departure from where we are today. Of course, the UK is not in the single supervisory mechanism, so there are already formal arrangements in place for that.

On a day-to-day basis, there needs to be proactive collaboration on the policy in the individual firm. What was brought home to us again in our discussions with people in the EU and the UK is that, in the event of an actual crisis—let us say of a bank or a major financial institution in the first instance—of course you would want to have arrangements in place to ensure stability and to enable everybody to understand what is going on. It is not that the collaboration would finish at that point, far from it. I am sure it would intensify. The key point is that he who has fiscal responsibility—he who will end up bailing out the institution should that ultimately be what is required—has the responsibility for taking that decision and that that decision is not a joint decision.

You asked about clearing. I am not the world's leading expert on clearing, but of course there are particular issues in relation to clearing houses because they are structured slightly differently, so they tend not to operate cross-border in the same way that financial institutions do. At the same time they can give rise to other issues such as the exposure to the euro and causing potential issues with liquidity in the euro in relation to euro-denominated instruments. There are special circumstances there, but in essence the solution is similar: supervisory co-operation, albeit, in the case of CCPs, with the probable extension—I believe the term is enhanced supervision—between the two.

The Earl of Lindsay: I think you are saying that, from the industry's point of view, continued supervisory co-operation is a good thing. Given the plans that there are perhaps for increasing the responsibilities and powers of the ESAs in future, would that change also be welcomed by the industry, or would there be concerns about that?

Rachel Kent: We did not hear concerns about that from the perspective of the UK industry, because of course, at least in the UK, they are not subject to that regime, nor does it need to be prejudicial to the concept of supervisory co-operation between the two. As I say, it would be much more complex; if we were in the single supervisory mechanism and subject to the ESA regime, taking us out would be complex. As it happens, we have arrangements in place to have that co-operation anyway. I personally do not see that a change on the EU side needs to affect their relationship with the UK, for example.

Q30 **Baroness Neville-Rolfe:** Is there scope for the UK to innovate on financial services and financial services regulation under your model? You mentioned the regulatory sandbox with approval, but how do we look after our leading FinTech companies and how do we develop new innovations in future?

Rachel Kent: We hope we will continue to innovate. It is a matter of personal pride probably for everybody in this room that the UK is

currently regarded as the FinTech capital of the world, principally because of its favourable regulatory regime. By favourable, I absolutely do not mean light touch; I mean right touch. I would absolutely like us to continue to innovate, and absolutely certainly having ideas and influencing global standards in the way we have already discussed I hope would continue. It is absolutely the case, you will see from what I said earlier, that at least if we are to maintain access there will need to be a degree of agreement and alignment, and so our innovation would need to be consistent with that. I would ask you, however, to think about our current regime, which, as I said, is highly regarded throughout the world. I am lucky enough to be talking about exactly that in many cases across the globe, so I can say it for sure. We are in that position subject to an obligation to incorporate EU law. There are things like the regulatory sandbox that the FCA have proposed, the Bank of England's regulatory accelerator, and the proposals by Innovate Finance at the request of the Government in relation to a broader industry sandbox to expand that concept. All those things have happened or continue to happen within our existing regime.

It has to be said that I recall Chris Woolard at the FCA saying, when the regulatory sandbox first appeared, that there were things that they had considered doing that they were not able to do because they would have been inconsistent with EU law. I do not recall whether he was specific about those, but they would have been things like we could not say, "Come into our sandbox and you do not need to be regulated for six months, or we will waive capital requirements". We could not do that because of EU law. However, it was not clear to me whether the FCA was simply making the point that there were some constraints and parameters within which they had to live, or whether they were saying that clearly they would have waived capital requirements if they could have done. I may have chosen two emotional examples, but I have not heard a railing against the existing regime preventing us from facilitating FinTech.

The Chairman: Thank you for that. Miss Kent, do you have any other thoughts on that? If so, please send them through in writing, and likewise for our other two witnesses today. We have come to the end of our session. Did you have any concluding brief thoughts that you want to share with us?

Mark Hoban: I have shared enough with you already.

The Chairman: Thank you, Mr Hoban. It has been very fruitful for us.

Catherine McGuinness: Thank you very much for listening to us. I would just stress that point about transition again.

The Chairman: Indeed, and do feel free to write to the Committee should you wish to. Thank you very much indeed. It has been a good session.

Examination of witnesses

Simon Lewis and Stephen Jones

Q31 The Chairman: Can I welcome Mr Simon Lewis and Mr Stephen Jones to our inquiry on regulation and supervision of financial services post Brexit? I note that you both heard the previous session so you will be extremely familiar with some of our concerns on this Committee. I wondered whether you wanted make any opening statements. Mr Lewis, I think you indicated that you would like to.

Simon Lewis: Thank you, Lord Chair—if I may, briefly, yes. I am Simon Lewis, CEO of AFME, the Association for Financial Markets in Europe. We are a pan-European trade group, so we represent a broad array of European and global participants in the wholesale financial markets. Our members include banks with headquarters and operations not just in the UK but in the EU 27, the US and Asia, and we see our purpose as serving as a link between capital markets participants and policymakers in both the UK and the EU.

Perhaps I may make three very quick points. Firstly, as you have just heard in the previous session, we have produced a recent report to understand the potential impact of Brexit on the end users of financial services. It is very easy to become focused on the industry, but this is about end users including corporates and SMEs. The process of the UK withdrawing from the EU and the forging of a new relationship is going to impact the real economy and jobs and growth. This is also consistent with the capital markets union project, of which we are very supportive.

Secondly, as you heard in the previous session, we need certainty as soon as possible on transition arrangements. I think we are only a year away from the deadlines set by Michel Barnier for concluding negotiations to allow for ratification. We also need a period of time to bridge and then adapt to future trading agreements, and in the meantime our members are planning for the worst and hoping for the best.

Thirdly, I would like to stress the importance of providing certainty for trade in cross-border financial services. The term of a significant volume of contracts between UK-based banks and EU customers will continue beyond March 2019. We believe that such contracts should be grandfathered to provide certainty to all parties. Throughout the Brexit process we need to maintain efficient, pan-European capital markets, because they are vital to developing and delivering sustainable growth and jobs for Europe.

Stephen Jones: If I may, I will introduce UK Finance. We are the new trade association that brings together six predecessor organisations. We came into existence on 1 July and represent 250 financial services groups based in the UK, both domestic and international retail, commercial and wholesale, covering also cards, payments and asset-based financing. We have subsumed within us predecessor organisations that you will have heard of such as the Council of Mortgage Lenders, the British Bankers' Association, the UK Cards Association et cetera.

I have a couple of points following on from the previous session. We do not think it is realistic to expect the UK to have complete freedom to regulate financial services while at the same time affording UK financial services firms levels of market access to the EU comparable to those we enjoy today. That is a fundamental choice that we need to address. The EU applies the concept of equivalence, as you know, to determine access to the EU market for non-EU firms in some areas, but we do not believe that that is a feasible basis for a cross-border trading relationship that retains many of the benefits of the current EU/UK status. We do think that there is scope to be more ambitious than a base-level equivalence deal.

Within the general prudential landscape that they cover, there are gaps in international frameworks for financial services regulation, which are generally pretty detailed, but we believe the priority is maintaining consistency as much as possible on a cross-jurisdictional basis, because that is what facilitates the cross-border and interconnected nature of the wholesale financial marketplace in particular. The question of whether it is in the EU's interest, therefore, to diverge from an EU rule framework will really depend on the impact on trade or the treatment of UK operations inside the EU that we are willing to contemplate.

Finally, we believe that any deep cross-border relationship between the EU and the UK after Brexit will require mechanisms for scrutinising regulatory convergence and divergence between the two parties and will be backed up by a clear process for enforcing commitments and resolving any disputes. May I suggest that parliamentary scrutiny should remain an important part of that process?

Q32 The Chairman: That is very interesting. Thank you. We have all had sight of both your papers, the written evidence submitted, so we are in that sense a little familiar with your thinking. I wonder, Mr Jones, if you would kick off by telling us what a good outcome for financial services looks like, and to what extent have you picked up differences between what we think would be good and what the EU 27 think would work?

Stephen Jones: If I can answer that question in a relatively neutral way, really what is important for entities conducting business on a cross-border basis, financial services or otherwise, is certainty. Businesses are remarkably adaptable and they can adapt to new environments. The struggle at the moment that many industries have is not knowing the future environment they are facing, particularly in this highly regulated financial services landscape.

The kind of certainty that we and our members believe would be beneficial is clearly a certainty that is based on high degrees of regulatory convergence rather than divergence, which has formed the basis of the post-financial crisis international regulatory framework. That regulatory convergence does not imply being solely an EU rule taker. That regulatory convergence, as the previous Committee referenced, has also been driven by the work of the Basel Committee, the work of the Financial Stability Board and the work of IOSCO across the banking

space. These are all global bodies in which the UK has a very important voice and will continue to have an important voice in a post-Brexit environment.

The Chairman: Mr Lewis, you will have a keen insight into the thinking in the EU 27, no doubt.

Simon Lewis: The first thing to say is that, looking at it from a pan-European point of view, avoiding fragmentation is very important. We have spent a long time developing integrated capital and financial markets in Europe, including the single market itself, and avoiding fragmentation is a very important and good outcome. Secondly, maintaining access to global markets, as we have heard already this morning, is such an important part of our industry and what we need to deliver to our customers—ensuring we maintain that access. Thirdly, and I am sure we will come back to this, good outcomes have to include early decisions on transition and what follows that.

Q33 Baroness Liddell of Coatdyke: I want to return to the issue of market access. Mr Jones, in your opening remarks you said that you thought it might be possible to lead to something that was more ambitious than the enhanced equivalence regime. What would that look like and what are the options for achieving it? Could it come out of this reported review that the Commission is doing? Taking that one stage further, if you look at a free trade agreement and what is required to negotiate a free trade agreement—bearing in mind that there is very little in the way of precedent for a free trade agreement that encompasses financial services, as it tends to be physical trade that covers free trade agreements—how is all that market access story going to be pulled together and what does the end game look like?

Stephen Jones: Thank you for a very broad question. If I may start with the lack of precedent, the lack of precedent in terms of an ambitious trading services agreement reflects the fact that in previous models of trade agreements, the parties have come to those negotiations with regulations and systems that are not harmonised. The starting point that we have today between the UK and the rest of the EU is clearly a highly harmonised system.

The model that we would advocate is very similar to the IRSG approach: one based on high levels of regulatory co-operation, mutual recognition and close co-supervision where that is required. We think that there are mechanisms that can be established in order for that mechanism to be set up and in order for choices to be made, because ultimately the choice of not adhering to an outcomes-based assessment of recognition or equivalence would be losing access to the other-markets area in that particular area of business. A key part of a mutual-recognition model with close regulatory supervision is a disputes forum or a consultation forum where rules can be tested, where divergences that are proposed by both markets can be tested and where the costs of going beyond the limit of what the other party is willing to accept can be assessed and a choice made. Having that forum being able to be undertaken in a

comprehensive way, with choices made in a clear and direct way in that light, is possible and, in many senses, supervisory co-operation already operates pretty closely on a cross-border basis within the EU. My previous role was chief financial officer of Santander in the UK. We were a wholly regulated Bank of England bank: all our capital was here, all our liquidity was here, our recovery and resolution plan was here, but I was very happy to welcome the ECB in, even though we were not part of the single supervisory mechanism, in order to be able to understand Santander UK in the context of the broader Santander group, which was an ECB-regulated institution. That is a very practical, live example of supervisory co-operation that already exists within the existing EU arrangements and which, of course, could be replicated. Are there aspects of your question I have not answered? Sorry—I probably have not answered the beginning of the question.

Baroness Liddell of Coatdyke: What would be a more ambitious model of the equivalency regime?

Stephen Jones: Equivalence can result in an asymmetric approach where you become a rule taker. From our perspective, a mutual recognition model is one where you have a symmetric approach where both parties are submitting themselves to mutual scrutiny of one another's proposed regulations and both parties recognise that the consequence of not agreeing is a separation of the harmonised free services agreement that exists, provided that agreement is maintained. Outcomes-based rather than rules-based is really how I would characterise it, and within that outcomes-based approach there is room for divergence, which can be agreed because fundamentally the end outcome, the end objective, is not fundamentally devalued.

Baroness Liddell of Coatdyke: One of the criticisms that is made of the existing equivalence regime is that it can be subject to political interference. How would you get around that? Given that there are gains to be made by other member states from a change in the status of the United Kingdom, how would you stop game-playing—or, to put it more bluntly, who is likely to be opposed to what you are suggesting?

Stephen Jones: It is difficult for me to comment on cross-border politics. What I can comment on is on an environment and a structure that, absent politics that is seeking to achieve national competitive advantage, is capable of working and maintaining a global and European financial regulatory system, which has worked extremely well over the last 10 years in the post-crisis environment. We detect some degree of political will in certain parts of continental Europe in order to reclaim what they perceive might be 20 years of lost wholesale financial services to the London market. At the same time, however, we are able to engage in those markets, which we do intelligently, and remind the politicians and the businesses within those markets that the cost of fragmentation for their consumers, for their businesses, could and would be very substantial if short-term politics in order to seek to achieve short-term fragmented gain by growing domestic financial services markets at the

expense of international co-operation and agreement becomes the order of the day. It is a very short-sighted approach to negotiations, but I recognise that in certain markets it is a political reality. We are working very hard behind the scenes in some of the markets that might be tempted to take a short-term political approach to persuade them that it is not in the best interests of their economies or of the consumers within their economies.

Simon Lewis: This is an interesting idea. It is undoubtedly the case that straightforward equivalence has a lot of very significant disadvantages, and the one addition to what we have heard this morning is that you cannot even in theory make a decision on equivalence until a third country has been created. For those reasons alone, equivalence is not going to do it. We need to test whether this model or a version of this model is going to work—but, as Stephen says, the idea of something that is more flexible and less asymmetrical has some attractions from a capital markets point of view.

Q34 The Earl of Lindsay: I want to ask two questions about supervision. The first is really about the EU's plans in the future in terms of enhancing, enriching and developing supervision; the second is about how joint supervision might work post Brexit. On the EU front, having looked at your written evidence, I detected perhaps a slightly different stance between you, or perhaps a different mood. I thought you gave a more upbeat analysis, Mr Lewis, of where supervisory powers might be going, and that if they can get them right, they could achieve some additional benefits over and above what they are currently achieving. I thought, however, Mr Jones, that in your paper you were much more cautious. You were much more worried about the unintended consequences and the problems that might flow from enhancing ESA powers and ESA responsibilities in the future. Do you want to comment on that first?

Simon Lewis: Thank you, Lord Lindsay. I should say that Stephen and I work closely together on a number of these issues and we are very much joined at the hip in the broad outlook that we are trying to achieve. The ESAs—the European supervisory authorities—have been a pretty good development, founded in 2011, and the one that is of most interest to our members is ESMA—the European Securities and Markets Authority. We will probably see an increase in its powers, although it has not yet been approved by the Parliament.

The reason that is important is that for a long time ESMA has been quite under-resourced. It has had to deliver a huge amount of activity, including the MiFID rulebook, which is one of the biggest pieces of legislation we have seen in the last few years. Better resource is something we would support, and the industry ought to make a contribution to the funding of ESAs, just as it does here with the FCA, and for ESMA to play a role in some of the enhanced supervision that we have talked about already this morning, particularly in relation to CCPs, is a good thing. ESMA could also have a role to play in the equivalence discussion as well.

Finally, if we have chance to talk about it, with the capital markets union it is conceivable that ESMA could play a role in helping to take that project forward. In summary, the ESAs—and that includes of course the EBA and EIOPA—have been a positive development, and it is right that their powers are enhanced and they are properly resourced, but we still have a clear sense of how they fit into the structure post Brexit.

Stephen Jones: We would agree broadly that the EU direction of travel around the capital markets union and the European deposit insurance scheme is key to providing more diversified access to funding sources and improving a resilient banking sector. In respect of certain proposals, it is perfectly legitimate for us to suggest that those proposals might not quite work. The EU proposals for intermediate holding companies at an EU level are particularly problematic in fragmenting; they do not work in the context of UK ring-fenced banks, and that proposal was rushed through without an impact assessment having been undertaken within the EU in terms of what the impact would be on banks operating across the EU. If you detect divergence, it is merely that we are pointing out the fact that in any legislation or regulation that is proposed, there is a process of understanding what the consequences of that might be and pointing it out and debating it and amending it and trying to settle on something that works. There is an element of the intermediate holding company legislation or the IPU legislation proposed by the EU that feels a bit like tit for tat with the US as well in terms of their IHC proposals, and tit-for-tat regulatory wars are not something that we or our members would be particularly grateful for, frankly.

The Earl of Lindsay: Can I ask then about how you see joint supervision working post Brexit? Mr Jones, you were describing earlier in the session the joys of joint and co-operative supervision when you were at Santander UK. In four of five years' time, do you see a continuing effective UK/EU 27 co-operation on the supervisory front being sufficiently resilient and effective in the event that we have some sort of a banking failure or a CCP failure that crosses the UK and the EU borders?

Simon Lewis: First, on resilience, our industry is much more resilient than it ever has been, certainly since the crisis. The reform programme that Mr Barnier oversaw in the Commission made significant and fundamental changes that mean that our industry is better capitalised, better governed and better run. It is important that people appreciate generally—as I am sure your Lordships do—that this industry is more resilient than it was, and therefore probably better able to withstand whatever shocks might come. That is a really important piece of progress.

There is a very strong will around joint supervision, and often these relationships or these joint supervisory roles are based on strong personal relationships. From my perspective, there is a huge amount of personal respect within the EU among the regulatory community. Related to that, we have to accept that, although the UK will be leaving

the boards of the ESAs, which will happen as a result of Brexit, there are models of how perhaps the UK can continue to be involved in the work of ESAs. To give one example, there might be some sort of advisory board or some sort of college that can be established so that people of the quality of Andrew Bailey and Sam Woods can continue to contribute to the work of the ESAs. There is a wide acceptance in the EU that the UK has played a very important and influential role in the development of the regulatory structure. There is, therefore, an understanding that if we can find a way of accommodating that expertise, that would be good for Europe's capital markets.

Stephen Jones: I would welcome and propose the same pragmatic approach as Simon. I sat on a panel in Washington DC at the IIF on Saturday with Andreas Dombret of the Bundesbank and he was waxing lyrical about high standards of regulatory co-operation and an ability to maintain that on a go-forward basis with enormous respect for the UK as a—if not the—regulatory centre in Europe.

To the root of your question, which is around resolution, clearly supervision and regulatory co-operation is most tested when an institution has cross-border footings and is faced by a crisis. I would point to the fact that the post-crisis resolution regime on a global basis has been led by the FSB. In fact it has been led at a detailed level by Andrew Gracie of the Bank of England, and that regime has been widely adopted around the world. My sense is that, as with any crisis planning, it needs to be tested but hopefully never used in anger, but having been tested through rehearsals involving regulators on both sides of the channel in cross-border groups, the opportunity for it then to work should its measures be required to be taken forward is greatly enhanced. Resolution is difficult in all circumstances for a cross-border group, but I do not believe that regulatory or supervisory co-operation is an obstacle to cross-border resolution.

Q35 **Lord Desai:** Half of my question was covered in the answer to Baroness Liddell's question. If we have this mutual recognition agreement or some bespoke thing, would it benefit the EU 27 as much as it would benefit us?

Stephen Jones: Lord Desai, I believe that if the consequences of not reaching a mutual recognition model are a break-up and fragmentation of the current harmonised financial order that exists across the EU, including the UK, the costs for the EU, as the previous panel highlighted, are potentially very high. It is possible for our largest wholesale banks to refocus their activities within the EU by removing activities from London. In doing so, they will create additional costs for themselves. They will create fragmentation of single clearing derivatives, foreign exchange capital markets and syndicated lending pools, which benefit from enormous efficiencies by being in a single centre across Europe at the moment.

As the previous panel also highlighted, however, that will result in both more expensive financial services but potentially, outside perhaps the largest six EU economies, a complete withdrawal of services in basic risk

management, foreign exchange capacity and the ability to serve significant parts of the EU in really what are quite fundamental financial services: for example, the ability to fix your interest rate costs, the ability to hedge in size your foreign exchange risk, and the ability to undertake cross-border trade finance if you are involved in a complex export-led supply chain. The danger of fragmentation is that a lot of the capacity that serves all but the largest corporates and financial institutions in the largest EU markets will, in our view, be potentially quite significantly damaged by allowing that fragmentation to happen.

Simon Lewis: Just to build on that, if I may, indeed the largest companies will always find a way of mitigating those kinds of risks, because large, complex companies are able to find alternative ways of transacting business. We are very concerned that the 22 million SMEs in the EU could suffer as a result of Brexit, because the very examples that Stephen gave are crucially important to a growing SME. The report that we did with BCG, which I hope we referred to in our submission, shows that most SMEs in the EU are not doing any planning for Brexit, partly because they are not resourced and partly because there is a bit of wishful thinking. There are, however, certain wholesale activities that those SMEs have come to rely on that could be withdrawn because the bank sitting behind them decides that it is not going to operate in the same way. There is a real concern at a pan-European level that, just at the time that we need SMEs to continue to be an engine of growth, we run the risk of that momentum slowing down. One of our requests coming out of our report from the BCG is to say, "Let us make sure that SMEs, as far as possible, have an understanding of what they need to do to prepare for not just the hard Brexit but for a version of Brexit".

The Chairman: Is that message getting through in Brussels?

Simon Lewis: Yes, I think it is. I think the SME community in Brussels is very well understood and appreciated. It is only recently that policymakers in Europe have understood just how important the growth of SMEs is to the wider capital markets union project, because as we know there is an over-reliance on bank financing generally, and where that really pinches is the SME community.

Q36 **Lord Haskins:** I want to come on to the EU (Withdrawal) Bill. I noticed in your submission that you said you were supportive of the objectives of it but you had a number of issues with it, and we are picking up that financial services generally have a lot of concerns about how this might work through. Is there the beginning of a moment of truth in the whole process? Have you anything to say about any of that?

Simon Lewis: I am not an expert on the legislative process at all. We looked at this from a pan-European perspective, and the first thing that is obvious is what an incredibly complex piece of legislation this is. It has not even reached your Lordships yet, yet this is such an important part of the Brexit process. The sheer complexity of the EU (Withdrawal) Bill should not be underestimated, and I know that some of the regulators within the community are having to beef up their legal teams just to think

about how they can understand the implications of what needs to be delivered.

The second thing is that it is not a complete answer, because one good example is: what is the status of legislation that is agreed post 2019 but before we actually leave the EU? There are going to be some areas where we need to have more certainty perhaps as to how the withdrawal Bill will ultimately impact, but I am very happy to perhaps consult my members further and revert with some more comments on that.

Stephen Jones: Just to echo those comments, it is an enormously complex piece of legislation that is required: essentially, the adoption of the *acquis* into English law. I believe there are 10,000 pages of EU-originated financial services rules and, frankly, there is very little time. I go back to my earlier comment about certainty: yes, we need to scrutinise the inoperables within those rules, but do we really have the time to go beyond that and think about discretionary policy changes? I would argue from a business perspective for that certainty, for accepting the rulebook as it is, subject to amending the inoperables: for example, where jurisdiction cannot any more be held by European agencies, it needs to be transferred to an equivalent UK agency—we have to address that. Then we probably need to wait to consider in the context of whatever the new end-state arrangement is between the EU and the UK whether there are aspects of that EU rulebook that we might then wish to adapt and amend. If you—dare I say it—try to do it through the withdrawal Bill process, you are not going to be sleeping very much for the next 18 months.

Lord Haskins: The issue is purely about the change of jurisdiction—that is what it is all about—and the concern I would have would be that the EU will have a view on the proposed changes of jurisdiction, which might be long drawn-out and controversial.

Stephen Jones: From a financial services perspective, the jurisdiction is probably not that difficult. It may well be in other industrial sectors, where European agencies, for example, are involved and new agencies perhaps do not exist in the UK to replace them. That may be an issue certainly, but from a financial services perspective, given how well harmonised the regulatory agencies are, there are relatively few instances where there is not an immediate and obvious UK equivalent to replace a European authority that currently sits as an arbiter of the EU. Obviously, as we are not part of the single supervisory mechanism, those parallel UK financial services entities tend to exist already anyway.

The Chairman: Mr Lewis, would your members have a view on whether the transposition of future legislation in terms of trying to be equivalent and follow the EU should form part of the regulator's rulebook or whether there should be parliamentary scrutiny on it?

Simon Lewis: I am very happy to talk to them about that, because it is a very difficult and complex issue. I suspect the answer might be a bit of both in terms of ensuring certainty. I come back to my opening point

that anything that minimises the risk of fragmentation and might inhibit the development of capital markets would not be in the interests of our members, but I am very happy to revert on that.

- Q37 Lord Bruce of Bennachie:** You have both already made strong references to transitional arrangements in your papers. The first obvious question is: you say that we need to have agreement by quarter three or four. We have missed quarter three; we are in quarter four. Can you just give us a repeat of that because, first of all, what is the latest that a transitional agreement would be useful, and what is the minimum content of the basis of a transitional agreement that works? Some people are saying that a transitional agreement with no idea where you are heading means you might as well resolve the uncertainty by relocating. I wonder if you could just tell us what is the latest and what is the minimum definition or detail that is required?

Stephen Jones: Thank you, Lord Bruce. Can I start with the vocabulary? One person's transition is someone else's standstill is someone else's implementation, and one of the biggest problems in this debate is language. The previous panel did quite a good job of exposing what different views of transition might be, but when we talk about an urgent need to create a transition agreement now, what we are really highlighting is that, absent certainty that the existing rulebook and the existing ways of operating can be extended beyond March 2019, given the lack of certainty around what an end-state arrangement between the UK and the EU is going to look like and the apparent timetable for reaching agreement on that being very hard to foresee, what businesses require is confirmation that they do not need to exercise their contingency plans. The latest date by which most of our mutual members tell us that they can avoid exercising their contingency plans is the end of this year, or possibly Q1 of next year. If there is no standstill agreement in that context, because I am using transition in the context of standstill, i.e. an agreement that there is an extension—

Lord Bruce of Bennachie: The existing arrangements will continue for an agreed period.

Stephen Jones: If the *acquis* is prolonged, as the Europeans would like to say, for a period of, say, two years, that will provide at least an ability for our members not to execute immediate contingency plans to start moving their core activities, which would be required to be based in the EU to serve their EU customers absent an end agreement. That is really what we would mean when we are talking about a timetable of the end of this year.

I worry a little that there are other interpretations. In the Prime Minister's Florence speech, which was very welcome, and as subsequently explained by her at the Tory party conference, she referenced an implementation period and an implementation period that would take effect in March 2019, there having been reached a detailed agreement in trade and services before then, such that all that is required is an implementation period from March 2019 in order to adapt to that end-

state agreement. I would be delighted if that were possible, but most of my members think that it is hugely ambitious. Being commercial beings, they are likely to take that with a certain pinch of salt, and if they have to wait until March 2019 for confirmation that there is that “implementation period” and for conformation as to what that implementation period is actually implementing, I believe that they will start to exercise their contingency plans to move their activities at the end of this year or in the first quarter of next year.

Simon Lewis: There are two windows on transition this year: first, the Council meeting taking place tomorrow and Friday. Chances of progress must be minimal, but there are some glimmers that there might be discussion about opening up an initial transition discussion. Then there is the December Council—and that is it. The other thing that I wanted to add is that, as I said in my opening remarks, our view, our planning, is that the negotiations will be completed by October of next year, because Michel Barnier intends to get ratifications from European institutions; therefore, probably the very latest that a transition works for our joint members is the first quarter of next year.

The final point is that the kinds of decisions that need to be made by our members are complex in their own right. As an example, applying for a broker/dealer licence in another European city is quite rightly not a straightforward exercise; it is costly, it is time consuming and it requires legal and other changes. Those sorts of actions need to happen and are happening now.

Stephen Jones: Can I also make the point in reverse? We have many members who are foreign banks operating under EU passports in the United Kingdom, and they too require certainty; they too require a clear understanding of what will be required of them in order to re-authorise their activities within the UK. While we have worked very hard with the UK regulators on this and they have been accommodating in seeking to delay when they might be required to formally trigger the authorisation process—which is very detailed and very substantive—our UK supervisors have said the latest they can do that is the end of this year.

Q38 **Lord Bruce of Bennachie:** Is it realistic, first of all, that we will get an agreement on transition—which you both say needs to be legally enforceable, so it has to be a quite a hard deal—in the timeframe? Secondly, can you then negotiate the detail by this time next year, given that we have not even started the negotiations? If I just prefix that by saying lots of people say in all the sectors we are talking about, “We know what we want; we know what it is about”. Do you really think that if we got to the stage that you are after we could get a viable, legally acceptable deal that would enable your members to say, “Okay, we can stay”, as opposed to “We go”? Is that realistic?

Simon Lewis: If it is a standstill, which is really what we are asking for, then we have to be relatively optimistic, because that is not a very difficult thing to negotiate. That is what we are all saying: that it is the standstill that we are looking for initially—what we call the bridge—and

we must then have an adaptation period. The standstill piece—and I am not saying it is going to be easy—at least does not require a completely different set of discussions.

Lord Bruce of Bennachie: In other words, we do not leave the EU for a number of years.

Simon Lewis: Well, that is true.

Lord Butler of Brockwell: Certain members of the Government will not find that acceptable.

Simon Lewis: That is my sense. If it is a standstill, then it is deliverable.

Q39 **Lord Butler of Brockwell:** May I return to the direction of travel in EU financial governance? Absent the UK, how do you see the proposals in the Five Presidents' Report developing the CMU, for example?

Simon Lewis: The CMU is even more important now than it was previously and, as I said earlier, Lord Butler, the initial insight is that an over-reliance on bank financing in Europe still exists, and indeed is in stark contrast—I was with Stephen in the US last week—with the US, where there is a huge variety of ways of funding a growing business. The basic idea behind CMU has to continue to be developed and there has been some progress. I must compliment on this Committee the Lord Hill, who did an outstanding job in his brief period as Commissioner by catalysing the capital markets union. Now under Vice-President Dombrovskis there is a real opportunity to take it forward, but it has never been, in my view, one big blockbuster; it should be, and is, a series of different initiatives.

We have made progress on the prospectus directive. We have made some progress on securitisation. There will be a pan-European venture capital fund. Hopefully we will make some progress on insolvency law, which is probably the biggest prize but the most complex one—but, to go directly to your question, it may require some different level of supervision. There is an idea, which will be interesting to explore further, that EMSA might play a role as the capital markets union supervisor. I am not sure that meets with agreement across the whole of the EU, but to deliver capital markets union it will require some supervisory muscle at some stage. It is really important that we continue to focus on CMU.

I wanted to say as well that we tend in the UK to be fixated on Brexit, and in Europe, in the EU 27, there are these big projects like the capital markets union that are continuing to be developed and taken forward: ditto banking unions. I am optimistic that CMU will continue to make progress, but it will probably require a supervisory element at some stage.

Lord Butler of Brockwell: Is our departure likely to have an adverse effect on that progress?

Simon Lewis: It will if the UK becomes significantly detached from Europe's capital markets, which then brings us back to the question of what the future model might be. It is not inconceivable that the UK can continue to contribute to capital markets union from outside the EU, because after all we are talking here about a framework and an approach as much as legislation. I do think—and have heard Vice-President Dombrovskis say very clearly—that there is a view that it is more important than ever now that the EU 27 delivers the capital markets union.

Lord Butler of Brockwell: Just going back to fragmentation, one might suppose that the current proposals by the Commission on EMIR to take further supervision of CCP is rather a bad omen in that respect. It does look as if they wish to remove CCP from the UK, which would have a fragmenting effect. What is your comment on that?

Simon Lewis: If that was to happen, it would have a fragmenting effect, but we are quite encouraged that the proposals for joint supervision of CCPs, which is what is envisaged, look like a very sensible step forward. Given the importance of CCPs in the financial infrastructure, to have an additional level of supervision—so in addition to the NCA, to have ESMA providing supervisory oversight—we think is a good development. The devil as always will be in the detail, so it is a rather good example, if I may say so, of joint supervision. The combination of a pan-European supervisor with the local NCA should reassure people that CCPs will be supervised even more effectively.

Lord Butler of Brockwell: You do not interpret this as a device to remove CCP from London.

Simon Lewis: No, not at all. This is another way of ensuring that a very important part of the financial infrastructure is properly supervised.

Stephen Jones: I would totally agree with that, and I would point also to the precedent announced in the US last week by Chairman Giancarlo of the CFTC and Vice-President Dombrovskis to accord mutual recognition of CCP regulation and supervision as between the EU and the United States. This recognises that where important parts of a market's infrastructure are happening offshore of that market, it is reasonable to have some degree of oversight in terms of the market impacted, if you like, as to how that market offshore is operating. That is probably a legitimate and reasonable concern that we would seek to exercise if the roles were reversed, and if we had 90% of clearing in sterling being undertaken in Berlin, we would probably wish to have the same kind of inward-looking oversight opportunity.

Q40 **Baroness Neville-Rolfe:** Still looking forward, it could be expected that, even with joint supervision, the UK and EU regimes could start to diverge. In what areas do you think regulatory divergence is likely? Given the past, is that likely to be driven by the UK, which tends to be more innovative and internationalist, or by the EU, which is perhaps more proactive and market constraining and indeed goes for standardised

regulation to a greater extent?

Stephen Jones: It is very hard to crystal ball gaze. Simon has outlined the future EU programme around capital markets union; EMIR we have discussed. The point I would like to come back to is a generic one, which is that it is very important that the off-ramp that would be required in order to break the mutual recognition model in order to impede access that the mutual recognition model would otherwise permit, is difficult. The process of the parties discussing whether they are willing to recognise the divergence in regulation that is proposed in the scenario that you are proposing, Baroness Neville-Rolfe, is open. It takes into account the costs, and to the extent that there is an overriding desire for the national regulator to say, "Actually, do you know what? That divergence is too much and we need to break this model", it does so knowingly. To me, it is that mechanic that is important, rather than seeking to predict where areas of divergence may happen.

Simon Lewis: If one looks at the very important role that the UK has already played in the development of standards and regulations, both in Europe and globally, we should take some reassurance from the fact that the possibility of major divergence is relatively minimal. We have already heard this morning about Mark Carney's very important role at the FSB, Andrew Bailey's role on ESMA and Sam Woods at the PRA. There was a stitching-in of the UK's influence in regulation that makes divergence less likely but not impossible.

Baroness Neville-Rolfe: That particularly affects the UK. My question was: are there forces in the EU that could be taking things in different directions or do you think we can also be reasonably confident that they will want to stay aligned?

Simon Lewis: My answer to that would be yes as well, particularly again because there is a general willingness in the EU to ensure that we keep our capital markets intact and not fragmented. Even, if may say so, the developments at ESMA, which could be seen at one level as a divergence, can be happily managed with the right level of supervisory co-operation, as we discussed earlier.

Q41 **The Chairman:** I note that in your written submission you do not deal with dispute resolution, but would you like to tell us what you think should be the alternatives for aligning the UK and EU's regimes, Mr Lewis?

Simon Lewis: Again, we did not answer that because that is a complex and challenging issue. I did not want to give just a general answer so, again, I could revert to you separately with further thoughts.

The Chairman: Indeed—thank you very much.

Q42 **Baroness Neville-Rolfe:** The next question was also mine, because we took the others out of order, and that was about how the industry across the EU is going to be affected by Brexit. This is a very interesting area and you have already touched quite a bit on capital markets, but are

there segments of the industry where there will be shifts? Are there implications for things like data sharing? It would be really interesting to hear, from your experience—again, a bit of a crystal ball—as to what might happen.

Simon Lewis: It is a slightly cloudy crystal ball, but it is a very good and pertinent question. It does really depend on the different business models that there are in industry. There are sort of three broad business models: there are banks that have London as a hub from which they have been used to passporting their activities to the EU 27, and clearly for those banks there will be potentially quite significant structural and legal changes. There are those of our members who have a pan-European structure, who therefore should be able to deal with the effects of Brexit a little more easily. Then there are banks that are heavily concentrated locally in one market.

The focus is definitely on those banks that are hubbed in London and, as we have been discussing this morning, the challenge there is to find a way of ensuring that the changes they need to make are not overly disruptive either in financial capital, regulatory or legal terms. That work is already under way, and those banks that are hubbed are the very banks that are thinking most intensively about their contingency plans and when they have to activate them.

Stephen Jones: The GDPR—the general data protection regulation—is being implemented. It is in flight; we will be fully harmonised by the time Brexit happens. While there is a lot of work to do to determine what happens next and how much divergence might be permitted, at least we are starting from an identical starting point in terms of GDPR and the payment services directive as that relates to data.

There are complexities, and you are right to point them out. At the CFTC in Washington last week, they highlighted an aspect of GDPR that they had just come across, namely that their ability to supervise their US-based global groups with operations in Europe, particularly around compliance issues, could be impeded because their ability to access files that related to personal data on EU nationals was potentially constrained by the GDPR. Therefore, there was an urgent need for a European/US solution.

The whole issue of data on a cross-border perspective is very complex. It requires greater scrutiny; it is absolutely right to focus on it. We will be publishing a paper jointly with techUK on data, probably in a couple of months, and we would be delighted to share that with the Committee in terms of our thoughts and how that impacts the industry.

Q43 **Baroness Neville-Rolfe:** We would very much like to see your thinking, as it is a key area. Do you think the others, the EU 27, are also getting on and thinking about these issues? Obviously there is a huge amount of effort going in here, but we need them to be doing that as well.

Simon Lewis: I think they are. As we have said earlier, what makes this challenging is the sequencing that has been so clearly laid out in the

Council guidelines, which means that obviously the EU is very focused on getting certain issues agreed before moving on to aspects like transition and adaptation. I do believe that once that progress has been made, things would or should move fairly quickly.

If I may, Baroness Neville-Rolfe, I will make one further point on data. We do a list of cliff-edge risks and data is in that top five, because the real risk of the inability of the UK to be part of the data safe zone post Brexit and the implications for personal data are really quite significant. It is important to note, and this Committee may wish to look at it further, just how significant a potential risk that is to the stability of the system.

The Chairman: That brings us up to innovation and Lord Desai.

Q44 **Lord Desai:** We have this rather marvellous FinTech sector growing. Is it worried about Brexit?

Stephen Jones: I have a chief executive of a very innovative unicorn on my board at UK Finance for deliberate reasons: it is very important that our segment and the FinTech sector are closely aligned, understand one another and work very closely together. All I would say, without revealing too many secrets of his business, is that he is concerned from an immigration perspective that our talent model in the UK may become more constrained than in the past. While he is based in London, his staff is largely international. It is a diaspora of highly talented data scientists who he has been able to attract from around the world because London is a superb place to live and operate. Anything that impedes the ability to attract, retain and develop that talent or creates uncertainty about their welcome in this market is to the detriment of the financial technology industry, and frankly to the detriment of the financial services industry as well, in our view.

Simon Lewis: I completely agree. The challenge here is the hub in London. There are other hubs in Europe as well that are developing, but if the hub in London is significantly affected by the inability to bring in talent, then by definition there is a possibility that what has been built up could be quite easily fragmented.

The Chairman: On the funding, because the sector gets quite a lot of funding from EIF, in your conversations with the United Kingdom Government, are you expecting our emphasis on innovation and the FinTech sector to result in filling those gaps where EU funding will be lost?

Stephen Jones: Certainly in conversations we have had with the Treasury, they are acutely aware of the risk. The Patient Capital Review, for example, is a very important response to that, and the intention is to ensure that if those gaps emerge, they are plugged where possible by national funding schemes. I am afraid that for more detail on that, you probably need Charles Roxburgh here from the Treasury rather than me.

Q45 **The Chairman:** Thank you very much. We will be seeing the Treasury Minister in due course. One final point I wanted to get very brief answers

from you on was that in our previous evidence sessions we heard about where, if we are approaching cliff edges and there is not a future trade agreement agreed, the United Kingdom regulators should offer unilateral market access to the EU 27's institutions. What are your views on that?

Stephen Jones: We have certainly had those conversations with the UK regulatory authorities, and the pushback is twofold. One is financial stability. If they are to take on the supervision of one large continental European bank's £700 billion branch balance sheet in the UK, to do so without having undertaken the appropriate local supervisory protective measures could be seen as irresponsible. Secondly, I think their point is about negotiation. At the end of the day, there is a negotiation going on, and regrettably there are two areas of negotiation that are on the table but I would rather were not on the table. One is that point and the other is contractual certainty, which was mentioned in your previous panel. The grandfathering of contracts which bridge March 2019 is an incredibly important issue. AFME and UK Finance have published a joint paper on this, and it is to our regret and our members' regret that both of those issues appear to be negotiating points rather than points that are being taken off the table.

Simon Lewis: Given that time is short, I have nothing to add to that.

The Chairman: Thank you very much indeed. We found that session to be incredibly fruitful. This concludes the public evidence session. The Committee will now meet in private. Thank you very much indeed.