



Select Committee on the European Union

EU Financial Affairs Sub-Committee

Oral evidence: Financial Regulation and Supervision Following Brexit

Wednesday 15 November 2017

10.15 am

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

Evidence Session No. 6

Heard in Public

Questions 79 - 98

Witnesses

I: Sally Dewar, International Head of Regulatory Affairs, JP Morgan; Julian Adams, Group Regulatory Director, Prudential.

II: Flora Coleman, Head of Government Relations, Transferwise; Charlotte Crosswell, Chief Executive Officer, Innovate Finance.



Examination of witnesses

Sally Dewar and Julian Adams.

Q79 **The Chairman:** Good morning, Sally Dewar, International Head of Regulatory Affairs, JP Morgan, and Julian Adams, Group Regulatory and Government Relations Director at the Prudential. Welcome to our inquiry on financial regulation and supervision following Brexit.

You have a list of interests that have been declared by Committee members. This is a formal evidence-taking session of the Committee and a full transcript will be taken. It will be put on the public record in printed form and on the parliamentary website. You will be sent a copy of the transcript and you will be able to revise minor errors. The session is on the record; it is being webcast live and will be subsequently accessible via the parliamentary website. Do you wish to make any opening statements? I understand that you are content to go straight into the session. Is that correct?

Sally Dewar: That is right.

Julian Adams: Yes.

Q80 **The Chairman:** Thank you. Perhaps you would share with us what you think are the legal options for continued market access to the EU post Brexit. How important do you think it is to have market access, given your different sectoral interests, and what do you think would be the best way forward in that regard from where you sit?

Sally Dewar: We are thinking about equivalence as we think about legal options. If equivalence is in the format and framework that works today, it does not represent a long-term sustainable solution for us. It is a very limited regime. It puts the EU in the driving seat for the decisions it can take; it is an uncertain form of market access because it relies on the European Commission making a positive and unilateral equivalence decision, which can be withdrawn at any time, so that framework does not put the UK on a level playing field. Nevertheless, if an enhanced equivalence framework is put in place, it could mitigate some of those impacts, particularly if it is in place at the point of Brexit. We need to think about how we plug the gaps in existing legislation and create more equivalence provisions.

On mutual recognition, we regard a free trade agreement as a better long-term solution. It is more comprehensive and covers financial services. One of the other downsides of an equivalence regime is that it does not cover all the aspects of financial services we need to cover. That would be a much more usable form of market access for the single market for financial services and would allow us to continue to use London as a hub.

Julian Adams: I will not repeat what Sally said. I entirely agree with the one-sided problem of equivalence. The only thing I would add is that



HOUSE OF LORDS

equivalence, as distinct from a bespoke mutual agreement/recognition treaty, runs the risk that we become a rule-taker rather than looking at whether our frameworks deliver broadly equivalent outcomes, which is a more secure basis for long-term regulation in the UK.

Our position is that we should not change for change's sake but, where EU regulation does not fit neatly or appropriately in the UK, we should have the policy freedom to make that choice and make it more appropriate. In my own sector, there are a number of aspects of Solvency II that not just the industry but the regulator does not think work appropriately. That relates to what is called the risk margin. People have tried to change that in Europe, but they have not been successful. Post Brexit, we would argue that that is a good example where an EU directive does not work appropriately for the UK, and we should have the policy freedom to change it. I do not think that would alter the broad equivalence of the level of protection that the UK regime, as opposed to the Solvency II regime, would deliver.

The Chairman: It seems to me that both of you are veering towards an FTA. As you well know, the problem with an FTA is that, traditionally, your sector is not covered, even in the Canada deal—there is an element of it, but it is not entirely mutual recognition. First, what form would you want an FTA to take that would deliver for your sector? Secondly, to what extent are you working with other sectors of the economy to have a coherent single voice in that regard, effectively to champion an FTA, taking into account the interests of other parts of the economy?

Julian Adams: A bespoke mutual recognition agreement along the lines TheCityUK has promoted could be negotiated outside an FTA. I agree with you that traditionally services do not fit easily within trade agreements; we know that throughout the world. It is jolly difficult to get consensus even within the financial services industry, let alone outside it, but given the fact that TheCityUK as a convening body has all the industry groups, plus associated financial services, if you wanted to pick a consensus position that would probably be it.

Sally Dewar: This would definitely be a novel, unique or new style of FTA, which would go beyond agreements that have been negotiated previously, but we think that is justified on the basis of the uniqueness of the arrangement and of the relationship between the UK and EU. We think it could cover a broad range of financial services as well as clients. For us, the key is that an FTA might be okay to cover goods, but it needs to cover services as well. As Julian says, we have been interacting with other members of our financial services sector and with the Treasury to help to formulate what an FTA could look like.

Lord Butler of Brockwell: Would you mind defining for us “enhanced equivalence”? You said that might be a better solution than pure equivalence, but not as good as an FTA. What do you mean by enhanced equivalence?



Sally Dewar: Enhanced equivalence would mean plugging some of the gaps in the standard equivalence regime. It would mean looking at existing legislation and creating more equivalence provisions. Equivalence today does not cover all services; it does not cover everything that a financial services firm does. For example, it does not cover banking, so we would need to plug the gaps to make sure that, as we define equivalence, we define it in a way that covers the broad range of financial services. That is number one.

The second thing would be the way in which the robustness of the framework underpins the equivalence arrangement so that it is not asymmetrical. At the minute, all the power resides within the EU; it is within its gift, so we would need an equivalence framework that created a level playing field between the UK and the EU going forward.

Lord Butler of Brockwell: How would that work?

Sally Dewar: It would have to come into the negotiations as they define whether the right regime going forward is equivalence, an enhanced equivalence regime or a mutual recognition free trade agreement. We are saying that the best solution is a free trade agreement, but if we cannot get there—potentially it is very difficult to achieve—at least in the short to medium term, an enhanced equivalence regime that covers all products and services and the point around asymmetry would be a better solution than the equivalence regime as it exists today.

Q81 **Lord Butler of Brockwell:** Do you think that a free trade agreement is realisable, and what would be your expected timescale for that to be achieved? Could it be done by March 2019?

Julian Adams: It is a challenge and it is unlikely. Our position would be that, rather than trying to do something through a free trade agreement, we would have more chance of getting bespoke mutual recognition. In a sense, the starting point should be the same. We have been operating under the same policy processes and law for 40 years. Given the competence and skill set of the regulators, and their extremely good working relations at national competent authority or ESA level, the ingredients for a bespoke mutual recognition agreement are in place.

The key point would be to establish a framework that allowed deviation on the initiative of the EU, which we may not want to follow, or on the initiative of the UK, which the EU may not want to follow. Policing, challenging and prompting that corridor of potential deviation is where the negotiation would lie. Do I think that is possible within the timeframe? Yes, given that we are starting not from mutual recognition but from an identical position with well-established, good and effective working relationships. The ingredients are there. The question is what one does over time, how one polices it and how one designs a framework that measures the outcomes that the framework is delivering, even though the mechanism by which it is delivered may change over time.



HOUSE OF LORDS

Lord Butler of Brockwell: Can you go a little further and say how that mechanism would work? Obviously, there would be discussion between the regulators, but suppose that the regulators cannot agree subsequently on a degree of divergence. Would there have to be a third body in such an agreement to adjudicate the two approaches?

Julian Adams: You anticipate an important point. I think this is anticipated by the current terms of the great withdrawal Bill. There will be a big transfer of power to the regulators post Brexit. Our position is that, in exchange for that responsibility, not only should there be enhanced accountability and scrutiny but that almost certainly we would want to introduce another intervention point, which we argue would be the Treasury. If regulatory action either initiated a deviation or did not respond to a deviation, such that it called into question the effectiveness of the mutual recognition agreement, that strikes me as not just a technocratic decision but something with a political dimension, and there would be a role for the Treasury.

Lord Butler of Brockwell: Surely, it would not be satisfactory to have just a national arbitrator; it would have to be agreed between the two sides. There would have to be an independent third party doing that mediation, would there not?

Julian Adams: Yes, but I thought your question—forgive me if I misunderstood it—was about how the UK reached a determination.

Lord Butler of Brockwell: No. My question was about intermediation between the EU regulators and the UK regulators if they appeared to be going in different and unacceptable directions.

Julian Adams: There would have to be some form of mediation, and it seems to me that that is largely a political decision about the competence of courts.

Sally Dewar: You are right that the mutual recognition decision is made by the regulators. Today, when they make an equivalence determination, they look at it as regulators across the piece. What we need to avoid is that they go into it at too detailed a level, such that they cannot see that the objective and the outcome remain the same. That is key in negotiating any free trade agreement or mutual recognition; you look at the outcome the regulation is delivering, not necessarily at all the detail around how it gets there.

Julian Adams: As a matter of fact, it is not the regulator that reaches an equivalence decision; it is the Commission, on the advice of the regulator.

Q82 **Lord Haskins:** Lord Butler has dealt with my point, but the dispute resolution issue comes up time and time again and I do not think we have received a satisfactory answer.



HOUSE OF LORDS

Julian Adams: It does come up time and time again, and I think I am right that ultimately it is a political decision. We can comment on what would work for the financial services industry within the UK, which is the framework I tried to sketch, but these are ultimately very political questions.

Sally Dewar: Obviously, there need to be dispute resolution procedures and mechanisms in place as you negotiate the agreement.

Q83 **Baroness Liddell of Coatdyke:** Can I ask about financial stability? How closely are you working with the regulators to address the whole area of financial stability? Do you recognise a threat to financial stability through systemic risk and so on?

Sally Dewar: We have been working very closely with the PRA, as you would expect. It asked firms to submit contingency plans, which we did, that looked at three scenarios: worst case, best case and a middle case. The PRA focus was on the worst-case scenario and the contingency around that. When we think about Brexit, we do not assume any negotiated position. For us, it is a hard Brexit position, so that we do not inadvertently take into account issues that we think will be resolved and then subsequently are not.

We are thinking very much about what will happen in April 2019 and how we as a firm and, more broadly, as an industry avoid the cliff-edge effect. Part of that contingency planning work was to identify with the regulators what we thought some of the worst-case scenarios could be—issues that might not be so much at firm level but, taken across the whole sector, could be systemic or create a financial stability impact. We worked with the PRA not just on our own plans but gave our thoughts on some of the broader potential issues.

Baroness Liddell of Coatdyke: Are the regulators helpful in that kind of setting?

Sally Dewar: It has been a very open, two-way and constructive dialogue.

Julian Adams: We have gone through the same process and have the same assumptions. On the question about stability, what markets do not like is uncertainty. In addressing stability concerns, there is a firm-specific contingency planning part, but there is another that is about being as transparent as one can as quickly as one can about the outcomes—the end state to which we are transitioning or aiming for—and prompting and pushing for as much transparency about those things as possible. There are certain provisions of EU law that do not sit easily within a domestic context—the so-called inoperables—and we are certainly asking the Treasury and the Bank to identify what they are and tell us how they propose to fix them, because the more uncertainty you can take off the table, the better for financial stability.

Baroness Liddell of Coatdyke: Presumably, therefore, the length of



HOUSE OF LORDS

any transition deal would be pretty important in getting all that done.

Julian Adams: It is useful to look at transition in a short-term and long-term perspective. In the short term, the priority is clearly how you domesticate the acquis, and that is an enormously complex undertaking. I think that argues for minimal change; given the vastness of the task, that has to be one of the few simplifying assumptions you can make.

In a longer-term perspective, when you look at transitionals, we would say that what needs to be clear is the state to which you are transitioning, not simply the length of the transition period. We would not want a transition period being used to defer hard decisions, because the residual uncertainty would continue and firms would continue to execute their contingency plans. For those reasons, it is not simply length; the state to which you are transitioning is as important.

Q84 **Baroness Neville-Rolfe:** You both represent big and important companies for Britain, paying tax, providing lots of jobs and innovation, and managing uncertainty well, despite what Mr Adams said about that, which I understand. How is Brexit factoring into your business planning, particularly over the medium and longer term? It would be good if you could give us a feel for the key parts of your business that are affected.

Julian Adams: The point I would have made in an opening statement is that it is important to understand that 75% of IFRS profits are generated outside the EU. Almost all our EU profits are generated within the UK, so as a business we are relatively well insulated against Brexit. We have an Irish subsidiary and a Polish branch on our insurance side. Those are capable of being reorganised in a way that supports Brexit. The fund management business, M&G, where we have used the passport to sell services in the EU, is more affected, but we have a well-developed contingency plan. We have set up a Luxembourg subsidiary. In the course of next year, we plan to transfer assets to that subsidiary, and by March 2019 we aim to replicate in Luxembourg the range of UK funds.

That is specifically how Brexit figures in our planning, but it is important in all these discussions to recognise that we are not self-determining actors. In part, our business responds to customer demand. Sometimes, European customers want to be able to deal with a European company and, whatever the transitional period, one is responding to customer demand as much as anything.

Baroness Neville-Rolfe: Are you making irrevocable decisions about the movement of infrastructure and/or people, and when would you do that?

Julian Adams: We have set up the subsidiary. We have a well-developed plan for the transfer. More jobs are being created in Luxembourg at this stage than are being lost in London, but it remains an active area of focus.



HOUSE OF LORDS

Sally Dewar: JP Morgan is a global business. The UK hub is our largest outside the US. We have 16,000 people in the UK; 4,000 are in Bournemouth—we are the largest employer in Dorset.¹ We have a big team in Glasgow, and 2,000 people across the EU. We have a large presence here.

From the outset, our Brexit strategy has been guided by three principles. The first is to ensure uninterrupted service to our clients. When we think about hard Brexit, the focus is on how we make sure that we continue to serve those clients in the same way as today from 1 April 2019.

The second principle is to maintain as much optionality as we can. This is a huge period of uncertainty for all institutions. We do not know, as we have discussed, what the final outcome will be and what financial services will look like in the long term, so we need a solution in the short to medium term that maintains optionality.

The third principle is to minimise execution risk. We put things in place in an organised and streamlined way so that we do not create undue risk as we go through the process. As Julian said, there is a huge degree of execution risk outside our control, so how do we minimise the execution risk to ourselves? We have three fully established credit institutions across the EU. We are leveraging those institutions to build up our businesses. The key business we do not have in the EU at the minute is our markets-based business. That is the key change, but all our affected businesses will grow out of our facilities already in Ireland, Germany and Luxembourg.

Baroness Neville-Rolfe: How far ahead are you working? Are there decisions, such as the move to Luxembourg Mr Adams mentioned, that can already be made, or have been made, or is there a ticking clock?

Sally Dewar: Clearly, there is a ticking clock and a countdown. We have a very well-established transition plan to make sure that we are ready in time, but we are already in execution mode. The infrastructure and the licences and approvals we need to set up branches, or transfer branches from existing legal entities to new ones, are already well in train, in discussion with our European regulators.

As regards clients and people, some key decisions have been taken and communicated, and will flow through between now and April 2019. By the end of Q1, we have to begin taking decisions about informing clients, which then become more difficult to unravel. When you start to move people, you have an impact on their lives and the lives of their families, and on the clients who make decisions on the back of your decisions. That starts to become more difficult to unravel.

Lord Butler of Brockwell: Does this mean that more of your business and profits will take place outside the UK, so that there will be a loss of

¹ Note by the witness: JP Morgan is the largest private sector employer in Dorset.



tax-take to Britain?

Sally Dewar: A key proportion of our business today comes back to London. London is our hub. When we think about what happens going forward, our objective today is not to create opportunity out of Brexit; we are merely trying to make sure we can replicate that business. If that business cannot be booked into the UK any more, naturally it will be booked elsewhere. That is just adding up the maths—what we have today and how we replicate it—so yes.

The Chairman: To dig a bit deeper on that point, you do not know today what you will or will not be able to do.

Sally Dewar: That is my point.

The Chairman: You are basically taking a risk.

Sally Dewar: Exactly. We do not know what the opportunity is going forward. We do not know what financial services will look like going forward; we do not know what the regulatory, political and legislative landscape will look like. All our planning is about replicating the business we have today and continuing to serve those clients. Because things are so uncertain and complex, we cannot think about what opportunities we could take as we go through this process.

Q85 **Lord Woolmer of Leeds:** Turning to regulation, could we take a few moments to talk about the EU (Withdrawal) Bill? Are there any aspects of the Bill that from your point of view may cause problems? What are the implications of the Bill for the way in which existing regulations are based, developed, informed and enforced?

Julian Adams: It is helpful to look at it through a short-term and long-term lens. In the short term, one of the issues that arises from the great withdrawal Bill is identification of the inoperables. We would like to see what they are and what the Government propose to do about it. We have asked for many months and have been promised for many months that it is coming soon. We think there should be an opportunity for the industry to reflect on what they are proposing. That is a short-term consequence of the Bill.

Another consequence of the Bill in its current form is a big transfer of power to regulators. One of the questions for us going forward is whether and how, in exchange for those additional powers and responsibilities, you strengthen scrutiny and accountability mechanisms. You want to balance a series of public policy priorities. You do not want to undermine the independence of a regulator. That is absolutely fundamental, and no one in the industry is calling for that. On the other hand, if an independent regulator has more and more powers to change rules on current level 1 terms, it is a big responsibility. In exchange for that responsibility, should there be enhanced scrutiny of their actions, and what form should that scrutiny take, whether it is a greater role for Parliament, a greater role for establishing reporting mechanisms, or



HOUSE OF LORDS

annual meetings? There is a plethora of choices to enhance scrutiny and oversight.

Personally, I think Brexit gives us the opportunity to ensure that we are comfortable with the objectives currently framed for the regulators. At the moment, they prioritise safety, soundness and consumer protection. All of those are absolutely laudable, and in no way would one want to undermine any of them. On the other hand, both of us have been regulators. The incentive structure in a regulator is that all your success is private and all your failure is public. In that world, if all your thinking is about how you address risks to your objectives, it can lead to a serially conservative set of outcomes, which cumulatively add a degree of conservatism that may not be in the best interests of either competition or the competitiveness of London as a market. The Treasury Select Committee has recognised the argument we made for competition as a primary objective for the PRA, at least for insurance. There is a debate to be had about whether one wants to call it competitiveness, or the promotion of London as a financial centre, that could and should be part of a post-Brexit regulatory landscape.

Sally Dewar: For us, it is less about how powers would be allocated and more about the outcome we are trying to achieve, which is striking the right balance between the right level of parliamentary scrutiny, the right level of transparency and the right degree of accountability and, importantly, having flexibility to amend the regulatory framework in the future. Rules evolve, and everyone has to be able to take a flexible approach, because of international standards.

Lord Woolmer of Leeds: Some parts of the financial services industry have argued very strongly for a great deal being left to the rulebooks and not for secondary legislation. You touched on that obliquely, but where do you stand on it? You referred to parliamentary oversight, scrutiny and so forth. Does that imply that secondary legislation, through Parliament, should deal with a lot of issues, or should much more freedom be left to the regulatory bodies and their rulebooks?

Julian Adams: I do not think it is an either/or. Clearly, it is for Parliament to decide how much is done by Parliament. Broadly, there are two ways to make rules: statute or the rule-making power of a regulator. The question is, where does Parliament want to cut that? In most circumstances, you could say there will be more scope or demand for regulation to amend rules than for getting parliamentary time and bundling things up to take through a statutory instrument. In that scenario, the regulator would emerge with considerably more power. That is why I refer to an oversight and scrutiny mechanism, not just for Parliament and the public but for different stakeholder groups—consumers as much as practitioners. There is also a role for the Treasury in the new landscape.

Lord Woolmer of Leeds: How can the Bill process help with the problem of contractual continuity?



HOUSE OF LORDS

Julian Adams: It is an insurance issue, but it relates to anything with a long-term contract. I do not think that the Bill in and of itself is a solution, because it can bind only the UK, and what you are interested in are rules that European countries adopt. Within the UK, there are two aspects of writing insurance business. The first is the writing and effecting of new business; the second is the administering of contracts. In a lot of countries, the administering of contracts is a regulated activity and needs to be authorised. If you were not in, would you be able to pay claims? I think that is best covered as part of a separation agreement that recognised and, essentially, grandfathered it. That is in everyone's interests, frankly.

Lord Woolmer of Leeds: The Government have made clear, we think, that there will be a separate Bill and a vote in Parliament on the actual withdrawal agreement and the future relationship agreement, one aspect of which, you say, should deal with the problem of contractual continuity and certainty. At this point, what would you want to see in such a Bill that gave financial service industries the confidence and comfort they seek?

Julian Adams: I am not a lawyer, so I will draft it in the vernacular. Essentially, there would be no change; you would grandfather the existing contractual terms, which would allow you to collect premiums and pay claims. I do not know what the equivalent would be on the banking side.

Sally Dewar: It is very important to say that it cannot be solved purely by the UK. This is one of the key issues as the Government pursue the negotiations. It has to be done as a bilateral agreement between the UK and the EU because it works on both sides. Contractual certainty for us is about issues that you might think did not necessarily warrant a change to the contract but do. Any small change in the life cycle of a transaction could be deemed to change the contract, whether it is a novation or even just a change in the terms of the transaction. On both sides, we need certainty, and it has to be done bilaterally.

The Chairman: In saying that, you are indicating a preference for regulation—the rulebook—rather than legislation.

Sally Dewar: We do not have a strong opinion on the allocation of the powers. As a former regulator, thinking about the question as you asked it, what is most important from my perspective is that there is transparency over who has those powers and who has ultimate accountability. In a situation of stress or in a crisis, if there is no clarity about that, and there is no clear division of responsibilities and no transparency in the marketplace as to who has authority, it gets very difficult for both regulators and the market.

Q86 **Lord Bruce of Bennachie:** What do you think our international engagement will look like post Brexit? You said you thought there was a basis for a unique agreement between the UK and the EU because of the



HOUSE OF LORDS

historical connections. We know each other and so on. We have been leaders both in international regulation and in the EU. Do you think we will have any influence on EU standards and regulation once we leave? Alternatively, should we take a more proactive role internationally in widening our engagement worldwide, and hope that there will be standards that the EU will effectively, in one way or another, be obliged to adopt?

Julian Adams: You are right to recognise that we have been leaders. We would certainly encourage the greatest possible involvement of our regulators in international standard setting, but that is more a recognition of continuation. After all, Mark Carney chairs the FSB; Vicky Saporta chairs the IAIS. We have always been leading members of Basel, ditto IOSCO. I see no change in that.

As to whether it makes international fora more important, in an integrated globalised world with interdependence between markets, that is the direction of travel in any event. Would we want to see the UK regulators continuing to play a key role? Yes. Their influence with the EU can be both direct and indirect. I imagine that, given the closeness and proximity, not just geographically, we will remain important to each other. There is bound to be an influence, whether it is direct or indirect.

Sally Dewar: The UK's engagement and co-operation at international level is going to be even more important. We do not know the outcome of an EU-UK relationship over time. We hope it stays as strong as it is, but in any event the international relationship is key. At supervisory level, our regulators work in very close co-operation today. We see that both in our interactions and in how they interact with each other to share information and work together. We have colleges of supervisors who get together every six months and talk about all the key issues impacting our firm. Those are our global US regulators alongside our EU and UK regulators. That important piece of supervisory co-operation needs to continue.

Lord Bruce of Bennachie: Given the dynamic situation you are in, in this scenario, to what extent do you sit back and let the regulators do it? You have been a regulator and now you are on the other side of the table. To what extent do the industry and companies such as yours, in this situation, perhaps more than you would otherwise, want to try to influence standards and regulations in ways you would not normally have been quite so engaged in? Is that discussion going on? Does that thought process exist?

Sally Dewar: We have always been very active in our advocacy, working with regulators and policymakers, providing, importantly, technical expertise in how a potential regulation would impact a market. That has always been fundamental to the way we have engaged with regulators, and we do not see that changing.

Julian Adams: I entirely concur.



HOUSE OF LORDS

Lord Bruce of Bennachie: We have talked about equivalence and all the gaps. How useful are international standards? Are there gaps in them that you feel it might be important to fill? Can international standards be the basis of a long-term agreement in the way the UK and the EU interact post Brexit?

Julian Adams: International standards are obviously incredibly important. What we are discovering on the insurance side is that the development and construction of an international capital standard for insurance companies is jolly difficult because markets are very nation-specific. It was difficult enough to get a long-term guarantee package agreed by the 28 different countries of the EU, let alone to try to do that on an international scale. The endeavour is important. We are very heavily involved in it, but it is jolly difficult, especially as there are fundamentally different valuation and accounting bases throughout the world, in particular in America and Europe. It is very important that we continue with that work, but we have to recognise that it is jolly difficult to get a one-size-fits-all international standard. At principle level, I can see progress. As to how the principles are implemented at individual country level, having some flexibility is probably how it will go.

Sally Dewar: I agree. Mutual recognition is a basis for an international framework that can work successfully, but it has to be done at a level that allows for flexibility and does not go into line-by-line interpretation, because then you will never get agreement. As Julian said, it is tricky to achieve, but as a global firm, international standards give us a huge amount of consistency that enables us to operate our business better.

Lord Bruce of Bennachie: It does not bode well for an FTA on financial services, does it?

Q87 **The Earl of Lindsay:** A moment ago, you referred to the importance of good supervisory co-operation. Can I ask both of you whether post Brexit you see the UK and the EU 27 and the Commission continuing effective supervisory co-operation?

Sally Dewar: We are engaging a lot with the ECB, our European regulators, the PRA and the FCA, as well as our US regulators, as we think about Brexit and the relationship between our entities. The relationship in the way we do business will change but it will not disappear, so regulatory co-operation is critical. From the conversations we have and the way we are working and discussing the relationship going forward, everything indicates that it will continue.

Julian Adams: I agree with all of that. There is a good prospect that it will continue, because it is in everyone's interests that it should. The relationships at the moment are very effective; they are good, deep working relationships. London will remain as the deepest European market, and there will be interest in what happens in the UK and how UK regulation develops, and exactly the same reciprocally.



The Earl of Lindsay: Is the direction of travel of continuing or further centralisation of supervisory powers within the European supervisory infrastructure to be welcomed? Do you see it being more effective in delivering outcomes, or do you see it causing problems for the UK post Brexit?

Julian Adams: It is important to understand that one of the primary motivations, if not the primary motivation, for that is the creation and promotion of a single internal market. To the extent that we are not part of that, there should be no direct consequence for the UK.

The Earl of Lindsay: Given that CCPs operate across borders, including within the UK, and the intended reforms that are being progressed through EMIR, potentially there will be an impact within the UK from the new measures.

Julian Adams: I think that is the logic of it.

Sally Dewar: Yes. It is another key issue that has to be addressed as we go through the negotiation. There could be significant disruption to the FMIs and CCPs, particularly if there are no transitional arrangements for them to receive recognition. The lack of equivalence and recognition that you refer to could lead to market disruption on day one. You cannot predict the extent, but from our perspective, when we had our contingency planning conversations with the PRA, it was one of the key issues we highlighted.

The CCPs would benefit from a transitional arrangement to make sure that they have their framework in place post Brexit, because in theory they cannot apply for and negotiate their equivalence and recognition framework until Brexit has happened. Until we have come out of the current regime—at the minute, it falls under EMIR and MiFID—and that framework no longer exists, they cannot negotiate a new framework. There is potential for significant market disruption if we do not have a solution that gets them from a passported framework to one that operates third country.

Q88 **Lord Skidelsky:** I want to raise a more general question about regulation and the adequacy or resilience of the regulatory framework established post the great financial crisis. It has been suggested to us, citing evidence we have received, that the UK has seen some of the worst elements of the great financial crisis but has also led the policy response, and a lot of EU regulation is based on that policy response. In your opinion, is the regulatory regime now sufficiently resilient to shocks? If not, what other measures might be needed? Will Brexit give us an opportunity to improve the existing regulatory framework? In other words, what degree of regulatory autonomy might be desirable moving forward?

Julian Adams: We are certainly more resilient, and the reform programme has definitely enhanced stability. As to whether, post Brexit,



HOUSE OF LORDS

the regulatory structure is appropriate, we completely accept the division of roles between the PRA and the FCA, but we would see room for ensuring that the objectives of regulators, from a societal perspective, are properly framed. It is not just that sufficient priority is given to the promotion of safety, standards and stability. All of those are fundamentally important to welfare, but so is competition, and, one could argue from an international perspective, so is relative competitiveness.

That must not be interpreted as a race to the bottom. There are all sorts of behaviours and attributes that make one excellent, so not just the maintenance but the promotion of London as a premier place to do business could and should be part of the regulatory toolkit. Otherwise, if your objectives are too narrowly drawn, whenever you do cost-benefit analyses you will be looking at the benefits of change or rules to your objectives, and you may not take into account the wider negative societal externalities of change of regulation—expanding welfare, as it were, and not just the promotion of safety, soundness, stability and consumer protection, even though they are important aspects of welfare. There may be other dimensions at the moment that a too narrowly drawn set of objectives may underplay.

Sally Dewar: We believe that the markets are more resilient, transparent and accountable, and a fundamental objective as we go through Brexit must be to preserve that. We want the strength of that framework to remain in place. We would absolutely warn against Brexit as an opportunity to revisit that set of rules and try in any way to undermine, change or limit that framework, not least because, if the rules in the future relationship between the UK and the EU start to diverge, the chance of getting enhanced equivalence or a mutual recognition framework that works for both sides is undermined.

As with any rulebook, over time, regulators have to be flexible. We have already seen that with the US Treasury report and the capital markets union. Markets evolve and change, and it is incumbent on regulators to be prepared to go back to the rules and challenge themselves on whether they are still fit for purpose. As a longer-term thought piece, we need to create flexibility so that rules can be subject to challenge and can evolve, but that is not in any way to try to undermine the current framework.

Julian Adams: I absolutely agree that one wants to take no action to undermine the reforms. On the other hand, we see Brexit as an opportunity to make a change where EU regulation does not sit neatly or appropriately within a UK context. If one does not take advantage of that policy freedom, what are we trying to achieve with the process if we simply follow someone else's rules? One has to be prepared to acknowledge that one can change but still deliver broad equivalence of outcome.

Lord Skidelsky: Mr Adams, earlier you gave what I suppose is the regulator's view that all your successes are private and all your losses are public. Is there not a tension between competitiveness and stability? In



HOUSE OF LORDS

your view, is it just a question of getting the right balance between the two?

Julian Adams: It is a question of balance. If you interpret competitiveness as a race to the bottom—low standards, bonfire of regulations—that is a caricature of what competitiveness might be. Competitiveness could be the promotion of the highest possible standards. We changed contract certainty within the UK market, where in wholesale insurance you have to agree the terms of contract before you go on risk. That is an area where we were “super equivalent” to the rest of the market, and it was taken as a differentiator of London as a place to do business. You could argue about the excellence of the supervisory framework. I do not think it is a question of a race to the bottom, but you can promote London as a centre, and in a post-Brexit world that may be more appropriate and necessary. How you choose to promote London would clearly be on the strongest possible terms, and that is not a race to the bottom.

Q89 **Lord Haskins:** Our remit has been to look at opportunities as well as risks in this whole exercise. We are struggling a little on the opportunities side. You have slightly kiboshed the idea of a bonfire of regulation, but is there scope for financial services to pursue further opportunities outside the EU as a result of Brexit, or could that happen at any rate?

Julian Adams: The fact that we have built a business where 75% of our revenues—our IFRS profits—are outside the EU means that clearly we can do that now. To reassure you on opportunities post Brexit, the point I made earlier about the risk margin being calibrated at an inappropriate level and being pro-cyclical in the way it operates is not just an industry view; it is a view that the regulator itself shares. A direct consequence is that we have withdrawn from writing individual annuities. To the extent that that means less capacity and produces less customer choice, and if, in time, other people respond, it may or may not affect pricing. We would argue that there are opportunities post Brexit when you have a degree of policy freedom. Clearly, you would want to exercise that policy freedom within a corridor of flexibility that does not call into question mutual recognition, but our starting point should be that we have a regulatory framework that is appropriate for the UK. That gives opportunities.

Sally Dewar: UK regulators have always taken a leading position on innovation and competition and looked at them in a positive way. Just look at some of the things the FCA has done recently, for example around FinTech, in taking a global initiative with an innovative platform on which to encourage new business. The regulators understand their competition objectives in the broadest sense and will look to enhance the UK market wherever they can, within their regulatory framework.

As a firm, our absolute focus, as you would expect, is on what happens to our clients and the market on day one post Brexit, and making sure that we have continuation of markets. Market players will always find



opportunity in the market in the longer term, but our current focus is on making sure that we are ready and can serve our clients on day one.

The Chairman: Thank you. This has been a very useful session. We will now conclude it and move on to the next session. Thank you for coming and taking the time to share your thoughts with us.

Examination of witnesses

Flora Coleman and Charlotte Crosswell.

Q90 **The Chairman:** Welcome, Ms Charlotte Crosswell, CEO of Innovate Finance, and Ms Flora Coleman, Head of Government Relations for Transferwise. Welcome to our inquiry on financial regulation and supervision following Brexit.

You have a list of interests that have been declared by Committee members. This is a formal evidence-taking session of the Committee. A full transcript will be taken and put on the public record in printed form, and it will be on the parliamentary website. You will be sent a copy of the transcript and you will be able to revise it if there are minor errors. The session is on the record; it is being webcast live and will be accessible subsequently via the parliamentary website. Do either of you want to make any opening remarks, or can we go directly to probing you about these very interesting matters?

Flora Coleman: We can go straight to questions.

The Chairman: Would both of you like to express briefly what you see as the drivers of innovation in FinTech? In that regard, could you also comment on regulation and supervision? How much of it do you think fits your industry? What elements do you want, or is it technologically neutral?

Charlotte Crosswell: We have to appreciate that FinTech is fundamentally changing the way financial services operate, in the way we transfer, borrow, protect and manage our money. Subsequently, barriers have been lowered, which has made it easier and quicker for new and innovative firms to enter the market.

The UK Government have explicitly supported FinTech for three reasons: competition, competitiveness and consumer outcomes. We have to remember that the largest four UK banks still provide 85% of SME banking. The competition mandate led to FCA's Project Innovate and the regulatory sandbox, which has been successfully copied across the world. Growth has been driven by talent, policy, capital and demand. Policy has been named as a key strength driving FinTech innovation and is one of our advantages here in the UK. I will pause and hand over to Flora to make some comments.



HOUSE OF LORDS

Flora Coleman: Transferwise is specifically a payments firm licensed as an e-money institution, so that will be the majority of my perspective, rather than speaking for the whole industry, as Ms Crosswell is able to do. The key drivers of innovation in UK FinTech from our perspective are consumer-led innovation. We listen to what our consumers want. For us, it is low cost, fast speed and being very convenient, and the regulatory space is to enable those innovations.

You mentioned technology-neutral regulation. A key aspect, rather than specifying a monthly statement that needs to be given out in a specific format, is the principle of keeping customers regularly updated at periods, such as a month, by means necessary for them. Different ways of drafting regulation are key in enabling innovation and enabling firms to respond to their customer needs rather than the specified needs of policymakers.

The Chairman: In that case, what are the major risks that you encounter and evaluate, to the industry itself and to UK financial stability, in regulating FinTech?

Charlotte Crosswell: There are still risks. There is operational risk from open banking. Cyber-risk is still significant, with some firms reporting attacks being attempted all the time. We have to be aware of that and provide against it. To mitigate that, in the UK there is activity-based regulation, which regulates activity in much the same way as other regulated areas of financial services, thereby not reducing the standards of regulation for FinTech.

The Chairman: In that sense, would you agree that because you do something slightly cutting-edge—a bit of frontier stuff—the regulation of your industry should not be different but should continue to be regulation that aims to enhance financial stability?

Charlotte Crosswell: Yes. We have to adhere to high standards. In FinTech, navigating the route to authorisation is key in making it easy to come to market. We still hear stories that it takes an average of 10 months to get authorisation, with an average cost of £65,000. It is very important that we aid companies to come to market by that route, but we must not drop our standards, because potentially that is what sets us apart globally.

Flora Coleman: In the payment sector, we are as regulated as a bank is for the service we provide. In particular, echoing the point about activity-based regulation, that is the key way of regulating and overseeing FinTech, because you are looking at the product and what it is necessary to provide. In particular, I would like to look at the opportunity of correcting some potential systematic risks, which relate to the fact that non-banks safeguard client funds and consumer funds with commercial banks. The UK Government have taken some excellent steps to rectify that. From next year, non-banks such as Transferwise will be able to safeguard funds at the Bank of England and have direct access to the



payments system. That will reduce systematic risk by enabling FinTech to have access to the payments system. It is really exciting.

Q91 **Baroness Liddell of Coatdyke:** Is the FinTech industry concerned about Brexit?

Charlotte Crosswell: There are constant concerns, not just affecting FinTech, but some things are specific to FinTech, especially in financial services. It is an area that is international from day one, so the ability to do business cross-Europe is high up the list of priorities. We certainly need to continue to be members of the single European payments area. That is available to non-EU firms, but only if we have regulatory convergence. Forty per cent of firms are payments firms; 40% of money raised by financial services goes to payments firms, so we have to ensure that those payments companies are still available to do business across borders. Concerns are raised most about passporting and single market access.

Flora Coleman: Transferwise was formed as a result of an EU directive. We were formed only in 2011, jointly in London and Estonia, by two Estonians. We have total interoperability across the EU, with three offices in the EU and a further six around the world. As a cross-border payments firm, we need to be able to serve our European customers. We do that currently under a UK licence that allows us to passport that service everywhere in the EU. The big concern for us is service continuity, and allowing consumers to get the same great product the FCA allows us to produce, because of minor differences in regulation in different markets.

Baroness Liddell of Coatdyke: Have you been involved at any point in the exercise that the PRA is doing on the impact of a cliff-edge Brexit and contingency planning? Do those mainstream issues affect the sector at all?

Charlotte Crosswell: The majority of FinTech is not regulated; over half the FinTech members of Innovate Finance are not regulated firms, because they may be in the data space. It differs widely and we should not forget that, but the cliff edge is an issue.

There would be huge value in a transition period, because FinTech firms would know what they were trying to move towards. The good thing is that they are nimble, agile and able to move very quickly. The advantage of that, if we have a transition period, is that firms will have time to prepare and can move quickly. If we do not have that, they will not know what they are trying to plan for.

The contingency planning may be that they have to look at offices in the EU. Transferwise has already done that, but for a lot of firms at an earlier stage of growth that is not necessarily what they are doing at the moment. Contingency planning for them is considering what is going to happen, and if there is a transition period they will use that to determine what their action is.



HOUSE OF LORDS

Flora Coleman: You asked how engaged we are. We are very engaged with the UK Government, and with other European Governments and the European Commission to explain some of the issues that might hit payments and consumers in the event of a cliff-edge Brexit.

The Chairman: Ms Crosswell, do you have any comments to make on talent? You mentioned talent in response to the first question.

Charlotte Crosswell: Talent is one of the key issues. Recently, a census was done by the Treasury in which it was raised as one of the major issues for FinTech and its concerns about Brexit.

The Chairman: Immigration and access.

Charlotte Crosswell: Yes, and the general skills shortage. We should not put it down just to Brexit. There is a skills shortage in the UK, as we look to replace STEM skills through education and university. We cannot risk losing out on talent; 30% of our members were born overseas—our FinTech founders—which shows that entrepreneurial spirit does not necessarily come just from the UK. In Silicon Valley, 40% of tech workers, taken collectively, are non-US workers. The relevance of that is that it shows that entrepreneurs have choice of location; there are roles overseas that they can go to, so we have to continue to make the UK a friendly and easy place to do business so that they continue to want to work here.

We have an ecosystem that is functioning extremely well, so there is a desire to be here. The reason FinTech has been so successful is that ecosystem and its proximity in one place, London. We have financial services firms with FinTech firms sitting alongside; we have a regulator who has done some very progressive work on this, but we should not forget that it is a global competitive environment for talent.

Flora Coleman: To add one extra aspect to the talent piece, for high-growth global companies such as Transferwise, intercompany transfers and arrangements between offices are really important when we are looking at new trade deals or new aspects of trade deals, and in our relationships with European Union member states.

Q92 **Lord Butler of Brockwell:** Can we look over the cliff? In the worst case, if there was no agreement, what do you think would happen to your industries?

Charlotte Crosswell: At the end of the day, it all depends on what we do on regulatory convergence. To take a step back and look at MiFID and what that did to firms sitting round the MiFID table, there are countries outside the EU that still comply with MiFID regulations. They do that to show best practice. If we continue to do that in the UK, and maybe adhere to some of the European directives, there may not be such an issue as we look to regulatory collaboration. We have to assume that.



HOUSE OF LORDS

Obviously, passporting is used by a significant number of firms in the UK. If we do not have passporting, how can we drive business forward and continue to do business with Europe? That is a more challenging question to answer. We have to show how many firms are using passporting. Over 5,000 firms are using it. What do we do to replace it, and how can we work with other European states to ensure that there is regulatory convergence and that we do not have regulatory arbitrage?

Lord Butler of Brockwell: I want to make it a bit worse than that. Suppose there is no convergence, and we just walk away from the table and passporting is denied to us by the EU. Could the industry continue to flourish in Britain at all?

Charlotte Crosswell: We have a strong financial services sector here. The reason FinTech is so successful is that it sits alongside financial services. I think we will continue to see FinTech being very successful while FS is strong here. In the worst-case scenario, if we suddenly see banks moving to Europe, there is potentially a different issue, but we have to remember that a significant number of FinTech firms in Europe want to bring their business to the UK. We have collaboration and sharing agreements across some cities in Europe to do that. It is not just about our FinTech industry wanting to do business in Europe; European firms also want to do business with financial services here, and that is why the ecosystem works. We have to continue to promote that.

As to the cliff-edge scenario, I think everyone is aware of the marketing push by Paris, Brussels, Copenhagen and German cities. Firms are sitting there trying to get FinTech companies to move to those cities, but it is not a simple matter. The fact that there is some fragmentation potentially works in our favour. I remain hopeful that we will find a solution, but it relies very much on successful financial services remaining here.

Baroness Liddell of Coatdyke: From what you said, I worry slightly that there could be a danger of FinTech industries being drowned by the regulatory voice of mainstream financial services. Is that a risk?

Charlotte Crosswell: If we look at the success of FinTech over the next few years and the way financial services are already implementing it, at the moment it is sitting slightly alongside. We are seeing it being implemented at the heart of every bank. I do not believe it is drowned out. Financial services are looking to continue to innovate and drive their business forward using FinTech, and we see more and more collaboration not only FinTech firm to FinTech firm, as they look to have a stronger, larger offering, but FinTech to financial services. I do not believe that is a risk. We will continue to see that innovation over the next few years.

Flora Coleman: I do not think there is a "We win, they lose" or a "They win, we lose" element. The payments market is so international that we have to undertake contingency planning that requires us potentially to get another licence somewhere. That is fairly straightforward; we are in the process of relicensing with the FCA under PSD2 anyway, and we have



HOUSE OF LORDS

multiple licences around the world. Most payments firms are quite experienced in this, so at a practical level in the short term, with a cliff-edge Brexit, we will have an extra licence that allows us to operate in two countries.

There are two small areas I have raised at both European and member state level where clarity would be very useful, because there could be lack of convergence. One is in payments. A concept introduced under PSD2 is the one-leg transaction. All the legislation under PSD2 refers to intra-EU payments, and payments involving only one party within the EU. Only some provisions of PSD2 apply to one-leg transactions. When we leave the EU, if it is a cliff edge and there is no agreement in member state law to update that, those will be considered one-leg transactions. It will be interesting to see whether that area is corrected over the course of the coming year.

The other area is that, prior to the triggering of Article 50, the UK Government agreed to implement all EU legislation in UK law, but there are a number of new proposals that the UK is currently negotiating as part of the European Union until March 2019. We are looking for clarity about what happens to initiatives such as those under the action plan on retail financial services. That will also be an interesting area to look at to make sure that the cliff edge is manageable for firms across the EU and consumers are not affected.

Q93 **Baroness Neville-Rolfe:** I am interested in how closely aligned the UK and EU FinTech regimes should be in the future. Ms Coleman has already commented a little on some of the things that are coming up. Beyond Brexit day, bearing in mind that we have heard that the UK is more pro-financial innovation than some other members of the EU, I would be interested in your comments on that.

Flora Coleman: As a payments firm, harmonisation is always valuable, especially in a high-growth tech firm with a small number of people. It makes it much easier to grow and enter new markets, but harmonisation pure and simple without being discerning about the policies will not be productive. There are some areas where there is lack of harmonisation, such as digital verification. Because AML—anti-money laundering—is a member state-led policy, that area has allowed for innovation. UK firms can offer digital verification to all European customers because of the FCA's decisions on interpreting anti-money laundering legislation. If it was fully harmonised, they would not be allowed to offer that service, because general consensus would have to be agreed and it might lack that sort of innovation. Harmonisation is great because it allows for expansion, but not when it is of the worst policy.

Charlotte Crosswell: Going back to the example I gave earlier, the seat at the table has been valuable so far for input to that. We may have been one voice, but we were quite a strong one, so we need to continue that collaboration. We should not forget that there are firms wanting to do business in the UK. Lack of market access could lead to issues such as



HOUSE OF LORDS

scaling, a decline in investment and limited access to the talent pool, which we covered earlier. We need cross-border regulatory and consumer protection rules and a strong collaborative environment to ensure that we continue the success of the sector.

Baroness Neville-Rolfe: Are you confident that there will be evolving rules for FinTech that allow continued equivalence, or, given the slightly different perspective of the two groups, do you think there will be divergence and problems without access to the single market?

Charlotte Crosswell: When we look globally, historically convergence has generally been the way forward. We have seen that happen in other jurisdictions. It is about adhering to the standards. The EU benefits from access to the UK; it benefits from progressive policy, the global financial services hub for Europe and the ecosystem I mentioned. It is a two-way approach, but we need to ensure that it continues.

Flora Coleman: You have to be sensitive in the way you interpret EU legislation. Currently, we build into the negotiating process member state derogations, echoing and using those, while spotting where lack of convergence has no harm and presents us with an opportunity. PSD2 is a very good example of recent European legislation. In the implementation process, the UK Government said that they would be interested in increasing transparency and pricing display for payments, but given that the EU legislation reaches only a certain level, they cannot go above and beyond it because that would be gold-plating. An environment where we leave the EU means that we can go above and beyond EU legislation, because it would not be gold-plating.

Baroness Neville-Rolfe: Thank you for your answers. This is quite a difficult area. If you have further thoughts in the light of the questions I asked, we would be interested to hear them.

The Chairman: Do write to us.

Q94 **The Earl of Lindsay:** How does Brexit impact on the regulatory framework on which you currently rely?

Charlotte Crosswell: We have already mentioned the response to PSD2. That is not just Brexit; it is something on which FinTech firms are relying to open up banking. We have to be aware of how GDPR sits alongside PSD2, and there is a need to align the FCA and the ICO to ensure that that works. As Ms Coleman said, there are dates when some regulatory technical standards will come in post Brexit. We have to understand, therefore, how they will apply to domestic law. If GDPR and PSD2 align, it will work very well, but we have to make sure that the alignment is there and that it is applied.

Flora Coleman: For us, the regulatory framework is the Payment Systems Regulator and the Financial Conduct Authority. They are our lead regulators in the EU. If Brexit has the effect that there is no passporting deal and no second main regulator, that would be our main



HOUSE OF LORDS

regulator for European transactions. It would have a straightforward effect. The other one, as Charlotte said, is the implementation of current and future legislation.

The Earl of Lindsay: Important issues such as data and payments systems are moving targets in one sense—there is an agenda, and progress is still being made. Decisions will have to be made by the UK Government in both respects as to how much further implementation of new measures is imposed; and, for PSD2, whether we want to gold-plate it once we are free. Are you both confident that the Government, the Treasury and other key players, such as the FCA, are pointing in the right direction for you on post-Brexit outcomes on data and payments?

Flora Coleman: On data protection, one of the exciting things about the UK Government's approach is the global outlook. We are a multinational firm, but very small, and we operate in a number of countries. There are multinational agreements, but storage of data is an area where there are a lot of conflicts. Say a European consumer living in the UK is sending money to Australia. Which data protection rules do you apply? My main point on data protection is about making sure that countries and Governments continue to co-operate to work out those conflicts and find some adjustment.

Charlotte Crosswell: It increases liability. Where does that liability sit? That needs to be clarified. FinTech and banks are likely to find consent a challenge while this continues to be a slightly grey area, with increased liability for those who handle data. We have to review it. Conversations are happening, but it needs to be aligned in the short term.

The Chairman: Ms Crosswell, in the replacement of Safe Harbour—the data privacy shield agreement with the US—do you see any opportunities for the UK in negotiating a new agreement, because we will not be covered by the privacy shield post Brexit?

Charlotte Crosswell: If I may, I will come back to you on that.

The Chairman: It would be interesting to hear what risks, threats or opportunities you might see in the negotiations. Perhaps you would tell us about the timeline over which you see that evolving. Thank you very much.

Q95 **Lord Woolmer of Leeds:** Are there any examples of UK regulatory innovations in your area being impeded by EU membership, or has EU membership been of no consequence in the ability of the UK Government to have an innovative approach to FinTech?

Flora Coleman: A primary area is one where we have a lot of freedom in the UK—anti-money laundering—to make sure that it is technology-neutral and pro-digital. It has not held back the UK, apart from where the UK has not sought to negotiate at least some freedom to make its own decisions. Another thing we spotted recently is more harmonised policy areas, such as the payment services directive, which are agreed fully at



HOUSE OF LORDS

the level 1 text. It is not just a UK issue. With strong customer authentication proposals, strict drafting at European level 1 has made it very difficult for all industry to implement a risk-based approach, which is the UK's approach to regulation. I would not say it is a UK-specific issue; it is a broader policy drafting issue when there are maximum harmonisation directives.

Lord Woolmer of Leeds: Some of the evidence to us has been concern that other member states post Brexit will make, and are already making, a major effort to innovate to attract FinTech and so on, and that rush for new industry—the frontier businesses—could itself result in more risk being taken than we would regard as sensible, and cause potential problems in the future. Do you have any comment on that?

Charlotte Crosswell: The European Commission announced the setting up of a financial technology task force to look at policy to be directed towards an EU-wide licence for technology companies in the financial services sector, with the regulatory framework and sandbox environment covering the Union. We absolutely need to ensure that we review the standards, and that there is no drop in standards. In the UK, we have a history of gold-plated standards. We have often led the way in asking people to adhere to higher standards than before. It is certainly something we are aware of and are keeping a watchful eye on, and if necessary we will speak publicly in due course.

Lord Woolmer of Leeds: My last question concerns what we can learn from other countries. We are all very pleased and proud of the developments in FinTech in the UK, in London in particular but also outside it. There are other centres around the world that are pretty vigorous in FinTech. Are there any lessons for the UK regulatory framework in an innovative approach to FinTech from our competitors elsewhere in the world, not just in the EU?

Charlotte Crosswell: We can certainly learn from abroad, and we continue to see successes across the globe. To a certain extent, we have led in this area, and other countries across the world have learned from our successes, such as the regulatory sandbox, maybe taking that to the next level. The Monetary Authority of Singapore is very supportive. One regulator is able to move things forward quite progressively, and it is becoming a FinTech hub, but that is Singapore; it does not necessarily cover the whole of Asia.

In Austria, we have seen strong developments in regulatory reporting. There is a shared reporting utility, with an interface between banks and the central bank. India's national digital identity scheme is being developed into IndiaStack. There are certain lessons we can learn. We should not forget that we have a progressive regulator here looking at that and trying to take that leadership role. We have done extremely well in that and will continue to do so.



Flora Coleman: The sandbox concept in the UK has been used, and the first cohort is coming through. The first two cohorts were announced only this year, and we will see the effects of that as it goes through. The concept is being used to allow existing firms to try to push the boundaries of regulation in a highly supervised environment. We have been in discussions with a number of countries about using the sandbox framework for that purpose. Developing the sandbox technique could be an opportunity where the UK could learn.

One of the most interesting things is that being the first mover is not necessarily an advantage, because, if you are the first person to try an innovation, other people can learn from it and just roll it out very quickly and easily. A new payments architecture has come from industry recently. The blueprint was consulted on earlier this year. There is no complacency in our faster payments system. We have had a comprehensive analysis of what is good and what is not, and what can be improved, and that will be rolled out over the coming year, so that is quite exciting.

The Chairman: Could I dig a little deeper into Lord Woolmer's question about other players. Who within the EU do you see as your greatest competition? Which city in the EU would you rank as your nearest rival?

Charlotte Crosswell: The one making the most noise is probably Paris. It has put in a two-week process to get a licence and set up a company. It has something called Station F, where people can get tax advice, regulatory advice and set up a company quickly. It is a very streamlined process. The French are certainly doing the biggest marketing push. We have regular visits from the French, and, to be fair, our FinTech firms go over there to do business with French banks.

We also see it in other cities. Berlin has the four-day Blue Card, to enable people to set up in four days. People could look at our area and be quite jealous of that. Copenhagen has been doing a big push as well, led from the very top by the Finance Minister. We have seen that. We were very pleased to hear the announcement by the Prime Minister today about putting more money into tech cities, and generally into technology and bringing in highly skilled workers, so we should not forget that we are continuing to push forward.

If anything, I believe there is a possibility of fragmentation in the EU post Brexit. Each city will have its own successes. In Germany, they have coined the phrase "cyber valley". Clearly, Germany is going after cyber firms. We will continue to see that, but the ecosystem is not there. While we can retain the ecosystem we will do very well, and we should be proud of taking that leadership role both within Europe and globally. We should share our experiences, not necessarily seeing a threat but encouraging firms to come and do business with us in the UK as well.

Q96 **The Chairman:** Do you have experience of being supervised in multiple jurisdictions? Do you think that will become necessary in the environment



post Brexit? Ms Coleman?

Flora Coleman: I am sorry. Could you repeat the question?

The Chairman: What are your views on supervision across multiple jurisdictions? We have just talked about how accessible other rivals are making themselves, but the issue of supervision is slightly different. Does Brexit pose an issue for you there?

Flora Coleman: It is already an issue.

The Chairman: I am thinking about EMIR.

Flora Coleman: There is already an issue in the European Union about the existence of joint supervision. Member states still reserve the right to supervise on anti-money laundering, and some exercise that right. The key thing for us as a company is effective co-operation between supervisors through things such as information-sharing and reduction of duplication. A good example would be sending suspicious activity reports. Where there is to be joint supervision, the key thing for us is clarity over which regulator leads on what issue, and good agreements between regulators. We see that with the FCA; it is very good at engaging with fellow regulators.

Q97 **Lord Bruce of Bennachie:** I want to develop that in terms of how you engage internationally. If you offer cheap, fast and secure transfers across geographical and currency boundaries, to what extent can standards and regulations inhibit that or enhance it, and enhance your capacity to compete fairly, because that is the real issue? What role do you think standards and regulation can play in ensuring that you can continue to do that and it does not inhibit you?

Flora Coleman: From our perspective, what I have seen over the few months that I have been working in Transferwise is a great example of international standard setters reaching out to FinTechs and providing an environment to enable us to engage. We are fast-moving small teams, so organisations such as the Financial Action Task Force have been very good at reaching out. The FATF had a FinTech forum in the US earlier this year, and its standard annual private sector consultation forum is attended by all the national regulators as well as financial services firms. Traditionally, it has been attended only by the incumbents. Earlier this year, I attended along with a number of other very high-growth, small payments firms and challenger banks. Reaching out and providing a platform and support for challengers and disruptors to engage in traditional forums and standard-setting bodies is a good element.

Lord Bruce of Bennachie: It is almost the opposite of how it operates in other areas of regulation. You are bright, young and small, yet what you are saying is that those organisations engage with you because you are developing new markets, whereas if you were in the traditional sector they would be worried about you.



HOUSE OF LORDS

Flora Coleman: Definitely. The efforts to reach out to us are really welcome. We have a different perspective from most firms, because the multiplicity of the jurisdictions in which we are operating corresponds to the size of the team. Traditionally, FinTech firms, when they go international, might have a core compliance team of five or six people, whereas an incumbent will have five or six people for just one jurisdiction, with very clear barriers between those jurisdictions.

Lord Bruce of Bennachie: Does that mean that you think you can help to set standards, effectively, and that you have enough of an ear to be able to help shape standards in a way that is beneficial to the consumer as well as to the development of the business?

Charlotte Crosswell: To pick up the point about five or six people across the whole team, we have to remember that FinTech works well because it is agile and nimble, and has small teams that have low costs. We do not want to put so much work on to those FinTech firms that they spend a significant amount of time looking at compliance and supervisory structures but do not actually grow their business. That is the push and pull. As companies start to scale up and grow and have a voice at the table, we want to ensure that we give them the ability to continue to scale up and grow without having that potential burden.

Lord Bruce of Bennachie: The suggestion is that FinTech in the UK is leading the field. Are you also leading the field in helping to shape standards? Do you feel you are in a position to do that? I am not saying that you are going to write all of them yourself, but do you feel you are in an influential position?

Charlotte Crosswell: As we said, it is a market people are listening to. This is not just within the regulators; it is within financial services firms themselves. Twenty per cent of my members are large banks, and the heads of innovation at those banks are driving forward their FinTech agendas. It is not just FinTech firms. Knowledge-sharing is incredibly useful and allows FinTech firms to share their experiences, and some banks understand how those experiences can help them as well.

Flora Coleman: The big pressure is time to engage with international forums. We are very focused on delivering our service, but our key driving factor is what is best for the consumer. That is quite an unusual opinion to bring to traditional forums where you are discussing financial services regulation, and where the first concern, traditionally, has been the impact on business rather than the impact on the individuals using the service. That has been one of the things FinTechs have been able to bring to financial regulation development.

Lord Woolmer of Leeds: You talk about the consumer all the time. What proportion of the FinTech business currently in the UK is servicing other businesses? It is about purchasers, not the way we as politicians talk about consumers. First, what proportion of the FinTech industry is servicing other businesses? Secondly, how many FinTechs are in-house to



HOUSE OF LORDS

existing institutions of significant size, as opposed to being small, entrepreneurial and frontier-led and servicing consumers? I am trying to understand the nature of the business and where it is making an impact.

Charlotte Crosswell: When FinTech started to evolve, it was definitely in the B2C space. The majority of payment services firms were definitely around that space. We recently conducted some research, and we saw that there was a pivot towards B2B and servicing other businesses. That is a trend we expect to continue, for several reasons.

When we looked at FinTech, people saw B2C very much as an innovation, and firms such as Transferwise were leading some of the innovation. We are now seeing collaboration coming through and that is where we see B2B—firms jointly finding a solution to provide it to firms as well. The major banks often have foundries, accelerators and incubators outside the general head office to lead their innovation, and there will be FinTech firms within those. Collaboration is not just start-up to start-up; it is start-up to bank and that, potentially, is leading the slight shift to B2B.

Flora Coleman: At Transferwise, we serve businesses as well and provide back-end payment services, which you may not even be aware of. Three banks in the EU currently use Transferwise for foreign currency provision to their consumers. When I say consumers or customers, it is ultimately an end-user focus rather than specifically our customers as a business. That is the driving force, certainly for our company and most of the FinTechs I know and deal with.

Lord Skidelsky: What proportion of total lending in the UK is done through or by FinTech firms?

Charlotte Crosswell: We would not have exact data. We may be able to provide it to the Committee. From the payment statistics on money raised at the moment both in the UK and globally, about 40% is going to payment services firms. Short of that, I do not have further data at the moment.

Lord Skidelsky: I would appreciate that.

Q98

Lord Haskins: I want to raise the issue of access to start-up capital. We have been given some information to the effect that the European Investment Bank is supplying as much as 50% of the finance for venture capital, and presumably FinTech companies benefit from that too. It is very likely that the European Investment Bank will no longer be part of that funding process in the future, and the Government are pushing forward the British Business Bank as the alternative. Is it a satisfactory alternative, and will there be a smooth transfer from one to the other?

Charlotte Crosswell: I hope there is a smooth transfer. About 50% of the EIF fund goes to UK companies, as you rightly say, so we definitely need a replacement source of funding.

Lord Haskins: It is a huge figure.



HOUSE OF LORDS

Charlotte Crosswell: It is a huge figure, but if we look at where innovation in FinTech is taking place, it should not surprise us that the majority comes to the UK. The EIF invests about 200 VC funds across the continent. To give a direct comparison, the British Business Bank invested 30 VC funds across the UK. We need to ensure that we have start-up support and are able to replace that funding. That could come either through the British Business Bank or the business growth fund, although the BGF cannot currently invest in FinTech firms. There is potential to use that vehicle instead, but there would have to be a dedicated focus on FinTech.

Alternatively, or as well as, we can expand British Business Bank resources with capital while reassessing qualifying activities for the EIF and the SEIS. It is something we need to consider quite urgently. It has been raised by a significant number of our members who are beneficiaries of the EIF. To have something that also addresses the regional coverage of the British Business Bank is incredibly important, where again we have seen the dominance of London and the south-east.

Lord Haskins: It seems to me that a huge amount is being relied upon from the British Business Bank, wherever you go. Is the Treasury taking the matter seriously?

Charlotte Crosswell: It is acutely aware of it. Obviously, this is data we work on constantly. If we come back to the concerns around FinTech firms—we talked earlier about talent and passporting—the biggest one by far is investment and access to start-up capital, and that is information we supply and on which we have regular meetings.

Lord Haskins: There is concern generally that, as European funding runs down, the alternative sources from the UK will not run up as quickly and there will be a void. I am not saying that it will be in this particular area, but is there a danger of a void in funding for businesses during the period from 2019 to 2021 onwards?

Flora Coleman: The UK Government announced a boost in funding, but there is also private sector capital. The environment is very healthy. Just last week, we announced the closure of our series E funding round, which was very oversubscribed. We raised \$280 million. It is not just us. Deliveroo raised even more than that recently, and Monzo, a new challenger bank, has also been raising money very successfully from the private sector.

While the boosting of public sector funding for these initiatives needs to be maintained and the British Business Bank is the right funnel for that, it is also about the supportive regime, particularly in taxation and employee capitalisation, which the Government can set for firms to enable them to capitalise better in the early stages pre-IPO. In particular, the Treasury released its patient capital review consultation. We anticipate some announcements next week in the Budget. The UK Government are



HOUSE OF LORDS

looking throughout not just at start-up or scale-up funding, but the through-space in financing high-growth firms.

Charlotte Crosswell: I have some statistics on that, if it would be helpful. Under EIS, 3,265 companies raised a total of £1.8 billion of funding in 2014-15 in the private sector. This was higher than any previous year, and three times higher than the average EIS investment level between 2001 and 2010. As we look at how we replace that EIF funding, it is important to look at it from the private sector.

Lord Skidelsky: To get some clarity, what do you see as the relationship between FinTech companies and the British Business Bank? First, are they going to pursue their paths separately from each other? How do they collaborate? Secondly, what you are addressing is a long-standing problem, is it not? Ages ago it was identified as the Macmillan gap, which was the lack of venture capital for start-ups. It is odd that we have relied on the European Investment Bank to the extent we have and, therefore, are now faced with the problem of filling the hole. Why have we not been doing it ourselves?

Charlotte Crosswell: If I can talk at a high level, we have a very vibrant VC industry in the UK. Many of those firms tell me they have plenty of cash to invest. FinTech, being the phenomenon it is, unless firms are getting through the series A to D stage, has not necessarily been able to tap into that capital. The VC industry is reviewing how there can be more certainty of investment at an earlier stage of companies' growth, and how to promote FinTech to the VC industry. As a member association, we are in active discussion about how we can educate the industry, and maybe showcase at an earlier stage of growth some of the talent that may be able to tap into that capital. We recognise that there is definitely work to be done, but hopefully we will continue to push that hard.

The Chairman: Thank you. We have come to the conclusion of our session today. It has been extremely illuminating, and we look forward to your further thoughts in writing. That concludes today's public evidence.