HOUSE OF LORDS

Select Committee on the European Union

EU Financial Affairs Sub-Committee

Oral evidence: Financial Regulation and Supervision following Brexit

Wednesday 29 November 2017

10.15 am

Watch the meeting

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

Evidence Session No. 7 Heard in Public Questions 99 - 115

Witnesses

I: Mr Andrew Bailey, Chief Executive Officer, Financial Conduct Authority.

II: Mr John McFarlane, Chairman, Barclays.

Examination of witness

Mr Andrew Bailey.

Q99 **The Chairman:** Good morning, Mr Andrew Bailey, Chief Executive of the Financial Conduct Authority. Welcome to our inquiry on financial regulation and supervision.

This is a formal evidence session. You have a list of interests declared by Committee members. A full transcript will be taken. It will be put on the public record in printed form and will be on the parliamentary website. You will be sent a copy of the transcript and you will be able to revise any minor errors. The session is on the record. It is being webcast live and will be subsequently accessible via the parliamentary website, should you wish to look at yourself a little later. Would you like to make any brief opening remarks?

Mr Andrew Bailey: No. Given the time schedule, it would probably be most sensible to go straight to your questions.

The Chairman: Thank you. The EU (Withdrawal) Bill, which is currently going through Parliament, seems likely to transfer quite a lot of powers on financial services to regulators. We have been taking evidence on that from our witnesses during this inquiry. How does that sit with your thinking about the role of the FCA? Would you like to tell us what you think should happen for orderly management of the regulatory process?

Mr Andrew Bailey: It raises a major issue, which in many ways goes well beyond the boundary of the FCA. In the nicest sense of the term, if you do not mind me saying so, it raises a big issue for the role of Parliament. I do not presume to have the answer for that, but I will refer to it.

Clearly, in the world in which the FCA operates at the moment, there is a split between policy originated from the EU and policy originated domestically, which in itself falls into two categories; there are things that come out of domestic legislation in the UK and things that we do ourselves. Obviously, there are boundaries around that. It is also the case in the EU system that the European Parliament plays a different role in its formal responsibilities, powers and scrutiny from the role that is typically played here.

The withdrawal legislation, and my interpretation of it, is rightly constrained from our point of view. It does one thing that is absolutely critical, which is that it gives us a rulebook on day one, post Brexit. In essence, it aims to have the same rulebook as we have today, the only change being, in the technical terms of the work we are doing on that, to deal with the inoperables—the things that would not work if you just literally translated them into a UK setting. Those are very tightly constrained, and rightly so. The question really is: what happens thereafter?

To my mind, there needs to be a sensible debate about the scrutiny of the process thereafter. I should say that, in the FCA, we operate, as does the Bank of England, under a very clear set of rules of engagement. We have responsibilities to consult on any proposals we make. We consult when we are implementing European legislation, although of course it is a very constrained form of consultation because we cannot change the underlying rules in that situation. We are under a responsibility to produce a cost-benefit analysis, which we do, for the proposals we make.

Looking forward to the future world, the question is about what degree of scrutiny, or ability to scrutinise, would Parliament wish to have of the role we would have in the future, given that, if you translate the European arrangements literally, particularly the powers that currently rest with the European Supervisory Authorities—the three ESAs—they would translate to us in the Bank of England. That is an open question. It would make sense from the point of view of our accountability for there to be the power for Parliament to scrutinise things that we do in the future. I would not object; in fact, I would welcome it in some ways. I would be hesitant about making it the norm, simply because of the sheer volume of activity across the board, not just from us but in every other walk of public policy implementation.

This is a very important issue, which in some ways, because of the many other important issues that Brexit raises, has probably had less consideration than it needs to settle on a system going forward. I am very happy to offer views in that debate, when it happens, as to what would be sensible.

The Chairman: Would you care to share a little of your thinking in that regard? When we heard from the industry, on the whole, most of our witnesses thought that having the regulator define the rulebook would be the preferred option.

Mr Andrew Bailey: The reason for that is that there is a greater degree of flexibility in giving a larger role to the regulator. In a sense, the degree of flexibility reduces, as you know better than I do. If you start with primary legislation, go through secondary legislation and end up with our rules, the degree of flexibility to change things increases as we go down that scale. There is value in flexibility; I understand why the industry takes that view, and I agree with it. What industry then reasonably says is, "Yes, but we want some degree of scrutiny, and checks and balances on what they do". As I said, you already get that through the consultation and cost-benefit requirements under which we operate.

In principle—we should discuss this more—I would have no objection if there was a view that in some way Parliament could say, "We reserve the right". In a sense, you have it today, but you might formalise it. If there is something you are consulting on or planning to do that turns out to be particularly controversial or raises particularly big issues, you can scrutinise it more formally. I would not object to that at all, because in many ways, from our point of view, it would be sensible accountability and transparency. I would not do it for everything because you will be swamped.

The Chairman: No, but the devil is in the detail, so can I press you a little on that point? Of course, this is formal scrutiny, in the sense that you go before the Treasury Select Committee and that comprises scrutiny. Were you thinking of legislation or statutory instruments?

Mr Andrew Bailey: I would characterise the sort of scrutiny here and what the Treasury Select Committee does as very important. It is scrutiny of our activities. The Bill goes a bit more broadly. There is obviously a process for formal legislative scrutiny, in which we participate when it is relevant to us. You could imagine a process, which does not happen today, where we are putting forward a consultation for some set of rules or other. You could say, "Look, if they raise particularly challenging issues and you think they are important, you can bring them into the net". That would be developing what we have today. On the whole, that does not happen a lot—not much at all really.

The Chairman: Are you having conversations with the Bank about onshoring the acquis, and are you developing ideas in concert with the Bank?

Mr Andrew Bailey: We have had a few conversations with the Bank and the Treasury. To be frank with you, we are cognisant that it is for you to decide what the role of Parliament is and not for us. As I said earlier, it is an issue that has been somewhat outside the discussions that have been held so far. Quite naturally, a lot of the discussion so far has been around the withdrawal legislation itself, but that of course is very constrained, and rightly so. It is just about achieving day one; it is not telling us anything about what happens thereafter. The other point is that what happens thereafter, which we may come to later, will obviously be determined by whatever agreement the UK reaches with the EU, and whatever arrangements we have in the future in any form of alignment with the EU.

Q100 **Lord Woolmer of Leeds:** Before we leave the European Union in, let us assume, March 2019, there will no doubt be EU legislation that has been passed but is not yet in force or brought into effect. That will take place after exit. Does that possibility raise any issues for the FCA? It is not impossible of course, depending on what agreement is reached on the transition period, that more legislation could be agreed that does not come into effect until after 2020 or 2021.

Mr Andrew Bailey: You are right. We have an eye on that from the point of view of whatever transition period arrangement there might be. The particular issue, as you rightly say, is what commitments the UK might enter into in a transition period to implement legislation that the EU puts into effect during that period. Then, looking beyond that, what is the arrangement more permanently?

We have obviously looked at that period. If we look as best we can at the period for two or three years after spring 2019, there is something of a dip—in our world; I would not generalise—in the volume of European legislation coming through. That is probably for two reasons. One is that we are coming towards the end of what I might call the post-financial crisis regulatory reform agenda. We have a lot of big implementation on our hands in the next month or so, particularly with MiFID II. The pipeline does not look anything like as big as that, going forward.

The second thing is that there is a cycle within the EU that is determined by the lifetime of the Commission and by European Parliament elections. I confess that I am not much of an expert on this. There is a dip towards the end of a Commission and in its early phase. We go into that period after spring 2019. For both of those reasons, although there are things that we can see in the pipeline, they do not look as big as some of the things we are handling at the moment.

Lord Woolmer of Leeds: You are saying that in theory there could be some problems, but in practice there will be a flow.

Mr Andrew Bailey: Yes. It is a bit of a serendipity thing in many ways, because it is not related to Brexit. The pipeline looks less full at the moment than it has done in the last few years.

Lord Woolmer of Leeds: What about level 2 and level 3 standards? They could change between now and March 2019 and 2021. How will you go about incorporating those? They are not in the EU (Withdrawal) Bill.

Mr Andrew Bailey: The clear rule of engagement up to March 2019 is that we are implementing EU legislation and EU rules. That is the very clear position of the UK Government. We are doing that, and we are engaged in European institutions to do that. Thereafter, the same position holds for level 2 and level 3. It depends on agreement on a transition and whatever future agreement the UK Government reach with the EU. In essence, it is the same issue.

Lord Woolmer of Leeds: What would you like to see in a transition arrangement that would make your job easier?

Mr Andrew Bailey: We may come on to this. I have said publicly that I think there needs to be a transitional period, and we need to agree it very soon. I am happy to talk about that if you wish.

There is then a question about what the UK and the EU agree as the rules of engagement during that transition period. From our point of view, I am not so fussed about what they are, provided they are absolutely clear. What we cannot have is ambiguity. We could live with a world where the UK goes on implementing EU legislation and rules; and we could obviously live with a world where we do not. It really is a matter for the Government as to what that rule of engagement is.

The Chairman: You mentioned ambiguity in relation to the transition and said that you obviously do not want ambiguity. Several of our witnesses said they wanted something legal to support the agreement on a transition arrangement.

Mr Andrew Bailey: Yes.

The Chairman: We understand that the EU would like the United Kingdom to have implementing legislation for the transition period. Do you have any views on that?

Mr Andrew Bailey: I am sure it would.

The Chairman: What would you like to see?

Mr Andrew Bailey: For the reasons that I set out a few moments ago, it is up to the Government. If the deal is that the UK goes on implementing legislation, we are used to doing it, and, as I was saying a few moments ago, the pipeline does not look as full, so I would expect that our load would be less. If the agreement is that the UK does not carry on doing that, we need absolute clarity about what that means for the rules of engagement with the EU. A bad outcome would be constant skirmishing about what it means if the UK still has rights in the system but has not implemented the latest rules or legislation.

Lord Haskins: How can you plan a transition agreement if you do not know where you are going to end up?

Mr Andrew Bailey: I would make a distinction; there are two things. I agree that these things get conflated. We are talking now about transition. There is a separate thing about what would be an implementation agreement. The reason why it is understandable that they get conflated is that they may well overlap in time, but they are conceptually slightly different. A transition period, in my mind now, is primarily designed to give us time to deal with the risks that we observe from a sudden exit. We have set them out, and the Bank of England has set them out. The biggest one that I would point to is so-called contract continuity, and the consequences of a sudden loss of the passport.

Interestingly, these risks are symmetric. That point is very important. There is a view that gets propagated in the EU that these risks are asymmetric; they are merely risks for the UK and not for the EU. Actually, contract continuity is a symmetric risk. If you buy the argument, it must apply on both sides of the fence because of the nature of the underlying issue, which is the sudden loss of the passport.

We have reached a point where it is necessary to have a transition period to allow us time to deal with those risks. That is the thing that needs to be sorted out PDQ, as they say. There is an important issue coming up. I very much hope that the reports we are hearing, with the more optimistic noises for the December Council, are true. I do not expect in any way that we would get a signed agreement on transition, but we need something that is legally binding, in the sense that it can be applied. To do that, there needs to be something like an unconditional commitment on both sides, which ideally would be written into the conclusions of the

Council in December, so that we could take that forward. Then you need to sort out the points that Lord Woolmer was raising about the legal basis on which you would be operating.

Implementation is slightly different, because it logically comes after the UK and the EU sort out where they want to go in the future, and how you bridge from where we are today to that point. That is important, too, because you would be giving both us and firms the opportunity to do that bridging and that transition, knowing where they are going and what the system of the future is going to be. The problem we face at the moment is twofold. First, we are trying to transition with not enough time. Secondly, we are trying to transition in an implementation state without knowing what we are moving to in the future.

Q101 **Lord Desai:** I was going to ask about contractual continuity, but I think it has been dealt with. Do you feel happy that contractual continuity would somehow be maintained in the transitional arrangement?

Mr Andrew Bailey: How to deal with it? There are potentially three ways of dealing with the contractual continuity issue. It follows from the loss of the passport. You could deal with it in the Article 50 agreement itself. In many ways, that would be the simplest thing to do—to write an agreement into it. The terms would be to preserve the necessary legal authorisation of firms to allow them to perform the acts that they need to do to maintain continuity of contracts. That is important.

If you do not do it there, each could do it in parallel—in the UK case at governmental level and in the EU case at the EU level. It would be separate, but they would do the same thing in parallel. That is the second way of doing it.

The third way of doing it, as I think the Bank of England said as well, is one that we would strongly advise not to follow; it is to leave firms to sort it out. The problem with leaving firms to sort it out is that it is extremely disruptive and there is not enough time to do it. It means novation of contracts, for instance. It involves court processes, and there just is not enough time to deal with the volume.

Q102 **Lord Skidelsky:** You have spoken about the importance of maintaining globally open markets.

Mr Andrew Bailey: Yes.

Lord Skidelsky: Most of us would agree that regulation is a prerequisite for free trade and open markets. What kind of regulation can be obtained in the world as it is? How large is the geographical scope of such agreements, and what kind of regulation? I wonder whether, outside the EU, we may not find ourselves in a regulatory silo of some kind. The EU will go one way and we will not be able to influence the way it goes, so there will be divergence and absence of the common standards that are necessary to maintain open markets and free trade.

Mr Andrew Bailey: Yes. That is a very important question. I agree fundamentally that, particularly in an area such as financial services, regulation is the prerequisite for open markets and free trade. Interestingly, to reflect on the last 10 years for a moment, it would be perfectly possible to imagine that one of the consequences of the global financial crisis was a retreat from open markets and free trade. Nine or 10 years ago, we saw quite a bit of home preference shock, for instance, in bank lending. The work that has been done by the G20 and the Financial Stability Board, which Mark Carney chairs, has been fundamental in putting stronger global standards in place to prevent that happening.

The good thing about that is that today, in some areas, we have a much stronger basis for global open markets. However, the problem is that it is quite patchy. The strongest area is bank capital standards built out of the Basel accords. In our area of wholesale conduct, for instance—it is mostly wholesale markets we are talking about—standards are still much patchier. We actively participate in IOSCO, which is the international securities market equivalent of Basel, but the standards are much more aspirational and less well developed.

One solution would be to get stronger multilateral standards in those areas. Interestingly, on bilateral engagement with the US, people often say to me, "It must be terrible to deal with the US at the moment", and I say, "No, actually, it isn't". Bilaterally, it is not at all; it is a very constructive relationship. Multilaterally, it is another thing. As we know, the US has phases of suspicion of multilateral engagement, which go back a long way in US history. There are signs of that at the moment. We have to be very realistic about where we are on that.

There is another route, which is more in the world of mutual recognition and would be based around some of the things I have said publicly about looking at agreements based on mutual recognition of regulatory outcomes. I have to tell you that at the moment, if I had to pick the best outcome we could get from the position we are in today, that would be it: a stronger degree of commitment to broad-based, not patchy, equivalent standards in the form of mutual recognition. That is quite challenging.

It would be sensible for the outcome, particularly from the UK's point of view, because it would address one of the underlying tensions that exists with the EU and always has, which is that the UK has a common-law system and the EU essentially has a civil code system. In the post-war world, the US and the UK, which essentially have common-law standards, have been the regimes where wholesale financial markets exist more comfortably. I am not a lawyer, but I think there are good reasons for that.

One of the tensions we have always had with the EU is how to bridge between those two approaches. It creates tension. That is where an outcomes-based approach rather than a rules-based equivalence approach would be helpful. I have to be realistic. That is what I would like to see happen, but getting it will be tough. At the moment, if we were in the position of saying what is a preferred outcome, that would be my preference as a means to achieve your outcome, which I share.

Lord Skidelsky: Suppose multilateralism is not possible and that the deals have to be done on a narrower basis. How does that affect the City of London? How does it affect our future relations with the EU?

Mr Andrew Bailey: At the moment, multilateralism exists within the single market. It is not the case outside the single market. Basel was probably the one obvious exception, where there is a stronger multilateral global standard. We are used to that world. The big question there is the EU. If you go back in trade history and the post-Bretton Woods era, the big question was about regional trade blocs. Is the EU a route to enhancing global trade or is it actually a route to diverting trade to a regional trade bloc? There is a big question for the EU and financial markets. Which way do you want to go in the future? Are you going to go down a route where you are more closed to the UK, and we only get some form of patchy equivalence at best, in the way other countries have; or do you put more emphasis on free trade and open markets? It is a very big question. I am afraid it tends to get somewhat submerged in the debates we are having at the moment, but if you strip it back it is a very big question.

The Chairman: What is your view about where the EU is on that?

Mr Andrew Bailey: I am not involved, as you know, in the negotiations, so I cannot comment on that side of it at all.

The Chairman: No, but you are an acute observer.

Mr Andrew Bailey: For some countries more than others, this is a cake-cutting exercise in getting business. The long-run outcome will be more interesting. If you look at the pure numbers, obviously London is the major financial centre, particularly for capital market activity in the EU. The EU has stated post crisis, very sensibly, a desire to enhance, through capital markets union, the presence of capital markets in the EU, with the sensible aim of reducing dependence on bank finance, particularly in the corporate world. It will set that back if they decide to separate themselves from London's markets or try to fragment London's markets. That is the other way of looking at it.

Your question was very sensible: what does the EU think about that? From where I sit, it is quite hard to know what it thinks about that. You would have to say, from the way a lot of the commentary goes, that it does not put a lot of weight on it, but we will see.

Lord Butler of Brockwell: I want to come back to parliamentary control for a moment. You said that it would be too much for Parliament to control all your regulations, but that on the other hand Parliament should control some of your regulations. I am not sure how that could work. Who is to decide, and how are you to distinguish the important ones that would need approval by a statutory instrument and the dross, if I may describe it as such—

Mr Andrew Bailey: That is most of what we do, most of the time. To be clear, I was not necessarily saying that some of them would get raised up to the level of statutory instruments. I was suggesting that you could decide to scrutinise us through hearings on some of it, and out of that you could produce reports that would encourage us one way or another. It would also give the industry and consumers an opportunity, if they wish to have it, to put their views formally. We are very clear, particularly in our role, that we do not face up to one side; we face up to all parties on this issue. I was thinking more in those terms, not about sucking them up to statutory instruments.

Lord Butler of Brockwell: You envisage a Select Committee of the Lords or the Commons, part of whose remit would be to look at significant developments and regulation.

Mr Andrew Bailey: Yes. I think that is an important part. What I would worry about in the future is a world where we became more autonomous. Superficially, that might be welcome, but in the long run it is not. In the long run, it would lead to big questions about the legitimacy of the process. In the long run, I am not sure it is a stable outcome.

Q103 **Lord Butler of Brockwell:** I now want to ask you about what dangers Brexit might cause for regulation. I am thinking particularly of the effects of fragmentation. You might have financial institutions that played one lot of regulators off against the other, and you would not have complete sight over what was happening.

Mr Andrew Bailey: Yes. It is very important that we do not have a race to the bottom. By the way, I should say that there is hardly anybody on any side, including industry, who advocates that. I am not saying that because I think there is a clear and present danger that it is going to happen, but clearly we do not want regulatory arbitrage going on in that sense. That is the first thing.

The second important thing is that we continue to have strong regulatory co-operation. Clearly, we have very integrated wholesale markets. In areas such as market abuse, for instance, where only very recently a major piece of European legislation came into effect—the market abuse regulation—that is very important because it drives a lot of common standards and a lot of close co-operation in areas such as countering market abuse. The same goes for money laundering. I would not wish to see that type of important objective compromised.

Lord Butler of Brockwell: Could the co-operation be good enough and tight enough to deal with new operators and new techniques coming into the market? Would it be able to cope with innovatory types of operation?

Mr Andrew Bailey: The simple answer to that is that it could be, but it needs to be done. I can give an example. There are so-called contracts for difference in cryptocurrencies sold to retail investors and marketed over the internet. That is a classic case where you need to be reasonably fleet-footed and you need strong co-operation. We have pretty strong co-operation and there is a pretty strong meeting of minds, but it is important that the system coming out of what is going on leads to a breakdown of that type of co-operation.

As regulators, we co-operate very naturally. We have certainly done so. Both sides have gone out of their way since the referendum to make it clear that we do not wish to degrade the co-operation that we have between us.

Q104 **Lord Butler of Brockwell:** Are there any particular risks at the consumers' end that might emerge from Brexit?

Mr Andrew Bailey: The short-term issues are largely around contract continuity, the ability to share data where necessary and having continued servicing of contracts. Contract continuity is important in insurance and, in the worst outcome, breakdown of contract continuity would lead to the inability to pay out on insurance claims, for instance. That is a very clear risk to consumers. A lot of the insurance industry operates on an annual policy cycle, so we need to be very clear on this issue before March 2018 because it will become very live at that point for people entering into contracts thereafter. That is one thing.

The second thing is what arrangements we have in the steady-state world thereafter for the selling of financial services over borders. Although we talk a lot about passporting, it is worth saying that there are two sorts of passports. There are the so-called branch passports, which involve setting up bricks and mortar in the country. Then there are the so-called services passports, which are more numerous and involve remote selling over borders. That will still go on; as I said in the example earlier, the internet is a prime example of how that can go on.

Lord Haskins: Over the last nine years—you have been here once or twice—this Committee has spent a lot of time looking at the post-2008 regulatory reform process, which has been massive. I was encouraged to hear that you think that the process is nearly complete.

Mr Andrew Bailey: I am encouraged, too.

Lord Haskins: Is Brexit going to affect that in any way, particularly on the issue of dispute resolution and how we manage without the ECJ?

Mr Andrew Bailey: As I said earlier, I think it is very important. The good news, as I see it, is that Brexit is not an opportunity to reverse the progress that has been made since 2008. That is not to say that every single thing that has happened since 2008 is absolutely right—we all learn by experience—but the whole broad thrust of the response to the financial crisis is important. As I said earlier, in many respects that is not just an EU response. It obviously goes much broader, particularly through the G20 and the Financial Stability Board. That is important.

You rightly raise the point about dispute resolution. That obviously goes with whatever the future arrangements are for the UK and the EU. If there is, let us say, some form of mutual recognition agreement between the UK and the EU that governs open markets and financial services, which I think would be a good thing, there will need to be a form of dispute resolution. That would need to operate at several levels. As you rightly say, there would need to be an understanding of how the court system would work. The assumption is that the UK is not subject to ECJ rule at that point. At a lower level, it would need to replicate the type of mediation arrangements that we are currently subject to in the European Supervisory Authorities, where there is binding and non-binding mediation. It is not used very often, but it is an important thing to have.

That would be more necessary if we were in a world where we were not conforming rules exactly but we were conforming outcomes. We have to be realistic. There may be more disagreements in that world, so it is more necessary to have that type of arrangement. It can be put in place. It is not impossible, by any means.

Q105 **Lord Bruce of Bennachie:** You have made it clear that you want to maintain good co-operation. You have said it is not a homogeneous arrangement because obviously within the single market there are individual national jurisdictions. By definition, if we are to leave the EU, the FCA will have a degree of freedom to do things differently, either because there are specific UK requirements we want to address or because we want to maintain our world leadership. How might you envisage using those freedoms, and are there particular areas where there might be scope for you to do things that you are currently inhibited from doing?

Mr Andrew Bailey: I come back to the point I made earlier about the English common-law system versus a civil code system. It is important to go back to that root. A common-law system tends to encourage more use of principles and more use of case-law type approaches. Rather than trying to do everything in specific rule-making, if the UK was left to its own devices, it would naturally have more of that. That is where we would end up more likely than not. It always has to be done against a framework of rules; you cannot be without that. The extent to which we go down that route will be conditioned, essentially, by the agreement with the EU and how much it is based on outcomes-based equivalence, in that there may be more than one way to get to the same outcome, or an equivalent outcome, which is okay, or how much it is a rules-based equivalence.

Let me be clear that, if it is a rules-based equivalence, we have the problem that, subject to the institutional arrangements that exist, we would be more of a rule-taker at that point. That is a pretty problematic world to end up in. People sometimes say to me, "But the UK has been in that position ever since it joined the EU". Well, yes, but it has had quite a big influence on the rules. I have been involved in this off and on for 30 years. Successive UK Governments have entirely rationally put a lot of effort into shaping and influencing what those rules would be. I think that has always been very rational. You may not always agree with the outcomes, but typically UK Governments conclude that, absent that emphasis and effort, the outcomes would probably have been less good. The rule-taker issue becomes more problematic in an institutional setting where there is less ability to influence.

Lord Bruce of Bennachie: Are there sectors we would want to do differently? People are saying that insurance requirements in the UK are different and they need to be regulated differently. With FinTech, you have gone to close supervision rather than direct regulation. Is there scope to develop those things, and would the EU look at that as Britain being difficult or as continuing to take an interest?

Mr Andrew Bailey: I will take those as two examples. FinTech, interestingly, is very little subject to regulation at the moment, and that is a good thing.

You have had some discussions in previous hearings about insurance. The lesson I would draw on insurance is that EU regulation has been more effective when it has been directed at wholesale markets that operate across the Union in a fairly homogeneous fashion. The problem with Solvency II is that it goes much more into the area of national retail markets. The issue, particularly in life insurance, is that national markets in products are not homogenised across the EU, and there is no reason why they should be. Although it is changing with the pension freedoms, the UK has a history of using a much larger annuity market, for instance.

Trying to write an EU directive such as Solvency II, which attempts to go across all those markets, which are in fact quite different, has been very challenging. I think you have had discussions about that. There are issues that relate to my former role in the PRA. Prior to the referendum, we were hopeful that we could see some change in some of the things that had been done in Solvency II over time, because they did not fit particularly well to some of the precise UK market situations, especially the annuity situation.

The underlying message is that it is difficult to regulate and legislate at EU level when you are trying to legislate across very different retail markets, which are not traded much. The amount of cross-border trade in that world is quite low.

Q106 **The Earl of Lindsay:** I want to move on from regulatory co-operation to supervisory co-operation. How does it work at the moment and how will Brexit impact the current arrangements?

Mr Andrew Bailey: We have strong supervisory co-operation. We have good relations with other European bodies, and that is another reason why in the post-crisis response we have been able to put in a lot of effort to build those up. That is very sensible. The working relationships are pretty good.

The EU system has put more emphasis on regulation versus supervision. It slightly comes back to the civil versus common law point. In essence, it is rule-making versus use of supervision, although there is a bit of a choice as to where you put the boundary for how much you rely on rule-making and how much you rely on supervision. I have to say that I think the argument is a bit flawed, for a reason I will come to, but there is that. In my experience, the EU has always been concerned that trying to harmonise 28 systems of national supervision is pretty hard. You would be right to say that.

The flaw is that, if you think that making rules at EU level and then assuming that they are all implemented in exactly the same way across 22 jurisdictions solves the problem of supervision, that is quite optimistic. It is a system that has tended to put more emphasis on rule-making and a bit less on supervision. Again, going back to the point I made earlier about common law, on the whole, if the UK was left to its own devices, it would switch the balance somewhat to be more in favour of supervision, with a bit less rule-making. In the post-Brexit world, that can be shaped in a number of directions; it just depends on the agreement the UK reaches. We have proved we can work these systems, so I do not worry too much about that.

The Earl of Lindsay: Do I detect optimism, or not, that post Brexit there will be a continuing level of supervisory collaboration or co-operation that perhaps addresses two different scenarios? One is routine steady-state activities across UK and EU borders. Would you particularly comment on the second, which is a crisis situation that involves cross-border activities?

Mr Andrew Bailey: On the first, what we might call business-as-usual type co-operation, it is strong. It got a lot stronger, as I said earlier, as a result of the experiences we had in the crisis. That is true outside the EU as well. I am reasonably optimistic that, unless the Brexit outcome is very disruptive and there is a lot of conflict in it, that basic level of co-operation will go on, because we have common interests. I certainly see at the moment desire to preserve that. I do not feel too concerned about that, absent of a very disruptive outcome.

On the crisis issue, it is broadly the same thing. The one thing I would say, and I would say it absent Brexit, is that a lot of this has been put in place post the global financial crisis and has not yet been tested for real. That is the caveat. Again, the experience of the global financial crisis has put a lot of effort and emphasis on making the system work. The challenge, which we have seen before—we saw it in the pre-crisis period, and I am not saying this because I want to have another crisis just so that we can have a bit of practice—is that the longer you are in peacetime, the more you have to work on making sure that you are ready to act if you need to, because things erode a bit over time.

Lord Haskins: I find the point about supervision and regulation fascinating. Forty years ago, the City of London was basically all about supervision, and regulation was secondary. Over the years, the regulatory thing has increased at the expense of the supervisory thing. Is that likely to change? Personally I do not think that it will; I think that trend will continue and strengthen, and the supervisory role will be less. It is very unfortunate, very complicated, very inflexible and entrepreneurial, but that is the reality we live in.

Mr Andrew Bailey: You are right that it has shifted over time. I have quite an interesting debate with people who have been around in the City for a long time about whether there was ever a golden age when things never went wrong. I have to be honest with you that most of them say no, there was not, actually. With that caveat, there has been a shift towards greater use of rules. I am afraid that in one sense that is inevitable, because you must have a framework of rules to operate in.

Having done both financial and now conduct regulation and supervision, however, I think that supervision has a very important role to play. I have to be honest with you; I think we stepped back too far from it in the pre-crisis world and we have had to go about rebuilding it and changing it, because the world moves on. It is a more complex activity than it used to be.

At the moment, one of the big things we are doing at the FCA is defining what conduct supervision actually is, because particularly in the retail area it is quite a green field. That is important. One of the things I always say is that it starts with understanding business models and understanding how money is made. There are big issues in conduct supervision about what I might call fairness. Those are really hard issues. I agree that they are not answered easily by rule-making. That is not the way to do it.

Q107 **Baroness Neville-Rolfe:** Mr Bailey, you tried to foster FinTech. Indeed, I remember that when we were in India together you were fostering the world's development of FinTech. What will be the Brexit impact on the FinTech work that you are doing? Are there risks for capital for start-up or, indeed, for international collaboration in this important area? Looking ahead, digital is very important.

Mr Andrew Bailey: It is interesting that, as I said, FinTech is mostly not within formal regulatory boundaries at the moment. Many of the debates we have about the future of regulation do not naturally quite apply to FinTech. As you said, there is an issue about start-up capital, although I hope that one of the outcomes from Brexit is not a reduction in the availability of capital in the UK.

What I think is interesting, and goes back to the time we were in India, is that our strongest relationships in FinTech co-operation and development are not with the EU. The strongest relationships we have at the moment are with Singapore and Hong Kong; they are developing with Australia and I hope will develop with India, after you and I invested some time in them. There are some conversations with the US, but I would say it is in places such as Singapore, Hong Kong and Australia where those relationships are strongest. It is quite interesting. It is a world that the EU is talking about a lot, but we do not have a lot of formal engagement at the moment. It is a slightly different world.

Lord Skidelsky: Is that area of operations in the EU mostly handled by state investment banks of one type or another—the European Investment Bank, the German KfW or the Nordic Investment Bank? Do they do a lot of the start-up operation? We just have what we call the Macmillan gap, and we do not do it as much.

Mr Andrew Bailey: The UK has been a success story in that world. We are not talking about, often, large amounts of start-up capital. In FinTech to date, the UK has been quite a success story in that respect. I took Baroness Neville-Rolfe's question as being about continuing it in many ways and whether it would be affected. So far, we can point to a good story in that respect.

Lord Skidelsky: But quite recent.

Mr Andrew Bailey: It is quite recent. It is a pretty recent world, but that is true everywhere.

Baroness Neville-Rolfe: The broader question that follows is this. Is there a risk that Brexit will slow down innovation and those kinds of dynamic developments, which need to be properly regulated where appropriate?

Mr Andrew Bailey: It goes back to Lord Skidelsky's earlier point. If Brexit disrupts trade and open markets, that will have an effect on FinTech. Inevitably, the effect will be felt.

Q108 **Baroness Liddell of Coatdyke:** I want to expand the discussion you had with Lord Bruce about the domestic versus the international. We have received quite a bit of evidence about the prospects of a future split in focus between domestic and international regimes. I am intrigued as to whether or not that would be practical. A lot of the industry actors who emphasise the domestic element are building societies and small insurers. How would you manage that, and how do you see it going forward?

Mr Andrew Bailey: There are a couple of dimensions. You rightly raise the proportionality issue. It is reasonable to ask whether Brexit would give us greater scope on that front. Potentially, yes. This is more in the Bank of England's world than our world.

The Basel capital was the global standard. The EU has chosen to implement Basel for all banks and building societies—credit institutions as they call them—irrespective of size, and to implement it in the same way. Interestingly, before the referendum, particularly when Jonathan Hill was the Commissioner because he was very open to this, there was a growing debate, which we were keen to foster, that that was not the right thing to do, and that it was better to have an element of proportionality, which recognised particularly that small institutions typically do not trade across borders. They are domestic institutions and they do not need the full complexity of the capital regime. Ever since the Basel regime's creation in the late 1980s, it has only formally applied to internationally active banks. That is what Basel does. It does not stipulate that the regime should apply to all banks. Some countries, therefore, have split regimes.

That was an argument that we put forward back in my PRA-Bank of England days. We felt that it was getting some degree of traction in the EU. I recognise that, because the EU had its crisis a bit later, people in some EU countries are still dealing with some of the smaller bank problems that they regard as possibly creating greater systemic issues. Therefore, they are a bit more worried about the systemic impact from smaller banks than I would like to think we are these days.

The argument was getting some traction. Unfortunately, post the referendum, it is the sort of area where we, the UK, just do not have traction any more in advancing an agenda in the EU. Jonathan Hill did a terrific job to advance the thinking when he was there, but obviously he had to leave. You are right to say that the argument is still there, and, in principle, it would be nice to think that post Brexit we could have the scope for greater flexibility and proportionality.

There is a second way. Some people have put forward this point, which is quite different: could we have a dual regime in the UK that is a bit like the regime that exists in Dubai? Could we have one ring-fenced regime that points towards the EU and operates under EU rules, with open markets and free trade out of that thing—in Dubai, it is the Dubai International Financial Centre—and the rest of the UK regime would do something different? That would be quite hard from a prudential point of view, because prudential regulation is whole-firm regulation.

The irony is that, if you look at the Dubai regime, the reason they set it up in Dubai is that the ring-fenced international financial centre regime operates under English law, so we would be flipping it round the other way in this case. It is a bit of an oddity in that sense. You have to be quite careful about those sorts of arguments. They are worth thinking about, but they are quite complicated. They are separate from the point you made about smaller, proportionality-type regimes.

Lord Butler of Brockwell: You have been praised a lot for the assistance you have given firms coming into the market. The innovation hub for FinTech is an example of that, is it not?

Mr Andrew Bailey: Yes.

Lord Butler of Brockwell: It is your own regime and I applaud it. Do you propose to apply that encouragement to start-up firms across the whole of the financial sector—for example, to investment management?

Mr Andrew Bailey: We extended it recently to asset managers. We announced that a month or two ago. I am quite encouraged. We have quite a strong level of interest from asset managers. It is a bit different from banks. In the case of the banks, it was a response to the lack of creation of new banks. In fact, there is not a lack of creation of new asset managers, but we think it can play a helpful role in enabling innovation and enabling new firms to get greater guidance from us.

Yes, I am open to extending it. I think we will absorb the asset management world first and then see what we do next. It is a model that has quite a lot going for it. In a way, it is like having a nursery. It is giving a helping hand to new firms. Also, from our point of view, which is where the FinTech thing comes in, it allows us to identify areas where the rulebook is getting out of date. A firm says, "We're knocking up against some rule that was designed for a different era". We can then look at that and say, "Can we do something about it or not?"

The Earl of Lindsay: I have a quick question about the future. You have described how, to date, Britain has had a major influence in helping to shape financial regulations coming from the EU. You described how we have played a central part in the supervisory relationships across the EU. You anticipated post Brexit what will be the underlying cultural difference between the common-law approach of Britain and the more civic code approach of the EU. None the less, given the sheer experience of the UK in regulating and supervising financial activities, do you think there will be a continuing influence within the EU post Brexit from the British experience and British wisdom, which we can bring to bear on what future financial regulation might look like?

Mr Andrew Bailey: Provided that whatever the settlement is does not lead to a serious breakdown of relations, the answer is yes. We have the same, very good relations with authorities elsewhere in other parts of the world that are not in the EU. We sit with other EU regulators in global bodies such as IOSCO and the Basel Committee. I think the answer is yes. In FinTech, for instance, there is great interest in sharing experience and ideas as we go forward. Left to their own devices, the regulators will go on doing that. I do not think there is anything that on its own would cause that to cease.

My one proviso, and hope, is that we do not get some very difficult outcome to the process that creates a degree of friction. It should not, and I hope it will not. We are certainly very committed. Immediately after the referendum, which was actually when I went to the FCA, I made it clear that one of the things that is very important is that we do not become isolationist. It is absolutely critical that we do not do that.

The Chairman: Thank you, Mr Bailey. It has been an incredibly fruitful discussion. If there are any thoughts that you want to elaborate, feel free to write to us.

Mr Andrew Bailey: Absolutely, and if you need any follow-up, do get in touch.

The Chairman: Thank you.

Examination of witness

Mr John McFarlane.

Q109 **The Chairman:** I welcome Mr John McFarlane, the Chairman of Barclays Bank, to our public evidence session on financial supervision and regulation post Brexit. We are very grateful to you for coming.

I need to go through my formal stuff before I come to questions. 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. It will be put on the public record in printed form and will be on the parliamentary website. You will be sent a copy of the transcript and will be able to revise any minor errors. The session is on the record. It is being webcast live and will be accessible subsequently via the parliamentary website.

Would you like to make a brief opening statement?

Mr John McFarlane: No. I am at your disposal.

The Chairman: Thank you. What is Barclays' planning assumption with regard to the possibility of a cliff-edge Brexit? We got the impression from some of our other interlocutors that some banks, in particular, were not adequately prepared for cliff-edge scenarios. We realise that the Bank of England's stress tests have just been announced, and it is quite content. What are your planning assumptions?

Mr John McFarlane: We have had to produce for the regulators a severe-case scenario, although perhaps not the worst-case scenario, in which we would have to cease activities in the UK and move them into the EU in some form. Fortunately, although the EU is material to us, it is less material than it would have been a few years ago, because we have had to scale back quite a bit of activity in the EU already. That has left us with a set of branches from the UK in the EU and a bank, in Ireland, so we start with an infrastructure that is very helpful.

We are prepared for a trade agreement or a WTO equivalent. The infrastructural aspect does not make a difference to how much we would have to undertake. Essentially, about 15% of the bank's assets, about 8% of its revenues and about 8% of its capital are in the EU or are EU related. Our planning assumption is that we would need to prepare for moving that into the EU. In that case, we will take the easiest route, which is to move it to Ireland. If necessary, which it probably would be, we will then branch from Ireland into the EU, because in that scenario our existing branches will not be allowed to passport post Brexit. We are prepared for the most severe outcome, but we hope not to execute it and that some trade agreement is forthcoming.

We do not think that will happen on the retail side. We think it will have to be domestic in the EU. It would be very helpful on the wholesale side, where the bulk of the activities now rest. They are quite large, so we assume that we will need to take care of that move.

Q110 **Baroness Neville-Rolfe:** You heard the previous session, Mr McFarlane. Do you see Brexit as a spur to innovation, or will it be more difficult for banks to balance innovation and financial stability, in pursuit of a return, during the Brexit period?

Mr John McFarlane: The one thing about the present and the future is that the level of innovation has to rise. It has been rising exponentially, because of the digital economy. We are very active. You may want to visit some of our centres. We have a very sophisticated centre in Manchester, where I was yesterday, that is developing a significant amount of consumer and small business-related mobile technology. That is already taking place, and it will increase going forward.

I am not totally convinced that Brexit will have a big impact on that. For us, certainly, it relates mostly to the United Kingdom and the United States. I do not anticipate that changing, from an innovation standpoint. There will be dislocation from Brexit, of course. Our mission is to try to balance that, to make sure that business continuity takes place for our clients, in particular, but also for the markets we operate in. We are a very big player in the financial markets.

Baroness Neville-Rolfe: Presumably, the overall effect on the economy is as important as any of the technical factors.

Mr John McFarlane: If you want to ask me about that later, we can cover it. The impact on the economy depends on the scenario. You referred to Oliver Wyman's report in other sessions. That was commissioned by the organisation I chair, which represents the financial and professional services sector in the UK. You can never be totally sure that the numbers are accurate, because they are estimates, but they are directionally correct as to the impact.

The worst scenario is a WTO scenario. Mind you, from memory, there is only one country that has pure WTO, and that is Mauritania. Most countries have WTO plus a trade agreement. We hope that the trade agreement will involve wholesale financial services. Of course, the legal profession is very concerned about this as well. We are concerned about the impact on the near-banking support system. A WTO scenario could have a very significant impact on the City of London, both in clearing and because, potentially, it would be necessary to move activity that would normally be cross-border into the EU.

The Chairman: I also want to acknowledge that you are the chairman of TheCityUK.

Mr John McFarlane: Yes.

Q111 **Baroness Liddell of Coatdyke:** In reply to the Lord Chairman's question, you said that access to EU markets was less material for Barclays than it used to be. I would be interested to hear how your engagement with customers and stakeholders in other EU 27 countries is panning out. What is the response from those other stakeholders? Obviously, your bank is a commercial concern and will be looking for opportunities for growth. Do you see opportunities for growth or constraints on growth as you move forward? You talked about passporting in relation to establishing in Ireland. Is there anything to be said for equivalence as a way of maintaining cross-border support?

Mr John McFarlane: I will give you some context. Barclays and RBS were probably the largest banks in the world by assets prior to the global financial crisis. That was due mainly to the acquisition of ABN Amro, in RBS's case, and of Lehman Brothers in the US, in our case, at the time of the global financial crisis. The impact of the financial crisis on the organisation was quite material. We found that roughly half our assets were non-viable in the new, post-financial crisis era, partly because of very low and negative interest rates in the EU, and partly because it was not a natural marketplace to be domestic. It is easier for us to be domestic here, where we are very large, and quite difficult against domestic players there.

In the course of resolving the global financial crisis, our capital requirements have gone up more than two and half times. Prior to the crisis, we operated on 5% ordinary, tangible shareholders' equity, which was way too low, frankly, so the regulators did a sensible thing. It is now 13% for a set of risk-weighted assets, and may even be required to be higher.

Together, all of that drastically affected the underlying economic viability of the assets. Therefore, we had to have a programme in which, basically, we disposed of about £1 trillion of assets. Most of that has happened in the last three years; I have been with Barclays for two and half years. Part of the programme involved retail banking assets in the EU, where we are left only with Barclays Germany. That is the number two credit card in Germany, so it is a decent business proposition. We sold all the others, because they were not viable in our hands. That made the journey a bit easier. In some ways, it would have been nice to have been there, but it was not possible. That context matters.

Our continuing activity in the EU is largely wholesale now. It comes largely from London outwards, and from counterparties and clients inwards. It is a very large contractual business. At present, we have well over 100,000 transactions with the EU outstanding, mainly from London. Barclays Ireland is essentially a local corporate bank. In order to passport post Brexit, we will have to change it into a broader permission organisation, as it does not have securities permissions or retail permissions. We will probably have to make Barclays Germany a branch of Barclays Ireland for that retail branch to continue. We have had to organise it such that we can deal with post-Brexit activity out of Ireland and/or out of the UK, if a suitable trade agreement happens.

If we passport from Ireland, the regulatory environment is already set, so there is not really a problem. If we want to do it from the United Kingdom, we are able, technically, to continue to operate our existing branches in the domestic market where they are located. There may be a problem with that. Given that they will be third-country national branches, rather than EU branches, the regulators will probably require us to hold greater activity on the ground than we have today, as well as locked-in capital on the ground in those jurisdictions, which passporting from Ireland would not necessitate.

The crux of the question about passporting or regulatory links relates to the wholesale side of the business, where we will be looking for a trade agreement and equivalent regulation. That would involve some form of mutual recognition of each other's regulation. We have looked at equivalence. It does not apply to the whole business, only to some of it, and it can be withdrawn very quickly. We do not think that provides a satisfactory method for security post Brexit. Some form of broader mutual regulatory recognition is where it will go. I do not know whether I have answered your question completely.

Baroness Liddell of Coatdyke: I see where you are coming from. You talked about the prospect of a WTO agreement, on the one hand, and an FTA, on the other. There are two things that we know about FTAs. One is that very few of them contain any reference to financial services.

Mr John McFarlane: Correct.

Baroness Liddell of Coatdyke: The other is that they take a terribly long time to negotiate. What is the impact of that on the sector? You have very extensive experience as an international banker. How do you fill that interim? How do you deal with it? What is the best outcome to aim for?

Mr John McFarlane: You are correct about financial services not being in trade agreements; for example, Switzerland has well over 100 trade agreements with the EU, but not one of them is on services. From the UK's standpoint, we have to understand the context we are dealing with. Services are 80% of this economy. Financial services and related professional services are about 10% of GDP. We are dealing with quite an important matter for the United Kingdom, and I would have thought that should be a priority going forward.

I am also well aware that the UK, being part of the EU, has not negotiated a trade agreement for quite a long time, whereas other countries that used to deal with us have had to deal with the EU. Australia, where I spent 15 years, is a good example. The Australians have become very adept at creating new trade agreements; for example, they have just done one with Peru, which took six months. They did one with the US that took 12 months, which is unusual for the US. They were able to do that because they have a standard template for services. Australia is a completely open economy on goods and services, and it looks for a reciprocal relationship. This one will be difficult, because of the fact that we have not done it for a long time. The EU will probably place some restrictions on the agreement that will make it a bit more difficult.

For most participants, that is where the question of transitioning has arisen. I will not go into the different components of transitioning, which

Andrew went through earlier. In essence, transitioning is most valuable if it is to somewhere worthwhile at the end. Transitioning to nowhere does not have the same value, other than to help us implement it. Ideally, we would like to know the end before we have to work out what transitioning involves. I do not think that is very likely, so we will have to work in this uncertain period not knowing where we will end up. Therefore, we will all assume a semi worst-case scenario, plan for it and be able to implement it. It is not impossible by March 2019. We could do it, if required, but a bit more time to implement for the sector as a whole would be valuable. The sector has argued quite strongly for that.

Transitioning could be important in another way. If it helps to secure a better final outcome, it will be valuable in and of itself. If it is going to be difficult to secure an end game in the timeframes we are talking about, and it will take longer, you can see why transitioning would be valuable, both in enabling us to reach an agreement that is satisfactory and in helping the sector to implement it.

Q112 **Lord Desai:** You have looked at different scenarios involving a rather severe crisis. Have you any idea how great the fiscal impact on the UK will be? How much will the UK lose from all this?

Mr John McFarlane: That is contained in the Oliver Wyman report. We assume that retail will move, and we will be dealing mainly with wholesale financial services. Banking is about 40% of the total. The next largest sector is insurance. The next largest sector is funds management. There is a very large residual component, which is the market infrastructure of the clearing systems, data and technology of the City of London and elsewhere.

In a trade agreement scenario, where activities were permitted from the EU into London, and vice versa, the impact would be relatively modest; it is of the order of 1%, which is not particularly significant. However, beyond that, it would be very significant, both in economic activity and tax revenue collection, and there would be a bigger effect on the infrastructure—the ecosystem Andrew referred to. I do not have the numbers in front of me, but I have them behind me. If you are interested, I can give them to you. They are very significant. There is significant loss of tax revenue associated with that scenario. If you would like the numbers, I can get my colleague to give them to you.

Lord Desai: Do you have a calculation for Barclays? How much loss would you sustain?

Mr John McFarlane: Yes. That is easier. I do not keep the other numbers at the top of my head.

You need to think of the impact on Barclays in three ways, the third of which is very significant. One is that we have to make it happen and we have to implement it. Potentially, that means creating capacity assuming that we will be operating in the new format in 2019. We have to make that happen. There is quite a significant on-cost to us in doing that. There is a lower charge per annum post that, because it becomes more expensive to operate in the new form than it is in our current form. We have a scale benefit from what we do today.

We have the implementation cost and then the ongoing cost. The thing that concerns me is that, given that the overhead has risen and that there is an on-cost to doing business post Brexit, the viability of the activities that we will move to post Brexit is not clear at this point, and may not be clear for some time. There may be a broader economic impact that we are uncertain of at this point in time, because we do not know what scenario we are dealing with. It is manageable, of course. We can do it in time—we have plans to do that, if required—although we could probably do it a little more cheaply if we had more time.

There is a second factor. Brexit is happening at the same time as other things that are more material. I do not know whether you can imagine what the dislocation of halving the size of your organisation has been. Remember, we are at the tail end of that. We did not reach the end-point until this year. We have had a year and three months associated with Brexit, and we have been undertaking that activity and selling assets at the same time. Part of that was the sale of Barclays Africa, which was a decent business, but was non-viable in our hands, because of the changes in regulation. We had to sell a very large bank in Africa while we were doing that activity.

At the same time, we had to build up capital in the organisation, not just ordinary shareholders' funds, which I have talked about. We are now required to hold loss-absorbing debt capital—we call it TLAC or MREL—that is twice the size of the ordinary shareholders' funds. We have to hold £100 billion of loss-absorbing capital that we did not have before. We have had to do all of that.

In the UK, which is just over half of the total, we have to ring-fence the UK retail and small business bank. We are required to do that by January 2019, but we have to get it done by Easter 2018. Unfortunately, we have only one bank in the UK—Barclays Bank, which has everything in it. We have to create a bank that does not exist so that we can put that activity into it, and we have to do that by March next year. That is going on at the same time as Brexit. It is a very large journey.

The US is just under a third of the total of the organisation. We have been required to create an intermediate holding company in the US for all our activities in the US and to have the US look through all activities at a single point of entry in the US. As you can imagine, that has been quite complex. It did not exist before.

I talked about technological aspects. We are now facing competition from new sources. The largest mobile payments provider in the world is a Chinese company called Ant Financial. It is a subsidiary of Alibaba and has a system called Alipay. It is going to move that out of there, as will others, so we need to be ready for that as well. There is also a significant cyberthreat, so we have to upgrade all our systems and take them into the cloud.

Brexit has come along at the same time as all that. I am not saying that it is unmanageable, because we will do it. It just makes it a bit more complicated, because we have to divert resources to it. I do not know whether that is helpful.

The Chairman: We feel your pain.

Lord Haskins: On the other hand, because of this restructuring, you are less exposed to Brexit issues than you would have been 10 years ago.

Mr John McFarlane: That is correct. Going forward, it is perfectly manageable.

The Chairman: To add to your woes, we know that the European supervisors are insisting that the entities there are more than just a letter-box or a nameplate; they want real people and tangible assets on the ground in the EU. Can you touch on the movement of staff numbers and personnel—the human cost of some of the Brexit-related change?

Mr John McFarlane: Because we already have people on the ground, it is not as significant as the financial numbers or the capital implications. In fact, it is relatively modest. Of course, there will be a pull to have more people there than we would like. We are feeling that already. It is in the hundreds, some of whom will be transferred and some of whom will be new jobs created on the ground in the EU. That is a more manageable impact. In a trade agreement scenario, the jobs lost are insignificant—tens—whereas in a worst-case scenario they are a bit more significant, but they are not the most important thing. The most important thing is that we may have to repaper hundreds of thousands of contracts in the EU. Andrew talked about that. It is the more significant impact.

The Chairman: We will pick that up.

Q113 **Lord Butler of Brockwell:** May we turn to regulation? In its written evidence, Barclays says, "Where there is a choice, post Brexit, between reduction of regulatory burden and remaining aligned" with the EU, "we would choose to remain aligned". As well as EU regulation, there are international standards, which an international bank such as Barclays also has to comply with. Do you see any risk that Barclays will be put in a difficult position by EU regulations deviating from international standards, or are you confident that they can remain in line?

Mr John McFarlane: We are fortunate to be a globally systemic bank. Although I use the word fortunate, we would not vote to be part of that, but we are. In that context, most of our regulations are global. We are bound largely by Basel IV, which is coming, and by Basel III and its amendments now. Essentially, we conform to the globally systemic rules, which are roughly equivalent to the UK rules. The PRA adopts the global standards for globally systemic banks. It is quite interesting that the globally systemic requirement capital numbers are almost identical to the

UK numbers, so there is no real implication from that. If there are changes to Basel, we will probably accommodate them.

There is a regulation that does not affect our whole business: MiFID II. We need to conform to that, anyway, because it is going to come earlier. We would prefer a global standard to a domestic or an EU standard. I do not think that there will be a bonfire of regulations, or that UK regulations will be narrowed. I asked the head of BEIS whether BEIS had considered the real-economy implications of evolving regulations to the same extent as it had thought about the safety of the regulations. The answer was quite clearly that regulations are required, they are adequate enough, and a lower regulatory burden would not be welcome. Of course, the Financial Stability Board has said that, once everybody is up to the required capital requirements, no more capital should be needed in the system. We take comfort from that.

Obviously, most of the European globally systemic players will have to conform to these rules. They tend to be our major competitors, along with the international American banks and others. I am not convinced that there is a big effect for us. Of course, it would be worrying, were it to happen.

Lord Butler of Brockwell: If we maintain consistency with the EU rules—Barclays gives priority to that—do you think that we will be able to influence them when we are no longer a member of the EU? Is there a risk that, in order to achieve that, the UK will have to become a rule-taker?

Mr John McFarlane: Effectively, the UK is a rule-taker in one respect anyway, because we conform to global standards. That said, it is very difficult for a country not to be in control of its own regulation, so you will probably find that there will be a contribution, certainly to global standards, by the UK.

There may be an effect. If the UK gets smaller as a global financial centre, which I hope will not happen, our economic power will reduce somewhat, in a sense. It may then be more difficult to influence global standards. I am not sure that will be a big effect. The global standards pride themselves on getting input from the UK, and I think that will continue.

Co-operation between the UK and EU regulators is also quite strong. The UK has chaired some of the committees in the past, particularly the insurance committee, so it has had significant influence. Co-operation between the two regulators is quite strong. I think that will continue.

Q114 **Lord Bruce of Bennachie:** You said that you are less exposed than you were because of the way you have restructured things. Nevertheless, you want uncertainty resolved, and some kind of mutual arrangement. Lots of proposals have been put forward. The International Regulatory Strategy Group and UK Finance have put forward proposals to try to maintain a kind of symmetrical agreement, but it rather looks as if the UK is putting forward proposals that are not being responded to in quite the same light from the other end. Barnier says, "You seem to have some dream that you can carry on as you were. Well, it's not going to be like that". What is your view of what might be achieved? Do you think that we can get an agreement that allows some sort of continuing engagement, although not the same?

Mr John McFarlane: I have spoken to some of the people in the EU who are involved in the negotiations and to some of the countries. It has been made very clear that, if you are not a member, you cannot keep the same terms. That has been quite clear. Therefore, there will be less, and we have to work out what that is.

From the sector's standpoint, a more seamless way of getting to the end-point, or a form of transition, would be to extend Article 50. It has been made quite clear that that is not possible, because we have to be out in March.

Lord Bruce of Bennachie: That is what we are saying, not what they are saying.

Mr John McFarlane: Yes. We are saying that that is not permissible. We talked about a standstill, but it has all the elements of remaining in. It has been made clear to the sector that that is not possible, either. We talked about moving into the EEA for two years. That would give us all the protections we need. Again, that is in, not out, so it is not possible.

We are now in the very unusual position of trying to find an "out" form of transition that has legally binding assurance behind it or that gives us sufficient assurance from European Governments and the UK Government, as well as the regulators in the EU and the UK. It is work in progress. We are trying to find that solution, but we have not found it so far. The IRSG is part of our group. Although we have not found the solution so far, over the last few days we have at least received some proposals that might lead to enough security, if we can get regulatory and government alignment, particularly if it is stated in the Article 50 withdrawal.

Lord Bruce of Bennachie: Do you mean proposals from the UK Government?

Mr John McFarlane: From the UK Government and the EU Parliament. We need to get some security about the nature of the transitioning in the Article 50 withdrawal. The regulators must be supportive of it, so that we are not in conflict on a regulatory matter post Brexit. We hope that we can come through to find that. It is not a strong forum, as you can imagine. There needs to be some agreement between the UK, the EU and the regulators for this to happen.

Lord Bruce of Bennachie: Lord Kerr, who drafted Article 50, says that the UK's position is not consistent with reality, and that it is not possible to continue to have transitional arrangements while not being in the EU. His argument is that either you have to extend Article 50, which is allowable, for two years, or you leave. That is the cliff edge. He argues that there is nothing in between.

Mr John McFarlane: I have heard all of that several times.

Lord Bruce of Bennachie: You believe that there is something in between.

The Earl of Lindsay: So do we.

Mr John McFarlane: That is a pretty safe assumption, if I may say so. I think that the politics around this will not allow that to happen, particularly in the United Kingdom. Therefore, we are working on the assumption that we will leave in March 2019 and that we will have a workaround of some description, with some form of support.

That is easier if we are heading towards a trade agreement that will facilitate the continuation of wholesale financial services. The thing that worries us about the economics of all this is not just that it costs more. Imagine that a new clearing system for derivatives has to be set up. Remember, there is £20 trillion of unsettled derivatives. That is in between the banks. Imagine then the clearing system, where you have cleared derivatives on an ongoing basis. Those are currently netted off for counterparty exposures, and the amount of capital that we use is lowered as a consequence. If we have to move part of it into another country, the netting reduces. Therefore, in both places, the amount of capital required will rise and the return on capital will go down. We have enough capital. That is not the worry; it is just that the amount of capital will rise.

Clearing systems are a different aspect. At the moment, we have a multicurrency clearing system in effect that is very cheap for interest rate swaps, for example; 90% of interest rate swaps are cleared in London. There is a tiny fee of about three basis points associated with that. Those economics work only because of the scale of the system and the netting effect across currency. If euros were taken out of that and had to be cleared separately, you would not have the same multicurrency netting in the new system. We would also have lost the benefit of the euros in the existing system. The implication is the same both ways. The amount of margin would have to go up, because you would not be able to lower it through netting. Therefore, the capital would go up.

The logic is to say, "That won't happen", simply because the multicurrency economics are so large. It is more likely that it will be left where it is, because it is in everybody's interest that the best economics apply. If that is not politically acceptable, all of it should move, because you need to get the best economics out of it. It could move into the EU or the US. I am assuming that it will not, but, as you can imagine, the need to maintain the scale and economics of that is really what makes the market work. I give that example to provide you with something realistic.

I know Lord Kerr and admire him deeply. He may be right, but we are going to work as hard as we can to get this workaround working. We have some time. We are working with the Government to try to achieve it. You are absolutely correct to say that, if we do not, we are between a rock and a hard place. We might be there anyway.

Q115 **Earl of Lindsay:** There are proposals in the EU to strengthen and centralise the supervisory functions that rest with ESMA, the ECB, et cetera. They could also be more intrusive with regard to third-country players such as yourselves, especially where you are deemed to be a systemic player or CCP. Are you comfortable with that direction of travel? Are you very uncomfortable, or do you find it easier to deal with regulators than with the more political end of the machine, which is making regulation and policy?

Mr John McFarlane: The whole system, barring domestic activities, is based on a level playing field, and on regulatory alignment and co-operation. While it is theoretically a concern, personally, I am not ultra-concerned about it. We have US dollars overseen by the Fed. We are quite used to that. We are quite used to euro activities being overseen by the ECB and others. That will continue post Brexit. I cannot imagine that it will change. What we have noticed, however, is that in our dealings on the ground in the EU, Ireland included, the European regulator has been present in all our meetings.

The Earl of Lindsay: Would you give the same answer wearing your CityUK hat as you have given wearing your Barclays hat?

Mr John McFarlane: I would say this. Financial services in the UK have about £200 billion of revenues, of which half are domestic and half are international. If you extend that into the ecosystem around financial services—legal accounting and so forth—it is £300 billion, with roughly the same proportionality. The EU accounts for just under half of the international piece. The issue for us is related to the impact on the whole sector. It will not necessarily impact on the domestic part to the same extent, but it would impact on the international business done out of London, which is half of the total. That is a much bigger percentage than it is for Barclays, which has activities on the ground in the US, et cetera. In that respect, it would be a bigger issue for the sector as a whole than it would be for us as a firm, although it is material for us as a firm. Given that they are all part of the Financial Stability Board and that global standards are likely to apply, and given that national standards in the EU will not necessarily apply to cross-border activity, I think this will all sort itself out.

The Chairman: Mr McFarlane, your conversation with us has been extremely fruitful. I thank you on behalf of the Committee. That was very helpful. It was particularly helpful for us to get an insight into an important globally systemic institution—however the terminology goes—and to be able to speak to you about the global level of operations and the element of risk there, as well as the particular Brexit-related issues.

This brings the public session to a close. The Committee will now meet in private. Thank you very much, Mr McFarlane.