HOUSE OF LORDS

Select Committee on the European Union

EU Financial Affairs Sub-Committee

Oral evidence: Financial Regulation and Supervision following Brexit

Tuesday 5 December 2017

11.05 am

Watch the meeting

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

Evidence Session No. 8 Heard in Public Questions 116 - 124

Witnesses

I: Mr Stephen Barclay MP, Economic Secretary to the Treasury, HM Treasury; Mr Richard Knox, Director, Financial Services (International), HM Treasury; Ms Lowri Khan, Director, Financial Stability, HM Treasury.

Examination of witnesses

Mr Stephen Barclay MP, Mr Richard Knox and Ms Lowri Khan.

Q116 **The Chairman:** Good morning, Mr Stephen Barclay MP, Economic Secretary to the Treasury. Thank you for giving evidence to us today on financial regulation and supervision following Brexit, the subject of our inquiry. You have a list of interests that have been declared by Committee members. This is a formal evidence-taking session and a full transcript will be taken. This will be a public record in printed form and put on the parliamentary website. You will be sent a copy of the transcript and you will be able to revise any minor errors. The session is on the record. It is being webcast live and will subsequently be accessible via the parliamentary website. Before I commence, I also welcome Ms Lowri Kahn and Mr Richard Knox.

We are delighted that you are here, Mr Barclay. We are conscious that you are quite tight for time. I understand that you have to be in the Commons later this afternoon. First, can you update the Committee on the developments in Brussels yesterday and the Government's position on coming to an agreement with the EU on the end of the first phase?

Mr Stephen Barclay MP: First, let me say what a pleasure it is to join the Committee. I look forward to the session. I will introduce my experienced colleagues. Ms Lowri Kahn is the Treasury director for financial stability and Richard Knox is the director for financial services. We are here today to assist the Committee.

On the events yesterday, the negotiations, as you are aware, are ongoing. As the Prime Minister set out, a lot of good progress has been made on many issues. There is a common understanding, but some differences remain on a couple of issues, which will require further negotiation. Talks will be convened before the end of the week.

The Chairman: Before the end of this week?

Mr Stephen Barclay MP: Yes.

Q117 **The Chairman:** Thank you. Turning to the immediate content of our inquiry, how are the Government providing legal certainty to financial services stakeholders, first through the Withdrawal Bill process? Could you also touch on legislation that will be agreed will be there by 2019 but will have been transposed into the UK at that point?

Mr Stephen Barclay MP: There are a number of key strands in that question which I know from earlier sessions that the Committee is keen to explore. First, there is the onshoring, through the Withdrawal Bill, so that we can be ready for day one, which I know Andrew Bailey and others have discussed with the Committee. Secondly, there are the immediate risks of transition; there are particular concerns in areas such as contract continuity and data protection. Thirdly, there is the question of the future state. The Prime Minister has set out the Government's intention for a free trade agreement on goods and services. That opens up some of the questions about equivalence and so forth which the Committee has been keen to explore. I am very happy to delve into each of those three large topics, or whatever the Committee wishes.

The Chairman: Could you touch briefly on each of them just to tell us where you are?

Mr Stephen Barclay MP: On the question of onshoring through the Withdrawal Bill, we have been very clear that we are not looking to make policy changes. In essence, it is a cut and paste of the status quo. We are not seeking to deregulate. The evidence that the Committee has received from the industry, and certainly the engagements I have with it, is that there is no desire for a race to the bottom or to deregulate. Indeed, the United Kingdom's regulatory strength is seen as one of the industry's key strengths, alongside our legal system, time zone, expertise and talent. The Withdrawal Bill will be to get ready for a day one, no-deal situation. Obviously, the Government intend to have a free-trade agreement, but the Withdrawal Bill is to ensure that we are ready for that situation. If it helps the Committee, we can come on to some of the areas where the role and powers of the regulators will sit within that onshoring process.

The Chairman: We are coming to that a bit later. Could you cover where a transition period would need to be legally binding, as opposed to a transition period that is reflected through a communiqué or an agreement? Where do you see the legally binding nature of it coming in, and in what sectors do you think it is necessary?

Mr Stephen Barclay MP: In part, that depends on how and when that is agreed. In his recent speech, David Davis set out his ambition that we can agree that if sufficient progress is made with the December Council early in the new year. I think we are all acutely aware that timing is a critical factor in transition for firms' contingency plans. Early agreement on transition is clearly desirable. That will need to be agreed at a political level in a way that will give firms comfort to slow down their contingency plans. On one level nothing is agreed until everything is agreed, but on another level firms are looking for sufficient clarity in order for them to be able to delay some of the contingency plans that they are looking at.

The Chairman: I just want to pick up on "nothing is agreed until everything is agreed". Beyond it being announced—hopefully, that will be fairly shortly, depending on what happens in the European Council in the middle of the month—and agreed between the EU, we are not going to see it incorporated into legislation until when?

Mr Stephen Barclay MP: The Government have not set out how they would legislate and whether they would legislate specifically for transition or whether that would be agreed. It will depend partly on what flows from the December Council and the nature of the transition agreement that is reached.

Q118 **Lord Butler of Brockwell:** I was just looking at the last paragraph of the letter which the Chancellor sent to us in reply to our letter. He says that the withdrawal agreement and implementation Bill will be introduced after the withdrawal agreement has been reached between the EU 27 and the UK and that the withdrawal agreement and implementation Bill will contain the necessary powers to legislate for the implementation period. That does sound as though there will be a separate Bill, which I suppose will be introduced into the House of Commons if satisfactory progress has been made in the early part of next year.

Mr Stephen Barclay MP: It would be conditional upon agreement being reached. In order to have clarity about what that Bill was implementing, agreement would obviously need to be reached at the December Council, but that would be the intention.

Lord Butler of Brockwell: Thank you. I come on to the process after departure from the EU. We had interesting evidence from Mr Andrew Bailey. He recognised that the regulators will have greater powers once they are cut free from Europe. The FCA will have greater powers within the United Kingdom. He welcomed the fact that that would need more parliamentary scrutiny of the FCA. Have the Government begun to think about that and what means that parliamentary scrutiny might use?

Mr Stephen Barclay MP: He did, and in his evidence I think he also posed it as a question back to the Committee. Parliament itself will have a view on that. I would break it down by saying that within the levels of legislation in Europe, levels 1 and 2 will clearly be for the scrutiny of Parliament, and levels 3 and 4—the technical standards—will be within the remit that the regulators already have under the guidance. Where at level 1 within Europe it is agreed by the Commission, because obviously the European supervisors have the scope to prepare the legislation but it is the Commission that actually implements it, the approach would be to apply that within a framework that is consistent with FSMA as now. So we already have through our regulators the scope for them both to design regulation and to bring forward the rules. They have been involved at a European level in advising on the technical nature of the rules, so they have the expertise and the capacity to bring forward those binding technical standards.

One would then look for affirmative SIs to bring level 2 within Parliament. So Parliament will scrutinise level 1, which will be for Ministers and Parliament; level 2 will be through affirmative SIs; levels 3 and 4 will be via the rule book, with Parliament giving delegated powers to the regulators for any corrections that will be necessary in order to ensure consistency with levels 1 and 2, as that is onboarded.

Lord Butler of Brockwell: Do you envisage that parliamentary scrutiny of level 1 or level 2 being by means of either primary or secondary legislation, or by Parliament setting up some sort of Select Committee? You may say that we have to answer that, but do the Government have a view?

Mr Stephen Barclay MP: I would expect that level 2 would be done through affirmative SIs. There is a question, which I think came out in the earlier session, about the extent to which this Committee or the TSC might want to have a call-in option. That was a point that I think Andrew explored with the Committee. Clearly that is an area that Parliament will want to debate. I know that my colleague in the other place, Dominic Grieve, has already expressed a view about that, and I am sure that Nicky Morgan will do so in due course.

Lord Butler of Brockwell: Thank you. Are the Government satisfied that the FCA is adequately equipped for its new role? It certainly has a very large staff already, and I am sure that Andrew Bailey will be preparing it, but are the Government satisfied that the FCA will be able to do the extra tasks required of it post Brexit?

Mr Stephen Barclay MP: I am frequently lobbied by parliamentarians for the FCA to do more across a whole gamut of areas, particularly in the consumer space. I do not think there is a particular concern in Parliament about the FCA's capacity. We are very fortunate in the United Kingdom in the expertise and quality of our regulators. The FCA, the PRA and the Bank have an extremely high international standing, and they often take a leading role in the formulation of many of the European requirements in the first place. These are areas that they have great expertise in dealing with. As I say, our approach is to transfer powers in a way that is consistent with the existing FSMA approach, and that approach is already agreed by Parliament.

Mr Richard Knox: As the Minister said, international comparisons, including the IMF's work, have recognised the UK's structure as being very strong. The overall structure under FSMA, where the overarching provisions in financial services regulation are taken through a parliamentary process and the detailed technical rules are made by the Bank, is seen as a good structure. In thinking about onshoring, we are trying to replicate that structure as best we can. As the Minister says, that means in effect that level 1 and delegated Acts will be taken through the statutory instrument process, but the more technical rules, such as binding technical standards under level 3, will be delegated to the regulator within those technical regulator rules, as currently operates under FSMA.

The Chairman: Mr Barclay, before we move on I would like to press you a little on capacity among the regulators. We are conscious as a Committee that the Bank of England will see quite a lot of churn at its most senior level just around the period of our withdrawal from the EU. We know that Mark Carney is due to go in June 2019, and two of the deputy governors, I think, are due to go within a few months either side of that. Are the Government contemplating these matters and thinking about the continuity of succession and succession planning in the light of that, because if so much of the leadership goes, institutional memory and institutional judgment will clearly be affected.

Mr Stephen Barclay MP: That is a very valid point and one that we obviously keep a close eye on. At the moment, the Financial Conduct Authority chair role is going through a period of change. There are always times when senior figures change within institutions, but it is something we are alive to.

The Chairman: May I just say on that point—I would not wish there to be a misunderstanding—that other senior figures are not necessarily leaving, but their contracts, their terms of office, need to be renewed? Perhaps in the interests of stability and reassurance the Government may wish to announce a renewal of contracts in a timely manner. I will leave it at that.

Q119 **The Earl of Lindsay:** Mr Barclay, you said a moment ago that parliamentary colleagues are forever pressing you to increase the mandate of the regulators. Does Brexit offer you a very good reason to look again at the mandates of the FCA and the PRA, specifically in respect of the future international competitiveness of the United Kingdom? We have certainly had evidence from parties, not least from the insurance sector, saying that this would actually be a most desirable and welcome move on your part post Brexit.

Mr Stephen Barclay MP: It is an area that there has been considerable industry comment on. In fact, one of my predecessors in this role, Mark Hoban, through the group that he chairs, has a report that is coming out in a matter of days. I would not want to pre-empt that announcement, but I suspect that this is one of the issues that they will touch on in their report.

The FCA already has a requirement in relation to proportionality and the need to set out the costs of its rules. Its primary objective is one of financial stability, and if you ask an organisation to do two things you always have to be mindful—I am sure Sam Woods would raise this—of whether the focus is on financial stability or on competitiveness, and the extent to which there might be some tension between the two. We start from the fundamental, which I set out at the start of this session, that we are looking to have a close relationship with the European Union that enables access to continue. We are not looking to deregulate. Our approach will therefore flow from the nature of the free trade agreement in goods and services that we are able to secure with our European colleagues. The pertinence of these other issues will flow from where that deal ends.

The Earl of Lindsay: On your first point, an economic duty has been introduced by this and certainly the previous Government on many other regulators across the economy. I do not think that any of them has suffered from confusion as to whether their other regulatory objectives are compromised. They simply have to balance that additional duty. I suggest that in line with the evidence that we have received, the inclusion of international competitiveness in their remit would not necessarily be too difficult for them to handle alongside their other objectives, such as stability.

Mr Stephen Barclay MP: I very much take note of what you say. It is a question I have asked myself in relation to the appropriate way forward. I will make a couple of points. First, with the regulation that we have, our regulatory approach to one area, for example—FinTech—which I know Baroness Neville-Rolfe has provided leadership on in her time in the Treasury, has been internationally competitive, whether that is the FCA's sandbox or the Bank of England's accelerator. The UK has taken a leadership position there.

In some of the other areas in which the UK has a global leadership position—Islamic finance, green finance, the work that Elizabeth Corley is now doing on social impact investment—the current regulatory approach, I suggest, has not constrained our ability to be internationally competitive. However, you are absolutely right: it is an issue that has been raised with me and an issue that I know people within the industry have raised. Obviously I will read the report that Mark Hoban and colleagues come out with, with interest.

Lord Skidelsky: I want to press you on a bit harder on this dual mandate idea, which is that the PRA should have responsibility for both financial stability and competitiveness. The fact is that it is very difficult to have dual mandates. It implies, first, the possibility of a conflict, and, secondly, going into a policy area that is much wider than regulating the banking system and, for example, the exchange rate. Would it have to pay attention to that as well? What are your thoughts on that, because it seems to me that you cannot do it? You have a mandate to do something. You cannot have two or three mandates and try to balance them, because then you get into the hopeless position that we have been in in the past.

Mr Stephen Barclay MP: Sure. As your question and the Committee's debate open up, this is an area of debate and there will be a conflict of views on it. As I say, a report is coming out which I think will enhance this debate. What underpins this issue is this Committee's correct focus on the importance, regardless of our relationship with European colleagues, of maintaining the international competitiveness of the UK financial services sector.

That is an area that the Chancellor is leading on. We have an economic and financial dialogue with China in a matter of days. The Chancellor was in Brazil over the summer for the economic and financial dialogue there. Next year, we have the continuation of the economic and financial dialogue with India. This all underpins how, within the developed economies, we tap into the deep pool of capital that London offers, the expertise and talent that we have, our leadership in a number of areas such as green finance, and how we combine that finance with the market opportunities in order to be internationally competitive.

The question that comes from the Committee's discussion is whether it is necessary to change regulators' objectives in order to facilitate that, or whether we can achieve it within the framework that we have. The debates on the report in the next few days, together with the deal that we are seeking to achieve with the European Union, will help to shape to shape that debate.

Q120 **Lord Fraser of Corriegarth:** Following Brexit of whatever complexion, would a split between domestic and international regulatory regime be workable?

Mr Stephen Barclay MP: There are currently differences in the FCA handbook between how institutional investors are treated compared with retail investors. So the principle is clearly already there. In the same way, national competent authorities across Europe will often, for long-standing reasons, have different requirements relating to retail customers compared to institutional customers. Indeed, and this goes back to Lord Skidelsky's point about competitiveness, just last week we introduced legislation on insurance-linked securities, a $90 billion global market with huge growth potential. There are international opportunities, because much of that business is not domiciled in the UK and there is scope to go after that global opportunity. So in answer to the question about the extent to which we flex passporting rights in a differentiated way between the institutional and the retail, that is one approach that has been suggested.

Clearly we need to get through the first phase of negotiations with European colleagues, which the Prime Minister and senior Ministers are engaged on as we speak. From that, we can then get into the substance, which we all want to get into, when it comes to how we take those sorts of initiatives forward.

Lord Fraser of Corriegarth: Would a more tailored regime for retail banks imply further differentiation between the remits of the Financial Conduct Authority and the Prudential Regulation Authority?

Mr Stephen Barclay MP: There is quite a spectrum of firms seeking passporting, obviously. There is a spectrum between sectors and within sectors. Challenger banks, for example, are far less affected by what is happening with Brexit. Again, alongside the international competitiveness point, another issue that we should not lose sight of is some of the other market developments that will impact on challenger banks. The capital requirements are a significant factor in the challenger bank sector, as are how FinTech will play in sectors like that, the role of AI and technology changes.

Much of the focus of today's session is quite rightly on the financial services post Brexit. However, other issues that I am very keen not to lose sight of, including in the retail banking space, are issues outside Brexit that will have a big impact on retail financial services, including the challenger banks.

Baroness Neville-Rolfe: Mr Barclay, that neatly brings us on to how the Government continue to support UK innovation. You have already mentioned FinTech, and I think the Committee has also been impressed by the innovation hub and regulatory sandbox that was introduced by the FCA. There are a couple of linked questions. First, obviously FinTech very often requires venture capital. It was good to see in the Budget that the British Business Bank is going to get more money. I suppose there is a question as to whether that is enough and whether it can be done quickly enough, given that we will have to depart from the European Investment Bank. Secondly, we have a question about unimpeded intercompany transfers, on which you put forward a proposal. How did Brussels respond to that?

Mr Stephen Barclay MP: As you said, we signalled our commitment to the sector in the Budget. That builds very much on the points you set out in your *Prospect* article in September, which I very much agreed with. The commitment was not only to the areas in the Budget that you cited; it was also a commitment to Tech Nation. I am very keen that we focus on regional strategy for FinTech and that it is not seen simply as a London element. I discussed this in Edinburgh and Manchester, because I think there is a big regional aspect to FinTech, particularly in how it plays in specific sectors. Tomorrow, I will launch a new FinTech competition for Generation Rent, which again underpins some of the points that you highlighted with regard to the opportunities for FinTech.

This is slightly away from Brexit but relates to FinTech. One of the difficulties experienced by many people who rent is that they cannot build the credit score necessary for buying a home. The Chancellor announced a £2 million prize fund in the Budget, and I will flesh out further details tomorrow—a slight plug, if I may. It involves combining with FinTech firms to build a solution to assist those who rent to build up that credit history in order to facilitate a mortgage. That is a very good indication of FinTech's potential and of what you alluded to in your *Prospect* magazine piece, which is the need for us to manage that process effectively.

Baroness Neville-Rolfe: Can you also say a bit about the shift from the EIB to the British Business Bank and perhaps reassure us in relation to our concerns?

Mr Stephen Barclay MP: First, I should probably declare for the record and for transparency that my brother works for the European Investment Bank. We are very keen to maintain our relationship with the European Investment Bank, and the Chancellor has on a number of occasions set out our desire to continue that engagement. There was progress in September with a couple of key loans being approved, the highlight being some legitimate questions that the EIB needed to ask about contract certainty following the Brexit decision. There has been an extensive dialogue on that. We are also looking to ensure that either through the EIB or through equivalent funding we maintain what is seen as a key source of finance.

The Chairman: May I just pick up the FinTech issue and their concern about talent, although this concern also goes across the rest of the financial services industry? Could you tell us a bit about your thinking on intercompany transfers and on FinTech? I think it is a moot point, because most FinTech start-ups are fairly small. They have come from elsewhere to invest here because the supply of capital, particularly VC, is much more available here. In our conversations with them, people tell us that it is not just a matter of allowing intercompany transfers; it is also a matter of being able to recruit the best from the rest of the world. We know that the Home Office's current form is something like 17 pages and is quite intrusive. What are you doing to assist not just the FinTech sector but the whole of the financial services sector to recruit the best talent?

Mr Stephen Barclay MP: It is an extremely important area. In fact, I held a round table with industry specifically on this very point in the summer with Brandon Lewis, the Immigration Minister, precisely to get into the specifics of this. You are absolutely right that talent is key within the FinTech sector. The Chancellor announced that the Government will be doubling the overall number of tier 1 exceptional talent visas from 1,000 to 2,000 and lifting the tech sector cap within that. The Home Office is also committed to looking at establishing sponsoring bodies outside London, and the Home Secretary will be inviting the tech community to help to design the system. We in the Government recognise the key importance of talents within the sector and that is why we are taking measures on this.

The Chairman: Mr Barclay, I recognise that an increase from 1,000 a year to 2,000 is a doubling, but have you had consultations with the industry? Do they think that is anywhere near enough?

Mr Stephen Barclay MP: I had a round table with them in the summer.

The Chairman: I am talking about the whole of the financial services sector, not just FinTech.

Mr Stephen Barclay MP: Indeed. As I say, this is an area that we are very allied to. Obviously the Home Office is reviewing our approach more generally, and this announcement gives a sense of the direction of travel within the Government.

Q121 **Lord Bruce of Bennachie:** You said right at the beginning that you are not looking for more deregulation and do not want a race to the bottom, but instead you want to promote the strength of UK regulation. So what scope is there for any change in our regime in the event that we leave? What difference would it make if we left with no deal as opposed to a deal that in any case would presumably require us at least to meet certain common standards within the EU? Does no deal give us more flexibility or less, on the grounds that we can travel the world but we will still have to deal with Europe and it may judge us according to which way we are going?

Mr Stephen Barclay MP: The point that I was making about not deregulating is that there is no push from the industry, certainly from the engagement that I have and I think in the submissions that the Committee has had, for deregulation. That does not mean that we cannot be agile and evidence-based, that we cannot capitalise on the expertise of our regulators, that we cannot build on the examples of the sandbox, the accelerator and so on, or that we cannot be quick to adapt to innovation. The Budget signalled the Government's commitment to growth areas of technology, combining with the industrial strategy to be very evidence-based and agile in our regulatory approach. What I was saying at the outset was that I think there were concerns within certain EU 27 capitals that the response to a no deal from the UK would be a heavy deregulatory agenda and I was seeking to signal that that is not the intention, as I understand it.

Lord Bruce of Bennachie: Certainly smaller, mostly domestic operators have said that they would like more tailor-made regulation for them. That is not shared across the sector, but do you have any sympathy for that position? If it were pursued, would it have any implications for the view that the EU would take?

Mr Stephen Barclay MP: It plays into the conversation we had earlier about retail. If you look at the original intention of Basel, it was for large systemic banks, and the regulation has been applied more widely than was originally intended. Would parliamentarians, would this Committee, seek in due course to have a hearing looking at how an area of the market that we are all trying to stimulate and that is not a systemic risk might be taken forward? It is far from me to try to pre-empt where the Committee would want to go, but if one looks at the original intention of Basel compared with where it has landed, one sees that it has been widened. So that might be the sort of area that people would look at. The broader point that I was making is that it is our intention to seek an ambitious agreement on goods and services. We are not seeking to pursue a deregulatory agenda. I think in the past there has been some preconception as to that being our intention in the event of a no-deal scenario.

Lord Bruce of Bennachie: Would you be more or less inclined to gold-plate? The question here says you have been accused of gold-plating, but other witnesses have pointed out that gold-plating is an asset if you are trying to promote a strong regulatory regime. Indeed, yesterday we were told that America has rather stricter regimes and that has not held its banks back. Do you think, post Brexit, that the UK would be more inclined to gold-plate or less?

Mr Stephen Barclay MP: We are not looking to gold-plate. We are looking to regulate in a smart, effective and safe manner.

Lord Bruce of Bennachie: You should be a politician.

Mr Stephen Barclay MP: I will take that as a compliment.

Q122 **Lord Haskins:** We come on to the issue of equivalence, which raises its head as one of the most sensitive subjects facing the industry. Obviously Brexit means a huge change in our relationship with that world. It is already clear that other countries are making it difficult for us to retain our equivalent rights. We are coming to the conclusion that for us to maintain equivalent access, we have to become a rule-taker rather than a rule-maker. From our point of view, that is rather concerning because in previous exercises that we have done on rule-making, particularly post 2007, it seems to me that the UK played a strong part in affecting the way that those rules were developed. That process is not complete yet, either. So I have two questions. First, how do we deal with the problem of the continued evolution of equivalence without being inside the tent? Secondly, even if we have equivalent rights but we are rule-taking, in rule-taking there must be an arbitrary process. When a dispute arises, who is going to sort it out—the ECJ?

Mr Stephen Barclay MP: You raise an extremely pertinent issue. I absolutely agree that you are right to focus on the risk of rule-taking and in particular how that may constrain the global competitiveness of the UK financial services sector. I think we all recognise that the equivalence model is not suitable for the UK-EU relationship; it is quite limited in scope and does not give the adequate long-term planning certainty that firms would wish for. That is why we are very keen to enter into a new arrangement with the EU. In the evidence that John McFarlane gave to the Committee, he was quite optimistic as to the potential for that. The read-across of Australia and Peru or Australia and the US is limited, but it was indicative of the points that he was trying to raise in terms of the potential for a deal.

On your second question, there are mechanisms already in place. First, not all the EU rules are designed by Europe; a lot of them are taken from international standards, Basel being the clearest example. IOSCO, while perhaps less certain, is a further example of international rules. There is also precedent around colleges and how they bring together equivalent regimes to operate; I do not know if Richard or Lowri want to come in on that issue. The point is that there are international standards that we would look to be a part of and they provide the framework through which we can look at an ambitious deal between the UK and the EU.

Mr Richard Knox: As the Minister says, equivalence does not look like the right answer for the UK and the EU, but there are a whole set of arrangements that support cross-border activity both within the EU and between the EU and other jurisdictions. There is a deference of rules across a whole range of jurisdictions, not just the US but elsewhere. The other point is that even if one is focused on equivalence, equivalence is not necessarily rule-taking. There are a whole set of arrangements that allow for the cross-border provision of services between, for example, the EU and the US. Obviously they do not rely on exactly the same rules at a granular level, because the EU and the US rule books are very different. What they provide for, and this is set out in the legislation, is an assessment of whether the rules are equivalent that is based on outcomes rather than line by line.

Lord Haskins: We have been led to believe that while the EU regulation of financial services is quite effective, international regulation leaves a lot to be desired. In other words, aspirational stuff is there but, when push comes to shove, can it be delivered? National regulations in the US work very effectively. However, on anything in this area that is global, the record on implementation seems slightly questionable.

Mr Richard Knox: There is a whole range of regulatory initiatives post financial crisis, some of which are around prudential standards for banks. They are extremely granular and applied broadly across jurisdictions through the Basel committee. You are right that there is a whole set of other standards on, for example, market conduct. Derivatives trading was obviously a major issue following the financial crisis, yet there are FSB and G20 initiatives to deal with that, and indeed there are provisions within EU law to allow for equivalence between the EU and other jurisdictions precisely on that outcomes basis.

Mr Stephen Barclay MP: This has been said many times before, but of course we start from a point of equivalence. That is the starting point.

Lord Haskins: It is the big area where we have been told that uncertainty is a great worry for the industry and the sooner that this issue can be clarified, the better.

Baroness Neville-Rolfe: I have a follow-up question on that. A lot of people have talked about mutual recognition, which seems a very good outcome if one could secure it. I do not know what discussions you have had and what they suggest in terms of being able to get something in that area. I know that David Davis has talked about it, but some of the smoke signals from Brussels have been slightly less positive.

Mr Stephen Barclay MP: I am conscious of Mr Barnier's recent remarks in this area, naturally. The Chancellor set out his position clearly in his remarks at Mansion House and the Prime Minister has done likewise, but we are mindful of the process of the negotiations and the need to clear phase one.

The Chairman: Before we let equivalence go, despite how flawed or otherwise the equivalence might be in terms of the EU, what happens when the EU has an equivalence agreement with another jurisdiction? Mr Knox mentioned the US, and of course that took three years. Would the UK post Brexit be using the EU third-country recognition of equivalence as a means to make itself equivalent with that third country—in effect, grandfathering off these mutual recognition regulations?

Mr Richard Knox: That is a very good point. We are dealing with that issue alongside the overarching work that we are doing on onshoring the acquis because, as you rightly point out, as the UK ceases to be an EU member state, the access privileges and rights with third countries by dint of being a member state fall away. We have systematically gone through all those arrangements with third countries. We are aware of them and our intention is to provide continuity for industry to allow those access rights to continue.

The Chairman: In your estimation, roughly how many countries are there?

Mr Richard Knox: There are a large number of agreements, I think 300 or so. I cannot tell you off the top of my head exactly how many jurisdictions there are. Some are quite easy to fix because we can just unilaterally determine equivalence ourselves and nothing is required on the other side to allow that to continue. Others require interaction and engagement with the other jurisdiction to make that possible.

Q123 **Lord Woolmer of Leeds:** Good afternoon. Is it afternoon yet? Not quite; I apologise. I turn to contractual continuity. In principle, there are four possible outcomes of the discussions. The first is that there is an agreement on a future relationship before March 2019, and there is then an implementation period for up to two years after that point to implement it. The second possibility is that there is not a full agreement in the sense of a set of terms and that still has to be negotiated and finalised post 2019, hence what we refer to as a transition instead of a period of implementation. The third possibility is that there is no agreement, but a no agreement with some bells and whistles—some tweaks to deal with real problems. The last possibility is that there is no agreement at all. You and the Treasury will obviously be looking carefully at being able to deal with all those situations as far as contractual continuity is concerned. Could you shed some light on your current thinking about how you would ensure contractual continuity in each of those scenarios?

Mr Stephen Barclay MP: You are absolutely right that this is the major cliff edge. That came out of the evidence that I saw the Committee received from Sam Woods. This is a symmetrical risk, one that applies to both sides. For over-the-counter derivatives, the figure is £12 trillion, which is expected to be impacted post March 2019. In the insurance sector, there are 30 million EEA customers with £40 billion of insurance contracts, while obviously there are 6 million on the other side in terms of UK insurance customers from EEA firms. It is an issue at the sharp end of the cliff edge. You have correctly set out the possible outcomes. We very much recognise that both sides—customers from both the UK and the EEA—will be affected. The most effective mitigant would be a bilateral agreement under the Article 50 withdrawal agreement between the EU and the UK; that would be the optimum way of resolving this.

Lord Woolmer of Leeds: But that implies that there is an agreement. What if there is no deal?

Mr Stephen Barclay MP: Then you fall from a bilateral agreement into supplementary co-ordinated action between the UK and the EU. If that were not there, the Bank of England’s financial stability report, which touched on this issue a matter of weeks ago, made it clear that we would then need to look at all the options that would flow from that. Our starting point is that, given that this impacts on both sides so significantly—not just on contract continuity; data is also a significant issue—we would be optimistic that a deal can be reached because this impacts European businesses and customers just as much as it does those within the UK.

Lord Woolmer of Leeds: Are you saying that no deal is simply not on your planning horizon, or that if there is no deal you are confident that business as usual can go ahead?

Mr Stephen Barclay MP: No, I am saying that no deal is on our horizon. Indeed, that is not just what I say; I can point to the FPC financial stability report showing that it is acutely alive to this issue, and the evidence that the Committee received from both Andrew and Sam touched on these points. So I am confident that our regulators are alive to this, and I know my senior colleagues within the Treasury are. The point that I was seeking to draw the Committee's attention to is that the impact of this—£40 billion-worth of insurance contracts, 30 million EEA customers, £12 million of over-the-counter derivatives contracts—is of a magnitude that means there is a commonality of interest between colleagues in Europe and those in the UK.

Lord Woolmer of Leeds: Nevertheless, there needs to be a legal basis for contractual continuity, and there are four quite different possible outcomes. I am interested in the legal basis for contractual continuity in the withdrawal agreement and implementation Bill at this end, for example. Particularly if no agreement is reached before March 2019, it is difficult to see how the Bill could specify a precise legal framework. How would the legal basis deal with the problem of contractual continuity in deals done between 29 March 2019 and two years later, and the changing trading environment?

Ms Lowri Khan: As the Minister says, the incentives will be there for people to do a deal, if not formally on a bilateral basis, and to take co-ordinated action in the various jurisdictions, even in the event of no deal. In that context, we are also looking at what we could do unilaterally. There is a range of options that would have different legal bases, depending on which route you go down. For example, a certain amount can be done by firms themselves, guided by their supervisors, to relocate activity. A certain amount can be done, for example, by bringing branches within a temporary permissions regime. A certain amount could be done by allowing inbound firms to continue to service existing contracts. A range of different approaches could be taken. We are working through them to see which would best fit the circumstances and our objectives.

Mr Stephen Barclay MP: As Lowri says, at one end of the spectrum you could have something similar to run-off within the insurance industry. To reassure the Committee, I draw attention to the remarks of the governor of the European Central Bank on 20 November. He called for both sides to work together to address this specific issue. It is not only when one looks at the numbers that there is an imperative for an agreement to be reached; there is clearly recognition at the most senior level of European decision-making that it is in the interests of both sides to do so.

Lord Woolmer of Leeds: But that sounds as if there are all kinds of possibilities and firms can do deals with each other. It sounds rather chaotic. There are all kinds of possible outcomes; we are not really sure what legal basis to develop; there is going to be a withdrawal Bill; after that there is, hopefully, going to be an agreement. Do you have no thinking at all about the legal basis for ensuring contractual certainty? Businesses and their customers or correspondents surely cannot do business on the basis of 20 options and possibilities. That is not a basis for industry to feel that the Government know what they are doing and where they are going and are confident that there is a legal framework. This is the discussion we are having with the European Union to ensure legal contract continuity. Out of all the issues, contractual continuity is absolutely the heart of commerce, is it not? That is not meant to be an aggressive question, but a concerned one.

Mr Stephen Barclay MP: We have alluded already to the fact that there is huge awareness and focus on this issue, as you would expect. Industry has obviously raised it with us. It is addressed specifically within the FPC financial stability report. It is recognised across Europe, as signalled by the quote that I have just alluded to. There is a strong mutual interest in a bilateral deal on this being reached. One recognises that it has to give sufficient certainty for firms to make their internal legal decisions. The other end of the spectrum would be firms having to come up with solutions, but that is the sub-optimum approach and we will be working to ensure that we get a bilateral agreement on this issue.

The Chairman: Thank you, Mr Barclay.

Q124 **The Earl of Lindsay:** I want to ask you your views on future supervisory collaboration and co-operation. By all accounts, at the moment, there is very effective and close supervisory collaboration between ourselves and other members of the EU and their supervisory bodies. Post Brexit, whatever the deal is in terms of access by our financial services industry to their financial markets and vice versa, how confident are you that the supervisory collaboration will continue? How confident are you that, in the event of a major financial mishap that has cross-border implications, the collaborative nature that will pertain will be able to deal with it? Finally, do you have views on the impact on the United Kingdom’s interests of proposals currently being discussed in the EU for further centralising supervisory powers, and the specific proposals on the location of CCPs et cetera?

Mr Stephen Barclay MP: You raise a number of very germane points in your question. We would be very keen to have the scope for regulators to work collaboratively. From the perspective of financial stability, there are benefits to both sides. There are significant precedents around colleges, particularly as they align to home state regulation. There are lessons from the banking crash 10 years ago and how regulators work together to understand a more holistic view of risk. Building on those, to have a lack of co-operation on those areas would be to move away from some of the very germane lessons that came out of the crash and the progress that has been. So there will be a strong desire to continue to act collaboratively. The expertise of the UK regulators that I alluded to is such that I expect their contribution would be valued in Europe. That is certainly the information I have received to date; the contribution of UK regulators has been valued in shaping much of that regulation. Your other points were about CCPs and the direction of travel there. Was that in the context of location policy or the resolution file and the other files?

The Earl of Lindsay: Both that specifically and the general move by the EU, through its proposals that the European Supervisory Authorities should take a more intrusive and aggressive approach.

Mr Stephen Barclay MP: On CCPs?

The Earl of Lindsay: And also to any systemic third-country business.

Mr Stephen Barclay MP: There is obviously a debate on the first point within Europe itself, on the balance between the ESA and the national competent authorities. One sees that specifically in areas like asset management. On the direction of travel on CCPs and the debate on the location policy, people have understood the nature of the CCP market better. A minority of the LCH business—around 14%—is European. If one was pursuing a policy in Europe of domiciling euro clearing back to Europe, the consequence would be less diverse and less liquid, with more market fragmentation, higher cost and more financial instability. I do not think that location policy would be sufficient to shift those markets to Europe. The consequence for European clients would be higher costs and less liquidity. You have got few customers, so it would be less liquid. The price would be higher and the instability greater. I do not think that is in the interests of the Europeans, nor is it in the interests of the UK. The debate on location policy has moved on constructively, as people have understood the nature of the market better. It is a good example of the value that London offers to European firms and customers in terms of access to capital at a good price in a stable manner. One looks at LCH and the clearing houses and the location policy gives voice to that.

The Chairman: To pick up on one of those points, we have heard all the arguments for why the EU should not do that and we are very cognisant of them. Are you building allies to support us, should politics overcome rationality in that regard? Who are your allies—third countries—who would also have an interest in not seeing the fragmentation of that market?

Mr Stephen Barclay MP: You make a very good point, Chair. Other third countries are not silent actors in this regard. In particular, to what extent might the US take a view on dollar clearing if there was a change in policy on euro clearing? If there was a change on asset management, would the US be silent with the delegation on the impact of that?

The Chairman: Hong Kong and Singapore as well.

Mr Stephen Barclay MP: Indeed. It also illustrates a wider point that has been recognised in comments from senior European colleagues. London will continue to be the leading European financial centre. Therefore, if businesses move to Europe, it fragments costs and increases stability, but it will not shift that business. If anything, that business will shift to Asia or New York. People are aware of that, but you are absolutely right that the other third countries are not silent in this regard.

The Chairman: I think that that concludes our session. I am cognisant that you have to go. Thank you very much, Mr Barclay. It was very useful to have this conversation with you. Thank you also to Ms Lowri Kahn and Mr Richard Knox for being here to support your remarks.