

# Exiting the European Union Committee

## Oral evidence: The progress of the UK's negotiations on EU withdrawal, HC 372

Thursday 19 April 2018

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Members present: Hilary Benn (Chair); Joanna Cherry; Mr Jonathan Djanogly; Richard Graham; Jeremy Lefroy; Seema Malhotra; Stephen Timms; Hywel Williams.

Questions 1311-1377

### Witnesses

**I:** Andrew Bailey, Chief Executive, Financial Conduct Authority, and Sam Woods, Deputy Governor Prudential Regulation, Bank of England.

**II:** Huw Evans, Director General, Association of British Insurers, Chris Cummings, Chief Executive, the Investment Association, Stephen Jones, CEO of UK Finance, and Nikhil Rathi, CEO of London Stock Exchange Plc and Director of International Development.

### Examination of witnesses

Witnesses: Andrew Bailey and Sam Woods.

**Q1311 Chair:** Good morning. I welcome our two witnesses to the first of two panels here today at Bloomberg—we are very grateful to Bloomberg for hosting this morning's meeting of the Brexit Select Committee—Sam Woods, Deputy Governor Prudential Regulation from the Bank of England, and Andrew Bailey, Chief Executive of the Financial Conduct Authority. We are very grateful to both of you for giving up your time to join us here today. We are looking at the question of UK financial services and Brexit. We have quite a lot of ground that the Committee would like to cover, so short questions and succinct answers, in so far as that is possible, would be much appreciated.

I want to kick off with this question to both of you. We are now 22 months on from the referendum and it would be very helpful to hear from you what you think, as things stand at the moment, both the short-term



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and the long-term risks of Brexit are to the financial services industry. May I start with you, Mr Woods?

**Sam Woods:** Yes, certainly. Focusing on the risks, the one that I would be most concerned about, which is potentially short term, is on contract negotiating. This is the issue that when the UK leaves the EU, derivatives and insurance contracts will not become invalid but the ability of companies to service them may be quite severely impaired. The extent to which that occurs varies a lot from one country to another. For instance, in the UK to carry out the regulated activity under FSMA, which are the sort of things you need to do to service an insurance claim, is potentially a criminal offence if you do not have authorisation for the relevant party.

We have been very clear publicly in saying that we think that needs a fix not only from the firms that can restructure to accommodate some of that, but from the authorities, in particular the UK Government and the EU authorities. The UK Government have committed to bring forward a means of mitigating that risk, and in the end this will come to you in Parliament. That is the single one I am most concerned about. Briefly, there are others. Data is one of them and we could perhaps come on to that.

**Chair:** We will.

**Sam Woods:** Then there is a lot of activity around bringing on board the rules, which again passes to Parliament in the end, and further specific restructuring. Those are the big buckets, if you like.

Q1312 **Chair:** Thank you very much. Mr Bailey?

**Andrew Bailey:** I have the same list. I would expand a little bit on the transition risk and what we tend to call the cliff-edge risks that Sam was talking about. I think it is important also to be clear that those risks are symmetric, in the sense that they go both ways for the UK and the EU. The reason for that, as Sam said, is because what would trigger those risks is the falling away of the passporting system on access without any substitute that would preserve the authorisations that are necessary to service contracts. It is very important to recognise that those are obviously symmetric, in the sense that the passports go both ways. There are passports into the UK and passports from the UK into the EU. That is important because these risks affect us in the UK but they also affect the EU.

The best form of mitigating those risks is in agreement on a transition period that allows them to be dealt with and then to be dealt with in the context of what the permanent agreement is, and no doubt we will come on to that later. In the absence of that, if there were a hard, sudden exit, the Government here have said in December—and we welcome this; indeed, we have worked with them very closely on planning this—that they would propose legislation to Parliament that would effectively create what we tend to call a temporary interim permission regime.



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The reason that is important is that it would effectively mitigate the cliff edge at the UK end because it would preserve the authorisations when passporting falls away and we would have time then to sort out what the sort of permanent future was. The EU currently does not have any proposals of that nature and so that is an asymmetric solution at the moment.

Interestingly, there was a report in the *Financial Times* yesterday that there may be some proposals around for emergency legislative provisions in the EU, so we will see what comes of that, but in the absence of that, of course, as UK bodies and the UK Government we can solve only one side of that issue.

**Q1313 Chair:** Mr Woods, you told the House of Lords EU Committee back in November that you thought about 2% of UK bank and insurance jobs might move to the EU and more might follow, obviously depending on what the nature of the final deal is. Is that still your view, or are you more or less optimistic now than you were back in November?

**Sam Woods:** I think I am in the same place. Should I elaborate a bit to give the Committee some idea of what the numbers are?

**Chair:** Please.

**Sam Woods:** This is all in relation to what are called the outbound firms, so firms that are having to restructure out of the UK to accommodate Brexit. There are also a lot of issues for us with the inbound firms, and perhaps we can come on to those separately. On the job numbers, we have 1.1 million financial services here in the UK, and 500,000 of those are in banks and insurance companies, which is what we oversee on the PRA. Another count you can do shows that 380,000 are here around us in the City and at Canary Wharf and two thirds are in other parts of the country.

Looking at the banks and the insurance companies, the 1% to 2% you talked about is our estimate of, at day one, the additional jobs that these banks are going to have to create in other jurisdictions in the EU. My estimate remains that that number is in the 5,000 to 10,000 window. Since that Committee, if anything there has been perhaps a slight downward drift, so I would say it is probably towards the low end of that, rather than the upper end. It is also the case that, in round numbers, maybe about 20% of those will simply be new jobs, so they are not all jobs moving out of London but most of them would be.

To the point about London specifically, you can think of it as 0.5% to 1% of financial services in total, 1% to 2% of banking and insurance jobs, 1% to 2% of London jobs. The jobs that are moving are probably about half front office—salespeople and traders—and about half support functions, so control functions and governance functions. Again, that is mainly London-focused.

**Q1314 Chair:** On the transitional arrangements, there is a political agreement



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on the transitional period. Apart from what you have already mentioned, is it deficient as far as financial services are concerned in any respect? Secondly, for those who ask the question, "Are we absolutely certain that legally, by definition, that is not going to happen until the withdrawal agreement is finally approved by the Council of Ministers, the UK Parliament and the European Parliament?" what has been the reaction on the question of certainty as well as what it contains?

**Andrew Bailey:** I think you have summed it up pretty well. The fact that there is an intention to have a transition period, which was agreed at the March Council meeting, is very welcome. However, as you rightly say, it is not done in that sense because it is not done until everything else is agreed and this is the "nothing is agreed until everything is agreed" principle. From the point of contingency planning, while we welcome the intention to have one, it does not at the moment provide the necessary certainty to assess the planning assumptions for the work to manage exit. We are still having to work on the basis that it could happen next March in a hard way and firms have to take that into consideration as well.

What I do think is important—I have said this publicly a number of times—is that we recognise that we are where we are on the "nothing is agreed until everything is agreed" point, but coming back to what I was saying a few minutes ago, I think that we do need to start work now with the authorities in the EU to plan at a technical level what the solutions and the mitigants would be to these cliff-edge effects and other things such as data, which we will no doubt come on to. If later this year we get—and we hope we do get—a final agreement on a transition period, it would not be preferable to then start the work to say, "What do we do with this?" It would be much better, given that we are where we are, to have done all that work and to be ready to roll.

To be frank with you, what that requires is for the EU authorities to engage. I think I can speak for all the UK authorities: we are ready to go and we have done a lot of work on this. You will see the work that we and the Bank of England have put out. I think we have a pretty good understanding of these issues and what it takes to solve them, but the best solutions would be at a co-ordinated level between the authorities; there is no doubt about that. My strong preference would be that we start now to put together the agreed ways of tackling these issues, just finally going back to my point that these are symmetric issues.

**Sam Woods:** I agree with everything Andrew said. I would add one point, which is that there is a distinction here between the inbounds and the outbounds. The outbounds is progressing exactly as Andrew said in the absence of that full certainty. For the inbound firms, we have said that we have sufficient confidence in the Government's and Parliament's ability to give us a temporary permissions regime that would bridge us if the political agreement on the implementation period is not translated into a legal pact later this year. On the basis of that, we are trying to



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make a reality of the implementation period at the UK end. It is another example of the way in which some of what we are doing in the UK is in a slightly different place from what is happening at the EU end.

**Q1315 Chair:** It could be argued that the EU has taken quite a hard line on financial services, making it clear from the beginning that passporting is not going to happen. To what extent would you agree with the observation that this is not so much because it cannot be done—if you look at the deal the EU did with the US on clearing house equivalence, it shows you can do stuff if there is a willingness—but in so far as there has to be a price that the UK pays, and the EU negotiators have been very clear about that, this is an area in which it can happen?

Secondly, do you expect any deal that is done on financial services, with all of the ends tied up in the form of a treaty, to be concluded between now and the end of October this year, or is it your judgment that inevitably, because of the complexity, if there is a will to agree something, that will spill over into the transitional period?

**Sam Woods:** On the first point, it is absolutely technically doable to create an arrangement that captures what you have described. We have done a lot of thinking about it. Indeed, I would say that from a technical point of view it is far less challenging than many other things that we have done, such as Solvency II or MiFID II on Andrew's side of the house. It is completely technically doable. It is just a question of whether it can be achieved politically as part of the wider agreement. On that, frankly, I have no greater insight than you, although it is clear from what the Chancellor and the Prime Minister have said that they intend to put such a thing on the table.

On the timing, it is my assumption that working such a thing through and making it operable would take longer than October of this year. My understanding of where the March Council had got to is that there would be a political statement alongside the withdrawal agreement setting out a broad framework. You perhaps have a direction of travel but I don't think anyone thinks it will be done.

**Andrew Bailey:** I agree with that. There is obviously a big distinction between trade in goods and trade in services in this respect. In trade in services you do not have the issues that you see in goods, with physical customs and other sorts of movements, but what you do need, and what lies really at the heart of trade in services, is agreement on regulatory standards. As Sam said, we start in a place where the UK is going to, in effect, be equivalent on day one because of the principles on which the withdrawal legislation is being done. Where it is being done only to put into place what you might call the minimal change to make the EU law work in the context of the UK, we start with equivalence. We then have to work out what the operating arrangement is going forward, but we start with regulatory standards, which is the key component of it. We also start, in my view—this is important in both our worlds—post the financial



crisis with a much stronger global consensus on regulatory standards. Those are the key building blocks.

Just to reiterate what Sam said, it is absolutely doable and I have said publicly that I reject the view that you cannot have a trade agreement on financial services. We observed that that is what the EU would have preferred to have with the US in TTIP, I guess.

**Chair:** Indeed.

**Andrew Bailey:** It did not come to pass but it was a very clear preference on the part of the EU.

Q1316 **Mr Djanogly:** Mr Benn has somewhat pre-empted my question. Given that we are starting from a position of perfect equivalence, a lot of people are saying that we are all making much too much of a hash of this and it should be a pretty easy starting point on which to move. What would you say to that?

**Andrew Bailey:** I think we have to accept that the starting point is just that. The real issue is what happens thereafter. What is really at the heart of that is what the framework is going to be for equivalence thereafter—I will use the word equivalence to start with and then come on and qualify it. First of all, there is an equivalence framework in EU legislation, but it is quite patchy in financial services legislation. It is there in some parts and not in others. I think MiFID II has probably the most advanced equivalence framework of any of the pieces of European law but it is not there in others. As you rightly say, it is clear in legislation and it has been used with the US.

Secondly, it does have the characteristic that at the moment, as constructed, it can be taken away pretty much without warning. To be fair to the EU, they have not done that yet—I think I am right in saying that—but none the less that is a feature of it and that is not a feature that looks particularly attractive. Interestingly, there was a report in the European Parliament, last week or the week before, which said that from the point of the EU they need to put it on to a sounder footing, and let us learn from other countries. I think there is promise there.

The second thing comes back to what is sometimes called the rule-taker issue: would we then be having equivalence at the level of rules or equivalence at the level of outcomes? That is the point that we have both said publicly. You will be unsurprised to hear that we would prefer the second approach and not the first. The problem with the first is that to have rule-based equivalence in a system where we are not a rule maker is a very difficult one. Frankly, I think that is a very hard role to imagine being in. You will understand why we prefer outcomes-based equivalence.

We have also—I think others have—used the term “mutual recognition” rather than equivalence, because that is a more sensible way of looking at it, but again it is a symmetric thing, so we would be recognising each other’s standards. I think it is possible to do outcomes-based equivalence



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or outcomes-based recognition. One can distil out of this legislation what the outcomes are because in a sense that is the basis of much of this legislation. You define what you want to get and then work out how to do it.

But it is a new thing—let us be frank—and that is why I think, answering the Chairman's question, as Sam said, we should reasonably want to get the framework put in place this year to take it on further into the detail we will require at some time, which again is why a transitional implementation period is highly advantageous.

**Q1317 Joanna Cherry:** Good morning, gentlemen. Mr Bailey, it is particularly nice to see you again. I know that you know—because your Scottish base is in my constituency, just along the road from my constituency office, where you were good enough to meet me—that a large number of my constituents in Edinburgh South West are employed in financial services. In fact, across Scotland financial services employs about 200,000 people directly and indirectly and contributes £8 billion to the Scottish economy. If you look at Edinburgh's economy, it is more reliant on financial services than even London's economy, so I am particularly interested in the impact across the nations and regions of the UK.

We talked earlier a bit about the risks to the financial services sector in general terms, but can both of you give us some insight as to how these risks differ in different parts of the UK? I am particularly interested in Edinburgh, of course, in Scotland, but others will be interested in other nations and regions of the United Kingdom.

**Andrew Bailey:** I can start by offering a reflection. I wish I could offer you more data that I don't have to hand, but we can try if you would like. I think it does depend on what the particular mix of financial services activity is in particular areas. I would hazard a guess that there is somewhat more asset management type of activity in Edinburgh than there is probably in—well, there is a lot around here but, as you say, London has a very mixed economy. That is relevant because it depends, going back to what I was saying earlier, on what is the prevailing regulatory system for each section of the industry. If we just take asset management for a moment, the key thing there is not the taskforce so much as the continuation of something called the delegation model. That is a system by which it is possible to delegate the operation of asset management to another location from the legal domicile. The delegation model is not an EU system; it is a global system.

Looked at from that point of view, that ought to reduce the fret in that sector of the economy but ESMA, the European supervisory agency of which I am a board member until we leave, has said that it is looking at what are the standards that it would want to see for the continuing operation of the delegation model. But I would be very clear that there is absolutely no reason, in my view, to remove the delegation model. That would be a step that goes well beyond what is necessary for Brexit. If you look at what we look at in the different sectors of the industry and,



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therefore, how it might affect it depending on the mix in any part of the country, you have to look at these individual planks of legislation: is it asset management, is it banking, is it insurance, for instance?

**Sam Woods:** I agree with what Andrew said. Perhaps I can add a little bit of colour on two points. On the jobs question, linking back to the discussion we had a few minutes ago, financial sector jobs are 6.5% of London jobs. Across the rest of the UK, by region and by country, the range is between 1.8% and 3.1%, and Scotland is the 3.1%. As you say, to some extent that is heavily concentrated in Edinburgh, so it is probably more like the London situation. However, if you go back to the numbers I talked about earlier, those are relatively modest numbers for day one. I think the much bigger question is where is this going to go longer term. That is where the focus of effort should be and that depends fundamentally on what sort of a deal is struck, so I really think it is about that.

My second point relates to that and to Andrew's point about delegation, which I think is likely to be the most relevant point for Edinburgh, for the reasons that Andrew gave. Based on our estimates, around 20% of the assets that are managed in the UK are EU-27 assets, so it is a significant chunk of what goes on here, but it is not the dominant thing that goes on here. On Andrew's point about delegation being a global norm, if you go over into the EU-27, again numbers are a bit slippery but broadly our estimate is that 20% of the funds that are over in the EU-27 are managed entirely outside the EU as it is today, that is not in the UK, in other places. I do not know where those places are, but presumably New York, Singapore and such places. In addition to that 20%, 10% of EU-27 assets are managed in the UK. The reason I am telling you that is that I think it would be an extraordinary rupture of a global norm, which is not a UK/rest of the EU thing, if delegation was put at risk. For that reason, I regard it as implausible, but it is true that some of the more excitable talk touches on it.

**Q1318 Joanna Cherry:** Having read the brief for today's meeting and prepared for the meeting, and having listened to your evidence, it seems to me that there is a huge amount of work involved for you and your industry in preparing for Brexit and a lot of unknowns still. If I could ask what we call in Scotland a "daft lassie question," given what you are telling us about how globalised the financial services industry already is and how much of the regulation is global and we feed into that through the EU, what are the gains for the United Kingdom financial services sector in leaving the EU? It seems to me as an outsider that it is causing you an enormous amount of extra work and I am not terribly clear what gains are seen for that work.

**Andrew Bailey:** I think that is a question that we do not really attempt to answer, in one sense. With all due respect, that is a decision that has been taken by the referendum and obviously the form in which it happens is a matter that the Government and Parliament will decide on—we do



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not really do that calculation. However, you are right in saying that there are nevertheless very relevant issues that play a part and, as both Sam and I said, one of the key things is—and this is particularly so post the financial crisis—a huge amount of work, particularly by the Financial Stability Board, which Mark Carney chairs, to put in place global standards. That is key because it was a global crisis.

What I would say about the issue with financial services in the EU is that we do not see those issues as what are called regional issues. They are global issues and financial stability is a global issue. I was surprised, frankly, to see that the argument for saying that there has to be a harder solution from the EU point of view on the relationship between the UK and the EU looking forwards is for financial stability reasons. I absolutely agree on financial stability and with what senior people in the EU have said about this, but financial stability is ultimately a global issue, not a regional issue.

**Sam Woods:** I am absolutely in line with Andrew. It is not something we are putting a lot of thought into because, frankly, we are heads down, bringing the rules, technically supporting the Government, and all of these issues with firms and transitional structures. The returns to investing too much in that question at the moment seem low, given that it depends fundamentally in the end on what sort of deal the Government can strike and Parliament can approve.

Q1319 **Seema Malhotra:** Thank you for coming to give us evidence today. I want to start by asking a couple of points of clarification on some of the comments that you have already made and then seek your views on the UK's proposal—the Chancellor's proposal—to have a future relationship based on mutual recognition and reciprocal regulatory equivalence. Mr Woods, you just mentioned about how a significant chunk of what goes through our clearing houses is EU assets and that has been acknowledged as a particularly sensitive subject for our EU partners. Could you share your perspective on how sensitive is sensitive and whether you think that there is a risk of other activity and operations being set up in the EU if the concern about EU assets leaving the EU and going to a third country means that they lose control or regulatory oversight of those assets?

**Sam Woods:** I am very happy to do that. Just to be clear, the central counterparty issue is adjacent to but not exactly the same as the asset management issue, but it is perhaps the most sensitive part of the debate. The reason is that the portion of that business that is done here in the UK on behalf of EU institutions is massively higher than the numbers we were just talking about in the asset management space. That gives rise to a perfectly legitimate question from the EU-27, which is: in the context of the UK pulling itself apart, in an as yet unknown way, from the EU, do we need some additional safeguards to ensure that our financial stability is not put at risk by having these very important



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services being provided from beyond our borders? That is a question that does not arise today and that question is being asked.

The debate is playing out in the context of something called the EMIR supervision file that is being debated and that basically has two sorts of ideas in it. One we think is broadly sensible, and one can argue over the detail; and the other we think is a bad idea. The one that is broadly sensible is the idea that we would need to have a very high degree of supervisory co-operation, information sharing, and things of that kind, in relation to the oversight and supervision and regulation of those particular entities. We agree with that as an idea. We do not agree with everything that has been proposed. We think the buck stops here in the UK. I would see it staying here in the UK but you can build a lot around that. Then there is another idea in that file that we refer to—and I think this is regarded as a pejorative term but I do not see why it should be—as the location policy, which basically says we cannot get confident about that, it has to come onshore. I think that is a fundamentally bad idea because the whole benefit of these sorts of institutions—the clue is in the name, central clearing, and if you tease them apart, that makes them more expensive for everybody, and there are a number of industry estimates around that.

**Q1320 Seema Malhotra:** When you say a bad idea, could you clarify who it is a bad idea for, and on what basis?

**Sam Woods:** I think it is primarily a bad idea for firms within the EU-27 that currently use those services, and for which those services would become more expensive if they were forcibly segregated into a much smaller type of unit. For instance, 15% of what one of the CCPs here is doing in London is EU business. There happens to be a very high proportion of EU business being done here, but it is a global thing. The cost of those services would go up. We have seen that in the case of Japan, where there is a similar onshore-offshore type of arrangement. I think that would be a downside for all. The other way that a downside could arise is if EU banks decide they need to continue contracting UK central counterparties but a punitive view is taken of those central counterparties by the regulators in the EU and capital requirements go up massively. I think that whole notion is completely wrongheaded. We should focus on the first option where in the end it is going to be for the Treasury to agree it, but we, as the UK, stand ready to engage on that.

**Andrew Bailey:** I want to reinforce what Sam said. It is not just a cost to the financial services sector; it is a cost to the economy financially because the cost of clearing obviously gets passed through eventually. It is worth bearing in mind that one of the very sensible policy measures that has been taken post the financial crisis is to increase the scale of cleared activity as opposed to over-the-counter activity. If you then fragment that clearing, you lose efficiency, you lose the ability to net across contracts, and that will have a cost to the economy, there is no question about that.



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If you don't mind me making an historical reflection on this, this is not a new debate at all. This debate has been around at least since the creation of the euro in 1999. I was Edward George's private secretary at the time and there was pretty robust exchange when the euro was created about clearing being in the UK and not in the euro area. This was a debate about what I might call broadly monetary control in the whole sense of the term. That debate then rolled on to the legal action that was going around a few years ago the other way. I think the context of this is that Brexit gives this argument a powerful new set of legs in that debate, but it is not actually a new argument.

Q1321 **Seema Malhotra:** We are in a slightly unusual climate where politics does seem to trump economics on some of these issues. Have you heard, as I have, from industry in the leading nations in the EU that the fear in the longer term of losing control to a third country would trump some of the economics on this point?

**Sam Woods:** I think the truth is that there is a variety of views. I am not at all making the assumption in relation to the central currency that, as you said, politics will trump economics. I think that is still debatable.

Q1322 **Seema Malhotra:** Mr Bailey, you mentioned the temporary permissions regime. Could you clarify under what circumstances you think that might be necessary, for how long and how it would be agreed?

**Andrew Bailey:** The reason, as I was saying earlier, is if we have a sudden falling away of the passporting system and with that goes the domestic authorisation created by the passporting, whether it is into the UK or the EU—

Q1323 **Seema Malhotra:** Would the sudden falling away be in the event of a hard Brexit?

**Andrew Bailey:** Yes. In that case, it goes back to what Sam was saying earlier, that will lose, in the absence of the legal authorisation, the ability to service contracts legally, the way in which the legal structure is set up, the servicing of those contracts. As Sam was saying, insurance stuff can be paying out claims and derivatives, it can be netting, it can be compression, going back to what I was saying about the efficiency of management. It does not undermine the legal validity of the contract when it was set up, before Brexit, but it does undermine the ability to manage the contract going forward. That is the key point there. That is why the risk would arise and it would arise if that happens in a timeframe where we cannot take the necessary actions to create a whole new world of a domestic regime in time. That is why a temporary permissions system bridges through to that.

Q1324 **Seema Malhotra:** What would that timeframe be? We are in a slightly unusual situation if the Government seem to have a policy intention of a transition period and you seem to have a level of uncertainty about whether or not that will be realised. Is there a point at which you think that will be a deadline after which you would need to be in the space of



having a temporary permissions regime agreement and when would that be?

**Andrew Bailey:** The agreement to a temporary permissions regime is a UK thing and it does not require the EU to be involved in it. It would involve Parliament passing a fairly small piece of legislation in the context of the overall withdrawal Bill and work has been done on that. There is a plan for that to enable it. Secondly, it requires us to have, I would say, memoranda of understanding, MOUs, with the home authorities in the EU in that case, from which the institutions are coming. That allows us to supervise them on an ongoing basis when they have the temporary permission.

The final point is that we do not know how many institutions would be in a position, for the reason that although we know how many passports exist—I can tell you about a month or two ago in all there were about 8,500 inward passports to the UK and just under 6,000 outward passports—what we cannot tell you is how many of those are used, and particularly here we are talking about the inward passports. We do not know whether the firms who have the passports are actually using them because only the home authorities will know that.

The reason I say that is that particularly in some sectors the number looks pretty high and it looks pretty high from some countries, but it may be that they give passports as almost a precautionary measure to say, “If you end up doing anything with a UK customer, don’t worry, it is okay because you have got a passport.” Whether they do anything is another matter. One of the things that this exercise would do is flush out how many real passports there are.

**Sam Woods:** If I could add to that very briefly on the passports question, it is quite interesting on the banks and insurance side. I think we are going to see about 150 applications from firms to be authorised here after Brexit and that is almost all in what we call a branch form. We have about 160 of those here today and the big question for us has been is that number going to get greatly increased by the sorts of firms that Andrew is talking about who are operating services with these passports but without a presence. On our side it turned out the answer is basically, no, there is a very small number.

A second point: on the temporary permissions regime I would like to emphasise to the Committee the central importance that that has in our planning for managing all of this in a smooth way. We are choosing to make the assumption that the Government will bring that forward and that Parliament will agree it, and obviously we are running a degree of risk in that but it has become very important.

Q1325 **Seema Malhotra:** By when would it need to be agreed by Parliament?

**Sam Woods:** My understanding is that the Government intend to bring it forward for June-July. I may be mistaken in that but that is my latest



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information. Imagine if we get to September and we do not have such a thing. We are then in a very difficult spot because we do not have confidence about whether we are in a sort of six-month countdown or whether we can use the period. It is reasonably pressing and very important.

**Andrew Bailey:** We are very much relying on Parliament for withdrawal legislation in its full form, by the way. I always slightly characterise it as like an iceberg; there is a piece sitting above the water that you are debating very actively and is important and then there is a huge piece under the water that we are working on actively with the Government, which is about translating the rules into the UK that will go in a secondary form through Parliament. All our plans are very much conditional on the fact that will happen.

Q1326 **Seema Malhotra:** The Chancellor said in his speech on 7 March that, "In certain circumstances we may choose not to maintain equivalent outcomes but we will know that there may be consequences". Do you have any view at this point about what those particular circumstances might be and what the consequences could be?

**Sam Woods:** I can only speculate, but I can tell you one aspect that is relevant to our thinking, which is that passporting is much more relevant and valuable for some lines of business than for others, so broadly some forms of investment banking, wholesale insurance, plugging into central counterparties across a border and delegation. There are other lines of business for which it is not much use and, frankly, we probably do not want it shipping in across the border. One example is retail banking. We are in the middle of ring-fencing the retail banking operations of our own companies. It would be very peculiar if we actively wanted it to come in across the border without a local authorisation. I do not want to speak for the Chancellor, but it is possible he was referring to the fact that it probably varies across different parts of the sector.

Q1327 **Hywel Williams:** Good morning. Can I take you back to the question the Chair asked earlier about contract continuity? As you will know better than I, it is of some concern to people who work in this area. Where do you see an agreement on that lying? As you indicated, Mr Woods, is it something that might possibly lie with the absolute broad agreements or, just to take the contrary view for a moment, why shouldn't firms just get on with it for themselves, which I know is viewed with dismay by some people?

**Sam Woods:** It is basically a question of scale and time. It is true that there are various mitigants that firms can and are putting in place to manage that. The most obvious example of that is what is called a part 7 process. I don't know whether you are familiar with this, but it is a core process for moving customers from one entity to another, so many of the insurance companies are doing that in order to move customers on to the right side of the border. But looking at the scale of the activity and the time that we have, even including the implementation period, we do not



find it possible to get confident that that in itself will provide a complete solution.

To give you a sense of that, our estimate is it is 26 trillion in gross notional derivatives crossing the border; that is for counter-derivatives. There is another 70 trillion in the central counterparty space and on the insurance side, which is perhaps a bit more tangible, you have got 10 million customers here in the UK who have some kind of an insurance contract with an EU-27 company. We estimate—and this is a combined effort by us and EIOPA, which is the place where insurance regulators get together—there are 38 million customers within the EU-27 who have some kind of a contract with a UK company. Our assessment is that while we want to encourage firms to mitigate these things, we simply do not find it plausible, based on our previous experience of moving books of this stuff around, that it can be done in a competent and complete way even by the implementation period.

Hence, we think the UK Government and the EU authorities need to bring forward legislation to their relevant Parliaments to put in a fix. This leads to a slightly longer answer, because some of those have happened before. It is not exactly the same but when the euro came in the same question arose: is this going to mess up all these contracts? A clause was put into the euro regulation that sorted it out. Our view is that that is a necessary fix.

**Andrew Bailey:** If I could add, and I agree with that, cleared derivatives is a case in point. As Sam said, the number is very large and it is not just a case of doing a straightforward lift and shift. If you think about the possible solutions, there are three possible solutions in this order of preference. There is what I might call co-ordinated action by the authorities in the EU and the UK. There would still have to be each one of them doing it but they would be co-ordinated to achieve it. There is what I might call unco-ordinated actions by authorities, of which the temporary permissions regime is an example, why we have decided to have a backstop.

The third level is leaving it to firms. As Sam said, that might be not only the least preferable but it is positively difficult and dangerous at this point. The point about lift and shift is it is not just a matter of saying, “I am going to take all my contracts and move them to this clearing house”. You have to reset the contracts at that point because these are all legacy contracts in the sense that they exist today. Some of them are in the money and some of them are out of the money, so you cannot just move them over, starting again with the same positions. It would be a very complex thing to do.

Q1328 **Mr Djanogly:** Can I ask for the record what your views are on the proposed transition period? Is it of a length that is suitable for your purposes? Could I ask you to give a little bit more detail on what your organisations have to do to prepare for transition as provided for in the



draft withdrawal agreement? In that context, I think I should also ask what elements of your preparations will probably not be completed by March 2019.

**Sam Woods:** I strongly welcome the period itself. We have argued since very early on that we needed more time than March 2019 to sort this out. On the doability of what needs to be done by the end of 2020, there are different bits of that. These very important planning issues we have been talking about, contract continuity and data, are things that will need to be fixed in such a period. I do not think it should take that long for governments to agree a fix for those; it is more a political question than a technical one. All the firm restructuring that has to take place in various directions across the border is a massive task but my assessment is that it would be doable by end 2020.

To give you just one flavour of that, if you think about it at our end—to come on to your second question partly—we have this big task, which is going through the authorisation process for the 150 or so applications that we expect to receive, of which about 29 have come in so far. In the first five years of the PRA's operation and Andrew passing it to me, we have done about 60 authorisations. We have done 60 in five years and we are talking about doing 150 in three years. That is doable. It is a big task but it is doable. That is just one example.

As a broader answer to your second question, we have these three blocks of activity. There is bringing in the rules, which is pretty well on track. It is going to be, in effect, over to you for the next part of that. There is providing technical support to the Government as needed in its negotiation and there is all this activity with the firms, which is the bulk of it. I speak for the PRA within the Bank, just to give you a sense of it, that we will have about 14 million out of our budget for this year that is just starting, the budget of 270 or so, that will be devoted to all of that activity, which will probably be 80 or 90 people. But that really does underestimate the impact of it on the organisation as a whole because the amount of senior management time that is devoted to this is massively high. Of course it can be debated to what extent senior management adds value within organisations but to the extent that it does, I can tell you it has been severely impacted by this set of issues.

**Andrew Bailey:** I think there are two ways to look at the transition period, and it is interesting that sometimes it gets called the transition period and sometimes an implementation period, but actually they are different. What I would call the transition reason is really what we have been talking about, which is dealing with the risks and particularly with what I call the UK backstop in place and I think we can deal with that.

The second is what I call the implementation reason, which is it would, of course, be much better to do the work on moving to the new regime knowing what the new regime is. Thinking about relating to that period, I would calibrate that length in terms of when we know what the new arrangements are and how long both we and firms would need to move



to that solution. That is obviously a much harder question to answer at this time because we do not know what the new regime is, but I would tend to distinguish those two reasons even though they sit within the same period of time.

On organisational issues, we are in a somewhat similar position. The largest volume of work for us so far has been on the legislation. We have about I think it is low-50s pieces of European legislation that fall within our area and we work mainly with Treasury, and in one or two cases with other Government Departments, on how those pieces of legislation are going to be transferred into UK legislation using the statutory instrument process once the Bill gets Royal Assent. Also sitting under that are what tend to be called binding technical standards in EU language at the next level down and we have about 9,000 pages of binding technical standards that we also have to bring onshore. That is the largest work, authorisations and designing the future supervision model.

Then, particular to the FCA, we expect to take on the responsibility for two things that are currently done by ESMA. One is regulating trade repositories that would be based in the UK. That is largely records of derivatives. The second thing is credit rating agencies. Both of those are responsibilities of the EU today, so we have to recreate that in the UK and we are pretty familiar with them because we are part of ESMA.

The final thing I would say is we are not having to build systems anything like customs movements, but if I give you MiFID II as an example, which is the best example, which was introduced at the beginning of this year, currently we transfer about 30 million trade reports a day to Europe, to ESMA, the biggest supplier by a long way because of the size of the markets. They will not go in that form to ESMA. We are already the creator and processor of them but we will do the end part as well.

**Q1329 Mr Djanogly:** There has been a lot of reference here at various times to relationships with the EU regulators and the fact that this is a two-way process and it does not matter what we do here, they have to play ball as well. I think it would be helpful for the Committee to get a feeling as to the current relationship that you have with the European regulators on supervisory co-operation looking forward. It would be interesting to hear what your views are.

**Andrew Bailey:** We are both heavily involved in the various parts of the landscape. Probably between us we cover the whole thing. From day one after the referendum—and I moved from Sam's job to my current job a week after the referendum—we have set out to maintain strong relations with both the national regulators in the EU and the EU authorities. That is sensible for a number of reasons, because we still have to do business as part of it today but also we are going to be dealing with them under whatever arrangements are in place. There are still going to be very large financial markets in London and we are going to be dealing with them in the future. From my point of view, one of the absolute priorities was to ensure that we did not become isolationist in that sense, and we have



not. We emphasise a lot that the relations go on and I will just illustrate that. One of the ironies of life, my life anyway, is that I have spent more time in the EU post the referendum than I did before the referendum. The reason is that we put a particular emphasis on maintaining those relationships.

**Sam Woods:** I would echo all of that. Relations are very good. We have all been investing extra because of the obvious strains that are being put on these relationships by what is going on. I have been dealing very closely with my colleagues in Frankfurt, Paris and Dublin, dealing interactively with all of those in the last few weeks. I spent yesterday in the European Banking Authority Board of Supervisors. The issue that we have is that some of the political complications do start to enter, to some extent, into some of these issues, of which contract continuity is one. The description by the EBA and EIOPA, which is the equivalent on the insurance side, of the contract continuity problem is basically the same as our description, but we then take the next step and say we really do need the politicians, if they are willing, to do something to fix this particular problem. They have not taken that step on the EU-27 side. They are being more cautious.

Q1330 **Mr Djanogly:** I think there are many people and regulators realising that they are going to have to be spending more time in Europe after we leave than they did before. There has been quite a lot of debate within Parliament as to the implication of new regulations being introduced during a transition period. The Secretary of State came to speak to the Committee and said we might have to take what they give us during that period but there is not going to be very much of it because I think he said it takes 22 months per regulation to gestate and, therefore, we can look down the line and say that it is not really going to be a problem in practice. In your fields, is that something that you would argue with? Should we not be concerned about a deluge of EU regulation happening during the transition period that might throw things for us at an early stage?

**Andrew Bailey:** We have a pretty good sense of the sort of pipeline. I think there are two reasons why the pipeline is not empty but it is looking somewhat less full than it has done in recent years. One reason is to do with there having been a large volume of post-financial crisis legislation and that is gradually coming towards a conclusion. The second reason is more to do with the cycle of the EU, which is that the transition period, as designed now, coincides with a change of Commission because you have European elections next year. Therefore, you do get a cycle and the low point in the cycle is either side of that process, as I understand it. That probably suggests that while the pipe is not empty, it is somewhat less full than it would be at other times. What we do not know at the moment, because of the way the EU process works, is precisely which pieces of legislation are going to come to fruition during that time. We are still



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involved in those processes at the moment and we are working on the assumption that we would have to in some form or other, yes.

**Sam Woods:** We have looked carefully across all the files at the ones that could come to fruition after March 2019 but before December 2020 that are relevant for us. As Andrew said, the volume that is important ones is not huge. There are two that I think are relevant on our side. One is the EMIR supervision file that we were talking about earlier, which is where the CCP debate is occurring so that is obviously important. There is also ongoing work, which possibly could come to fruition before that, on what is called CRR II and this is the next round of the banking regulations, which is important. The Government have negotiated a number of safeguards in its agreement. Hopefully those have some salience for things that have a very specific and significant impact upon the UK, which is how I read what they have.

To go back to Andrew's much earlier comment, I think that is all perfectly manageable for transition. What it comes down to is it would not be a satisfactory state to be in long term.

Q1331 **Jeremy Lefroy:** Thank you very much indeed. Could we come back to the second point that you made, Mr Woods? In your opening remarks you talked about the contracts being the major risk, but then it was data. What do you need to see, in terms of data, for the smooth transition to the post-EU regime?

**Sam Woods:** I am worried about data. I am slightly less worried about it than I am about the contract continuity issue, and that is for a number of reasons: one, this is not just financial services issues, so I see a problem in all sorts of places and my guess is that criminal justice issues may be bigger than the ones that we have. I do not know, but it is clear that it is an issue right across the patch. Whereas the contract continuity issue, although it is an issue in other places, seems to be predominantly a financial services issue, which makes me worry about it more. That is the first reason.

The second is—and this comes directly to your question—what the authorities on both sides have said about it so far, which, crudely, I take to be from the EU side, for anything that has come across before the UK exits out it will be grandfathered and for stuff going forward we want to use the GDPR adequacy regime, and that is a new regime that we are just bringing in right now. The UK Government's position seems to be they want something more ambitious than that. Perhaps they would enshrine the agreement on data in the trade agreement or something of that kind.

Of those I prefer the firmer position, so I prefer the UK Government's side, but it does not seem to me as though the point that the EU is starting from in terms of some kind of a mechanism of finding adequacy under GDPR, which means people are okay to pass stuff back and forth,



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is particularly problematic. Therefore, it seems to me that the negotiation starts in a place within which I would be content.

The last point is that I think through time this is—although it will be a great pain if this was not fixed by the authorities, and I think it will be for the reason I gave—slightly more amenable, in my view, to a fix by firms than some of the contract continuity issues. There are model clauses that firms already use quite extensively for shipping data out of the EU into other parts of the world. The problem with those is they can be struck down in court and there is currently a case in the ECJ on this, Schrems II I am told it is called, so that is the weakness of that so I would not want to rely on that, or binding corporate rules, which again I am told is not brilliant.

Therefore, I am worried about it, but of the two crosscutting issues those are the two, but the contract continuity one is a bigger worry, for the reasons I gave.

**Andrew Bailey:** While I agree, the only thing I would add—and Sam has referred to GDPR a few times—is that it is an illustration of a slightly double-edged sword in this process because on the one hand, as you know, GDPR comes in pretty soon. It is in the next few months. Trying to do the on-shoring, as we tend to call it, of a piece of legislation in the EU that has not yet been implemented is interesting, so that is a challenge that we recognise we have to deal with. It would be great if the EU would just stand still while we onshore it all, but they won't and that is fine.

On the other hand, if you look at it from the positive view, as Sam said, it gives you the basis for equivalence, because as the UK is going to implement it on day one we all start off in the same place. From the point of view of what needs to be put in place to, in a sense, set up the framework for data flows post day one that ought to be a robust starting point.

Q1332 **Richard Graham:** Sorry for missing some of the earlier exchanges and I apologise if this has been covered already, but if we assume the goal is fundamentally continuity rather than disruption, and if we assume—as per some of Mr Bailey's written comments to Parliament—that there are precedents, by encouraging precedents in terms of the work that has been done on TTIP before, the whole argument of mutual recognition and so on, what I am interested in is how the structure of all this is going to work and what the arrangements for the architecture around financial and professional business services will be. Michel Barnier has talked to us about a four pillar structure, but it strikes me that financial services and professional business services are so important to both of us—us and the EU—that there is a need for a separate pillar to cover that, and a place where you can have regular structured dialogue before decisions are made on, say, new EU regulations and so on.

Therefore, my question is this: to what extent do you believe this is important, and what sort of discussions have gone on so far that might



lead us to be encouraged that there is an architecture that will be created for this?

**Andrew Bailey:** I will start. You are absolutely right to point to the need for the architecture, and you can see several pieces down the line, so you are right to say there needs to be, in a sense, an institutional provision to be able to be involved in the shaping of things.

Some of that of course goes on in global fora. Some of what the EU does in legislation as a translation of global agreements—Basel would be the obvious case in point here, but it is not unique—in EU legislation and of course the UK will be involved obviously in the global fora going forwards, but you are right that it does require an institutional setting in which we can be involved in the shaping.

I think, and this then depends obviously—we did have a discussion before you arrived about outcomes-based solutions versus rules-based solutions. I will take the best case here and assume we do get some form of outcomes-based equivalence. You obviously then have to have a means of judging whether those outcomes really are equivalent in a sense, and being able to have an institutional structure to do that. The third thing I would say is you do need to have some form of dispute resolution mechanism, because that is in the nature of things. It will happen.

In terms of what the architecture would look like, those are the things—there may be others—that you would need to put in place. The heads of terms that you would want to see is to, first, as you said, have a commitment on both sides that we want this to happen. As we were saying earlier, I do think there are precedents for this and I have said this publicly. I reject the argument that you cannot do it for financial services, but then obviously coming out of those heads you have to have the momentum to get on and do it, frankly, which again would involve a combination of Government and us as regulators.

**Sam Woods:** Yes, I think those are the blocks. You need something specific for financial services, the way Andrew describes, and presumably then it would dock with whatever wider agreement was in place, but you would need something around the financial services bit in isolation I think.

Q1333 **Stephen Timms:** I apologise for missing so much of the session as well. You have just been talking about the kind of regulatory settlement that would work from a UK and an EU point of view. I heard you speaking about this at the all-party parliamentary group on wholesale financial markets and services a couple of weeks ago and you made similar points there. I was sitting on that occasion next to an official from the French treasury who said to me afterwards that even if the kind of arrangement you described was in the interests, both of the UK and the EU, it would be unacceptable because it would be an invitation to other countries to cherry pick bits of the regulatory framework that they liked. Maybe coming from somebody in France that is not too surprising, but there was



someone else there who told me she was sitting next to a Swedish official who said exactly the same. I just wonder how achievable do you think the goals that you have set out are going to be in practice, given those concerns particularly about cherry picking elsewhere in Europe.

**Andrew Bailey:** Let us be honest: we have a way to go before it is welcomed as a solution. I recognise that. What I would say about it is that I think we need to be clear what the term “cherry picking” applies to here. Let me divide it up into two parts. I think there is a debate around: is it cherry picking for the UK to want an arrangement on financial services, per se? I would say no because I think that if we all believe in open markets—“all” being both sides of the debate—and the benefits of open financial markets, and of course what goes with that is robust regulation.

But if we believe in the benefits of open markets and we believe that—as you rightly said it is not just the UK but the EU who will get benefits from that. They get benefits from access to capital markets, in a sense the capital market infrastructure here in the UK. Then that is not cherry picking. What would be cherry picking—and this comes back to the equivalence or recognition point—if the UK then says, “By the way, here is my top 10 list of things from EU legislation that I have always wanted to get rid of and now is my opportunity with one bound”, and that is what we have to recognise. That is where you get into this delicate issue between rules-based and outcomes-based equivalence. I think you can have outcomes-based equivalence without having that sort of cherry picking and, as I was saying a minute ago, you have to then have very transparent processes for judging it.

Clearly, if the UK came along and said, “We want this and, by the way, here is a list of things where we have never agreed with these EU rules and now is the chance”, yes, I think we will get that response.

**Sam Woods:** Just to add briefly to that, what are we talking about here? It is about a particularly efficient means for financial services’ companies to sell across the UK/EU-27 border, so in the form of a passport and you can do that without an additional permission.

The next most efficient structure inside that is a branch structure where a firm does not have to set up a separate entity in the other jurisdiction. It can just plant an office there, which is part of the home entity, and that is also very efficient from a capital liquidity point of view.

What happens if that more efficient form falls away and people are falling back on branch or subsidiary structures? Well, business becomes less efficient and more expensive for financial services’ firms, some of which are British firms, many of which are third country firms and many of which are EU-27 firms, and the costs of that are then borne by the users of all of those services, which are spread around the world, in fact, from here. I think that is the prize to go for and that is a prize worth



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something. It is logically worth something to both sides, not just a UK thing.

Then Andrew's second point on cherry picking, there is this great fear—I think this is the great fear—that somehow the UK is going to race to the bottom on regulation. I and all others involved in it are absolutely clear we have no desire or intention to do such a thing, having just spent 10 years rebuilding after the last disaster.

**Q1334 Seema Malhotra:** Yes, I want to come back on the point following the question from Richard Graham, and this was about the architecture. I understand what you were saying in terms of what needs to happen. Indeed, the Chancellor had also laid out what would need to happen in terms of governance structures, dispute resolution mechanisms. How much progress has been made on what those models might be?

**Andrew Bailey:** I would say at the moment we are still having the conversation in the way that we have been having it this morning. I could not tell you that there is a lot of activity gone on between us and the EU that is saying, "Let's come up with a plan that we can roll out when the moment comes". That is not happening. I would say obviously, when I said not much more progress had been made, quite a lot of thinking has been done in this country about: what could this look like? But in terms of engagement with the EU, no, that has not happened yet.

**Q1335 Seema Malhotra:** That is quite extraordinary in some ways, bearing in mind we have less than a year until we step into transition.

**Andrew Bailey:** Yes, but I think it comes back to the point that Mr Timms made, which is, let's be frank, there is a degree of suspicion about this. I do not think we should be surprised that we are not getting a, "Let's get on with this. It is such a good thing". The onus is on us to take—

**Q1336 Seema Malhotra:** Within the UK, do you think there has started to be a consensus about models and what it could look like in terms of the architecture?

**Andrew Bailey:** Yes. You see that in obviously some of the things the Chancellor and the Prime Minister have said. I think there has been a lot more thinking done here and a lot more focus on the financial services issues, and obviously I welcome that.

**Q1337 Chair:** To what extent do you think—depending on what kind of arrangement was reached, if one is possible—that on the EU side they are worried about then having to apply that, for example, to Canada, first point? Secondly, would you accept, given what you said a moment ago, Mr Bailey and you, Mr Woods, it is not just from their point of view a question of the UK engaging in a regulatory race to the bottom? It is that they do not fancy, particularly in the light of the experience with Switzerland, an arrangement in which the Brits who are never short of an opinion—particularly in this field, for reasons we well understand—are



going to be all the time saying, "Now, hang on a minute, and what about this and that?" They do not want to enter into an agreement in which that is what happens, and that they would like much more certainty about what the rules are going to be rather than a continuing dialogue with a non-member state. Do you think that is in part where they are coming from?

**Andrew Bailey:** I will offer two thoughts, one thought on each of those points. On the Canada and Switzerland points, I see the point. On the other hand, you can see—and this is very clear in the short report the European Parliament produced the other day—that there is a body of opinion in the EU that says, "When you look across the tapestry of arrangements we have, we do not seem to have one that looks as robust as it probably should do." There is some body of opinion there that says, "We have all these quite different arrangements and there isn't one that particularly wins out in terms of the one that works." I thought this was one of the interesting things about the European Parliament report. That leads to an argument that it is in our interests to look at this as well. I would say that I think that is a very relevant point to make. Sorry, I have forgotten what the second was.

Q1338 **Chair:** The second was about an arrangement in which we are constantly in dialogue saying, "What about this? What about that?"

**Andrew Bailey:** Yes. On the other hand, going back to the conversation we were having about, in a sense, what the pattern of business is going to be in the future. On everybody's expectation, the largest financial markets in Europe are still going to be based in the UK. What I would say is that I think that that means there is a distinct rationale for why there should be a close dialogue and why it is in the interests of both side to have a close dialogue.

Going back to what I was saying about our commitment to continue to engage. What we can obviously bring to the table is a large amount of experience of being in the midst of the largest financial markets, in some cases, in the world and that is what we do. Yes, of course, that sometimes spills over into, "The pesky British keep turning up and saying unhelpful things," but a lot of it is that we bring a lot of information, a lot of experience and a lot of data to the table, given my 30 million trade reports a day that I made earlier. I talk to a lot of people in the EU and they do say, "We do still want to have the benefit of that."

**Sam Woods:** Just on your second point, there would be a naturally strong EU aversion to any arrangement in which post-Brexit somehow the UK had a veto over their rules. It is understandable. It is their version of rule taker. But I would make two points subsequent to that. One is it is entirely possible to construct an arrangement of the sort that we have been describing which, at the same time, gives confidence that neither party is going to race to the bottom in order to have some kind of competitive advantage over the other one but does not result in either party setting the rules for the other. You can construct such a thing. I



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think that is in the spirit of what the Chancellor said, and the sooner we can get something on the table—to Ms Malhotra's point—with opposite numbers at the negotiating table, the better.

There is perhaps another thing, though, which is when I look at the sort of models we have been talking about, it is true that some of the thinking—and particularly the outcomes-based equivalence nature of what we are talking about—is somewhat more of an alien concept to some of our colleagues in the EU-27 than it naturally is to us, for a whole series of reasons. That is another aspect to this, a philosophical aspect that one would need to get over in order to have a good conversation about it.

**Q1339 Chair:** Finally, assuming that there was a willingness to negotiate the kind of approach that both of you have set out so cogently today, coming back to the question that was asked about the length of the transition period, and bearing in mind there is going to be a new commission in place and then, at the end of the transition period, any treaty involving a new, deep and special partnership in financial services and in everything else, would need to go through a ratification process with the European Parliament, it leaves quite a small negotiating window. I come back to, I suppose, a supplementary to the question I asked you earlier: bearing in mind you have both accepted that the detailed negotiation on this would inevitably be taking place in the transition period and not being sorted out between now and October, do you think that is going to be enough time to tie all of this up in the form of a legal treaty?

**Sam Woods:** The truthful answer is I do not know. We are not in trade negotiations ourselves. What would be highly non-ideal would be if there was, in fact, such a process that was going to result in a deal and firms had to move for a while to a third country and then back up. If it did take longer you would want to find another way to bridge it I think.

**Chair:** Mr Woods and Mr Bailey, on behalf of the Committee, can I thank you both very much for coming along here today? It has been a very illuminating session. We are extremely grateful.

### Examination of witnesses

Witnesses: Huw Evans, Chris Cummings, Stephen Jones and Nikhil Rathi.

**Q1340 Chair:** Can I, on behalf of the Select Committee, welcome our second panel this morning: Huw Evans, director general of the Association of British Insurers, Chris Cummings, chief executive of the Investment Association, Stephen Jones, CEO of UK Finance, and Nikhil Rathi, CEO of the London Stock Exchange and director of International Development? You are all very welcome this morning. We have a lot of questions to ask, so succinct questions from my colleagues and succinct answers would be great. Please do not feel under an obligation, all of you, to answer every



question because we have to be able to get through everything in the time available.

Can I begin with you, Mr Evans? On the subject of contracts and the certainty of future contracts, it would be helpful if you could outline for the Committee what you see as the potential problems and, in the course of that, to tell us what discussions your members are having internally and with regulators about what should be put in contract terms, given that there is some uncertainty about what is going to happen in the future when you let a contract that lasts 12 months or longer.

**Huw Evans:** Thank you, Chair. If I take the first one first, around contract continuity, so contracts that were written before Brexit and how those operate in the post-Brexit period. As you have heard from the previous witnesses, EIOPA and the PRA between them estimate this could be up to 38 million policyholders across the UK. Some of those will be short-term policies but some of the more problematic ones—to give you examples—would be, for example, director and officer insurance that is sold to companies, and where those policies are sold to multinationals they can be a pan-European policy applying to every different company within the European Union and they typically have at least a 10-year liability attached to them. As you would understand, things can go wrong in corporates and they subsequently get sued several years after the event, so these policies have a shelf life that is much longer than the actual period for which they are sold. That is one example of the type of insurance contract that is relevant here.

Another of course is pension contracts because pension contracts as sold by insurers, as you would expect, last for 30 years or so. Pensioners are increasingly mobile, so where somebody in the UK goes to retire in a different country and sets themselves up there, and is having that pension paid through a local bank account, if it is an insurance-based pension contract there is some legal uncertainty about the extent to which that is legal.

I ought to reassure at this point that there is no question of any of our members pulling the plug on those payments, but it is an example of the legal ambiguity that faces insurance companies in wanting to do the right thing, continuing to fulfil the contractual obligations they have entered into, when the laws of many of the countries prevent them from fulfilling the terms of a contract if they are not authorised to operate in that country. That is why we urgently need some form of agreement of the type that your previous witnesses referred to, to cover both those contracts that have already been written and to ensure suitable regulatory co-operation so that customers can be served. That can only be partly done through the part 7 transfers that were described. It will not cover all the types of contracts. I am happy to elaborate on that if required.

In terms of future contracts, well, that is where the benefit of the transitional agreement, which was agreed at the March Council, is of



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benefit in avoiding an immediate cliff edge for things such as travel policies that are being written at the moment and given to customers, which obviously now extend beyond the March 2019 deadline for exiting the European Union. We were very keen to see that and that certainly helps in the short term for those customers.

However, as we approach the next deadline—the December 2020 deadline—we will have the same problem beginning towards the end of 2019 when those annual contracts are being written again. If we do not have an agreement at that point on how the European health insurance card works, then that is a problem for travel insurers. If we do not have an agreement on how the green card system will operate and whether we will continue to be party to that, that is a problem for UK people travelling to the continent and, in particular, for UK freight travelling back and forth. So there are some significant challenges that still have to be resolved in terms of the writing of future insurance contracts, which are very much bound up in the next stage of negotiations.

**Q1341 Chair:** That is very helpful. Just picking up your example of health insurance. If the EHIC card system does not continue beyond December 2020, then British citizens who are travelling in Europe, who want to make sure that they are covered against any emergency medical costs, are going to have to take out insurance, and that is going to be a cost that they do not have to bear currently. That is correct?

**Huw Evans:** That is correct. Our advice is always that people have travel insurance to complement an EHIC, because an EHIC provides only quite limited cover, but it is undoubtedly the case that travel insurance policies would have to adjust and the cost would go up because everyone would have to pay more under that situation because the insurance policy would have to provide cover that previously the EHIC covered them for.

**Q1342 Chair:** That would be an additional cost to British holidaymakers travelling in Europe?

**Huw Evans:** It would indeed.

**Q1343 Chair:** Thank you. On contract continuity, are there any observations? Yes, Mr Jones?

**Stephen Jones:** I would just like to complement the industry insurance example with the wholesale markets, sometimes more difficult to bring to life. They are not quite travel insurance and health insurance policies but we are talking about \$27 trillion, at the last estimate, of cross-border significant financial contracts perhaps relating to foreign exchange or interest rates, and which underpin domestic financial services products, for example, fixed rate mortgages. That is a very, very significant market. It is between thousands of counterparties flowing between the UK and continental Europe, and one where the suggestion that the market could just sort it out itself exposes, I think, significant risks. Clearly, the relative simplicity of including a provision in a withdrawal treaty that would at least deal with in-flight contracts at a point of exit, I



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would have thought outweighed the risks of a private sector only solution, which is certainly what we hear sometimes on the other side of the channel as being the desired outcome.

Q1344 **Chair:** Okay. Mr Cummings?

**Chris Cummings:** Simply to add a point on duration and why individual companies are not capable of sorting this out for themselves. Duration, certainly in the asset management industry, where we are looking at 30-year hedging arrangements being made, suggests that this is not a problem that will wind itself up very quickly, and a point that was made very tellingly in your last panel was that some companies will find themselves in the money, some companies will find themselves out of the money, and the sheer scale of those individual negotiations would swamp the system, hence the pressing need for contract certainty and for this to be taken care of.

Q1345 **Chair:** Is there nothing to add? Mr Jones, can I just ask you, I put to Sam Woods in the earlier session what his current assessment was of the number of jobs that were likely to leave or be created afresh elsewhere. Where do you think things stand at the moment, given what has happened, the transitional arrangement but also the future uncertainty as to what agreement, if any, is going to be put in place?

**Stephen Jones:** First of all, to very much welcome the efforts that have been made in getting the transition agreement that is there but, secondly, as you point out, to reflect on the fact that that is not yet a legal certainty. There are other conditions around the withdrawal agreement that have yet to be negotiated, which we have no control over, Northern Ireland and the border being a significant one. Therefore to reflect on the fact that many of the members who are contemplating future business models in order to be able to serve their customers, need to continue to plan on the basis of a risk that there is no agreement on transition in March 2019 and work towards that deadline. That is what we see happening and continuing to happen across our members. I would like to feel that some of the measures that are being taken are reversible, but the process of applying for a licence in an EU jurisdiction, securing premises, starting to employ staff, these are processes that have a very long lead time as well as deploying IT systems.

I heard Sam talk about 5,000 to 10,000 people being the first initial estimate. I think he was referring to March 2019. I would agree with that as an assessment of the initial loss of jobs in wholesale banking. I would also concur with Sam in that loss of jobs may be the wrong expression. Some of these may well be new jobs created in continental Europe without necessarily displacing jobs here, but banks are and need to be efficient and the idea of duplication is unlikely to be sustainable so I do fear eventually we are talking about loss of jobs.

Q1346 **Hywel Williams:** Just to follow up on the Chair's question and the question is for Mr Evans, really. You did refer to people travelling abroad



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and the insurance implications there. What about the 1.5 million or so of British people who are living in France, Spain and so on, and any insurance contracts that they might have, are there particular implications for them?

**Huw Evans:** I think the green card that I referenced for those certainly who travel back and forward is highly relevant, because we are used to not having the physical document anymore. While that is not too difficult to get from an insurer—and you sometimes have to get it if you are travelling further afield—it is something that customers are not used to getting, but the real hassle would come with the checking process and the queues that would develop from green cards being checked, both for freight and for individuals.

For individuals who have chosen to go and retire overseas, the main consequence for them is less around travel insurance because frankly they need a different policy rather than travel insurance, which assumes they are a temporary visitor, but more I think around the pensions issue that I talked about, because there is considerable legal uncertainty about how some of those insurance-based pension contracts can be paid out in a safe and legal way. Nobody will stop paying those, but it does not put the insurers in a very comfortable position in terms of being compliant with the regulation in the countries in which people have settled. I know from my own discussions, including with the Spanish regulators, obviously given the very significant number of UK citizens who retire to Spain, that that is something they are very concerned about and are themselves trying to push up the agenda within Europe.

The blockage to this, quite squarely, is with the European Commission. The European Commission has steadfastly, openly and resolutely vetoed any attempt to find an EU-wide solution, whether it be around grandfathering contracts or anything else. It has said that it is completely untenable to have sector-by-sector arrangements of that kind and it will not countenance them. Therefore, we know what both the issue is and we know where, sadly, the blockage currently is as well.

**Q1347 Hywel Williams:** Can I just ask another one, a domestic one? The financial sector in Wales is smallish but we do have an insurance industry. Do you think there are any particular implications for the sorts of insurance companies that we have in Cardiff and in Swansea basically? They do deal in particular aspects of the industry of course.

**Huw Evans:** As my name might imply, I take a close interest in the insurance industry in Wales and enjoy my opportunities to visit there. Clearly, Admiral is the largest name there and they have chosen—as is in the public domain—to set up a subsidiary in Spain to try to manage some of these issues and, if necessary, to transfer contracts.

Wales has a growing centre of operational jobs around insurance—Lloyds Banking Group insurance part has a very significant operation centre in Newport—and there are also in Swansea and in other parts of Wales, it is



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significant mini hubs that are growing as there are also in Scotland where Glasgow is one of the largest centres of operational activity for insurance in the United Kingdom.

Two-thirds of the insurance industry's jobs are outside of London, so this is an issue that matters to every nation, region and city of the United Kingdom because ultimately, as with some of our colleagues, the financial services sector and the economic allocation of it around the country is much more widespread than people realise.

**Q1348 Joanna Cherry:** You have already outlined some of the problems that arise in relation to pensions, particularly health insurance contract continuity. We know that with ongoing dispute resolution, where EU law is relevant during the transition period, the United Kingdom will still be under the jurisdiction of the European Court of Justice. Does it worry you that, in terms of the withdrawal agreement, there will no longer be any British judges on the Court of Justice after 29 March next year?

**Stephen Jones:** No. Clearly, it is good to have British judges there. The British legal system is fantastic, but the ECJ has been a trusted dispute resolution mechanism for the last 40 years and I do not think that judges have exhibited particularly national bias in terms of the decisions that they have delivered.

**Q1349 Joanna Cherry:** You all seem a little surprised. Did you know that, in terms of the withdrawal agreement, after 29 March there will not be any British judges on the Court of Justice? You did. All right. Okay.

**Chris Cummings:** We have been thinking a great deal about what should be in a free trade agreement in order to look at dispute resolution beyond that, recognising that some parties would like the ECJ to continue but within a free trade agreement. As we saw with CETA and others, European policymakers have been happy to create other dispute resolution mechanisms, whether it is an investor court system or another dispute resolution mechanism, that bring together recognised judiciaries who are both parts of the free trade agreement. We are minded to see what comes next and are drawing up plans for that eventuality.

**Nikhil Rathi:** I would just add that I think, when it comes to financial services, the UK is a very active complier with European financial services regulation. If you think about MiFID II, which was implemented in January this year, one of the most wide ranging changes to European wholesale market regulation, very, very large changes across the industry, the UK industry is pretty compliant. Therefore, the number of cases taken against the UK authorities or UK industries is quite limited. In the case of MiFID II, the deficiencies of compliance are in a number of other EU member states.

**Q1350 Joanna Cherry:** We are all veterans of the TTIP negotiations, and those of us who were Members of Parliament at the time those negotiations were going through will be very well aware that many members of the



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public have concerns that tribunals or investor court systems or arbitration models perhaps are not as transparent as the existing Court of Justice. Are you aware of those concerns?

**Chris Cummings:** Yes. I was also quite closely involved with the TTIP negotiations and I thought from the moment when the then Trade Commissioner, Malmström, made clear that she was going to be even more transparent on the terms of the negotiation, that sent a good signal about the fact that the European Commission wanted to set a new standard for transparency, which I thought was very welcome. I know here in the UK there was a job of work to be done to reassure some groups that TTIP would not lead to the privatisation of the NHS and some of the other concerns that were validly raised at that time. Certainly we would like financial services to be included in a free trade agreement with the European Union recognising that there is a job of work to be done to reassure all parties as to how transparent it would be, what right of access there would be, the decision-making process, so that it was clear and transparent.

Q1351 **Joanna Cherry:** Can I move on to another topic, immigration? We are all waiting with baited breath for the Immigration Bill, which has not as yet appeared or, indeed, the White Paper that is supposed to precede it. Can you give us a feel for how immigration issues are impacting on the industries that you serve? What I am interested in is whether uncertainty about the UK's future immigration regime is affecting the ability of UK financial services to recruit, and whether you have noticed any impact in staff recruitment from other European Union member states.

**Huw Evans:** Yes, anecdotally, that is certainly something that I think is increasing from when we talked to CEOs and executives of member firms. That is something they are increasingly concerned about. Although, to be fair, I think they have been concerned about it since the day after the referendum. Obviously, for the insurance and long-term savings industry, we are the largest market in Europe. We are the fourth largest in the world and we are easily the most international sector in the world, and so we act as a magnet for talent, not just from across Europe but from across the world, who want to come to work at the heart of this sector. There is undoubtedly growing anecdotal evidence that it is proving harder to attract talent within the EU. They feel uncertain about what their status will be. Understandably many people do not want to uproot families, schools and all the rest of it if they are uncertain how long the job will be. These are jobs where it is often more about quality than quantity.

As I said, the vast majority of jobs are outside London anyway but often if you look around, certainly in my industry, then you will see very senior, important positions being held by EU nationals, and so it is being able to get the quality of those people as much as just a numbers game about how many are allowed in and how many are not. I would very much hope that we start sending different signals to those people in order to be able to continue to have the best possible people working in our industry,



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which is obviously good for financial stability and resilience both of our country and the customers we serve.

**Chris Cummings:** If I could add a little bit of data to that from our perspective. In the asset management industry, one in five employees come from outside of the UK, outside of Europe, one in 10 from other European member states, so proportionately we employ more non-Brits—if I may put it that way—than other parts of financial services.

Therefore, for us, it is a hugely important issue that the immigration policy is conducive to broadcasting and signalling very clearly that we want to attract the best talent, but the best talent at different levels of their careers. A lot of the discussion takes place as if the only people that we want to attract are those who are running the firm. Actually, we are very interested in continuing the process where people come to the UK at different stages in their careers. That not only offers great professional development because they get to work not only here in London but, from an asset management perspective, one-third of our footprint is in Scotland and we want to make sure that there is that free flow of talent at different stages of people's careers. That is very good for UK plc and our competitiveness, so it is particularly important.

Firms always have a choice as to where they site operations. Is it where the market is or is it where the talent is? Today the talent is here in the UK. The UK is the preeminent international centre for asset management, second in the world outside the US and, looking across Europe, we are bigger than Germany, Italy and Switzerland added together. That is because we have the talent and the expertise here. Therefore, getting the right immigration policy is hugely important and there are worries.

Anecdotally, it is getting much harder to uproot people from, yes, around continental Europe but also from other parts of the world and bring them to the UK. That is not to say we are blind to the need to continue to develop our own talent pool, though, and we have been giving that considerable focus not only since the referendum but over the last few years.

**Nikhil Rathi:** Speaking on behalf of the London Stock Exchange group, I would not say that we have detected any strains in recruitment from European countries yet. We employ over 50 nationalities and being able to attract the highest quality skills in all of our different businesses remains essential. We would want to see an immigration system that enables that to continue.

There is also another important dimension to the immigration debate, and that is quite vivid this week as the UK hosts the Commonwealth Heads of Government Meeting. We are a global business centre and we need to have an immigration policy that enables people throughout the year just to come and visit and do business here and meet with financial services providers. That is a very important part, I would say, of any forward planning when it comes to immigration.



**Q1352 Joanna Cherry:** Just quickly coming back on that, I imagine for all of you a large amount of your staff come from outwith the European Union. Can I just ask you what your members' views are on the current Tier 2 visa procedures for recruiting non-EU staff? Would you like to see any changes there?

**Stephen Jones:** The whole process is under consultation, as you know, and it was raised in the context of the Immigration Bill, which you said. I think we are all working with the Migration Advisory Committee to make representations on that and, frankly, in terms of distinguishing between the European Union and other parts of the world, we do not distinguish between that. We think about talent as a global resource, a global necessity.

If I could just make the point that that extends not just to the industries we represent at this table but also into the highly prized fintech industry with whom we work very closely, with whom we collaborate and, where that issue is particularly acute, data programmers and coders are a global pool of highly, highly mobile, often quite young labour and they are definitely being put off coming to the UK at the moment. We have board members of our organisation, UK Finance, from that industry and we have a number of members from that industry, so I would highlight this as being an issue not just for perhaps the more traditional industries represented at this table but also the future of our industries, which is close collaboration and working with fintech.

**Q1353 Chair:** To follow up on that point, you have been very forceful in talking about the need to ensure that we can continue to attract the best talent. From your discussions, do you think that the Home Office gets it? I seem to have stumped you all.

**Stephen Jones:** Yes, but it is work-in-progress and, as ever, this is about execution, this is about creating a system that is low bureaucracy, fast judgment, realistic and commercial, and sometimes—if I can use the term loosely—government processes do not always reflect that.

**Q1354 Chair:** Does anyone else want to offer a comment on that because this is the one area of the things that we are discussing where the answer is wholly in our hands? Mr Evans.

**Huw Evans:** Indeed, and I would hope—and hopefully this is not a vain hope—that the politics does not get too much in the way here, because I do not think there has been any analysis of leave voters' concerns about immigration. They are really focused on there being too many actuaries and fund managers coming from Europe. That was not part of the dynamic I think. It would be a huge shame, post-Brexit when we have a very significant economic task to deliver, as well as many, many millions of customers, both corporate and individual, who we have to continue to serve, if we make it more difficult for ourselves to have the people who are vital to that. Financial services, professional services are people businesses.



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Q1355 **Chair:** Yes. Do you think that the net migration target helps or hinders the Home Office getting it and putting in place exactly the kind of system that you would like, which is fast and efficient and low bureaucracy?

**Stephen Jones:** I worry about quotas from a commercial perspective, because that implies a bias in terms of where one is able to recruit available talent from, which hinders business effectiveness.

Q1356 **Joanna Cherry:** A quick follow up. Mr Jones, you mentioned the fintech industry, which is a hugely growing area in Edinburgh. I represent part of the City of Edinburgh. Have any of you looked into the possibility for immigration of the United Kingdom having a system like Canada has, where different provinces can have their own visas to attract the sort of talent they need, and have you looked at the possibility that that could answer some concerns about parts of the United Kingdom that are seen to be overcrowded but perhaps also answer concerns of the part of the United Kingdom that I live in, Scotland, which is certainly not overcrowded and really needs to attract new talent? I wonder if any of your professional bodies have looked at the Canadian model as a potential model for the UK in that respect.

**Chris Cummings:** I would have to confess that we have not looked at it per region, but we have looked at it in terms of category of occupation, category of job and then that would automatically follow into where those jobs are based. As other people on the panel have said, in asset management, although the perception is that everything happens within a square mile of this building here in the City of London, that is actually not the case. One-third of our jobs are in Scotland. We also have jobs across the whole of the UK, so you would understand why we take more of a sector view rather than a geographic view.

The one thing that we would be most keen to point out to all Government Departments is the fact that, as a growing industry, asset management is one of the UK's growing export earning industries. In fact, we are now 6% of service exports. We would like Government policy, in all shapes but particularly around immigration, to focus on supporting those industries that are growing very, very quickly. We have mentioned fintech. In asset management fintech is a huge boom opportunity and certainly, as we look around the world, our companies have a choice of either siting their operations in those faster growing parts of the world—in Asia, Latin America, Africa and so on—or to keep the talent here in the UK. If we are going to do that then we need people with a deep understanding of those local markets. That can only come from people who grew up in those markets, have lived there for a period of time, coming to the UK and sharing that expertise. The fundamental is an immigration policy that supports global Britain but, certainly, an exporting Britain that will have to find a way to pay its way in the world.

Q1357 **Jeremy Lefroy:** Thank you very much indeed. I would like to turn again to the question of data and ask you what needs to be done to ensure that we have a smooth transition as regards international data flows?



**Stephen Jones:** I am happy to go. You are right to highlight the issue. Your previous panellists discussed it as a critical transition issue. Andrew Bailey talked about GDPR being a point of convergence so, therefore, necessarily a good starting point. But it is a complex issue and any impediment on the free flow of data is extremely difficult, both from a business process perspective and from an ability to serve customers well.

The current EU data protection framework is one that we are working on. The EU, in particular, is likely to scrutinise the UK's Investigatory Powers Act in that context, in terms of affirming the UK as being adequate as a third country, from a data adequacy perspective. In particular, they will be looking at the UK's data sharing security arrangements with so-called Five Eyes' countries to determine whether or not they have concerns in that respect. Given that that is a complex set of discussions that need to take place, and will probably be tied up in terms of mutual security arrangements between the UK and the EU going forward, I do think we need to allow ourselves sufficient time to make sure that business processes in the meantime are not interrupted and disrupted by there being a period where data is not deemed to be able to flow across border because the UK is not deemed adequate from an EU perspective.

**Chris Cummings:** If I may, this is a non-trivial issue for the asset management industry. We manage some £1.7 trillion-worth of European assets here in the UK; £1.7 trillion, with European clients coming from the EU-27, normally with the legal vehicle, the fund domicile being in Luxembourg or Dublin but the fund management expertise being here in the UK. Therefore, you can see that a three-way relationship means how absolutely essential it is that getting the data adequacy statement sorted out very quickly becomes hugely important for the industry.

**Huw Evans:** Yes. It is absolutely vital the Government now have this, if not near the top of their list, at the very top of their list. The agreement on the transition allows enough time to negotiate an adequacy agreement that could then come into force at the point the transition period ends. It is vital it does. Nobody knows how you would possibly manage any form of gap. Data transfers are absolutely central to how all our businesses work and how individuals and businesses are served. Of course, these are individuals, in particular, who are living highly mobile lives, so it is completely unconscionable to not have this in place at the point at which we finally leave. It is an area, unlike financial services regulation—which we will probably talk about, and which you covered in the first panel—we do not have any concerns about inadequacy or equivalent framework, because this has been negotiated over many years. It is cross-sectoral. It is much harder to imagine the European Commission gaming it in a way that impacted a particular sector and we have been at the heart of the UK of framing the regulation, so I think we are all in favour of getting the adequacy agreement negotiations under way very quickly with a view to getting that agreement in place. There will be very real consequences for consumers if this is not done. This is highly, highly important for



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businesses and individuals, and the somewhat sort of dull title should not put anyone off about just how central an issue this is.

Q1358 **Jeremy Lefroy:** If I could just come back on that. Clearly, the United States is hugely important in financial services areas and has a huge presence in the UK and throughout the EU. How is the data sharing coped with in respect of the United States in United States' businesses, and indeed others that are outside the EU?

**Stephen Jones:** GDPR is the most advanced manifestation in developed economies of the right to data privacy, so I think the answer is that we are all learning. Coming from an environment where the free flow of personal data was more permissive in favour of businesses as opposed to individuals, so we need to get the balance right. The honest answer is: I think we are all trying to figure this out now in terms of how we move forward, but the answer is the flow between ourselves and the United States, in the past and currently, is potentially easier than GDPR regulation will require it to be going forward.

**Nikhil Rath:** Taking a slightly different angle on the data question, also with the United States, and when it comes to supervising global market infrastructure, like the clearing house, and the way the London Stock Exchange group operates, which was talked about extensively in the previous session, there are explicit clauses in the EU/US agreement on this that enabled data sharing between supervisors, and that requires both sets of supervisors to be willing to share data on an ongoing basis for supervising what are globally systemic institutions.

**Stephen Jones:** Just to add to that, I have had conversations with the chairman of the CFTC about concerns that GDPR would prevent them from being able to perform their global supervisory functions in respect of US institutions and their European activities, and the need for some form of safe harbour or other protection to enable them to do so. So these are complex issues that are in flight at the moment and require significant thought in working through internationally.

Q1359 **Jeremy Lefroy:** If I may just ask one question, Chair. In the previous panel it was made clear there was a kind of hierarchy of preferred outcomes where passporting type arrangements were at the top followed by branch, followed by subsidiary. In a previous session, in talking with businesses in other areas, I have asked whether, in certain parts of your business areas, the fact of having a branch or indeed a subsidiary give opportunities because what it does is give a greater presence on the ground as opposed to passporting. Could you see in certain areas—I think Mr Evans you mentioned Admiral opening up in Spain—that it would give opportunities for UK businesses, both in the EU-27 and around the world, if they see opening subsidiaries as an advantage, an opportunity to expand businesses internationally whereas previously they had just sat in the UK and said, "We will do everything from here"?



**Huw Evans:** I think for firms that are looking for certainty and that have significant plans to grow businesses in particular countries the subsidiary model is an important one. I do not think it has been a surprise to any of us that in response to the uncertainty that was described by your previous panellists, firms and boards looking for certainty have in many cases opted to set up a subsidiary, transfer contracts to it and use that as the basis for operating within the EU going forward. That is a perfectly respectable model. It was used very widely before Brexit and it will continue to be used afterwards. Clearly that is the answer for many firms wrestling with some of the headache issues that we have been talking about.

It can only be a partial answer while we still wrestle with these other issues that have we have talked about around data transfer, around regulatory co-operation, around what the future relationship overall is between the United Kingdom and the EU-27. Those macro issues, if you like, still affect firms that have moved to a subsidiary, even though in the short term they have more certainty, providing the regulatory authorisations come through, about how their business is going to operate next year.

**Nikhil Rathi:** From the perspective of running global market infrastructures, if I take the example of LCH, we clear 90% of the world's OTC interest swaps at over \$800 trillion last year, serving members in 55 countries, 18 currencies all out of London. This is a hugely significant responsibility to manage systemic risk globally. It is not sensible to try and fragment that and break it up because through managing all that centrally we estimate something like \$30 billion of capital is then made available for use in the economy for other productive purposes.

In this debate around passporting equivalence, mutual recognition, one of the models that is often used for financial market infrastructure is direct supervision. We recognise that many authorities around the world have a legitimate interest in our activities, be that the US authorities, and we have licences in Australia, Canada and Japan. It is quite possible to have a model where the EU authorities going forward, be that ESMA or whoever is decided as the authority, is able to co-operatively participate in the supervision of global market infrastructure like ours, recognising we are serving the global public good.

**Stephen Jones:** If I may, from the wholesale banking and markets perspective—and it complements Nikhil's point—a lot of that business is provided out of London. There may well be branches of London-based legal entities that are on the ground in the relevant Continental Europe jurisdictions but fundamentally forcing those branches to convert into fully capitalised, fully liquidity-backed, locally regulated subsidiaries in order to have the permission to do business in those markets with full local infrastructure, IT compliance, risk, hearts and minds on the ground, directed on the ground, and trading books on the ground, will cause substantial fragmentation both for the banks as well as the infrastructure



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providers. That leads to higher costs and that will feed through into the costs for companies and individuals accessing financial services.

You are right, it is a way forward but, at least so far as the wholesale markets are concerned, it is a much more expensive way forward.

**Q1360 Richard Graham:** Yes, Mr Rath, on the issue of London Clearing House, you have laid out and your predecessor laid out the rational case as to why having a consolidated player doing 90% of the trade was of huge benefit to the industry at large, whether based in the EU or here or anywhere else. Of course the ECB did have a go effectively at trying to ensure that all that trade could only take place in the eurozone and failed with the ECJ ruling. But is it your understanding that were they to try again and insist that all those trades were cleared purely by EU members that the ECJ would take the same attitude? To what extent is there a risk to the LCH and that part of your business in the same way that the EU has concerns about the race to the bottom and London trying to take business from them?

**Nikhil Rath:** I do not think I could prejudge a future ECJ decision. In the court case that was determined, what the ECJ said was that the Europeans in fact did not have the power to mandate a location policy. They did not have the competence to do so. There are now discussions ongoing as to whether their statute should be amended to enable them to take powers to regulate third country clearing houses, be they the United Kingdom, United States or elsewhere.

I also think that in this context it is important to think about where this regulation started. It started in G20 after the global financial crisis where regulators came together and said that these are global cross-border markets. It caused great financial stability concerns when transactions in these contracts were happening across border. There was not transparency globally for regulators to understand where the risks were lying in the financial system and therefore central clearing with a globally co-operative model of regulation, supervision and standard setting was the way forward.

We have made huge progress in the last nine years or so in building that model and with regulators around the world co-operating. The statistics there, I think, are important: 52% of the business done by the clearing house at LCH is in US dollars. That is over 90%, all US dollar business and OTC interest rate swaps globally done, traded in the United States but cleared here in London. The next biggest currency is the euro but of our total pool, 20% of our business is euro business done by non-EU-27 entities. So these are entities outside the European Union, 7% is euro-denominated business done by euros and entities and the remainder is done in other currencies. The only way ultimately this policy could be implemented would be to ban European businesses from accessing the global liquidity pools in London. It is 7% of the overall business.

**Q1361 Richard Graham:** If I could have a supplementary, Chair, would you be



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stronger in your reassurance were the merger with the Deutsche Boerse to go ahead?

**Nikhil Rathi:** I think that was prohibited by the European Commission last year so that is over and done with. Our business has been performing strongly and this global clearing business has grown very strongly in the last year. I do not think that conversation is so relevant anymore. What is relevant going forward is what is the supervisory arrangement that is going to be in place globally between the UK and the European Union, then indeed, also with the United States and other jurisdictions as well.

Q1362 **Mr Djanogly:** We have spent much time this morning discussing the challenges of Brexit but I wonder what opportunities, if any, do your members see arising from leaving the EU.

**Huw Evans:** The nature of the timescales and the lack of any contingency planning by the Government before the Brexit vote means that we are inevitably doomed to spend most of our time trying to work through the short-term things. Trade is an interesting area to continue to focus on. The Government in recent years has done very good work with India, China and some of the Asian economies to try to open up trade routes and for financial services, it is always worth bearing in mind that often the dialogue frameworks are more productive than an all-singing, all-dancing FTA, not least because they provide an iterative way of tackling barriers and opening up markets. It is an area that Chris has spent more time on in his previous life, and he probably wants to talk more about it. We are right to continue to look at where the economies of the world are growing most quickly in terms of financial services capacity, in Asia, and indeed in Africa as we have been reminded this week with the CHOGM summit. There are definitely opportunities there.

**Chris Cummings:** When we think about the asset management industry and how international it has become, that has happened, yes, partly off the back of the fact that here in the UK we have been servicing the European markets—1.7 trillion of the money we look after today does come from other European member states—but well over a trillion comes from markets beyond the UK and Europe. We are seeing faster growth across Asia, and particularly China where there is huge interest in dealing with UK-based asset managers. Around the world every year, 147 million enter the middle class. Those are the people that need to have their savings managed, who want to prepare for their pensions and all of those are future asset-management customers.

The challenge that we face is what is going to make sure that they deal with UK-based asset management firms as opposed to others around the world. We see asset management growing in all corners of the globe. The big things for us are, of course, having a UK regime that is open and welcoming to asset management businesses where we have a commitment to preserving delegation—that is because it is an international standard that has been rather tied up with Brexit but, as



your last panel has made clear, it is an international perspective—and that we have the talent here in the UK of people who understand markets and who understand asset management, where we have the confidence to deal with the emerging Asian middle class but also Brazilian pension funds, because across Latin America as well there is significant growth and that is where, as we look to the future of asset management, we see huge potential. Government policy, particularly through the Department of International Trade, has been very positive about supporting the growth of asset management in other parts of the world.

**Q1363 Mr Djanogly:** Are these trends that are existing since the referendum or are talking about what you hope will happen? What do the statistics show us?

**Chris Cummings:** The trends have been there. What we have seen since the referendum with the creation of the Department of International Trade is perhaps a more clear sighted view of the fact that Government and industry need to be working closer together to take advantage of those opportunities that have always existed. What everybody is looking at at the moment is what is the shape of the free trade deal that the UK negotiates with the European Union. They are looking at that for two reasons, first, what type of partner is the UK going to be but also what type of partner will the European Union be: how does it treat those who want to do trade deals with it. So often we look at this from a European-centric point of view but in other parts of the world people will make decisions about how good a partner the EU is if it can treat one of its longstanding members in a particular way as it heads to the door.

**Nikhil Rathi:** I would echo some of these points. I would not link it directly to Brexit but the Government has been very focused on ensuring very strong financial dialogues with emerging markets. If you look at PwC estimates, six of the top seven economies in the world by 2050 will be emerging markets. We are establishing ourselves as the international partner of choice for China, in our case building a connection with the Shanghai Stock Exchange, centre for renminbi financing, centre for Indian rupee financing, supporting infrastructure in India, in Indonesia and the Indonesia rupiah as well, as Mr Graham knows.

Emerging markets are a big opportunity for us. Green finance is very significant across all of our sectors from capital markets through to Lloyds of London and insurance. Just this week we saw the Republic of Fiji launching a green bond in London, a product that is absolutely essential for the island state like theirs in delivering climate resilience. FinTech: notwithstanding the conversations earlier around skills, we are the home for FinTech globally where greater emerging technological innovation is happening and our regulators are at the forefront in engaging in that technological innovation.

**Stephen Jones:** If I may just echo all the points that have been made and reflect on what UK needs to project to go forward in order to continue to maintain its position as a global financial centre post Brexit,



we think very much that being the safest and most transparent place within which to conduct financial services business is extremely important. Therefore the continued vigour with which we pursue the economic crime agenda and we continue to pursue rule of law, the transparency of our legal system and the effectiveness and unbiased nature of our legal system, are incredibly important skills and attractions for the UK as a base from which to conduct financial services business.

**Q1364 Seema Malhotra:** Some of the areas I wanted to cover, just probing a bit further around the clearing house, have already been addressed in some of the discussion but there are two points I want to ask Mr Rathi to start with.

Xavier Rolet gave evidence to the Treasury Select Committee about potential job losses—I think the figure was around 232,000 jobs that could be at risk—if we lost clearing capacity in the UK. That is because of the knock-on effect of those who would be impacted beyond the few thousand jobs employed in the clearing business. Could you talk through what the implications could be if indeed a threat to clearing business in the UK is realised?

**Nikhil Rathi:** Certainly. As I said earlier, these are global liquidity pools and they come with risk managers operating here in the UK and in other markets around the world and a whole series of back office and middle office functions around clearing, because this is the largest pool of systemic risk in the world. The primary implication of a policy that seeks to close off the European market from any global infrastructure, so create a small pool of liquidity onshore in Europe and prevents European institutions from going outside, I think first of all increases the systemic risk level because there will be fewer institutions within the European Union that are able to absorb the risks that they are taking on on behalf of their clients. That increases costs. That will increase costs right across the system, of course for EU clients but also for clients in the UK and around the world. They will also risk wider retaliatory measures and I think that is, in the longer term, the challenge we have to be alive to. If Europe goes down one route what would stop the US thinking, “Well, hang on a second, should we also continue to subscribe to this global model of regulatory and supervisory co-operation that people worked so hard to put in place in the G20 in the aftermath of the crisis?”

**Q1365 Seema Malhotra:** On the issue of job losses potentially in the UK, it is quite a stark figure, over 200,000 being at risk. Where would those people be working now and why would there be such a huge number at risk?

**Nikhil Rathi:** There are lots of estimates and scenarios that have been put out. That was probably a report that was done before the transition agreement was put in place. The Bank of England have put some figures out as well today. The issue is that London as a financial centre operates as a great cluster of adjacent financial service industries in capital markets, banking, insurance and asset management and in areas like



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FinTech. Global infrastructure and global liquidity lies right at the heart of that. When you start unpicking that global infrastructure and unravelling it that could have a whole series of implications for front and back office jobs right across the system.

Q1366 **Seema Malhotra:** I will not probe further. It was interesting that Xavier Rolet did comment that in terms of jobs, losing clearing business, as far as the entire United Kingdom is concerned, it could be 230,000. It would be interesting to see whether any of those estimates do change in any way. I only raise this because, as I mentioned in the previous hearing, recent conversations I have had with senior members of industry and in the EU-27 suggests this is still very much on the radar for them as a question, notwithstanding the points you have made about the impact on the global economy and efficiency in financial services.

If I could just pick up on a point that has also been raised about FinTech, is there a potential alternative view that suggests that if the UK ceases to be part of the EU, no longer part of the single market, potentially a smaller player on the edge of Europe, that it could be a risk to us remaining a global centre for Fintech? Perhaps I could ask both Mr Cummings and Mr Rathi for their perspective on that.

**Chris Cummings:** At the Investment Association we have just launched our own FinTech accelerator. This is a way of bringing the 2,500 FinTech companies across the UK that are focused on capital markets into closer alignment with what their customers, the buy-side asset managers, need of them. It is a way of bringing potential buyers and sellers, and indeed investors, together. Just in the few weeks since we launched our own accelerator, I think within the first couple of days, we had over 50 applications from firms, all with market viable products, so FinTech companies that actually had a product offering. The reason I mention it is that we had applications not just from the firms based here in the UK but also from companies across Europe, from Israel, from the US and further afield. So the UK still has prestige as a FinTech centre. Part of that is because I think the Government and the FCA have done a good job in communicating the fact that, whether it is the regulatory sandbox or Project Innovate, there is a welcoming attitude to FinTech companies. That is very good news.

The thing that worries me is that no FinTech company starts off thinking about itself as being limited by national horizons. At its heart, technology is an international business. I know how hard our members work to attract young programmers, people who are good analysts, the type of people who are entrepreneurs who are looking for international markets to come to the UK. While we have played our hand particularly well, and I hope government policy continues to promote that, what I am very conscious of are the gathering clouds based, yes, around the immigration policy but also around the investment environment here in the UK.

Every country that I go to wants to create its own global FinTech hub. This is a hotly contested political environment from Singapore, which is



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offering some fantastic deals for companies to open their own FinTech centres at the moment, through to Berlin and other European countries. All I would I say is we need to run hard to keep up.

**Nikhil Rathi:** I agree with Chris. I think the Government's incorporation of regulators has shown global leadership in this area, but it is a hugely competitive space and we need to stay on top of our game. I would think one thing that is striking about the FinTech story in the UK is that it is not just a London story. Ms Cherry is not here anymore but we have had three FinTech companies listing on the London Stock Exchange from Edinburgh and Scotland in the last year or so. There are FinTech centres in Manchester, in Cardiff, and one of the fastest growing financial industries in Belfast is FinTech so this is a great story for the whole country. The other element to this, which I think is significant in terms of what has happened in London since the referendum, is the number of jobs announced in technology generally by Amazon, Facebook, Google here in London. What you are starting to see are greater synergies between traditional large technology companies and financial services. This is, I think, one of the defining features of the next 10 years and will really shake the future of our industry.

**Huw Evans:** Perhaps I could add one final line on that briefly, because I think it is so important to have this FinTech talent in these companies here, not just in terms of what they produce themselves but in terms of what they add to the incumbent companies that are already here. Our sectors are all living through the digital revolution, certainly in insurance and long-term savings. All the major players are investing heavily in how to transform their claims processing, new products, make themselves ever more accessible to customers who are living ever more mobile lives. So having this FinTech talent here is vital to that whole process of helping regenerate our incumbent industries and make sure that they are still in a position of strength, be big employers going forward. It is a very organic partnership rather than just a separate subset of people sipping lattes over in Old Street making money for themselves but not engaging with the rest of us. It is much more intertwined.

Q1367 **Richard Graham:** Can I pay tribute to all four of our witnesses because in all four of your organisations you have not only shown great leadership but there are these really exciting things happening that are innovative and will keep Britain, I hope, at the forefront of all the financial services change. The figure, Chair, that I quite often use, and which surprises people, is that Prudential now employs over 230,000 agents in Indonesia alone for its insurance business; that is quite striking.

Nonetheless, today, bearing in mind I am on this side rather than as a witness, and we are looking particularly at the whole business of Brexit, Mr Cummings, the question I really wanted to ask you about was the six bullet points in your March report, which seem to me to be absolutely focused and clear about what is needed for the asset management industry. Have you had a chance to discuss this agenda with Treasury



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officials, even maybe the Department for Exiting the EU, and perhaps, above all, with the EU counterparts over there? What is your sense of how fast people are moving to try to take those points on board?

**Chris Cummings:** Thank you, I am always delighted when I hear that people have read our reports. We have had a very good and ongoing dialogue with Government, various Government Departments, in order to make sure that the needs of the asset management industry are heard and well understood by policymakers at all levels, Ministers and officials. Particularly in the last 12 months or so, we have had a growing realisation that when it comes to financial markets the asset management industry makes up the buy side and without a buy side there is very little need to have a sell side. What we need to maintain here in the UK is a capital market ecosystem that works. It works not only because of the businesses it serves but the investors are savers, UK voters, that we serve so well and certainly from an asset management point of view, 75% of British households now use our services. We are seen to be increasingly important to the UK economy.

**Q1368 Richard Graham:** What about the EU side? I am looking in particular at your response after phase 2 negotiations, "We look forward to working with the UK Government and our European partners to help shape the transition period and the ensuing free trade agreement" and so on. Absolutely right, but what in practice have you been able to achieve so far with your European partners on this?

**Chris Cummings:** We have been having a series of individual member state dialogues. We are talking to countries, not just Ireland and Luxembourg who are natural partners to the UK because of their deep interest in asset management, but also other European member states—Germany, France, in particular, as well as Holland and many of the others—to help them better understand that the asset management industry, which they may not first think is structurally important to them, but because it is about better pensions for their citizens means that doing a good deal with the UK at exit is very important. We have had meetings with the Commission, we have had meetings with many members of the European Parliament. I have to say it depends quite often on the country that we are visiting as to the warmth of the welcome.

If I may just add a final point, we have also been talking to countries beyond the European Union as well, for instance Switzerland, and particularly America, because occasionally those outside voices can act as a voice of reason, as a welcome friendly intervention, particular at times when it may be that those in the room are going through a more difficult negotiating patch.

**Q1369 Richard Graham:** Lastly, I think all of you were probably in the room when I was asking the question about future architecture and the concept of perhaps having a financial services and professional business services separate pillar, such is the importance of these sectors to both us and the EU. Do you have any thoughts on that and is there something that you



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have had any dialogue on, either with our own officials or on their side?

**Stephen Jones:** The answer is yes and it is very much a work in progress as Andrew suggested. In terms of working on the architecture, in a sense the plumbing, the principles need to be agreed first, certainly so far as the European Commission is concerned and then engaging with any great depth on what that architecture would look like. Clearly that negotiation is in train at the moment.

So far as the UK side is concerned, yes, very joined up I would say and we are working well with regulators and Treasury and DExEU in terms of thinking about that what would look like and how it would sustain and support our respective industries.

**Huw Evans:** I would agree with that. I think we are clear that what we would like to see is a financial services sector, the mutual market access model that has been discussed already and which would be probably enshrined in a free trade agreement. That is clearly the best. I think what is also helpful, though, is to think about how attractive the fallbacks are. You focused in your earlier session about how ambitious an agreement of that nature would be both in terms of timing and scope but I think it is also helpful to think, "Okay, if we don't get that in the short term, what do the alternatives look like?" I think that is where, for many of us, there are significant concerns about what the fallbacks look for. Most forms of equivalence, as discussed and currently in practice, would be very difficult for the UK insurance industry, possibly okay on reinsurance but on the rest of it would be very, very difficult. It is a Commission mechanism; it involves largely being rule taker of the Commission at their will, whether it is called enhanced equivalence, excellent equivalence or anything else, it is still equivalence and it is a Commission-run model.

It is increasingly important for us, not least because—in answer to your earlier question to Chris, Mr Graham—it is a real challenge how this is going at the moment. We should not kid ourselves we are as far forward as we would like to be. We have taken a very long time as a country to reach an agreement on transition, and both the political goodwill and the thinking about what a future relationship would look like with our European partners is not where it needs to be. As a consequence, I think we therefore need to think about what might the fallback look like and if we are getting into 2020 with no agreement on what the future relationship will look like and no prospect of getting an agreement, then what are the options and the trade offs involved. That is a discussion we should be having now because as the contract continuity point that we touched on earlier illustrates, there are some pretty hardboiled attitudes within the Commission in particular.

**Richard Graham:** The only recommendation I would offer out of that is that if Mr Evans or indeed any of the other four wise men here today have thoughts on what the fallback position should look like, we would welcome anything in writing.



Q1370 **Chair:** Indeed, we spend our lives reading stuff that people have produced.

Just to follow out the point that you were making, Mr Evans, I asked the previous witnesses whether they thought there was any possibility of negotiating a deal on financial services between now and basically October when the Article 50 negotiations come to an end. The answer we got was, and I paraphrase, that I do not think that is going happen. Would any of you disagree with that?

**Chris Cummings:** If I may, the point I would like to make is just the distance left to travel. We have had the Prime Minister's speech, we saw the European Council agree to a transition period, the regulator, the FCA, the PRA, then talked about interim position regimes. So far—to use a tennis analogy—we have served but nothing has come back to us. From a business point of view that starts to feel an increasingly risky position.

The UK authorities are saying they will help but the European authorities are not responding in kind and that will inevitably bring about the crystallisation in firms' contingency plans as more jobs, to relate back to Ms Malhotra's question, inevitably move. There is a reluctance today for people to move in the hope that what we see is a transitional deal that comes to fruition. Firms need the legal certainty and, indeed, for European regulators to adopt a more ameliorative tone than we have seen so far. I think there is now an opportunity for other European regulators to act in a similar way and with similar good intent as the FCA has shown.

**Nikhil Rathi:** I would agree that in the short term having regulators on both sides behaving and giving assurances that the transition period is going to be real is important. In many cases the legal obligation or the legal ability to co-operate with third country supervisors is already in European legislation embodied in the statutes of the ECB or ESMA so the inhibition to agree co-operative mechanisms is really a political inhibition rather than anything that is formal and legal.

Looking forward the TTIP proposal that the EU put forward, Monsieur Barnier when he was Commissioner put forward, is an interesting starting point. It essentially requires three things: one is an agreement about standards and common standards, and a means to discuss standards; secondly, a co-operative process when standards change so that no disruptive cliff edge effects happen, recognising that both sides will have regulatory autonomy; then finally a degree of deep trust between the different supervisors, particularly for large global institutions, on an ongoing basis to supervise but critically an understanding of how each side will react in times of stress. That was what was missing in 2008 but would be fundamental to any enduring agreement going forward.

Q1371 **Chair:** Just to press the point, given what you have said—I do like the analogy of we have served and nothing has come back—do any of you think that we are going to have an agreement, legally binding agreement



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on financial services negotiated between now and the end of the Article 50 period? I want to get a sense of it, given what you have said about lack of response, the Commission saying, "No, this cannot be done". I take your point about what was in TTIP but when that is put to them they say, "Well, that was all very different" and it was Britain that was doing the pressing. But anyway, leave that on one side—

**Stephen Jones:** If we are talking about the length of the transition period, Chair, I think there is a chance that between now and December 2020 a decent agreement of financial services—

Q1372 **Chair:** Right, December 2020 but not by the end of the Article 50 period.

**Stephen Jones:** The end of the Article 50 period is effectively October because that is when the Commission needs to break in order for the parliamentary process in Brussels. Frankly I think what we need to work very hard on and we need to see real progress on this, is on there being a clear intention to negotiate on financial service history because at the moment it is in the negative in the way the Council document of March is drafted, with clear aims for negotiation and also, to use the trade term, clear modality: how agreement might be reached or technical outcomes determined. If we see that then we can start as an industry to have confidence that this is something where the outcome is clear and what we are talking about is the detail. If what we get in October is something that is very woolly and certainly not much further progressed than in March, then the loss of confidence that business will have in there being a meaningful agreement will require businesses to make and continue to consider alternative business models in order to serve customers in the European Union.

**Huw Evans:** I think we would all salute the Government's ambitions and certainly nobody could have worked any harder than the Chancellor has over the last couple of years to try to make sure that the financial services sector of the UK has a viable future and one that can work for the Europeans as well as for us. To give a straight answer to your question, a more realistic hope for us would be that there is some form of heads of terms agreement reached during the transitional period that can then lead to a further managed process, while that could be turned into a treaty, possibly involving managed divergence around regulations so that there is a no surprises policy, that regulators become independent, that they do not operate in a way that causes any major upsets you would then have the paving of a way through to a full agreement.

We have to be realistic in terms of free trade agreements. As we all know, they take years. There has never been a free trade agreement that has included financial services and certainly not of this scale and nature. A bit of context here is helpful and it would be a major achievement to get such a heads of terms agreed over the next 18 months. It is something we should all put our weight behind trying to achieve. For that to happen, as I think you have seen from the evidence we have all given today, there needs to be a bit of paradigm shift, particularly within the



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Commission about the way in which it is engaging with the United Kingdom.

**Chris Cummings:** That is absolutely true and I would agree with that. The only caveat I would put to Huw's excellent comments is that we are starting absolutely aligned today, so unlike any other trade deal, which is normally about bringing two systems together, this trade deal is about taking a system and making it two. That would have a bearing on where they are starting from, the heads of terms and so on. For me—and I agree with Sam Woods—it is technically doable. Politically, is it acceptable?

**Chair:** That is absolutely the point. It seems the fact that we are aligned creates loads of difficulties but that is to do with the politics of the process. Stephen Timms.

Q1373 **Stephen Timms:** I would like to pursue this discussion a little bit further but I go back to what you said right at the start, Mr Evans, when you welcomed the fact that thanks to the recent agreement we do not now face a cliff edge at the end of March 2019 but there is a danger we might face a cliff edge at the end of December 2020 and you said that the insurance industry needs certainty by the end of 2019 to avoid that. Do I take it from what you have just been saying that the level of certainty that you need by the end of 2019 is the heads of terms agreement rather than something that is legally watertight by that point?

**Huw Evans:** I think my comment about December 2019 specifically had in mind annual insurance contracts, which of course are written a year in advance and typically sold 14 months in advance ahead of a renewal period. Particularly in mind with the examples of motor policies, with requirements around green cards and travel insurance policies, with requirements around European health insurance cards, that is where you are back to the same problem again in the autumn of 2019 if you still do not have any certainty that insurers are writing those policies, but they are writing them for a period beyond the exit point and they do not know what it has to cover.

My point was really that that position that we faced in the run up to March this year could easily be replicated. Clearly the slightly wider point about a future relationship would be much broader than that. I think that could easily run into 2020, but we would want by then to have reached, in any case, in the negotiations an agreement that we can stay in the green cards system, which should not be that difficult. Turkey and Serbia are members of the green card system and they are not even members of the EEA, so it should not be beyond agreement. Similarly on EHIC, it is a reciprocal benefit to everyone involved so it should be possible to reach an agreement on that under the citizen's rights part of the negotiation.

We would very much hope those things can be resolved early and are not part of some more ambitious framework, which may well go right up to the wire.



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**Q1374 Stephen Timms:** If we look at the position that we are going to be in at the end of March 2019 we still do not have legal certainty about what is going to happen at that point. We do have a welcome political declaration. So how is the political declaration that has been arrived at averted the legal problem around what might happen?

**Huw Evans:** That is a very good question and through close dialogues with the regulators they are happy for our members to write the policies on this basis because they are taking the view, as you heard earlier, that this political agreement will translate into a more formal agreement over the course of the year. As Stephen pointed out earlier, if that does not happen, that is a big problem, but the regulators have been open and helpful in this I would say, and helpful in the run up to the March Council and beyond it in clarifying for firms what their expectations were about how they treated customers. The FCA in particular were extremely helpful in putting that on the record in March so that firms knew exactly where they stood and there could be no risk of them selling to customers about what that policy covered. We welcomed that pragmatic approach and expect to see that continued.

**Q1375 Stephen Timms:** Would you anticipate that a similar level of political declaration achieved by the end of 2019 ought to be sufficient to avert problems at the end of 2020 for insurers?

**Huw Evans:** If the regulators continue with their ongoing approach of offering public and open assurance that that is good enough for them, then that should be fine for insurers in terms of writing the types of contracts we are talking about. There is, as obviously has been pointed out, a much wider issue around the legal certainty that firms can rely on in a broader sense but in terms of specific customer contracts on these issues, that should be fine.

**Q1376 Stephen Timms:** Can I just ask the other witnesses then, given that nobody wants a cliff edge at the end of December 2020, when do the interests that you are speaking on behalf of need certainty by and what would that certainty look like? Would heads of terms be sufficient and when would it be needed by?

**Stephen Jones:** If I may, I would like to focus back on March 2019 first because we still do not have a legally valid transition agreement and we still have significant elements of a withdrawal agreement that remain to be defined agreed, and on which the transition agreement is highly dependent. If we have got through that and the transition agreement is in full flight, December 2020 remains a very important date. I would just echo the comments of Sam Woods earlier today, namely that if we are making good progress towards a treaty at that point in time, it would be a catastrophic result for us to drop out altogether, that is to have the cliff edge at December 2020, the negotiations to continue and then 12 months later for an end-state treaty to be arrived at. Some flexibility about a potential extension in circumstances where that extension is deemed appropriate given the progress that has been made I think would



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be very welcome by all parties and give greater confidence that an end outcome that is satisfactory will be arrived at.

**Chris Cummings:** I am afraid mine is a more nuanced position because in a lot of the work that we are doing on behalf of our industry, what the members are saying to us is, "We have had the political agreement" but what our clients—the Californian pension funds, the Brazilian investors—are asking us is, "The politicians seem to be not able to make a decision. What is the legal position?" Firms are being forced into opening up premises in other European member states in order to provide certainty to their clients.

We have also seen welcome gestures by the FCA, as we have heard earlier today, but because they are not being reciprocated by ESMA that does put our member firms in a more difficult position, when the week after the FCA grants an interim positions regime, the European regulator writes to UK-based firms and again challenges them, to say, "Nothing has been agreed until everything has been agreed, we need more clarity on your Brexit plans." For me it really boils down to this: the large international firms, who probably already have operations in other European member states will find legal certainty; smaller firms who are only based here in the UK, serving a UK audience, they carry on; it is the middle-ground firms who are having to move and who are looking for every indication as to what is going to come next. So, yes, it is legal certainty that will win out.

Q1377 **Stephen Timms:** Those medium-sized companies, they are moving jobs at the moment, are they?

**Chris Cummings:** They are establishing premises, they are gaining licences or expanding licences, they are changing their mandates; the last thing to move is the people.

**Stephen Jones:** From a banking sector perspective, the largest firms are also having to perform substantial changes now, from a contingency perspective, because March 2019 is not certain. I want to make that absolutely clear. There is significant investment and contingency planning, which continues to have to be executed not least because of the approach taken by the regulators across the European Union saying, "You have to have your licence, you have to be up and running, you have to have substantial premises, and hearts and minds, on the ground in March 2019. We do not care what was agreed in March. It is not certain. It may fall away."

**Chair:** I am afraid we have run out of time but on behalf of the Committee I thank all of you for giving up your valuable time to be with us today. It has been a really helpful and useful evidence session.