



Select Committee on the European Union

Financial Affairs Sub-Committee

Corrected oral evidence: Financial Services after Brexit

26 February 2020

9.25 am

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Members present: Lord Sharkey (The Chair); Lord Cavendish of Furness; Baroness Couttie; Lord Desai; Lord Giddens; Baroness Liddell of Coatdyke; Lord Thomas of Cwmgiedd; Viscount Trenchard; Lord Turnbull; Lord Vaux of Harrowden.

Evidence Session No. 4

Heard in Public

Questions 41 - 69

Witnesses

[I](#): Bruce Carnegie-Brown, Chairman, Lloyd's of London; Sir Adrian Montague CBE, Chairman, Aviva.

[II](#): Michael Dobson, Chairman, Schroders; Sir Douglas Flint CBE, Chairman, Standard Life Aberdeen; Stephen Jones, Chief Executive Officer, UK Finance; William Nott, Chief Executive Officer, SYZ Asset Management.

Examination of witnesses

Sir Adrian Montague and Bruce Carnegie-Brown.

Q41 **The Chairman:** Good morning, gentlemen. Welcome to the EU Financial Affairs Sub-Committee's public evidence session on the future of financial services after Brexit. You have before you a declaration of Members' interests. The session is being broadcast on parliamentlive.tv. A full transcript is being taken and will be made available to you to make any corrections shortly after the session.

Perhaps I can start with the first question, to establish some kind of context. Could you tell us how important the EU market is to your business?

Bruce Carnegie-Brown: We have not produced numbers for 2019 yet, but in 2018 Lloyd's derived £4.6 billion of premium income from the European economic area, excluding the United Kingdom, which represents about 13% of all of Lloyd's revenues.

Sir Adrian Montague: Aviva is a different sort of animal from Lloyd's. We are fundamentally a retail insurer. We have headquarters in the UK, where the bulk of our business is. We then operate in five European territories: Ireland, France, Italy, Poland and Lithuania. Together these businesses account for about 30% of our income. We have a different structure from Lloyd's, because each of these businesses is separately incorporated in the country in which it operates, separately capitalised and separately regulated by the local regulator. It is an important part of our business.

Q42 **Lord Vaux of Harrowden:** Can you let us know what measures you have already taken to prepare for Brexit? As part of that, to what extent might you have done those anyway?

Bruce Carnegie-Brown: Immediately following the referendum in 2016, we determined to prepare ourselves for the worst possible Brexit outcomes, as indeed we were encouraged to do by the regulators in any event. We effectively canvassed various countries within the European Union to determine where to establish a subsidiary of Lloyd's. We determined to do that, ultimately, in Belgium, reached the right agreements with the National Bank of Belgium as the regulator in Belgium, and established that subsidiary. That subsidiary has actually been operating since 1 January 2019. We have already written 15 months of business into that subsidiary. We would not have done that in the absence of Brexit. The arrangements from London were perfectly satisfactory, but of course we have become increasingly committed to that subsidiary as the way of originating our business in the European Union since 1 January last year.

Lord Vaux of Harrowden: Is there still a sort of tail of business that's still at risk, written here, but still at risk?

Bruce Carnegie-Brown: There has been some risk to the business anyway during the transition period, because, as you might imagine, European competitors to capital providers in London have been urging people to move their policies into the European Union, where there would be greater certainty about the ability of insurance companies to pay claims post Brexit. The payment of claims is a regulated activity and the European regulator has not been particularly helpful in saying that claims could continue to be paid in whatever circumstances.

We made that statement ourselves unilaterally—that we would pay all valid claims whatever the European Union’s position was—and devised a variety of different potential mechanisms should the need arise. We received quite a lot of support from the Financial Conduct Authority in making that statement, because clearly it is in the interests of our customers.

There has been some attritional loss of business in the intervening period, because of the uncertainty. Now that uncertainty is perhaps lifting we are hopeful that that will stabilise and potentially grow in the future. There is no doubt there are some additional frictional costs, in terms of capital, people and regulation associated with establishing a subsidiary in Belgium, and operationally in the way that we now have to issue our policies to comply with the rules of the subsidiary within the EU. Everything we do outside the EU then creates additional competitive challenge for us, but we think this is addressable.

Sir Adrian Montague: In Aviva’s case, like all the other insurers, we have been expecting substantial change in the business as a result of the European Union withdrawal. We have had a long time to prepare for it. The impact for Aviva is quite modest because of the local incorporation and regulation of each of the companies.

There are three things I would call out. First, this famed European passport has had limited relevance to Aviva because of the local incorporation of the businesses.

We did have some business that was cross-border. We had written some general insurance business in the UK that extended to property, houses or business premises in the EU, and we did have a small amount of life business that was placed in Germany on the back of a UK carrier. It was necessary to address both of those. What we have done is we have transferred both of those books of business to a subsidiary in Ireland. In the same way, we are obviously, as a big multinational group, constantly passing data between the UK and our overseas businesses, so the impact of the data adequacy rules has been an important consideration for us.

We are as well prepared as we can be. It requires us to look at millions and millions of policies. Just in connection with the policies that we transferred to Ireland, we had more than a million customers. We had to go and find these policies and then we had to transfer them to Ireland. The data flows are much broader than just the million customers we have transferred to Ireland. The data adequacy provisions are going to be very

important to us. We can survive without a data adequacy ruling, because we have done all we need to in order to incorporate the standard clauses into our agreements. The protection that they offer is incomplete, so the data adequacy ruling would be of real value to groups such as Aviva.

The third thing to mention is the asset management business. Aviva is a big asset management group as well as a big insurance group. We have an existing centre in Luxembourg and big offices in Paris and in Dublin. We have had to do a little bit of reorganisation of where businesses are managed from. Again, we have digested that impact and we are off and running under the new structure.

Q43 Lord Giddens: Good morning. I have three linked questions, so you can pick and choose. First, what impact do you think Brexit will have on your longer-term business activity, with the emphasis on "longer-term"? This is obviously a transitional situation.

Secondly, what would you see as the ongoing advantages of continuing to operate in the UK?

The third question interests me especially. Every problem is an opportunity. Where do you see the opportunities in this situation for your business?

Bruce Carnegie-Brown: There are still a variety of outcomes from Brexit that could be better or worse for Lloyd's in terms of competitiveness. The long-term impact is still reasonably difficult to predict. The one area where we continue to advocate is for reinsurance equivalence between the UK and the EU. It is not our view that that requires any surrender to rule-taking.

Those rules, for instance, exist as between Switzerland and the European Union, and between Bermuda and the European Union. Those places are the second and third largest international wholesale reinsurance markets outside London. It would be extraordinary, but perhaps not entirely surprising, if Bermuda continued to have access to the European Union under equivalence but the UK did not. That might pose a medium-term disadvantage to us were we not to be able to enjoy the benefits of equivalence in reinsurance.

The principal reason why reinsurance is important is that typically reinsurance contracts are larger-ticket items, where the movement of capital is much more substantial than in individual contracts. Cross-border access is incredibly important to the economics, where we are effectively collecting lots of premiums from different places but we move capital to a point of need, when there is a claim under a reinsurance policy. This is particularly important for a large wholesale market like Lloyd's. For instance, our largest line of business is natural catastrophe insurance and, when natural catastrophes happen, the claims on those are very substantial. The free movement of that capital across borders would be underpinned by an equivalence regime on reinsurance between the UK and the European Union.

Some of the individual states within the EU permit this reinsurance to happen anyway. Its long-term impact is not a binary issue for us, but those individual states themselves could change their positions subsequently. To have something that was substantive between the UK and the EU on this issue would be very helpful to us so that we could protect our long-term position.

Secondly, as referenced by my comment on our market share in Europe of 13% of our revenues, we punch below our weight on the continent of Europe relative to other parts of the world, largely for historical reasons. By contrast to the 13% that we derive from the European Economic Area outside the UK, we derive 44% of our revenues from the United States. We derive 6% each from places such as Canada and Australia. There are some other very substantial markets that are important to us where we absolutely have larger market shares and larger impact than in the European Union.

That, therefore, might be something that leads on, in the third part of your question, to opportunity in the future. If we get this settled and set ourselves up correctly, we would certainly have aspiration to increase our relative share of European insurance markets.

Sir Adrian Montague: In Aviva's case it is probably a shorter answer, because so much flows from the fact that we are locally incorporated and locally regulated in all these countries. Our businesses are almost separate businesses, and their future really depends on how successful they are in competing against local incumbents in all these markets. You think of France and the powerful companies there. We are relatively small in France, but there are opportunities for us there. It is the same in all the European territories that we are engaged in. In the retail sense, we have very limited cross-border business.

Brexit will not directly have new opportunities for us in Europe, because the balance is more on the disadvantage side rather than on the advantage side, because there are things that might happen in relation to equivalence that would cause us extra costs and perhaps some difficulty in relation to supervision. Perhaps we will come to that in due course.

Our home market is the UK. It accounts for 60% of our business. It is going to be where we are strongest and where the future of the group will be determined. We have operations in the Far East and we have operations in Canada. The task of the chief executive and the board is to allocate capital to these businesses in a way that gets the strongest return. At the moment, we have a policy of being even-handed between Canada and the European businesses and the Far East. I would hope that that would not change.

Lord Giddens: You both sound quite calm and relaxed about it.

Sir Adrian Montague: You ought to be worried if we were worried.

The Chairman: Is the converse true?

Bruce Carnegie-Brown: We had to be ready for March 2019, so we are effectively nine months on or maybe even 12 months on from that period. We really have adjusted our business models and put contingency plans in place. Are they less optimal than the single market arrangement? Yes, absolutely, in terms of cost and friction. Are they survivable in terms of the viability? Certainly speaking for Lloyd's, in terms of Lloyd's business model, we are in a place where we can continue to compete.

Sir Adrian Montague: Would we have taken these dispositions but for the British exit from the EU? Certainly not. In some cases, we are turning tail on ourselves, because we used to conduct business in Ireland through a subsidiary. We converted that to a branch for capital efficiency reasons and we have now had to convert it back into a subsidiary. That is just the way it goes.

Q44 **Baroness Couttie:** Can I just ask a very quick supplementary there? Could you estimate the loss to the UK, for your businesses and your sector, in terms of both jobs and GDP? I know that is extending further than perhaps you might be comfortable. I know that is quite a difficult question, but I would just be interested to know what we have lost as a country.

Bruce Carnegie-Brown: In terms of jobs in the short term, it is marginal. We have clearly moved jobs from London to Belgium, but at this point the numbers are that about 50 jobs have moved from London to Brussels.

Baroness Couttie: In the longer term, do you see these branches getting a bit more substantial and, therefore, jobs moving there that could have been here? It is a difficult one.

Bruce Carnegie-Brown: That is the risk. Let me give you an example. Lloyd's is a marketplace rather than a corporation. One of the great advantages of Lloyd's and why business comes to Lloyd's is that we have licences to underwrite insurance in 200 countries and territories around the world. That means we can issue one policy in London to cover risks everywhere, because we are licensed in all of those places.

Effectively, in the hard-Brexit analysis, we lose all those licenses for the European countries from London, which we are replacing in Belgium. It means today that if you want a global insurance policy from Lloyd's that covers EU risks and non-EU risks, you effectively now have to have two insurance policies. That is unhelpful to our competitive position relative to other people who could continue to issue a single policy to their customers for global risks, for instance.

It is quite hard to translate that into dollars and cents of lost opportunity. I would be reluctant to do that at this point, and we will obviously be working really hard to try to mitigate those losses and, indeed, over time to increase our business, as I mentioned before. The real opportunity cost of this will never really be something capable of calculation. Is there opportunity cost? I am convinced of it, because we have moved £300

million of capital to Belgium. We have moved 50 staff to Belgium. We now have an additional regulator. We issue multiple policies where before we were issuing one policy. You can see the friction costs on our operations are much higher than otherwise.

Baroness Couttie: Indeed, there is also an increasing focus over time on the Belgian business as it starts to grow and get its own momentum. That would otherwise have stayed in the UK.

Bruce Carnegie-Brown: Yes.

Q45 **Lord Turnbull:** I want to follow up on Mr Carnegie-Brown's reference to Bermuda and the argument that if they are deemed to be equivalent and they did not give us equivalent equivalence, that would be outrageous. Is that not precisely the message that we are getting? Some of the messages from Brussels are, "We are very big and we are very near. We cannot afford simply to treat you just like some other third country. You are a special third country and we want to pay more attention to you than we would to other third countries".

Bruce Carnegie-Brown: I avoided using the word "outrageous", as it is more emotive than I would like to be this morning. It would be surprising, if measured in any objective sense—whether economically, from a regulatory point of view or from an alignment point of view—that you would find Bermuda equivalent but not the UK. Of course, I am incredibly conscious that, at the end of the day, this is about the politics of the issue and not the economic reality of the issue.

I might even venture that this is part of the problem in the UK's historic relationship with the European Union. For us, it has always been an economic relationship and for them it has always been a political relationship. This is why we are condemned to misunderstand each other on so many issues. Looking objectively at the capability, capacity and alignment of the UK insurance market with the European Union, it is inconceivable that you could give reinsurance equivalence to Bermuda and to Switzerland but not to the UK. That does not mean that that will be the outcome.

Sir Adrian Montague: There is another aspect of this as well. Normally when you are considering equivalence decisions, you are looking at systems that have been or have grown up differently, with separate traditions and provisions; you are working out whether these two could be regarded as substantially equivalent. The point is different in relation to these discussions, because we operate under entirely the same system as the European countries. It is a question of whether there should be divergence, rather than whether we start from a position of being equivalent. We have the same regime; it is equivalent. The question is about how far we should be allowed to diverge while remaining equivalent.

Q46 **Viscount Trenchard:** My question has already been half-answered, so I have to vary the question I was going to ask, to some extent. I would like

to go a bit further into this question of equivalence and ask how important it is for both of your businesses that the EU should grant equivalence. Could you go into the possibility of enhanced equivalence?

Could you also talk about Solvency II? Solvency II was considered to be the piece of European legislation that was most inappropriate for the UK. The capital requirements for insurance companies under Solvency II were considered unreasonable. Therefore, I would have expected that there would be considerable pressure from within the insurance industry that, once we have the freedom to diverge, we should diverge. So far, the temporary equivalence decisions that have been made have not been reciprocal. In some cases, the EU has given us a much shorter period than we have given to them. I would like to ask how you think equivalence decisions before the end of the transition period will work out.

Sir Adrian Montague: The first thing to say on equivalence is that there is no universal rule. It very much depends on your business model. There are two or three different categories of business model out there. Many of the UK insurance companies have a predominant, and sometimes an exclusive, UK focus. For them, equivalence is almost an irrelevant concept. They are looking to operate in the domestic market. They are very concerned whether the price of equivalence might be to be required to align for the future with European legislation in a situation where we have no influence over the evolution of that legislation. That is the major concern that we all have. This is the famous rule-taking argument.

It is a different situation, because there are at least three categories of people. There are some categories of insurers, such as the retail insurers in the UK, for which equivalence is pretty much irrelevant. There are some, such as Lloyd's—Bruce will speak for himself in a moment—for which it is very important. There are some, a bit like Aviva, for which it will be a convenience, but not at the price of having to accept rule-taking from the EU. It is a situation that varies according to the nature of the company and the business model. Speaking for Aviva, which is not unique but is in a very small minority of insurers in having very extensive European operations, it will be a convenience.

There are three basic types of equivalence that you are discussing in this context: equivalence from the point of view of reinsurance, equivalence from the point of view of solvency and equivalence from the point of view of group supervision. The way our supervisory model works at the moment is that we have a lead supervisor in the form of the PRA. The PRA heads a college of supervisors from Europe, so that there is a more or less consistent view taken across Europe in relation to the application of Solvency II.

I know that the Committee has a certain lack of regard, perhaps, for Solvency II, but it is a system that we have got used to and we have spent literally hundreds of millions of pounds preparing for it. It is a question of trying, over time, to remove its inadequacies and deficiencies, rather than junking it wholesale and trying to start again. That would just

cause us to replicate all of the cost and expense we had in preparing for Solvency II, not for huge benefit.

There are features of Solvency II that the regulators and companies here, and indeed regulators and companies on the continent, think are not working very efficiently. You had Sam Woods from the PRA here a little while ago. He was talking about the PRA's reservations with regard to the risk margin. That is one of the features that all the insurers in Europe would like to be reviewed. It may be possible to do that in parallel. It will not be possible for the future to do it in a united way, as has been done at the moment. That is the essence of the rule-taking dilemma.

If we are forced to accept the level playing field proposition, which is so dear to French hearts, we will be bound for the future by a system of rules. It will evolve as all systems of rules will do. I am sure we will continue to have some influence, because there will be close contact between the regulators here and the regulators on the continent, but it is a different matter from having a vote on the process. We will lose that vote on the process. I am sure there will be consultation and co-ordination, but we will lose that essential vote on the process. If the price of equivalence is rule-taking then, speaking for Aviva and for most of the UK companies, that would be a price too high to pay.

Q47 Lord Turnbull: I have noticed, in the course of this investigation that the Committee is doing, a change in opinion. When we started, people were still hoping after being in the single market. They quickly realised that was not going to happen. Equivalence seemed like the next best thing. We have then seen some quite hard-line statements about equivalence coming from Brussels, maybe as part of their negotiating mandate. People are beginning to realise that if equivalence is run by them unilaterally, if they determine the rules unilaterally and they decide unilaterally whether the move you have made takes you out of equivalence, it becomes being a rule-taker, just by another means.

I was interested in this thing handed out before the meeting. It is from the ABI and seems to have come to the same conclusion, basically. It says that there is a genuine risk that wide-ranging equivalence could indirectly result in rule-taking. That is the position we have now reached. People may want to say, "By the end of this year, we want a determination that we are equivalent". They may want it only for short-term purposes so that there is not a cliff edge, and that buys time while you decide what you really want to do. There may be some sectors for which equivalence is fine; for them it is a price worth paying. There some people that really want to conclude that they do not want to find equivalence. They want to find some different arrangement. Is that a reasonable summary of where opinion is moving?

Sir Adrian Montague: Equivalence is very important for Lloyd's, but can I just set out the scope of the debate as I see it? The challenges that the current system of equivalence determinations gives us are threefold. It is clearly a political process and therefore does not have very clearly defined rules. There is a lack of flexibility because, depending on your

view of how equivalence decisions will be determined in the future, they may involve a long-term adherence to EU rules. That is a sort of rule-taking by the back door. That would be a real problem.

As you have said, there is a lack of stability in these equivalence decisions because, as the Swiss found to their discomfort, they can be withdrawn on 30 days' notice at their most brutal. It was not the case in Switzerland, because they had a sunset clause and they were not able to renew their equivalence, but the impact had been quite severe on the trading in Swiss stocks.

If there was no change in the equivalence mechanism, it would be, at least for some companies, a price too high. You would hope, in the process of the next few months, that the Government and the EU authorities will be able to explore how they could make equivalence a more stable tool for regulating financial services industries in the UK and in Europe going forward.

You would want clearer criteria for establishing equivalence in the first place, then a more clearly defined process for challenging existing determinations. If you had that and you did not have the millstone of long-term rule-taking attached to equivalence decisions, you would have a perfectly viable framework. I am conscious that equivalence is probably more important to Lloyd's than it is to some of the UK companies. I do not want to steal your thunder, Bruce.

Bruce Carnegie-Brown: Just building on that and being consistent with where the argument is developing, it is not just important to have equivalence, which for us we are defining narrowly around reinsurance. I fully respect Adrian's comment that you do need to look at the different business models and where people are pointed in terms of the business they are trying to win in continental Europe. Personal lines or retail insurance companies will have different requirements of this than we do at Lloyd's, dealing in a wholesale and reinsurance space. Equivalence without some stability in terms of reasonable notice periods for regulators to change their minds on these things would be pretty much valueless. You have heard Adrian's Swiss example.

You commented that this needs to be in place by year-end. It needs to be in place quite a bit before year-end, because otherwise we will all have to lean on other kinds of contingency buttons to try to avoid losing our reinsurance business from Europe.

There is a difference between how the equivalence regime could be established versus this issue of rule-taking. These kinds of equivalence arguments happen in lots of different places. Bermuda would not say that it is a rule-taker of the EU. There is clearly a disproportion between the weight of the EU and the weight of Bermuda. As people discover when dealing with the United States at the moment, if the bear wants to growl, you probably need to pay attention. That is different from being an automatic rule-taker.

I do not think, in asking for reinsurance equivalence, we are agreeing that would necessitate the UK becoming a rule-taker, but it does necessitate creating, as Adrian says, sensible mechanisms for evaluating these things objectively and putting in place things that can last for a meaningful period of time and are not subject to political change at short notice.

Lord Turnbull: Are you optimistic that this more reasonable way of operating equivalence can actually be negotiated? It is odd. Let us say that one country is 90% overlapping so is deemed to be equivalent. Another country is starting at 100% and wants to go to 99%, but because it is moving from 100%, it gets a different verdict than if it had been in a different place historically. That is illogical but is probably psychologically correct.

Sir Adrian Montague: My answer to that would be that you are closer to the decision-makers than we are. It is an extraordinarily opaque and challenging process. My understanding is that the Government are hopeful, but it takes two to tango.

Q48 **Lord Cavendish of Furness:** Sorry for my lateness. I want to get a little bit behind the flavour of this and explore whether there is a policy arising out of this equivalence. As a complete layman—I left the City 40 years ago—is there hostility to the City and our financial institutions, or does it stem from a vulnerability on the part of the EU? Reading the papers, one sometimes feels they are frightened; one sometimes feels that they are just hostile; one sometimes feels that they just need to improve their game at our expense. Is there a policy in the EU, and is there a policy among certain member states to alter the competitive position?

Sir Adrian Montague: There is not an openly declared policy. The policy guidelines that Michel Barnier is pursuing in his mandate do not specifically reflect any ambitions by any member state to attract a share of London's business to its local financial centre. There are lots of suggestions that that may be a case in some of the countries.

If you take a step back, you reflect that London has been extraordinarily successful in attracting large amounts of euro-denominated business. Some political circles on the continent, in particular, see it as suboptimal that all the trading in their currency should be done in a centre that is outside their jurisdiction. At a very high level, one needs to understand that. London has a unique ecosystem. It is not just any individual area of business that makes London great. It is the fact they are all together and have this sort of vibrant culture based on what the economists would call aggregation. All the skills, all the talent and all the money are in London. It is not straightforward to bodily transfer big chunks of business to the continent. The longer-term aspiration probably is to relocate euro business at least into the continent. That will be a net loss to London, and I suspect that is going to happen.

Bruce Carnegie-Brown: I would support that. Emotionally, the Europeans are very committed to gaining control of the euro as a

currency in all its forms. That is particularly manifest in things like clearing-house activity. I would expect them to push quite aggressively to try to reshore that into the European Union and away from the United Kingdom. More narrowly with respect to insurance, I do not see any particular angle that the European Union is trying to push separately from a broader financial services agenda.

My view would be that it is a simple matter of negotiation and leverage that financial services are more important to us than they are to them and that therefore this is a point of potential opportunity for them to extract other concessions from us. One of the problems with all this is we will end up trading banking for fish and the equivalence of all that will be entirely opaque to most people.

There is something of an issue within our country in that financial services more broadly has got itself into a bad place in the last 10 years in the consciousness of individual voters in this country. That makes it much harder for politicians then to defend it on the grounds of its positive economic contribution to this country. There is some risk that, because of its complexity and the fact that it is hard to touch, the much more tangible issues of things like fish and motor cars are more real for people in terms of Brexit impacts than financial services are. All of us who work in financial services are acutely conscious of the importance of these flows and keeping these flows open for the United Kingdom, and disproportionately, of course, for London.

Q49 Lord Thomas of Cwmgiedd: I want to ask one question about reinsurance. The issue, presumably, on reinsurance equivalence is completely different. It is really concerned with solvency, is it not?

Bruce Carnegie-Brown: It is broadly. This gets back to Adrian's comments on the whole Solvency II conversation, but it is not just about solvency. It is about creditworthiness as counterparties.

Lord Thomas of Cwmgiedd: Sorry, I meant solvency in the broader sense. In reinsurance, you are not concerned with selling to the public. You are simply concerned with—

Bruce Carnegie-Brown: Will the policy pay.

Lord Thomas of Cwmgiedd: Will it pay? Therefore, it seems completely different. It goes to Adrian's point that equivalence in reinsurance is completely different to a matter of asset management or something like that.

Bruce Carnegie-Brown: I would not quite have gone there. It was a "yes" up to that point. The real distinction is between the wholesale nature of what we are talking about versus the retail or personal-lines nature. I would make that distinction in asset management. If you are talking about selling individual securities to individuals, I would align that with retail insurance policies, motor insurance policies or whatever. If we are looking more institutionally and wholesale, you might have a read-across to asset management, at a macro fund management level, with

what we do in insurance in terms of managing risks and exposures through wholesale and reinsurance policies.

Lord Thomas of Cwmgiedd: I will not pursue although I do not necessarily agree with you.

Q50 **Lord Desai:** You were talking about how people are more conscious about equivalence in cars and fish, and not so much in financial markets. With the car business, there are some supply chain logistics that you have to do. Coming to financial services, what would happen if you just said, "We will go. We will walk out"? It will not be that damaging for London as a financial centre to say, "We are not playing this game. We will make our own routes". Is that possible?

Bruce Carnegie-Brown: Limiting my comments to insurance, which is safer territory than banking more broadly, where the issues are more complex, and speaking more narrowly for Lloyd's, I believe if we took that line we would still have a defensible global position within our industry. This is an industry in which the UK enjoys global leadership. To risk cutting off a fair piece of global GDP and access would, in the long term, diminish our potential relative to what it might otherwise have been. If your question is whether we could survive by walking away, as Lloyd's, in the wholesale insurance and reinsurance markets, the answer is yes.

Sir Adrian Montague: It would be much the same in Aviva's case. We are helped by the fact that all our continental operations are in effect siloed in their own individual companies, but there would be substantial extra costs and administrative friction, so it is quite definitely suboptimal. We would not encourage the Government to go that way.

Q51 **Lord Vaux of Harrowden:** Sir Adrian, you previously touched on the data adequacy question, but could we explore a little further for both businesses what impact a lack of a data adequacy decision would have on your businesses, and what steps you have taken to mitigate that?

Sir Adrian Montague: Happily, we have had a lot of notice of this coming up. It is interesting. Data adequacy was not seen, until quite an advanced stage of the negotiations, as creating a major problem. It does create a major problem. It is not just a UK problem. It also affects some of the European companies. For example, I do not have positive confirmation of this, but I believe that Volkswagen maintains all of its customer finance records in the UK, not in Germany. It has a profound interest in free data flows across borders. You may get a note from Volkswagen protesting that that is not the case, but apocryphally that is what I understand.

Certainly, in our case we do have large data flows across borders. It is very important to us that we can continue those data flows. Effectively, we have this data adequacy concept. That requires there to be appropriate safeguards in relation to those data flows. You can do this in a number of different ways. You have the data adequacy decision, under which effectively the Europeans would agree that our procedures for

safeguarding data are adequate and therefore there can be free transfer. We hope that that will be the case, because it will be administratively more convenient.

You can do it in a number of other ways. The way that most people are addressing this problem is through putting standard contractual clauses into all of their underlying arrangements. That it is a fantastically cumbersome and expensive administrative process, but it can be done. That is what we have set out to do. We are 85% complete now.

There are problems with the way that these clauses work, because they are very inflexible. You have to include precisely the correct form of words in a contract. This is a civil-law approach rather than a common-law approach; I bow to greater authority on this than I have. They are very prescriptive in the way they approach these things. Even so, there are holes in this, because there are some limitations on the flows of data from data processors to data owners. It is a complicated area, but we think we will manage even if there is no data adequacy decision.

It is a bit like my answer to Lord Desai a few moments ago: it is going to be less expensive and more comprehensive if—I am not sure I dare say this—common sense prevails and both sides recognise that they have a legitimate interest in allowing data to flow freely across borders, subject to the safeguards imposed on all of us by GDPR.

Bruce Carnegie-Brown: I share that view. Clearly, data is incredibly important within the insurance industry, because, ultimately, it affects risk models and pricing models. We are dealing with statistical data and pricing risks that have not yet happened.

You need to look at it through more than one lens. Is the data protection around aligned to the policyholder is or where the risks are that we are underwriting? Even in an individual policyholder relationship, that creates some complexity for Lloyd's in being able to share data. If the policyholder happens to be in France and the risk we are underwriting is a factory the policyholder owns in Canada, you can begin to see immediately the complexities of how the data might flow between France, the UK and Canada on these issues and, ultimately, where jurisdiction is on who owns that data. Data adequacy is a really important point for us.

On Adrian's point, it is incredibly important that people reach a sensible agreement on this, because there does not seem to be relative commercial advantage in this issue as between the UK and any other counterparty. It will create complexity for us in the management of these risks and how we manage our data if there is not an adequacy standard, because we will end up compartmentalising that data in different places, which of course will undermine our ability to use it in an aggregated form to become better pricers of risk and better innovators of new products for our customers.

Lord Vaux of Harrowden: The stories one hears in the press, et cetera, are that it may not be in place by the end of the year, which seems

slightly bizarre given that we have signed up to GDPR, et cetera. None the less, if we do fall off a data cliff, are you ready for it?

Bruce Carnegie-Brown: I do not know.

The Chair: That is a good answer.

Sir Adrian Montague: I do not know either, but I hope so.

Q52 **Lord Turnbull:** Reference has been made to the fact that when existing directives are being reviewed—and Solvency II is one of those—we will no longer be at the table, but there are still other mechanisms by which our view can be heard. For example, if the Commission is talking to an industry group, are those industry groups defined as the industry, or are they particularly only the people in the EU?

Sir Adrian Montague: That is a good question.

Lord Turnbull: Can we be effective, or almost as effective? For example, to take a different field, pharmaceuticals, there are basically four countries: the UK, Germany, Switzerland and the US. The EU cannot make policy on pharmaceuticals without talking to these other groups. Can we nevertheless retain some influence? How would we best do it?

Sir Adrian Montague: It is right to recognise that our position will be less strong going forward than it is at the moment. I have observed the EU decision-making process with a mixture of respect and awe in the past. They get to a decision, but it is obviously quite a long and complicated process. It makes a difference if you are in the room, speaking to your own brief. We will no longer be in the room; we will no longer have a vote. Our position is clearly less influential, but it is not without influence, because you are right; it is not just with industry groups. If you talk to the regulators, they have already established very significant MOUs with their continental counterparts. There is a ready exchange of views not only in supervision but also in policy-making. I understand that the approach the Government are going to be taking to the discussions on this issue is to offer and to welcome a degree of co-ordination in relation to policy-making. There will still be lots of discussion about the direction of policy-making and lots of consultation on many of the details, but it will be a different sort of consultation involving the Government.

As far as the industry is concerned, many of us have been part of pan-European industry groups. There is an insurance group; there is a banking group; there are several financial services groups. All I would say is that, at the moment, my membership has not been revoked. Because London is such an important financial centre, our continental counterparts welcome continued British involvement. It is quite clear that everyone regrets the loss of a British voice at the policy-making table, but that is where we are. Because of personal connections, because of perceived expertise and because of the weight of activity in the UK, you cannot make one set of rules for the UK and an entirely different set of rules for Europe; it is just nonsense. There will be a lot of co-ordination, but it will

be a different sort of coexistence from what we have had over the last 40 years.

Bruce Carnegie-Brown: Just developing that thought modestly, as we come out of this period of negotiation with the European Union, there may be an opportunity to reposition some of these discussions in terms of global minimum standards, as opposed to UK versus European standards. Increasingly, what we know in all forms of life—and insurance is no different—is that the connectivity between our businesses internationally is growing. Supply chain issues and the exchange of capital across borders make the need to move to a global minimum standard of activity much more important. You see this very aggressively in things such as anti-money laundering, which is a good example.

Indeed, that may be an opportunity for the UK to become more of a broker among many participants, rather than just this binary “us versus them” issue between ourselves and the European Union. Reshaping the discussion in a different way may give us an opportunity to continue to have the influence we would like to have in our leading industries.

Sir Adrian Montague: There is an upside case here. I referred a moment ago to the respect—I think that is the right word—that continental counterparts have for regulation and financial services in the UK, and I hope it is accepted to be clearly in our national interest to have a very strong financial services industry in the UK, irrespective of any changes that flow from the British withdrawal. We need to have the self-confidence to go out and aspire to continue in the leadership role that we undoubtedly had on a pan-European basis over the last 15 or 20 years.

If we are able to step forward proudly and confidently, the force of gravity will force the Europeans to have regard to what is happening in the UK, because we are a standards-setter. Much of the regulation that we have in Europe and that we are inheriting now has had a profound British imprint on it. I do not see any reason why that should not continue, but it requires confidence, engagement and a conviction that London will prevail in the long run. Most of the people in the industry have that, but that is the way we need to approach the future.

Q53 **Baroness Couttie:** We have heard from various people in the financial services sector how the one-size-fits-all regulation approach from Europe does not necessarily work for various sectors. Insurance has been highlighted as one of them; we have touched on Solvency II and its inadequacies. Where else do you see the opportunity for divergence from the EU? In terms of what impact that might have on equivalence, as we have just discussed, how important is the reinsurance area in particular to Europe? Setting aside the politics, which may come to override all of this, in a pragmatic world, how important are we? Would that help the EU to accept that divergence, if it was done in a sensible and proportionate way?

Bruce Carnegie-Brown: You characterised things like Solvency II as European rules imposed on the UK, but in fact we were largely the architects of this regulation. For those reasons, as Adrian commented earlier, having invested in all of this, it makes sense for us to keep on going.

Where you are going with your comment is that there is a separate opportunity around regulation, which is independent of the relationship with the European Union, to look at how we want our markets to be regulated once the UK is independent of the European Union. This too often then gets mischaracterised as a race to the bottom in terms of regulation; it does not need to be that, nor should it be that. We have always been a country that prides itself on rigorous and robust regulation, and of course that regulation has only become more rigorous and more robust since the financial crisis. It seems to me to be inconceivable that the UK would be trying, as a point of principle, to move aggressively away from robust regulation in the future.

There are lots of things that are within our control to improve the regulatory environment in the UK, which is not about removing a lot of regulation. The most obvious one, which the financial services industry has been engaged on with the Treasury and the regulators, is this concept of air traffic control: that what we have is a “pile it on” sense from regulators; because there are so many of them, all with their own initiatives, the net impact on the financial services industry is huge, disproportionate and very negative in terms of cost.

We need to get more organised about requiring regulators to assess the impact of the things they are proposing to do before they do them, and require them to think in a more co-ordinated way about what one set of regulators wants to do and the timing of that relative to others. That could be enormously important in improving the sense of overregulation that we have in financial services in the UK.

Baroness Couttie: Perhaps it is not granular enough to distinguish between the size of businesses and indeed their markets, whether they are UK-only or whatever. It tends to be a one-size-fits-all approach, which can be very disproportionate on certain sizes of business. If we do take what I would consider to be the sensible approach on divergence—as you say, not lowering standards but making it more appropriate for our financial services industry—is that then going to lead to issues with equivalence, or will our size and respect, as Sir Adrian mentioned, mean that we could, in a pragmatic world, have a sensible discussion that would allow that to take place?

Bruce Carnegie-Brown: I suspect we need to jump one fence at a time here. If we put too many things in the hopper, it could then provide the political characterisation of divergence and therefore a lack of equivalence, or a risk of a lack of equivalence, over time.

It may be that we should just be smart about anchoring some things initially and, provided we are not ending up as rule-takers, then make our

own decision on further things that we would like to change. For some of those we would engage with the European Union to see whether they agree with us, and there would be other decisions that we would be willing to make unilaterally and argue that they do not undermine equivalence but merely improve the quality and efficiency of regulation in our marketplaces. Again, this is not just a debate between the UK and the European Union; it is a global debate on the minimum regulatory standards that we need to have. I come back to the example of money laundering, which does not respect the boundaries of Europe versus the UK or, indeed, Latin America versus Europe.

There are opportunities here for us, as Adrian has said, to continue to exercise leadership in the area of regulation. We have to recognise that, certainly from a commercial perspective—I was going to say “as a victim of regulation”—regulation is extraordinarily burdensome and ultimately has a competitive impact on financial services in the UK, in the same way that the wrong kind of post-Brexit arrangements with the European Union could also have a negative impact on the UK. Those things are not necessarily mutually exclusive. They can exist independently and exist in partnership in terms of how we evolve it.

Viscount Trenchard: I am very happy to hear Mr Carnegie-Brown say that our influence might be enhanced even in global fora for discussing regulations, and that we should stop thinking about this as purely a UK versus EU matter. It is surely arguable, is it not, that our influence will not be diminished but will be enhanced in bodies such as IOSCO, because we will be sitting as a sovereign regulator in our own right? I would like to go back to what Adrian said about Solvency II. He said, “We spent billions complying with it”.

Sir Adrian Montague: I think I said “hundreds of millions”.

Q54 **Viscount Trenchard:** I apologise; I should be more accurate, but he did say that we have spent a lot of money on complying with Solvency II. Mr Carnegie-Brown said that we had actually driven most of it, but my recollection is that there was a big argument and a lot of unhappiness from the insurance industry about the capital requirements.

It is interesting that ABI’s briefing, which has already been referred to, says very clearly, “We urge the Government to make changes to the domestic insurance regulatory regime before an assessment of equivalence is undertaken”. It further says, “Changes to Solvency II will unlock billions in infrastructure spending, because insurers in the UK are currently required to hold three times more capital than Canadian pension providers for investment in green infrastructure projects”. There seems to be a little bit of difference with your view, Sir Adrian, that we are where we are and we have spent a lot of money so it is probably better to stay with Solvency II as it is; the ABI is arguing something different there.

Sir Adrian Montague: Let me back up, because you are right to ask for more precision on this point. What I was trying to explain is that there is a broad range of opinions regarding how to position the insurance

industry. There are some for whom equivalence is important, some for whom it is honestly irrelevant and others for whom it is attractive but not at the price of accepting rule-taking into the indefinite future.

If you look at Solvency II as a whole, there is one area above all where there is a consensus that it should be improved, and that is in relation to the risk margin. If I remember rightly, Sam Woods said that this was an artificial intellectual construct, which has been found lacking as the system has been applied over the last three or four years. That is a change that would be welcomed on the continent just as much as in the UK, and EIOPA, the European supervisory agency for insurance, is working hard on a review of Solvency II, and this is one of the things it is thinking about.

There is another area where Solvency II is terribly important for UK companies, and that is in relation to the so-called matching adjustment. The UK industry and, on a smaller scale, the Spanish industry are really the only places where you get long-term annuities offered to you. It is not a product known in the rest of Europe. The overall question is about how much capital you have to put against annuities. This matching adjustment allows you to match long-term assets against long-term liabilities very precisely so you are not subject to mark-to-market fluctuations during the tenor of the liability; it is terribly important.

EIOPA did a study a couple of years ago that said that if we remove the matching adjustment, the solvency ratio on the 53% of British firms that use the matching adjustment would drop from a healthy 154% to 58%. The loss of the matching adjustment would have a very serious impact on the life companies in the UK. That is the reason, above all, why the industry is emphatic that it should not be subject to rule-taking from the continent, because that will be a huge threat to British industry. It is a provision in Solvency II that the Treasury had to fight hard for, because it was of such limited geographical impact. Only the UK and Spain need that sort of protection.

We have a framework of rules here that has been operating quite well. We can have a go at the risk margin. This is a tactical issue more than anything else. You have to weigh up whether it is better to suggest changes to that regime now before the equivalence discussions come to a head or whether you can leave it until afterwards. This is a point on which reasonable men can disagree.

Q55 Lord Desai: Chairman, much of my question has actually been answered, but just to make sure of what Mr Carnegie-Brown said, when we are making our own regulations, you would prefer that we continue to be as tough as we are and that our regulatory regime is not relaxed to our disadvantage. Would that be a fair summary of what you were saying?

Bruce Carnegie-Brown: No. It will be for us to choose. My point was that it is not automatic that, in managing our own regulation, we will choose to eliminate or reduce regulation substantially. I have never seen

us do that, but it is obviously within our ability to choose that outcome. Nobody would advocate that. If you look at all of the consumer-related regulation in financial services over the last 10 years, much of this has effectively been within the gift of the United Kingdom, irrespective of the partnership with the European Union, and we choose to protect our citizens from the financial consequences of some of the decisions they make. Why would we wish to change that as a country, given the journey we have been on?

We absolutely are in a position to choose, but I was trying to address the issue that it is not automatic that you need to move all the way to a different place. Viscount Trenchard made a comment that was quite interesting with respect to the issue on Solvency II and capital relative to Canada and the United States. I feel his question was beginning to push into international competitiveness issues. Certainly, I would advocate our regulators having an international competitiveness mission within their mandate. If you only focus on the risk, there is always too much of it and there is never enough capital.

My scepticism about the relationship between the European view of Solvency II and our own is tempered by the fact that I have never met a regulator who will tell me there is enough capital in the insurance system or the banking system. In order to be talking about reducing levels of capital, you have to believe that you have enough. That requires an issue of risk-and-return analysis, not just risk analysis. The best way to introduce that risk-and-return analysis is through an understanding of international competitiveness, bringing in the relevance of what people are doing in Canada, Australia and the United States with respect to their rules and regulations relative to ours.

The Chair: Sir Adrian, did you want to comment?

Sir Adrian Montague: I will just add one thing. The London financial ecosystem is a unique asset for Europe as a whole, but it also has a powerful presence in international financial markets outside Europe. You have to ask yourself, "What do external participants in financial services businesses want from a financial centre?" I do not think they want a race to the bottom, which is how some people characterise this competitiveness argument. What they want is a centre that has, and is proud to maintain, very demanding standards, because that is the way you get really strong businesses. That is the strength of London. The ecosystem is underpinned by purposeful regulation, independently administered by the regulators. People around the world understand the value of that. It would be wrong to see a competitiveness condition as inviting a race to the bottom. That would be very dangerous.

Lord Desai: Can I slightly dramatically summarise this? There is an idea that, with Brexit, we will be free to do our own things. Whether or not we want to do our own things, the things we already do are good enough and we do not have to drastically—

Sir Adrian Montague: They can be improved. There are opportunities for improvement. We cannot tear up the rulebook and start again. You hear this “Singapore-on-Thames” analogy. We have a business in Singapore. The Singaporean regulators are some of the most capable on the planet. It is a pleasure to do business with them. They are tough but firm and demanding. They are very professional. It is not the way forward. We have a rulebook. We can optimise the rulebook, but we cannot tear it up.

Bruce Carnegie-Brown: I would like to build on that with an anecdote. In October 2018, there was a Financial Stability Board meeting in Ottawa, chaired by our current Governor of the Bank of England as the then chair of the FSB. On the way back from that meeting, the most senior regulator of Singapore’s financial services business stopped off in London for 24 hours and came to spend two hours at Lloyd’s, because we have a regulated business in Singapore. Of that two-hour meeting, he spent half an hour discussing with me regulation and the compliance of Lloyd’s with regulation in Singapore, and the other hour and a half encouraging me to do more business in Singapore. As an example, why was I not bringing cyber-risk insurance technology from London to Singapore?

Now, my challenge would be this. Do you think our regulators, on the way back from Ottawa, stopped off in New York to try to win business for London alongside underpinning the robust nature of the regulation and the regulatory environment they have put in place? I suspect the answer is absolutely not.

Q56 **Lord Thomas of Cwmgiedd:** Much of what you have said has answered the question I wanted to ask, but can I focus even more on the regulatory objectives? At the moment, weight has to be given to competition. You would both seem to indicate that you would like it to go much further. Could you be more specific in your views as to how you see competitiveness being a regulatory objective? Apart from regulators promoting London, what would you see being done differently?

Sir Adrian Montague: It has to be acknowledged that the regulators hate this idea, because they say, “Our process of policy-making is already challenging enough. We have lots of different duties that we are required to take into account”. The problem from their perspective with a competitiveness obligation is that it is a slightly ephemeral concept and it requires you to make value judgments not only about the UK but about other competing financial centres.

It is difficult to do, but there are other financial centres that do it. We were talking about Singapore. In legislation, the Monetary Authority of Singapore is subject to a duty to grow Singapore as an internationally competitive financial centre. You cannot get more explicit than that. Hong Kong, Switzerland and the US have not precisely identical but similar obligations on their regulators.

It is not a panacea. The challenge is to establish the right understanding in the Government, in the Bank of England, in the regulators and in the

industry as to how they see London developing as a competitive centre. In a sense, narrowly focusing on the regulator's duties is only addressing one part of the dilemma. You will first see how the regulators are complying with this duty when a draft regulation appears and, honestly, that is a bit too late in the process, because what you want to get at is the policy behind the directive behind the regulation.

There is work yet to be done to try to create within the UK the right sort of conjunctions between the industry, the regulators, the Treasury and politicians to look to the future of London as a financial centre, both in the national interest but actually also in the global interest to maintain London's pre-eminence as a financial centre. It is not the only answer to the question.

Q57 **Baroness Liddell of Coatdyke:** It is interesting. We are talking much more widely now about the new regime in which you will be operating. You have talked about global minimum standards, robust regulation, international competitiveness, and earlier you talked about aspirations. What should the UK's priorities be in terms of promoting international standards with, for example, the International Association of Insurance Supervisors? Where does the advantage lie in creating an international environment of regulation that would benefit the United Kingdom?

Bruce Carnegie-Brown: One example of that within the insurance industry, particularly in the wholesale reinsurance space in which Lloyd's operates, would be combating protectionism, which manifests itself most often in ring-fencing capital. This is something that has happened in the banking industry, partly in reaction to what happened in 2009; there was a flight of capital back to parent organisations. Regulators have been trying to ring-fence capital geographically.

As soon as you start to do that in insurance, the model breaks down. As I indicated before, effectively what insurance does is collect lots of little premiums from different places but then periodically send huge amounts of capital to a point of need. Particularly if you play in wholesale and reinsurance markets, as Lloyd's does, and you deal in things like natural catastrophe insurance, if all of our capital is trapped in all of the operations in which we are engaged, our ability to move that capital to the place of need is restricted and the economic model breaks down.

An obvious example of this would be in Christchurch, New Zealand, when they had the earthquake in 2011. The volume of capital that went from the insurance market into New Zealand to rebuild Christchurch was many, many multiples of all the premiums ever paid by New Zealand policyholders and was immensely to the benefit of New Zealand in the recovery process from that disaster. The same is true pretty much annually at the moment, I am afraid to say, in the southern states of the United States. Insurance operates on a state-by-state basis in the United States. In places like Florida and Texas, which have natural catastrophes every year in the form of windstorms coming through, the net capital that comes into those markets to help rebuild those economies post a disaster is huge.

In the UK, partly because it is very seriously to our advantage as a centre of global insurance, we should be advocating for those open markets, provided that the minimum standards across the world are sufficient, that this capital can continue to move and that there is still value in buying reinsurance in London. This goes back to the earlier comment that was made on the nature of insurance in terms of solvency. If you buy reinsurance in London, that policy will pay out and it is therefore capital equivalent in terms of the support that domestic insurance companies can get in their marketplace when they are faced with these kinds of disasters. That would be an example, for instance, of a place where the UK could take a leadership role in the global insurance market around minimum standards.

Sir Adrian Montague: We are part of the international insurance community. We need to play our part in places like IOSCO. We all have an interest in trying to increase regulatory convergence. We have been talking a lot about Britain and Europe, but it also applies more globally.

The other thing you need to reflect on is that many of the issues the insurance companies will come to face are not narrow regulatory issues or solvency issues; they are much broader issues. If you think of climate change, sustainable finance, the digital economy or cyber, all of these are risk issues or opportunities that the insurance companies will be facing in the years to come. A degree of commonality in the approach to how these opportunities and challenges are managed is definitely in the common interest. Because many of these things are pioneered in London, it is a natural opportunity for Britain to take a leadership role going forward. Viscount Trenchard was talking earlier about the way in which the Europeans are thinking about relaxing capital requirements for green investments. I am not sure that that is entirely prudent, but we will pass on that comment.

London is a strong financial centre for green financing; it is one of the areas where we see a very rosy future for London going forward. It would be useful to have a greater degree of commonality in the approach to how these investments are treated from the point of view of capital standards. Not just in relation to Europe but on a worldwide basis, greater co-ordination and greater participation in these bodies is entirely in our interest.

The Chair: I am afraid we are now running out of time. We did have one more question. Perhaps if we remind you what the question is, you might write to us with the answers. Thank you very much indeed for your evidence.

Examination of Witnesses

Michael Dobson, Sir Douglas Flint CBE, Stephen Jones and William Nott.

Q58 **The Chair:** Welcome, gentlemen, to the EU Financial Affairs Sub-Committee's public evidence session on the future of financial

services after Brexit. You have before you a declaration of Members' interests. The session is being broadcast on parliamentlive.tv. A full transcript is being taken and will be made available to you for any corrections shortly after the session.

I will kick off by asking a general context question. How important is the EU market to your business?

William Nott: The EU market is absolutely critical. We are an EU business. I am the chief executive of a small Swiss asset management business as of the beginning of last year. Prior to that, I had been 34 years at M&G. The last 16 years of that was spent building and developing the European business for M&G.

With a market of 500 million consumers, it is a hugely important market for the asset management industry. It goes back to the UCITS directive, which was first conceived in 1985. It has been developed and evolved. There have been about six iterations of the UCITS directive, and the UK has become a very big beneficiary of a cross-border passport for retail funds. Today, the UCITS industry is about €8 trillion of assets, and the UK manages around a third of the assets in the European UCITS industry.

In terms of the UK, over the last 20-odd years we have seen a lot of consolidation of asset management activity into London and have benefited enormously from that passport. Yes, it has been an important market, and I do not doubt that it will be a very important market in the future.

Stephen Jones: If I can frame it in data, the EU is the UK's largest single export market for financial services, and the banking industry makes up broadly half of that. Exports of financial services to the EU were worth about £26 billion in 2017; that is about 43% of all global financial services. Nearly half of all UK global financial services exports from the UK go to the EU. If you add in the activity of subsidiaries and operations of UK-headquartered institutions within the EU, that number is much larger. We had a surplus in trade with the EU in financial services, which is important for balance-of-payments purposes, of about £21 billion in 2017. The answer, in market terms, is that it is a very important market.

Sir Douglas Flint: I agree with what has been said. It is a very important market in aggregate. In terms of Aberdeen Standard Investments, we have 378 people in 10 countries in Europe. We run our collective funds out of Luxembourg. We have about €100 billion of funds that are run through Luxembourg. We provide distribution through the 10 countries that we operate from, and in seven countries we do portfolio management, largely for real estate. It is a very big market for us, and we have quite a presence on the continent.

Michael Dobson: It is very important for Schroders. We manage £85 billion of assets from European clients, of which £55 billion comes from clients from the EU. We also have a very big Luxembourg fund range of over €100 billion, which we sell to EU clients and around the world. We

employ 800 people in Europe, of whom 400 are in the EU. The EU accounts for about 20% of our revenue, so it is a very important market for us.

Q59 Lord Vaux of Harrowden: Given the importance, what measures have you already put in place to prepare for Brexit? If you give us some sort of flavour of the extent to which you might have done those anyway, that would be helpful.

William Nott: I have two perspectives. From an M&G perspective, which is the bulk of my experience in this industry, we had to relocate the European investors from the UK, where they were invested in an OEIC, to Luxembourg, where they became invested in a SICAV. We had to move the management company from the UK to Luxembourg, to Europe.

For the business I run at the moment, we have simply had to repaper branches of the UK asset management company; instead of being subsidiaries of the London asset management company, they have become subsidiaries of the Luxembourg management company. We have moved the German, Italian and French branches of UK to Europe. Effectively, we have repapered it so that we now have the management companies and the branches in the right jurisdictions for the future, so it is all Brexit-proof.

Stephen Jones: From a banking industry perspective, most of the preparation has been put in place, both by banking firms and by regulators, since the referendum. That has largely involved setting up subsidiaries, to the extent that they did not already exist, within the EU to whom business that is or has been transacted in the UK with EU customers can be migrated in order to ensure that it can continue legally, on the assumption that passporting rights or an equivalent to passporting rights will be withdrawn and to ensure that the activity can legally be switched over.

Although I would say that the preparations, from an infrastructure, investment and licensing perspective, are there, the actual process of migrating all of that business is not. Many customers are waiting to see what may happen during the course of this year in the context of negotiations, to the extent that they do not have to migrate. Clearly, that involves time, lawyers and money. Would any of that activity have taken place anyway if we had not withdrawn from the EU? Probably not. To the extent that people were happy with business models that involved their operations serving institutional and professional customers, which is what we are talking about here, from the UK into the EU, I suspect they would have probably wanted to continue doing that. Therefore, although it is not impossible that the industry would have bulked up operations within the EU, it is less likely had the vote not happened and the referendum gone the way that it went.

Sir Douglas Flint: During the period in which Brexit has been negotiated, Standard Life and Aberdeen Asset Management came together. The consolidation of the two firms' operations in Luxembourg

would probably have happened anyway, but there is an element of scale-up just to manage a bigger business in Luxembourg. We set up a MiFID investment firm for segregated mandates in Dublin, and we have populated that with a few tens of people.

That is in terms of our own business. We are prepared for whatever kind of Brexit ends up being negotiated by the end of the year. The big issue that is still under-way is about working with clients to understand infrastructure changes that might take place in terms of clearing and settlement and so on, and the repapering of contracts that might be necessitated, depending on how negotiations take place over the course of this year. That is preparation work rather than actually doing something.

Michael Dobson: We at Schroders have made limited changes to our business because of Brexit, because we were, we felt, very well placed at the start, with a very big Luxembourg fund range and 250 people in Luxembourg. We have done two things. We have extended the regulatory permission for our Luxembourg business not only to manage mutual funds, UCITS funds, but to contract directly with EU institutions, if they need to or wish to contract with an EU entity. We now have permission to manage segregated institutional mandates from the EU, contracting with Luxembourg. We have extended the regulatory permission for that Luxembourg business. That is basically the only thing we have done.

We have also made our European entities branches of Luxembourg, for the same reason, and we think that covers us for what comes out of Brexit. In terms of people moving, two people have moved from London to the EU, one to Luxembourg and one to Frankfurt, as a result of Brexit.

Q60 **Lord Vaux of Harrowden:** Mr Jones, all of this involves the movement of business out of the UK, and you gave some statistics earlier about the balance of payments, et cetera. What is the impact, and particularly the fiscal impact, on the UK? What are we losing in terms of the tax take?

Stephen Jones: It is very hard to predict at the moment, because ultimately the preparation for a non-passporting environment in the wholesale market has not yet been fully activated. Therefore, the scale of the activity that may be required to move by regulatory change, if you like, is not yet clear. The most recent fiscal estimate I have seen is that, in the short term, of the £37 billion or £38 billion that the banking industry contributes directly and indirectly to the Exchequer, £3 billion to £5 billion is at risk.

Over the longer term and in the absence of a collaborative, co-operative and interdependent relationship that allows the UK and continental Europe to rub along together well as friends, in a co-operative manner, that impact could be higher. About £17 billion or £18 billion of the £37 billion that I quoted of bank taxation revenue comes from the international banks that are based in the UK. Therefore, your question requires a lot of crystal-ball gazing in terms of the general attractiveness of the UK as a global financial centre for international banks in an

assumed absence of interconnectedness with Europe that makes the UK a sensible place to be based in order to undertake business with European customers. We are not necessarily predicting that as the outcome yet; we are all crystal-ball gazing in terms of trying to figure out what might happen.

Q61 **Lord Giddens:** What impact will Brexit have on your longer-term business activity in the UK, with a stress on "longer-term"? What are the advantages of continuing to operate in the UK to balance that out?

William Nott: There are cyclical factors going on in the industry as well as Brexit, so you cannot attribute anything solely to Brexit. I have taken the decision to enter into a strategic partnership with iM Global, which is a French-owned asset management firm with big activities in the US. That is part of the consolidation; it is not really a Brexit issue. It is just business development or evolution.

In terms of the UK, the obvious advantages of operating in the UK are the deep pool of talent, English law, the time zone and the clustering effect. What we have seen over the last 20 or 25 years is the migration of asset management talent to London. It is just a very deep pool of remarkably sophisticated and able talent. That is why you are in London; you are tapping into that.

Stephen Jones: From a banking perspective, it depends on which segment of the banking sector we are predicting the long-term outcome for. For retail banking, the answer is probably quite little, because retail banking has always been and remains a very local, national business. Therefore, the consequences of not being a member of the European Union, subject to long-term economic impacts, which will always indirectly impact retail banking, are limited, from a model-operating perspective.

The cross-border wholesale trade is likely to be much more impacted, in terms of the extent to which future arrangements do not allow that cross-border activity to continue as it does under existing passporting arrangements, particularly in areas where the EU's existing regimes for third countries provide very limited access. For example, corporate banking and capital markets are relatively limited in terms of what they allow. Therefore, to the extent that that activity is currently taking place for European entities from the UK, it is possible that that activity over time will migrate into continental Europe.

In terms of the market infrastructure that supports that activity for Europe, a lot of that happens in London. There is a very big question about the extent to which that permission for European firms to undertake clearing and settlement activity and trade on London-based exchanges will continue going forward. Therefore, there will be implications in that space as well.

That leads to relocation, which I referred to earlier. Frankly, for some of the mid-sized and smaller-sized wholesale businesses, the need to

relocate or to be based in two centres in Europe may actually lead to closure of activities, because it may no longer be economic for two centres to be maintained to serve the European client base, which in wholesale markets is not supported by a fee pool that is as generous as, for example, the United States'. There could well be some overall loss of capacity to the disadvantage of the UK and continental Europe over the long term.

Clearly, I repeat William's list of advantages of operating in the UK. With Lord Thomas present, clearly the rule of law has to stand at the top of that. We also have very complicated regulators. I meant to say competent, but they are complicated as well. That was very Freudian.

Lord Giddens: There is a name for that kind of slip.

Stephen Jones: We export our regulatory competence, and our regulatory depth and knowledge is a real strength. The language, the talent pool, being a good place to live, and the deep and vibrant cultural heritage will continue to be a draw for London, but we are going to have to continue to reinvent ourselves and find new reasons for our financial services to be competitive on a global basis in order to build on those advantages to which William referred and with which I agree completely.

Sir Douglas Flint: From our perspective, we do not see a major impact from Brexit itself. The industry trends, in terms of the move to passive, the technology impacts and the challenge to the industry around climate change and ESG, are going to be far bigger drivers of business-model change than Brexit. We sell our skills all over the world, and therefore it is simply another aspect to be taken into account. Clearly, we will succeed if we continue to retain and attract the talent we need to be successful in that demonstration of our skills.

I will not repeat, but I agree with, what has been said before about the historic advantages of the integrated cluster and ecosystem that has built up over decades, if not 100 years, in the UK. It is that integration of law, accountancy, custodian infrastructure, banking and so on that is near to unique. If we can continue to develop and protect that environment, we will continue to be successful.

Michael Dobson: It will not have a major impact on our business. We have a separate UK fund range that we sell here and a Luxembourg fund range that we sell in the EU, as I said before. Some 65% of our revenues today come from clients outside the UK. If you go back 20 years, it was probably 25%. That 65% is going to go up, to probably 75% or 80%. Notwithstanding that, we will definitely remain headquartered here, because it is probably the best market in the world to run global asset management portfolios. That will not change. It does depend on the ability to attract talent, which has been mentioned already. It depends on effective and efficient regulation; it depends on the continued ability to delegate portfolio management activities from the EU and elsewhere to London. I do not see that being threatened.

Those are incredibly important givens, but, provided they are not threatened, London remains a very compelling place.

- Q62 **Viscount Trenchard:** How important do you think the EU's equivalence decisions will be for your businesses? Perhaps I should widen that and ask about the UK's equivalence decisions, not only about the EU but about other major financial centres—the US, Japan and so forth. There has been a lot of talk that we should have equivalence, but presumably this will be granted directive by directive. The situation might be very different under AIFMD from the UCITS directive or MiFID II and MiFIR. I would like to know, in respect of each major directive, how important the EU's equivalence decision will be. Is it likely that they will be granted before the end of the transition period, whether or not the EU thinks we are likely to wish to diverge?

William Nott: That is an enormous question. I need to give my colleagues here a chance also to answer it. The UK has said, and David Frost has said, that the UK would seek to be treated as an equal, no more and no less. At the same time, Michel Barnier has said that he sees equivalence for financial services as being a unilateral one for the EU. Those two do not reconcile, for a start.

In the earlier session, I heard a reference to global equivalence. The asset management industry is a uniquely global industry. We are investing in asset classes around the world. We need alignment among global regulators a lot more than we realise. Where we see misalignment, we get complexity and operational difficulties. We have seen that in MiFID II with the unbundling of research and execution. It caused a problem for the Americans, and then we realised that the EU had enacted a law that had extraterritorial impacts, and we then had to reconcile it and the US had to move. As an industry, we are massive fans of what I call global equivalence. It is much bigger than just the EU-UK issue.

The good news is that, as Andrew Bailey has said many times, we must be, by definition, equivalent today, so we start from a different position from other equivalence issues. Equivalence is so important and so crucial for us, in the long term, in terms of negotiating trade deals with many different jurisdictions, as Viscount Trenchard has referred to, that an equivalence division needs to be set up to understand what equivalence means, particularly in financial services.

Very quickly, I would also say that we have seen this with the STOs, with trading and derivatives. We have extensions or whatever going on at the moment, which extend equivalence beyond the end of Brexit for a short period. These are very fragile. They are not really load-bearing decisions and mechanisms. As Michel Barnier has said, they can be withdrawn unilaterally at 30 days' notice. That is not very robust; that is not what you would call weight-bearing or load-bearing apparatus.

In our industry specifically, we rely on MOUs for the delegation of activity. The biggest area where we rely on what I call equivalence is under the MOUs, where management companies can delegate investment

activity to London. We are hugely reliant on that. That is done because we have good regulatory co-operation.

There is a great regulator-to-regulator rapport, and we heard that again in Andrew Bailey's testimony to you a couple of weeks ago. This has really worked well post the referendum. In fact, the UK has been strengthening that. That is great news for us, but it would probably be nicer to lift it up a level and get it in the treaty rather than just having it as an MOU between regulators. For us, in our industry, that is the biggest area of equivalence. If that got pulled, it would signal a big problem for us. We are just assuming, blindly, that it will not get pulled, because the regulators are being so rational, logical and reasonable, but it is not written in stone.

Stephen Jones: Depending on whom you talk to in France and the UK, there are 40, 42 or possibly 52 areas where equivalence is theoretically possible and useful under existing EU regulations. I am talking about EU activation of equivalence at the moment. Broadly, those designations cover two areas. The first is prudential and operational—the ability to access clearing, markets and platforms or the ability for a risk weighting on a cross-border exposure to be consistent and recognised in the home jurisdiction for an exposure taken in the third-country jurisdiction.

There is then a much smaller group, surprisingly, of those equivalence areas that relate to perhaps the most sensitive area, which is cross-border market access. These are those equivalence designations that allow third-country firms to operate within the EU, especially MiFID, which governs trade in derivatives and key areas such as that.

The process of prioritising which of those equivalence designations matter depends on which firm you are. I represent a very broad diaspora of 255 firms. Broadly, the firms that care most are those that operate in the wholesale markets and those that operate on a cross-border basis. In terms of the precise priority order that we are talking to the Treasury about, that list has not been agreed formally. In that context, trying to come up with a consensus about what matters most across an industry is quite difficult.

Broadly, I can tell you what you might want to think about. I will write to you with more detail on this if that is helpful. You should think about third-country access, which is Article 46 and Article 47; shared trading venues, which William has referred to; derivatives trading venues; CCPs, which is about central counterparties and the ability to access UK-based central counterparties for EU firms; transaction-related requirements, which is about reporting and intergroup exemptions, et cetera; short-selling; data transfer, which we have not discussed yet; and then, as William mentioned, regulatory and supervisory co-operation arrangements.

Those are probably the broad buckets of things that really matter and that are really sensitive to the ability of industries to operate cross-border. Many of those are highly political in the way that William

described, in the sense that they are not just technocratic assessments, although that is what is currently going on. I am sure—and I hope the EU and UK teams will be able to agree that this is in fact the case—that we are technically equivalent, because we have fully adopted the EU acquis, but the key will then be whether that permits the equivalence designation to be awarded and switched on and, if so, under what conditions and with what trade-offs with other sectors, for example, to the extent that this is part of a global set of negotiations.

That is a much more difficult thing to predict. Under the way that equivalence currently works in the EU, it is also a very difficult thing for a business to rely on, because, if an equivalence designation can be granted, it is likely, I would suggest, to be temporary in almost every case, and it is likely to be capable, theoretically, of being withdrawn at very short notice, as the Swiss discovered in respect of their Swiss stock exchange. On that basis, businesses will then have to decide whether this is an adequate and robust basis to rely on in terms of how they operate their client-facing businesses and their cross-border activities within their firms to manage risks across Europe.

So far as the UK granting of equivalence is concerned, I have every confidence that, politically and regulatorily, we will want to do what is right, on the one hand, to maintain the UK as a great international financial centre and, on the other hand, to protect UK financial stability, given that we ultimately underpin that financial centre by being the sovereign that sits behind it. Given the regulatory competence and the regulatory colleges that exist for global businesses and our influence in global standards-setting entities, I would expect that the UK will be reasonable in terms of how it chooses to recognise and grant equivalence to third countries whose businesses are operating here.

Sir Douglas Flint: From our perspective, we are not dependent and will not be dependent on any elements of EU equivalence for our own business. However, we are tracking very carefully, in the infrastructure space, what may be required in the wholesale markets, because that will impact the way we may have to clear and do custody and so on and so forth. That is an ongoing dialogue on one side with the infrastructure operators and providers and, on the other side, with our clients, because it may require some repapering of contracts and some rerouting of the plumbing or wiring in terms of sending instructions. That is a cost issue rather than something that would mean we could not do business. It is just different wiring.

I agree with what Stephen said. So much of equivalence is actually about whether one recognises documents produced in one part of the world or another as opposed to the very limited piece of market access that is much more sensitive. In the asset management industry, when you stand back, because we are effectively managing other people's money, from America through to Europe and the UK, across the world, the industry is underpinned by the absolutely shared principles of financial stability, operational resilience, treating customers fairly, transparency and so on.

There is never going to be a disagreement on that, because that is at the level of international standards.

Where the UK should be positioning itself, or continuing to position itself going forward, is in being a leading voice, both in terms of policy development and pragmatism, particularly in many of the new areas that are beginning to be explored in terms of data, artificial intelligence, fintech and so on, so that we continue to have a voice at the table and lead or contribute to the international discussions, which then basically get followed around all the leading markets of the world.

To take a specific example, there was the point about the Swiss stock exchange. People write about the share trading obligation and what that could mean, but that is an interesting challenge. Do you, for political reasons, say that shares have to be traded onshore in Europe if that means that the liquidity, the price transparency and the best execution is weaker than it would otherwise be? Do you take a political decision to give a poorer outcome for the ultimate beneficiaries of the investment? That would be quite a hard decision to take as a political or regulatory body. We have to make sure the transparency, liquidity, executability and price dynamics of our market make it a compelling market, at which point the political issues get put in that context.

Michael Dobson: We, like Sir Douglas, do not rely on an equivalence regime, partly because of the substantial existing presence we have in Europe and, secondly, because the main piece of EU legislation that covers funds activity—the UCITS directive—does not contain equivalence provisions. What is key for us is the ability to rely on being able to delegate portfolio management. As William Nott mentioned earlier, we assume that will continue. If it does not continue vis-à-vis the UK, it will not continue vis-à-vis the US, Japan or anywhere else, so the whole global funds management business will be called into question. It is highly unlikely that that arrangement will not continue into the future, because it is not just a UK-EU question; it is a global question affecting everybody.

Otherwise, I do not have very much to add in terms of share trading obligations. One would hope that sense would prevail and there is something that benefits the investor, counterparties and the company seeking to raise capital. Being precluded from trading your stock on the largest financial market in the world would make no sense whatever, so although we have not seen that sense break out vis-à-vis Switzerland, we would hope vis-à-vis the UK it will prevail.

Q63 Lord Cavendish of Furness: I have a related question: how might the EU's existing equivalence framework be improved? That is perhaps a big question.

William Nott: The process really just needs to be a bit more structured with a bit more governance around it, with consultation, participation and some lead times if changes are going to be made and so on and so forth, so there are no cliff-edge withdrawals with 30 days' notice.

The other one is that we might be being a bit naive if we are just thinking about it in a technical or regulatory sense. I have heard in the halls of Europe people talking about tax as part of equivalence. This "Singapore-on-Thames" notion is a slightly mystical concept, which means what it means to each individual. One thing I have heard with some sort of clarity is that the EU is worried that the UK will suddenly compete on high standards for environmental sustainability, high standards for regulation and very aggressive standards on taxation, which creates an un-level playing field.

We should not be naive and think that equivalence is purely technical and that it is about liquidity and consumer outcomes. It is much bigger. We heard Barnier say, "We want fishing rights if you want equivalence". There is something more to equivalence than how we are defining it at the moment, in the sphere in which we are answering these questions. We should not be too naive.

Lord Cavendish of Furness: You do not detect a fundamental flaw in the framework.

William Nott: I do, absolutely. The fact is that there is no proper framework, and one needs to be established. At the moment, there is no proper industry consultation; there are no lead times. I would like to see robust regulatory interaction on when an equivalence decision is going to be considered, how you consult on that, what the unintended consequences of it might be and, if a change is made, securing enough time for the industry to adjust and make appropriate alternative arrangements.

Stephen Jones: Just to build on William's point, there is a lot of support within the EU for that as well. It recognises that its own equivalence frameworks are highly political and very unpredictable. From a business perspective, that is not necessarily good in terms of continuity. I sit on the board of the European Banking Federation. There are 32 banking federations that sit on that board, and 31 of them think the equivalence framework in Europe needs to be strengthened, and we will be submitting a paper to the Commission quite quickly on that basis. There is one that does not agree with that; I cannot reveal the name of that country, but you might guess which one it is.

Even within the EU there is a recognition that this is a very difficult basis for business to operate on, because this is something that is political, that can be withdrawn at short notice and that pretends to be technical but actually gets caught up in much bigger questions. It is also probably difficult to change, because there are aspects of sovereign prerogative that Brussels will seek to preserve in terms of whether it chooses to switch an equivalence designation on and what commitments it demands going forward in order for equivalence to be granted today.

Technically, we are equivalent; we have the same rulebook across financial services. That does not mean equivalence will be switched on in those areas where potentially it could be switched on, because there will

be forward-looking commitments that are required by the EU regarding where the UK will go in the future. As the Government rightly put it, we cannot bind future Governments. We cannot commit ourselves, in the UK, to adopt law in the UK that is created somewhere else.

To William's point, therefore, what is critical in a free-trade treaty negotiation is not so much what equivalence is granted but how rules are formulated and what the mechanisms are for potential divergence between the two systems as we go forward. This is about the institutional mechanisms: discussion; debate; cost-benefit analysis; an understanding of what would happen if one were to diverge on a particular rule going forward; what equivalence designations might be at risk and what the consequences of that would be; and then long timeframes for equivalence designations to be switched off, not 30 days. That kind of framework would provide much greater certainty for those businesses that want to rely on robust equivalence designations in order to conduct cross-border business.

Sir Douglas Flint: I agree. Equivalence can work well when there is a clear framework of how equivalence will be judged, what the trigger will be to reassess it and what the evaluation process will be. It works best when there are technical factors rather than judgmental factors. As a parallel, I hope we are going to end up with an equivalence regime in medicines and food standards, because it is very difficult to see why we would have a very different view on medicines and foods in terms of them not killing you. It should be more based on outcomes rather than a line-by-line examination of detailed regulation.

There also needs to be a consultative process that says, "We have reached a trigger point that means we are going to look at it. How should we look at it?" We will look at it together, and this will then be the process to take it forward so that people can plan accordingly. This suggests that the notice period for starting to re-evaluate equivalence, where it is relied upon, and the process, once it has been determined that a change is needed, would be a great deal longer than 30 days to give people time to adjust.

Michael Dobson: I cannot add to that. I agree with what Douglas has just said.

Q64 **Lord Vaux of Harrowden:** Mr Jones touched briefly on data adequacy a little bit earlier. What impact would a lack of a data adequacy decision have on your businesses? What steps have you taken to mitigate any problems? How ready are you for the possibility of no decision being in place by the end of the year?

Stephen Jones: Many financial institutions, banking and otherwise, rely on cross-border data flows, and therefore data adequacy designations in both directions are very important. They underpin services to customers across many jurisdictions. Many wholesale banks operate important service centres covering Europe from the UK—and outside London and the south-east, in line with the Government's levelling-up agenda. They

depend on data adequacy designations. It is the best way to ensure that these operations can continue on a cross-border basis; there is no question about that. It ensures there is no undue burden of compliance on firms to the extent it is available.

There are alternative arrangements that firms are working on in case no adequacy deal is granted, but I stress that adequacy is absolutely the number one solution. Given that we have, as usual with European regulations, gold-plated our implementation of GDPR, I find it very hard to believe that there are technical reasons why GDPR cannot be recognised as being well implemented in the UK for the purposes of that designation—but politics comes into force here.

Firms can set up standard contractual clauses that allow data to flow, but those clauses are currently subject to challenge in the European Court of Justice. Firms can also have binding corporate rules, which enable intra-group transfers of data between one operating subsidiary and another to continue on a cross-border basis. There are some derogations within GDPR that allow the transfer of personal data across borders where necessary to execute a contract.

Clearly, all firms are working on contingency arrangements to deal with potentially impacted relationships, whether inside a group or outside a group, to address this, but this is a very significant, costly, administrative and burdensome task. When it involves a third company, not one within your own group, it is more difficult to implement, because you have to persuade the other party that it is as important to them as it is to you. Frankly, for smaller firms that are also dependent on cross-border data, there is less expertise available in terms of addressing some of these issues.

Sir Douglas Flint: We have been exploring putting in place bilateral contractual arrangements, if it came to those being needed, and we do not see at the moment any difficulty in those bilateral contracts being agreed. Data is going to be a much bigger subject than the financial services industry, never mind asset management. The issues around data privacy, data security, data location, permission to use and permission to be forgotten form a huge subject, and we are going to be at the bottom end of the consideration of that. We will get swept up in a tide, but, for our own particular business, we can mitigate it.

Michael Dobson: We do not think it is going to have a big implication for our business. We do not hold personal data on the underlying investors in our funds, because our clients are the bank distributors rather than the end retail investors. It is the bank concerned in Germany, France or Spain that would hold that personal data; we do not hold it. That is the first point. We also do not process it, therefore, on a cross-border basis. From our point of view, we do not see this as having an impact on our business.

William Nott: I would be the same as Michael. We are not holding personal data. It is the platforms or the institutions that we are

wholesaling to. Small firms generally have a problem if we do not get high-level sensible agreement. It is just a generic issue: if you do not solve the big questions, the small firms do not have the bandwidth and the capacity to deal with everything. Let us hope, as Sir Douglas said, that we do get swept up in the considerations and this does not become a problem.

Q65 Lord Turnbull: I was impressed by your opening remarks about the skill with which each of you has adjusted your business. You may have incurred some costs, but they did not appear to be anything like those that Project Fear told you there might be. Are you going to be able to apply the same sort of adaptation to whatever comes next?

William Nott: Obviously, I hope so. We have essentially gone local. That is the hard-Brexit mitigation strategy, which is that you set up the local management or service companies that you need to operate in Europe. That is all in place. We have had plenty of warning and notice on that. Going forward, we will be aligning, hopefully, as a financial services industry, to persuade Government and regulators to co-ordinate, align, be pragmatic, be practical and not put political considerations ahead of good consumer outcomes.

So far I would say that the evidence is that people have acted very responsibly and followed the guidance from the Bank of England, from politicians and from regulators, and today we are in a good place. We are hoping that the storm passes, that common sense, wisdom and wise counsel prevail in the future, and that, when things change, they change in a proportionate way and with plenty of lead time and discussion.

Stephen Jones: William used a very important word there, which is "alignment". If we think about this over a longer-term basis, we are in a short-term negotiation, but alignment is not just a question of UK and EU rules and how they impact businesses; it is about the global standards that are set that govern how financial institutions operate and how risks are managed in a very interconnected and global world.

Sir Douglas has listed some very important ones: data, AI, cyber and economic crime. These are not issues about borders. We could also include recovery and resolution in there. When there is a problem in a firm that operates on a cross-border basis, it is absolutely vital that there is connectedness and strong regulatory, supervisory and indeed political co-operation and collaboration to ensure that the storms are well managed and contained. They will happen again, so alignment, institutional mechanisms, dialogue and thinking forward to the challenges that we face collectively as economies going forward will determine the answer to your question in terms of whether or not we can "manage" and adapt to whatever is thrown at us.

Sir Douglas Flint: The evidence is that we can, because the last 12 or 13 years post the financial crisis has seen a tsunami of regulatory change that was well beyond anything that we face with Brexit. It was consequential to the financial crisis and necessary because of everything

that was uncovered in the financial crisis. This tsunami of regulatory and supervisory change we have had to accommodate—the process of adjusting business models and data recording and reporting—over the last 12 years is, hopefully, a larger-scale change than we will have going forward.

As I said and as Stephen repeated, the impacts of AI and data policy going forward will be another challenge much broader than the financial industry, but they will have a big impact on this industry. All we sell is intellectual capital, either from human beings or from technology.

Michael Dobson: There will be political issues that colour decisions by institutions and retail investors. Our best defence against that is the local presence we have on the ground throughout Europe. We have 12 offices on the ground, each one staffed by local nationals with great local knowledge and relationships embedded in their own markets. It comes across, therefore, as a French, Spanish or Swiss company, as opposed to a British company. That is our best defence in the future against whatever backlash comes our way. Therefore, we feel that the growth opportunity in Europe and the EU remains a very exciting one for us, notwithstanding Brexit, because we are offering services that these people want to buy and to access.

Lord Turnbull: We are starting from a position of equivalence, but then the Government have the opportunity to redraw certain aspects of the rulebook in the UK. Are there any particular areas where you would want to see us take this and adapt it much better to UK circumstances?

Michael Dobson: I would like to see a more outcome-oriented approach, an approach that is closer to the markets and is more flexible. There have been several issues coming out of Europe, such as PRIIPs, which has been implemented in this country. It has been very expensive to implement; it is confusing and it is hard to represent to clients what it means. Accounting for transaction costs, for example, can in some cases lead to, supposedly, a negative transaction cost, which is, by definition, nonsense. We also need to forecast future performance on the back of past performance, which is absolutely not what we want to do.

There has been quite a lot of stuff coming out that is being implemented here, and I hope it can be improved. I hope that total alignment is not the future but something better, more responsive and quicker. I hope we have something that is stress-tested ahead of time and, having been implemented, we then look back at it and, if it is not working properly or has unintended consequences, it can be changed. That is not in any way a dumbing down or a race to the bottom. It is something that is closer to markets, closer to reality, listens more to practitioners, is more flexible and is actually better and not worse. That is what I hope could come over time.

Sir Douglas Flint: That is a really important point. The UK within Europe agrees and the UK outside Europe agrees that it is time to look at some of the regulation that has been put in place over the last decade and ask

whether it is achieving the purpose for which it was intended at a proportionate cost to the industry. That is much more outcomes-based.

Europe is looking again at PRIIPs; it is looking again at MiFID reporting. Everyone has the view that Solvency II did not necessarily get to where it wanted to get to in terms of its impact on how long-term insurance money could be invested, and product disclosure. In a lot of the detailed areas, we will look at them again and Europe will look at them again, and we will probably come to slightly different outcomes. As I said earlier, however, in the fundamentals of financial stability, resilience, treating customers fairly, appropriate outcomes and transparency, there is no difference. It is at the edges—the data you have to report, how you disclose it, the documents and so on—that I am sure we will end up diverging to make it more proportionate. On the fundamentals, we are the same and always will be.

William Nott: Can I challenge all of us to show a little humility here on this topic as well? I have heard very senior European regulators say to me, “This is quite extraordinary. You have given us all this regulation; now you do not want it. You are off and leaving us with it”. Let us be honest: we were pretty substantive in some of those debates around MiFID II, the implications for research commission and PRIIPs II. Let us not absolve ourselves of some culpability, but it is fair play: things do not always work as intended, and it is completely right and proper that over time they are evaluated and reviewed.

As an industry, I would expect us to be encouraging European regulators as well as UK regulators, in a proper consultation process, to modify and refine those areas where, clearly, the outcome has been slightly unintended and not quite gone in the direction we perhaps initially envisaged. We certainly should not say, “This is an opportunity, finally, to break away from what we created”. We also have to think about this honestly. In a future as an independent state, a sovereign state, we will make mistakes on our own and we will not have anyone else to blame. It will be very obvious where the source of the issue stems. Let us not be arrogant here. I hope, as an intelligent industry operating across many markets, we will be able to consult with the various regulators. If the regulators also co-operate properly, I also hope that the moves will be moderate, proportionate and aligned across markets.

Stephen Jones: May I just echo that? Based on many dialogues across Europe, when public figures in the UK stand up and say, “We are going to diverge”, we fan the flames of mistrust that underpin the potential negotiation. From the perspective of the industry I represent, high regulatory standards, safety and transparency are absolutely core attributes that we value in the UK system and that we wish to maintain. Deregulating for the sake of deregulating is not an aspiration that we would encourage or recommend.

We do, on a case-by-case basis, have the scope to customise certain regulations to the specificities of the UK market. Building societies are a unique movement that exists in the UK, which is ill-suited to the way EU

regulations have developed; we have an opportunity there. We want to be a global leader in fintech. We have an opportunity to lead the way in which regulation is built around that sector. There are areas where we can take global leadership positions, which can then offer the opportunity for Europe and others to want to be based here, to learn from us and then to adapt in their own environments. Green finance, cyber and operational resilience are all areas where we have great opportunity in terms of developing regulation, at the global forefront, as we move forward.

I have to stress that there are also a number of activities where the benefits of regulatory freedom are insufficient to outweigh the disadvantages of diverging. In the wholesale markets, which are very interconnected and operate extremely well, we do not aspire to strike out on our own unless we want to be isolated.

Q66 Baroness Couttie: I fully accept the point you are making about how any form of race to the bottom is just not where we are at as a financial services centre. In fact, it is quite the reverse; having high standards is paramount to our position in the world globally. Nevertheless, as we have just discussed, there are areas where some form of divergence would simply suit our market better, because currently we have one-size-fits-all, but we are up against the political aspects of the negotiations?

How important do you feel your sector of the financial services industry is? Would its importance perhaps offset some of those political fears or the political ambitions of the EU and force it to take a more pragmatic approach to accept a prudent divergent regime, if you see what I mean?

Sir Douglas Flint: I used to be in the European Banking Federation and similar bodies. Our European colleagues always respected the view from the UK, because there was perhaps more pragmatism and a broader understanding, because of the breadth and depth of the industry that was hosted in the UK. One of the big differences going forward is that we have the opportunity and indeed the intent to put more regulation into the regulatory bodies, subject to appropriate accountability, rather than putting it in law. Europe has to put it in law so you get the same across, going forward, 27 countries, so that you do not get divergence.

As we did with the senior managers regime, for example, we can put the principles into law and let the regulators work out what it means. That means it is much more adaptable. When circumstances change, you can change regulation and people are held to account through committees such as this and the Treasury Select Committee, and Parliament can usefully give a steer as to what it wants the product of regulation to be, so there is a framework and people can see where we are heading. There is an opportunity to diverge in a good way.

All the way around the world, every time there is a new issue that suddenly pops up because there is a problem, people look around the world and say, "What is done in Canada, Australia, the United States,

Britain?" You go and look at where best practice is, and you raise standards. It used to be that you could look around the world and say, "We do not do it in quite the same way", but as soon as something is better, it catches up pretty quickly around the world to best-in-class.

Baroness Couttie: You do not feel that, for political reasons, equivalence would be withdrawn, because of the respect and the size of the market here, when we diverge, if it is a sensible divergence.

Sir Douglas Flint: If it is proven and if we can demonstrate that we give better outcomes at a better cost, with transparency to the ultimate beneficiary of what we do—the consumer—why would you want to diverge from that? Why would you want to give a worse outcome for a political reason? It would not make sense. We would be fine.

Baroness Couttie: We would be fine. That is quite an important point.

Michael Dobson: The other important point to make is that this is a very global industry. We are operating in 35 markets around the world, with multiple different regulators. We actually want to see more global convergence. This is not just EU-UK; it is America, Singapore, Australia and Japan. Diverging in a thoughtful way, as opposed to by accident, is great if it is better for specific reasons, but we do not want to see this being done thoughtlessly or by accident. We really want to see, if anything, more global convergence, because we are dealing with the same problems in multiple markets around the world. This is not just a UK-EU discussion.

William Nott: The divergence issue is more of a retail than a wholesale issue. Where you have different consumer dynamics, different products and different traditions in financial services, divergence is fine; no one cares. The wholesale area is where you want complete alignment, and that is where we want global alignment.

Going back to Viscount Trenchard's point right at the beginning, we do not want to be thinking about equivalence just as an UK-EU thing; we should think about equivalence as global equivalence. Think about IOSCO; think much bigger. Use this as a case study to set up an equivalence team that understands the issue and can work with every trade negotiating team to understand what good equivalence looks like in financial services. Why should we not be a world leader in that kind of competence? We should.

Stephen Jones: I would just echo those comments but also emphasise what I said earlier. It is very important to have clear dialogue and institutional mechanisms within which potential divergence is discussed, understood, assessed and calibrated for impact and then consequences are drawn by one side or the other, political or technical. I do not rule out that there will be political consequences, I am afraid. That is very important.

There are areas of our current alignment that are seen as sovereign issues for the EU, particularly the eurozone. There will be political considerations, I am afraid, brought to bear in the wholesale markets in relation to the very significant volumes of euro-denominated wholesale markets activity and clearing that takes place in the UK. Even if we were and remained fully aligned, there remains a sovereign ambition in parts of continental Europe to repatriate part of that activity. Those political factors will continue to be brought to bear in those markets, but that is no reason for us not to work with them to ensure that any transition is thoughtfully and carefully managed in a manner that does not damage businesses or customers of those businesses in the way that transition is executed.

The Chair: We did ask the PRA and the FCA whether there was a mechanism anywhere in the world for managing or trying to manage divergence from equivalent regimes; the answer was no.

Q67 **Lord Thomas of Cwmgiedd:** I wanted to ask about regulatory objectives. I was hoping to concentrate on one in particular, which is competitiveness, particularly in the international market. How do you see that? Should it be an objective? How would you see it working?

Michael Dobson: It should definitely be an objective. It was an objective of the FSA before the financial crisis. It does not seem to be inappropriate that a regulator in possibly the pre-eminent financial centre in the world should have the continuing competitiveness of that financial centre as part of its mandate or as something to take into consideration.

I heard the panellists in the previous session talking about Singapore. It is very much the case that the MAS is a very tough and effective regulator, but it also promotes Singapore. It does not see that as a conflict of interest or something that is contradictory. This does not mean a race to the bottom, because financial institutions, clients, investors and counterparties all want to see firm, sensible and effective regulation. It is not a code for a race to the bottom at all.

I find it strange that a regulator does not have anywhere in its mandate any consideration at all of the future competitiveness of the financial centre it is regulating. I am sure that is not the case with the SEC. It is certainly not the case with the MAS; it is not the case in Japan; it is not the case in Australia. We are rather out of step in that regard, so I would like to see that reintroduced. It was there 15 or so years ago; it should come back.

Sir Douglas Flint: I completely agree. It is seen by those who dislike the concept as a race to the bottom. I agree with what Michael said. We want to stay competitive because we want to be the leading financial centre in the world. To do that, it means a framework of integrated policy-making, regulatory and supervisory activities, in collaboration with the industry, that leads to the best outcomes for financial stability, market transparency, and for consumers.

If I dare make the analogy, our legal system is widely admired around the world because of its adaptability and the strength of its independence. We would say we have a competitive legal system in terms of those who have the choice of choosing a legal system to use for their arbitration or to bring disputes. We do not do that by making it weaker than any other system; we make it better. We can do exactly the same with our system of financial regulation and supervision, and the interaction between that system and policymakers.

We should be embracing competitiveness. I have absolutely no doubt that a dozen-plus countries in Europe will be looking to see how they can make their financial systems more competitive to attract business. For us not to have the ability to respond to that would be a mistake.

Stephen Jones: I wholly agree, as you would expect. The vehicle to do that is the Future Regulatory Framework Review, which Philip Hammond announced in his Mansion House speech last June, which I hope will be reiterated by the current Chancellor in the Budget on 11 March. Competitiveness is not in conflict with competition, consumer protection, integrity and financial stability.

Frankly, while we are looking at competitiveness, we might also look at how well the regulators are actually prosecuting their competition objectives as well. There are many things they do that actually impede the development of effective competition within the financial services marketplace, despite the fact that there are four regulators overseeing the financial services industry, all of whom purport to have competition objectives either as primary or secondary objectives.

William Nott: I also agree. Why not? We all know why it was taken out; it was post the 2008 financial crisis and there was a concern that there was a dumbing down of regulation that had not been sufficiently robust to protect consumers. Lessons have been learned; let us move on. Competitiveness is also about global alignment. Once you realise you have to globally align and have global standards, you need to align competitiveness with that. Why would you not?

We are in a winning position. Going back to the beginning, why do you locate in London? It is time zone, competence, clustering, legal certainty—you name it. If we could get regulation proportionate and globally aligned, it could be a very interesting next few years.

Q68 **Baroness Liddell of Coatdyke:** Having listened to that, it is probably appropriate, then, to look at what the international standards should be. Sir Douglas said that Britain should be pragmatic and should lead international discussion. What should that lead to in terms of UK priorities in international standards?

Sir Douglas Flint: On top of doing what we do at the moment, which is participating in all the regulatory fora and international bodies, there are a number of areas where the industry is beginning to have to think much more broadly about issues that are of great concern to us, our owners

and individuals. These are areas where there are no policy directives or guidance yet.

Climate change and ESG would be a huge issue. How do you embed environmental, social and governance standards and climate change into the allocation of money into assets? This is not just for the protection of consumers; how do you want the investment money to flow to the assets and activities of the future? We are incredibly well placed. The Bank of England has done more on green finance than anyone else, and indeed has also done it with China, which is an interesting combination, given that China is hugely critical to that.

The whole area of the ethics, scale and scope of artificial intelligence is enormous. When a machine makes a rational decision that is a very bad outcome for individuals, because it denies them insurance or it gives them a product that its metrics led it to but that is not particularly suitable, how do you punish the machine or those who coded it? It is a really big issue for our industry and for the financial industry going forward.

Operational resilience is also an area about which we should be very thoughtful, because we do not host the major cloud computing companies in the world, which are incredibly dominant, incredibly successful and incredibly good at what they do. We are getting a concentration of risk that perhaps is easier to think about when you are not the country that hosts those companies.

There is the whole issue of safety and standards around market infrastructure. We are in a much more technologically driven world, where everything is almost instantaneous and people talk about cybercurrencies, virtual currencies and so on and so forth. These are all areas where we have a depth of expertise and experience, and yet we do not have the conflict of being the major players in any of these areas in terms of providing the owners of the infrastructure or the data services. That is where I would be.

Michael Dobson: I would add pension provision. In many ways, this country leads in this area. Very often people follow the US example, but we have more to do in terms of what we have done in auto-enrolment, tax provision, encouraging global diversification and promoting an investment culture and so on. We can also do more there. There is an industry in this country that can benefit from that.

Stephen Jones: I have two further thoughts, but I agree with everything that has been said. In the context of climate and carbon risk, COP 26 this year in the UK presents an enormous opportunity for us to come together to demonstrate that leadership in an area where the world is looking to the UK, frankly, to take the Paris Agreement forward in a manner that is implementable. It is really now about execution and delivery and how we make that happen across our economy. It is a responsibility for all of us in the public and private sectors to come together to try to deliver that successfully.

Secondly, another area that is borderless where the UK is good—and “good” is relative—is in the fight against economic crime. Of course, we can do better. We work extremely well in public and private partnership across a number of areas: money laundering, counterterrorism financing and the fight against fraud. What we do is watched very carefully in other jurisdictions. All of those things we are seeking to fight are borderless in terms of how the criminal is behaving. We need to think about it, as a connected global leader in that space.

Q69 **Baroness Couttie:** We have talked a fair amount about international standards and international equivalence. Do you see opportunities for bilateral agreements with third-party countries? If so, how would you like to see business involved with those discussions?

Sir Douglas Flint: There will be a place for bilateral agreements, but I would hope they would be subsumed into global agreements. This industry works best when there is an underpinning of global co-operation. As a consequence of the financial crisis, in this country there has been less interaction between policymakers, regulators and the industry than there was before the financial crisis, because there was fear of regulatory capture and so on and so forth.

At some point, I hope the industry will be recognised as having a contribution to make to consultation and to leading the discussion from a business perspective about what outcome we are trying to get to. That will possibly include the balance between certainty of outcome and where we want the money to flow. That flow might be through bank lending or investment funds, but should not just go to the least risky or most certain assets in terms of outcome. We need to build the operational assets and infrastructure of the future; that involves a bit more risk, but we are investing over 20 or 30 years. That is what we used to be really good at.

I hope it is more international than bilateral, but there are specific relations to consider. Clearly, between the US and the UK, we should make sure that we speak and understand each other’s position. It is terribly important for London that the US regulators give us equivalence recognition, as they already do in very important ways, particularly in the derivatives markets.

Michael Dobson: We meet once a year with the so-called College of Regulators, which is facilitated by the FCA. It brings together in London all the regulators that regulate our business around the world. It brings the regulators from Singapore, Australia, Japan and the US. It is a very productive session. There is no fixed agenda; we are just sharing thoughts about what works well and what works badly. We are being regulated now in about 35 countries around the world. We can assist in that process and share that with the FCA; we can get that multilateral engagement progressing effectively.

Stephen Jones: I would just say that openness is generally not negotiated. It is something that you offer, and you offer it because there is political, regulatory and economic alignment around the reasons to

offer openness. The co-operation and regulatory diplomacy that engages positively with that culture is the key to building market opportunities for the UK, both in financial services and in other sectors. We either are or are not open, and there are increasing protectionist forces in the world. Therein potentially lies a competitive advantage and a way to build those third-party relationships which you are referencing.

Firms should be involved, by the way. There are plenty of insights that we can offer. Look at Sir Douglas, in both his current role and his previous role. We are in the field all the time, operating on a cross-border basis. Michael has his College of Regulators in 35 countries. We see a lot; we feel a lot; we suffer a lot sometimes. We can learn from that and we can share that experience with the Government in terms of how they then choose to take that forward in delivering those third-party structures.

William Nott: I would just offer a note of caution. We are whipping ourselves up into a lather of excitement about these global opportunities, but let us not forget that there are 500 million consumers on our doorstep.

There is a lot to be done and a lot of work to be built on, initially led by the European Commission's financial services department, on the capital markets union. The dependency that small and medium-sized companies in the EU have on bank finance versus the US is a huge competitive disadvantage. Being sensible and pragmatic about keeping everything open, liquidity open, with capital flows into the EU, will have huge knock-on effects, because we do so much trade with our neighbours. Yes, it is exciting to talk about India, China, America and Latin America—we are all excited; do not get me wrong—but do not lose sight of this. Do not throw the baby out with the bathwater. Europe is deeply important to us. Europeans are our neighbours. We have a long historical relationship; we should be working to strengthen and support that in this process.

The Chair: Gentlemen, I am afraid I have to bring the excitement to an end. Thank you very much for your time and your evidence. This public evidence session has now ended, and the Committee will resume its private deliberations. Thank you very much indeed.