HOUSE OF COMMONS

International Trade Committee

Oral evidence: Trade in services, HC 1776

Wednesday 24 April 2019

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Watch the meeting

Members present: Angus Brendan MacNeil (Chair); Mr Nigel Evans; Mr Ranil Jayawardena; Julia Lopez; Faisal Rashid; Matt Western.

Questions 78 - 149

Witnesses

I: Alastair Evans, Head of Government Policy & Affairs, Lloyd's of London, Alison Hook, Director of Hook Tangaza, and Stan McCoy, President and Managing Director, Motion Picture Association EMEA.

II: Mike Hulme, Managing Director of Trains and Modernisation, Alstom UK, George Riddell, Associate Director of International Trade, Deloitte LLP, and Dr Richard Torbett, Executive Director, Commercial Policy: UK and International, The Association of the British Pharmaceutical Industry.

Examination of witnesses

Witnesses: Alastair Evans, Alison Hook and Stan McCoy.

Chair: Good morning and welcome to this small room with an interested audience this morning. I hope we do not all cook in here. We will be taking evidence on the UK trade in services and our first panel is particularly looking at the barriers to trade in services. Can I first ask the panel to introduce themselves—the usual name, rank and serial number, as you choose—from my left?

Alastair Evans: Morning, everyone. My name is Alastair Evans. I am with Lloyd's of London, the insurance and reinsurance market, and I am Head of Government Policy and Affairs there.

Alison Hook: Good morning, everyone. My name is Alison Hook. I am a director of Hook Tangaza, which is a specialist consultancy working in the legal sector. We do not give legal advice, but we work with institutions, governments and regulators around the world on legal services.

Stan McCoy: Good morning. My name is Stan McCoy. I am with the Motion Picture Association. I am the President of the MPA for Europe, Middle East and Africa. Our members are Walt Disney, Netflix, NBCUniversal, Sony Pictures Entertainment, Warner Media and Viacom International, which includes Paramount Pictures and the UK PSB, Channel 5.

Q78 **Chair:** Thank you. I think I might have heard of some of those names. It is good to see you again. Thank you, panel, and thank you for being here this morning. I am going to kick off by just asking a general question. Could you outline the importance of international trade for your business and sectors? Maybe start with the Motion Picture Association. Wherever you go, you tend to see motion pictures.

Stan McCoy: Absolutely vital for us. Our sector realised from very early on that once you have made a film or television project, exporting it around the world is highly desirable. We spend over £1 billion a year making film in the UK and upwards of £800 million making television in the UK. Those film and television projects include things like the Harry Potter franchise, Star Wars movies, James Bond movies and so on, which find a great audience internationally. Being able to get those film and television projects into theatres and on to online services around the world is highly desirable and supports about 170,000 UK jobs here in the film and television industry.

Alison Hook: As my business is small and we do a lot of work internationally, I am going to talk mainly about the sector because I think that will be of more interest to you. In terms of the legal sector, I think most people think of it very much in terms of the conveyancing of their property or perhaps a criminal law issue, but in fact international trade in legal services has grown hugely over the last couple of decades and

English law and UK lawyers have played a major part in that. For example, on what Stan was talking about, just about any deal that is international will involve a lawyer.

UK lawyers, like American lawyers, have played a huge part in globalisation, so just about every privatisation that you would find in India and every nuclear power station that might be built in China will probably involve an English lawyer or a UK law firm somewhere in that process. We can see how that is internationalised in terms of the numbers and the proportion of the English profession in particular. I will come on to Scotland and Northern Ireland separately, but in terms of internationalisation, it started very much in England and Wales over the last couple of decades. Now probably about 10% of our practising profession are based internationally around the world in various centres. The European Union in particular has been a very big part of that.

Alastair Evans: Trade in international services is very important to Lloyd's. I ought to explain that Lloyd's is not the company; it is a marketplace in which members of Lloyd's underwrite principally commercial non-life insurance and reinsurance risk for their own account through syndicates, which are kind of annual ventures. Last year the Lloyd's market wrote £35.5 billion-worth of premium income worldwide, and 86% of that derived from non-UK. Our major overseas markets were the US and Canada, which was 50% of premium income. Just to quickly go through the percentages: the rest of Europe 13%, central Asia and Asia Pacific 11%, other Americas 7% and the rest of world 4%. So open markets are very important to Lloyd's and the Lloyd's market.

The sorts of risks that we are writing are, as mentioned, essentially commercial risks. They are often complex risks, with high monetary exposures and they are often characterised by high severity and low frequency. Just under a third of our business is reinsurance, which is insurance of insurance. We also write marine, aviation and transport. That is another source of income. We also write non-marine lines, including property, liability and so on. We are doing this international trade in GATS terms both on a kind of mode 1 and mode 3 basis.

I ought to explain that although legally the risks are accepted individually by the Lloyd's members, Lloyd's does have a very unique structure, and in order to often gain entry to write direct insurance in other markets, we need to have Lloyd's recognised as a single unitary entity to be able to enter those markets, because insurance is a highly regulated profession.

Chair: Thank you. I am tempted to plunge into the area of trade agreements at the moment, but I will leave that because I think it will come up as the discussion goes on.

Q79 **Faisal Rashid:** Thank you for coming and contributing to this review. Of course the exporting is very important for our country and your companies, and you mentioned you are exporting to various different markets. I have a question about legal services and insurance. I lead a group in the House of Commons on BRI—the Belt and Road Initiative. I just want to know how engaged and familiar you are with that whole initiative, and what are the prospects for your companies moving forward? Alison in particular, you did mention that the European market is the major market for your business. I would like to know what percentage of your business is in the EU and the rest of the world.

Alison Hook: As I said, my business is a consultancy and it is probably more relevant to give you a picture of the sector. In terms of the sector as a whole, Asia is of huge importance to the future of international legal services because basically wherever the growth is, that is where you will find legal services are interested and lawyers are part of helping those growth prospects. UK lawyers have been investing and have offices in particular hubs like Hong Kong, Singapore and Beijing.

The Belt and Road Initiative is something that certainly is of great interest. It is early days yet. I think that also realistically where a lot of the emphasis and the resources are coming out of China, there is also now an expansion of Chinese law firms and they are going to take advantage of a lot of that, because essentially you follow the money and the money will tend to go to home-grown businesses, if you like.

Also the Belt and Road Initiative is very interesting because it covers a very wide number of countries and those reflect a lot of the different types of barriers that I am sure the Committee will be interested in talking about. It is not always easy for lawyers from other countries to practise in many of those countries that might be involved in the Belt and Road Initiative.

Chair: Just briefly on the Belt and Road Initiative.

Alastair Evans: It is certainly something we are interested in. We are licensed in various jurisdictions there, including China, where we wrote some £358 million last year. We also operate out of Singapore and Hong Kong. Certainly the spectrum of insurance and reinsurance we offer ought to cover many of the risks that are within the Belt and Road project. It is something that is being followed with close interest in the Lloyd’s market. Some of the countries out there do have certain barriers to trade, particularly the cross-border reinsurance, so to be able to offer the full panoply of cover we need to address some of these market barriers we face.

Q80 **Mr Ranil Jayawardena:** Mr Evans has already touched on this, but I wondered if you could set out for the record the modes of supply that are most commonly used in your sectors, and also whether you could just expand a little bit on the so-called mode 5, which might be of relevance to some of your sectors where services are embedded in the production of goods. Ms Hook referenced English law being used in the production of nuclear power stations, for example, and I wondered whether you could expand on how those sorts of things are packaged up. I do not mind who wants to start.

Stan McCoy: From the standpoint of my sector, the most important thing to understand about the modes of supply and the classifications that are associated with them is that these serve an anti-liberalisation purpose, so they serve a purpose of limited liberalisation. They were created for the purposes of the WTO General Agreement on Trade in Services in order that members of the WTO could pick and choose only the sectors and modes where they wanted to make commitments.

For a major services exporting country like the United Kingdom, it is far more advantageous to pursue what is called the negative list approach, where rather than picking and choosing a positive list of sectors where commitments are made, you make commitments across all sectors and then you list the exceptions; you list the particular measures, the particular laws that might raise issues with the liberalisation commitments. This is much more transparent for everyone involved because, for example, in our sector it then becomes possible to see what laws we have to look to in order to understand whether there are particular regulatory barriers on the ability to distribute film and so on.

Q81 **Mr Ranil Jayawardena:** You anticipate my next question, Mr McCoy, because I was going to ask what further liberalisation would be beneficial to the UK. You have already given me a bit of an answer to that. Could you also just expand on mode 5 and whether that is of relevance to your sector? Perhaps the other witnesses could do that as well.

Stan McCoy: Sure. Just to answer your original question, cross-border is very important for us for OTT, online type of services, accessing markets, but we very often do establish a physical presence, both to do production locally, as many of our members do here in the UK, and also to distribute film locally. All of the modes are important to us. Mode 5 is not part of the WTO architecture; it is more of an academic concept and not one that I am very well informed about, I am afraid.

Q82 **Julia Lopez:** Could I just ask what makes the UK such an attractive destination to US film and TV producers? If there were to be an agreement between the US and the UK on trade, what areas do you think would be most beneficial to liberalise from your perspective?

Stan McCoy: On the attraction of the UK, there is a great combination here of skills: the creativity and the technical skills of the people who work in film and television in the UK. It is a wonderful regulatory environment, a wonderful IP environment, where the intangible property in film and television is well protected. Also, frankly, there is the depth of technical expertise that you can find here, so you find films like "Gravity" or an animation project like "Isle of Dogs" that could be made, in principle, anywhere in the world. Those projects are brought to the UK because the UK has the right combination of skills, resources and expertise to do that project.

Q83 **Julia Lopez:** Which areas do you think could be expanded upon?

Stan McCoy: In terms of the US-UK agreement, it is already one of the most mutually liberalised trade relationships in the world, so you have two-way investment in film and television projects going in both directions. Our sector does not need a great deal of liberalisation from a US-UK trade agreement. The primary thing we would be looking for from that agreement would be to set a gold standard, to set an example: where the two major audio-visual exporters in the world get together, they should reach a high-standard agreement that will then be an example for the other trading partners who the UK would be doing business with in the future.

Q84 **Chair:** Following on from that, how important is it that the UK maintains its openness to the rest of the EU? Is that important here?

Stan McCoy: The openness of the UK to the rest of the world is absolutely critical.

Q85 **Chair:** No, the EU. With Brexit being the opposite of making trade agreements—closing trade agreements—is that important here and does it matter?

Stan McCoy: Yes, it is very important to us in multiple ways. Of course when we are making a film and television project in the UK, very often we need to be able to send cast and crew back and forth between the UK and Europe. Every project is international by its nature, so you are bringing in talent of multiple nationalities with particular skills that are going to contribute to the project, so the ability to move back and forth is quite critical. There are certainly some things where losing the ability to have an Ofcom licence, for example, recognised as the basis to provide broadcasting services into the rest of the EU, will be a setback, but prioritising the ability to move cast and crew back and forth and to access distant markets will be important. The EU remains a very important market. The EU and North America are both big stable markets for UK audio-visual exports that are not growing very fast. The fast growth is happening again in our sector in the Asia Pacific region.

Mr Ranil Jayawardena: Mr McCoy, thank you for that very full answer. I am pleased that we can all agree that having good relations with the whole of the rest of the world is important to your sector.

Chair: I think there is a proxy Brexit debate occurring.

Q86 **Mr Ranil Jayawardena:** But moving back to the core question, if I may, Ms Hook, would you like to comment on modes of supply?

Alison Hook: Yes. The question was modes, wasn't it? In terms of the legal sector, a lot of attention has been paid to mode 3 because that is how a lot of legal services are measured. We know who is opening offices, we know how many lawyers are in those offices, but all the modes matter to lawyers. A lot of work is done through mode 1, so basically lawyers sitting here—a barrister, for example, providing an opinion in another part of the world, which a lot of barristers do, is a really important factor. We do not have a handle on how much that brings into the UK.

We do have a better idea in terms of mode 3 because that is how we measure it. We know that there are offices right around the world from particularly the larger UK law firms. Mode 2 is also important because I am sure you will have read or heard about divorce cases being done in the UK. That is where the client is coming and using the UK courts. The arbitration industry is very important. London is a major centre of arbitration, so we get a lot of people coming in to do that. Mode 4 is also absolutely critical because whether you have an office or you do not have an office, being able to visit a client is a very important way of doing business, and particularly in those countries where it is not possible to open an office.

One of the other things I would say is I would agree with Stan that to some extent this architecture at the WTO is now looking a little bit creaky, in that this is 20, 30 years old. Basically we have already been through a second wave of change where the architecture in which this was originally built already for the last decade has looked a little bit antique, in the sense that most international law firms want to be able to deliver blended services. They want to be able to work with local lawyers in an office. They do not want to have to think, "Can I send someone to that office and what are they able to do? What are the limits of what they can do?" They want to be able to provide services to their clients and to be able to do it without worrying whether they are going to be committing an offence by flying somebody in and out to work with a local lawyer in that jurisdiction.

We are about to start on a third wave, which is about digital, and we have not even really come to terms with the second wave. To answer your question, all modes are important. Modes 3 and 4 are probably those that my sector would highlight as being particularly important to them, but we ought to be thinking about looking at the architecture as a whole.

Alastair Evans: Modes 1 and 3 are the most important in our sector. When I say "our sector" I refer to Lloyd's and the London insurance market. This is the market that offers wholesale specialty insurance and reinsurance, mainly of a commercial nature under mode 1, for which just over 60% of Lloyd's non-UK business is written by mode 1. As Alison has said, these are concepts that have been kind of superimposed on business transactions that certainly preceded the introduction of the GATS. In mode 1, this would typically work by a risk in a foreign country—a property or a liability or a marine/aviation transport risk—and a local broker or a Lloyd's broker would bring that risk into London and negotiate with one or more Lloyd's underwriters or London market underwriters, leading to agreement on terms and conditions, price and so on, and the contract is concluded in London. That is the typical mode 1 transaction.

We do also a substantial amount of mode 3 business. This could be defined as where insurance and reinsurance business is being written through local cover holders. These are entities that hold delegated underwriting authority on behalf of Lloyd's members to enter into insurance contracts within the country of the risk. There is a substantial amount of, if you like, mode 3 activity that occurs in different parts of the world. In order to do that, we would need to obtain a local licence and the conditions that attach to that local licence vary substantially from jurisdiction to jurisdiction and also according to class of business and whether it is direct and reinsurance.

We certainly have a preference for the mode 1 form of supply, but it is often necessary for us to establish locally in order to write local risk. Indeed, with Brexit we have established a subsidiary in Brussels in order to have continued access to the European Economic Area market.

Mr Ranil Jayawardena: You are all doing so well at anticipating my questions, because my supplementary question, Chairman, was going to be to Mr Evans.

Chair: Do you now need to ask it?

Q87 **Mr Ranil Jayawardena:** Sadly, I do. Mr Evans has been very helpful at highlighting that a subsidiary has been set up in Brussels. Could you just expand a bit more on how that will work and the progress made to date?

Alastair Evans: It has been set up. It was operational from 1 January of this year. It is a subsidiary of the corporation of Lloyd's, the corporation being the body for which I work, which is the body at the centre of Lloyd's that helps to regulate, promote and represent the market. There are outsourcing arrangements from the Lloyd's subsidiary to managing agents in London, so underwriters will accept European Economic Area risks on behalf of the subsidiary in Brussels and then those risks will be 100% reinsured back to the individual members, so this is a way of ensuring that underwriters bear the responsibility, credit and consequences of their individual underwriting decisions, which is how the Lloyd's market works.

The subsidiary also will permit local underwriting where the subsidiary has a branch. Generally there will be a Lloyd's representative in that jurisdiction and this will enable Lloyd's members to delegate authority to either service companies or brokers to accept risk, again on behalf of the Lloyd's company in Brussels. We still hope to write reinsurance primarily from the London market and therefore post-Brexit we would be very keen for the UK to obtain Solvency II reinsurance equivalence. Indeed, as the London market, we have suggested that the Solvency II equivalence test should be expanded to cover non-commercial large risks, non-marine, aviation and transport, property and liability risks. Again, that would help to facilitate the flow of business into London as well as through our subsidiary.

Q88 **Chair:** Just briefly, before I move to Faisal Rashid, how big is the operation in Brussels that started in January?

Alastair Evans: Because most of the underwriting is being done in London, it is a fully Solvency II company, having to comply with European regulations. The number of staff out there will be around 50.

Q89 **Faisal Rashid:** Could you explain how cross-border services trade is regulated in your sectors, including opening offices and branches in different countries?

Stan McCoy: Shall I start? For us, the cross-border mode 1 trade is highly regulated because these are audio-visual services and they touch on cultural sensitivities. Typically we expect for there to be comprehensive audio-visual media regulation in any given country that we go to. It can take different forms, it can have different levels of restrictiveness in terms of accessibility of the market. In general, we consider that the UK is quite a good model for getting the balance right in terms of media regulation, so we would hope that the UK would be looking to export that kind of sound balance to other trading partners. But in addition to audio-visual regulation, we also care a great deal about protection of intellectual property rights, since that intangible value in a film and television project is dependent on strong copyright protection, so we also value that element a great deal when we are looking at regulatory climate.

Alison Hook: In the legal sector, in order to understand how international trade is regulated, you have to understand how domestic services are regulated. That varies from jurisdiction to jurisdiction. In some countries it is only a title that is protected. In Finland, it is only if you are called a Finnish advocate that you are protected. In some other countries like the UK it is a mixture of title and reserved services, so there are certain things that are reserved to lawyers and anything else anyone can do. In some other jurisdictions, like a lot of the US states, it is very highly restricted and basically you find it really difficult to provide legal services in any shape or form unless you are regulated and licensed in a particular state. First of all, you have to understand that.

Secondly, one of the things that I have noticed has not come up in your discussions that I have looked at online—forgive me, I may not have seen everything you have talked about—is the definition of the sector in the GATS schedule, which is incredibly important, particularly in legal, because every different WTO member seems to decide to define the sector differently. You can look and see that you have mode 3 commitments, but you do not know what those mode 3 commitments mean unless you look at how the sector has been defined. A most common approach is to say, "You can do home country law"—and that is the law of the country that you come from—"or you can do international public law or international law", which is a bit of a fuzzy concept. Essentially they carve out any idea of any domestic law, but obviously if you are going into a country that does not regulate domestic law and keep domestic law purely for local lawyers, then it is possible to go in and provide legal advice that is legal consultancy rather than something that might be regarded as advice in the local law.

Thailand is a good example of that, where foreign lawyers can go in and provide quite a lot of advice but cannot go to court. Those are the limitations of somewhere like that. It is a complex patchwork, so you have to look at every country to understand how you are going to be regulated when you go into another market.

Q90 **Faisal Rashid:** It is not that easy that you go in and this is the market, this is the country you want to expand in and where you want to open an office or a branch, so it is quite complicated. It varies from country to country, of course.

Alison Hook: Yes. If someone came to me and said, "I am a law firm and I want to open an office in another jurisdiction", first we have to look at what that jurisdiction is, what they permit in terms of foreign lawyers doing things, what they permit in terms of their local lawyers, so what are the areas reserved to local lawyers, what sort of co-operation there can be in regulatory terms between foreign and local lawyers and what kind of establishment you can set up.

Most law firms would prefer to go into a country and work in partnership with local lawyers, so to set up a mixed entity where they have the cultural and the local advice on tap, but many countries will not let their local lawyers go into partnership with foreign lawyers. India is a case in point: a foreign lawyer cannot go into partnership with an Indian lawyer. Even if you go in, you may have to have a certain proportion of local lawyers. Hong Kong has a limit on the number of local lawyers and they have just changed that so that it makes it extremely difficult. I will not bore you with any more of it, but that is complex.

Q91 **Mr Nigel Evans:** Is it the same here though, that we have the same sort of protectionism in the UK?

Alison Hook: No.

Q92 **Mr Nigel Evans:** We do not. We are more open?

Alison Hook: We are very open. I think we are about as open as we possibly can be, because there is always a balance between consumer protection. We do not let anyone walk in off the street and do your conveyancing, for example, or represent you in court, but aside from a limited number of things, we are very open. We do not know how many foreign law firms there are in the UK because we do not require them to register and we do not require them to be licensed or regulated unless they are delivering certain types of services or they are in partnership with a local lawyer.

Q93 **Julia Lopez:** If there was a market that the British Government could concentrate on in terms of helping UK lawyers penetrate in a future free trade agreement, which is the one that you would love to be able to have better access to?

Alison Hook: If you were asking me that question in the future, it would probably be the European Union, but today I think one of the markets, which is not a single market but law firms here have been trying to crack for decades, is the US. The problem with the US, though, is it is a federal structure and it is almost impossible. It is impossible.

Q94 **Julia Lopez:** Are those barriers faced by US lawyers in other states wanting to go into—

Alison Hook: Yes. Over the last decade in particular, there is the beginning of a change. There are moves afoot to certainly make it easier for US lawyers to work across different state lines and they have a model code of conduct, which most states have adopted, and that makes it easier.

One of the things where there is a real prize, which I do not know if it is possible to get, is equivalent treatment to a US lawyer in terms of fly in/fly out rights because nobody wants to go and set up an office in 50 different states, but if you have an office in New York and you have a client who has business in Louisiana, if you are a foreign lawyer at the moment, you cannot simply fly into Louisiana or Alabama or somewhere else and provide advice there to your client, not necessarily on Alabamian law—not that there is such a thing—but on law in Alabama. US lawyers can now do that, so there is much more freedom of movement for US lawyers than there has been in the past.

There are still restrictions and it is only in around the last 10 years that an American lawyer from any other state flying into Texas to give advice to their own company, not to a third party, could do that without being at risk of unauthorised practice of law and therefore being hauled before some disciplinary body.

Q95 **Julia Lopez:** You think you could potentially take those liberalisations of the past decade that have happened within the American system and see whether they might be applicable to UK lawyers in an agreement?

Alison Hook: The problem is there is no mechanism for putting that in a trade agreement because it is state rights and it is something that, over many years in discussions right across the US at every level, is just impossible to crack. My understanding, even in preliminary discussions with USTR about what might or might not go in a UK-US trade agreement, is that there is simply no dice when it comes to talking about, "Let's include legal services in this", beyond a very broad-brush federal commitment and a sort of exultation to states to do things.

Q96 **Faisal Rashid:** Just very quickly and to clarify: if you have an office in New York, you still cannot provide any services to other states?

Alison Hook: No.

Q97 **Matt Western:** Just to drill into that a bit further, because that is extremely interesting, with the likes of some of our major players—and it is a while since I have looked at this sector, but I think of Slaughter & May maybe and Linklaters and other big companies, very successful UK companies—what is their current presence in the US and what scale of opportunity do they realistically think we could get out of that market, given what you have just said?

Alison Hook: Most of our top 10, the Magic Circle at least, have offices in New York. That is where the focus has been, because that is where the financial market is. When I visit their firms there, they are of a completely different nature from how they are in many other parts of the world, so they are very Americanised because that is the only way they can do business in that market. They are fully staffed by American lawyers and they are trying to come across as American law firms rather than UK law firms who happen to be in America. There is some presence on the west coast through Silicon Valley. There are a number of law firms like Osborne Clarke, for example, that are very tech-focused, who have offices and have had them for a long time.

What has happened over the last number of years that is interesting is that law firms have found ways around these issues. One of the ways around these issues, which is not perfect and may end up not working out, has been to copy what the accountancy firms have done in terms of starting Swiss verein instead of partnerships, traditional partnerships. The Swiss verein model has allowed for mergers to take place so that there you will find, for example, Norton Rose Fulbright, which has offices that are called Norton Rose Fulbright across the US, and DLA Piper, which started originally as a very small north-west law firm that merged and merged and merged and is now one of the world's biggest law firms. It has a big presence in the US, but it is not a British presence, it is the American half of the verein, if you like. That is the way that a lot of law firms so far have cracked it.

If you were going to ask them today, "Where do you think the UK Government should focus?" they would probably say as much Asia and Africa and other emerging markets. The only problem is if you were to say to me one market, which was the question earlier, the US is the attractive one. How much business will be there is difficult to say, but realistically it would probably yield more than say China, where it is great, but you are never going to get paid.

Chair: With time galloping on, we will go to Matt Western.

Q98 **Matt Western:** Can I just move on to look at the other trade barriers? Stan McCoy, you were talking about the movement of people, which is clearly a big issue in the creative sector and the performing arts sector and so on, but also the mutual recognition of professional qualifications. What are the other trade barriers that you have not mentioned so far that each of you would raise as a barrier to our future trade in services?

Chair: We have not heard from Alastair on this, so he can start.

Alastair Evans: I think we face four principal types of trade barriers in the wholesale insurance and reinsurance sector. One is access restrictions. This is where there is complete or partial denial of access to business. That is one form. There could be preference for local insurers and reinsurers. Some might be state-owned; there might be insistence on local presence.

The second form of market barrier I see is prudential: for example, the need to hold excessive local technical reserves or limiting the balance sheet credit that insurers can take for purchasing reinsurance from foreign reinsurers. This has been a big issue for Lloyd's and the London market in relation to the US, which is going to be addressed from 2022 by the UK-US covered agreement, the bilateral agreement on insurance.

Another example of a prudential requirement might be, for example, that the UK has to be considered equivalent to the EU regime post-Brexit. I think a third category of barriers are legal restrictions. For example, a local licensing law may say that to participate within the jurisdiction you have to be in the form of a company limited by shares or guarantee. That is a particular issue for Lloyd's and that is why Lloyd's has therefore had to secure particular recognition of its unique form in local law as a kind of precondition of applying for a licence.

Another type of legal restriction could be one that prevents local entities, local cover holders, from accepting risk on behalf of principals outside the jurisdiction. That is quite a significant restriction, because Lloyds does a lot of business in that way. Then perhaps the final category I would mention is that we are very much an intermediated market. Risks are brought by intermediaries representing the client to Lloyd's underwriters. They are agents for the clients; they present the risk; they are professionally qualified. If there are restrictions on the ability of intermediaries to act within a jurisdiction, that can also damage the flow of business into the London market.

Q99 **Matt Western:** Just to go back to one of the points you made, I think point two was about prudential measures and you referred to this agreement between the US and UK, which was agreed in 2017. How will that improve the supply of services between the UK and the US in terms of scale?

Alastair Evans: I ought to say that as Lloyd's we have very good access to the US market at the moment. The US is regulated at state level, but we are licensed insurers in the states of Illinois and Kentucky, and in the territory of the US Virgin Islands we are also a surplus lines insurer. It is our major market. We write over 44% of our total premium there. It is more than £14 billion. Certainly we see scope for increasing the amount of business we do there.

The major benefit of the covered agreement is that it will remove the requirement in respect of reinsurance contracts to have to localise technical reserves within the jurisdiction. At the moment we hold in a trust fund in New York almost $11 billion, which can only be invested in very highly conservative assets, so it kind of impedes the efficiency. It forces us to Balkanise assets. Insurance and reinsurance works on a principle ideally of pooling capital and investing it efficiently. I suppose the more that our costs are reduced through these unnecessary and previously quite discriminatory reinsurance collateral rules, our competitiveness in the US ought to materially increase further.

Q100 **Matt Western:** That is very interesting. Alison Hook, are there any other barriers that you want to raise in the legal sector?

Alison Hook: The two that I would particularly highlight are free movement of people, which kind of goes in both directions. As UK nationals, it is usually quite easy for us to get visas to a lot of places if we need them. One of the things about legal services is that sometimes if you need to go quickly, being able to move relatively quickly and freely can be difficult. I think there is also an aspect of us being able to give visas to people who want to come here to do arbitrations and mediations quickly enough to be able to keep our market attractive in that area.

The other big one is domestic regulation. That has many different aspects to it and one of the things that has been a sad characteristic of a lot of the access that we have maybe had through the WTO or through bilateral trade agreements—the EU and Korea, for example—has been that the benefit of being able to say, "Yes, we can set up a law firm in Seoul", may be taken away in effect by all of the domestic regulation that then comes in, which makes it almost impossible to open a functioning office that is going to make any money at all, so that side of things.

One aspect of the domestic regulation side is also nationality provisions. Many countries still have a nationality restriction on legal services, which means that you can be limited in terms of what you are going to be able to do.

Chair: I am going to have to put a rush on questions and answers as well to tighten them up, if we can take that advice on board. Have we finished on that point?

Q101 **Matt Western:** Can I just ask this one to Stan McCoy? In your written evidence, you cited that the audio-visual sector currently attracts 114 exemptions to the World Trade Organisation's most favoured nation rule. In what areas are those exemptions and how do they affect the industry?

Stan McCoy: Those exemptions exist under the General Agreement on Trade in Services. It is basically a big carve-out from the general rule to treat all your trading partners according to the most favoured status you accord to any trading partner. That is typical of the larger problem, that the WTO regime is not very helpful if you are exporting audio-visual services because the majority—in some cases the large majority—of members of the WTO have opted not to take commitments in the area of audio-visual services. It is, at a WTO level, one of the least liberalised sectors. It is also a major export sector for the UK, as I have explained already, so this would be a bilateral and regional trade challenge potentially for the UK and one where we would very much encourage that the UK Government looks at bilateral and regional trade agreements as opportunities to advance the interests of its audio-visual exports.

Q102 **Julia Lopez:** Mr Evans, you discussed how you had agreements in Illinois and Kentucky, was it?

Alastair Evans: Yes, we have local licences there, which enable Lloyd's underwriters to accept risks located within those states.

Q103 **Julia Lopez:** Why those two states and how did you establish those relationships?

Alastair Evans: These go back in the mists of time. I think in Kentucky there were links to the equine industry—the Kentucky Derby and so on. These were licences that date back about a century or so, where the kind of initial—

Q104 **Julia Lopez:** So it is possible to establish very specific relationships and probably done on quite a personal level?

Alastair Evans: Yes, it is. These days with the larger so-called surplus lines insurer in the US—and we write around £8 billion-worth of business by surplus lines—this is business that cannot be written by state-authorised insurers. There is a process whereby a broker has to see if he can get quotes from a number of state-authorised insurers. If he is unable to, he is then able to look to the wider market and that includes Lloyd's underwriters, who are active as surplus lines insurers. What we are talking about here is quite complex technical risk.

Q105 **Julia Lopez:** I suppose my interest is if we were to suggest to the UK Government that they deploy diplomatic and trade resources to specific areas of the US and establish specific relationships in certain states, is that something that would be worth doing? I think about the two big insurance events in the US—9/11 and Hurricane Katrina—which caused their insurance big problems. Do you think it would be a wise thing for the UK Government to look at the states that are vulnerable to those kinds of big insurance events and try to establish relationships on that basis?

Alastair Evans: On those two events you mention, a substantial proportion of the liabilities flowed to Lloyd's and the London market, certainly in the case of 9/11 and Katrina and many other events. The US does substantially export a lot of its insurance needs, as mentioned. Our feeling is that the covered agreement addresses the major issue that we had with the US regulatory system, so we are not looking in our sector—or at least in the wholesale insurance reinsurance sector—for anything beyond implementation of that covered agreement.

Q106 **Julia Lopez:** A question for Mr McCoy. You talked about the WTO level and how a lot of countries are opting not to cover audio-visual services.

We know from our visit to Geneva that there are now sub-groupings of countries that are looking to work together on liberalisation of services and not be held back by the lowest common denominator. Australia and Singapore are looking at digital in particular. Do you think that the UK, if it were able to join those groupings, would be a very influential voice and could help your sector in that regard?

Stan McCoy: Those are very important efforts and any kind of forward progress that can be made in the broader liberalisation of services I think is helpful. I say that not only from the perspective of the services industry, but also we are huge consumers of legal services and insurance services, not to mention catering services and all other kinds of services, so yes, that is all to the good. I am afraid that audio-visual services will not see any progress through that particular forum. I think the nature of audio-visual services is such that any progress that the UK Government are able to achieve there would probably be through smaller bilateral and regional agreements.

Q107 **Mr Nigel Evans:** Could I say, you are probably three of the most interesting witnesses we have ever had before us? I have to say; it is absolutely fascinating. We could have had you each individually for at least a couple of hours.

Mr Evans, how many people do you have working in the new Brussels office?

Alastair Evans: Around about 50.

Q108 **Mr Nigel Evans:** Around about 50, so it is not a token affair, because we hear all these stories that people are shoving one person over there and pretending they have something. You have done something quite effective.

Alastair Evans: This is a substantial operation. We had to meet all the requirements of the Solvency II rules covering risk management, compliance and capital disclosure. It has a board, it has a CEO, compliance and risk management. It is a substantial operation.

Q109 **Mr Nigel Evans:** Can you get your heads around—because we find it difficult—where we are currently with Brexit? How would you best describe where we currently are and the impact it is having on each of your sectors?

Alison Hook: When you say "describe where we are", do you mean—

Mr Nigel Evans: Well, the mess, because we are where we are, wherever that is, and you know what impact it is having on your industries now—the inability for us to come to anything concrete at this moment in time.

Alison Hook: I think that what is happening right now is causing huge reputational damage to the English legal sector. For example, I would divide it into relationships inside the EU and those outside. The relationships inside the EU, which are currently probably 40% of our recognised trade in legal services, those relationships are being seriously damaged. Initially there was a sense of pity and now it has gone into just irritation.

We are seeing some sort of difference in the way in which different Bar associations, who tend to be the ones leading on the legal sector, around the EU are dealing with this. Some are seeing that there is an opportunity for them to take some of the work from London, some are seeing that their main approach is going to be protectionism and keeping us out and others will be more accommodating. In the rest of the world beyond, I think there is complete and utter bemusement of, "What the hell is going on?"

Mr Nigel Evans: Anybody else want to chip in?

Stan McCoy: From our sector, the Government was very quick to announce after the referendum that UK tax reliefs would be maintained to encourage film and television production. That has happened, so the level of production happening in the UK has continued at very similar levels to where it was. From the production side, everything is continuing, as reflected in the data. From a market access to the EU side, the biggest questions have been around broadcasting and the loss of recognition of an Ofcom licence as a basis to serve broadcasting service into the rest of the EU. That question has led some companies in the sector to make establishments in the EU so that they can be licensed in other jurisdictions and continue, but uncertainty around that whole set of issues has been an ongoing issue.

Alastair Evans: Currently the Lloyd's market, the London market, operates on the basis of a passport into the European Union and that gives us access services into all member states. We are viewed as a single entity; we are regulated by the PRA. We have to comply with the conduct of rules in other jurisdictions. Once we leave the European Union, we will encounter market barriers if we continue to try to trade from London. That is why, as mentioned earlier, on the reinsurance side we are very keen to see reinsurance equivalence. It was this kind of loss of access that has forced us into setting up a subsidiary in Brussels in order to write European risk.

Many of the risks that we write are global in nature, so the insured may have risks in the European Union and outside, so we are going to have to incur extra cost friction in arranging, if you like, separate insurance policies to cover those risks. I think leaving the European Union also may create challenges around loss of authorisation because insureds can make claims some considerable time after the expiry of the contract, so a number of member states are introducing laws that would allow run-off, which we are very pleased to see, because otherwise we would lose our legal right to settle claims, so that would be an uncomfortable position to be in.

The other thing we are seeing is perhaps pressure on the intermediary sector as well to have to establish within the European Union in order to be able to export risk, perhaps via branch, into the London market. Under Brexit—I will not comment on the politics of this—we would certainly welcome as close an economic trading relationship in our sector as is achievable.

Q110 **Mr Nigel Evans:** You touched earlier, Stan, on the importance of getting people in and out, the physical movement of people both into the European Union and maybe the rest of the world. How important is that to you—this is to all of you—and briefly, could you say whether Liam Fox's Department has been in touch or whether you have been in touch with them as far as all these trade deals that he is talking about around the world, whether your sector has been asked to have an input into the areas where you believe there are new and fresh opportunities with Brexit?

Alison Hook: In terms of the first part of your question, free movement of people is absolutely vital. I am not going to say any more than that. It just is absolutely vital.

In terms of the second part, the Department for International Trade has been doing quite a lot of asking around about what trade deals would be most useful, where are the barriers and so on, so they have done a lot of asking. One thing I would say is whenever I have participated in any of those sessions, the one thing that has come back from the legal sector is, "The most important deal for us right now is the EU", so getting those relationships sorted out is far more important than any other trade deal.

Stan McCoy: I completely agree from the perspective of our sector. Free movement is absolutely vital. Making any film or television production requires bringing together people of different nationalities in whatever the place is, often multiple places, where you are making that film or television project.

In terms of the outreach from DIT and DCMS, yes, we have had a lot of outreach from both DIT and DCMS to try to understand our sector and the trade needs of our sector. We have had several in-depth discussions with them about potential priorities for future trade agreements.

Alastair Evans: Similarly, we have had extensive outreach from DIT. It did issue consultation papers at the end of last year dealing with the US, Australia, New Zealand and the Trans-Pacific Partnership. We have responded to that. We have also had regular and very fruitful contact with the Treasury, which has continually sought our view.

On the movement of people, yes, we are looking for the right skills and the best talent, whether it be in risk management, legal or actuarial, to be able to assess and quantify the risk. Insurance is a very mathematical activity so, yes, we are very keen to see continued unimpeded flow of talent. I note that around 11% of London market employees are non-UK nationals, so they already represent a significant percentage of our broader London market.

Alison Hook: Can I just add one very small thing on the free movement of people? There is a supply chain that starts very early on. Something like around 25% of all of those now entering university courses that are the professional preparation course to become solicitors are from 170 countries around the world. About 10% are EU; the rest are from other parts of the world. The free movement starts early on because we capture those people. We train them as solicitors. They go back to their countries or they enrich our industry here. They go back to their countries and they take the concept of English law and using the UK as a centre back with them, so that is a really important point.

Q111 **Chair:** Just before I move to Matt Western and following on from Nigel Evans's first question, it would be useful for us to hear the Brexit experience from your point of view and your sector's point of view. In the interests of brevity, I will ask for one word: good, bad or indifferent?

Julia Lopez: Oh, for goodness' sake!

Chair: It may be good. What is this negativity that Brexiteers have about Brexit?

Stan McCoy: Confusing.

Alison Hook: Omnishambles.

Chair: Omnishambles, that is worse than bad. Mr Evans?

Alastair Evans: Can I pass? I would rather not comment.

Chair: You certainly can. You are free as a witness to choose.

Q112 **Matt Western:** Alastair Evans, you were saying that you were given by DIT a consultation document at the end of last year.

Alastair Evans: I think it was, yes.

Q113 **Matt Western:** Is that surprisingly late, in your view, given how long we have had to be considering our future trade agreements?

Alastair Evans: We welcome every opportunity to share our views with the Government. I have to say—

Q114 **Matt Western:** It would have helped if it had been 12 months earlier maybe?

Alastair Evans: We have been in regular contact with trade people from Government over many years, so we have fed in information about barriers. Our Government have been feeding into the EU Commission and the trade talks, so I cannot honestly say consultation started with our trade people at the end of last year.

Q115 **Matt Western:** Okay, but was the timing similar for you both as well in terms of the consultation you may have received?

Alison Hook: The consultations have probably been going over the last year or so, but the thing to bear in mind is that trade deals take a decade at least.

Matt Western: A long time.

Stan McCoy: Yes, we had informal contacts going in both directions well before the formal consultation process got up and running.

Q116 **Matt Western:** Finally, very briefly from each of you, in terms of the trade in services, does geography and proximity really help in the trade in services or is it not an issue?

Alastair Evans: It should not, because in underwriting an insurance contract you do not need to be physically proximate to the risk. As long as you have information about it, you can write it in different jurisdictions. Indeed, we write substantial business from the US, Australia and New Zealand and have done for a long time. At the same time, what we are seeing, particularly post-financial crisis, is a growing trend of regulators and governments insisting on local presence, underwriting within the jurisdiction, perhaps a subsidiary and capital there, so that is forcing more local underwriting at the same time.

Alison Hook: It depends what you are doing but, yes, I think it is a reasonable rule of thumb to say geographical proximity definitely helps. That is why people open offices.

Stan McCoy: It is not much of a factor for us, far less important than reasonable and fair regulation and good IP protection.

Chair: Thank you very much, panel. You have had so much to say that we have overrun. It has been interesting and fascinating and I think that any one of you could have done as a witness by yourselves on the panel. Thank you for your time and for your co-operation working together on the panel too. We appreciate it. We will switch over to the next panel as soon as we can.

Examination of witnesses

Witnesses: Mike Hulme, George Riddell and Dr Richard Torbett.

Chair: Gentlemen, thank you. It is a panel of gentlemen. Can I ask the three of you to introduce yourselves, please—name, rank and serial number—starting from my left?

Mike Hulme: Mike Hulme, Managing Director of Trains and Modernisation with Alstom UK. I am also a professor at Aston University looking at servitisation.

Dr Torbett: My name is Richard Torbett. I come from The Association of the British Pharmaceutical Industry, which represents those small, medium and large pharmaceutical companies engaged in the discovery, development and manufacturing of medicines from around the world, but located here in the UK.

George Riddell: George Riddell, Associate Director of International Trade at Deloitte. I also act as the secretariat for the Professional and Business Services Council.

Q117 **Chair:** Thank you. Can I kick off by asking what the main ways are in which the export of goods and services are interlinked? Can you provide some examples from your industries? We are all reasonably familiar with trains and pharmaceuticals at least, but anyway.

Mike Hulme: From a rail perspective, it is a huge link between products and services. What we have found is, because of the level of risk that needs to be managed on behalf of the financier, the manufacturer tends to not only just supply the original equipment, but follow through into the ongoing services thereafter as well. If we look at recent train procurements, not just in the UK but across Europe and the broader world in general, that financing approach and engagement of leasing companies is pushing this bundled approach in terms of capital procurement and then procurement of the services is a hand-in-hand approach. It is absolutely linked.

Q118 **Chair:** You are saying it is the insurance that drives that?

Mike Hulme: It is the financing. If we take a capital procurement activity of a billion, then you may find that the services to support that equipment over 20 years may be another billion, but the important point for the actual financier is the ability to manage the risk of that product through its life cycle and therefore preserve the value of the asset for the leasing company.

Dr Torbett: With pharmaceuticals, I would say there are two broad categories. One is a set of issues that the Committee discussed with the last panel around the free movement of people, particularly very highly skilled, very highly qualified individuals, at all the stages of our value chain. We are a very global industry that needs to tap into a global talent pool, so free movement of people and mutual recognition of professional qualifications is incredibly important.

In terms of a couple of specific examples relating to pharmaceuticals, one is that we are seeing more services activity through the value chain. A lot of companies will outsource aspects of their clinical development programmes, for example. There are contract research organisations that will be organising and performing clinical trials and that will be a service to companies engaged in that, small, medium and large. Similarly, outsourced contract manufacturing is an issue.

Then finally I would say we are an innovative industry producing new things all the time. Some of the new technologies and therapies that the companies are bringing to market also involve more services. One brief example would be something like cell therapy, which is a world away from a daily pill. This involves the sort of thing where you are taking cells from a patient, sometimes transporting them across borders to a specialist lab, where a very personalised medicine is produced or some modification is made to the cell, and then that cell is transferred back across borders to the patient. That distribution chain itself is very highly specialised and technical and the services associated with absolutely making sure that the right cell is going back into the right patient are very highly specialised services. Whenever we do new things, new innovations, we have to think about the services model and manufacturing model in a different way.

George Riddell: I would like to categorise it in two different ways in how embedded services happen. The first is that services are embedded in the physical product itself, in the way that it is manufactured, in the way that it is transported, in the way that it is recycled, in the way that it is advertised, in the research and development. All of these things go into producing the physical product itself.

Another way that embedded services can happen is those that are linked to the company, and this is I think where the professional business services sector really comes in. When you are talking about legal services and accountancy services, all of these things are designed to make companies more efficient, more competitive. Consultancy services looking overseas for additional market access opportunities, all of these types of things embed a service into that company that is producing the good, versus the services being embedded in the good itself.

Chair: Thank you. That leads us neatly on to Matt Western.

Q119 **Matt Western:** Can you just expand a bit more, particularly Mr Hulme, aon what sorts of services are embedded in the production process and global supply chains and why that is so in your sector?

Mike Hulme: There are two aspects. One is processes are embedded purely within the actual manufactured goods, and then the second part is about how that asset is then maintained through its full life. For the former, digitisation is playing a huge part within the rail industry today. The level of diagnostics capability that is being installed, not just within trains but in signalling systems, track assets, stations, customer applications and so on, is the real breakthrough in technology to drive costs down in the industry. All those services associated with digitisation around rail supply and ultimately rail service are the real breakthroughs in industry today and that is where a significant amount of our R&D is being invested.

The second point is in terms of how the asset is maintained. As I said previously, the risk model for managing an asset through its 20 or 30 years is driving manufacturers to move away from just purely a manufacturing base to one of having a significant service capability to manage those risks.

Q120 **Matt Western:** You provide the leasing service as well?

Mike Hulme: We do not. We have partners. Effectively, in most commercial deals there is an owner, who is a leasing company; there is the operator, who can be the train operating company or the likes of Network Rail; and then thirdly, there is the manufacturer. It is a tripartite agreement to provide these capital services and goods and services.

Q121 **Chair:** Is that across the world, that model?

Mike Hulme: In general, yes.

Matt Western: Dr Torbett or George Riddell, do you have any comments or anything else to add on that?

Dr Torbett: Not from my side. I summarised the main issues. Trade in goods is the big priority for us, but what is quite clear, as I have seen has been submitted to you in other modes of evidence, is we are seeing more service-like activities cropping up across the value chain. It is becoming a greater trend, not less. As we think about what will make for a thriving life science sector based here in the UK that is able to trade globally, these things do go hand in hand.

Q122 **Matt Western:** We visited Glaxo in Tokyo. On the movement of skilled workers—so the opportunity for some of our very fine pharma companies setting up elsewhere and the product development and research side—how easy is it for you currently and what are your concerns about the barriers on movement of skilled workers in that sector?

Dr Torbett: As I said before, at every stage of the value chain, whether it is in discovery science or clinical development, it is very important to be able to both move colleagues within the company, working on collaborative programmes across borders, and to tap into a global talent pool to get the best in the world, whether you are hiring a geneticist or a bioinformatician or people in software development and things like that. Broadly speaking, the rules that we currently have within the European Union work well and the associated agreements that we have through that with the rest of the world provides a level of framework. I think that none of the free trade frameworks provide the same level of ease of operation that we have within the European Union today, which is why it is so important to think through how we can make sure that free movement in terms of access to type 2 intracompany visas and general visas works seamlessly and that we have an approach to mutual recognition of professional qualifications that is as inclusive as possible. It is a big priority.

Q123 **Matt Western:** Mr Riddell, I want to ask you about proximity. I do not know if you heard my question to the previous panel on that. Do you have any comments about proximity in terms of delivery of service or trading in services from your side?

George Riddell: This is one area where we do follow our clients. With the growth of global supply chains and their increasing sophistication, our clients expect a global and integrated service from us. They do not really care, if I can be blunt, if I am located in the UK or in Germany or in Australia. They want the best person for the job to do that job and they expect us to work internally in order to provide that team. We do work with colleagues around the world in order to meet those demands, whereas if they operate regionally, it is more likely that we will provide that service regionally. If they are operating globally, we provide the service globally.

Q124 **Chair:** Are time zones important for what you do?

George Riddell: Sometimes we do not sleep a lot.

Chair: Okay, full stop. Thank you.

Q125 **Faisal Rashid:** I have a question for Mr Hulme and Dr Torbett, perhaps. Normally in the production process, do you import any services, and if so, what is the value as compared with domestic services?

Mike Hulme: From a rail perspective, there is significant importing of products and services to support the products that we then either supply into the UK or export.

Q126 **Faisal Rashid:** What would be the percentage?

Mike Hulme: A typical project today would probably have 50% or 60% by value imported and that is across the train manufacturers in the UK today. Although the final assembly would be UK, if we look at the actual product supply into any of the trains built in the UK today, 50% or 60% of those trains are imported materials.

Q127 **Faisal Rashid:** What specifically are those services?

Mike Hulme: The supply of goods are from more traditional heavy manufacturing through to electronic control and then the services thereafter are to support that equipment through the ongoing life. If we look at capital projects and we take the likes of Crossrail or we, I suspect, will take HS2, then those projects are key for our international engineers and project staff to deliver. If we look at Crossrail, a heavy proportion of the Crossrail project would obviously be delivered by non-Brit services.

Q128 **Faisal Rashid:** Dr Torbett, for your sector?

Dr Torbett: Within pharmaceuticals, in general it is very highly traded—there is almost £25 billion-worth of exports and around about the same amount of imports, often in intermediate kind of activity. I am not sure that we are able to disentangle what component of it precisely is services versus manufacturing. I will certainly be happy to go away and, if we can, write to you about that. My belief from being in the sector for quite a number of years and from what we do know is that it is a very highly complex supply chain with a lot of trade in goods and services in both directions. In final products, to illustrate the point, there are 45 million packs of medicines that go from the UK to the EU every month and about 37 million that come back in the other direction at various stages in the supply chain. I would imagine that is true for all activities we are engaged in.

Q129 **Julia Lopez:** I have a similar sort of question. What proportion of the value of the goods that your company manufactures—this is for Mr Hulme and Dr Torbett—derives from services such as R&D, design, logistics and marketing? It is probably quite difficult to tell.

Mike Hulme: It is probably 30% to 40%. Again, working within a global organisation, we have various work packages at R&D that are cascaded into each of the actual countries. We have had heavy R&D work packages in the UK for electronics and also in long-term service support packages. From that has stemmed a fair amount of contracts on behalf of the train operators in the UK. Probably 30% to 40% of our turnover is driven by that type of R&D that is initiated in the UK.

Dr Torbett: Unfortunately, as with the last question, I do not have a precise figure to give you. What I can say with some reliability is that if you compare the UK to most other countries in the world, certainly including most of the EU, there will be a greater share of that that is associated with R&D simply because the UK has been one of the long-term traditional homes for researching and developing medicines from anywhere in the world, if that helps you. We spend more on R&D than any other sector in the UK economy. It is over £4 billion and probably every pound that is spent is in some way connected in some kind of international project. That includes for UK domestic companies. All R&D fits within global projects, so I would say there is a very strong R&D component to it.

Q130 **Julia Lopez:** How do you think that the UK could enhance that leadership role in life sciences after Brexit? I am particularly interested in what you were talking about in terms of the movement of cells between different countries. I recently had a blood test, for instance, where the blood went to America and got tested. Are there restrictions on how that movement can happen at the moment in our relationship with America? What opportunity is there, given that America is also a massive leader in life sciences, that we could work more closely with the United States to develop that leadership role and become a major force, which other countries would then be compelled to follow in terms of ethics and the rules that govern that sector?

Dr Torbett: You are quite right that the United States is the global leader in life sciences and has been for many years. I think that there are opportunities to explore how we can deepen our relationship with the US, including in things like conversations around regulatory issues. It is in everyone’s interest to make sure that there is a globally coherent regulatory system, which makes everything more efficient. It gives everyone a better chance of getting better medicines to patients in a quicker, more efficient way. What I would say in terms of the priorities—and it is a very strong, unanimous view from our members—is that it is certainly a priority for us to have a very clear and deep agreement with the European regulatory system as a first priority. We are very much embedded in the European regulatory system, but that is not to say there are not opportunities to explore with the United States as well.

Q131 **Mr Ranil Jayawardena:** Further to the question from Mrs Lopez, I should refer members to my entry in the Register of Members' Financial Interests. I wonder if Dr Torbett could expand a bit further on what he said. The US is the clear leader in life sciences. The UK clearly has a significant industry in this regard. What can the UK Government do to make this country a better place to undertake more of the R&D and then retain the production? Often that is what is lost, if I am not mistaken.

Dr Torbett: Indeed. There are a number of factors and I would certainly refer the Committee to the Government's life sciences programme and the Life Sciences Industrial Strategy that has been developed. The life sciences sector—meaning not just pharmaceuticals, but working collaboratively with devices, diagnostics and digital industries that are engaged in healthcare—has engaged in quite a lot of work after the referendum to reflect on exactly the question you asked: what do we need to do in order to give ourselves the best possible chance of being a world leader? That included things like making sure that we are identifying mission-oriented research where we have key themes that we can coalesce around, which are societal challenges like ageing, for example. Setting out the challenge for the industry to coalesce around and invest here and trying to create a healthy investment environment for small and large companies to collaborate with the public sector on is an important part of it.

An important part of it also of course is ensuring that we can work effectively with the National Health Service. The National Health Service is an incredible asset for the UK. We partner with the National Health Service all the time. There ought to be a real potential win-win in terms of the data generated through the National Health Service as a means of attracting companies to work here as well. It is getting all of these factors right and I think that free trade agreements can play into it in the fullness of time. If we are able to, as a first priority, establish a deal with the European Union that gives us a solid regulatory framework, if we are able to roll forward as many of the EU deals as is practical, it will make sure that we are able to continue to trade effectively here and that is important.

Q132 **Mr Ranil Jayawardena:** With respect, we are straying slightly from the question, which is what more the UK Government can do to make this country a better place to undertake R&D and retain production.

Dr Torbett: I think that those points about the sequence of trade are material to the question because there obviously is significant business uncertainty at the moment.

Q133 **Mr Ranil Jayawardena:** But this is in progress, so what more? The Government are trying to secure a deal and we can park that discussion because that is one that could take the whole of this session. What more can the Government do in the future? Let's take Brexit out of the equation. What can the Government do?

Dr Torbett: Continue to make sure we have a very strong basic science base here, continue to make sure that we are as open as possible in terms of attracting talent and continue to ensure that we are a world leader. Regulation I have already mentioned, but also intellectual property protection. It is a real challenge for us. It is the life blood of our industry. It can take 12 or 15 years to go from the lab to a patient, so it is incredibly important that we have an intellectual property regime. All of those themes are well-documented in the strategy that I have mentioned and I refer to that because I think it is quite a helpful, thoughtful document. There is not a single component of it that does not matter, if that makes sense.

Q134 **Mr Ranil Jayawardena:** I would welcome perhaps a written submission, in the interests of time, with any further ideas that you have on where the Government can build on that document from your perspective.

Dr Torbett: I am very happy to do so, yes, certainly.

Q135 **Mr Nigel Evans:** To put together the two descriptions of two of the three witnesses before saying that the handling of Brexit is a confusing omnishambles, what impact is it having on each of your sectors at this moment in time? I am referring mostly to the indecision or the inability for you to know exactly what the final outcome is going to be, whenever that is.

Mike Hulme: In terms of ongoing projects, it is all about stock and inventory in the UK, so it is preparations for a chaotic Brexit and the ability then to be able to provide services using equipment that is non UK-based equipment. That is the first comment. I think that we are reasonably prepared and I know that there have been a lot of quotes within the press about British industry making preparations and the amount of stock that has been built up over the last few months.

The second point is in terms of free flow of technical expertise to support and deliver projects. There is an open question there at the present time. How are we going to move forward and safeguard that capability in the longer term? Commercially, tariffs: if we are bidding for key projects in the UK today or any project that is going to need a flow of goods across boundaries, what assumptions do we take, because they can obviously have a reasonably significant impact on the cost base?

Those are probably the three big impacts. Given that rail tends to be quite binary in terms of major projects, we do not see the issues on a transaction-by-transaction basis on a day by day, but in the longer term that stability in terms of what the trading arrangements would be is going to be key to underpin those bidding and commercial activities.

Dr Torbett: You could probably add most of that list to the pharmaceutical industry as well. Some of these issues are very common, but the biggest issue by a very long way for us has been that from day one after the referendum we have been working incredibly hard to make sure that we are able to continue to supply medicines to patients here in the UK and also to supply medicines to patients in the EU. I have mentioned the around 40 million packs of medicines that go across borders in both directions every month. That is a very significant logistical challenge.

The companies have been working from day one after the referendum to make sure that we are in the best possible position. That means a number of things practically. It means all companies have been stockpiling to the extent they can, bearing in mind that some medicines are very short shelf life and are not able to be stockpiled. It also means transferring licences, given that we do not know what regulatory environment we are going to be in. For an individual company, that may be tens of thousands of applications, so it is a very big administrative exercise. Supply routes also: it certainly had been the case that a large majority of medicines would go through the Dover strait, so companies have been working to diversify supply routes around Europe.

Finally, with medicines, because we are rightly very highly regulated, every batch of medicine that gets produced has to be tested in an accredited laboratory. Because it has not been clear whether or not the so-called batch release testing of medicines would be acceptable in the EU, companies have also had to invest in additional duplicative batch release testing facilities in the EU. The main thing is around supply for us and obviously—

Q136 **Mr Nigel Evans:** You have done that just in case?

Dr Torbett: Absolutely. An 80% solution can sort of work for many industries, but it cannot work for medicines because there is a patient at the end of it. It has to be as close to 100% as we can possibly make it and that is what the companies have been doing.

George Riddell: There is a difference between regulated and non-regulated industries. For regulated industries, it is not a question of your trade becoming slightly more expensive either through a tariff or a customs declaration or whatever it may be. There is a question of you not being able to provide that service. The preparations we have done are in order to meet every eventuality so that we can continue to provide those services. The indecision is—

Q137 **Mr Nigel Evans:** Deloitte is everywhere anyway, isn't it?

George Riddell: We have member firms in a number of—

Mr Nigel Evans: Throughout the whole of the EU, so you do not have an issue as far as that, but perhaps some of the companies you represent within the UK you might have a problem with.

George Riddell: The indecision is definitely impacting them in terms of investment decisions, hiring decisions, all of those types of things. There is a stockpiling issue because what you stockpile in March may not necessarily be what you stockpile in October. That said, a number of our clients are also looking at Brexit and all the preparations they have done as an opportunity. They have done a huge amount of work to understand their businesses, to understand their vulnerabilities, to understand how they trade. For many UK companies, they had not done that for a serious number of years and there are things that they can do to improve, so that where they do have that ability they are taking those types of actions.

Q138 **Mr Nigel Evans:** Very rarely do we hear anybody talking about the opportunities from Brexit, so well done on that.

Looking back to the differentiation between services and manufactured goods, the statistic normally thrown around is that four fifths of our economy is service and 20% is manufactured goods. Is that roughly the same, do you think, for the sectors that you are looking at—and the number of firms that you operate with, George—and do you think that it is right therefore that we focus on the service sector far more as where the future is going and that we should be less worried about the manufactured goods bit?

Mike Hulme: In terms of any supply that is on the back of a manufactured piece of equipment, the risk in removing the build capability from the region is that the expertise to support within a service life environment is decreased significantly. There is a big skills point. If we just purely focus on service, are there the required skills in that region to be able to deliver that service in the longer term?

Q139 **Mr Nigel Evans:** On things like Dyson, for instance, it can manufacture in Malaysia and Poland and goodness knows where, but a lot of the R&D is done in the UK. Do you think that there is a risk that that could be shifted as well?

Mike Hulme: I think that it boils down to standards. If you have global standards it may not be too much of an issue, but where you have specifics—and I suppose rail is the most standardised industry that one could think of—clearly local presence is important.

Dr Torbett: My comment would be that I suppose there is a risk that sometimes we organise the policy thinking according to how we organise the statistics. Given that we have these sector classifications, sometimes it is a bit unhelpful. In a way, the statistic that you mentioned around the proportion of trade in services may well be an underestimate because the £25 billion of exports from pharmaceuticals will probably be classified as trade in goods, but there is a really important component of that supply chain, that value chain, that will be services activity. It might be helpful to think in terms of activity rather than sectors as such.

What I would say is that if the UK is able to identify and articulate what the key strategic sectors are that we need to be supporting, there needs to be a proper, deep dialogue about how those sectors work to understand the practicalities of how the business works. Inevitably, that is going to be a mix of what looks like traditional goods trade issues and services issues. That is what I would say, rather than polarise it, trade versus services; it is always going to be a little bit of both and that is why we need to have a good dialogue with the Government.

George Riddell: I completely agree with Dr Torbett. Those statistics are very questionable. I know this is something that the Committee has looked at before. That 80% of the UK economy is services is true. Once you take out Government-provided services you are at about 65%, so the majority of the economy is still service-based. Something that we have been very vocal to the Government about is that services need to be included as part of any discussion with the European Union. Just looking at goods alone does no favours to the UK economy.

We have to be looking at both together because distinguishing between the two is becoming increasingly difficult, particularly when you start looking at things like digital transformation, e-commerce, all of these types of things that are developing at quite a rapid rate and changing the way we trade. Some of the goods that we currently trade will not be traded in the future, things that we do not trade now will be traded in the future, so just sticking to a goods-only mindset certainly is not helpful.

Q140 **Chair:** Again following on from Nigel's first question, as I did with the last panel, I have a neutral question. For your organisations and what you generally do, do you find Brexit to be a help, a hindrance or an indifference to your day-to-day or to going forward?

Mike Hulme: Rail, because of its binary nature, tends not to be a significant activity on a day by day basis, the actual transfer between boundaries. It is fairly neutral, albeit there are some hot topics. We have touched base on the hot topics before in terms of skills in particular, and then there are some tactical points regarding inventory and ability to move goods. It is reasonably neutral, but there are hot topics to address.

Q141 **Chair:** More of an indifference than a help or a hindrance?

Mike Hulme: I would probably say it is more of a hindrance, but it—

Chair: A small hindrance?

Mike Hulme: Yes.

Mr Nigel Evans: Nobody is indifferent to Brexit.

Q142 **Chair:** In pharmaceuticals?

Dr Torbett: I will use slightly more than one word, if I may, Chair. I would say the pharmaceutical industry has always been respectful of where the democratic process has led us. What matters the most to us beyond anything else is making sure we are able to continue to supply medicines to patients. That has clearly been a huge amount of work and a challenge, but we will do that to the best of our ability. Moving forward, we will be looking at opportunities as well as some of the challenges once we get through wherever we get to in finalising a relationship with the European Union in terms of how we move forward.

Q143 **Chair:** I could challenge further, but I do not think I will get an answer: has the democratic process led to a help, a hindrance or an indifference? I think that would be skirted around, am I right?

Dr Torbett: There is a risk we might.

George Riddell: I sit in Deloitte's central Brexit team, so for me and the clients that I talk to Brexit is certainly a huge part of our job. The challenges are many and it depends on the client that you are talking about. Each company is different; each sector is different.

Q144 **Mr Nigel Evans:** What did you do before Brexit?

George Riddell: I was working for the Foreign and Commonwealth Office representing the UK at the WTO.

Mr Nigel Evans: Very good.

George Riddell: Certainly in terms of Brexit, it is very much something that we deal with daily. That said, these are not the only trade challenges that companies are facing. You have the US-China trade tensions. You have the escalating tensions between the US and the EU. You have India and several legal reforms that they are making. These are challenging times for many companies and dealing with the potential disruption of Brexit is one, but it is not the only one.

Q145 **Chair:** Would it be more of a help, a hindrance or more of an indifference?

George Riddell: Pass.

Q146 **Chair:** It is still interesting that at this stage people do not like the discussion on Brexit. Can I move on to ask if there are barriers on trade in goods with a third country and customs duties and checks at the borders? What impact might those sorts of checks have on domestic service suppliers? What are people going to be coming up against?

George Riddell: Transport services. A lot of people think about the truck itself crossing the border, but you also have the driver crossing the border, driving licences, driving permits, safety standards, all of these types of things. They are services and they impact the physical goods trade. That is something that is very much at the forefront of our minds.

Dr Torbett: Would you mind clarifying your question? It was specifically in relation to the customs union I think I heard you say.

Chair: If you have customs duties and checks at borders, what impact might that have on domestic service suppliers?

Dr Torbett: I have to say that any delays at borders have very immediate implications for us in terms of ability to transport medicines. That is by far and away the most important thing. Services will certainly come into it and as I mentioned previously, for example, some clinical trial work will be through a service provided by a contract research organisation. Clinical trial medicines that trade across borders are often delivered just in time. Delays at borders obviously will cause problems there and there may be other implications as well.

Q147 **Chair:** If we look forward to beyond what we can see on the immediate horizon, in future trade agreements are there ways of writing them? Are there ways of constructing them that will better respond to the interplay between goods and services and that, given the global trade flows that happen at the moment, would help those trade flows move more freely?

George Riddell: I think that there are a couple of different elements that you can bring into those future FTA discussions, the first being when the UK is designing its priorities not to have one team looking at goods priorities and one team looking at services priorities. You do have to put them together and in the case of life sciences, think about it as a whole industry or a sector and decide what sort of market access you are looking for, both for life sciences goods and services or whatever the other example may be.

The second is around digital. We are seeing digital trade provisions being developed in FTAs. They are still in quite early development, I would say, but a good supporting environment for digital trade will help enable trade in a lot of other services.

Dr Torbett: I have to reiterate that the first priority from our sector is by far and away sorting out the relationship with the European Union from a regulatory point of view. That will help trade in services as well as goods because 45% of our trade is with the European Union, which is by a long way the most important region for us.

Beyond that, if we get to a point where we are doing trade deals, then doing as much as possible to ensure free movement of highly skilled people and as open as possible an approach to mutual recognition of professional qualifications is incredibly important. There are some useful precedents in some trade agreements for facilitating that, but I think we need to look at that carefully and build on it. Beyond that, in order to get it right, I would just reiterate that there needs to be a deep dialogue with the key sectors where trade is very complicated. To get the right text in trade agreements, it has to be well-informed by how that interplay between services and product trade works.

Q148 **Chair:** Just on that point, if there are restrictions in the international trade in services, how does that affect manufacturing? Have you any particular examples? If services are restricted, how does it interplay then with manufacturing?

Dr Torbett: The simplest answer would be where manufacturing is outsourced. There will be contract manufacturing organisations. Firms of all sizes—but particularly critical for small companies, as they are growing—may outsource a part of their manufacturing process to a service provider. If there are restrictions on services there, it will be a problem. Even if you are a manufacturing organisation within the UK and let's say you buy a piece of equipment from another country, the services rules could have an impact on whether or not you can get a service engineer to go from one country to another to fix whatever issue you have with your piece of equipment. It is always very intertwined and that is why sector by sector we need to have a sophisticated understanding of not just what is happening today but what the trends are in future. There are future innovations, future ways of doing business and future products, all of which will present new challenges and opportunities for trade.

Chair: Thank you. Mike Hulme, any thoughts?

Mike Hulme: Yes. Richard has talked through the key logistics points. The only other point I would say is in terms of standards. The UK and Europe have driven global standards in rail. What will be difficult is if we had a drift away from the commonality of standards today for convenience to the UK domestic market, which would then give difficulty in terms of export longer term. I think that standards is an important point to ensure that we do not see a drift.

George Riddell: Can I add some details to one of the examples, which was around a piece of sophisticated machinery where you need to import a service provider in order to repair it, for example? If we are just talking about the services barriers to that, first is whether a particular type of company needs to provide that service for safety reasons or whatever it may be. Then when you are importing the service provider, can they enter the country? Then even if they can enter the country, does the local jurisdiction recognise their professional qualification? It is not just about getting the right person in the right place; there are a lot of other complexities that can come with even a simple example like that.

Q149 **Chair:** That is fascinating, thank you. I have a final point that I want to clear up and probably one of you on the panel could do this. There are two terms that have been hanging about in my head. They are servicification and servitisation. Can somebody give me a brief on that jargon and what it might mean? George, you are looking the most likely candidate in the headlights to attempt to do something there, or would you rather get out of the headlights?

Dr Torbett: Can I just offer one example?

Chair: Yes.

Dr Torbett: My understanding of those terms is that it is there to describe how traditional manufacturing industries have been engaged in more service-like activity. For example, there are plenty of circumstances where pharmaceutical companies would be engaged not just in producing a medicine but in potentially the delivery of homecare services, for example, so that the patient can receive a certain treatment in the home rather than a costly hospital setting. Sometimes that is attractive for both the patient and the NHS to have a pharmaceutical company provide that service alongside the manufactured good. That is my understanding of how those terms are used.

Mike Hulme: Slightly different: servitisation is about the process, I understand, of a traditional manufacturer growing a service business to support their products in the after-sales life of the product itself. Then servicification, as I understand it—I may be wrong—is where the original designer has thought digital and then started thinking how to embed digital capability within that original equipment to make it more serviceable. You can think about your BMW. You take your car to the local dealership to have it serviced, so that is servitisation. Servicification is where BMW has put apps within the actual driver management system to give indications in terms of next service and service alarms et cetera. That is my definition.

Chair: That will certainly do for this panel for this morning. Thank you very much. I thank all three of you and I thank you for the help with the jargon there. It is interesting and important. Thank you for your time—it has been very useful this morning—and for your thoughts on Brexit as well.