European Affairs Committee

Corrected oral evidence: UK-EU financial services

Tuesday 15 March 2022

4 pm

Watch the meeting

Members present: The Earl of Kinnoull (The Chair); Baroness Couttie; Lord Faulkner of Worcester; Lord Hannay of Chiswick; Lord Jay of Ewelme; Lord Lamont of Lerwick; Lord Liddle; Lord Purvis of Tweed; Baroness Scott of Needham Market; Viscount Trenchard; Lord Tugendhat; Lord Wood of Anfield.

Evidence Session No. 1 Heard in Public Questions 37 - 49

Witnesses

I: Peter Bevan, Partner, Linklaters; Caroline Dawson, Partner, Clifford Chance; Andrew Pilgrim, UK Government and Financial Services Leader, EY.

Examination of Witnesses

Peter Bevan, Caroline Dawson and Andrew Pilgrim.

The Chair: Welcome to the hybrid House of Lords and the European Affairs Committee. We are doing an inquiry into the future of trade in financial services with the European Union; this is the third evidence session of that inquiry.

Thank you very much indeed to the three of you for coming along this afternoon. We have Andrew Pilgrim from EY, Caroline Dawson from Clifford Chance and Peter Bevan from Linklaters. We are grateful for you coming along this afternoon to what I hope will be a very interesting session of 90 minutes or so.

When you speak for the first time, I would be grateful if you could give a brief background on yourself. We know exactly who you are but the watching public will not, and that would help them. I should say that, as a public evidence session, a transcript will be taken. We will send you the transcript and we would be grateful if you could check it, because we will be using it as the basis of our report going forward.

There is quite a bit to get through so I would appeal that both questions and answers are kept relatively crisp so that we can get through everything. Lord Wood is going to open the questioning.

Q37 **Lord Wood of Anfield:** Thanks very much for coming. We have heard a bit about the UK financial services sector's view of the emerging relationship with the EU, but I wanted to ask you about how the financial services community outside the UK is viewing it. It is early days and everything is still taking shape, but I will start by asking Caroline about the mood of the EU financial services community. How they regard the emerging relationship is a big question but can you perhaps, as a very unfair general question to start with, give a sense of how you interpret the mood of the EU financial services industry?

Caroline Dawson: I am a partner in the Financial Regulatory Group at Clifford Chance in London. I have been a partner for three or four years, and have been at Clifford Chance for about 15 years. Brexit has been a huge part of my career as a financial regulatory lawyer.

As you say, it is a massive generalisation so I will try to break it down a little. It probably depends very much on whether you are talking to the regulators in the European Union or to market participants. Within that very broad brush of market participants, there are quite a lot of subcategories as well. If we look first at the regulators, the primary concern there is probably about cross-border business and their ability to continue to supervise it adequately.

Their key concern is that there is quite a lot of latitude at the moment in terms of cross-border business between the UK and the EU. They are concerned about loopholes there. The primary driving criterion that they always have when they are looking at cross-border financial services is making sure that they do not create loopholes or unlevel playing fields for their own market participants, but also for people receiving services in the EU.

Looking at the financial services industry in the EU, its key concern is going to be market access. So far, the majority of the restrictions on market access are probably from the European side. The UK has remained fairly open, although obviously we have this ongoing review of our overseas framework, which has caused a little concern. The key things have been continuing access to UK CCPs, the continuing ability for the asset management industry to delegate to UK asset managers and advisers, and that continuing openness. That has probably been the primary framework within which the European financial services industry is looking at that relationship.

Lord Wood of Anfield: You mentioned this concern about the overseas framework. Is there also a concern about the process of re-examining which parts of the acquis we are going to retain and which parts we are going to have domestic legislation reverse or amend?

Caroline Dawson: Yes, there is. At the moment, that is a massive question because it is such an enormous part of our financial services framework. Rather than a concern about which bits we are going to retain and which bits we are not, the primary concern at the moment is around the process for that and making sure that, to the extent possible, there is transparency around what changes are made. For example, is it a genuine change in substance and policy or purely a format change, in that the relevant rules go from being in onshored European regulation to being in regulatory rulebooks? That is clearly going to involve a change in format but, I hope, not a change in policy.

The other big concern is that that change would happen in a death by a thousand cuts over multiple years, which then means that the financial services industry is in a constant stage of implementation, which clearly has costs and other implications.

Lord Wood of Anfield: Peter or Andrew, do you have any thoughts on the sector’s reaction so far to the changing shape?

Peter Bevan: I am from Linklaters, where I have been a partner for nearly 20 years, advising market infrastructure and asset managers. In addition, I have been working with the global investment banks.

The experience we had working with those clients through the Brexit process was that they were most concerned to ensure continuity of service to their customers and clients, and to ensure that, whatever legal settlement arrived, they remained able to serve their clients and customers in the UK and in the EU on a continuous basis, rather than finding that that came to an end.

They had previously done that through establishing a hub in the UK to access the single market, which of course was no longer was possible, and so it has been necessary for many of them to establish an additional hub in the EU single market in order to access that market while maintaining a hub here in the UK.

I agree with Caroline’s comments, but would add that one of the concerns they have is not to duplicate costs through maintaining two hubs where one would do. There is a great deal of concern that regulators, both here and in the EU, would want to see the same roles performed in both locations through the maintenance of the necessary substance within those locations, for obvious reasons of the safety and soundness of those institutions. That can result in a duplication of capabilities and cost. That is an additional concern I would mention.

Andrew Pilgrim: I am from EY. I run our government and financial services team and looked after a lot of our Brexit response over the past six years.

I would agree with all of what we have just heard and would add a couple of things. On the equivalence point, it is interesting to look at it from an EU-to-UK perspective, because those equivalence determinations have not been granted by the EU. That not only impacts UK firms looking to get market access in the EU; it can also make business more expensive for EU firms to do if they are trying to access EU markets, because they are required to hold greater capital in some instances.

In terms of mood, we have heard a lot from the European Union around strategic autonomy—this idea that they need to have their own capabilities against a breadth of financial services. For some of it, they want the infrastructure themselves. For some of it, they want to ensure that they just have leverage in terms of global fora where these regulatory issues are discussed. We will certainly see that play out more and more over the next few years.

The Chair: Thank you very much. We will come on to equivalence, of course, in some detail later in the question set.

Q38 **Lord Tugendhat:** What do you think your clients see as the primary opportunities for a post-Brexit world? We have heard a lot about the disadvantages of a post-Brexit world so I would like, if I may, to ask you where you see the primary opportunities. By that, I mean different sectors and different parts of the world. What do you see as the Government’s role in supporting the pursuit of these opportunities?

Caroline Dawson: There are two main types of opportunity that I would flag. The first one would be in terms of new types of business. Here, I am thinking about opportunities that we have as opposed to the approach that would have been taken if we were still within the EU. The EU’s approach to new types of business and new products is very much to get in as soon as possible and aim to be the global benchmark for regulation. It aims to set a gold standard-plus-plus-plus in regulation and then restrict the ability that people have to do cross-border business in relation to those products or activities by, for example, setting equivalence regimes.

One key opportunity that we potentially have outside of the EU is more flexibility around regulation of new areas of business and new products, with, I hope, a slightly more outward-looking approach to regulating new business. Instead of thinking, "What are the risks and how do we prevent people bringing those risks from other countries onshore into the EU?", the UK's traditional approach to regulation has been more like, "This is an opportunity for us to export this business globally and regulate with that approach in mind". That was the first, which is new business.

The other big opportunity that we have is about openness to cross-border business and global markets, and that key philosophy that has made the UK one of the major financial centres globally, which is that openness to other business. The ability for UK firms to do cross-border business and for non-UK firms to deal with UK clients is in danger, in the EU, of being restricted, because they have this fortress Europe approach. The second key opportunity that I wanted to flag is that we do not have a fortress UK approach, but a global financial centre approach and an openness approach. We have the ability outside of the EU to maintain that better than we would have been able to within the EU.

Peter Bevan: I very much agree that it gives us the opportunity to regulate differently and regulate better in a way that is more targeted towards the business that we are able to succeed at here. I guess I would pick out two examples of that.

One is the already market-leading wholesale markets business that we have across the country, but especially here in the City of London, where the wholesale markets ecosystem and the related professional services that go with it is a leading global player. It has struggled sometimes to fit with the straitjacket of regulations made on a basis that covered 28 markets, not all of which looked alike, and so the ability to make targeted reforms that can support the continued growth of that business is something that we would welcome and where the Treasury has already begun to do some work.

Secondly, with the incredible importance of transforming our economy to a more sustainable one in future, the use of the financial sector to drive that transformation is clearly critical. The regulation of sustainable finance is something where the EU has gone way out in front, doing exactly what Caroline just described in setting a very high standard of regulation, but one that is not always easy to follow or apply in practice. There is an opportunity for the UK to take a different approach, which is based on the ability to trust the communications that you are receiving and to know that the money that is being invested towards sustainable use is being put to that use through appropriate, fair, clear and not misleading disclaimers, using traditional English common law standards, rather than the more civil law approach that the EU has tended to adopt. Those are two examples that I would give of where more could be done.

Andrew Pilgrim: At a high level, those themes of fast innovation and tailoring are absolutely going to be key for the UK in terms of sitting outside the EU. The ability to not have to compromise with 27 other

Member States but to target regulation specifically to our own needs, and to do it faster than might be possible within EU frameworks, is something that we need to capitalise on.

Lord Tugendhat: When you look at various subsets, emerging markets, green finance, fintech and things of that sort, is there any particular area in which you think London, or at least the UK, might have a first mover advantage?

Andrew Pilgrim: Within fintech, the UK is incredibly well placed, given some of the technology companies here but also the associated financial, legal and other related service companies that sit around that ecosystem. Many of the international benchmarks put the UK in a fundamentally good place in that regard, and we have to champion that.

The green agenda is a priority for a number of jurisdictions globally. We have seen the EU take an early lead, particularly in terms of taxonomy that it is using, for example, and it will be important for the UK to show that it is equally prioritising this very important issue but also thinking a little further ahead.

Lord Hannay of Chiswick: Can I pick up on something that you said, Caroline, about being better able outside to avoid a closed approach and to have a more open one? That, presumably, remains a bit to be seen, but how much will we have lost by not being able, as a member, to influence the European Union's regulatory approach to be a more open rather than a more closed one? How much influence have we lost in the future? I am talking not about what has happened—what has happened has happened—but about how much we are losing by not being able to influence directly the shape of European legislation.

Caroline Dawson: In terms of openness, there are a few Member States for which being open to the outside world is a fundamental tenet of their regulatory philosophy, in the same way that it is for the UK. Unfortunately, it is primarily a coalition of the smaller Member States that have that approach: Ireland, Benelux and the Scandinavian jurisdictions. Germany is a notable exception there, in that it has a very flexible cross-border regime and will hopefully be a loud voice in the European Union for the continued ability of non-EU firms to deal with local clients.

The UK has, individually, lost a huge amount from not being able to influence that debate, because we do have what was the biggest financial centre in Europe. We have, aside from Ireland, the most open and flexible cross-border regime. In terms of advocacy, it is a much more persuasive argument, if you are within the EU, to say, "We should be open to the outside world", than being right on its doorstep and saying, "You should be open to the outside world". Clearly, it is a very different argument. In terms of cross-border business, that is clearly a lost opportunity for influence.

Aside from that, the EU is in a very similar position to the UK in terms of where the inspiration for its financial regulation comes from. Increasingly, a lot of financial regulation stems from international standards, which is where the UK's continued participation in those international standard-setting bodies is going to be tremendously important for our ability to continue to influence how those international standards are set, what they are set at and, through that, how that is implemented in the EU. In terms of the detail of how these things are implemented in the EU, the EU tends to go belt and braces, so it will take the fullest and maximalist approach to implementation. We are no longer in a position to influence that.

The Chair: We are going to return to this area later in the question set.

Lord Purvis of Tweed: I have a quick follow-up to a comment that Peter Bevan made with regard to one of the potential advantages of moving away from a highly regulated to a more trust-based system of common law communication. From a consumer and reputation point of view, in moving towards more of a trust base, given that people are still impacted by the financial crash from the UK, and more recently with regard to the world seeing oligarchs and kleptocrats gaming UK financial services, legal services and enablers, I was just wondering whether that trust is as strong as we think it might be in its ability to be a net positive for the City of London.

Peter Bevan: It is true that trust must be earned by demonstrating yourself to be trustworthy, that is for sure. I certainly was not meaning to advocate for lower standards of regulation. If you think of the way in which we deal with prospectus disclosures for companies raising capital here in the UK markets, the standards of the premium listing regime in the UK go beyond what would be required of the standards set at an EU level. That tougher level of regulation gives you a greater degree of trust in the companies in which you are investing, because of that greater degree of transparency, and that creates a more vibrant and attractive market.

For the market to work, you need not only people who want to raise capital but people with capital to invest. That higher standard of disclosure and the greater trust that you can have in that system contributes towards that and grows the market. It is not necessarily the case that you might assume that a lower standard of regulation creates more activity while increasing risk. The right kind of regulation can increase activity and reduce risk at the same time, and that is the sort of thing that I was aiming at doing.

Similarly, in the area of sustainable finance, a high standard of disclosure and transparency would be consistent with that kind of prospectus approach, without the need to adopt a civil law type of approach that forces you into certain straitjackets, where you must disclose that you are one of these kinds of investment and you can do only certain limited types of activity and not others. That can be a straitjacket on business growth. That is the kind of distinction that I would like to see.

Q39 **Lord Jay of Ewelme:** I want to look forward a little bit. I wondered whether you or, indeed, your clients had a view on what was the best long-term strategy, at least as far as the UK is concerned, for the shape of UK-EU financial services looking ahead. As a subset of that, is it important, in your view, that both sides—the UK and the EU—derive some mutual benefit from this? Can one side win without the other winning too? How compatible is that with what you, Peter Bevan, were talking about a little earlier: the EU's views on strategic autonomy? Perhaps you could go first.

Peter Bevan: First of all, the financial services sector does not exist exclusively for its own benefit but to facilitate growth in the economy at large. A strong and vibrant financial services sector should, in principle, be serving the economy as a whole, and so it is not a zero-sum game in terms of where things work.

I agree with the other comments that have been made that the right strategy for the UK is to maintain an open market. You ask whether that needs to be of benefit to both sides. It would be a mistake for the UK to take the view that, because the EU is building a fortress that is very difficult to enter from outside, we should do the same to give ourselves a bargaining chip and say, "Well, we'll take our wall down now if you take yours down", because the building of that wall would inhibit the very kind of global financial centre that the UK has become so well known for and so successful at.

If it becomes difficult for parties outside of the UK to do business here, that immediately shrinks the amount of activity that takes place here in the UK. As a smaller centre, it naturally becomes less attractive for that international activity to come to as well. Building up those barriers would be a mistake, so it is the right approach for the UK to keep those barriers to entry low, appropriately protecting consumers in the way that the UK's current regime does. It allows very open wholesale markets with appropriate protection for consumer markets, which seems to me a sensible balance. Maintaining that balance, even if there is no reciprocity on the side of the EU, will in itself be good for the growth of the UK system.

Lord Jay of Ewelme: When you say "even if there is no reciprocity", can one envisage there being no reciprocity? Will there not always be some sort of reciprocity in some areas?

Peter Bevan: For the time being, the EU is a collection of Member States, each of which takes its own individual approach as to how open it wants its market to be to cross-border activity. I used to think that you could roughly say, for each European country, the better the cuisine, the worse the regulation. You can form your own view on which is which, but some tend to be much more protectionist and restrictive than others. There is a drive on the EU side to introduce more uniformity on that, as in so many other areas, and that uniformity is liable to be a levelling up of restrictions rather than down in the current direction of travel.

Caroline Dawson: I completely endorse everything that Peter has just said. I absolutely agree that, as Europe develops more of a fortress, we should not react to that by developing our own fortress. Europe is in a very different position to us in terms of developing financial markets and balancing the very different interests and regulatory philosophies of all the Member States. We already have an open, global financial centre. It has grown to be a global financial centre through openness, and we are not going to grow it further by shutting it down, particularly if the reason for shutting it down is purely to try to score points against one other potential trading counterparty. That just seems counterproductive.

On your point about reciprocity, when we talk about reciprocity in the sense of cross-border business, we are thinking slightly more technically about the fact that certain equivalence decisions occasionally bake in reciprocity—that is, "You can get access to our markets only if you provide exactly identical access to yours".

That is fine if you are looking at it purely in the context of the UK and the EU, but we have GATT commitments and trade commitments. We have trading partnerships with the rest of the world. You cannot build a global financial centre purely based on the relationship that you have with one trading counterparty. Lord Tugendhat mentioned emerging markets earlier, which are a classic area where you are not going to have reciprocity, because their financial system is so completely different from ours, as are the economic drivers. Reciprocity is not the way forward.

Lord Jay of Ewelme: Andrew Pilgrim, do you have any points to add to that or disagree with?

Andrew Pilgrim: Openness is key. International standards are incredibly important for us to be leading on the setting of. We have probably focused outside of Europe, but we need to focus on Europe too. There needs to be a balance there, so we should not necessarily be prioritising one jurisdiction over the other in terms of different relationships.

The final point that I would make on openness is not directly on financial services, but on immigration. The ability to bring people in from all over the world to experience what we do in London and the wider UK, so that they can have a positive experience of the connections and networking impact that that has when they go to other jurisdictions, is absolutely key. We need to continue to focus on it.

Lord Hannay of Chiswick: I just want to follow up on Lord Jay's point about reciprocity. Your united view was very clear for openness and not for a reciprocity approach. Do you think that the Government's trade negotiators, who will be negotiating a wide range of trade agreements in some of which financial services will figure, understand this, or are they classical trade negotiators brought up on the mother's milk of reciprocity?

Caroline Dawson: That is an excellent question. We are developing in this sphere of trade negotiation. We have had 40 years of all of our trade negotiation being done by the EU. This is purely from public figures and newspaper reports, but I understand that we did not have a huge capacity in terms of trade negotiators. Law firms such as mine were called on to support with some of the early trade negotiations, just to try to get some of that experience in.

I do not have any direct personal experience of the approach that the trade negotiators are taking, but the trade lawyers within my firm who have been helping the Government on some of these things have quite wide international experience and have my team to talk to in terms of financial services specifically. I would hope that that is either understood now or will be part of people's developing understanding as we move forward with trade negotiations.

Q40 **Baroness Couttie:** In the TCA, there was a declaration that committed the UK and the EU to agree to establish structured regulatory co-operation on financial services. There was an MoU where I understand the text has been agreed in principle but not formally. That was supposed to take place at the end of March last year, so a year ago, and it still has not happened. Can you tell me what impact the lack of this regulatory framework is having on your clients, in both the UK and the EU?

Andrew Pilgrim: It is fair to say that the MoU has been such a long time coming that many have now almost forgotten about it. There was great hope, when the TCA draft text was released on Christmas Eve, that this would all be signed and sealed by March 2021 but, clearly, that has not happened. To an extent, the world has moved on.

There is an important foundational element to what the MoU might do that is important to understand, which is that it is not guaranteeing equivalence or a greater degree of cross-border market access. It is a framework to allow, in essence, the Treasury and the Commission to discuss their respective financial services industries and to look at ways in which the two might work together. Even if the MoU is ratified, it does not necessarily mean that there is going to be a significant shift in the relationship, albeit everyone would say that it was a good thing that there was a formal mechanism for communication, even if some of that communication can happen informally.

The other important thing to note is that there is a huge network of MoUs in place between UK authorities and their European counterparts. While that MoU is not in place at a more political level, there is almost a clean sweep of them from a regulatory and supervisory perspective, so that is helpful from an ongoing financial services perspective even if it does not provide that framework for a slightly deeper relationship between the two jurisdictions.

Caroline Dawson: I agree with all of that. From my clients' perspective, their relationships are with their direct supervisors and regulators. As Andrew mentioned, there are MoUs in place between the UK regulators and between individual Member-State regulators. Those are the MoUs that probably have the most direct impact on my clients' business. As Andrew said, the broader MoU would be helpful in getting that relationship back on a more structured footing, but may be less relevant in terms of direct impact on their business.

Peter Bevan: I agree with everything that has been said. My understanding is that, at those regulator levels, those cross-border dialogues are happening on a reasonably continuous basis between the UK regulators and their EU opposite numbers.

Baroness Couttie: What I am hearing is that it is not a particularly significant step now, that people have got used to the way things are and are working with it, and that, if the MoU was signed, it would be a good thing but it is not going to make a significant difference to your clients.

Peter Bevan: That would be my conclusion.

The Chair: Do lists of these bilateral MoUs exist within your firms?

Caroline Dawson: I think they are on a website somewhere.

The Chair: I am sorry to ask but would it be possible for you to forward those on? We would be very interested in them and it would save us a lot of time, as you probably know where they are and we do not.

Caroline Dawson: Yes, of course.

Lord Purvis of Tweed: My question has been answered. I was going to ask you to characterise the relationship in the absence of this MoU, but it may be no different, given what you have just said to Baroness Couttie. How would you characterise the current relationship between the regulators?

Caroline Dawson: Between individual regulators, the relationship is reasonably strong. Based on these MoUs and on the traditional relationship that the regulators have had, the FCA is used to speaking to the AMF, to the BaFin and to the ESAs at an EU level.

Where the relationship is more distant is at a legislative level. The relationship between the UK and the EU is much more at arm's length. I hesitate to say "suspicious" but if you look at the wording of a lot of the equivalence decisions, for example the recitals for the CCP equivalence decision, there is a lot of talk about the uncertainty around the UK regime, and the fact that it is open to change and that the UK could withdraw its own equivalence decisions at a moment's notice. They are unsettled by the fact that the UK is proposing to make fairly sweeping changes, at least to the structure of its financial services, although whether or not to the policy is still to be determined.

Lord Purvis of Tweed: Would you say that the MoU is more important for government relations rather than necessarily for regulatory relations?

Caroline Dawson: That is right. The purpose of the MoU is also more at a government level.

Andrew Pilgrim: I echo all of that. The supervisory relationships are not going to be as deep as they were when the UK was a Member State. For example, there is no UK representative at the European supervisory authority forums—EBA, EIOPA and ESMA—where a lot of that supervisory discussion happens. In terms of international norms, the MoUs that the UK does have on a supervisory basis are exactly the practice that is used globally and appear to work well.

Peter Bevan: I also agree with that. The things that the regulators are trying to achieve in the two markets are remarkably similar: consumer protection, cleanliness of markets, reduction in financial crime and the safety and soundness of financial institutions. These are things that are pretty common on both sides, which makes the relationship a lot easier.

Q41 **Lord Liddle:** In the House of Lords, we sat through many hours of the EU (Withdrawal Agreement) Bill going through. The Government said that they were embedding EU law in our law, except where we chose to change it, and that we would no longer be subject to the jurisdiction of the ECJ in terms of any changes that we wanted to make. In financial services, how has this worked out in practice? Have you seen a difference in how the UK has implemented the retained EU regulations so far? Do you think that the Government are or should be going further than they have so far?

Peter Bevan: There was overwhelming welcome for the idea that the body of EU law should be retained as is at the point of departure, because there was quite enough upheaval and change going on already without having to deal with an extraordinary amount of regulatory change. Such a huge proportion of the regulation in the area of financial services has been inherited from EU rules; it impinges on almost everything. The fact that we started from that point is a positive and has been welcomed.

Since then, we have seen quite a mix of approach as to whether to remain consistent with the EU, to make small-scale changes or to make larger-scale changes in different areas. For example, the EU has introduced new rules in a number of areas that we have not followed in the UK. Some are related to discipline in the settlement of securities transactions, where a whole new body of rules has been introduced on the EU side but not followed here.

In other areas, we have followed very closely. For instance, in the area of the prudential supervision of investment firms, new rules have come in in the EU, and we have new rules in the UK that are strikingly similar.

Others have been in the middle. For instance, in the area of wholesale market regulation, under the EU’s MiFID regime, the EU introduced what it called a quick fix of some changes and the UK followed suit with a quicker fix, which was making similar although not exactly the same changes.

There has been a bit of a mix, and it is only really now that we are beginning to see more purposive changes where we will look at the body of law that we have inherited and make changes to that. The two biggest examples of that to emerge so far in terms of adapting the UK's approach are, first, in the insurance sector, related to a set of rules called Solvency II, and secondly, as I have already mentioned, in the wholesale markets, where the Treasury is consulting on a number of changes. Those will be the first bigger steps by the UK that will depart from what we inherited.

Lord Liddle: So you do not think that, so far, this divergence has been of great practical significance. Is that the message of that? Could it be so in the future?

Peter Bevan: I am sure that it will be in the future, and it will take some time to move from where we are to a future settlement. I would like to see that happen through deliberate policy choices and through consultation with appropriate stakeholders, case by case, rather than embarking on a grand project to rewrite the entire body of law just for the sake of it.

Lord Liddle: Do the others agree with that?

Caroline Dawson: Yes, I absolutely agree with Peter that consistency initially was key. No one was keen to see the general upheaval of Brexit and, on top of that, have to have a wholesale implementation project. In terms of the divergences that we have seen so far, Peter mentioned the investment firms prudential regime and the fact that it is strikingly similar to the similar regime in the EU. That is primarily because the UK was the primary author of that EU regime, so when we are outside of the EU we want to implement something similar. You are not going to draft it from scratch again. They used the same playbook.

One key thing that we have at the moment is that, because of that inherited European acquis, our current financial regulatory rulebook is all over the place. We have regulatory rules, primary legislation, secondary legislation, secondary legislation inherited from the EU and secondary legislation with the force of primary legislation, so the ability for the regulators to waive parts of their rulebook that they have traditionally been able to waive is limited. The ability for the regulators to change their rules is limited. The ability for secondary legislation to be amended is limited. There is a lot of work that needs to be done, and it is impossible to find anything at the moment.

Lord Liddle: When he came to give evidence to us last week, Jon Cunliffe said that the Bank wanted to look at how things could be less prescriptive in legislation and more flexible in regulation, as it were. Do you think that is a desirable development?

Caroline Dawson: It is consistent with the UK's traditional approach to financial services, which is having a framework piece of legislation and then delegating powers to the regulators, with appropriate safeguards, so that the regulators, which have the day-to-day supervisory experience and the in-depth knowledge of the financial markets, are the ones writing the rules rather than taking up parliamentary time. That makes a lot of sense and I agree that that seems like a sensible way forward.

Andrew Pilgrim: There is a balance going on here between the need to innovate and tailor regulation in the UK, and just moving too fast or not really thinking about what sort of future regulatory infrastructure we are trying to create. This needs to be done carefully and over an appropriate period. We cannot rush it.

In all of this, there is also an interesting eye to what it might ultimately mean if we got that memorandum of understanding and people started to talk again about equivalence determinations and the fact that, the further you diverge, the more difficult that might be. I do not get the sense that that is a pressing priority in a way that it might have been even a year ago, but it is still one potentially to have an eye to.

Q42 **Lord Lamont of Lerwick:** You have touched, up to a point, on my question, which is about the number of reviews into the regulatory framework that the Government are undertaking, with the aim of maximising the benefits of the new situation in which we find ourselves. Which areas do you and your clients see as most likely to benefit from regulatory change? What kind of a broader regulatory approach would be likely to maximise any potential benefits? You have answered the last point in terms of openness and flexibility, but perhaps you could answer the first point about which areas you think are most likely to benefit.

Caroline Dawson: My area of specialism is banking and wholesale markets. There are a number of benefits that could be had in that sector as a result of the change in approach. Before I talk about the benefits, it is really important to flag the point that Peter, Andrew and I have made in our responses to other questions, which is that you have to be very careful about how you make these changes. You do not want, essentially, a constant implementation project for the entirety of the financial sector. You want clarity around exactly what is changing and whether this is a policy change or just a change in format. There is quite a lot to be got over in terms of the architecture of how these changes are made.

There are specific strategic changes that could be made to help ease the regulatory burden on those sectors and facilitate cross-border business. A number of them have already been addressed in the FCA's wholesale markets review. If you read that against the advocacy that has been published, aimed at the European institutions in relation to the MiFID II regime, you will see that it reads as, essentially, a greatest hits of all the advocacy points that people have been making, the concerns that people have about MiFID II and the burden it places on the industry, and, in particular, obligations that do not seem to have any obvious benefit either for the market or for the regulators. The UK is already starting to address a lot of those.

Probably the main thing is going to be that implementation projects are expensive, so, whatever changes the Government make, you need to balance that consideration of the benefit that the change is going to bring versus the cost of implementation, not just as a one-off cost but also in situations where we are doing cross-border business with the EU and other jurisdictions and we might end up having to comply with multiple pieces of duplicative legislation. There is always going to be that play-off.

A few years ago, I was talking to an MP about the potential benefits of Brexit, and he was saying, "Everyone's been complaining about the cost of implementation of Solvency II. Let's just scrap it". There are a lot of things that people found objectionable about Solvency II but, once the industry has gone through the process of implementation, the answer is not necessarily to say, "It's fine, we can scrap the lot of it". What I am saying is that there are a number of targeted changes that can be made, but we just need to be careful about balancing the benefits that you get from change versus the cost of implementing any change.

Andrew Pilgrim: I agree with everything that Caroline has said. In terms of areas we should be focusing on from a sector perspective, I would go back to green and fintech, as well as some of the fledgling technologies that we are seeing in payments around central bank digital currencies and what we are going to do with crypto assets. This is about ensuring not just that we have the right regulation and frameworks for the financial services world over the next decade, but that we are creating energy in UK financial markets in terms of that policy thinking and enthusing our own markets as well as those around the world about our intentions. It is fair to say that our eyes were firmly distracted by the UK's departure from the EU for a fair amount of time, so it is great to see the eye back on the ball, looking at future opportunities.

Peter Bevan: We have mentioned most of the material areas, including the emerging areas of sustainable finance and fintech, and the core operations of the wholesale markets of the City. I would call those three out as particular areas of focus.

I agree that empowering regulators to make the rules for themselves, rather than them being set down in excruciating detail in legislation, is an important part of that. As we were talking about that a moment ago, I would just make a couple of comments. That should be with, first, the appropriate scrutiny and accountability of the regulators and, secondly, the appropriate resourcing. If we want to have a leading market for financial services in the UK, it is important that we also maintain the leading standing of our regulators here. We have excellent regulators but they also risk being short on resources. With all the additional work that they are being called on to do in order to take advantage of these opportunities that we are talking about, they are potentially going to need more resources than they currently have.

Lord Lamont of Lerwick: Could I just ask Caroline one follow-up? Early in your evidence, you referred to the EU as being a first mover in regulation, trying to pre-empt a global position and hoping to influence the regulation of the rest of the world by having very extensive and innovative, or at least first, legislation. Is that such a great problem? Is that really how it operates?

Caroline Dawson: There are two key areas where they have taken that approach. One is the regulation of benchmarks. If you look at the European benchmarks regulation, it was a clear implementation of the IOSCO principles for financial market benchmarks. They took everything that IOSCO had in there as a recommendation, everything that IOSCO had as a "nice to have", and everything that IOSCO suggested people might want to think about, and they implemented the lot.

On top of that, they were thinking about how to prevent people circumventing this entire regime by using benchmarks produced by non-EU administrators. The obvious way to prevent that is to prohibit the use of non-EU benchmarks, which is where it becomes a problem. It is not necessarily a problem to have gold-standard, market-leading, first-out-the-door regulation. All of that is good stuff. The problem comes when you look at your regime and ask, "How do we prevent people circumventing our gold-standard regime? We do that by just prohibiting cross-border business". We saw that with the benchmarks regulation.

We are starting to see that with all the green finance regulation that the EU is producing as well. It tends to be that, where there is a completely green field in terms of regulation and unregulated space, the EU gets in there, regulates to the max and then prohibits cross-border business, unless it is done on the basis of rules equivalent to its own.

Q43 **The Chair:** My question has been substantially answered already but it is worth just going over some of the areas again. This is really in respect of changes that the EU is bringing in and effects that it might have on our market here. There are three sub-questions.

First, what types of challenges can be posed, if the EU changes, to things in our market here? Secondly, we always have the choice, when it changes, of either aligning or not. In what circumstances should we be choosing to align? Do you have some sort of idea behind how that works? Thirdly, you have said several times that we have a very open approach in general to the market. I wonder whether there are any other opennesses that we should be considering in order to make ourselves even more open and provide even greater market access. Perhaps I should start with Caroline as the "ladies first" principle applies.

Caroline Dawson: Forgive me but I did not catch the first question.

The Chair: Are there any specific challenges posed for our market when you get changes to the EU markets and the way in which they are doing things? Are there knock-on effects of people trying to run their businesses in one single way? If they change it in some way, you will probably have to try to change it here. I just wondered whether there was anything there that we should be aware of.

Caroline Dawson: There are challenges where you have changes in EU regulation that are not reflected in UK regulation, purely because, up until very recently, we had exactly the same regulation, so it is the divergence issue. Where you end up with divergence being a problem is where you cannot easily comply with one set of regulations and then either that is the higher standard or only one jurisdiction has regulation in a particular sphere. If you have duplicative or conflicting regulation, that presents a barrier to and increased costs for cross-border business.

You have those sorts of frictions in the areas of compliance, reporting and the conduct of business. On top of that, you have the broader issues around market access and the fact that, at the moment, the EU is taking quite a limiting view on the ways in which people can continue to do cross-border business into the EU.

Clearly there are costs associated with divergence. The reason that we are flagging those and that they are so evident is purely because we have had this harmonised regime for so long. If you are doing cross-border business between the UK and the US, you are in exactly the same position that you do not have a perfectly harmonised regime, and people have got used to that and accommodate it. Eventually, that is the situation that we will be in with the EU. It is just going to be another cross-border survey and approach that you have to accommodate if you want to do business in that jurisdiction.

That takes us to your second question, which is whether there are benefits to remaining aligned. There are probably two points here. One is the point that Andrew made earlier. If you had asked people on 1 January 2021, immediately after breakfast—sorry, Brexit; although you could have asked me immediately after breakfast on 1 January as well—whether we should remain completely aligned with the EU, while people still envisaged that we might have an equivalence-based regime, people would have been a lot more positive on remaining aligned.

Andrew's point, which I completely agree with, is that, as we have gone further forward and realised that equivalence is not going to be given just because we have a perfectly aligned regime, the benefits of remaining aligned seem less and less. Then you are moving into a situation where you remain aligned only if that is your genuine policy position. It is interesting. You can look at what the EU is doing and say, "That is fantastic, well done them", or you can say, "That looks like a great idea and we'll be aligned with that".

The Chair: Peter, you were the great advocate of openness. Do you want to have a go at my third sub-question?

Peter Bevan: I remain an advocate of openness. Just to pick up on where you were going with your questions, complexity is clearly a barrier to entry. The greater complexity we introduce in cross-border business for the UK, the more that stifles innovation. Introducing additional complexity through divergence between the UK and the EU is something that we should consider in a targeted way, having regard not only to the specific merits of what we are doing but to the potential additional complexity that this introduces and whether that might have some kind of stifling effect on innovation and new areas of growth. I remain a strong advocate of openness of the market for that reason, in addition to the ones we spoke about earlier.

The Chair: Do you have any ideas of extra openness?

Peter Bevan: One area of openness to consider is in market infrastructure. We know that we have a great strength in the UK of our clearing houses and central counterparties, to the extent that, in its self-interest, the EU has concluded that it will acknowledge those as equivalent to its own, in order to enable its own markets to utilise them. We should be taking advantage of this great strength of market infrastructure here to ensure that parties coming from outside who want to access market infrastructure here in the UK do not in some way get captured by our regulatory system. That is one of the areas where the complexity of our regime for overseas persons can sometimes trip people up. That is one that perhaps would merit a look.

The Chair: That was very helpful indeed. Andrew, do you have something to add to those very complete answers?

Andrew Pilgrim: On openness, I would go back to people. It is really important that the country is open to those we are doing trade agreements with, but more generally too. It is important to have a compelling proposition there. The other one, which I can just about squeeze into openness, is data. Clearly, data needs to have very strict standards around it, particularly where it involves people's personal data, but we are increasingly seeing a world where data is key to understanding transactions and understanding financial markets. If we can become that centre where data can flow freely from lots of different parts of the world, we will be in a very good place.

The Chair: This is a very good time to move to Lord Hannay's question.

Q44 **Lord Hannay of Chiswick:** All three of you have touched a bit on equivalence issues as we have gone through, but perhaps we could drill down a little more into that area. I am talking here more about the EU giving us or others equivalence, rather than us giving the EU equivalence. I judge from what you have said that you approve of the way the Government have given very wide equivalences to the EU. That is not the main thrust of my question, which is, first of all, on numbers.

Is it your understanding that we are right in believing that the EU has recognised third-country financial services sectoral equivalences in the case of 21 sectors for the US, 15 for Singapore, 13 for Switzerland and one for the UK? If those figures are correct, that is a pretty big imbalance in the granting of equivalences to some of our main competitors. Does that create a competitive disadvantage for UK firms that are not getting that equivalence from the EU while their competitors are? If it does create that imbalance, and if that imbalance does create a competitive disadvantage, is it likely to persist as long as the imbalance exists?

As a final part of the question, the other countries I mentioned—the US, Singapore and Switzerland—have obviously attached a lot of importance to being given equivalence, and they welcome it. They are not countries that spring to mind immediately as being happy to be ruled, as it were, by another jurisdiction, nor ones that give up their own autonomy easily or lightly, so why have they done it? Is it because there is real advantage? If so, are we missing out?

Caroline Dawson: To start with the last question, that is absolutely right. Certainly when you look at the US, you do not think of it as being a financial system where they are very happy to give up any element of their territorial reach, and certainly not one where they would say, "In order to get equivalence, we're happy now to implement to a European standard".

You cannot look just at the numbers of equivalence decisions. There are somewhere between 45 and 50 equivalence decisions that we counted in European financial services legislation. They range from being core equivalence decisions that give you key elements of market access—for example, CCP equivalence is clearly a critical market access equivalence—to areas where it is stated, "We're happy to acknowledge that your trading venues are regulated in a similar way to ours, purely for some abstruse point of capital regulation". Not all of those equivalence decisions are equal in importance.

Particularly if you followed any of the discussion about the US getting CCP equivalence, it was a tremendously hard-fought battle. There was a huge amount of negotiation between the US regulators and the EU authorities, but as part of that the US did not feel that it gave anything up. It felt that it won a battle in demonstrating that its regime was equivalent to the EU's and that the EU was applying the wrong set of standards in assessing equivalence, in that it should be looking for something much more outcomes-based rather than line by line, which is where it had originally started.

That is quite a long-winded way of saying that, just because the US has 21 equivalence decisions and the UK only one, there is not automatically some sort of imbalance in the ability to do cross-border business. Clearly in practice there is, but it is not in the ratio of 21:1 because of the different natures of these equivalence decisions.

As for why those other countries have equivalence and the UK does not, one purely practical, boring answer is that equivalence decisions take a really long time. For the equivalence decisions made under the credit-rating agencies regulation, you had a two-year process of ESMA getting evidence and producing reports on regulation of credit-rating agencies in a number of jurisdictions, and then it had to go through the process of being turned into an equivalence decision. It took four years, top to tail, and we have been outside the EU for less than four years. The EU did not feel that it was empowered to start making these equivalence decisions until we were actually out the door.

It has started making these equivalence decisions. It is prioritising them, because it is resource-constrained in the same way that the UK regulators are. Ideally, we would have more recognition and equivalence decisions than we do. That will come with time as the UK financial system stabilises and the EU gets more confidence that we are not going to see a complete bonfire of red tape and that the UK does want to have a stable, gold-standard financial services system.

As that persists, we are going to see more equivalence decisions come through, but we are not necessarily in a position where we are automatically massively disadvantaged because we do not have equivalence, partly because of the nature of some of those decisions, and partly because in a number of cases there are transitional periods and transitional regimes. You can grant someone equivalence and, from the point of time where they get equivalence, a new regime applies, but if you do not get equivalence, you carry on with the status quo ante.

It is quite a nuanced point and there are a number of factors, but my key point is that it looks like the US has an enormous amount more market access than the UK does just based on the numbers, but that is not the whole story.

Lord Hannay of Chiswick: I take that point. Would you or your colleagues be able or willing to give us some kind of qualitative judgment on which of the sectors where the EU has given equivalence to other third countries and not to us really matter—the ones you say we would benefit from if we had it—and which ones matter less? Sir Jon Cunliffe said something very similar. He said in a very broad-brush way that some matter and some do not, but he did not tell us which ones mattered and which ones did not. Can you or your colleagues help the Committee with that?

Caroline Dawson: We could certainly follow up on that. Off the top of my head, CCP equivalence is clearly a big deal. That is very much the focus of the regulators, and it is something where we are comfortable we will get to a good landing. At the other end of the scale, if we had equivalence under MiFID for cross-border business, it would actively damage our ability to do cross-border business because it would undercut our ability to rely on the third-country regimes that are available in the EU at the moment. Yes, we could probably give a range of situations with some examples, if that would be helpful.

Lord Hannay of Chiswick: It would be helpful if all three of you could.

The Chair: You are volunteering for the second thing that is on my list.

Lord Hannay of Chiswick: It would help us a good deal in understanding how big a disadvantage the numbers imbalance is. I take perfectly well what you have said, in that it is not as big an imbalance as the numbers can make you think, but that does not mean to say there is not an imbalance at all. It would help a lot if you could give us a bit of a qualitative judgment. Can either of you add to that now and perhaps follow it up?

Peter Bevan: I am happy to give some observations now. There are some equivalence determinations that seem to be in the EU's own self-interest, for instance recognising that, when its banks invest in government bonds issued in the United Kingdom, those are not risky emerging markets instruments but are of an equivalent standard to those issued by its own Governments in their creditworthiness. Some of them are quite small and, you would think, ought to be given in the EU's own self-interest.

Caroline mentioned the importance of the recognition of CCPs, clearing houses, in the UK. At the moment, there is no recognition of the equivalence of trading venues in the UK. That would be another important one. To your question of whether some of the other markets you mentioned have benefited from equivalence in a way that the UK has not, this is an area where that has been the case. Business has been able to migrate to swap execution facilities in the United States or Singapore when it cannot take place in the UK. It seems extraordinary, really, that when Europeans and UK counterparties want to trade with each other, they have to go to another continent to find a venue to do so. That is an example of something that would deliver an immediate benefit to some participants in UK markets.

Andrew Pilgrim: I agree with all of that. The only colour I would add is that the European Commission does think about the UK differently from other markets, regardless of the departure from the European Union, purely because of the scale and the proximity to the EU. Equivalence decisions that it might be more likely to make for a jurisdiction a long way away, where it expects occasional trade, are a very different kettle of fish compared to a major capital market in its own geography.

Q45 **Baroness Scott of Needham Market:** Staying with the question of equivalence, it is clear from what you have said that not all equivalences are equal or matter quite so much, and, as Caroline has said, that they take a long time. As the sector is adapting to equivalence not being there, is there an extent to which equivalence down the road in some sectors could be positively harmful? In other words, is equivalence broadly a strategy still worth pursuing?

Peter Bevan: From the point of view of equivalence as a means of accessing the provision of financial services into the EU, perhaps the one that has had the most attention is equivalence under MiFID to enable firms in the City to provide their services to European counterparties and trade with them. It was always understood that you needed to prepare on the assumption that that equivalence would not be forthcoming. It is as well that that was the understanding, since it was not. Firms are well prepared for the reality that they find themselves in.

Were that equivalence to be introduced in future, there would first need to be an assurance that, once given, it was unlikely to be withdrawn. One concern with equivalence is that it can be withdrawn by the party granting it on very short notice, so building a business model and making an investment on the basis of shifting sand would be quite difficult. Were an equivalence of that sort to be introduced, it would be extraordinarily helpful if it were given with some degree of permanence or some assurance that it would not be removed lightly.

Even then, for those firms that have now invested a significant amount in building an onshore presence in the EU and have transferred a bunch of business into those legal vehicles, the cost and upheaval of retransferring that back again would need to be considered if you were going to take advantage of the equivalence regime to enable the provision of those services outward from the UK into the EU going forward. It may well be that many firms would say, "We've invested in this setup now so we're not going to dismantle it. We'll make the best of it", in which case equivalence would not provide as much of a benefit as it might have done, had it come in at an earlier stage.

We also know that the supervisors in the EU of those new businesses that have been established want to see substance in them. Even if the EU gave equivalence for the provision of those services across borders, it is perhaps less likely that the regulators of those vehicles that have been established would want to see them turn into a shell of their former selves, because they would feel nervous about regulating such an entity.

There are a number of ways in which an introduction of equivalence in the future for that kind of service would be of limited benefit. It is a topic we talked a lot about a year or two ago, but perhaps it is not something we hear being called for so much these days, for those sorts of reasons.

On the other hand, some of the others I mentioned, such as recognition of trading venues, could immediately open up new ways of doing business together that are currently closed. They could perhaps more quickly open up new opportunities.

Q46 **Lord Faulkner of Worcester:** Good afternoon. I want to ask about the different attractions of free trade agreements, mutual recognition agreements and other similar instruments with third parties. The Government are very keen to go ahead with as many free trade agreements as they can at present, but what are the respective relative benefits and disadvantages of mutual recognition agreements, such as that being negotiated with Switzerland, compared with free trade agreements?

Andrew Pilgrim: A mutual recognition agreement is an interesting construct for financial services, effectively saying that the two sides are going to certify each other's financial services products as suitable to be traded in each other's markets. Some of it might be considered akin to what you could see in a free trade agreement. Some of it you can do simply through regulatory co-operation between regulators. It is probably important not to get too caught up on the semantics when we talk about trade in financial services and exactly which sort of framework it sits under. The bigger focus should be on what is inside these regulatory co-operation agreements, trade agreements or mutual recognition agreements to understand what the underlying allowances are within them.

Caroline Dawson: I completely agree with that. The key thing to note is that free trade agreements do not typically do that much for cross-border financial services. Typically, if you are looking at a free trade agreement, it would have provision for services that are provided in the relevant jurisdictions, but when you are looking at cross-border financial services, the most ambitious free trade agreements are still really looking only at cross-border services on the basis of national treatment. While superficially that might sound attractive, if national treatment means that you have to have a place of business in the relevant jurisdiction and get authorised in that jurisdiction, that is not cross-border business any more. That is essentially the basis on which most free trade agreements look at cross-border financial services. The practicality is that even the most ambitious FTAs do not give you much for cross-border financial services.

As Andrew says, there may be more optimism on mutual recognition agreements. The MRA that is in the process of being developed between the UK and Switzerland is intended to be a gold standard for financial services MRAs and to be as ambitious as possible. With a free trade agreement, you could say, "Okay, the parties agree that we can do X, Y and Z services on a cross-border basis". With a mutual recognition agreement, you need a basis for that mutual recognition. You need to identify a particular product or standard that is going to be subject to recognition. You need to identify a benchmark for assessing whether recognition is going to be granted. Then you need processes for monitoring that.

All of that means that it is quite a granular process. When we look at what goes into the UK-Swiss MRA, it is a matter of identifying the exact elements of cross-border provision of services. Are we looking at cross-border fund marketing, in which case are we looking at recognition of the UCITS regime? Are we looking at unregulated funds, so maybe looking at recognition of key information documents? Are we looking at recognition of prospectuses? Are we looking at licensing requirements?

There is a huge amount of detail that goes into it. For each of those elements, either you need to say, "That's going to be within the scope of mutual recognition so we need to find a benchmark and work out the process of monitoring that", or, as Andrew mentioned, there might be other ways of achieving the same goal, whether through regulatory co-operation or through the territorial scope of the relevant regime, meaning that a particular activity does not fall within the scope of regulation in the first place.

Again, it may be quite a long way of saying that the two types of arrangement achieve different ends. A free trade agreement is much more flexible but traditionally does not do much for cross-border financial services. There is more potential for a mutual recognition agreement to do more for financial services, but it is going to be quite a detailed, granular assessment.

Lord Faulkner of Worcester: That is a very helpful answer. Do you think that the agreements that are in place already or are being proposed are too unambitious and need to go further if we are to avoid the loss of trade in financial services with EU Member States?

Caroline Dawson: It is going to be really interesting to see where the UK-Swiss agreement ends up, because the stated ambition is for that to be a very ambitious arrangement. If we can achieve a very ambitious mutual recognition arrangement with Switzerland and that opens up markets that were not previously open between the two, it would be fantastic if we could use that as a template to roll out to other jurisdictions. I am not in a position to judge whether the agreements we have so far are unambitious, but the fact that people are stating that they want the Swiss one to be ambitious may indicate some sort of qualitative assessment of the previous.

Lord Faulkner of Worcester: The reason why this is important is that financial services are different from trading in goods. We are not having free trade agreements for exchanging motor cars; it is financial services. You are saying that the mutual recognition agreements are more likely to give us a better deal than the FTAs.

Caroline Dawson: Yes, traditionally the position has been that FTAs do not get you much for cross-border financial services. To be honest, the reason people are talking about the UK-Swiss mutual recognition agreement as being ambitious is that we do not already have something similar with other jurisdictions. There is not a history of mutual recognition agreements in the financial services space either, but your point about financial services being different is a very good one. If you are talking about the marketing of tractors, you can have some sort of ISO standard for production of tractors, and that is quite an easy one to benchmark. There is not a huge amount of complexity there. If you are talking about an entire financial services regime, it is going to be a lot more complex and granular.

Peter Bevan: I agree with what has been said. In my many years of working with clients in this area, it is extremely rare that I have been called on to help somebody get their head around a free trade agreement, because they just do not speak to financial services. That just demonstrates that it is not something that comes up. If we are able to crack that in the Swiss agreement, perhaps that will be a useful template going forward.

Q47 **Baroness Scott of Needham Market:** This is a change of tack entirely. Before the signing of the TCA, there was a lot of concern about the movement of jobs to the EU, as the regulatory framework made adaptation necessary. Andrew, I understand that your organisation is monitoring job relocations from the UK to the EU, and presumably vice versa. I wonder what you can say about what in reality has happened with jobs and why.

Andrew Pilgrim: We have been monitoring jobs since 2016 on the basis of public announcements. It is important to say that the monitoring we have done here is based on 222 firms. This is purely public data that they have put out. To give you some context, at the tail end of December 2016, we were looking at what we thought were publicly announced job moves of just over 12,000 from the UK to the EU. As of December 2021, that figure is down to 7,400; indeed, it dropped from 7,700 in December 2020 by 300, primarily due to some large investment banks revising down their numbers.

It might be helpful to give a bit of flavour as to where those jobs have gone. The most popular destination for new offices was Dublin, where 36 firms went. Luxembourg was the second most popular, with 29 firms; Frankfurt had 23 and Paris had 21. If we look at purely the specifics of where people have moved in terms of numbers of individuals, that is slightly flipped. We see Paris with the highest number of relocations at 2,800; Frankfurt at 1,800; and Dublin at 1,200. To give you some context of overall numbers employed in financial services within the UK, the latest figure from TheCityUK, which puts out an annual report, is about 1.1 million financial services employees across the United Kingdom.

The other piece of data we have been tracking that may also be of interest is the amount of assets being transferred from the UK to the EU. As of December 2021, £1.3 trillion-worth of assets had been transferred from the UK to the EU. That was broadly unchanged—a very minor change from what we saw in December 2020.

Lord Hannay of Chiswick: Do you have any figures at all on the gain or loss of revenue to the British Government from financial services in that period?

Andrew Pilgrim: We have not done any specific calculations on the Exchequer.

Lord Hannay of Chiswick: The Government have not produced any.

Andrew Pilgrim: No, not that I am aware of. We will start to get figures out in terms of what happened in 2021, the first year that the UK was outside the single market, over the course of this year. It will only be at that point that we get a true sense of those figures.

Baroness Scott of Needham Market: I want to ask our other two witnesses for their observations in terms of UK jobs going to Europe but also EU jobs—or, indeed, jobs from the rest of the world—coming to the UK.

Peter Bevan: I definitely recognise the picture that Andrew paints. Inasmuch as new jobs have been created in the EU, they have been in multiple centres and split across the cities he mentioned. The fact that there has been such diversity is interesting in itself when you consider the primacy of London as a single hub for financial services and the UK more broadly as a centre for that business. There is no other single location that is so far growing in a way that would rival London as that hub. The multipolar approach we see in the EU is quite interesting in that regard.

My second observation is about the types of roles we are talking about. Many of them are client-facing roles—the face of a bank, for example, to its customers, taking their orders to execute transactions or whatever it might be, and giving them advice. That is because that interface with the customer must be done by someone in a regulated European body; it cannot be done from outside. Those kinds of roles have tended to move. Many of those roles are people who were in any event quite mobile and often travelling to visit their clients. They are now travelling to visit them perhaps from a base in Paris, Frankfurt or somewhere else in the EU, rather than from London.

The second type of role that has particularly needed to move is the governance of a financial institution. Say you are creating a bank in Europe. I talked about them in one of my earlier answers as being legal vehicles. You must forgive me for talking like a lawyer, but the regulator sees them as banks, not legal booking vehicles. If you are a bank, you have to have a proper board of directors, a proper risk management function and appropriate compliance oversight. Those kinds of governance jobs have also been created in the European location.

Those are among the main areas where we have seen particular moves, whereas roles such as portfolio management have tended to remain in the UK, with funds that are established in the EU continuing to delegate the management to where the expertise lies, which has remained in London or Edinburgh, for example. In our experience, those roles tend to be less likely to have moved.

Caroline Dawson: Part of that ties into what we are seeing coming back the other way. There are a number of European firms that were doing cross-border business into the EU, on the basis of either the cross-border business services passport or a UK branch. With the temporary permissions regime coming up for its expiry, you are seeing those entities establishing a UK presence, bulking up their UK branch where they were doing cross-border business and maybe establishing a UK branch. They are all the points that Peter made about the types of person you need to have in the branch, such as the sales force and the governance. All those jobs are potentially being created in the UK.

To echo the point that Andrew and Peter made about the disparate locations where jobs are moving out from the UK to the EU, there are obviously excellent financial services reasons for that. There are also personal reasons. You have availability of schools with English language schooling, for example, if that is important to you. There are all sorts of personal factors. Clearly, for the past two years, we have had significant restrictions on movement for pandemic-related reasons. With the end of pandemic-related restrictions, it is going to be interesting to see whether more moves start taking place, because quite a lot of that is being hidden by the fact that people just could not travel. Regulatory capacity is another factor.

The Chair: Thank you. We move to our most patient colleague and the final question.

Q48 **Viscount Trenchard:** I have noticed that some commentators have suggested that business has been relocating—meaning a movement of where business is booked—from the UK to the US, rather than to the EU. If so, does that indicate that US-based practitioners have easier access to EU clients than UK-based practitioners do, notwithstanding the fact that the US is five hours further away with no time zone overlap? Have you observed this among your own clients? If true, does it pose a risk to the UK's position as one of the world's pre-eminent financial centres?

Caroline Dawson: Part of this is just another example of the types of job moves that we have been talking about. If you are looking at doing cross-border business into the EU, you might choose to do that from a hub in the EU. If you are choosing not to, you are going to have to comply with the European patchwork of cross-border business regimes, regardless of where you are located.

If you are a business with strong historical links to the UK, it makes sense to stay in the UK, do that cross-border business and work your way through the patchwork. If you are a JP Morgan, a Goldman Sachs or a Morgan Stanley with strong historical links to the US, it might make more sense for you to start pulling that business back to the US, because you are going to have to do business in the same way regardless of where you are located. Your point about a five-hour time difference is a very good one but some of these people do not get much sleep.

In terms of the impact of those moves on London's status as a global financial centre, clearly New York and Hong Kong are the other two major global financial centres. Hong Kong has its own struggles at the moment. Any loss of business to another one of those financial centres is potentially relevant to the UK's status, but the key thing we are seeing at the moment is that there is no single destination for people's moves.

People move for personal reasons. They move for historical legal connection reasons. They move because of relationships with regulators. They move because of personal taxation. They move because of bonus caps or experience of the regulators. There is a whole world of reasons why people move their businesses. It is a big decision to make and they do not take it lightly. The fact that we are seeing people moving to disparate locations still means that London retains, for the time being at least, its strength as a global financial centre.

Peter Bevan: I agree with those comments. As a global financial institution looking at where to allocate capital, you are also likely to want to look for opportunities in the wider economy. We should not forget the relationship between the growth of the economy in the UK and the opportunity therefore for financial services to develop. It is sometimes quite difficult to unpick these global allocations of capital and resources from specific drivers. We should not necessarily assume that everything we see is related to regulation, Brexit or cross-border flows. We should also remember the importance of having a thriving and open economy more broadly.

Viscount Trenchard: Andrew, have you seen any of EY's clients moving business to the US?

Andrew Pilgrim: I have not seen evidence of significant numbers moving to New York. It is certainly talked about. On Caroline's point, there is an issue around market access. On the earlier point on equivalence, there is an issue about the equivalence determinations that the US has that the UK does not, but as of now it does not appear to be a significant amount of movement.

Q49 **Lord Tugendhat:** The most spectacular example of job relocation and movement of headquarters since we left the EU has been the decision of Shell and Unilever to cease being Anglo-Dutch and to decide to locate in London. Had they taken the opposite view and decided to locate in the Netherlands, I am sure that would have been interpreted as an inevitable consequence of our leaving the EU and a vote of no confidence in London.

Do our witnesses believe that the decision of these two great companies—international companies if ever there were—to locate in London rather than in the EU is of significance beyond those companies? Do they see this as simply a matter of interest to Shell and Unilever, or do they think it is of significance when comparing the situation of London and the financial centres on the continent?

Caroline Dawson: I was not involved in either Shell or Unilever's decision to move. If we look at it purely from the perspective of them being listed companies looking to access finance on global capital markets, if you were concerned about your ability as a non-UK-headquartered institution to continue to be listed on London and access those financial markets, that would be a major factor in your decision on where to locate.

While there is no current indication that the UK is going to restrict access to listing for foreign-headquartered entities, the concern might be more regulation in the home of those foreign entities. If you are an EU-headquartered entity, the risk might be that it says, "Actually, you need to have accounts that comply with EU standards. You need to be primary listed in an EU location". Then you run into all the problems that the EU is currently facing in trying to grow its capital markets. That is potentially one factor.

In the regulated financial services space, where I am more qualified to comment, we are certainly seeing Dutch entities looking at relocating and moving their global headquarters. These are not institutions on the same scale as Shell and Unilever, but Dutch-headquartered groups are looking to move to the UK for regulatory reasons because of the flexibility and experience of the UK regulators.

Peter Bevan: My area of expertise is financial services rather than those other sectors, so I cannot comment on those particular companies, but I am sure that they will have taken into account a number of factors in the decision where to locate their headquarters. Many of those will be the same factors that financial services businesses are considering, but they are global organisations that will continue to have operations in multiple places.

The consequence of Brexit for financial services, which we have been talking about today, is that, if you want to operate in multiple European markets, you can no longer do that solely from the UK but will have to have a combination of UK and European bases from which to do that. Where you choose to put your headquarters of the entire group is one thing, but that is not going to alter the need to be present in both markets in order to access them both fully.

Lord Tugendhat: If they had located in the Netherlands, it would have been regarded as a very big blow to London.

Peter Bevan: I imagine so.

Andrew Pilgrim: I have no further to add; I endorse all of that.

The Chair: Thank you very much indeed for that extremely interesting final question, Lord Tugendhat. We have slightly overrun. It has been a really interesting session. Thank you on behalf of the whole Committee for being quite so frank. We have got many valuable things. I am afraid that Caroline promised two things: the list of bilateral MoUs, and some idea of which equivalence decisions really count rather than the long list. We have the EU table in front of us. We would be very grateful if you could send those on in due course. In the meantime, and with all our thanks, I declare the evidence session over.