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Witness: David Lawton

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Members present

Lord Tugendhat (Chairman)
Baroness Bonham-Carter of Yarnbury
Baroness Coussins
Lord Foulkes of Cumnock
Baroness Henig
Lord Jopling
Baroness Quin
Lord Radice
Earl of Sandwich
Lord Trimble
Baroness Young of Hornsey

Examination of Witness

David Lawton, Director of Markets, Financial Conduct Authority

Q137 The Chairman: Good morning, Mr Lawton. I am sorry to have kept you waiting, but I think you heard some of the last evidence. Before that we had the Treasury, so we have had quite a busy morning and have covered quite a lot of ground. If you feel that some of the questions put to you are rather discordant or inconsistent, it will be because people are referring back to something that came earlier or filling a gap that remains. As I think you are aware, this is a formal session, so it is all on the record. If an issue arises on which you feel you would like to reflect and send in written evidence, we would be perfectly happy to deal with that.

The final point I would make, which I made to the other people and which is now much clearer in our minds, is that until this morning we were very struck by the emphasis that the British Government and the industry placed on including financial services in TTIP, but we were equally struck by the lack of tangible reasoning that lay behind that. I think we have a much better grip now on the reasoning and why people want it, but we want to be clear about the extent to which having financial services in TTIP is essential to making progress or whether, if the Americans remain adamant, one can make equal progress through the

existing financial regulatory rules: in other words, whether the process is absolutely crucial to getting the result or whether one could hope for the same results through a different process. That is just a preliminary.

As a first question, please talk us through what mechanisms already exist and what processes are already under way when it comes to regulatory dialogue, and explain how TTIP might fit into the dialogue under the G20 and other levels.

David Lawton: Thank you very much, my Lord Chairman. Good morning, everybody. An important point to emphasise at the start is that there is no single regulatory dialogue; there is a multiplicity of dialogues. That reflects clearly the very diverse and complex nature of financial services, but also of course just the multiplicity of actors on the stage, the number of regulatory and legislative bodies that exist globally.

The second point to make is that most of the important regulatory dialogues are genuinely multilateral within which the Europeans and the Americans are participating, but they are not solely focused on an EU and US interaction. The pinnacle of those multilateral dialogues is the Financial Stability Board, which brings together representatives from finance ministries, central banks, prudential regulators and markets regulators. There are also sectoral multilateral groups such as IOSCO for securities Commissions and market regulators, there is a parallel insurance group and of course there is the Basel committee that is working on prudential standards. Most of the key regulatory issues that affect cross-border markets are being discussed, at least in part, in these multilateral dialogues, in which of course the Europeans and the Americans participate and interface, but they are not solely EU-US dialogues.

In the EU-US context, there are a range of interactions. There is the financial markets regulatory dialogue, which brings together the European Commission on the European side, the US Treasury and, I think, the SEC and the Federal Reserve on the American side.

Member states are not involved in that from the European side, and national regulators certainly are not. There are other interactions in relation to specific pieces of legislation, so there is a multiplicity of interactions. Most of the issues are multilateral, but within that there are some specific EU-US conversations.

The Chairman: That is a very clear exposition, thank you.

Q138 Lord Jopling: We are grateful for that overarching description of this, but let us just turn to the details of the US regulatory regime and the EU one, which is dealt with in Dodd-Frank. Could you give us a brief outline of what the differences are between the two and how the two regimes differ in their approach to cross-border issues and extraterritoriality?

David Lawton: Yes, of course. I will illustrate that question by talking specifically about the arrangements for derivative markets, which have been a particular point of focus for regulators in the US and Europe recently, but I think that will serve to illustrate some of the more general points. Most European capital markets legislation, certainly the legislation that has been developed over the last 10 years, has explicit provision in it for how to deal with third-country access. The basic proposition from the European side is to say, “We have established some agreed rules from a European perspective. Non-European firms, non-European actors, can access European markets, but only on the basis of being subject to broadly equivalent rules”. The European legislation typically sets up some process—typically again for the European Commission—to make some determination jurisdiction by jurisdiction as to whether equivalence pertains in relation to that piece of legislation. If you had a sector, a piece of legislation where the Commission had determined that the US was equivalent, US firms will be able to participate in Europe with no further ado and would be supervised by the US regulators against the US rules that had been deemed equivalent.

The US approach to those sorts of issues had traditionally been rather different, which has been to say that participation in US markets needs to take place on the basis of adherence to the US rules, so typically third-country firms who have wanted to participate in US markets have had to register with US regulators as if they were US firms. One particular example of that has been the approach to exchanges that trade shares and equities. The SEC has always said that non-US exchanges that trade shares can only do business in the US if they register with them as a US exchange, and because that carries implications for the rules that apply to the companies that trade on those exchanges, exchanges have refrained from doing that. That is at the hard end of the spectrum.

Within the US regime, there is typically provision to switch off specific rules if they are found to be equivalent to the US rules—it is called substitute compliance in the US terminology—but unlike the European approach I described earlier, it is not a holistic whole-jurisdiction assessment, it is a rule by rule assessment, so you have a bit more of a patchwork approach from the US side. Third-country firms can participate in US markets if they adhere to US rules, with an ability for the US regulators to switch off specific rules if they deem the European approach to be equivalent, but not typically a jurisdiction by jurisdiction approach.

Lord Trimble: Looking at the question of including financial services in TTIP, we have been told by other witnesses that key US regulators such as the Fed and the SEC are distinctly cool on this situation. What is your assessment of that, and what sort of relationship do you have with those US counterparts?

David Lawton: Let us take that second question first. Based on the myriad regulatory dialogues that I described at the outset, we have lots of contact with our US counterparts. It is constructive and we engage very effectively together. We are obviously talking about our individual rule-makings and in some respects have firms active in both our markets that we share supervisory perspectives on, and from time to time we work jointly on sharing

information around enforcement cases. I think the relationships are constructive and very vibrant.

We have had no dialogue with our counterparts as to their views on TTIP, so I am afraid I cannot speak from personal experience as to what they might be.

Q139 Baroness Young of Hornsey: Does the FCA have an official position on TTIP?

That is one question. You have mentioned already that you have a very strong dialogue with your US counterparts but not specifically on their views on TTIP. Are you engaged in discussions about TTIP with the UK Government and the Commission? Also, has the tenor of the conversations and the dialogue that you have been having with your counterparts elsewhere changed as a result of engaging in TTIP?

David Lawton: The FCA does not have a view on TTIP. We have no mandate in relation to trade, so we have no position on TTIP. We have had no dialogue with the European Commission or other member states about TTIP. We have had some engagement with the Treasury around some of the technical aspects of how some of the existing regulatory dialogues are operating and how they might fit into a TTIP proposition, but beyond that, no. In answer to your final question on whether it had any impact on our other engagement, no, it has not.

The Chairman: Presumably the FCA would not have a separate and distinct position from that of the Bank of England.

David Lawton: I suspect that both of us would say that trade is outside our mandate. It is very much a European community competence, and while it is clearly part of the broad context in which we operate, we would not expect to be involved in any of the discussions or negotiations.

Lord Foulkes of Cumnock: I do not understand that. Why are you here then?

The Chairman: He is here because we invited him.

Lord Foulkes of Cumnock: I know that. Why did we invite you? It is called the trade agreement, but we are talking about financial services within the trade agreement. It is what we are discussing.

The Chairman: I think it is important for us. Mr Lawton has explained very modestly why he is not central to this negotiation, but it is useful to get the Financial Conduct Authority's views on the issues that we are raising with him, so I am very grateful to him for coming.

David Lawton: May I attempt an answer to that question?

Lord Foulkes of Cumnock: Yes.

David Lawton: The FCA does not have a view on TTIP. We are not, as I say, an organisation that engages with trade and its mandate, but clearly there are some discussions going on about whether it would be useful for the TTIP agreement to have some sort of arrangements within it that provide for an enhanced dialogue between Europe and the US. I think that part of that justification reflects some concern or dissatisfaction with how the existing dialogues have been going. The dialogue that I have most experience of is the detailed implementation of some of the G20 commitments around the OTC derivatives markets, which are being promulgated through Dodd-Frank in the US and a couple of pieces of legislation in Europe.

I would say in relation to that exercise that two things have in retrospect generated the most challenge. First, the different legislative timetables have been different. The US Congress moved early with Dodd-Frank, but the European side has been slower to develop its legislation. Therefore, as we get to the nitty-gritty now of comparing our regimes and deciding whether they are equivalent or comparable, the US has moved early and is therefore inevitably a bit reluctant to want to reopen or change things, and Europe has not yet reached the finishing line, and from the US perspective the US is saying, "It is very

difficult for us to know whether you are comparable or not because you have not finished yet”.

Lord Foulkes of Cumnock: But I could not understand why, when Lord Trimble said, “Have you been talking with your counterparts?”, you said no.

David Lawton: We have had no conversations with our counterparts about whether TTIP could play any role in this process or what might feature in it. We have extensive dialogue around the implementation of the G20 commitments in our respective jurisdictions.

Q140 The Chairman: Just taking up Lord Foulkes’ question, one of the things that comes up a lot in evidence is the role of the US regulators and how unhelpful some people feel that might be. Also, the US regulators apparently, we are told, do not wish to see financial services included in the TTIP; they wish them to be dealt with outside in the established dialogues that you talked about earlier. Do you think, therefore, that it would be helpful to progressing this negotiation if regulators on this side of the Atlantic such as you, but above all you in London’s position, engaged, and do you think there is a contribution that you might be able to make in view of the alleged attitude of your United States counterparts?

David Lawton: I would not want to comment on the views of my US counterparts, partly because, as I was saying earlier, I do not know what they are because we have had no conversations around TTIP. Perhaps I could answer the question more constructively by exploring what sort of features would be useful in the TTIP in relation to financial services issues. This perhaps comes back to the question that we were talking about earlier. There are probably three or four elements that would be essential, and then two or three points to think about or questions to explore. The first element goes back to what I was saying earlier: that it is critical, where financial services industries are global, that any EU-US dialogue recognises that fact. In relation to the implementation of the G20 agreement, for example, not just the US and Europe but the huge Asian markets are clearly going to

become bigger over the next few years, so any framework within TTIP for discussion about financial services also has to recognise the broader global dimension.

The second thing I would say is that the right people have to be around the table. One of the weaknesses with the financial markets regulatory dialogue, as I would see it, is that from the European side it only engages the Commission. It does not engage any of the relevant technocrats. A challenge, of course, is that there are a lot of different technocrats and regulatory organisations, so if you want to cover financial services en bloc you will need a big room. That clearly has some disadvantages in terms of the efficiency, but you need to involve the technocrats.

The third thing is that you need to be clear about the basis of the conversation. Is it a conversation around just generating a greater understanding of where each side is coming from, or is it a bit harder-edged? Is it around committing to common implementation dates, or is it around committing to exploring the rough interfaces between different existing rules? Even more hard-edged, is it a dialogue that has some sort of mechanism within for resolving differences and disagreements? It definitely needs to reflect the multilateral element and to have some process for including technocrats, but it also needs to be clear about what it is a dialogue about and what the nature of the conversation is. Is it just a conversation or is it some sort of harder-edged decision-making process, and if so, what are the elements of that decision-making process?

Q141 Baroness Young of Hornsey: In a way, that has covered my question. In a sense, you have just said that you thought that the main area thus far identified as a priority within TTIP was the establishment of an agreed mechanism for having discussions and having them conducted in the future, and that you have to recognise the broader global dimension and having the right people around the table. These are clearly what you see as the priorities for this agreement. I suppose I could ask, therefore, whether there are other bigger prizes,

which perhaps are slightly more intangible, that would indicate that a good deal had been struck. You have featured on the realistic, the pragmatic, but is there anything over and above that?

David Lawton: It is consistent with what I was saying earlier about the FCA not having a view on TTIP per se: that we have not thought about the issues in those terms, about market access or a good deal and so on. We have done no analysis that has produced a league table, if you like, of parameters in the terms that you have been describing. I would say, to echo what we were saying a few moments ago, that if we understand correctly that what is being talked about within TTIP is some sort of arrangement for enhanced dialogue, it is important—a priority, from our point of view—that those arrangements have the features that we were talking about earlier.

Earl of Sandwich: You are saying some of the same things but using different terminology. You probably came in when we were discussing the idea of a living agreement earlier. If there are things that seem to be intractable, like accounting methods, why have we not over so many years come nearer to common accounting methods? Those things are going to be out of reach almost at TTIP, yet we have to have regulatory convergence somewhere—that is the bottom line—to make any progress. What does it mean, this living agreement? The Trade Commissioner is using the term already as though we are not going to get anything in TTIP in that sector.

David Lawton: I am afraid I am not familiar with the term “living agreement” so far, but it is clearly the case that regulation, and within that financial services regulation, is an ongoing activity and that financial markets are continually evolving. If by living agreement it is meant that arrangements need to be kept under continuous review in order to ensure that they remain fit for purpose and are dealing with the markets as they exist and are likely to evolve,

then I would say that that is what any dialogue would need to be about and would need to provide for.

Earl of Sandwich: So in TTIP terms, that means making the best of a bad job?

David Lawton: Let us step right back. There are two immovable features of the legislative and regulatory world that any TTIP would have to recognise. The first, as we were saying earlier, is that any jurisdiction, having established a framework of regulation for what happens within its jurisdiction, is always going to want to have an eye to the regulatory requirements that apply to firms from outside that jurisdiction that want to do business within it. That is the basic approach that you will find from any legislature or regulatory authority, so then that narrowly focuses already on a set of questions around what does equivalence mean and how do we evaluate it.

The second immovable object is that within each jurisdiction, certainly in the larger ones, there is a philosophical starting point, if you like, that you need to work out what works for your jurisdiction first and foremost, and within that your regulatory authorities have some degree of independence. Any TTIP arrangements have to hang between those two pillars. Although we are not involved in elaborating what they might be, it just seems to me, looking at it from the outside, that one has to be realistic that those are two walls within which the TTIP has to be built.

The Chairman: Do you think there would be scope for the regulators to have impact studies on regulatory issues concerning transatlantic relationships?

David Lawton: There is certainly scope for impact studies to be done. Whether the regulators need to lead those or whether it could be done by Governments or industry is perhaps an open question.

Coming back to the example that we have been talking about this morning, the implementation of the G20 commitments on derivatives markets, one of the concerns is that

there is dual regulation or dual oversight, so in other words the G20 has committed to implement certain changes in derivatives markets and the US and Europe have gone away and implemented those in their respective jurisdictions. One would have expected that that would have produced a similar outcome in each market, so the need to have dual regulation or dual oversight of transactions or firms is an extra cost that is not needed. Some sort of impact study looking at those sorts of questions could be useful to feed into a regulatory dialogue.

Q142 Baroness Coussins: You said that the FCA does not have an official position on TTIP, but given that consumer protection falls within your remit, I am hoping that you have given some thought at least to what the likely benefits or negative consequences might be of the kind of regulatory coherence that TTIP is meant to be about. I wondered whether you could outline what you see as the potential advantages and disadvantages of having the financial services sector included within TTIP from the consumer perspective.

David Lawton: Two of our statutory objectives are to ensure an appropriate degree of protection for consumers, but also to enhance competition in the interests of consumers. Trade agreements generally have been seen as ways of broadening both competition and consumer choice. In general terms, the FCA could see that trade arrangements could contribute positively to the context in which we operate and positively help indirectly pursue those two statutory objectives.

On the opposite side though, of course one would need to be careful that those arrangements do not result in a diminution of the previously agreed standards, so it would be a retrograde step if, in the interests of promoting coherence or convergence, we had standards that defaulted to the lowest common denominator. I do not sense, in the conversations that are being had around the role that financial services could play in TTIP,

that that is in any way the intention. Rather, it is about establishing a process for discussion. The substance of that discussion comes later.

Lord Foulkes of Cumnock: Just following up Baroness Coussins' excellent question, you said that we would not want to go to the lowest common denominator with regulatory harmonisation. Does that mean that if we adopted some of the procedures that they have in the United States, for example, bankers who defrauded their customers in the United Kingdom would be in prison now, as they are in the United States?

David Lawton: That is a series of stages beyond the level of conversation that we have been having around the nature of the TTIP arrangements. The discussions around regulatory coherence and regulatory harmonisation have been about getting coherence in the standards that apply within each jurisdiction, as opposed to extending the reach of one jurisdiction into the other. I think that is a different dialogue completely, and indeed one of the perceived benefits of greater regulatory coherence is that its jurisdiction sees less of a need to reach out into the other jurisdiction because it has greater confidence that the arrangements that pertain in that second jurisdiction match its own.

Q143 Baroness Young of Hornsey: I am not quite sure whether you have answered what I am going to ask you, but my question relates to and follows on from that. You talked about choice and competition for the consumer, and in earlier evidence we heard the same two things as being part of the benefits. Then there are concerns about standards always being expressed in the negative, it seems to me, such as, "We hope it will not go down", or, "We intend for it not to be diminished", rather than thinking, "We would to make it in such a way that consumers could feel much more confidence in financial services"—confidence that, as you will be well aware, has been absolutely shattered over the past few years. Do you think there is an opportunity to take perhaps a more positive stance on the confidence aspect of consumers' engagement with financial services?

David Lawton: Undoubtedly. It seems to me that the conversation about TTIP has two elements to it. The first element, which is the one we have focused on mainly this morning, is, “What is the process?”. Once you established the process, you could use it for a variety of things. You could go up, you could go down, you could stay the same, but that entirely depends on what you use the process for. All I was saying earlier is that in general terms, free trade agreements are held to be beneficial for competition and choice. The regulatory standards that apply in a regulatory dialogue are open to discussion. It entirely depends on the outcome of the discussion. The only point I was making in relation to those is that simply setting up a dialogue should not lead to any presumption that regulatory standards would be driven downwards. Indeed, speaking from an FCA point of view, I do not think that would be a good outcome.

Baroness Young of Hornsey: I suppose all I would say is that the notions of competition and choice have not particularly served the consumer well in financial services over the past five or six years.

David Lawton: That is why financial services are regulated.

The Chairman: Mr Lawton, thank you very much indeed. I think you have helped clarify our minds, and it may be that after consultation with the clerks we have one or two additional questions to ask you.

David Lawton: Yes, of course.

The Chairman: Thank you very much for coming before us.

David Lawton: My pleasure.