HOUSE OF LORDS

Select Committee on the European Union

Financial Affairs Sub-Committee

Uncorrected oral evidence: Financial services after Brexit

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Watch the meeting

Members present: Lord Sharkey (The Chair); Lord Bruce of Bennachie; Lord Cavendish of Furness; Baroness Couttie; Lord Desai; Baroness Neville-Rolfe; Lord Thomas of Cwmgiedd; Viscount Trenchard; Lord Turnbull; Lord Vaux of Harrowden.

Evidence Session No. 3 Heard in Public Questions 26 - 40

Witnesses

I: Andrew Bailey, Chief Executive Officer, Financial Conduct Authority (FCA); Nausicaa Delfas, Executive Director of International, FCA; Sam Woods, Deputy Governor for Prudential Regulation, Bank of England, and Chief Executive Officer, Prudential Regulation Authority.

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Examination of Witnesses

Andrew Bailey, Nausicaa Delfas and Sam Woods.

Q26 **The Chair:** Good morning and welcome to the EU Financial Affairs Sub-Committee's public evidence session on the future of financial services after Brexit. You have before you a declaration of Members' interests. There will be a transcript taken and you will have the opportunity to look at the transcript before it is published. I will start with the first question. Before I do, on behalf of the Committee, I would like to give our congratulations to Mr Bailey on his appointment as the next Governor of the Bank of England.

What do you think are the outstanding Brexit-related risks for the UK financial sector and what further measures need to be taken either by firms or by public authorities?

Andrew Bailey: I might start, but I will hand over to my colleagues because Nausicaa, certainly for the FCA, is responsible for all our preparations. It is still obviously necessary to prepare for a number of scenarios for the end of this year. While, as no doubt we will come on to later, we have every expectation that there will be an agreement, we still have a reasonably large amount of work going on to consider the consequences of the agreement, whatever it is, not being all-inclusive.

Sam Woods: As Mr Bailey said, we are focused on that question. We have put a huge amount of our effort over the last three and a half years into preparing for a no-deal, cliff-edge exit. The question for us is: now we are in the implementation period, which bits of that could re-arise at the end of the year? I would draw your attention to three, which are the most important.

The first is the very well-aired issue of the ability of EU companies to trade with UK central counterparties. That is £57 trillion of notional and derivatives across the border. Unfortunately, that issue will come back again in September because firms need a bit of time to act if a solution is not put in place. I am cautiously optimistic that our colleagues in the EU will deal with that one because they have done it twice before. That is probably the most important.

The second one is uncleared derivatives, so bilateral trades between UK and EU companies. The UK end is taken care of through the temporary permissions regime, which you and other colleagues in Parliament gave to us, but the EU end may become an issue again. It may not, because clients have been repapering into the new EU entities at a reasonably high pace: north of 80% to 90%, by revenue, of EU 27 clients of UK companies have now done that repapering. The caveat I would give is twofold. First, repapering is just the first step of onboarding. People have to plug in their IT, do test trades and things of that kind. Secondly, there is little sign of back books novating, so there is a question about whether the local regimes and the new trades that customers are doing can take care of this back-book issue.

The third one is on data where, again, you and colleagues in the other House have legislated to allow data to go from the UK to the EU. The EU has not reciprocated but there is a commitment in the political declaration to do the assessment, which should lead to a finding of adequacy under something called the GDPR. I hope that will be sorted in that way.

Nausicaa Delfas: As Andrew said, we have done a lot to prepare for a range of Brexit scenarios. What the outstanding risks will be, as Sam has described, largely depends on what arrangements are made between the EU and the UK Government during the course of this year. For example, we had previously said that some outstanding issues were around the derivatives trading obligation. If an equivalence arrangement is reached, that risk will fall away. There are other areas, though, that do not fall within equivalence regimes, such as insurance broking and some retail business. Unless some other arrangement is made, the arrangements that firms have put in place already will be important in those scenarios.

As Sam described, we have instituted a temporary permissions regime that will allow firms and funds that are currently passporting into the UK to continue to do so. The EU did not create a similar regime and, therefore, individual member states instituted their own laws, but those varied in scope and duration. We need to see, during the course of this year, depending on what arrangements are made, what the status of those laws will be at the end of the year, so we can be sure that firms in the UK can continue to service customers in the EU.

Q27 **Lord Turnbull:** I am looking at the *Financial Stability Report*. There were copies sent to us. Table B.A has lists of things that you think are dealt with. Table B.B has things that could go wrong in Europe and spill over to us. Then you go over the page and, when we have translated all this legislation here, there are still problems around the gaps, so to speak. There seem to be rather more of them than you have referred to already. Are you worried about table B.B, for example, "Other risks of disruption to financial services"? Are you worried about the things on that list?

Sam Woods: From a financial stability point of view, we have deliberately ordered them and the three I mentioned to you are the ones that, in our judgment, if they went seriously haywire, could lead to a financial stability problem. The others are lower down, but the one I would pick out from the list you are looking at is the payment systems issue. The big question of whether UK banks will be able to plug into EU payment systems, by which I mean TARGET2 and SEPA, has been solved; they can plug in and that will be fine. The issue that arises is a technical one, which Andrew and colleagues have also been working on.

Under the new arrangements, banks need a bit more information about the payer, particularly for direct debits. The volume of those is quite high. Banks should be able to fix that in time but, if they do not, there is a risk that quite a lot of small payments get disrupted. Although I do not think that should threaten financial stability, it could be quite noisy. That is the one I would pick up.

Andrew Bailey: Sam and I are obviously both members of the FPC. The second table, as you point out, has in some ways been more dynamic during the year in the sense that things have come out of the woodwork. On the scale of things, the issues are not as big as the stuff in the traffic light presentation but they are things we have learned more about over the last year, some of which we are still chasing down. Sam has mentioned the retail payments issue. To pick up on a point Nausicaa was making earlier, a lot of that has to do with ensuring customers, particularly in the EU, can still be serviced and, where they are making a payment back to the UK, they can.

It is fair to say that we thought that had been mainly solved by about the autumn. Then we found that, while the main point had been solved in the sense that there was an agreement to let it happen, when you are not in the EU, you have to add more detail to your payment instruction. Then we had the question of whether UK banks are fully ready to do that. Going back to what Sam was saying, some were and some were not, and we are still chasing a few down. We have a bit of extra time to sort that out. The second table has been a bit more dynamic, in the sense that the devil is in the detail.

Lord Turnbull: When you go to them and say, "Here is a problem that is largely affecting the UK?", are they still interested or are they only interested in the things that might affect their end?

Andrew Bailey: Somewhat to the point that Nausicaa made earlier, in a way, we dealt with a lot of the UK issues quite early on by designing the temporary regime. In a sense, it was designed to allow a continuation of the current regime and take it out on a glide path, so we could deal with it more smoothly. That has solved a lot of the issues in the UK. That is why we have pointed out that more of the issues are in the EU, because, as Nausicaa said, they have not adopted the same approach. That is why, when you look at the balance of issues over the last 12 months, more of them have been on the EU side than the UK side.

Q28 **Lord Cavendish of Furness:** Sticking with Brexit-related risks, on the other side of the coin, could you give me a broad-brush feel for the risks that the EU, its institutions and the individual member states face as a result of Brexit?

Sam Woods: Each of the three main issues I described could rebound just as much on the EU as on the UK. That is particularly true for the central counterparty issue because, if you sheared off that bit of financial plumbing, it could have quite a dramatic effect for all of us.

It gets slightly more complicated for things such as the uncleared case, because another consideration comes into play for the EU, in that, if it runs a bit more of a risk on it, that might have the effect of putting more business over into the EU. I do not think that features in my colleagues' thinking, but it features in the Government's thinking. The clearest evidence for that is the difference Andrew has just described. Here in the UK, we did the temporary permissions regime because it removed financial stability risk and it suited our industrial policy, whereas that second part of the logic does not hold on the other side. They would be quite at risk from those things I mentioned.

Andrew Bailey: At a high level, one of the large initiatives that the European Union has had in the wake of the EU financial crisis, which obviously came a bit later, is the capital markets union. The reason for that is sensible. One thing the crisis illustrated was an overdependence on bank financing, particularly of the corporate sector. There was a sensible desire to shift the balance towards a more developed capital market. A certain amount of progress has been made on that front in the intervening period, but everybody involved recognises that there is quite a long way to go.

The big issue for the EU, which goes to your question, is whether to develop the capital markets union in isolation from the largest European financial market or not. If the answer is the second, and we would say that is the sensible thing to do, to regard it as a European issue, you get back to the question of what the future relationship will be. It is then in their interest, and in all our interests, to enable that to happen with the involvement and support of markets and capacity in the UK.

Nausicaa Delfas: Our counterparts are interested in continued co-operation and the ability to oversee our respective markets, which are quite interconnected. As Andrew says, capital markets union and open markets would benefit their own customers and investors. The EU is mindful of that as well.

Q29 **Lord Vaux of Harrowden:** In which areas is EU market access particularly important for the UK financial sector? What discussions have we had so far on equivalence in those areas?

Andrew Bailey: Going back to the previous question, in wholesale markets it is important. Generally, the equivalence regime is probably more widespread in wholesale markets than it is in retail markets. For the reasons we were discussing in the answer to the last question, it is important in wholesale markets.

In retail markets—colleagues may want to come in on this—it is pretty patchy. The equivalence regime, as is often commented, is a patchwork. It has developed over time and is somewhat different in each piece of EU legislation; some of them do not have anything in them and there is no equivalence. The most developed is probably the MiFID II equivalence regime, which is the big plank of wholesale markets. It may be because it is wholesale or because it is the most recent to be done. If you look at the history, you can trace the evolution, somewhat, of equivalence regimes over time as they have been more developed.

You have this patchwork. If you look at the dependence on it, it is more important in the wholesale world and quite patchy in the retail world. Some of the issues we were discussing earlier illustrate why it is necessary. For instance, for obvious reasons, there are a lot more cross-border payments these days, in the retail markets as well.

Sam Woods: I agree with that. Perhaps I can add a tiny bit of colour. You can come into the question in two ways. First, what is happening at the moment? What business is being exported from the UK to the EU? Second, as Andrew was saying, which equivalence files touch on that question directly?

On the first, a crude way to think about it is based on the ONS stats. We have £280 billion of output from our financial services sector. Our estimate is that roughly £30 billion of that is to EU clients and maybe £50 billion or so is related to the EU in some quite close way. Within that, about half of it, as Andrew says, is investment banking—wholesale banking of various kinds but really investment banking—and the rest is split between asset management, insurance and infrastructure. That immediately leads you to see where the focus might be.

As it happens, the equivalence files take you in the same direction. As Andrew was saying, the MiFID/MiFIR equivalence provides significant market access for wholesale. Of the other files that touch on my responsibilities, the banking files—CRR and CRD—do not confer market access. You get equivalence to that but it is not about market access. For Solvency II and insurance, there are three different bits. Two are nothing to do with market access and one, reinsurance, is indirectly to do with market access. At its simplest, it takes the focus to investment banking.

Lord Vaux of Harrowden: Do the steps that most investment banks have taken already to offshore what needs to be offshored, and all the rest of it, make a difference to the end result of being able to access those markets?

Sam Woods: In my opinion, it does. We have been very keen, since very soon after the referendum, to say to financial institutions, "You need to be in a position where you are okay for no agreement whatsoever". They have all acted on that and, as a result, have established offices in the EU of various kinds. That means they should not be in a position where a chunk of their revenue just falls away from those groups in the event of no agreement.

That does not mean, though, that equivalence can have no effect. First, it affects how much of that revenue comes into the UK. Secondly, where the parties get to on equivalence will send a signal about what confidence banks, insurance companies and other types of financial institutions can have about running business across the border. We can come to that, but it is relevant.

Q30 **Baroness Couttie:** Where do you envisage the relationship between the EU and UK financial services ending up, particularly in light of the Prime Minister's Written Statement where he said he would enhance "provision for regulatory and supervisory co-operation arrangements", which sounds rather woolly. As a slightly different limb to that, where would you like it to be? It is slightly different from where you think it is going to end up.

Andrew Bailey: This is a central question of the day. We have said all along that we are very strong supporters of open markets, globally and not just regionally, so we want the arrangements to support that. The question, and your point goes directly to it, is about the best way to do that, given the framework we have.

We have an equivalence process that has been agreed and we will go through that. Interestingly, there are two questions in this equivalence process. The first one, in many ways, ought to be the more straightforward: are we equivalent on day one? It would be hard to imagine the answer being that we are not. Indeed, even our counterparts on the continent, such as Steven Maijoor, head of ESMA, have said some of these things. The approach, essentially, has been to copy out the rulebook. That does not answer the true question, which is a different one: thereafter, what is the scope for sensible divergence?

Interestingly, that is not a question that the equivalence process answers. Classically, the equivalence process is to take two regimes, such as the EU and US, that have grown up largely independently, albeit with some global standards embedded in there, and assess whether they are similar enough to declare that you are confident to open markets in whatever way is provided under equivalence. They are answering a different question to the one our process has to answer, where you start pretty much the same and then look at the scope.

That is why the thing that is commented on a lot at the moment is key: what framework will enable that to happen? There is no question that, ultimately, the decisions are taken by each jurisdiction. We do not pool decisions internationally in that sense. We create mechanisms—with due respect, this is the "woolly" piece you mentioned—first, to have strong co-operation and co-ordination between whichever authorities are involved. Drawing on a point Nausicaa made earlier, regulatory co-operation post the referendum has remained very strong. We have deliberately gone out on both sides. We have very strong relations with our continental counterparts and have been keen to make sure they were not eroded.

Secondly, you need mechanisms to say, "At the end of the day, we each take our decision, but the process by which we reach the assessment is not going to be done on a separate planet". We have strong, effective co-ordination. We each want to understand what the other is doing. The mechanisms that the Prime Minister and the Chancellor have been talking about are how I would imagine, sensibly, we would achieve that.

That is very important, because history tells us that there is plenty of scope otherwise for this not to work. Going back only to 2012, Sam and I remember the then European Commissioner for Financial Services accusing us of seeking competitive advantage by imposing higher capital requirements on banks. We thought it was a mistake at the time to conclude that. You would want to have a mechanism to say, "Let us sit down and talk about what we are doing here, because we do not think we are doing that; we think we are doing sensible things". If that ended up every time in a metaphorical punch-up and a threat to withdraw equivalence, that process would not work properly.

Nausicaa Delfas: The sorts of arrangements that Andrew described we also have with other countries in the world. With Japan and the US, et cetera, we have these strong co-operative relationships and regulatory dialogue, where we can have either set-piece discussions or constant discussion about areas of common interest, whether it is fintech, supervising connected markets, sharing information or data. We definitely want to get to that position with the EU, which is our closest neighbour, and continue the kind of co-operation that we have.

On the other point on equivalence that Andrew made, the Commission itself has explained that the equivalence process is risk-based, proportionate and outcomes-focused. There has been a lot of discussion about whether our rules will be aligned and whether we would follow rules, et cetera, but the framework of the equivalence process is not that. As Andrew said, different countries have different rules and have equivalence arrangements. Within that framework, it is possible for each jurisdiction's regime to evolve yet still deliver the same substantive outcomes.

Baroness Couttie: Say we diverge on building societies, which are pretty unique to the UK, or annuity pensions. In various areas, there would be very good reasons for us to have divergence domestically. We may want it on some things that cross over into international areas of business, for good, sound reasons. Are you saying the mechanisms are there to have the dialogue so we do not lose equivalence? If you are, is there a danger that Europe, for various political or protectionist reasons, should they come to the fore, would withdraw equivalence in perhaps what is not necessarily an entirely logical way?

Andrew Bailey: It is interesting to unpick that because you go right to the point about the circumstances in which we would want to, in a sense, move apart somewhat. I can see three things there. First, both of us are going to have to review our rulebooks, because the world moves on. Also, let us be honest; we do not land everything perfectly first time. It would be a pretty bizarre world if we did.

Secondly, there are bits of European legislation that just do not work particularly well for the UK. You referred to annuities. The world expert is sitting next to me. I retired from that subject but sadly I have been dragged back into it. Thirdly, you referred to building societies. That is another interesting one. What about firms that do not do international business? The Basel regime applies only to internationally active banks. Are you going to have the same regime across the board?

Sam Woods: We may come on to specific areas, but logically, and in the way that the equivalence frameworks are described, it ought to be possible to manage divergence. Looking across the 240 or so equivalence decisions that have taken place, they manifestly cover regimes that are very different. That is true, for instance, on the Solvency II side, in terms of the difference between the US regime and the EU regime. That ought to be the case. We want it to be and it should be. Whether it will be, honestly, we do not know.

Perhaps I could briefly add one other point. It is helpful to distinguish here between regulatory co-operation, about rule-making, and supervisory co-operation, so what we are doing with firms. On the latter, I have very high confidence that it will be absolutely fine. I say that because there is a very strong norm established with colleagues in the EU, but also in other jurisdictions, about the way that works. None of that needs the special European infrastructure. It happens in colleges; it happens bilaterally; it happens every day. As a precaution, we have signed MOUs now with 23 out of the 27 national competent authorities. We have been doing that together to cover that. If you have that, you are good. That side will be fine. The more tricky area is the regulatory one that we have been touching on.

The Chair: What lessons, if any, have been learned or are to be learned from the Swiss example?

Andrew Bailey: If you had the Swiss here, you would have some interesting views. They have given them publicly, so I am not blowing any confidences. It has been pretty difficult in a sense, because, first, the origin of the issue in the Swiss case is not to do with financial services. One of the painful lessons is that you can find yourself brought into an issue that does not originate in your own area of activity.

Secondly, it then led to a quite abrupt withdrawal of equivalence and the consequences of that. Ironically, if you take the equity market, the result was that all the equity trading went back to Switzerland. I can tell you that we have all talked to the Swiss at some length about this. It was quite a difficult experience.

Sam Woods: The abrupt point is an important one. There was a bit of debate in public yesterday about this question of permanence. The Government's objective, as I understand it from what the Chancellor has put in the newspaper, is to achieve some kind of greater durability around equivalence. If it can be withdrawn with 30 days' notice, firms are going to be quite reluctant to put much weight on it. I hope it will be possible to agree something more durable, but whether that will be the case in the negotiations is hard to say.

Baroness Couttie: To the point I was making earlier, political reasons or fear of competitive advantage might mean that the EU would withdraw equivalence. It is largely political with Switzerland. We are a bigger financial services sector, which would have a bigger impact on Europe if it treated us in the way it treated Switzerland. Is that something to be seriously concerned about or would the mere size of our financial services industry mitigate the more draconian measures that it might be able to take if it chose to?

Sam Woods: In my view, we should be concerned about it, because, plainly, it could occur. You are never going to remove that from this system. It is not realistic to expect that. It may be possible to make it less of a problem by lengthening phase-out periods, because firms would rely on equivalence to some extent if they thought they would have time to rearrange themselves should it be withdrawn for political reasons. It is the combination of the abruptness, as Andrew said, and that factor that makes it less valuable than it would otherwise be.

Baroness Couttie: They are talking about a change to two years, are they not?

Sam Woods: On the EU side, the Commission has said nothing. The Government have yet, as far as I know, to say something public. Two or three years is a normal off-ramp for something like this.

Nausicaa Delfas: I was going to explain the experience we have had so far with the way that the Commission has operated this. In Switzerland's case, the equivalence arrangement was temporary, so there was a time limit on it. Yes, it was abrupt but everybody knew that it was that time limit so it did not suddenly arise in 30 days.

There has been one other case in which the EU has withdrawn equivalence, which is on credit rating agencies for Australia, New Zealand, et cetera. In that case as well, the Commission made it clear that there was a long dialogue before that occurred. We do not know what the future holds but we can draw some conclusions from the way that it has already operated, in that there is some dialogue and some notice.

Andrew Bailey: In the Swiss case, it was bringing financial services into an argument that was going on in another part of the landscape.

Nausicaa Delfas: Yes.

The Chair: That is not entirely impossible this time round. Take fish, for example.

Q31 **Lord Desai:** Looking at the opposite, what are the risks of very close alignment? Yesterday's headline in the *FT* was that we are about to sign up to complete closeness for ever and ever. Are there risks to the UK position globally of aligning too closely?

Sam Woods: There are two risks, one of which is directly relevant for us in the Bank, and one of which is not so relevant for us but may be relevant for you. The first is that we do not think we can have confidence about our mandate of maintaining financial stability if we have no say over the rules, given the size of the financial sector we have and the fact that it is very different from what there is in most of the rest of the EU. There are numerous examples of things that either do not work perfectly but we are able to fix or could become a problem.

To illustrate the point for you, something called CRD V will land in this country on 29 December. Our team had to work strenuously to make sure that, as an accidental by-product to that, it did not become impossible for us to capitalise our ring-fenced banks to the extent we want to. This was something that we had done, as a major plank of our reforms, and that had not been done in the rest of the EU. There was a very real possibility and, indeed, without the intervention of our teams, that would have been frustrated. It gives you a sense of the sort of thing that could happen if we blindly aligned. That is the bit that is relevant to the Bank of England and regulators more broadly.

The other piece is less for us, but is worth mentioning. There is an industrial policy question given our Government's objective to have a large global trading centre here, and the openly stated and perfectly respectable objective that some other Governments have to move some of that into their jurisdictions. There is a question as to whether it is sensible to sign up to rules set by those other jurisdictions with that in the background.

Andrew Bailey: There are two points for me here. The first goes back to something we mentioned a few minutes ago. It is absolutely essential that we have the capacity to review and adapt the rulebook. As I said, the world moves on and we find that some things work better than others. To find that that was constrained would be very difficult.

The second thing is a little harder. I do not want us to come across as arrogant on this point. The rulebook we have today, which has come out of the EU, has been developed with a very large amount of input from the UK. I have been involved in it for over 30 years and successive UK Governments of whatever party have rationally taken the view: "If this is going to affect us and we have the biggest financial markets, we should get in there and influence it." We have been pretty successful over the years. You can point to things we do not like but there are a lot of other things that we either wanted or, frankly, wanted to limit the damage of, where we have been pretty successful.

Now we are going to move into a world where that is not the case. Counterfactually, what the future will look like in the absence of that is hard to judge, but it is clearly a risk, if we were to be locked in very tightly.

Q32 **Lord Turnbull:** I wonder whether we can get into some elementary psychology. People fuss more about losing something they already have than forgoing something they do not have. We start off and we might have 100% overlap with the EU. Let us say the US has 80%, but it is deemed to be equivalent. Yet the EU fusses about us moving a small amount from where we are now, a lot more than it fusses about the much bigger gap it is tolerating with someone else, because it is not giving up something it already has. My worry is that it will get obsessed by some small changes we make that are already tolerated in agreements it has elsewhere in the world.

Andrew Bailey: You are right to point to that. I have two thoughts. First, we do not know, of course, but you are right to point to the potential for this to happen. That is why it is right to want to have the surrounding mechanism, to ensure that these decisions are taken sensibly. At the end of the day, each of us takes our own decisions, but they are taken sensibly to limit the risk that you rightly point to.

The second thing is also very hard to judge. Noises have been made by the European Union that it will treat us differently in what you might call a slightly reversed proportionality argument. Because we are near and big, we are going to be held to a different standard from anybody else. We do not know what that adds up to in practice, but it is another reason to be alert and sensitive to the point you raise.

Nausicaa Delfas: I would add a further, more contextual point. We and the EU will continue to influence global standards. We operate in a global context and a lot of the standards in domestic and EU rules are formed at an international level. There are lots of examples of that, particularly in financial stability, insurance and even cyber-resilience. There are a lot of issues that we discuss at a global level, which then cascade to domestic and European rulemaking, and we will still be at the table on those and will continue to influence that. That is an important contextual point.

Andrew Bailey: That raises an issue, which is really more in Sam's world, looking at it from us to them. If, as is the case, they do not implement the Basel accords properly, what do we do about it, in terms of the equivalence judgment that we have to make?

Sam Woods: An interesting example of that will come up in June next year. It sounds rather small and techie but is quite important. One deviation that the EU is proposing from the latest Basel deal is to allow banks to count as capital their investment in their own IT systems. We have always been very cautious about that idea because we have had numerous blow-ups where IT systems have not worked. It seems highly dubious to think that, when a bank hits the wall, it will be able to monetise that.

To be fair, we lost that argument in the EU 28 setting. Our leverage has been greatly reduced, of course, but it will be a question for us, which we have not made a decision on, when that comes in, in the middle of next year. Do we join the EU in being noncompliant with Basel and allowing in this thing, which I do not think is a terribly good idea, or do we hold the line?

Q33 **Baroness Neville-Rolfe:** I would like to turn to opportunities, because we have had a good discussion on risks. Where are the opportunities for the UK to diverge from future EU rules? You, Mr Bailey, championed the sandbox and, of course, the world is changing with the huge digital revolution. I am concerned that we could be held in a straitjacket and not be able to look forward to the future adequately. I am also concerned that UK businesses and UK banks—I sit on the board of a small one—should get the chance to move forward in this new global vision that you have described so well.

Andrew Bailey: That is very interesting. We have discussed it before. It is interesting, looking back at our partnerships around the world, in the area of fintech and the sandbox, over the last few years. We at the FCA have created something called GFIN—the Global Financial Innovation Network. It is based around IOSCO, which is our equivalent to the Basel committee in many ways. It is interesting that certainly the early and stronger relationships were outside the European Union. The European

Union, frankly, has been rather suspicious of it. I keep hearing slightly suspicious arguments that this is going beyond the rulebook, which I do not think it is.

There are signs that that is changing, and I hope it is, but, to your question, that illustrates that we have a global market. We have developed very strong relations in that area with other countries, and we want to go on doing that and develop them. That is, frankly, one of the opportunities we have and we should take that opportunity.

Sam Woods: I would pick out two examples for you. The first is on the insurance side. I remember vividly Lord Turnbull describing Solvency II as an absolutely dreadful piece of legislation, which I think was a little harsh, but there are bits of it that do not work well. In particular, there is a thing called the risk margin, which is a great example of an unintended consequence, in that it was designed in one environment and now we have found ourselves in a very low-rates environment.

For UK firms writing long-term annuity business, the effect of that risk margin is not what was intended, which was that insurers should hold a bit of extra margin in their liabilities; it is that they are offshoring longevity in huge volumes. That is very unhelpful. We will want to change that. There is a discussion going on in Europe in the Solvency II review as we sit here about whether to change that, but we are not in the room. That is one opportunity, and an important one.

The other one may be more interesting, given what you said in your question. We are very keen on the idea of not a weaker regime, but a simpler regime, for small firms and particularly small banks. My colleagues and I believe that would be a good thing, from both a safety and soundness perspective and a competition and competitiveness perspective. We would like to work such a thing up. It is very difficult to get such a thing agreed in an EU 28 setting because one person is big, another person is small and things of that kind, and given the difference Andrew described. Our opinion is that such a thing could be done. For instance, going back to the building societies question, it has no relevance to equivalence whatsoever. Whether that proves to be true, we will have to find out.

Andrew Bailey: The problem with Solvency II—and why it works better in general insurance than life insurance—is that it presumes a single market in life insurance products in the European Union. As Sam said, there are still a series of national markets, essentially, and that is why it has not been easy to make it work in that market.

Lord Turnbull: One of the reasons I said it was a dreadful piece of legislation is that it not only impeded a particular market but it frustrated certain government policies. We are trying to get banks to invest in long-term infrastructure, and the way the risk weightings were decided made that more difficult.

Anyway, this is the more general question. Over the years, we have managed to be quite successful in moulding the financial legislation in ways that are suitable to us. Sometimes, we have lost the argument, and Solvency II was one of them. We went along with it because we did not have any opportunity but we were slightly resentful about it. Now we think, "We can do the things that we really wanted to do." Are there any others beside the two you mentioned that you would put into that category?

Sam Woods: There is a more structural thing, which we refer to sometimes as the style of regulation, and that is exemplified by Solvency II. If you look at the way financial regulation has been done over the last 20 years in this country—Members of the Committee will understand some of this better than I do—FSMA 2000 essentially set the objectives for the FSA and then the FSA made all the rules. If you wind forward to the latest version of EU 28 rulemaking, of which Solvency II and MiFID are great examples, you have a huge volume of detail in legislation, including some very complicated algebra, actuarial tables and things of that kind in Solvency II.

In between those two bookends is the way that we have done things in the UK since. The senior managers regime is an interesting one where important things were put into the law but then a certain amount of detail was left to the regulators. There is an opportunity here and, indeed, it would be sensible for Britain, once it has exited the EU, to move back to that more British style of regulation and have more of the regulation done down in the rulemaking of the regulators.

There is an accountability question, which we may come on to alongside that, but such a move is a rare win-win. It would be good for safety and soundness, and financial stability, because we would be able to adapt to things as they go along, and it would be good for competition and competitiveness for similar reasons. That is more a structural point but, from our point of view, it would be very desirable and sensible to move in that direction.

Andrew Bailey: I agree with Sam that it is a British style. That is because it is associated with common-law systems as opposed to civil law systems, which tend to embed more of the rulemaking in the legislation. There is this fundamental difference. Over the years, of course, we have had to essentially adapt to that world but, in a sense, we are now going back to that question again, as Sam rightly puts it: what is the sensible way to do it in a common law regime?

Viscount Trenchard: Could I ask another supplementary to that? You have mentioned Solvency II and bits of MiFID II where we were outmanoeuvred and we might not have adopted exactly the same regulation.

Andrew Bailey: We were outvoted.

Viscount Trenchard: Another one, which has not been mentioned, is AIFMD; in other words, the whole alternative fund management regime, which was almost entirely the UK's. Indeed, it was relatively recent that the Commission decided to legislate in this area. It was not expected when the Commission moved into it and it has certainly not been in the interests of smaller asset management companies. It has definitely cost London and others, such as the Crown dependencies, business. Are there, therefore, opportunities to be gained by diverging or even abolishing the entire alternative fund management regime? Most of the investors in it are high net worth, professional or institutional and they do not need the protections that AIFMD purports to give them. It is bureaucratic; it is expensive; it has cost jobs. Bits of MiFID II have resulted in mergers and decimation in the number of analysts covering smaller companies, which reduces choice for investors. Could you say a little more about what opportunities to diverge there might be?

Then there is the difficult question of the timing because, if you do not say anything, 31 December comes and we are wholly aligned, we can claim equivalence but, if they know or suspect that on day one we are going to seek to diverge in certain areas, it will encourage them not to grant full equivalence from the beginning. You hear often that many Ministers have said it is easy to get equivalence because we will be equivalent on day one. If we already know that we want to diverge on day one, it seems to me that we are more likely to get a durable framework by being honest about it up front.

Andrew Bailey: That is why, earlier on, I set out the two parts to the question. The second part, in a sense, was the much more important part, which is, as you rightly say, not whether we are equivalent on day one. The answer to that question ought to follow reasonably easily. There will no doubt be a lot of work involved, but I do not think the question is hard to answer. The real question, as you say, is what happens thereafter.

There is an interesting question then as to whether we say, "Now, we do not like the following things," or whether we say, "Look, just as the EU will do, we will have a process by which we review big parts of the stock of legislation." The EU will review MiFID. It has said it will review MiFID. It will review PRIIPs, which is another malfunctioning piece of regulation, and we will do the same. We have a real issue here. Do we run the flag up the pole and say, "Here are the following things that we are going to go for", or do we say, "You have to accept that there will be a review process"? This is why we need a structure around it. "You will do reviews and we will do reviews. That will be the normal course of events."

In doing that, we will expose the question of whether AIFMD is fit for purpose and, if not, what we do about it. I would rather see us set up a structure in which those questions can be answered and it is understood that that is how we do business, because it is.

Nausicaa Delfas: In doing that review, we also consider the costs that the industry has already outlaid to implement the rules. We do the usual cost-benefit in how we review different aspects of our respective regimes.

To add to the previous discussion we were having, at the FCA, we have some instances where areas that have been onshored into our own rulebook and legislative framework may not work so well in the sense that, for example, we have detailed PRIIPs rules in legislation equivalent to primary legislation, so we will need to have a look after exit and think, "Where should all this settle? Is that something for Parliament or is it for the regulators?"

We have also said that we will look at our regime as a whole and look at whether our regulatory rules, et cetera, are fit for the future. We are looking at the future of regulation. Should we go to a principles-based or an outcomes-based approach? Baroness Neville-Rolfe talked about the fintech agenda and the digitalisation of the industry. We really need to think hard about whether the frameworks we have in place work in that context.

I know from my own experience with cyber-resilience that a lot of the rules and requirements are quite high-level. That is a good thing because, if we start to draft very detailed rules, they will be out of date by the time the ink is dry. There are things that we need to be considering going forward and, as Andrew says, we will be developing our regime just as the EU will be developing its own. It will not be static. It is good to have that acknowledgement at the outset.

Q34 **Lord Cavendish of Furness:** Some of this question has been touched on but not all. How might the UK take a different approach to financial regulation after leaving the EU, such as giving greater discretion to regulators? Specifically, how would this compare to other jurisdictions beyond the EU? How would the "hybrid approach" that we hear about work in practice?

Sam Woods: Perhaps I can add colour on the comparison with other jurisdictions beyond the EU, because my response to your first question is the one I just gave.

If you look across jurisdictions, you can do two comparisons. First, you can pick something in our world, which is the Basel III reforms, the main banking reforms following the crisis. In every single Basel jurisdiction in the world, apart from the EU and Switzerland, all of that was done through regulators' rules. It is only in the EU and Switzerland that that gets drawn up into legislation. The main reason for that is a perfectly respectable one in the context of the EU, which is to make sure that everybody does it in exactly the same way. If you have left, that no longer binds and the question naturally arises. That is one comparison you can do.

Secondly, you can look across different jurisdictions at the rulemaking powers of regulators and—we may come on to this—the ability of government and Parliament to intervene directly in that process. If you map that out, you see that, in nearly all jurisdictions, people who do our sort of job have a rulemaking power like we have. There is a slight quirk in Canada, where formally it is not binding but they have another power that can make it binding, so you could consider that the same. One exception, interestingly, is France.

Then, if you look at the ability of government or Parliament to intervene and change those rules, which gets to the question of the balance between operational independence and accountability, that is a pretty mixed picture. In some jurisdictions, such as our own, that is not the case, although there is a lot of examination of regulators, in the way that we are doing today. In others, there is a more direct role.

The US is an interesting one. The way it works over there, crudely, is that Congress does not have the ability to get in and change the rules, but it has a backstop ability if the regulators make rules. Within 60 days, if Congress can pass a resolution that is also signed by the President, it can in effect veto that. That is a sort of backstop. It has hardly ever been used. As far as I know, it was only used, in recent times anyway, in the early days of the Trump Administration. That is just an example of a different kind of model.

Baroness Neville-Rolfe: I have a follow-up to the prior question. If the rules go to the regulators, which seems quite sensible, as you are very professional and you will consult, I expect that your direction of travel will be to look after the consumers, the small banks as well as the big banks, and try to cut down the bureaucracy. I have to say, as somebody who is involved in financial services in lots of different areas, it is very burdensome, so you have a lot of cost within the economy going in as well as this terrific contribution to GDP.

How, in this new world, if you are to take over more of this regulation, can we be sure that the spirit of the regulatory sandbox will rule okay, rather than always thinking about supervision and therefore having treble checks on everything? In this Committee, we talk about innovation and moving forward, and we ask, "Is this an opportunity?" That is a supplementary on that point.

Andrew Bailey: There is an interesting question here about the future direction of what I might call the broad oversight. This has been driven by the fact that a lot of the rulemaking has originated in the EU, but the oversight is more in the direction of what I would call accountability than scrutiny: in a sense, looking backwards rather than scrutinising by looking forwards. I know you have had hearings with other witnesses on this subject. There is an interesting question that goes to Sam's point. It makes sense not to legislate at that level of detail, but then the question becomes one of the appropriate level of scrutiny. That question, broadly, has not been answered because the EU has, in a sense, occupied that space so extensively in the past.

Nausicaa Delfas: It is worth reflecting why the EU has done that. Because it relies on national supervisors to implement rules and does not have as much control over whether the rules are applied consistently, it needs that control of the rulemaking process in more detail to ensure the consistency across the EU 27. Obviously, that is not the position for us when we leave the EU.

Q35 **Lord Bruce of Bennachie:** What is, in your view, the role of Parliament in all this? As you say, the EU has been doing the rules and the European Parliament has had a very substantial role. As you, Mr Bailey, have said, there is a cultural difference of approach, for good reasons but nevertheless. Freed from that, we are going to be more outcomes-based, more pragmatic and more flexible, so we do not necessarily need all that. On the other hand, Parliament is going to face a rapidly changing situation, with a restructuring of our committees and really not very much clarity over whether we can monitor what is going on effectively and, indeed, whether we will have the resources to do it on the scale that is necessary.

As a minor point, there is the question of whether we need to keep ourselves more connected with what is going on in the European Parliament and whether that matters. How do you envisage Parliament monitoring this and how well resourced will we need to be to be competent at it?

Andrew Bailey: It is a really interesting question. There are answers to that question that would require you committing vast amounts of time to scrutinising very low-level detail. It is not for me to presume what you want to do.

Lord Bruce of Bennachie: I do not think parliamentarians want to do that. We need to know is what is going on, whether it is doing the right things and what it will mean for the wider economy. What is happening?

Andrew Bailey: Going back to Viscount Trenchard’s point, I hesitate to give advice on this, but there needs to be a shift of the emphasis towards asking the question—let us take AIFMD as a cause célèbre—before it is done and it becomes ex-post, and ensuring the process. We do consult. We have an industry of consultation and I read them all. It was a commitment I made when I went to the FCA and occasionally I wondered whether my evenings could be spent doing other things.

The question is how we can help to design an efficient process that allows scrutiny at that point, without swamping you, frankly, which would be easy to do and counterproductive.

Sam Woods: Andrew and I have been discussing this. At the moment, we both produce a business plan that says everything we are going to do, and people can take interest in that if they want. What we are talking about here is a possible change in the way we are doing rulemaking specifically. I had a look back at our own business plan in that context and it was apparent to me that it might not serve the purpose that you describe. If we end up moving in this direction, a contribution we can make—obviously, it is for you to decide how you want to do the accountability in committees and all that—would be to signpost much more clearly and directly to the relevant committee or committees in Parliament: “Here is our forward work programme for the next 12 months. Here are all the rules we expect to be making.” You may summon us on any of them to ask us what we are doing, but we can highlight and say, “These two are pretty significant. We are setting up a new framework and it is a big change, whereas these are more procedural.” At the moment, we do not have that. That would be relatively easy to achieve and I think would help you in your task.

Andrew Bailey: We also need to help the process to focus. I want to pick up a point Viscount Trenchard made quite rightly about AIFMD. You made the point that this is a regime that applies to people who should be able to take care of themselves. It is interesting, possibly not so much for AIFMD but with asset management more generally. With the evolution of asset management in the last 10 to 20 years, and changes in the pension system, far more of the population is now using the asset management industry as the vehicle to long-term saving than in the past, as, going back briefly to Solvency II, the traditional life insurance industry is declining.

This is the challenge for us as regulators. We have seen it with some quite celebrated cases, and one in particular in the last year. Where do we draw that line? Those are the sorts of issues that, when doing this sort of scrutiny, we need to focus on. I entirely take the point you are making. It is not an easy line to draw.

Lord Bruce of Bennachie: The point I was making is about the change from the detailed work that the European Parliament does to what will happen here. We have seen that the European Parliament is able to commission reports and bring in all kinds of activities. Does Parliament need some sort of capacity to do that or would that be regarded as intrusive from your point of view?

Sam Woods: If we end up moving from the mode we are in currently—where, exceptionally, when we do a piece of UK-only legislation such as the senior managers regime, we do a lot more of the work, but the bulk of what is coming through is in the European model—to more of the former, it is entirely natural that Parliament would have a bigger role in examining what we are up to.

The difficult question, which in the end is for you and Parliament to decide, is whether you want to remain in examination mode or to be in intervention mode, with the ability to intervene in the rules. That is more sensitive because this principle of not goal independence, but operational independence, is quite important. It is also very important for us in a Basel context. That is where the tricky judgment lies, not in the basic idea that, if we are doing more of the rulemaking, more of that will be scrutinised here or in the other House.

Lord Bruce of Bennachie: You know that, if things go wrong, there will be interventions.

Q36 **Lord Thomas of Cwmgiedd:** Can I go back to the area of global co-operation and the opportunities we have globally? Quite naturally, we tend to focus on the EU and forget the wider world. Which global opportunities do you see us taking advantage of?

Andrew Bailey: Do you mean in the development of markets or regulations?

Lord Thomas of Cwmgiedd: I mean the development of markets and the way we work with other regulators. I want to come back in a moment to supervision and exchange of data, but could we take that very general picture first?

Andrew Bailey: It is substantial. Going back to Baroness Neville-Rolfe's questions, we have seen very substantial developments of fintech co-operation globally. We are very strong supporters of that. It has pleasantly surprised us, frankly, and is going well. I see that very clearly. The balance of growth in the world economy has shifted decisively, obviously, over time. The UK is a financial centre that supports global activity. It is not just a European financial centre. It is important to bear that in mind and align ourselves to develop that.

I arrived at the FCA the week after the referendum, which was not accidental, and this is one of the first things we said: "It is critical that we do not become isolated and that we engage globally." We have both set out to do that.

Sam Woods: We invest heavily upstream on the prudential side, both in Basel and in the IAIS, which is the insurance version of Basel. I am very sorry that our colleague, Dr Saporta, for reasons of bereavement, could not join us today; she is chair of the IAIS. That is where, on the prudential side, the opportunities are there for us going forward.

In Basel, the main one I have an eye to is this operational resilience agenda, which we have been trying to lead on here in the UK, and there is a consultation paper coming out, I hope, at the end of this month from Basel that will have a strong UK imprint on it. This is joint work with Andrew's team.

On the insurance side, quite a big milestone occurred in November. The IAIS agreed, with Dr Saporta chairing, to establish and test an international capital standard for insurance companies, a bit like what we have for Basel. It has been very difficult to achieve that agreement. Our priority on that side will be to make sure that that holds so we can develop something like that.

Nausicaa Delfas: From the FCA's perspective, we engage in the multilateral fora—the FSB and IOSCO. The FCA is the UK representative on IOSCO. We engage very heavily on the multilateral global standard-setting work, covering areas that Sam has mentioned such as operational resilience, cyber, fintech and non-bank finance risks, but we also engage in a lot of dialogues bilaterally with other countries. For example, with Japan, we have talked about green finance, co-operation and fintech. With the US, we have done a lot of work on Brexit preparation but we have also signed up to a fintech partnership. Of course, with China, there have been economic and financial dialogues on Stock Connect, et cetera. We are already engaged in these and we envisage continuing to be.

Lord Thomas of Cwmgiedd: To what extent does what Mr Bailey has described as our common-law approach marry more closely with the international view, bearing in mind that so many of the major financial centres have that base? Does this help us?

Andrew Bailey: I have to defer because I am not a lawyer.

Lord Thomas of Cwmgiedd: I know.

Andrew Bailey: It is blindingly obvious. I would start with the observation that it does not seem to be a random outcome that wholesale financial markets tend to be present in common law regimes. That is not a coincidence. They find it a more natural environment to operate in. It can be adapted more rapidly, as you know much better than I do. You get the opposite argument that you can become too hooked on case law that turns up out of who knows where.

History tells us that that is not a random outcome and much of the discussion we have been having over the most recent part of this hearing really goes to that. Where are the boundaries between what is in legislation and what emerges out of either case law or regulators' rulebooks to reflect that? In a sense, we have to re-find where we want to position ourselves there because, over the period of our membership of the European Union, we had to adapt our approach, to reflect the fact that we were in a union that predominantly was not a common-law system.

Lord Thomas of Cwmgiedd: In connection with that, in enforcing standards, you touched on the college of regulators a little earlier. To what extent is that area developed and will it enable us, bearing in mind the nature of global markets, to continue the detailed supervision that is necessary for financial stability and other areas?

Sam Woods: It is extremely well developed with some of our main partners. I have mentioned, in particular, the US, the federal agencies there as well as, to a much lesser extent, the state agencies, and Switzerland. We also have arrangements of these kinds with lots of other jurisdictions. Indeed, it is a precondition of us allowing people to have big branches here in the UK. All of that works very well and, in fact, it works at least as well with the US and Switzerland as it does with our European colleagues. We are in good shape on all of that and I am not really worried about it.

The more difficult issues are about whether our role in regulation on the international stage changes as we leave the EU. I have to say, though, on that topic so far—it may be that we do not see ourselves clearly—it really is not at all apparent to me that our status or influence in those international fora has been much affected by what is going on. That is because those are technical gatherings and, to be blunt, if you make the effort, do the work and bring a convincing analysis, you can often make progress.

Q37 **Viscount Trenchard:** The balance between maintaining the competitiveness of markets and protecting the user or consumer of those markets has a very long history and goes back to the Financial Services and Markets Act. In 1999, there was a long debate as to whether competitiveness should be an objective equivalent to the other objectives or whether it should be a secondary objective. At present, you have an existing objective of promoting competition, which seems to me to mean the same thing as having a competitiveness objective. I am not quite sure what the difference is, but perhaps you could explain how you see this conflict and how you think we should find the right balance.

Andrew Bailey: We both have competition objectives, but they are different so we should probably explain both of them. We can start with the FCA's competition objective, because for the FCA competition is a primary objective whereas yours is slightly different.

Precisely, it is competition in the interest of consumers. That is important. If we can achieve that, we are providing a platform for firms to be competitive. That is a view that we hold very strongly. There are different views on this and I recognise that. As you suggested, the word "competitive" can be interpreted in different ways. It is sometimes interpreted as "internationally competitive", sometimes as "domestically competitive" and sometimes both.

In the current regime, as well as having the objectives that Parliament has given us, we both receive from the Government, at least once during the lifetime of a Parliament, what is sometimes called a remit letter, although I think that is probably technically wrong. It essentially sets out the Government's objectives and policies. The ones that we are both operating under use pretty similar language about the UK as a financial centre, and the importance that the Government place on that and on developing and encouraging it, and that feeds through into our approach. From our point of view, it is a combination of having a primary competition objective and then having this letter from the Government that says what the Government want to see happen.

Sam Woods: I agree with all of that. I have always been a little cautious on this topic, for two reasons. First, the history of the FSA's competitiveness objective is not an entirely happy one. Certainly, my colleagues who worked there believe that that is part of what came undone in that organisation. Of course, they may be wrong and others will disagree with that, but it is sometimes understood to mean a proxy for, or a route to, weak regulation, which is a great mistake. Our job is often more like a referee's. As a referee, you want an organisation that is reasonably firm, and that is part of what attracts money into the UK and particularly into the City. That is one caution.

My other caution is about complexity in the sense that financial regulation is a moderately complicated field and it helps that we have a very clear objective: safety and soundness, policyholder protection and competition as a secondary. The more you add to that, the more you risk diluting the effectiveness of the regulator. I know you had witnesses here from the IRSG and they wrote a report on this. In a way, their report exemplifies this because they make exactly that point, which I agree with, but they then suggest we should have a competitiveness objective. They go on to ask, "What about an objective for promoting climate technologies or promoting intergenerational justice?" This illustrates that if you load us with things, like a Christmas tree, there is a risk—it is not a known fact or a certainty by any means—that you dilute effectiveness a little.

Nausicaa Delfas: From the FCA's perspective, Andrew talked about our object of competition in the interest of consumers. That is why we have done a lot of work on market studies and financial innovation. FCA Innovate came out of the competition remit that we already have, which is to enhance competition in the UK in the interests of consumers.

If we look at it from an international perspective, the fact that we are known to have high regulatory standards and a strong ecosystem around financial services, and our common-law jurisdiction, are important aspects for the UK's competitiveness. The way that we are set up with our objective and, as Andrew said, the overarching remit letter is probably a good balance.

Q38 **Lord Cavendish of Furness:** I declare an interest, in that my world has been the SME sector, and I am interested in small business, as my colleague, Lady Neville-Rolfe, is. I would make the point that somebody needs to look at competition rather strongly. My sector, not to mention the very small business and the sole trader, has difficulty accessing finance and that finance tends to be expensive. Do you have a role there? I perfectly understand your reservations about competition.

Andrew Bailey: This is quite a big one. One issue that runs through the FCA's world, rather differently from the PRA, is what we call the regulatory perimeter. The legislation defines activities that are regulated. If you sum up those activities, you get an area.

The perimeter is extremely complicated. One of my colleagues describes it as like the coastline of Norway. It looks perfectly simple when you view it from far enough up in the air. The Norwegian coastline is something like 26 times longer when you measure it. It is, unfortunately, extremely complicated when you get down to that level. As an aside, it is interesting that many of the most difficult and controversial issues we deal with have the perimeter in common. They are activities right at the edge, just over the edge or involving complex activity through the perimeter.

As an example of this, small firms are not within the regulatory perimeter as such. Some are, because they are so small that they are sole traders, for instance, and they fall within it because they are classed as individuals rather than small firms. It has been an issue for us. We have had very well-known problems with banks, going back to the crisis and its immediate aftermath, as to how small firms have been dealt with and access to finance. It has been a problem for us as to how far we intervene in an issue that is either at the perimeter or beyond it. It also goes back to the questions we have been discussing this morning about how much regulation we want. It is not easy.

On the whole, the decision has been taken by the Government not to extend the perimeter in that respect. That is fair enough and I understand why. In many ways, the origin of where the perimeter was put was a desire not to burden small firm banking, particularly, with the overhead of regulation. It has left us, at times, somewhat limited.

Recently, we have probably gone somewhat beyond how the remit was interpreted in the earlier part of the life of the FCA because, frankly, the public interest and the volume of public interest has really caused us to look harder at what we can do and how we can use our voice at times. But it is a good illustration of the complexity and challenge at the boundary of regulation.

Q39 **Lord Turnbull:** I am trying to go through the items we have covered today. First, are there some things that are really immediate? Which of the issues that we have covered are going to be, say, three-month issues?

Sam Woods: I would pick out one. There has been a commitment made by our Government and the EU to complete, or "attempt to complete"—I think that is how it is worded—the equivalence assessments by the end of June. That is a very live issue. Our team has already got going. As Mr Bailey said, this ought not to be tremendously demanding given the position we are starting from but, none the less, there are some things to be gone through.

I am still in the dark about exactly how our colleagues are going to pursue that at their end, which of course lands on us. I suspect it will land in the form of an extremely long questionnaire, which we will have to fill in. I am not worried about it, but that is the most immediate bit of this for us.

Nausicaa Delfas: That is the same for us. The Commission has said that it will proceed immediately to equivalence assessments, so that is what we are prepared for. We are also supporting the Government on free trade negotiations and free trade agreements. During the course of this year, as we did before January, we will continue to look at how things evolve and the issues for the industry, and make sure we take a pragmatic approach and communicate to the industry in a timely way.

Andrew Bailey: We are on day 12 now of being outside the European Union. We are no longer participating in EU fora, but it is important that we maintain close regulatory and supervisory connections with the authorities in the EU because we have such close connections with the firms. We have all been very focused on this because obviously we have been anticipating it but now is the time when we have to make sure that the lines of communication are still there.

Lord Turnbull: I like the distinction between those things that are dealt with at the technical level, where a rational economic man or woman prevails, and the political level, where I suspect the mercantilist instinct is very strong. Can we prevent bits of the EU thinking, "This is a great opportunity to steal London's business", even if it does not really make sense for them, for the EU as a whole or globally? There is a very opportunistic temptation.

Sam Woods: That temptation is there. To exemplify your point, in the last couple of years, those factors have had an impact on our status, even in the technical fora, where a lot of stuff gets sorted out further down. I do not think you can entirely get away from that, but there is a chance to conduct the equivalence work here on a technical basis and reach a clear view, although there would in the end be a political decision on that on both sides. A negative decision based on technical advice to the contrary would say a very big thing about how the EU approaches equivalence to the rest of the world.

Andrew Bailey: I will give you an example that we have been involved in. It really goes to the question of the cost and risk of fragmentation. It is something called the share trading obligation, which was little understood before it surfaced about a year ago. This goes into the world of MiFID. The share trading obligation essentially says that, absent equivalence, parties resident in the EU should trade shares in the EU. That was relevant in the Swiss case, but it would also be relevant here because a lot of EU share trading happens in London. That is very well established.

Our view is that the principle we always want to see is best execution: that firms are getting the best execution for their clients. It does not really matter where they get it, as long as it is a fair market. The intention is not to say it must all be here, but it must be done under the principle of best execution. Your mercantilist point is to the fore there. It would be very interesting to see where this comes out. It can be solved with equivalence, and it may well be. If it went the other way, it would be a very interesting test of this question.

Q40 **Baroness Neville-Rolfe:** Some of us are going to Brussels at the beginning of March. Obviously, that helps with influencing and continuing relationships. Is there anything other than the list you have already given Lord Turnbull that we should be thinking about in those dealings?

Sam Woods: I have mentioned the main ones from my point of view. It comes back to a point that Viscount Trenchard was raising. It is better to acknowledge that we are moving into a process of managing divergence here. If you enter the equivalence dialogue with a notion that you are going to stay exactly the same, that would rapidly come asunder. It could come asunder in a way that causes feelings of bad faith and it would be better to be plain.

The Chair: Are there any existing models of managing divergence?

Sam Woods: I do not think there are.

Nausicaa Delfas: There are none, other than the framework as it exists, which is that these are two independent countries with their own jurisdictions, legal history and regulatory history, and they evolve differently, but they deliver the same outcomes. That is what exists currently.

The Chair: It is a way of doing it, yes.

Lord Vaux of Harrowden: Divergence goes both ways. Are there any areas where we are expecting them to diverge from where we want to go?

Andrew Bailey: We mentioned one of them earlier, which is Basel III and where they will go on that.

Sam Woods: In a way, it is almost inevitable because, absent us at the table putting across our point of view, unless you think we have had no influence on regulation at all, it will go in a slightly different direction. The next leg of Basel III is what we call "Basel 3.1" and what the banks call "Basel IV"; this is what passes as a joke in financial regulation.

Andrew Bailey: It is as good as it gets.

Sam Woods: As Mr Bailey was saying, there will be different instincts about it and, broadly, we will want to be firmer on it than some of our colleagues.

The Chair: Thank you very much indeed for your time and for your evidence. The public evidence session has now ended and the Committee will resume its private deliberations. Thank you very much indeed.