HOUSE OF LORDS

Select Committee on the European Union

Financial Affairs Sub-Committee

Uncorrected oral evidence: Financial services after Brexit

Wednesday 5 February 2020

10.10 am

Watch the meeting

Members present: Lord Sharkey (The Chair); Lord Bruce of Bennachie; Baroness Couttie; Lord Desai; Lord Giddens; Baroness Liddell of Coatdyke; Baroness Neville-Rolfe; Viscount Trenchard; Lord Turnbull; Lord Vaux of Harrowden.

Evidence Session No. 2 Heard in Public Questions 12 - 25

Witnesses

I: Julian Adams, Director, Public Policy and Regulation, M&G plc; Peter Bevan, Financial Regulation Partner, Global Practice Head, Financial Regulation Group, Linklaters LLP; Miles Celic, Chief Executive Officer, TheCityUK.

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Examination of Witnesses

Julian Adams, Peter Bevan and Miles Celic.

Q12 **The Chair:** Good morning, gentlemen, 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. The session is being broadcast on parliamentlive.tv. A full transcript is being taken and will be made available to you to make any corrections shortly after the session is completed. I will start by asking the first question, which is to establish some context. Could you tell us how you see the current state of the UK's onshored framework for financial services? Why do you think, if you do, that this should change after Brexit?

Peter Bevan: There are two parts to that. First, all the key legislation is going to be carried forward in the UK, following the end of the transition period at the end of this calendar year. All the framework legislation is in place, both primary and secondary, to allow for that to be transferred into UK law. Over the next year, the European Union (Withdrawal Agreement) Act also allows for legislation that changes over that period to be onshored, which means that we are now ready. At 31 December this year, the UK will have a regulatory regime that is fully aligned and up to date with the EU regime that we will be leaving, amended to take into account those things that are necessary for a domestic rather than multistate regime. That needs to take place to enable financial institutions and other firms to carry on their business with a degree of certainty.

The onshoring of EU legislation has also given clarity on the powers that are to be given to the different institutions in the UK. That involves identifying the UK equivalents for the various different institutions with relevant rule-making powers at the European level, and there are many. EU legislation, as you know, adopts the so-called Lamfalussy process of three levels, so the European Parliament and Council make level 1 legislation. Those powers have been transferred to the Parliament here. The European Commission has certain responsibilities that have been passed to the Treasury. Then the responsibilities of regulatory bodies at a European level, the ESAs, so-called level 3, have been passed to the UK regulators. That process has been put in place and is ready to go.

The second part of your question is why this should change after Brexit. The requirement to onshore EU regulations and the competences of regulators has, inescapably, created a lot of complexity. Our report finds something of a lack of coherence in the framework we have ended up with, with responsibilities fragmented across the UK regime. There is no perfect mapping from the EU system, which in any event was not perfect to begin with, to the UK system. It is clear, therefore, that more work is to be done.

In the preparation of our report, we received widespread feedback from across the financial industry that the Treasury had done the best possible job, given the difficult circumstances of time pressure and complexity it was working in. Now, there is perhaps more time to reflect on where we are and how that can be improved, and there are a number of ways that

that could be done. The first is to address what I have just mentioned, the complexity of the laws that has resulted. It is very difficult to navigate what the law actually is, which provides a barrier to innovation in business.

Secondly, there are a number of issues with the way in which the powers of the institutions have been transferred, which we can explore more if you would find it helpful. We now find that some things that have been transferred at level 1, so as matters for primary legislation, which is a call on parliamentary time and not a swift process, address matters that overlap with those more ordinarily dealt with by regulation. The ability of the Treasury to make statutory instruments is subject to varying different procedures. It is not always apparent why some are subject to positive and others negative review by Parliament. In moving everything to a single set of domestic regulators, you lose the interaction between the European-level and national-level authorities, whose dialogue with and accountability to one another provides an additional level of regulatory scrutiny, which will now be lacking.

Finally, a number of provisions built into the European legislation have not been onshored here, which provided for certain matters to be subject to a review, as a matter of law, requiring fresh scrutiny of whether the regime was operating in the way intended and with the correct market and consumer outcomes. Those automatic, in-built reviews have been removed as part of the onshoring, which means a degree of scrutiny has been removed that way too. Overall, a number of steps suggest that the job that has been done, while it has been done in a very respectable way, nevertheless, with the luxury of more time, could be looked at again. Our report is intended to make some suggestions for what should be considered in doing so.

Miles Celic: We are very grateful for the opportunity to present to the Committee. This issue is extremely important, from the point of view of not just industry, but the regulators and the future of what is a national asset. There is a point that we think is important about the role of scrutiny and accountability. As Peter has set out, the Treasury has done a very good job under a lot of time pressure. Industry was keen to play its role in supporting it.

As we move forward, it is important that there is an appropriate structure in place, not least because a lot of the European regulation that we are talking about was designed with precisely that degree of scrutiny in place. If you look at the trilogue process within the European institutions or the role of the ECON committee in the European Parliament, these structures are in-built in the European system, but do not exist here. We are not suggesting that they should simply be ported over or replicated in some kind of Xeroxed manner, but there needs to be an appropriate mechanism here in the UK.

The Chair: We will come on to some of those points in later questions.

Q13 **Lord Desai:** Is there a fundamental cultural difference on the philosophy of regulation between the European Commission and the UK? Do we not believe in the market more than they do?

Julian Adams: I will let others answer, but I would not say it is a fundamental difference in the philosophy of regulation. There may be a fundamental difference of purpose. In the European construct, they are essentially trying to have the apparatus and law to create a single market. That is less important to the extent that we remain a single sovereign state. Some of the Lamfalussy superstructure that you legitimately have in Europe to create, enhance and embody a single market will not be required, so duplication is not necessary. In fact, our first report made that very point.

Philosophy is a broad question but, when we get on to talk about some of the substance, we might want to differentiate between slightly different approaches to wholesale versus retail markets. Perhaps we have traditionally been more professional-to-professional wholesale. There may be a different touch of regulation there than a lot of the European regulation, which is essentially predicated upon a retail business.

Miles Celic: I agree entirely with what Julian said. This was brought home to me in a meeting that we had with a very senior European official about 18 months ago. We arrived and had a constructive discussion. We set out the issues that UK industry had identified, which were also relevant to European industry, and we set out some potential ways of minimising, ameliorating and addressing the impact. The European official sat back and said, "Well, this is exactly why we will miss you in the European Union. You have approached this from the classic, empiricist, British approach. This is a little pragmatic representation of the key issues and practical solutions for them. Here in Europe, it is Cartesian. We start with the concept and then build around that". There is a philosophical difference, but I do not think that has necessarily been unbridgeable in the past. The common law, case law nature of the UK tends to come from a slightly different starting point.

You can also see this in the approach that you typically see in a lot of European regulation, not just in financial and professional services, which begins with the precautionary principle alongside this. There is a different starting point. Our view has always been that, if the outcome is ultimately comparable and leads to similar ends, it is not necessarily problematic.

Q14 **Lord Giddens:** Let me add my welcome. What would be the benefits of redistributing powers for financial regulation and providing greater discretion to the regulators? Where do you see the opportunities in this situation for your particular branches of finance? I do not know whether you are up to this, but it seems to me that this overlaps with the huge structural changes going on within finance, because of the development of deep learning and AI. These things have to be regulated at the same time. Should we follow European regulation, as we have with the General Data Protection Regulation, for example? I do not know how far you would like to cover these issues. It seems to me that leaving the EU is one thing, but it is operating against a very rapidly evolving world of finance. It would be good to hear a few comments on that.

Peter Bevan: You are quite right that the pace of change can be fast in financial services. That highlights the need for regulators to keep pace with developments that are coming, and respond to market developments, innovations and emerging problems or outcomes for consumers. We think it is important, in considering what the UK's regulatory framework should look like, that it builds in the right ability to be innovative and respond quickly to developments in the market.

Picking up on Miles's point, making rules close to the market and with the right input from stakeholders—importantly consumer stakeholders, market professionals and experts—should enable you to identify what those failings are and then respond to them with regulation, rather than beginning, as some of the financial regulation we are inheriting did, with high-level principles for regulating markets and financial instruments. These are not often easily applied to specific situations. You gave the example of AI; I would add financial technology, fintech, which is related, and the important area of sustainable finance. There will be emerging ways to provide funds into a growing low-carbon economy. There are a number of important areas where flexibility of regulation will be important.

Of course, it also helps to ensure that rules are made by people who have the appropriate expertise. All these have contributed to why our report found that people would like to see more powers given to regulators. Those powers should operate within the appropriate bounds. No doubt we will come on to this. Therefore, appropriate democratic accountability and oversight of how the regulators exercise their powers are an important trade-off with an increase in those powers. Nevertheless, our report found that there are considerable benefits from increasing those powers, and the examples you have given are among them.

Julian Adams: There was a range of questions in your question, but the use of discretion is clearly an important tool available to regulators. In a way, Brexit gives us an opportunity. One of the guiding principles of our regulation should be that it is fit for purpose for the UK. Now, there are a lot of European directives that we were, if not the author of, certainly at the beginning of or developing the thinking of. They are fit for purpose but, where it does not fit, where the shoe pinches, we now have the ability to exercise discretion not to apply.

I will give you a concrete example from the world of insurance. There is a directive that governs insurance called Solvency II. It has a feature called the risk margin, which has affected UK annuity writers particularly hard. We are almost unique in Europe in having an annuity industry in the way we do, certainly in the size and importance of it. The regulator agrees that its construction is inappropriate, pro-cyclical and, given the current levels of interest rates and the assumptions it makes about the fixed cost of capital, inappropriate. The industry argues that it is inappropriate. We now have an ability to use discretion to modify it. If we do not do that, it will be a missed opportunity. If we do that, in one way it is taking advantage of an opportunity that Brexit presents.

It is, nevertheless, an important decision, because it will change the relative application of a European directive. That immediately brings you to an equivalence debate. Narrow regulatory decisions need to be legitimised by an enhanced level of scrutiny by public authorities, in my view. I hope we get the chance to talk about how that might be discharged.

Miles Celic: I completely agree with what my colleagues have said. The issues you have raised about the future impact of technology in this industry are particularly pertinent and important as we look to the future growth and role of the industry. This week, we launched some work with Accenture on the role of AI, which we would be happy to share with the Committee. This is an issue with which regulators are struggling globally.

From conversations that I have had with British and European regulators recently, the approach they are taking is, or is likely to be, very different. In many ways, this goes back to their philosophical approach. One European regulator I spoke to was deeply sceptical about the sandbox approach that the UK has adopted, which we think has been enormously successful. This particular regulator felt that it was playing with the nature of the rules and the precautionary principle, and that, actually, a proportionality approach would make more sense.

From our perspective, another issue is that, rightly, as you say, the industry is going through an enormous evolution, as we speak, of which Brexit is only a part. When we look at the future role of the regulator and of regulation and supervision, Brexit provides an opportunity to fine-tune and, as Julian puts it, deal with where the shoe pinches. But we need to be thinking about the longer term here, as well.

This is also about issues such as the rise of new players, ensuring innovation and appropriate regulatory standards, and where the regulatory perimeter sits. A number of regulators have said to us, “At the moment, I can regulate on an entity-by-entity basis”, but, if a large tech firm were to come into this space and start operating at the edges of the waters, dipping its toes into traditional financial services areas, what would the role of regulation and supervision be there? Are you operating on an activity-by-activity or entity-by-entity basis? Do we need a matrix approach to regulation in this space? The FSA, as was, issued a paper on this back in 2013, as I recall. These are not new issues, but this is an opportunity to address them and look at how the UK deals with them.

Q15 **Lord Vaux of Harrowden:** We touched on this a little in the previous question, but how might any changes to the UK’s regulatory architecture affect the access of UK firms to the EU markets? Has that risk been increased by the recently articulated more stringent approach to equivalence that the EU has taken? If I can add a further one, does it matter, in the light of the changes that financial services entities have already made and that we are seeing in financial services generally?

Miles Celic: The architecture is less of an issue here than the content and approach. We have touched on the philosophical approach. Ultimately, the EU is very well versed in dealing with a range of different regulatory architectures, from a single, integrated, comprehensive regulator, such as the Japanese FSA, which is based on the old FSA here in the UK, through twin-peaks models such as we have here, to a patchwork or a much more sophisticated set of regulators operating in a single jurisdiction, such as you have in the United States.

The issue is less the architecture, with the important caveat that, as we move into the particular architecture we choose to have in the UK, it is important that there are mechanisms for tracking international regulations, not just from the EU but from our other partners, and how those interact. When one looks at the nature of the free trade agreements or the global financial partnerships that we will need to build over time, regulation, regulatory co-operation and regulatory interaction is a fundamental part. It is important in those terms, but I suspect that the answer to your question on market access is ultimately about the content and shape of regulation and supervision, more than the architecture itself.

On the approach that is being taken to equivalence and equivalence determinations, it is important to recognise that there is an ongoing debate within the European Union at the moment about the future of equivalence, which is not entirely settled yet, but is still quite vibrant. Bruno Le Maire, the French Finance Minister, gave a speech on this in Helsinki in September last year, when he talked about the need for equivalence to be driven much more by sovereignty concerns, almost by political concerns, not taking away from the importance of the technical element of an equivalence determination, but recognising that this is a political process as well, in the way that many FTAs often have political elements.

What seems to be emerging, which will have implications for both the UK's architecture and its relationship with the EU, is a sense that certain markets and jurisdictions are going to be more important for the EU, systemically, politically and economically, than others. If I can steal Michel Barnier's famous steps slide, you may well see differing forms of supervision, implementation, judgment and assessment of equivalence, over time. I suspect the UK and the US will fall into the upper tier, where there is an expectation of far closer supervisory alignment, because of the importance of those markets and the potential systemic issues, in both economic and regulatory terms, which might come from engagement in those markets.

Q16 **Baroness Couttie:** We have touched on some elements of what I am about to ask, with both Julian and Miles. Given that the regulatory framework across Europe is one size fits all, it does not necessarily fit the UK. We have talked about the annuity issue in insurance and it also affected pensions. There are other parts of the financial services sector that the regulation just does not work for. Is there an opportunity to have a hybrid arrangement where in certain sectors we can align more closely with Europe, and in others we can diverge to suit our own financial services sector? If that is the case, what would you do? What would you change?

Julian Adams: I very much agree with that. People talk of equivalence as though it is a monolithic issue. You can make a strong case for equivalence by different sectors, and equivalence will matter more or less to different sectors. At one extreme, some business models are more integrated with the rest of Europe, such as the investment banks, international banks, international asset managers, reinsurance, et cetera. As you go down a business model continuum, you get to retail banks, domestic banks, building societies, life insurance companies and general insurance companies, for which the issue of cross-border access is less important. That lends itself to a sector-by-sector approach.

Whether it is strategic or tactical, we have to make a very big decision about the point at which you push for equivalence. Do you make changes, so that it is fit for purpose? Our starting point has to be that it is largely fit for purpose, apart from those bits that are not. Do you then change those bits that are not and say, "I still think the outcome of the regulation delivers equivalence and, on that basis, I am equivalent. I am not identical, but I am equivalent"? In that case, at T+1, you make those changes, put them on the table and say, "I still think I am equivalent. Do you agree?" You could also try to say, "I must be equivalent, because I am identical. At T+1, I am identical; I have not changed a thing". If you are in that space, you need to try to pre-agree corridors of permissible deviation. That is incredibly difficult to do a priori.

Baroness Couttie: I suspect, and correct me if I am wrong, that you need both. In an ideal world, you would go into the negotiations knowing where it does not work for the UK and set out your stall. You would agree all of that, which will mainly be around domestic rather than international stuff, and large banks can split the UK from the rest. We have talked about AI and fintech. This is a vastly changing world and we may not want to do the same things as Europe. Therefore, we need the corridors of change, as well. I think you need both.

Julian Adams: To be clear, I am sure you need both. The question is whether you try to pre-agree a permissible corridor. Life is a continuum and, at some point, something that may be equivalent edges to non-equivalence. All I am saying is that it is difficult, from first principles, to agree on what those corridors are. We might want to do things, but Europe might want to do things that we do not. We might want to differentiate between professional wholesale and retail markets. There is a set of things we might want to do, but there are things they might want to do that we do not want to follow.

Baroness Couttie: It is about a mechanism of agreeing how you agree.

Julian Adams: It is, exactly.

Miles Celic: One of the important things about equivalence is that it is designed as a hybrid system, perhaps not deliberately, but it is a hybrid system. There is very little opportunity for interactivity between different forms of equivalence. From recollection, there are 17 directives that cover equivalence and 40 forms of equivalence within them. No country I am aware of has every one of those, so every country that has some form of equivalence determination with the European Union has something missing from the available forms of equivalence.

Baroness Couttie: It is not just about what is missing; it is about doing it differently.

Miles Celic: This is where we get into the debate we have already touched on about equality of outcome, versus a line-by-line approach, and the approach the Europeans may take. It could well be that the EU expects jurisdictions that are particularly important for European companies, financing and systemic issues, over time, to adopt equivalence in total. I would be surprised, but it is possible. Importantly from a UK perspective, as the report makes clear and Julian said as well, there is a mechanism for managing alignment and a mechanism for managing divergence over time. One problem with the equivalence system, as it currently stands, as I am sure all Committee Members are well aware, is that it can be withdrawn, in some cases at 30 days' notice.

Baroness Couttie: They are debating two years now.

Miles Celic: There are debates, but it differs on an equivalence-by-equivalence basis. Some do not have any mechanism for withdrawal at all. We have made the point consistently over the last three years that this is not a basis on which you can set up a European activity, particularly given that it has taken the industry, in close co-operation with regulators, two-plus years in many cases to deal with the consequences of the UK leaving the European Union. A 30-day basis for withdrawing your businesses is not sustainable. No board that I can think of would be willing to devote significant amounts of capital on that basis. The European Union is talking about looking at that.

There is another element. Whenever we raised this as an issue, we were consistently told, "Don't worry; equivalence has never been withdrawn". It has subsequently been withdrawn. We point to the experience of the Australians, which was not a process that was formally legislated for, but took a degree of time. Both sides engaged with each other. There were opportunities for the Australians to shift their regulation to remain aligned with European regulation, but they chose not to. But it was done in an orderly fashion. Our argument is that it would be in the interests of both sides to create a mechanism that allows you to do that, given that, inevitably in certain areas, the UK or, particularly because of the issues we have talked about, both sides will diverge. It will not just be the UK; the European Union may choose to diverge from where we currently are

Baroness Couttie: Going back to the other leg of my question, where else does the EU one-size-fits-all regulation not work for the UK? We have talked about annuities. I can think of a few, but I would like to hear from you.

Miles Celic: This is an area of considerable diversity of view within the industry, so I could not give a single answer, because you would get a different answer depending on which sort of subsector you are in, which sort of entity you are or what your business model is. In some cases, you will get a different answer from different parts of a single company on what form of equivalence they would like to hold on to.

Our view is that, if you look at this ecosystem-wide and we remain Europe’s financial centre, one of the two leading financial centres globally, with a role to play in international debates, it is important that there is a structure that manages where we align and, over time, where we choose to diverge.

Baroness Couttie: I would be very interested if anyone else has any sectors.

Julian Adams: I will offer one, which I mentioned before, but it builds on something that Miles said. We are, bluntly, the capital market of Europe at present. A lot of the securities market regulations have been drawn up from the perspective of investor protection, but for the protection of the retail investor. I am not arguing about that—it is fit for purpose, good and comprehensive—but we have the capital market, and there are different players within that. You could differentiate: the level of protection you owe to the professional dealing with a professional might legitimately be less than that which you owe in dealing with a retail or less sophisticated customer. If you were to ask me, in one size fits all, to look for areas where we could legitimately differentiate between the regulatory approach we might take and Europe’s, that is one. I mentioned annuities, but some of the theoretical bases that underpin Solvency II are well worth re-examining.

Q17 **Lord Vaux of Harrowden:** This goes back to my previous question a bit. I asked whether it really matters. As I understand it, most financial services institutions, because of the uncertainty, have taken action on the basis of no deal and set up new entities. Having done that, to what extent does equivalence actually matter to the industry?

Miles Celic: It does matter, at the very least as a starting point. As I mentioned, companies have worked very closely with their regulators to make sure that they can serve their customers. Originally that was done with an eye to the concerns about a no-deal departure, not getting the withdrawal Act through and the hard exit that was talked about. You are right that companies have done everything within their power to serve their customers.

There is one thing that it is important not to lose sight of here. That is a very inefficient way, in many cases, of doing business compared to doing it under the passport. People have had to move regulatory capital and people. They have had to get licences and go through the Part VII transfer process. This has led not to the emergence of a single European competitor to the UK ecosystem. There has actually been a fragmentation effect across Europe. The big winners, as the studies show, would be Frankfurt, Dublin, Luxembourg and Amsterdam, to a degree. I suspect that, over time, Berlin will emerge as a fintech centre. Paris has not been as successful as it would have liked, despite strenuous efforts, but there has been this fragmentation effect.

Going back to the question we were asked by Lord Giddens earlier about the evolution of the industry, for many companies Brexit has proven to be a strategic catalyst or accelerator. Decisions taken about serving the rising middle class in Asia, and the savings pools that have developed there, have been accelerated, in many cases. The US, which has taken a slightly amended view to Dodd–Frank, has also been a beneficiary.

Actually, that entire European ecosystem, by which I mean broader than the EU, I suspect is slightly smaller than it would have been if Brexit had not happened. The question, which is perhaps a counterfactual that we cannot answer, is whether that would have been the case anyway. If most of your growth, from a financial and professional services perspective, comes from outside the European Union, if you have 3.5 billion people in the Asian middle class in the next 10 to 15 years and if you look at a classic development curve, with the consumption of services particularly rising as per-capita income increases, it is an opportunity for this industry in the UK. It is an opportunity that I think the UK industry is seizing.

Peter Bevan: I will add one thing to what Miles said regarding equivalence and whether it is important or relevant. You have addressed it there, very fully and rightly, recognising the equivalent standing of firms in the UK to provide their services to EU-located customers, consumers and counterparties. As we have heard, there are more than 40 types of equivalence, some of which are in other important areas, such as market infrastructure. Recognising the equivalence of clearing houses and exchanges in the UK and the EU is also important and has not been addressed in the work done by individual firms.

For instance, in the absence of equivalence in derivatives trading markets, there could be a transaction between a UK and an EU party, in which for one party it is illegal to trade in the EU, for the other party it is illegal to trade in the UK and the only way you can break that is by trading in the United States, which both parties regard as equivalent. That seems crazy. There are similar problems regarding trading in equity shares, where you might have a company that is dual-listed in London and one of the European centres, the shares in which are subject to the obligation that they be traded only in Europe, but also to a rule that they be traded only in the UK. In the absence of an equivalence recognition that either is good enough, trading in those products becomes extraordinarily difficult. There are a number of other elements of equivalence that remain important, in addition to the one that Miles has been describing.

Miles Celic: There are also issues that cross industries, such as data adequacy.

Lord Vaux of Harrowden: That is a different question.

Miles Celic: It is a different but related question, yes.

Q18 **Viscount Trenchard:** We have already started discussing this. I want to go into the timing, as to when you think the UK should set out its stall. The debate hitherto has been about UK access to the EU financial markets, but it seems to be the other way round: it would be much better and an advantage to us in the forthcoming negotiations if we set out our stall more clearly and quickly. We talked about whether we should wait until T+1.

Does "T" mean the end of implementation?

Julian Adams: "T" normally stands for time. The next day was the point I was making.

Viscount Trenchard: Do we say, "We are completely equivalent, so can you recognise equivalence as of now"? They will already know where we want to diverge. It seems it would be much better for us to set out our stall sooner. You talked about Solvency II, which was a very clear example, but there are also parts of MiFID II that have damaged smaller asset management companies in particular. The UK was out-manoeuvred and forced to accept the entire AIFMD, and I do not think it has served a real purpose in protecting the consumer. Given that there are some regulations from which we already know we would like to diverge, how do you address timing? When should we set out what our regime will be, and talk about the basis on which we will recognise EU institutions and allow them to continue operating? We might continue to regard them as being equivalent in outcome and the EU has different ways of looking at equivalence. This is all about UK-EU, but equally important is UK-US and UK-Japan. How are we going to deal with the timing of these changes bearing that in mind?

Julian Adams: My own view is possibly similar to yours. There is value and merit in setting out our stall as quickly as we can. Not only will it, in the long run, make it easier to reach an accommodation with Europe, if we are open about the way our thinking is developing, but you also make the extremely good point that we send a signal to the rest of the world about where our priorities and positions are. It would be a mistake to regard the framing of regulations in simply a mono-dimensional way. Basically, as soon as we are in a position to know our mind, we should tell the world what it is.

Peter Bevan: To build on that, if you look at some of the recommendations we have made in our report about the institutional framework of the UK, there is no doubt that they could be commenced now without impacting at all on these decisions regarding equivalence or any suggestion of divergence from the EU, as Miles has already mentioned. Some of them could be implemented very quickly and would help us to develop our regulatory policy and the content of those rules, having got the framework of the institutions right. It could also help us with certainty for business, as we go through this period of change.

You mentioned timing. We have a bunch of in-flight legislation going on right now, which poses a question about whether the UK is going to adopt the changes coming from the EU. Does business need to invest now to be ready to comply with those rules and, if so, by when? Under the current architecture, some of those changes would require primary legislation, which puts an enormous pressure on parliamentary time to make them happen. Some of the changes we have suggested might enable those things to be dealt with as a regulatory matter.

I can give an example, which is not a very exciting subject matter, but is live this week. The central securities depositories regulation, of all things, contains regulations on settlement discipline that will apply to all trading parties and custodians in securities markets. That was due to come into effect in September this year and, therefore, would have applied to all UK market participants. That has just been delayed to February of next year and hence falls outside. Do UK businesses have to continue investing to comply with those rules, and in what form? The reason it has been delayed is that the rules are flawed in a number of important ways. If those flaws are not fixed at an EU level, would they be fixed at a UK level? The regulatory architecture would benefit from giving a flexibility to enable those decisions to be made quickly, to give businesses certainty about what the law is going to be.

Miles Celic: I will briefly add to what my colleagues have said. This is a question that we are being asked abroad. In recent meetings I have held in the US, Singapore and Indonesia, and in conversations we have had with the Swiss, there is this question about the philosophy of the UK's approach and the architecture we will take. Importantly, what access will the UK have to the European market? That is an important point that they need answered. As I mentioned earlier, it is a feature of any trade agreement or economic partnership that the other side needs to know what they are docking to. At the moment that question has not been answered. It would have been helpful, although I understand it would have been difficult, for reasons of bandwidth and negotiations, to have had these debates far earlier in this process and to have set out the thinking on what the UK's regulation, regulatory approach and regulatory architecture would be.

Viscount Trenchard: How are we going to deicide? How do you think we should make these decisions? I am not even clear how we move from the European system with the three ESAs to our 'twin peaks' system, which is a mismatch. Do we even know who is going to be responsible for making which decisions?

Julian Adams: That is one of the big points we make in the report. On the specifics of who would make a change to MiFID, I think that mapping has probably been done. The question we ask in our report, though, goes back to regulatory objectives: what do you want the regulators to be doing? When you are satisfied that you have drawn them sufficiently broadly, and we are not—we think they should be expanded—there is then an allocation between Parliament, Treasury and the regulators. We need a clear articulation of where regulation fits within the promotion of public welfare—we want to push welfare out—and how to balance competition, competiveness, protection, financial stability, and clean and fair markets. All these essentially involve trade-offs. The essence of the report is that, in the political economy of the UK, you cannot point to where those trade-offs are managed.

This is an appeal. We need to be clear, as a nation, where these trade-offs are, who recognises them, who makes a decision on why they have struck the trade-off and why. They may or may not be right, but that does not matter. What matters is the transparency around that. The point we make in the report is that that debate exists today. There is a natural and unavoidable tension between regulation, on the one hand, and competition and competitiveness, on the other. It is unavoidable. The more conservative you are, the more you will impact those two functions. The question is how it is managed, who manages it and why they reached that structure. You are right to say you are confused, because it is confusing.

Miles Celic: We have argued, for some time, for the creation of a top-level partnership group, chaired by the Chancellor, with the regulators, industry and HMT, brought together to meet reasonably regularly, to look at the industry from a strategic partnership, as a national strategic asset. There is always the risk of politicisation of regulation or of the industry, but this is just to get a sense of what direction we need the industry to take and what we want to do to maintain the effectiveness and positive nature of what the industry contributes. At a more micro level, something similar already exists in Scotland, between the Scottish Government and industry. It would not be impossible to replicate that at national level.

Q19 **Lord Bruce of Bennachie:** You have already highlighted the complexity of changing the law, and there is more to come. You have recommended a number of supervisory and regulatory oversight roles, almost in a parliamentary dimension. First, you say that the current regulatory framework does not have the same level of resource, specialist mechanisms or scrutiny as exists within the European system, which I suggest is a substantial understatement. You then say that you think there should be an enhanced role for Treasury and Parliament in co-ordinating public policy, which is not just scrutinising, obviously.

Then you go on to recommend a parliamentary committee, with a mandate focused on the regulators and the formal mechanisms. You say that this should be appropriately staffed and resourced. I wonder if you could articulate how you envisage the parliamentary dimension. A special interest of this Committee is whether you think it should be done in the House of Lords, Commons or jointly. Having been on the Treasury Committee as well as this Committee, I doubt that the Treasury Committee, as constituted, could do this. It is a smaller political committee covering all aspects. This Committee has been much more focused on financial services.

How do you envisage this happening? Do you have a clear idea of whether it should be this House or joint, because I do not think the Commons could do it alone? What kind of resources are you talking about? Could you explain the public policy bit, as opposed to just scrutiny?

Julian Adams: I will deal with the organisation point. We have to be careful not to be presumptuous. It is for Parliament to decide how it discharges this. We see a TSC that is driven almost by the topic du jour and is, as you point out, Lord Bruce, a very political forum. We are not going to change that and we are not suggesting that the regulators are not subject to that ongoing discipline.

We see a role for more systematic scrutiny of the decisions, actions, policy-framing and impact of regulators, which you could create as a sub-committee of the Select Committee, or you could have this Committee or a joint committee, as you point out. In a way, we are neutral about those. The expertise and the experience in regulation around this table is noted and would be useful to bring to bear on a more systematic basis. If you were to ask for some form of Joint committee, it may well be the best way forward, rather than managing the hand-offs between a Commons and a Lords committee. You understand the politics better than I, but we would want to depoliticise it as much as possible, so a joint approach may be the best.

In terms of resources, we observe that a lot of regulation is incredibly technical. Some of it is philosophical and framing, so you can debate at that level, but sometimes you simply need to roll up your sleeves and get involved in the detail. The committee structure does not lend itself to that at the moment. It is inadequately resourced. You can compare that to not just the staff available within the European Parliament, but also the budget and resources to call on skilled people. That may well be a better model, in the sense that you have access to current expertise, rather than taking people on to the permanent staff, then seeing that amortise over time. All we are saying is that, if you are going to do this job in a non-political way that needs technical expertise, you need access to that. We would be encouraging a budget to support the activities of that committee. The regulators have developed a concept of close and continuous supervision; it would almost be equivalent to that. You have a structured programme of engagement, then the political TSC deciding on fake investment bonds, gender equality or whatever topic they want.

Lord Bruce of Bennachie: You have put your finger on it. A lot of these things are technical and detailed. They do not fill the Public Gallery, but are very important. Not only that but, when it is not done or goes wrong, the consequences fill the Public Gallery. It may help if you could develop what you are recommending a little. We have our own views and interests, and we are lobbying our own authorities, business managers or what have you, but it will require Government to accept this as a desirable path and to fund it. Your point was about not necessarily replicating the way the European Parliament does it, but acknowledging that it has not only expertise and staffing, but the right to commission staff. It would be interesting to have a more formal development of your thinking, because it would help us, as Parliament, and Government to come up with the right solution. At the moment, it is just in the mix that we should do something about it. We have our own reorganisation of the Committee, but that is only a limited step on the way.

Miles Celic: I wonder if it might help for us to look at how this is done in comparable jurisdictions, so by the Americans, Australians, Canadians and so on. As much as I am familiar with all those examples, it will require a step change, and that is what we are arguing for, in the funding and support given to committees such as this or the committee that we have set out to take this forward. It cannot, in my view, by done on the basis that Select Committees or committees such as this are currently supported. It would need something considerably more. Within the bounds of what is possible, it is also entirely appropriate for the regulators and industry to look at formal programmes of secondment or expertise into those committees, over time.

Lord Bruce of Bennachie: They will come here and go back on an enhanced basis. Chair, it would be very helpful to see that.

Q20 **Baroness Liddell of Coatdyke:** To extend the points that Lord Bruce has made, particularly with his Treasury Select Committee experience, you are quite specific about one element. You talk about regulatory cost-benefit analysis to be carried out by the financial regulatory policy committee. How did your thought processes get you there? It is interesting, because this takes us into a different way of doing things as a Parliament. One nervousness I have is whether it takes us into the realm of second-guessing the regulators on specific cases. You said at the beginning that you need people who have appropriate experience, and we have just been talking about that. It has to be resourced properly.

Like Lord Bruce, I would like to see more flesh on the bones. I do not expect it today, but we would like you to think through all this. One of the reasons why I am slightly nervous is that, having seen it in Australia, sometimes you find the parliamentary set-up getting involved in very specific cases. Does that help the operation of regulation? Is that not for a regulator to do rather than a parliamentary committee? That crossover is so different from how we do things at the moment. It emphasises Lord Bruce's point: you need flesh on the bones.

Julian Adams: The thrust of the report is around policy. There are two dimensions of looking at the impact of regulation. One is the policy itself and the second is the manner in which it is implemented and interpreted. You cannot look at this as though it is all aimed at policy; it is also aimed at the manner in which they elect to discharge their duties. We do not anticipate a role for case-specific handling. That must be a matter for the regulator. If it goes wrong, they will have to account for themselves, but politicising that was not part of our discussion.

There is cost-benefit analysis done on any piece of work they do, but it tends to focus on the simple, most obvious and most direct costs. It tends not to focus as much, because it so difficult, on the unintended consequence and its cost. We had the retail distribution review, which successfully looked to promote high standards in selling advice to UK citizens, driving up the professional standards of financial advisers. That is clearly what we were trying to do. We are in a place, at the moment, where a lot of people in the UK do not have access to advice. They do not have enough money to justify an adviser going through all the processes they need to in order to meet the rules. You could argue that the policy was very successful: it drove very high standards in advance. But one of the consequences is that the people who most need it—and, by golly, they have to deal with not only their own market risk, but their own mortality risk—are essentially on their own. I cannot see that that is a success of regulation. Someone needs to call that out and, in fairness, they are looking at that belatedly and seeing what they can do. That is part of what I would describe as proper cost-benefit analysis of regulation.

Baroness Liddell of Coatdyke: I am slightly nervous that you are now building quite a complex structure. The more complexity you add into it, the more confusion you can add. That is why greater clarity is needed.

Julian Adams: You are right to say we need to guard against that, but the whole point of the recommendations we are making is to clarify who is responsible for what and make them give an account of how they have struck the trade-offs. Yes, you are right to guard against it, but I do not think it is an inevitable consequence of what we are proposing.

Miles Celic: I completely agree with all that. It will also be important to set a clear remit on what we expect from our regulators and supervisors in the UK, and a clear scope and terms of reference for the particular group we are talking about. There is always the risk of scope creep and mission creep, which is something that the committee and regulators will need to guard against. The top-level group we talked about could be a place where that is watched out for.

Ultimately, we are looking for a further point of accountability for the regulators, in light of the sorts of issues we have talked about, which industry, members of the public and consumer groups can utilise, through their parliamentarians. The fundamental point for us here is about avoiding the politicisation of regulation and the regulators. Industry would be entirely nervous about and opposed to that. Other regulators in other parts of the world would end up creating a much more damaging investment profile for their jurisdictions because of the sense, in some quarters, of increasing and creeping politicisation of the regulatory process. We cannot have that in the UK.

Q21 **The Chair:** On that note, it is not just politicisation, but also the sense of the true independence of the regulators. How will we ensure that increased scrutiny of the regulators does not compromise their independence or unhelpfully increase any conservative tendencies they might have?

Julian Adams: It is a mistake to regard enhanced scrutiny as compromising independence. It legitimises independence, if done properly. Otherwise, you have too much power in the hands of an unelected agent of the state. The purpose of this is not to tie them down or compromise them. The purpose is for them to be subject to enhanced scrutiny, especially when some of the mechanisms that give accountability under the law are not utilised, or rendered redundant. The purpose of that would be to legitimise their independence. Without that, you have real concerns about overmightiness. It is a quid pro quo for having more power in a post-Brexit world.

We make a point about broader public policy. This is another area, which is nothing to do with Brexit, but there are many strands where the regulator is either cutting up against or touching the membrane of broader public policy. As we have savings for retirement, as we green the economy, there are bigger public policy priorities. In how the regulator manages those priorities, the enhanced accountability that we anticipate almost gives them cover for some of the decisions they are making and explaining why they have made them.

Q22 **Lord Turnbull:** Much of the discussion at the moment is bilateral, about UK-EU relations, so UK-based businesses are doing business in Europe and we have the regulatory interface. We are going to a world in which we also need to take account of third countries, the way they are regulated, what that means for our ability to do business and the competitiveness of UK institutions. We have other places where regulatory policy can appear from: the FSB, Basel, the US and sometimes even the OECD. As this regulatory architecture emerges, how do we make sure that third-party aspects are fully taken into account and we do not lock ourselves into a purely bilateral debate about equivalence with the EU? These third countries will probably be even more important for us.

Julian Adams: As I said in my earlier remarks, regarding this in a bipolar way is profoundly unhelpful. First, it is one of the reasons why we think the objectives of the regulator ought to be expanded to include both competition, which is domestic, and competitiveness. That is one aspect. Secondly, we put our weight behind international agreements and the promotion of them. There is strong support for that across all aspects of the City.

Miles Celic: In our view, this is about making sure that you have a principle embedded under FSMA for the regulators to take account of international standards, as we move forward. You are right that this should not solely be a cross-channel or cross-Irish Sea debate. The respect in which UK regulators are held and the prestige that the UK has as an international financial centre mean that UK regulators are listened to and have a very active contribution, in exactly the kinds of international forums you are talking about.

More broadly, this is one of those areas where the UK ought to be investing in what we term regulatory diplomacy. We ought to be making sure that the international debate and the rules that are particularly important in areas such as banking reflect UK input and priorities. In fact, when I was in the United States recently, a senior figure in DC said to me that there would be three approaches to the rules, in the future: the American approach, the European approach and, increasingly, the Chinese approach. Whoever the UK backs is going to have a much better chance of winning those debates.

There is an expectation that the UK will play a role in these debates and will be active in shaping them. This is merely formalising and embedding a role that British regulators already play, and it something that is already done by other regulators internationally. The Australian regulator has a duty to take into account rules that have been reached, based on consensus, in international forums. Unless there is something that can be added from an Australian basis, that is expected to be embedded in the work of the regulator, and the rules and supervisions it puts in place. The Monetary Authority of Singapore, Singapore's regulator, has a similar approach, including a duty to look to international agreements and standards. This is one of the reasons, if I may digress for a moment, that the Singaporeans are terribly upset by the use of the term Singapore-on-Thames as a euphemism for a low regulatory standard. Having worked at two large companies with big Singaporean operations, I can tell you the Singapore regulators are absolutely at the top of their game and set a very good example

The Chair: So Singapore-on-Thames is a good idea.

Q23 **Lord Turnbull:** I have one follow-up about your discussions in Washington. There was this huge regulatory process with Dodd-Frank. Do you detect any sign that they are rowing back from that?

Miles Celic: Is that a regulatory dogfight between the different elements of American regulation or at an international level?

Lord Turnbull: They changed their regulation quite substantially. Some say that they may have gone too far in reaction to the financial crisis and argue that they should swing back to a freer system. Do you detect any of that?

Miles Celic: The conversations I have had with the US have been interesting. There is clearly a process of evolution going on. The changes from Dodd-Frank were aimed much more at smaller and mid-sized domestic players. They have clearly taken a particular view on global systemically important financial institutions but, from talking to a number of American regulators or legislators, that sense of extraterritoriality is not where the Americans are moving to. A sense of substituted compliance is more in their thinking. I am not sure that I look at the United States and see a radical deregulatory agenda. The pendulum has swung back a degree from where it was in the reaction to the financial crisis, but it is not Singapore-on-Potomac.

Q24 **Baroness Neville-Rolfe:** I would like to further probe why the financial regulators should have a secondary competitiveness objective. There will clearly be new opportunities post Brexit, so scope for more innovation, fintech and AI. Mr Celic said he was going to send us an extra paper on that, which we would much welcome. From what you have been saying, there is potentially also scope to cut red tape and perhaps help smaller players. What is the case? There are a couple of wrinkles. How would that differ from the competition objective that you also mentioned? Secondly, could a competitiveness objective increase financial stability risks or be seen to do so?

Julian Adams: I do not think it needs to increase risks, but there are a number of elements to your question. We essentially see competition as a domestic issue. It is about how you strike the right balance between barriers to entry. That, in varying degrees, is part of the current regulatory framework. Competitiveness is about the relative attractiveness of the UK to do business, attract business and import what is working elsewhere. We have talked about Singapore. Singapore is a leading regulator of the world, not only in the toughness of its standards, but as a thought leader in, say, artificial intelligence and some of the CPs it has put out. It is leading the way, yet it also looks to attract business to Singapore. I honestly do not see what is wrong with that.

Look at Bermuda. It has become one of the international reinsurance centres of the world. It has also, separately, become a centre for insurance-backed securities and the development of derivatives related to property catastrophe insurance. It has also enhanced its regulator, increased the size of its regulatory resources and is deemed Solvency II equivalent by the EU. What is wrong with that?

Brexit is going to bring competiveness into focus anyway. Either Europe will try to do something and we then have to say, "Do we match them or don't we?" or we will want to do something. The question of how that affects the relative attractiveness of London will be a factor. All we are saying is that that factor that should be considered. We are not saying it is a super-trump that can trump anything. Inevitably, you are faced with having to make a choice between the conservatism of your regulation, domestic competition and international attractiveness. We would like you to explain why you have struck the trade-off that you have.

Peter Bevan: To elaborate on that, Julian is right that regulators are going to be taking this into account, and already take it into account, in any event. In the relatively recent past, this was already a feature of the statutory underpinning of the Financial Services Authority, the forerunner to the current regulators. It was changed a few years ago. It must already be the case that regulators, in deciding an appropriate and proportionate way of addressing their policy objective, will take this into account. As they accrete more powers, transferred from Brussels, they will be making those decisions more often. It seems appropriate that they should be held accountable for how that is part of their decision-making process. Therefore, being explicit about it, far from being indicative that it is in conflict with financial stability, means that those issues of financial stability will be considered, and seen to have been considered, in the round.

Julian Adams: If you look at the debate in *Hansard* at the time of the original Financial Services and Markets Act, there was a lot of anxiety about the power of this emerging regulator. For that reason, the objectives were enhanced by a series of "have regards to". It was an attempt by the parliamentary process to say, "Look, you are awfully powerful, but please bear in mind small businesses. Please bear in mind international attractiveness". There was a whole set of "have regards to".

In a world in which we are not part of a big trading bloc and have to set out our stall, we should explicitly require someone to give an account of how the regulation affects the relative attractiveness of London. Reasonable people differ about whether this should be an objective of the regulator or someone else's responsibility. You could argue that, by internalising the conflict, you make it easier to manage. You certainly preserve your independence if that is what you do. If, on the other hand, you say that is far too complicated and that that way leads to perdition, someone else will have to do it. It would have to be the Treasury, which would be at a cost to your independence. We make the point that you are essentially managing a series of trade-offs between public goods. We want to be transparent and clear who is making the decision and why. Be accountable and transparent about that.

Peter Bevan: Those trade-offs are not necessarily in conflict either. The listing regime for public companies, in the UK, is the gold standard. A premium listing requires levels of disclosure and compliance that go beyond some other international standards. That is attractive to pools of capital, which have a high degree of trust in investing in companies that achieve that listing standard. That therefore means that companies are attracted to that market to access those pools of capital, so it can be a virtuous circle. A more sophisticated, appropriate and heavier degree of regulation, in that sense, is consistent with greater competitiveness.

Miles Celic: I very much agree, and I have two final points to add on that. We find that the UK is attractive to international companies and investors because of the strength and professionalism of its regulation, not the contrary. Even if anybody had a deregulatory agenda, which is not the central case in this industry or what we are looking for, it would actually be damaging over the longer term. That leads to additional competitiveness, as competitiveness is driven by appropriate, strong, high standards of regulation, not by a deregulatory agenda.

Baroness Neville-Rolfe: You make a strong case for the competitiveness objective. I was trying to tease out, in addition, how it would encourage things such as innovation and cutting red tape. What you are saying is that one of our competitive strengths is the rigour of our regulation.

Julian Adams: If you remember earlier in the evidence, bluntly, one of the areas where I would focus attention is the distinction between retail and wholesale. That could promote the international attractiveness of London as a place in which to do business, without in any way compromising the security we offer our domestic citizens. You can approach this in an imaginative way but, as soon as you say "competitiveness", people assume you are on some sort of slippery slope, and you need not be. That is not the aspiration of those of us who have asked for this to be part of their objectives.

Miles Celic: On your point about red tape, it is worth bearing in mind that one issue that has existed in regular dialogue and debate with the regulators is how, for instance, European rules and regulations have been implemented here in the UK with the so-called gold-plating approach. This is an opportunity to look at how supervision is conducted here in the UK. As my colleagues have said, this is not about reducing standards; it is about making sure that we have regulation and supervision that is fit for purpose for an industry that is going through enormous degrees of change and evolution.

Baroness Neville-Rolfe: As you develop your thinking, we here have discussed how you use the opportunity of Brexit to bring in more innovation and change. Does the competitiveness objective do that or is there some other way? That is the question.

Q25 **Lord Desai:** Have you had informal discussions with the Treasury or any of the regulators about this? How do they feel?

Julian Adams: I will let them talk for themselves but, yes, we have. This was the second report we did. The first was just over a year ago. In some ways, they were grateful that we had started this because, when we did the first report, people recognised that it is an issue, but they did not have any bandwidth to focus on it, because of the urgency of the tasks in front of them. I am not going to interpret their position, but the meetings we have had have been entirely constructive.

People recognise the contours of the debate and that there has been a relative shift in power. They recognise the points that Peter made about the coherence of the rulebook and the law, that we have an odd mismatch of responsibilities at different levels and that it needs to be made appropriate. People understand the point about scrutiny and accountability, but are anxious about not becoming more of a political football. We are at pains to explain the structured approach we have gone through, looking at both policy and the way they do their role. They have made no secret of being antipathetic to the competitiveness objective. We have set out our stall and will let them respond.

The Chair: Did they say why?

Julian Adams: I do not want to interpret them.

The Chair: Your recommendation is that we ask the Treasury.

Julian Adams: There is an assumption that this is a slippery slope towards the lowest possible denominator, which we have bent over backwards to say this is not about. It is genuinely not what we mean. There is, nevertheless, a nervousness that, whether this is our intent, it would be the consequence. My response to that is that it will only be true if you let it: "Physician, heal thyself." In my view, there is a bit of a smokescreen around the extent to which the FSA's attention was diverted pre the crisis, because of competitiveness. I can talk about that as a former senior member of the FSA. There are lots of things one would do differently, but having regard to the competitiveness of London is not one of them.

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