



HOUSE OF LORDS

European Union Committee

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9th Report of Session 2016–17

# **Brexit: financial services**

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## CONTENTS

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	<i>Page</i>
<b>Summary</b>	<b>3</b>
<b>Chapter 1: Introduction</b>	<b>5</b>
Financial services and the UK economy	5
The EU Committee's work	6
<b>Chapter 2: Passporting, equivalence and market access</b>	<b>7</b>
Possible trade agreements: existing models	7
Box 1: The EEA, or 'Norway' model	7
Box 2: The customs union	7
Box 3: A free trade agreement	8
Box 4: EFTA membership and bilateral agreements 'The Swiss model'	8
Box 5: WTO terms	8
Passporting and equivalence	9
The legislative framework	9
Box 6: EU Legislation granting passporting rights	10
The extent of passporting in the UK	11
Table 1: Number of inbound and outbound passports issued by the Financial Conduct Authority and Prudential Regulation Authority	11
Table 2: Number of firms with at least one passport under each directive	12
Table 3: Sectoral breakdown of UK financial services revenues 2015, segmented by source of revenue	12
The impact of passporting	13
Conclusions and recommendations	14
<b>Chapter 3: The impact of the loss of passporting</b>	<b>15</b>
The 'ecosystem'	15
Third-country equivalence	17
Euro clearing	22
Chart 1: Average daily turnover by notional value of global OTC derivatives in April 2013 - interest rate derivatives, in USD	22
Chart 2: Average daily turnover by notional value of global OTC derivatives in April 2013 - FX derivatives, in USD	23
Chart 3: Top five euro-denominated OTC foreign exchange markets trading in euros, daily turnover in April 2013 in EUR	23
Chart 4: Top five OTC interest rate derivatives markets trading in euros, daily turnover in April 2013, in EUR	24
<b>Chapter 4: Beyond market access—free movement and FinTech</b>	<b>28</b>
Free movement and recruitment	28
FinTech	29
Attracting and retaining talent	29
Data	30
London as a FinTech hub	30

<b>Chapter 5: The way forward</b>	<b>32</b>
A bespoke arrangement?	32
Planning and transition	33
Transitional arrangements	34
The role of the Government	36
EU reliance on UK financial services	37
<b>Summary of conclusions and recommendations</b>	<b>39</b>
<b>Appendix 1: List of Members and declarations of interest</b>	<b>42</b>
<b>Appendix 2: List of witnesses</b>	<b>45</b>
<b>Appendix 3: Passporting and third country access for financial services</b>	<b>47</b>
<b>Appendix 4: Global Financial Centres Index 20: Top 30 cities</b>	<b>50</b>
<b>Appendix 5: Examples of FinTech services</b>	<b>51</b>
<b>Appendix 6: Glossary</b>	<b>52</b>

Evidence is published online at <http://www.parliament.uk/brexit-financial-services> and available for inspection at the Parliamentary Archives (020 7129 3074).

Q in footnotes refers to a question in oral evidence.

## SUMMARY

The financial services industry constitutes around 7% of UK GDP, directly employs 1.1 million people, two-thirds of them outside London, and contributes a significant proportion of tax revenue. Avoiding major disruption to this industry and the resulting job losses should be a high priority in the Government's negotiations on leaving the EU. This report examines the likely impacts of Brexit on UK financial services and seeks to identify issues that the Government will have to contend with as it attempts to reach deals on the UK's withdrawal terms and its future relationship with the EU.

We find that a key priority will be to ensure that there is an adequate transition period, avoiding a 'cliff edge' both at the moment of withdrawal following the Article 50 process and as the UK and the EU move towards a new relationship. It will of course be in the interests of businesses to be able to plan for the future on a firm footing, but we believe that achieving such clarity will also assist regulators in adapting to new circumstances, the wider UK economy and the European economy as whole. The danger is that, in the absence of clarity, firms will restructure or relocate on the basis of a 'worst case' scenario. We call for an early commitment from both sides in the negotiation that there will be a transition period.

The length and terms of a transition period will depend on the extent to which a new relationship with the EU differs from the current arrangements. The Government is seeking a bespoke deal with the EU, but at this stage it is not clear how much access to the single market will be sought; it is even less clear how much will be achieved. The existing business models of UK-based financial services rely to a degree on 'passporting' rights granted in several pieces of EU legislation, and it has been estimated that around £40 to £50 billion of annual revenues are related to the EU. Were the negotiations to result in the UK being treated in the same manner as any other non-EEA 'third country', the UK could find itself seeking equivalence under legislative provisions that are patchy, unreliable and vulnerable to political influence<sup>1</sup>. It has recently been reported that the European Commission is proposing to tighten the equivalence provisions in EU legislation: this highlights the unpredictability of such a regime. We conclude that, if the current passporting regime is not maintained, the Government should seek a deal to bolster the current equivalence arrangements for third-country access, to cover gaps in the regime and to ensure the continuation of equivalence decisions as financial services regulation develops.

A vital task will be to determine the extent to which firms currently rely on passporting and the degree to which equivalence provisions might provide a substitute. The Government should go into the negotiations with the strongest possible evidence base. This will not be an easy task: we heard that even the firms themselves did not have a clear idea of their reliance on passporting.

Establishing the likely impact of a reduction in market access will be made more difficult by the existence of the so-called UK financial 'ecosystem', in which network effects resulting from the concentration of services increase the efficiency of the system. The UK currently benefits from the co-location and interconnection of firms providing a range of financial and professional services: a change to the business conditions for one of those services could affect many others.

1 See paragraphs 40–59.

London is currently ranked as the leading financial services centre in the world, closely followed by New York. Other European cities are far behind. There is a tension, in that unpicking a highly developed ecosystem such as exists in London or New York could have unpredictable effects. It would also be very difficult to replicate it, in the short term at least, in a less developed centre. We were told that much of the business lost by the UK would be more likely to relocate to New York than to the EU.

The strength of the UK's financial services industry, means that the UK has a large trade surplus in financial services with the EU. Though this demonstrates the extent to which the industry benefits from access to the EU market, it also demonstrates the reliance of the wider EU economy on the services provided in the UK. If the UK ecosystem cannot be replicated in the EU, which is not a realistic prospect according to the evidence we heard, we conclude that it would not be in the EU's economic interest for services to be provided less efficiently, or in New York instead of London.

One example of this is euro-denominated clearing, of which the UK is the leading centre. The European Central Bank has already attempted to repatriate euro-denominated clearing to the eurozone, and the issue was reopened, by the President of France among others, shortly after the June referendum. Repatriation could happen. But the difficulties associated with replicating the services currently provided in the UK give us some hope that a deal might be reached that would be in the mutual economic interest of both the UK and the EU.

# Brexit: financial services

## CHAPTER 1: INTRODUCTION

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### Financial services and the UK economy

1. The UK is the world's largest exporter of financial services and insurance: in 2013 UK net exports were \$71 billion. London is ranked by the Global Financial Centres Index (GFCI) as the world's leading financial services centre, just ahead of New York and significantly ahead of other EU cities.<sup>2</sup> In 2011–12 the sector contributed 12% of PAYE income tax and national insurance, and 15% of onshore corporation tax received by the Exchequer, and in 2013 employed an estimated 1.1 million people.<sup>3</sup> In his evidence to this inquiry Anthony Browne, Chief Executive of the British Bankers' Association, put these figures in context:

“Financial and related professional services pay over £60 billion a year in tax. Of that, banks pay about £31 billion. Of that £31 billion, slightly over half ... is paid by foreign banks based here. It is worth noting that that is bigger than the entire UK net contribution to the EU budget.”<sup>4</sup>
2. When related professional services are added, the UK workforce in financial services numbers nearly 2.2 million. This includes 483,000 in management consultancy, 314,000 in legal services and 391,000 in accounting services.<sup>5</sup>
3. The health of the sector is thus hugely significant for the UK economy. Moreover, while ‘London’ or ‘the City’ are often used as shorthand for the UK financial services industry, the reality is that a large proportion of jobs and activity in the sector are based in other parts of the UK. Simon Kirby MP, Economic Secretary to the Treasury, told us that “financial services contribute more than 7% of UK GDP, and around half of that comes from outside London. They employ more than one million people, two-thirds of whom are outside London.”<sup>6</sup>
4. The UK financial services sector plays a vital role in providing services to the wider economy, both in the UK and internationally. Analysis by the consultancy Oliver Wyman calculates the annual financial revenues at around £200 billion, £90–95 billion of which is domestic business, £40–50 billion relates to the EU, and £55–65 billion relates to the rest of the world.<sup>7</sup>

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2 Long Finance, ‘Global Financial Centres Index 20’ (September 2016): <http://www.longfinance.net/global-financial-centres-index-20/1037-gfci-20.html> [accessed 29 November]. See Appendix 4 for the full rankings.

3 HM Government, *Review of the Balance of Competences between the United Kingdom and the European Union - The Single Market: Financial Services and the Free Movement of Capital* (Summer 2014) pp 35–36: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/332874/2902400\\_BoC\\_FreedomOfCapital\\_acc.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332874/2902400_BoC_FreedomOfCapital_acc.pdf) [accessed 29 November 2016]

4 Q 15

5 TheCityUK, *Key facts about UK financial and related professional services*, (March 2016), p 6: <https://www.thecityuk.com/assets/2016/Reports-PDF/Key-facts-about-UK-financial-and-related-professional-services-2016.pdf> [accessed 29 November 2016]

6 Q 57

7 Oliver Wyman, *The impact of the UK's Exit from the EU on the UK-based financial services sector* (4 October 2016): <http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/oct/OW%20report-Brexit%20impact%20on%20UK-based%20FS.pdf> [accessed 29 November 2016]

5. Despite the poor public perception of the sector since the financial crisis of 2007–2008, financial services are vital to the prosperity of the whole of the United Kingdom, and therefore should be an important element in the forthcoming negotiations on Brexit. Ensuring a smooth and orderly transition to a new relationship with the EU will be a critical consideration, which we discuss in greater detail in paragraphs 97–111.

### **The EU Committee's work**

6. Following the referendum on 23 June 2016, the European Union Committee and its six sub-committees launched a coordinated series of short inquiries, addressing the most important issues that will arise in the course of negotiations on Brexit.<sup>8</sup> The pace of events means that these inquiries will necessarily be short, but with this constraint we are seeking to outline as far as possible the major risks and opportunities that Brexit presents to the United Kingdom.
7. Our inquiries are running in parallel with the work currently being undertaken across Government, where departments are engaging with stakeholders, with a view to drawing up negotiating guidelines. But while much of the Government's work is being conducted in private, our aim is to stimulate informed debate, in the House and beyond, on the many areas of vital national interest that will be covered in the negotiations. As far as possible we aim to complete this work by March 2017.
8. Given the size of the financial services industry, its importance to the wider UK and EU economies, and the potential impact of Brexit on the sector, it was clear to us that financial services should be the first issue to be investigated by the Financial Affairs Sub-Committee.
9. This report was prepared by the Sub-Committee on the basis of evidence sessions with nine panels of witnesses, in September, October and November 2016, as well as written evidence. Before we embarked on this inquiry, immediately following the referendum, members of the Sub-Committee met industry representatives at a seminar hosted by the City of London Corporation to discuss key issues. We are grateful to all those who contributed to the inquiry.
10. **We make this report to the House for debate.**

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8 See the European Union Select Committee, *Scrutinising Brexit: the role of Parliament* (1st Report, Session 2016–17, HL Paper 33).



## CHAPTER 2: PASSPORTING, EQUIVALENCE AND MARKET ACCESS

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### Possible trade agreements: existing models

11. Much of the debate about the UK's future trading relationship with the EU has been cast in terms of various main models of access: full European Economic Area (EEA)<sup>9</sup> membership (the 'Norway model'); membership of the customs union; a bespoke free trade agreement (the 'Canadian model'); EFTA membership and a series of bilateral agreements (the 'Swiss Model'); and the 'WTO model'. Our report *Brexit: the options for trade*<sup>10</sup> considers these models in more detail. Boxes 1 to 5 below contain brief descriptions of each of them, focusing on their impact upon financial services.

#### Box 1: The EEA, or 'Norway' model

As a member of the European Economic Area, Norway must accept the 'four freedoms'—freedom of movement of goods, services, persons and capital—as well as the authority of EU law.<sup>11</sup> It must also make contributions to the EU budget, albeit on different terms from full EU members.

EEA-authorised firms are eligible for the financial services passport in the same way as EU-authorised firms, although EEA states have little say over the rules governing the single market.

#### Box 2: The customs union

Under the customs union individual Member States are prevented from introducing charges which have an effect equivalent to that of customs duties on goods; nor are they permitted to impose quantitative restrictions or quotas. The customs union also has a Common External Tariff, imposed on all goods imported from third countries.

Turkey, though not a member of the EU, takes part in the customs union through an association agreement covering all industrial goods, but excluding agriculture (except processed agricultural products), services or public procurement. The Turkish arrangement does not provide access to the EU market for financial services, but does exclude free movement of labour.

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9 The EEA comprises the 28 EU Member States and the three members of the European Free Trade Agreement (EFTA) that have signed the EEA Agreement—Iceland, Liechtenstein and Norway. Switzerland, while an EFTA member, is not a member of the EEA. Following Brexit the UK could seek to become a non-EU member of the EEA. In this report, unless otherwise specified, references to the EEA should be taken to include both EU and non-EU EEA members.

10 European Union Select Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

11 Enforced by the EFTA Surveillance Authority, which has been given powers corresponding to those of the Commission in the exercise of its surveillance role, and the jurisdiction of the EFTA Court, which largely corresponds to the jurisdiction of the Court of Justice of the European Union over EU States.

**Box 3: A free trade agreement**

The most current example of a free trade agreement is the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada. This contains a financial services chapter and provides, in principle, for trade in financial services under the four ‘modes of supply’ contained in the General Agreement on Trade in Services (GATS). However, it is possible for a party to impose terms and conditions and restricts the ability of firms from one party to do or solicit business in the other’s territory. Firms may have no greater access than under the current third country equivalence regime.

These terms reflect a specific deal between the EU and Canada, and the UK could attempt to negotiate something more favourable. Experience suggests, however, that negotiating a free trade agreement with the EU is likely to be difficult and time-consuming.

**Box 4: EFTA membership and bilateral agreements ‘The Swiss model’**

Switzerland, through its membership of the European Free Trade Area (EFTA) and a series of bilateral agreements, has secured market access in a number of areas. Its access to the market for financial services is, however, limited to an agreement on the supervision of non-life insurance services and it is largely reliant on WTO GATS terms (see below). As a third country, Switzerland has been deemed equivalent under Solvency II and under the European Market Infrastructure Regulation (EMIR) in respect of central counterparties (CCPs). Equivalence determinations under the Alternative Investment Fund Managers Directive (AIFMD) and the Markets in Financial Instruments Directive (MiFID) are in train.

**Box 5: WTO terms**

In the absence of a deal with the EU the UK would fall back on WTO terms, and in particular the General Agreement on Trade in Services (GATS). Under GATS, WTO members must ensure “treatment of services and suppliers from other members no less favourable than that accorded to like services and suppliers of any other country”. GATS divides trade in financial services into four ‘modes of supply’:

- Cross-border supply—the supply of a service from one state to another;
- Consumption abroad—the consumer of a service being in one state and consuming the service in another state;
- Establishment—the supply of a service from one state to another through the incorporation of a commercial presence in that state;
- Presence of natural persons—a service supplier sending individuals from one state to another to supply a service.

Commitments to market access vary depending on the mode of supply. Typically, GATS members make limited commitments with respect to cross-border supply and consumption abroad of financial services. Under GATS, members are able to impose licensing or other requirements that make it difficult for a non-resident supplier to conduct business. GATS also includes a ‘prudential carve-out’, which enables members to take measures for prudential reasons: this could lead to the retention or introduction of measures which effectively reduce cross-border supply.

12. There is general agreement that EEA membership, the Norway model, would replicate most closely the access to the EU market currently enjoyed by UK-based firms. However, the price would be acceptance of the ‘four freedoms’, including the free movement of people, and of the jurisdiction of EU law through the EFTA institutions. A bespoke arrangement, along the lines of the comprehensive Canadian agreement, could provide a degree of market access. Membership of the customs union would provide no access for services, and the UK would have to fall back on WTO terms in this regard. Under WTO terms the UK would be treated as any other third country, with more limited market access, accompanied by significant drawbacks.

## Passporting and equivalence

### *The legislative framework*

13. By virtue of the UK being in the EU, financial services firms authorised in the UK are able to provide services into and within other EU Member States without the need for further authorisations. This is commonly referred to as ‘passporting’. The ability to passport services means that a firm can either provide its services directly on a cross-border basis or can establish a branch in another Member State, having received authorisation from its home state regulator and without the additional requirements and costs associated with establishing a subsidiary in that Member State. Subsidiaries, in contrast, may be subject to local governance and regulatory requirements, and may require separate capitalisation, both of which increase costs.
14. Passporting rights are set out in several pieces of EU legislation, most of which regulate particular activities or services. An individual firm can provide more than one of these services, so the extent to which a firm relies on passporting will vary depending on the range of its activities, with the result that the legislative regime governing a particular business can be difficult to untangle. As Simon Gleeson, Partner, Clifford Chance, told us:

“Our attempts to take businesses apart passport by passport have proved to be extremely difficult because we are now aware in a way that I do not think we were beforehand of just how poorly the passporting and legal structure maps on to the commercial business of the banks.”<sup>12</sup>

This echoed a comment by Peter Snowdon, Partner, Norton Rose Fulbright, who said that firms “often discover that they need permission to do something and had not realised it”.<sup>13</sup>

15. European legislation also allows for ‘third-country’ access to the market in respect of specific activities. The difficulties associated with the current arrangements for gaining third-country equivalence, where it is available, are discussed in paragraphs 40–59. Following Brexit, unless the UK were to join the EEA or negotiate an alternative arrangement allowing full single market access, it would be classed as a ‘third country’ and its firms would be subjected to those provisions. Market access in such situations is based on demonstrating regulatory equivalence between the third country and the EU.

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<sup>12</sup> [Q 33](#)

<sup>13</sup> [Q 27](#)

16. Box 6 describes some of the more important pieces of legislation providing passporting and equivalence regimes. A table in Appendix 3 sets out the situation in more detail.

**Box 6: EU Legislation granting passporting rights**

*Capital Requirements Directive (CRD IV)*<sup>14</sup>

CRD IV and the accompanying Capital Requirements Regulation came into force for banks in 2013, bringing into EU law the capital adequacy standards agreed at international level in the Basel III regulations. The CRD regime covers banking services, including deposit taking, lending and other forms of financing, financial leasing and payment services, some corporate finance advisory services and some trading services. There is no third country regime under CRD IV.

*Solvency II Directive*<sup>15</sup>

Solvency II sets the prudential framework for insurance and requires insurers to hold enough capital to have 99.5 per cent confidence that they could cope with the worst expected losses over a year. It allows an EEA firm to provide insurance or reinsurance services either cross-border or by establishing a branch in another state. Third-country insurers can provide services by establishing a branch within the EEA, authorised in the member state in which it is established. A third-country equivalence regime exists under Solvency II for reinsurance but not for direct insurance.

*Markets in Financial Instruments Directive (MiFID)*<sup>16</sup>

MiFID has been applied in the UK since 2007 and was recently revised. MiFID II and the accompanying Markets in Financial Instruments Regulation (MiFIR) will come into force in January 2018. Under the MiFID regime, banks and investment firms can passport services related to securities, funds and derivatives, including trade execution, investment advice, underwriting and placing of new issues and the operation of trading facilities. MiFIR will introduce a third-country regime, allowing firms from third countries to offer these services cross-border to wholesale customers and counterparties.

14 The CRD IV package comprises Directive 2013/36/EU, 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, [OJ L 176/338](#) (27 June 2013) (CRD IV) and Corrigendum to Regulation (EU) No 575/2013, 26 June 2013, on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, [OJ L 321/6](#) (30 November 2013) (CRR)

15 Directive 2009/138/EC, 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), [OJ L 335/1](#) (17 November 2009)

16 The MiFID II package comprises Directive 2014/65/EU, 15 May 2014, on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, [OJ L 173/349](#) (12 June 2014) (MiFID II) and Regulation (EU) No 600/2014, 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, [OJ L 173/84](#) (12 June 2014)

*Undertaking in Collective Investment in Transferable Securities (UCITS) Directive*<sup>17</sup>

The UCITS regime has been in place since 1985 and was most recently updated in 2014. Investment funds that meet the rules set out under the UCITS Directive may be sold freely, including to retail investors, throughout the EEA on the basis of single national authorisation.

There is no third-country regime under UCITS, so were the UK to become a third country UK-based asset managers wishing to continue marketing these products would have to re-domicile—though there could be scope for a re-domiciled management company to delegate day-to-day management of the fund back to the UK. Alternatively, funds could be marketed from the UK as alternative investment funds (AIFs).

*Alternative Investment Fund Managers Directive (AIFMD)*<sup>18</sup>

The AIFMD sets the rules for alternative investment fund managers. It created an EEA-wide passport for EEA fund managers to market those funds across the EEA. A national private placement regime (NPPR) exists to allow non-EEA fund managers to market funds in EEA jurisdictions to professional investors, depending on the specific rules in those jurisdictions. AIFMD envisages that the NPPR will be phased out: it does, however, contain third-country equivalence provisions, which could enable UK firms to market their funds.

*The extent of passporting in the UK*

17. Many UK-based firms use the passporting rights granted under the legislation outlined above. The Financial Conduct Authority provided the figures in Tables 1 and 2 to the House of Commons Treasury Select Committee.<sup>19</sup>

**Table 1: Number of inbound and outbound<sup>20</sup> passports issued by the Financial Conduct Authority and Prudential Regulation Authority**

	Total	Inbound	Outbound
Number of passports in total	359,953	23,532	336,421
Number of firms using passporting	13,484	8,008	5,476

17 Directive 2014/91/EU, 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, [OJ L 257/186](#) (28 August 2014)

18 Directive 2011/61/EU, 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, [OJ L 174/1](#) (1 July 2011)

19 Letter from Andrew Bailey to Andrew Tyrie MP, Chair of the House of Commons Treasury Select Committee, 17 August 2016: <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/AJB-to-Andrew-Tyrie-Passporting.PDF>

20 An 'outbound' passport refers to a passport issued by a UK competent authority to a UK firm. This allows it to do business in one of more EU or EEA member states. An 'inbound' passport refers to a passport issued in an EU or EEA member state to a firm from that state, enabling it to do business in the UK (or other Member States).

**Table 2: Number of firms with at least one passport under each directive**

Directive	Outbound	Inbound
Alternative Investment Fund Managers Directive (AIFMD)	212	45
Insurance Mediation Directive (IMD)	2758	5727
Markets in Financial Instruments Directive (MiFID)	2250	988
Mortgage Credit Directive (MCD)	12	0
Payment Services Directive (PSD)	284	115
UCITS Directive	32	94
Electronic Money Directive	66	27
Capital Requirements Directive IV (CRD IV)	102	552
Solvency II Directive	220	726

18. As we have noted, it is possible for a firm to have more than one passport in order to provide different services under different directives. It is also possible for a firm to hold more than one passport under the same directive. In reality, more EU companies than UK companies hold passports, but more passports in total are held by UK companies.
19. The figures provided by the FCA indicate very broadly the extent of passporting and the scale of the job of unpicking exactly how much use is made of it by UK businesses. The analysis published by Oliver Wyman, summarised in Table 3, provides a further indication, in cash terms.

**Table 3: Sectoral breakdown of UK financial services revenues 2015, segmented by source of revenue**

Sector	Domestic business earned from UK clients	International and wholesale business not related to the EU	International and wholesale business related to the EU
Banking	£65–70 billion	£20–25 billion	£23–27 billion
Asset management	N/A <sup>21</sup>	£15–18 billion	£5–6 billion
Insurance and reinsurance	£27–29 billion	£7–10 billion	£3–5 billion
Market infrastructure and other	n/a <sup>22</sup>	£13–15 billion	£9–12 billion

Source: Oliver Wyman, *The impact of the UK's exit from the EU on the UK-based financial services sector*, October 2016, p 6.

- 21 Portfolio management for UK client funds included in the international and wholesale business not related to the EU.
- 22 All 'market infrastructure and other' is considered potentially internationally portable. There is £10–14 billion of UK client business included in the International and wholesale business not related to the EU category.



20. These figures suggest that around a quarter of revenues in banking and asset management, and nearly half of revenues in market infrastructure and others, are related to the EU.<sup>23</sup> Insurance is less reliant on EU revenues. In total, Oliver Wyman estimated that a ‘low access’ scenario following Brexit would result in a loss of £18–20 billion in revenues.<sup>24</sup>

*The impact of passporting*

21. Notwithstanding the analysis published by Oliver Wyman, witnesses urged caution, suggesting that it was difficult to read much into these bare numbers. As Sir Jon Cunliffe, Deputy Governor of the Bank of England for Financial Stability, told us:

“It is quite difficult to go from the number of passports and firms to the amount of what I would call economic activity. In some areas like insurance, where passports are used, they are very cheap and easy to get. Passports are used for relatively small volumes of business such as selling travel insurance cross-border.”<sup>25</sup>

22. The extent and complexity of passporting add to the difficulty in assessing the impact of Brexit. Douglas Flint, Group Chairman HSBC, told us that “Everyone is affected by passporting rights to a greater or lesser degree”,<sup>26</sup> while Elizabeth Corley, Vice Chair, Allianz Global Investors, told us that, in the asset management sector, passporting was variable and only part of the equation.<sup>27</sup> Sir Jon Cunliffe, while acknowledging the Oliver Wyman estimate of the impact of a ‘low access’ scenario, said that firms needed to be asked: “Which of your business lines, which of the transaction chains and which of the bundles of services you operate use some or all of the passporting permissions?”<sup>28</sup>

23. Anthony Browne described some of the activities that relied upon passports:

“If a German company was trying to raise €500 million for an investment to build a factory, it might do so by raising a bond with, in addition, a syndicated loan, and then hedge that in respect of foreign exchange payments, currency risk and interest rate risk. Those are three different products. The company would come to London for that. All of that is based on passporting rights. If passporting rights were lost, the company would not be able to come to London for bonds, for a syndicated debt or for hedging foreign exchange or interest rate risk. If we got equivalence, under MiFID and EMIR, it might be able to come for the bond and to get some hedging, under EMIR, but it would not be able to get the syndicated debt, because there is no provision for lending under any of the existing regulations. So banks based in London would only be able to provide a narrower range of services. They would not be able to be the sort of one-stop shop that they are at the moment.”<sup>29</sup>

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23 Taking the higher figures for non-EU related business with the lower for EU, and vice versa, this works out as 19–24% for banking, 22–29% for asset management, 7–13% for insurance and 38–48% for market infrastructure and others. Domestic revenue for asset management and market infrastructure is included in ‘international and wholesale’.

24 Oliver Wyman, *The Impact of the UK’s exit from the EU on the UK-based financial services sector*, p 14

25 [Q 41](#)

26 [Q 19](#)

27 [Q 19](#)

28 [Q 41](#)

29 [Q 11](#)

24. Huw Evans, Director General, Association of British Insurers, said that the extent to which his members relied on passports was still being worked out: “it is not something we have ever had to know before, or overanalyse”. He warned that any estimates of the value of passporting were “either rubbished as too low or viewed as not specific enough in what they can actually relate to”. This situation may not apply across the wider insurance sector and Mr Evans pointed to a recent announcement by Lloyd’s of London, that about 11% of its revenues were at risk from the loss of passporting, but noted that it was “a very big deal for the firms it affects [but] does not have that big an impact on others”.<sup>30</sup>
25. Sir Charles Bean, Professor of Economics, London School of Economics, said that reliance on passporting would depend on whether “the firm in question is mainly operating in wholesale financial services where it can sell its services crossborder or whether it needs to connect with retail consumers. If you need to connect with retail consumers, you basically need to physically operate in the member state, and the loss of passporting rights will essentially mean that firms will need to set up subsidiaries over there.” He added that many major non-EU banks headquartered in London already had subsidiaries in other parts of the EU. The question was the extent to which those banks needed to transfer activities to another Member State.<sup>31</sup>
26. In written evidence, the Association of Foreign Banks noted that banks were more or less concerned, depending on their country of origin. UK branches of EEA banks, providing both wholesale and retail services, were concerned about the loss of passporting (more so for retail services) while UK branches of non-EEA banks and UK-incorporated subsidiaries of overseas banks did not view passporting as a central issue.<sup>32</sup>

### *Conclusions and recommendations*

27. **The legislation underpinning access to the EU market is based largely on the regulation of activities, and does not map easily onto the business structures of many firms. A better evidence-base is needed, and it is imperative that the Government gains a detailed understanding of how firms are likely to be affected by changes to their rights of access to EU markets, building where possible on the work undertaken by the firms themselves.**
28. **It is striking that some firms do not themselves appear to be aware of their reliance on the current passporting arrangements. It would be in the interests of the firms themselves, as well as in the national interest, if they were to cooperate with the Government and the regulators to determine the true extent of such reliance, so as to inform the Government’s negotiating position.**

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30 [Q 51](#)

31 [Q 3](#)

32 Written evidence from the Association of Foreign Banks ([BFS0004](#))



## CHAPTER 3: THE IMPACT OF THE LOSS OF PASSPORTING

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### The ‘ecosystem’

29. Such is the size, complexity and interconnectedness of the UK financial services sector that many of our witnesses described it as an ‘ecosystem’. In the words of Douglas Flint, Group Chairman, HSBC:

“The principal priorities of our regulators and public policymakers [since 2009] have been to eliminate risk through consolidation, central counterparties and more transparent arrangements. That has led to an ever greater concentration of financial activity into the major centres of the world. What takes place in the ecosystem, the cluster that operates in London as one of the world’s greatest financial ecosystems ... means that our biggest concern is to understand whether financial stability in the ecosystem can be preserved if you start playing with the range of activities that can be conducted from a single location.”<sup>33</sup>
30. Andrew Gray, Global Financial Services Brexit Leader, PwC, explained that “It is not just about banking in isolation or asset management in isolation. You need to look at financial services holistically”. He added that “any forms of fragmentation of the existing way in which financial services are structured will have implications. You need to be clear about what those implications are before decisions are made”. Alex Wilmot-Sitwell, EMEA President, Bank of America Merrill Lynch, put it more graphically:

“It is not a Lego set in which little pieces can be built up and put somewhere else. The interconnectedness is very significant and ... we need to be assured that whatever happens from this point forward, the consequences and implications of any steps are understood.”<sup>34</sup>
31. Simon Gleeson, Partner, Clifford Chance, imagined a banker explaining his services to a corporate client:

“I sell the entirety of the product range of the bank, everything from payment systems to lending to foreign exchange hedging, you name it. I cannot tell you what my position would be if I lost the right to offer one of those products but not the others.”<sup>35</sup>
32. The ecosystem effect provides the background against which any assessment of the impact of Brexit has to be made, and makes that assessment particularly complicated. Katherine Braddick, Director of Financial Services,<sup>36</sup> HM Treasury, told us that ecosystem effects, or the network effects of having a concentration of financial services in the UK, had “defied quantitative analysis for a very long time. The industry can explain how it works, but we find it difficult to translate that into what the impact scenarios would

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33 [Q 18](#)

34 [Q 18](#)

35 [Q 31](#)

36 On 24 October 2016 Katherine Braddick was appointed Director General, Financial Services at HM Treasury.

look like. That is more difficult, and I do not think it is a nut we can crack analytically for these purposes and in this timescale.”<sup>37</sup>

33. This complexity works both ways: analysing the impact on the City is hard, but replicating such an interconnected system may be harder. Simon Gleeson thought that it was not possible to create a rival financial centre to London “precisely because of that ecosystem”:

“An asset manager employs half a dozen portfolio managers; there are 200 skilled people ranging from accountants to consultants to lawyers. The fact that you have a big pool of those to draw on means that that is where you put the business. So the fundamental position that, almost whatever happens, London will remain the financial centre of the continent of Europe precisely because of the depth of that pool is correct. Therefore, it is also correct that that should be an important factor for the European Union in discussing future arrangements.”<sup>38</sup>

34. Other witnesses spoke of London’s advantages as a financial hub. Miles Celic, Chief Executive, TheCityUK, said: “It is very difficult to identify another individual smaller financial centre in Europe that has anything like the sort of advantages that London has. Indeed, in some sectors of the financial and related professional services industry, London has an even stronger advantage than somewhere like, say, New York”. He gave the FinTech industry as an example: London had the creative, regulatory, legislative, funding and technology centres in one place. He described the ecosystem effect as a “virtuous circle that has kept feeding itself. It has led to greater competition, greater innovation and reduced costs. The risk of fragmentation is that you reduce that.”<sup>39</sup>
35. Sir Jon Cunliffe also thought that London’s role was unlikely to be replicated elsewhere in Europe in the foreseeable future. He noted, however, that a similar system already existed in New York, which benefited from similar “economies of scale, scope, information-sharing and ancillary services”, and he thought that some business currently conducted in London could go there.<sup>40</sup>
36. The Minister, Simon Kirby MP, described the possibility of an important element of the financial services industry moving to New York as “a very bad place for all of us, not only in the UK but for everyone in Europe”.<sup>41</sup> The European and global impact of a fundamental relocation of activity was also expressed by Douglas Flint:

“If the benefits that come from consolidation allowing people to bring all the risk into one place and get the compression effects of risk management and offsets were fragmented, we would risk an element of financial stability as it adjusts, we would make the system more

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37 [Q 58](#). It should be noted, however, that Oliver Wyman has attempted to calculate the impact of ‘low access’ and ‘high access’ scenarios, taking into account the ecosystem effect. Its estimate of the first order effects of a low access scenario is the loss of £18–20 billion in revenues and 31,000–35,000 jobs. When the ecosystem effect is taken into account it estimates that £32–38 billion of revenues and 65–70,000 jobs are ‘at risk’. Its estimate of the ‘high access’ impact is a loss of around £2 billion. Oliver Wyman, *The impact of the UK’s exit from the EU on the UK-based financial services sector*

38 [Q 33](#)

39 [Q 54](#)

40 [Q 41](#)

41 [Q 60](#)

expensive and we probably do not know where the system ends up if it gets fragmented. Does it get split over a number of centres or does it find some other place in the world that can offer the consolidated benefits that come from the system that exists today in the UK?”<sup>42</sup>

37. **The UK has a number of advantages as a financial services hub. The concentration of activity allows for economies of scale and a depth of capital market activity that cannot be easily replicated, except possibly in an existing major centre such as New York. Our evidence suggested that it would be to the EU’s advantage that such a system should remain intact.**
38. **The interconnectedness of the UK financial system presents serious difficulties for firms and the Government in determining the impact of changes to the relationship between the EU and the UK. Unless it is extended, the two-year period of the Article 50 negotiations would appear to be insufficient to resolve the uncertainty. We therefore recommend, both for the business environment and for financial stability, a considered and orderly transition to any new relationship. The earlier any aspects of this new relationship can be agreed the easier it will be to determine the impact on each sector of the industry.**

### Third-country equivalence

39. Unless a deal is struck granting firms market access along the lines of the current passporting system the UK may find itself seeking third-country equivalence under provisions in EU legislation (see above, paragraphs 15–16). Equivalence allows for third-country firms to operate in EEA Member States on similar terms to those granted by the financial passport, as long as the third country’s regulation and supervision arrangements have been found to be equivalent to the EU’s. This type of access is, though, available to a smaller number of activities than those able to use the passport, and entails a potentially laborious equivalence process, which is vulnerable to political influence.
40. Some of the major activities covered by third-country equivalence provisions are:
  - Cross-border provision of investment services to wholesale clients or counterparties (MiFID II/MiFIR);
  - Permitted execution venue for shares and over-the-counter (OTC) derivatives<sup>43</sup> subject to trading mandate (MiFID II/MiFIR);
  - Non-discriminatory access to trading venues, CCPs and benchmarks (MiFID II/MiFIR);
  - Establishment of CCPs and trade repositories (EMIR);
  - Marketing of Alternative Investment Funds (AIFMD);
  - Reinsurance (Solvency II).

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<sup>42</sup> [Q 19](#)

<sup>43</sup> Over-the-counter (OTC) derivatives are securities traded in a context other than on a formal exchange, such as through a dealer network.

41. Other major areas of activity are not covered by equivalence provisions. Simon Gleeson told us that the most important omissions were the provision of banking services such as lending and deposit-taking, under the Capital Requirements Directive (CRD IV), and retail asset management, under UCITS.<sup>44</sup> Professor Eilis Ferran, Professor of Company and Securities Law, University of Cambridge, echoed this caution, particularly with regard to payment services:

“We should be careful about assuming that there will be equivalence solutions across the board. There are not. There are key areas that are not covered by equivalence. For example, the area of payment systems is one that is critically important and not covered. If we look at MiFID and MiFIR, yes, it is true that wholesale services will be covered under the new regime, but retail will not, and indeed that will depend on a member state by state permission to provide retail services.”<sup>45</sup>

42. Professor Ferran also referred to complications in the position of the asset management industry. UK-based fund managers would not be able to market UCITS funds, and would instead rely on the equivalence provisions under the AIFMD. She described those provisions as “one of the most complicated and unsatisfactory sets of EU post-crisis law”—compliance with that regime would be “a heavy price”.<sup>46</sup>
43. Professor Ferran was more optimistic about the longer term, suggesting that “there will be opportunities to do things differently while remaining equivalent and while remaining within the bounds of international financial regulation. We can more easily be super-equivalent, for example, and we can be a first mover in solving new problems that come along.”<sup>47</sup>
44. Katherine Braddick said that it was difficult to assess the value of equivalence, as the regimes were new and many of them had not yet been used. She noted that the Government was analysing the difference between the current passporting arrangements and equivalence, both in terms of what equivalence made it legally possible to do and what was commercially viable.<sup>48</sup>
45. Anthony Browne described equivalence provisions as “relatively untried and untested ... uncertain and limited in scope”; they could be “removed at relatively short notice”, and were “subject to change in the future, if there are changes to regulation either side of the Channel”.<sup>49</sup> Elizabeth Corley made a related point: “In financial services one needs a dynamic and agile means of regulation and supervision ... anything that assumes a static status quo will not work in practice”.<sup>50</sup>

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44 [Q 29](#)

45 [Q 3](#)

46 [Q 3](#)

47 [Q 9](#)

48 [Q 63](#)

49 [Q 11](#)

50 [Q 22](#)

46. As well as highlighting the narrow scope and potential unreliability<sup>51</sup> of the equivalence regimes, many of our witnesses raised concerns about the process of demonstrating equivalence. On 2 October 2016 the Prime Minister announced plans for a ‘Great Repeal Bill’, to be introduced in 2017. The Bill would ensure that all existing EU law that is currently given effect in the UK through UK domestic law would still apply after Brexit, with the result that UK regulation and supervision would presumably be, at least initially, equivalent to that in the EU. That equivalence will, however, have to be signed off at the EU level. Katherine Braddick noted that the “process for deciding equivalence differs from one piece of legislation to the next”, and highlighted the complexities of equivalence decisions under MiFID II:

“That is a Commission decision. The parameters for that decision are not terribly clear; they are quite open. The way the Commission can make the decision is open to interpretation. There are no time limits for how long the Commission has to take to make a decision. Then there is a further process where, if it wants to give equivalence, it has to go through a committee of member states, and then the European Securities and Markets Authority has to [register] each individual firm from that jurisdiction. They do not approve them but they have to register them. That registration can be withdrawn and the equivalence can be withdrawn.”<sup>52</sup>

47. Professor Ferran, while noting that a recent equivalence decision in relation to US clearing houses had been slow, was confident that such decisions could be taken “pretty efficiently, provided that politics does not get in the way”.<sup>53</sup> She thought mutual interest and a common commitment to open markets would ensure that politics did not intrude. She also pointed to a history of regulatory cooperation between the UK and the EU, and to the technical role of the European Supervisory Authorities in providing a “buffer zone” and a “shield against political interference”.<sup>54</sup>
48. Professor Ferran’s passing reference to the possibility of politics getting in the way was developed by other witnesses. George Hay, European Financial Editor, *Breakingviews*, Reuters, agreed that, in technical terms, there was no reason why Europe should not grant equivalence, but pointed to forthcoming elections in France and Germany as a possible “check on being too generous to the UK”.<sup>55</sup>
49. Miles Celic also thought it could be “a political as much as a technical decision”.<sup>56</sup> Simon Gleeson, referring to the US clearing houses decision, said it had been “fairly notorious that the regulatory experts took less than six months to conclude that they broadly were [equivalent], and there was then two and a half years of discussion before the recognition was actually

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51 Though our witnesses were generally discussing the equivalence regime as it currently exists, the various legislative provisions granting third country access could themselves be altered to the UK’s detriment. A recent *Financial Times* article suggests that the European Commission is considering making the process more rigorous. ‘EU reconsiders financial market access rules’, *Financial Times* (6 November 2016): <https://www.ft.com/content/838d084c-a19d-11e6-86d5-4e36b35c3550> [accessed 14 November 2016]

52 [Q 63](#)

53 [Q 5](#)

54 *Ibid.*

55 [Q 14](#)

56 [Q 55](#)

made”. He thought that the latter discussion “happened almost entirely at a political rather than a technical level”.<sup>57</sup>

50. Stefan Hoffman, Head of European Affairs, Swiss Bankers’ Association, suggested that the UK and Switzerland could be allies in pressing for the EU to establish “an EU equivalence regime or process that is streamlined and more structured, in the sense that in the end you would get a right to be granted EU equivalence when you met certain conditions”. In contrast, there was currently no right to be judged equivalent: “You really depend on the mercy, so to speak, of the Commission”.<sup>58</sup>
51. Sir Jon Cunliffe acknowledged that equivalence decisions could “conceivably” be politicised, but noted that the issue went wider than equivalence between the UK and EU. The EU’s equivalence regimes were relatively new, but responded to a lesson of the financial crisis: “If we want globalised financial services, we all have to have confidence in each other’s regulatory and supervisory machinery”. He pointed to the importance of international standards and noted that, while the EU and the US treated the issue of prudential capital for banks differently, both regimes were equivalent, in that they were implementing a Basel international standard. Equivalence regimes were easier to establish when they were based on such international standards.<sup>59</sup> Although Sir Jon did not make this point, we also note that, to the extent that the UK already benefits from equivalence regimes between the EU and the US, such as that for CCPs, new agreements between the UK and US will be needed following Brexit.
52. Though he accepted that the UK would lose influence in setting the EU regulatory regime post-Brexit, Sir Jon believed that the UK was and would remain influential at the international level. The UK had “much of the machinery and investment in international standard-setting”. As for the EU, he said that “to the extent that we are able to show that we have analysis, good evidence-based approaches to dealing with financial service regulation and practical ideas, I think we will continue to have an influence”.<sup>60</sup>
53. Officials from HM Treasury endorsed Sir Jon’s approach. Katherine Braddick referred to the UK’s “massive intellectual capital through the regulation and supervision of some of the most complex markets in the world”, which had “given us a lot of influence in international fora”. Lowri Khan, Director of Financial Stability, pointed to the UK’s level of engagement in the Basel Committee and the Financial Stability Board.<sup>61</sup>
54. Huw Evans, though, questioned the ability of the UK to use international standards to manage equivalence from outside the EU. He said that there was a “much less well-developed international architecture for insurance than

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57 [Q 29](#)

58 [Q 55](#)

59 [Q 45](#)

60 [Q 46](#)

61 [Q 63](#). The UK is represented on the Financial Stability Board by HM Treasury, the Bank of England and the Financial Conduct Authority. The Bank represents the UK on the Basel Committee on Banking Supervision (BCBS) while the FCA represents the UK on the International Organization of Securities Commissions (IOSCO).



there is for banking”, and pointed to significant differences in the attitudes of the US and EU to regulating insurance.<sup>62</sup>

55. **The existing third-country equivalence regimes in certain pieces of EU legislation are an inadequate substitute for the financial passport. They do not cover the full range of financial services activities, excluding in particular deposit-taking and lending, retail asset management and payment services. As they are agreed at a point in time, and are static, they may also be vulnerable should regulation change to respond to the development of the financial system. The process of updating them as EU-wide regulation changes would be laborious and time-consuming.**
56. **We endorse the Government’s work in analysing the difference between the opportunities afforded by passporting and third-country equivalence. That analysis will be problematic, thanks to the complexity and newness of the regimes, but it will be crucial in determining the true impact of third-country status on the financial services industry. The priority should be to establish at an early stage the extent of the lacunae in the regimes, the likely restructuring that will have to be undertaken by businesses to adapt to changed circumstances, and the consequent effects of such adaptations on the financial services sector and the wider UK economy.**
57. **If the Great Repeal Bill successfully ensures that the UK continues to apply EU legislation post Brexit the UK will, on a technical level, have a regulatory regime that is initially identical to that in the EU. However, it will remain for the European Commission to decide whether the UK is equivalent for the purposes of retaining market access. This process could be lengthy and could be politicised: the Government should seek agreement prior to withdrawal that the UK will be determined to be equivalent at the point of withdrawal, to avoid damaging disruption to financial services providers.**
58. **While the UK might be deemed equivalent at the point of withdrawal, there is no guarantee that it will remain so. Regulation must adapt to changes in the financial services system, raising the risk of regulatory divergence between the UK and the EU, and indeed between the UK and the US. The UK’s influence on international standard-setting bodies, such as the Basel Committee and the Financial Stability Board, will be crucial to ensuring that changes to regulation are consistent internationally. But it is in the UK’s and EU’s mutual interest that the UK should maintain direct influence within the EU, especially in areas such as certain types of insurance, where there are less well-developed international standards. The Government should encourage direct regulatory cooperation between UK and EU authorities and, as part of its negotiation, should seek UK input to EU regulation-setting upstream.**

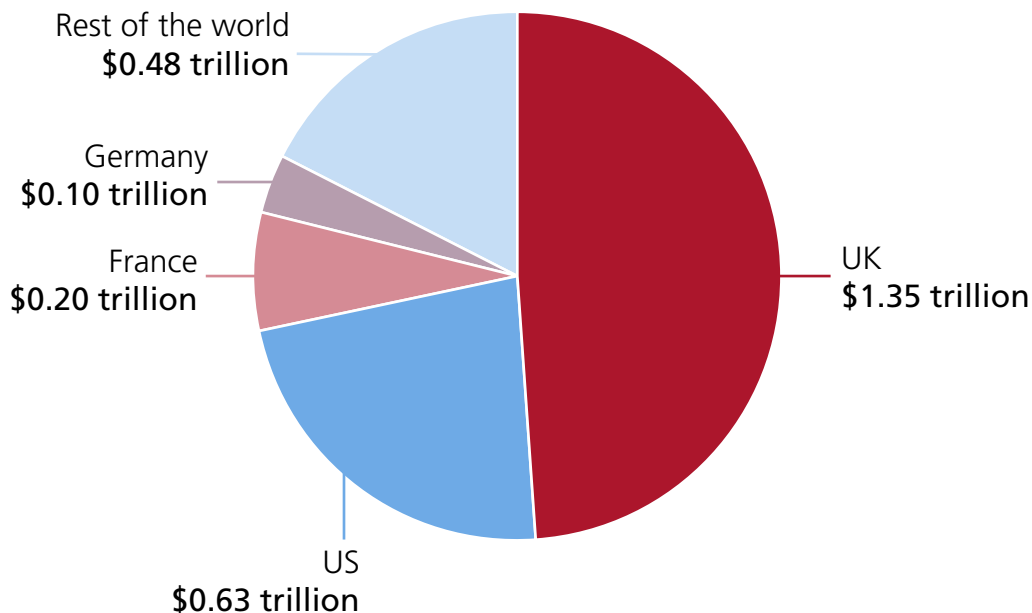
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62 **Q 50.** Though it should be noted that a forum analagous to the BCBS and IOSCO exists for insurance: the International Association of Insurance Supervisors (IAIS). The three organisations meet jointly as the Joint Forum and are represented on the Financial Stability Board.

### Euro clearing

59. When a trade takes place in financial instruments, such as equities, derivatives or bonds, a central counterparty (CCP) or clearing house sits between the buyer and seller. It acts as the buyer to every seller and the seller to every buyer: if either party defaults the CCP owns the risk and becomes accountable for the defaulter's liabilities. As part of the process the CCP collects collateral, or 'margin', from buyers and sellers. This process aids financial stability and introduces efficiencies to the market, as buyers and sellers can make transfers to the clearing house rather than to each entity with which they trade.
60. Following the financial crisis of 2007–08 the role of CCPs became more prominent, and G20 leaders introduced a requirement for certain over the counter (OTC) derivatives to be centrally cleared.<sup>63</sup> At EU level this requirement is contained in the 2012 European Market Infrastructure Regulation (EMIR).
61. The UK is a major centre of OTC derivatives activity and central clearing, accounting for around half of global activity in interest rate derivatives, and over a third of global activity in foreign exchange derivatives contracts. The UK's share of such activity is illustrated in Charts 1 and 2.

**Chart 1: Average daily turnover by notional value of global OTC derivatives in April 2013 - interest rate derivatives, in USD<sup>64</sup>**

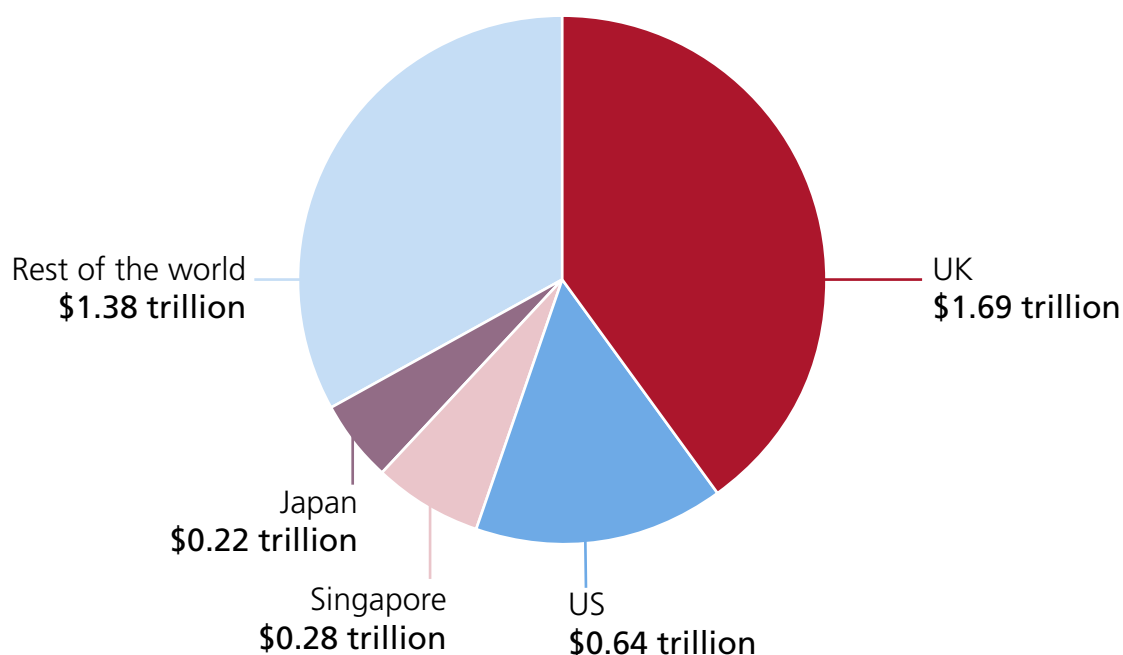


<sup>63</sup> See footnote 43.

<sup>64</sup> Bank of England, 'Over-the-counter (OTC) derivatives, central clearing and financial stability', p 286 <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q306.pdf> [accessed 29 November 2016]

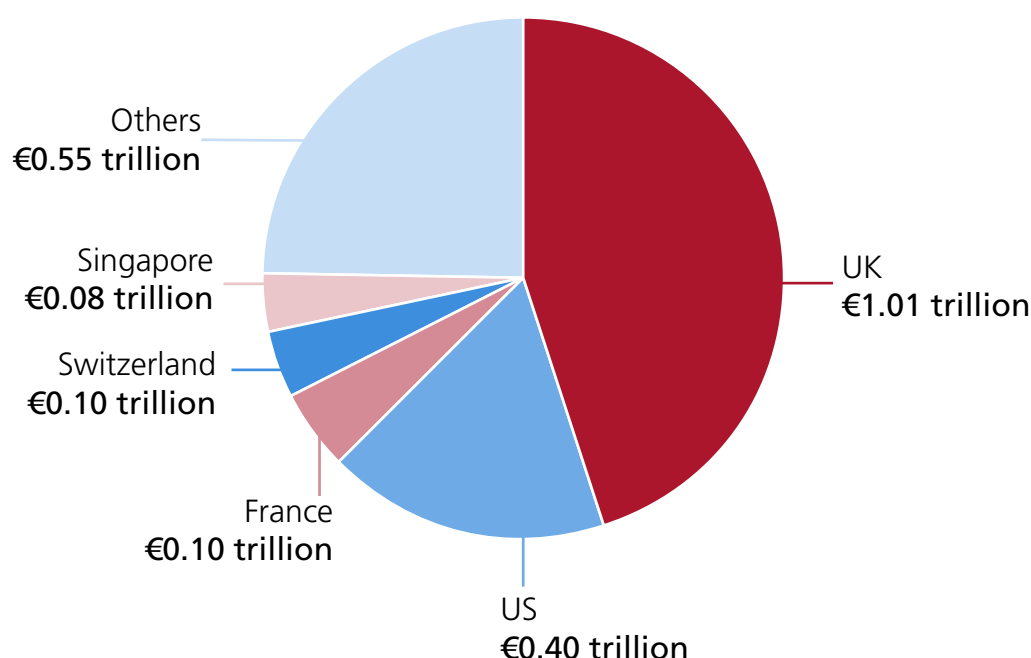


**Chart 2: Average daily turnover by notional value of global OTC derivatives in April 2013 - FX derivatives, in USD<sup>65</sup>**



62. The UK also dominates euro-denominated clearing, as illustrated in Charts 3 and 4.

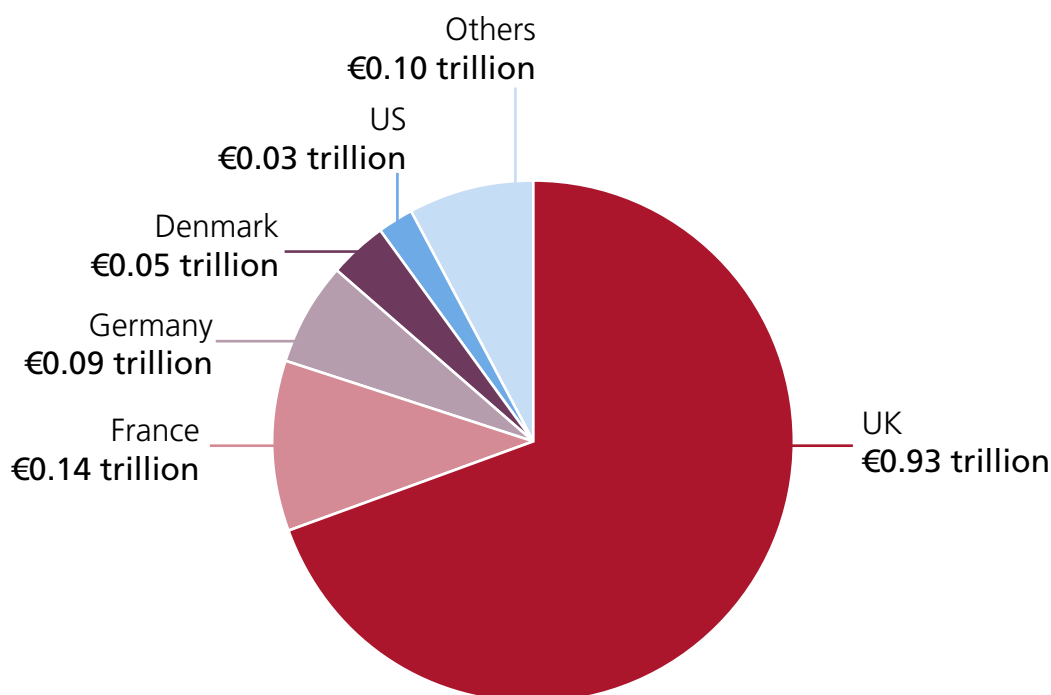
**Chart 3: Top five euro-denominated OTC foreign exchange markets trading in euros, daily turnover in April 2013 in EUR<sup>66</sup>**



65 Bank of England, 'Over-the-counter (OTC) derivatives, central clearing and financial stability', p 286 <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q306.pdf> [accessed 29 November 2016]

66 Bank for International Settlements, *Triennial Central Bank Survey—Global foreign exchange market turnover in 2013*, (February 2014), table 6.2: <http://www.bis.org/publ/rpfx13fxt.pdf> [accessed 29 November 2016]

**Chart 4: Top five OTC interest rate derivatives markets trading in euros, daily turnover in April 2013, in EUR<sup>67</sup>**



63. The UK's dominance in this area has drawn the attention of European politicians and the European Central Bank (ECB). In 2011 the ECB launched its Eurosystem Oversight Policy Framework, or 'location policy', under which it would have refused to provide liquidity support to any CCPs dealing above a certain threshold of euro-denominated transactions that were not legally incorporated and run from the eurozone. The UK challenged this policy at the Court of Justice of the European Union, and in 2015 the General Court annulled the requirement for CCPs to be located in the eurozone, on the ground that the ECB's competence was limited to regulating "payment systems" alone, by virtue of Article 127(2) TFEU and Article 22 of the ECB Statute, and that this competence did not extend to the activity of securities clearing systems.
64. Following the referendum on 23 June the issue was re-opened. For example, President François Hollande of France said on 28 June that that the City should be prevented from clearing euros, describing such a step as "an example for those who seek the end of Europe ... It can serve as a lesson."<sup>68</sup>
65. Professor Ferran noted that the UK had previously been able to use its position as a Member State to resist the ECB's location policy, but thought the ECB would return to the issue following Brexit.<sup>69</sup> Sir Charles Bean went further: "I will not say that it is likely that we will lose it: I will say that it is certain that we will lose it."<sup>70</sup>

67 Bank for International Settlements, *Triennial Bank Survey—Interest rate derivatives market turnover in 2013* (December 2013), table 3.2: <http://www.bis.org/publ/rpfxfl3irt.pdf> [accessed 29 November 2016]

68 'François Hollande rules out City's euro clearing role', *Financial Times* (28 June 2016): <https://www.ft.com/content/e8e0c44a-3d89-11e6-9f2c-36b487ebd80a> [accessed 29 November 2016]

69 *Q 3*

70 *Ibid.*

66. Sir Jon Cunliffe accepted that the political weight attached to euro clearing might determine the outcome. While he would not speculate on the politics, he helpfully outlined some of the technical considerations. The benefit of the post-crisis move towards central clearing was that the margin provided against changes in the value of derivatives contracts was provided centrally and transparently, so regulators could look at the models that generated the amount of margin required. Concentration of central clearing allowed firms to net their risk: “A firm that has some contracts with a plus direction and some with a minus direction with different counterparties can put them into central clearing and only has to take the margin cost of the net rather than the gross positions. That is a huge reduction in the margin that they would otherwise have to post.”<sup>71</sup>
67. Sir Jon noted that because clearing was a multi-currency infrastructure firms could net in different currencies: “you can take the pluses on your dollar-denominated interest rate stocks and the minuses on your yen-denominated ones. It all goes in and it comes together.” This reduced costs, a benefit that would be lost if the system were fragmented. If one followed the argument that clearing had to take place in the jurisdiction of the relevant currency the multi-currency system would break down. Central clearing was thus an important contributor to financial stability.<sup>72</sup>
68. Xavier Rolet, Chief Executive of the London Stock Exchange Group, which owns the LCH.Clearnet clearing house, provided figures for this netting effect. In 2015 LCH’s SwapClear engine “cleared the equivalent in US dollars across 17 currencies of \$555 trillion of interest rate swaps. Through its compression service, which is done across all these currencies, it compressed \$328 trillion, which enabled LCH to eliminate \$110 trillion net of risk ... that saved our customers the equivalent of \$25 billion of regulatory capital.”<sup>73</sup> Mr Rolet pointed to a study by Clarus Financial Technology Group, which had shown that the disaggregation of the euro component of LCH’s clearing engine would cost the financial services industry \$77 billion of additional margin.<sup>74</sup> This would affect banks’ balance sheets and their ability to lend to the real economy.<sup>75</sup>
69. Mr Rolet noted that other countries were keen for that business to migrate, but argued that clearing was “systemically relevant, and the migration of such businesses, while technically possible, also entails a number of non-financial risks, particularly operational ones, of a systemic nature that must be taken into consideration by all policy stakeholders”.<sup>76</sup>

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71 [Q 42](#)

72 [Q 42](#)

73 [Q 67](#). SwapClear describes its compression services as allowing “members and clients to combine or offset trades with compatible economic characteristics, resulting in a reduction in notional outstanding. This simplifies portfolio management by allowing members and clients to reduce the number of individual positions in the portfolio, while maintaining the same risk profile. As a result, fewer reconciliations are needed, delivering more efficient portfolio transfers and, in some cases, lower capital requirements for financial institutions under Basel III.” See: SwapClear, ‘Compression Offerings’ [http://www.swapclear.com/service/compression\\_offerings.html](http://www.swapclear.com/service/compression_offerings.html) [accessed 29 November 2016]

74 Clarus Financial Technology, ‘Moving Euro Clearing out of the UK: The \$77bn problem?’ (28 September 2016): <https://www.clarusft.com/moving-euro-clearing-out-of-the-uk-the-77bn-problem/> [accessed 29 November 2016]

75 [Q 69](#)

76 [Q 67](#)

70. Mr Rolet also thought that the compression benefits available in London were a key attraction for his clients. Clearing in euros could not be efficiently separated from other currencies, and if these benefits were lost then the “whole engine has to move”—he described New York as an attractive alternative location.<sup>77</sup> At the same time, Mr Rolet acknowledged that any attempt to repatriate euro clearing to the eurozone would prevent it taking place in New York as much as in London: he believed that such a move “would not be consistent with the existing agreement around equivalency in mutual recognition”.<sup>78</sup>
71. The Minister suggested that the whole of Europe, including the UK, would be worse off if clearing were to be dismantled and redistributed across Europe. A move to New York would also be “a very bad place for all of us”. He said that euro clearing would be an element in the negotiations, but continued: “Is it the most important element? Probably not, but it is a significant consideration ... as things develop and when we are in a stronger place and have listened, and understood exactly what we are seeking, it will become more apparent how important that particular element is.”<sup>79</sup>
72. In the General Court’s judgment on the ECB’s location policy it suggested that the ECB could revive its policy were its Statute to be amended to give it competence to regulate euro-denominated clearing:
- “It must be pointed out that Article 129(3) TFEU provides for a simplified amendment mechanism—derogating from the mechanism in Article 48 TEU [Treaty revision]—in respect of certain provisions of the Statute, including Article 22. It enables the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, and on a recommendation from the ECB or a proposal from the Commission, to amend those provisions.”<sup>80</sup>
73. It thus appears that the legislative changes necessary to bring about repatriation of euro clearing could take place without recourse to treaty change. The UK, as a non-EU Member State post-Brexit, would not be able to challenge its lawfulness before the General Court. Other EU Member States could, of course, and it is notable that Sweden supported the UK challenge in 2015. A further consideration, however, is that, in order for UK-based CCPs to clear trades involving an EU firm, the UK would have to be found to be equivalent under EMIR and the relevant CCPs recognised by ESMA. The US has already been judged equivalent, in a process that took several years.
74. **The current clearing regime provides benefits to the wider economy by aiding financial stability through the compression of risk and therefore of the collateral required to support trades. These benefits, which depend in large part on the ability to conduct multi-currency clearing, are felt in Europe as well as the UK and internationally. The possibility of a new attempt to require euro clearing to be conducted within the eurozone thus presents significant risk to both the UK and EU economies. Nonetheless, the ECB has attempted to do so once**

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77 [Q 74](#). New York is London’s nearest competitor in the GFCI rankings. See Appendix 4.

78 [Q 74](#)

79 [Q 60](#)

80 *United Kingdom of Great Britain and Northern Ireland v European Central Bank (ECB)*, Judgment of the General Court (Fourth Chamber, 4 March 2015) [T-496/11](#), para 108

**before and the risk of its doing so again should not be taken lightly, particularly in view of the jobs at risk.**

- 75. New York has been suggested as a plausible alternative to London for clearing activity, but a move to ‘repatriate’ euro-denominated clearing to the eurozone would appear to rule out New York as well as London, notwithstanding the positive equivalence decision already granted to the US. The question is whether any eurozone location could provide the same benefits to the wider economy as London and New York, and whether a politically-driven attempt to repatriate euro clearing to the eurozone would invite retaliation by other non-eurozone states, leading to the breakdown of the system of multi-currency clearing.**

## CHAPTER 4: BEYOND MARKET ACCESS—FREE MOVEMENT AND FINTECH

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### Free movement and recruitment

76. The UK financial sector employs over a million people, of whom around 60,000 are EU nationals and 100,000 non-EU nationals. While these proportions are roughly in line with the workforce as a whole, financial services employs a greater proportion of highly-skilled migrants. Around 50% of the general workforce are educated to level 3 (equivalent to A-level) or above, while the figure is 63% in financial services.<sup>81</sup> When asked to provide reassurance that the financial services industry would continue to be able to recruit skilled staff, the Chancellor, Rt Hon Philip Hammond MP, said on 25 October that “I see no likelihood of our using powers to control migration into the UK to prevent companies from bringing highly skilled, highly paid workers here.”<sup>82</sup>
77. Nevertheless, witnesses expressed concern over the ability of the financial services sector to recruit and retain staff. Sir Charles Bean said that access to a deep pool of skilled labour was one of the attractions of London. Financial services firms would want “to get the specialised labour that they need in a relatively efficient and smooth way.” His worry was that “some heavy bureaucratic process is put in place that takes a very long time to operate and becomes very cumbersome”.<sup>83</sup>
78. George Hay, of Breakingviews, Reuters, believed that concerns had subsided since the referendum:

“At that point, a lot of people in the financial sector were saying, ‘We need an EEA model. We need a Norway model. Basically, we need freedom of movement, which would allow us to keep access to the single market and pretty much to keep the passport that we have’. Now there is probably a bit more realism that that is not going to be possible. There will have to be some kind of action on restricting on freedom of movement.”<sup>84</sup>

Anthony Browne reported concerns in the industry, but noted that “we accept the verdict of the British public”.<sup>85</sup> Huw Evans, on the other hand, said that “for the insurance and longterm savings sector it is something that comes up repeatedly from our CEOs”.<sup>86</sup>
79. Andrew Gray echoed Sir Charles’s point about bureaucracy. Financial services was “an industry that is used to moving its people internationally and doing so quickly. Again, there would be impediments to that movement.”<sup>87</sup>
80. The issue of free movement goes wider than just the financial services industry, and a more detailed inquiry into possible models for UK-EU

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81 PwC, *Leaving the EU: Implications for the UK financial services sector* (April 2016): <https://www.thecityuk.com/assets/2016/Reports-PDF/Leaving-the-EU-Implications-for-the-UK-FS-sector.pdf> [accessed 29 November 2016]

82 HC Deb, 25 October 2016, [col 134](#)

83 [Q 4](#)

84 [Q 13](#)

85 *Ibid.*

86 [Q 53](#)

87 [Q 13](#)

movement of people is being undertaken by the EU Home Affairs Sub-Committee, as part of the EU Committee's wider work programme.

81. **The ability to continue to access to highly qualified staff and the ability to transfer them between the UK and the EU is a key issue for the financial services industry. While we welcome the Chancellor's reassurance that highly skilled migrants will not be prevented from coming to the UK, as far as it goes, we note that maintaining appropriate labour market flexibility will be critical to the UK's long-term economic prosperity.**

### FinTech

82. FinTech is a relatively small but growing part of the UK's financial services industry, estimated to generate annual revenues of around £20 billion.<sup>88</sup> FinTech covers a wide range of activities in which companies use technology to make financial services, enable financial services, or drive technological innovation in provision of financial services. They often compete directly with banks—through a process of disintermediation—to sell financial services and solutions to customers, examples of which include money transfer, lending, investment and payments (see Appendix 5). Daniel Morgan, Head of Policy and Regulation, Innovate Finance, described the area as an “amorphous space”, within which “Brexit will hit each sector differently”.<sup>89</sup>

### *Attracting and retaining talent*

83. FinTech relies upon foreign staff to a greater degree than the wider financial services sector, and may thus be affected more acutely by any restrictions of movement of people following Brexit. Daniel Morgan told us that 30% of the founders of Innovate Finance's start-up member base were born overseas. FinTech was “inherently an international sector”, where access to talent was particularly important. The sector relied on three types of talent: those with Science, Technology, Engineering and Maths (STEM) skills, financial services talent and entrepreneurial talent.<sup>90</sup> Giles Andrews, Chairman, Zopa, added that half his workforce was from outside the UK, mainly from the EU, and that he was “already finding less desire among bright eastern Europeans, Germans and French people to come and work in the UK”. He felt that the UK was “underdeveloped in terms of its STEM education”.<sup>91</sup>
84. Daniel Morgan was particularly concerned by the impact of a stricter immigration regime on entrepreneurial talent:

“Obviously there is an entrepreneurial visa, but you have to have a huge amount of capital already in place behind you or prove that you are about to set up a business. Many of our founders came here just with an idea, and with a smaller labour pool that talent will no longer gravitate here.”<sup>92</sup>

Mr Morgan also felt that, if EU immigration were restricted, the UK would need to increase the numbers eligible to enter under a new visa regime, “or

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88 Ernst and Young for UK Trade and Investment, *Landscaping UK Fintech*: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/341336/Landscaping\\_UK\\_Fintech.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341336/Landscaping_UK_Fintech.pdf) [accessed 29 November 2016]

89 [Q 75](#)

90 *Ibid.*

91 [Q 78](#)

92 *Ibid.*



keep them open to review on a constant basis. We would have to be a lot more flexible in trying to address some of the skills shortages if we were going to do that.”<sup>93</sup>

### *Data*

85. Access to data is another key priority for the FinTech sector. Bruce Davis, Managing Director, Abundance Finance, said that the issue was about where it was stored and how it was shared. As a result, the arrangements for accessing data facilities would have to be re-examined. A lot of data was currently stored in Ireland, and it was “not straightforward to unravel all those different commercial agreements and what commercial providers are prepared to take in terms of risk within those agreements, as well as the political ones”. There were two levels of complexity: what companies were prepared to do and what might have been agreed at a policy level. Mr Davis said that he was still working out how to unpick that complexity.<sup>94</sup>
86. Daniel Morgan pointed to the forthcoming implementation of the General Data Protection Regulation (GDPR).<sup>95</sup> It would be essential that, following Brexit, the UK continued to observe similar standards, so as to comply with the third-country equivalence regime: “Any extra layer of friction will have an impact on investment and business models, so it is critical that we do not go down our own path in terms of data processing given the size of the neighbour next to us”. He also noted that FinTech companies with business models based in the Cloud would be affected disproportionately by any divergence, and supported continued equivalence with the Payment Services Directive II (PSD II), which would make customers’ data available to third parties.<sup>96</sup> Giles Andrews agreed, noting that, philosophically, the UK was closer to the EU than the US on issues of data sharing. It would be helpful to maintain a strong relationship with the EU on such matters.<sup>97</sup>

### *London as a FinTech hub*

87. Other cities have been keen to attract FinTech companies from London, with Berlin particularly active.<sup>98</sup> Giles Andrews, while noting that London’s position as a FinTech hub was helped by the close proximity of regulation, legislation, funding, research and advice, was concerned that entrepreneurs would be less likely to choose to start companies in London in the future.<sup>99</sup> Daniel Morgan highlighted the ecosystem effect: “If you take one vital part out of it, you do not know what the effect will be. Taking one part of the food chain out could be benign. It could readapt or it could crumble.” On the other hand, FinTech had been successful in London largely because of its role as a financial services centre: “There is a venture capital community

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93 [Q 78](#)

94 [Q 77](#)

95 This package comprises Regulation (EU) 2016/679, 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), [OJ L 119/1](#) (4 May 2016) and Directive (EU) 2016/680, 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA, [OJ L 119/89](#) (4 May 2016).

96 [Q 77](#)

97 *Ibid.*

98 ‘Berlin claims post-Brexit success in luring start-ups’, *Financial Times* (8 November 2016): <https://www.ft.com/content/2c5334a0-a271-11e6-aa83-bcb58d1d2193> [accessed 29 November]

99 [Q 80](#)



that fed off a wider and older financial services ecosystem, which has meant that London is more of a natural home.” He noted that the US FinTech industry, which had emerged in California, had recently moved to New York because of its financial services industry.<sup>100</sup> Witnesses also praised the work of the FCA in creating a supportive regulatory regime.<sup>101</sup>

88. **The FinTech industry has thrived in London, but could potentially move elsewhere. We note the concerns of the industry over future adherence to the EU data protection regime, and over its ability to recruit adequately qualified staff, and to attract the entrepreneurial talent needed for innovative start-ups. The Government should be particularly mindful of the opportunities for FinTech to develop further in the UK and of the effects of Brexit on a promising industry.**

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100 [Q 80](#)

101 [QQ 75, 76, 80](#)

## CHAPTER 5: THE WAY FORWARD

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### A bespoke arrangement?

89. Many of our witnesses, and the Government itself, have referred to the need for a ‘bespoke’ deal for the UK. This section addresses some of the key features of a bespoke deal, insofar as it could affect financial services.
90. It is clear that full membership of the EEA, providing full access to the single market, would be least disruptive to the financial services sector. If this is not on the table, it is equally clear, from the evidence we have heard, that a deal to bolster the existing equivalence provisions should be a high priority. George Hay told us that “the success of the negotiation will be whether we get a workable, bespoke equivalence regime. If we can get that, we will have succeeded.”<sup>102</sup> Miles Celic argued for a “bespoke equivalence regime as part of a broader bespoke agreement”,<sup>103</sup> while Anthony Browne supported “some version of the passporting regime that we have—in the sense that, bilaterally, banks based in the UK can serve customers in Europe and vice versa—as well as some influence over future rule-making, and some predictability”.<sup>104</sup>
91. Stefan Hoffmann, drawing on Swiss experience, said:

“All the equivalence rules will probably be applicable, but probably that will not be enough for a bespoke arrangement. You could try to arrange a sort of EU equivalence and, on top of that, at least part of EU passporting ... I think it would be feasible to negotiate at least partially the passport rights that are in place at the moment, because there are certain passport rights that are applicable to third countries in the EU.”<sup>105</sup>
92. Huw Evans also advocated a bespoke agreement. He argued that the current regimes did not guarantee market access, were based on political decisions, were temporary and did not respond to a changing regulatory environment. The last point was particularly relevant to the insurance and longterm savings industry, in light of the forthcoming review of Solvency II in 2018.<sup>106</sup>
93. Sir Jon Cunliffe provided an overview of the factors that would determine the success or failure of any bespoke deal:

“A bespoke arrangement is about understanding how those permissions are used and which parts of the financial services industry use them most ... It would have to work out how they are used, where they are used and which are the most important, and what the alternatives are ... Some of the alternatives involve doing things in a different way through different legally incorporated entities registered in the European Union. What are the extra costs of that? If you do the business that way—business used to be done that way, so we can go back—what is the extra cost and who pays that cost?”<sup>107</sup>

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102 [Q 16](#)

103 [Q 55](#)

104 [Q 16](#)

105 [Q 48](#)

106 [Q 55](#)

107 [Q 40](#)

94. The Minister, Simon Kirby MP, also acknowledged the complexity of the problem: “by its very nature it is very difficult to try to predict what the effect will be, because it is a moving target”. Katherine Braddick, of HM Treasury, agreed that it was hard to model a bespoke arrangement: “firms themselves are in a dynamic environment in terms of their profit and business models. They already have plans for location and structure. Distinguishing effects to do with altering our relationship with Europe from planning that firms were doing in any case is quite difficult, both in real time and to forecast.”<sup>108</sup>
95. **A main purpose of any bespoke agreement, so far as financial services is concerned, will be to supplement the current equivalence regimes to mitigate any loss of access, and to ensure the continuation of equivalence decisions in order to maintain that access. The Government has acknowledged the complexity of predicting the impact of a bespoke deal. Nonetheless, we urge the Government, as a priority, to model the effect of different scenarios as accurately as is possible in order to achieve the most appropriate bespoke deal.**

### Planning and transition

96. Any significant change to business conditions is likely to cause disruption, and businesses will need to adapt to those new circumstances. Our witnesses were consistent in warning against the impact of a ‘cliff edge’, where the UK’s relationship with the EU changed suddenly, for instance at the end of the Article 50 negotiations. They called for a suitable transition period, to allow sufficient time to plan and adapt. In the absence of certainty over the impact of Brexit, financial services firms are considering their business models in order to minimise disruption.
97. Douglas Flint told us that firms would need to decide how to configure themselves once the UK had left the EU in two or more years. They needed two pieces of information: “where are the Government aiming to get to in their fresh relationship with Europe and what is the bridge arrangement between leaving and getting to that arrangement—how long will it be and what will it encompass?” He described the process of moving large numbers of people to another country, setting up arrangements and getting licensed as a “non-trivial task”.<sup>109</sup>
98. Peter Snowdon told us that many banks were waiting to see what happened, but that “the bigger ones may not have that luxury because the consequences of it not going in a way that suits them would result in an awful lot of work for them in restructuring their businesses”. Anecdotally, he had heard that some of them were already thinking about restructuring.<sup>110</sup> Anthony Browne, Chief Executive of the British Bankers’ Association, told us that, if banks ended up needing to move operations, it could take “two, three or more years” to plan.<sup>111</sup>
99. Miles Celic said that “companies are going through scenario planning; they are making their plans at the moment. I have no sense that companies are saying that they will relocate.”<sup>112</sup> This echoed the evidence of Sir Charles Bean, who said that “until you know exactly what the model is, it is a bit

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108 [Q 59](#)

109 [Q 24](#)

110 [Q 31](#)

111 [Q 13](#)

112 [Q 53](#)

precipitate to take hard decisions to start moving”. But Sir Charles added: “The more that you think that there will be a transition period after the actual implementation of Brexit, the less need you will have to move now.”<sup>113</sup>

### *Transitional arrangements*

100. The experience of EU trade negotiations suggests that it may not be possible to reach a bespoke agreement within the two-year period allowed for withdrawal negotiations under Article 50 TEU. Witnesses therefore consistently argued for a transitional period, to bridge the gap between withdrawal and conclusion of a comprehensive agreement. Professor Ferran supported “replicating as far as possible the current arrangements that we have with the EU, partly through equivalence, partly through bespoke provisions in the exit terms, and doing that as soon as possible so that we can avoid that cliff edge and businesses can start to plan.” It was important to agree at an early stage on both equivalence and on issues of legal certainty, for instance in settlement finality, as quickly as possible.<sup>114</sup>
101. Simon Gleeson told us that it would take two years to move a significant part of the business of an investment bank—the same as the entire length of the Article 50 negotiations. Ideally, he said, the industry would be able to restructure itself in the knowledge of the final agreement made between the EU and the UK, and he therefore advocated a two-year transition period once the terms of that deal were agreed. He suggested that the Government and the European Commission issue a joint declaration that such a transitional period would be put in place. In the absence of such certainty “a rational bank should start moving its business on the day that the Article 50 notice is signed”.<sup>115</sup>
102. Alex Wilmot-Sitwell agreed that the two-year Article 50 period was not enough to allow the industry to plan effectively, and a two to three year transition would be necessary. He described the transition as a bridge:
 

“If that bridge is not long enough or, indeed, if it is not even built in time, it is impossible to make that journey without incurring huge risks and harm to the participants. That does not mean us; it means the markets and our clients. These are very complex processes. Migrating huge businesses from one jurisdiction to another requires an enormous amount of work. It requires a huge amount of regulatory approvals; it requires an enormous amount of co-ordination with other participants, clients, counterparties and clearing houses. That process is very dangerous; it is fraught with risks. The materials that are being moved are risky. You do not move nuclear waste in a race; you do it in a carefully co-ordinated and managed process.”<sup>116</sup>
103. Elizabeth Corley also spoke of a bridge, involving many spans: from now until Article 50 is triggered, the negotiation period, and then the transitional period leading to the end state. The first challenge would be to ensure “continuity of service and continuity of risk management and controls”; the second would involve “passporting, future business growth and growing from the status quo”.<sup>117</sup> Miles Celic noted that it was difficult to start building any

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113 [Q 8](#)

114 [Q 4](#)

115 [Q 36](#)

116 [Q 24](#)

117 [Q 25](#)

bridge without knowing “what the bank on the other side is like: is it firm ground, soft ground, how far is it and how fast is the river moving?”<sup>118</sup>

104. Sir Jon Cunliffe commented that “political uncertainty is the most difficult thing for markets to calibrate”. Transitional arrangements for trade deals normally came at the end of the process, but Sir Jon noted that normal trade deals were about increasing rather than decreasing market access. In the case of Brexit, he thought that it was “possible that [firms] will need more advance warning of what is going to happen, or what will happen in the transition, than when you are increasing trade access”. There were different political ways in which this could be done, but the Bank’s interest was in ensuring “a smooth and orderly progression from where we are to where we are going, wherever that is. That is to do with ensuring that firms are able to plan and to execute those plans.”<sup>119</sup>
105. The Minister agreed that it was “important that we make sure that there is as smooth a journey ahead as possible and as little disruption as we can manage”. At the same time, he argued that “businesses make money by analysing the risks, preparing contingency plans and making the best possible decision for their shareholders or owners. I do not think in any environment you can ever remove uncertainty.”<sup>120</sup>
106. In our report on *The process of withdrawing from the European Union*,<sup>121</sup> we noted that two agreements between the UK and the EU will be necessary: one on the terms of withdrawal and another on the UK’s future relationship with the EU. We considered it likely that these would be negotiated in parallel. Article 50(2) TEU requires the withdrawal agreement to take “account of the framework” of the withdrawing Member State’s “future relationship with the Union”, but the details of the future relationship might, at that point, remain uncertain. There are therefore at least two points at which a ‘cliff edge’ might make itself felt: the point of UK withdrawal following the Article 50 negotiations, and the point at which the future relationship came into effect.
107. **Negotiations on the UK’s new relationship with the EU are likely to take longer than the withdrawal negotiations under Article 50. A transitional period will therefore be needed in relation to financial services following the completion of the Article 50 process, when the UK leaves the EU. This may need to be adapted and extended in the light of subsequent negotiations on a new long-term relationship with the EU. This will enable firms and others such as regulators to adapt to any new business conditions.**
108. **It will be vital, in the interests of all parties, to provide certainty as early as possible in the process. Negotiations on financial services should commence as early as possible after notification under Article 50 and the Government should pursue an early announcement on a transitional period. This period should extend through the negotiations on the new relationship and continue thereafter for a period sufficient to provide stability after that relationship is agreed.**

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118 [Q 49](#)

119 [Q 43](#)

120 [Q 64](#)

121 European Union Select Committee, *The process of withdrawing from the European Union* (11th Report, Session 2015–16, HL Paper 138)

**The more the new relationship departs from the status quo the longer any further transitional period may need to be.**

109. **We are concerned that, in the absence of clarity over the future relationship, firms may pre-empt uncertainty by relocating or restructuring, for instance by establishing subsidiaries or transferring staff, even though such changes may ultimately prove to be unnecessary. This would not be in the interests of the industry or the UK.**
110. **An orderly transition to a new relationship, whatever it may be, would ensure continuity of service to clients and the wider economy and would provide time for regulators and supervisors to adapt to changes in business practices adopted by firms. Avoiding a cliff-edge when the UK leaves the EU will benefit financial stability, and should be in the interests of the EU as well as the UK**

### **The role of the Government**

111. We noted in Chapter 3 that modelling the impact of Brexit would be difficult, given the range of business activities involved, the complexity of EU legislation underpinning those activities, and the range of scenarios for a future relationship. It will be a considerable undertaking for the Government to arrive at a robust analysis to support its negotiating strategy.
112. The Minister emphasised that “There have been extensive consultations not only at Treasury level but across government with interested stakeholders”. He also said that “We are very much in listening mode”. At the same time, he was hesitant when asked on which department would lead in negotiations on financial services. First he said that “It would be reasonable to suppose that the Treasury would lead on the negotiations for financial services, but the deal is there to be done”; then he said that “The Treasury is responsible for financial services, and you might suppose that it would have a very strong interest in the negotiations that directly affected that policy area”; before finally he confirmed that HM Treasury was leading and coordinating the financial services elements of the negotiation.<sup>122</sup>
113. **In the interests of stakeholders across all sectors, the Government should provide clarity on the division of responsibility for the negotiations between departments. While the negotiating strategy must be agreed as a whole across Government, we are clear that HM Treasury is best placed to lead on financial services.**
114. While Brexit is understandably the priority for the Government as a whole, we heard some evidence that it may be distracting the Treasury in particular from other matters. Giles Andrews mentioned a piece of mis-drafting in a peer-to-peer lending regulation, which he ascribed to “a lack of bandwidth” in the Treasury and the FCA: “We found, before Brexit, that considerable time and energy was put into working with our industry and we have noticed a fall-off in that, which is perhaps not surprising given the stretch in resources that is being taken up by activities such as this.”<sup>123</sup>
115. **We were concerned to hear that Brexit might already be having an effect, through diversion of resources, on the quality of legislation**

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<sup>122</sup> [Q 58](#)

<sup>123</sup> [Q 75](#)



**produced by the Government. Brexit is rightly the Government's top priority, but not to the exclusion of other important responsibilities.**

### **EU reliance on UK financial services**

116. The Oliver Wyman analysis, cited above at paragraph 4, suggests that £40–50 billion of UK financial services revenues relate to the EU. That analysis put the trade surplus for financial services for 2014 at £19 billion. These figures, while they underline the importance of EU markets to the industry, also demonstrate the extent to which the EU relies on the services provided by the UK.
117. Katherine Braddick admitted the Government's statistics were scattered, but said it was clear that “banks based in the UK lend very material quantities into the real economy in European member states. It is also clear that the asset management industry in the UK manages very significant proportions of the funds of investors who are based in the EU.” She added that the compression effect of UK-based CCPs offered “a very cost-efficient and low-friction way for capital to move and trades to occur in Europe”.<sup>124</sup>
118. Douglas Flint said that EU businesses had consolidated their financial services requirements in the UK. Such an efficient service could not be replicated in one place, nor could the individual pieces be replicated “other than in a fragmented way over a long period of time”. Europe would want to ensure that the economy received the financial support it needed during a period of transition to a new model.<sup>125</sup>
119. Alex Wilmot-Sitwell touched on the difference, to which we have already referred, between political and economic interests across the EU: “corporate clients, institutional clients and other market participants want the most efficient access to products and services at the most effective cost. At the moment, having that hubbed substantially in one place, which happens to be London, is a great benefit to those clients and the users of such services. Clearly there is a potentially different political agenda.”<sup>126</sup>
120. Could a system as efficient as that in the UK be replicated elsewhere? Sir Jon Cunliffe was sceptical, at least in the short term:

“It is pretty unlikely that what we call London ... will be replicated in the foreseeable future in one place in the European Union. It takes an awful lot of time and human capital. It is based around the interaction of financial services and other services. A great deal of the business is not to do with the European Union; in fact, only a minority of the business is to do with the European Union. The idea that this ecosystem is transplanted somewhere else into Europe in the foreseeable future is highly unlikely to me; over time, I do not know.”<sup>127</sup>
121. The Minister related London's status to a wider point about financial stability: “There are places across Europe that perhaps do not have an immediate benefit from London and the UK, but are very focused on our not having financial instability because it would be absolutely the last thing

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124 [Q 60](#). See also footnote 73 for an explanation of compression services.

125 [Q 20](#)

126 [Q 20](#)

127 [Q 40](#)



they would want.”<sup>128</sup> Lowri Khan developed a similar point: “German motor manufacturers have very large finance companies attached to them, so these issues will inevitably come together. Industry does not segment itself neatly into the buckets that policy necessarily does.”<sup>129</sup>

122. This underlies the interdependency between the financial sector and the wider economy. As Douglas Flint said of the motor industry: “You do not sell a bit of metal; you sell a financial contract which is secured by cars.” He believed that European manufacturers would continue to require access to UK financial services. This represented “a huge mutuality of interest in preserving access to finance to make the underlying business work”.<sup>130</sup>
123. **The UK currently has a significant trade surplus in financial services with the EU, and it is to be expected that EU governments may wish to attract some of that business to their own territories. The efficiencies provided by the UK financial services industry, the reliance of EU firms on the services it provides, and the interdependencies between financial services and other EU businesses, mean that such efforts could be as harmful to the wider EU economy as to the UK economy. The Government should go into the negotiations armed with robust analysis of the economic impact on the EU of an attempt to dismantle and relocate UK financial services.**

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128 [Q 61](#)

129 *Ibid.*

130 [Q 25](#)

## SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

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1. The legislation underpinning access to the EU market is based largely on the regulation of activities, and does not map easily onto the business structures of many firms. A better evidence-base is needed, and it is imperative that the Government gains a detailed understanding of how firms are likely to be affected by changes to their rights of access to EU markets, building where possible on the work undertaken by the firms themselves. (Paragraph 27)
2. It is striking that some firms do not themselves appear to be aware of their reliance on the current passporting arrangements. It would be in the interests of the firms themselves, as well as in the national interest, if they were to cooperate with the Government and the regulators to determine the true extent of such reliance, so as to inform the Government's negotiating position. (Paragraph 28)
3. The UK has a number of advantages as a financial services hub. The concentration of activity allows for economies of scale and a depth of capital market activity that cannot be easily replicated, except possibly in an existing major centre such as New York. Our evidence suggested that it would be to the EU's advantage that such a system should remain intact. (Paragraph 38)
4. The interconnectedness of the UK financial system presents serious difficulties for firms and the Government in determining the impact of changes to the relationship between the EU and the UK. Unless it is extended, the two-year period of the Article 50 negotiations would appear to be insufficient to resolve the uncertainty. We therefore recommend, both for the business environment and for financial stability, a considered and orderly transition to any new relationship. The earlier any aspects of this new relationship can be agreed the easier it will be to determine the impact on each sector of the industry. (Paragraph 39)
5. The existing third-country equivalence regimes in certain pieces of EU legislation are an inadequate substitute for the financial passport. They do not cover the full range of financial services activities, excluding in particular deposit-taking and lending, retail asset management and payment services. As they are agreed at a point in time, and are static, they may also be vulnerable should regulation change to respond to the development of the financial system. The process of updating them as EU-wide regulation changes would be laborious and time-consuming. (Paragraph 56)
6. We endorse the Government's work in analysing the difference between the opportunities afforded by passporting and third-country equivalence. That analysis will be problematic, thanks to the complexity and newness of the regimes, but it will be crucial in determining the true impact of third-country status on the financial services industry. The priority should be to establish at an early stage the extent of the lacunae in the regimes, the likely restructuring that will have to be undertaken by businesses to adapt to changed circumstances, and the consequent effects of such adaptations on the financial services sector and the wider UK economy. (Paragraph 57)
7. If the Great Repeal Bill successfully ensures that the UK continues to apply EU legislation post Brexit the UK will, on a technical level, have a regulatory regime that is initially identical to that in the EU. However, it will remain for the European Commission to decide whether the UK is equivalent for the purposes of retaining market access. This process could be lengthy and could

be politicised: the Government should seek agreement prior to withdrawal that the UK will be determined to be equivalent at the point of withdrawal, to avoid damaging disruption to financial services providers. (Paragraph 58)

8. While the UK might be deemed equivalent at the point of withdrawal, there is no guarantee that it will remain so. Regulation must adapt to changes in the financial services system, raising the risk of regulatory divergence between the UK and the EU, and indeed between the UK and the US. The UK's influence on international standard-setting bodies, such as the Basel Committee and the Financial Stability Board, will be crucial to ensuring that changes to regulation are consistent internationally. But it is in the UK's and EU's mutual interest that the UK should maintain direct influence within the EU, especially in areas such as certain types of insurance, where there are less well-developed international standards. The Government should encourage direct regulatory cooperation between UK and EU authorities and, as part of its negotiation, should seek UK input to EU regulation-setting upstream. (Paragraph 59)
9. The current clearing regime provides benefits to the wider economy by aiding financial stability through the compression of risk and therefore of the collateral required to support trades. These benefits, which depend in large part on the ability to conduct multi-currency clearing, are felt in Europe as well as the UK and internationally. The possibility of a new attempt to require euro clearing to be conducted within the eurozone thus presents significant risk to both the UK and EU economies. Nonetheless, the ECB has attempted to do so once before and the risk of its doing so again should not be taken lightly, particularly in view of the jobs at risk. (Paragraph 75)
10. New York has been suggested as a plausible alternative to London for clearing activity, but a move to 'repatriate' euro-denominated clearing to the eurozone would appear to rule out New York as well as London, notwithstanding the positive equivalence decision already granted to the US. The question is whether any eurozone location could provide the same benefits to the wider economy as London and New York, and whether a politically-driven attempt to repatriate euro clearing to the eurozone would invite retaliation by other non-eurozone states, leading to the breakdown of the system of multi-currency clearing. (Paragraph 76)
11. The ability to continue to access to highly qualified staff and the ability to transfer them between the UK and the EU is a key issue for the financial services industry. While we welcome the Chancellor's reassurance that highly skilled migrants will not be prevented from coming to the UK, as far as it goes, we note that maintaining appropriate labour market flexibility will be critical to the UK's long-term economic prosperity. (Paragraph 82)
12. The FinTech industry has thrived in London, but could potentially move elsewhere. We note the concerns of the industry over future adherence to the EU data protection regime, and over its ability to recruit adequately qualified staff, and to attract the entrepreneurial talent needed for innovative start-ups. The Government should be particularly mindful of the opportunities for FinTech to develop further in the UK and of the effects of Brexit on a promising industry. (Paragraph 89)
13. A main purpose of any bespoke agreement, so far as financial services is concerned, will be to supplement the current equivalence regimes to mitigate any loss of access, and to ensure the continuation of equivalence decisions

in order to maintain that access. The Government has acknowledged the complexity of predicting the impact of a bespoke deal. Nonetheless, we urge the Government, as a priority, to model the effect of different scenarios as accurately as is possible in order to achieve the most appropriate bespoke deal. (Paragraph 96)

14. Negotiations on the UK's new relationship with the EU are likely to take longer than the withdrawal negotiations under Article 50. A transitional period will therefore be needed in relation to financial services following the completion of the Article 50 process, when the UK leaves the EU. This may need to be adapted and extended in the light of subsequent negotiations on a new long-term relationship with the EU. This will enable firms and others such as regulators to adapt to any new business conditions. (Paragraph 108)
15. It will be vital, in the interests of all parties, to provide certainty as early as possible in the process. Negotiations on financial services should commence as early as possible after notification under Article 50 and the Government should pursue an early announcement on a transitional period. This period should extend through the negotiations on the new relationship and continue thereafter for a period sufficient to provide stability after that relationship is agreed. The more the new relationship departs from the status quo the longer any further transitional period may need to be. (Paragraph 109)
16. We are concerned that, in the absence of clarity over the future relationship, firms may pre-empt uncertainty by relocating or restructuring, for instance by establishing subsidiaries or transferring staff, even though such changes may ultimately prove to be unnecessary. This would not be in the interests of the industry or the UK. (Paragraph 110)
17. An orderly transition to a new relationship, whatever it may be, would ensure continuity of service to clients and the wider economy and would provide time for regulators and supervisors to adapt to changes in business practices adopted by firms. Avoiding a cliff-edge when the UK leaves the EU will benefit financial stability, and should be in the interests of the EU as well as the UK (Paragraph 111)
18. In the interests of stakeholders across all sectors, the Government should provide clarity on the division of responsibility for the negotiations between departments. While the negotiating strategy must be agreed as a whole across Government, we are clear that HM Treasury is best placed to lead on financial services. (Paragraph 114)
19. We were concerned to hear that Brexit might already be having an effect, through diversion of resources, on the quality of legislation produced by the Government. Brexit is rightly the Government's top priority, but not to the exclusion of other important responsibilities. (Paragraph 116)
20. The UK currently has a significant trade surplus in financial services with the EU, and it is to be expected that EU governments may wish to attract some of that business to their own territories. The efficiencies provided by the UK financial services industry, the reliance of EU firms on the services it provides, and the interdependencies between financial services and other EU businesses, mean that such efforts could be as harmful to the wider EU economy as to the UK economy. The Government should go into the negotiations armed with robust analysis of the economic impact on the EU of an attempt to dismantle and relocate UK financial services. (Paragraph 124)

## APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

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### Members

Lord Butler of Brockwell  
 Lord Callanan  
 Lord De Mauley  
 Lord Desai  
 Baroness Falkner of Margravine (Chairman)  
 Lord Fink (from 12 September 2016 until 18 November 2016)  
 Lord Haskins  
 Earl of Lindsay  
 Lord Shutt of Greetland  
 Lord Skidelsky  
 The Duke of Wellington (from 22 November 2016)  
 Lord Woolmer of Leeds

### Declarations of Interest

Lord Butler of Brockwell  
*Adviser to TT International*  
 Lord Callanan  
*Director, ML Associates (Europe) Ltd*  
*Consultant, New Direction*  
 Lord De Mauley  
*No relevant interests declared*  
 Lord Desai  
*Chairman, Advisory Board of Official Monetary and Financial Institutions Forum (OMFIF)*  
 Baroness Falkner of Margravine (Chairman)  
*No relevant interests declared*  
 Lord Fink  
*No relevant interests declared*  
 Lord Haskins  
*Chairman, Humber Local Enterprise Partnership (LEP)*  
*Director, JSR Farms Ltd*  
*Director, Quarryside Farms Ltd*  
 Earl of Lindsay  
*Chairman, BPI Pension Trustees Ltd*  
 Lord Shutt of Greetland  
*Shareholding in Bank of Ireland (Spouse)*  
 Lord Skidelsky  
*No relevant interests declared*  
 The Duke of Wellington\*  
*Director, RIT Capital Partners plc*  
*Shareholding in Lloyds Bank*  
 Lord Woolmer of Leeds  
*No relevant interests declared*

The following Members of the European Union Select Committee attended the meeting at which the report was approved:

Baroness Armstrong of Hill Top  
 Lord Boswell of Aynho (Chairman)  
 Baroness Falkner of Margravine  
 Lord Green of Hurstpierpoint  
 Lord Jay of Ewelme  
 Baroness Kennedy of the Shaws  
 Earl of Kinnoull  
 Baroness Prashar  
 Baroness Suttie  
 Lord Teverson  
 Baroness Verma  
 Baroness Wilcox

During consideration of the report the following Members declared an interest:

Lord Boswell of Aynho

*Personal Shareholdings as detailed in Register of Members Interests*

Lord Green of Hurstpierpoint

*Shareholdings in: BB Biotech AG (investment in biotech companied), Biotech Growth Trust plc, Capita plc (business process management and outsourcing solutions), Cochlear Ltd (implantable hearing devices), Comcast Corp-Class A (media and technology), CVS Caremark Corp (pharmacies/ medical prescriptions), Google Inc, London Stock Exchange Group plc, Microsoft Corp, Oracle Corp (computer technology), Roche Holding AG (medicines and diagnostics), Safran SA (aircraft and rocket engines, aerospace), Ses Sa (global satellite owner and operator) (interest ceased 31 July 2016), Sonic Healthcare Ltd, UnitedHealth Group Ltd, Sky plc (TV and WiFi services), UK Commercial Property Ordinary GBP 0.25, Union Pacific Corp (railroad and freight transportation services) (interest ceased 20 September 2016), Baxalta Inc (research, development, and manufacture and biopharmaceutical products) (interest ceased 31 January 2016), Schlumberger (oilfield services company), Mastercard, Inc (electronic payments), Novartis AG (healthcare products), Cognizant Technology Solutions (provider of information technology, consulting and business process outsourcing services), Mastercard Inc (global payment solutions company), Sky plc (pay television), Taiwan Semiconductor Manufacturing Company Ltd (manufactures and markets integrated circuits), Thermo Fisher Scientific Inc (manufactures scientific instruments, consumables and chemicals), UK Commercial Property Trust (UKCM) Ordinary 25p Shares, Ashtead Group plc Ord 10p, Franco-Nevada Corporation (resource royalty and investment company), Samsonite International SA (designs, manufactures and distributes luggage)*

*Chair, International Advisory Council, British Chambers of Commerce (interest ceased 31 March 2016)*

*Member, Akbank International Advisory Board, Istanbul (remunerated with an attendance fee which the Member donated to a registered charity)*

*Member of informal working group on Brexit and trade, convened by CEO of Engineering Employers' Federation*

*Chair, Advisory Council of the Centre for Anglo-German Cultural Relations, Queen Mary University, London*

*Member, Steering Group, Sabanci University Centre for Excellence in Finance, Istanbul*

*Member, Board of Regents, St Benet's College, Oxford*

*Chair of Trustees, Natural History Museum*  
*Chair, Natural History Museum Trading Company*  
*Trustee, Asia House*  
*Trustee, Archbishop of Canterbury's Anglican Communion Fund (registered charity)*  
*Trustee, Wintershall Charitable Trust (registered charity)*  
*Trustee, the Bishop Radford Charitable Trust (registered charity)*  
*Vice Prices, Iraq-British Business Council*  
*Chair of Trustees and Trustee, Friends of Anglican Communion Trust*  
*Trustee, Natural History Museum Development Trust*  
*Trustee of the Natural History Museum Special Funds Trust*  
*Trustee of the Natural History Museum Benevolent Fund*  
*Member, Advisory Board of the Centre for Progressive Capitalism*  
*Member, Advisory Council, Institute of Business Ethics*  
*Member, Cancer Research UK*  
*President, Institute of Export (professional body representing international trade) (registered charity)*

**Earl of Kinnoull**

*Executive consultant, Hiscox Group (Insurance active in the EU)*  
*Member of Supervisory Board, Fine Art Fund Group funds (fund management active in the EU)*  
*Shareholdings in Hiscox Ltd and Schroders plc*

**Lord Selkirk of Douglas**

*Diversified investment portfolio in McInroy & Wood Income Fund managed by third parties*

**Lord Teverson**

*Fellow, Chartered Institute of Securities and Investment*  
*Director-designate, Green Purposes Company Ltd*

A full list of Member's interests can be found in the Register of Lords Interests: <http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>



## APPENDIX 2: LIST OF WITNESSES

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Evidence is published online at <http://www.parliament.uk/brexit-financial-services> and available for inspection at the Parliamentary archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with \*\* gave both oral and written evidence. Those marked with \* gave oral evidence and did not submit written evidence. All other witnesses submitted written evidence only.

### Oral evidence in chronological order

- \* Professor Eilís Ferran, Professor of Company and Securities Law, University of Cambridge and Professor Sir Charles Bean, Professor of Economics, London School of Economics and Political Science [QQ 1–9](#)
- \* Andrew Gray, Global Financial Services Brexit Leader, PwC, Anthony Browne, Chief Executive, British Bankers' Association and George Hay, European Financial Editor, Breakingviews, Reuters [QQ 10–17](#)
- \* Elizabeth Corley, Vice Chair, Allianz Global Investors, Douglas Flint, Group Chairman, HSBC and Alex Wilmot-Sitwell, EMEA President, Bank of America Merrill Lynch [QQ 18–26](#)
- \* Simon Gleeson, Partner, Clifford Chance and Peter Snowden, Partner, Norton Rose Fulbright [QQ 27–37](#)
- \* Sir Jon Cunliffe, Deputy Governor, Financial Stability, Bank of England [QQ 38–47](#)
- \* Huw Evans, Director General, Association of British Insurers, Stefan Hoffman, Head of European Affairs, Swiss Bankers' Association and Miles Celic, Chief Executive, TheCityUK [QQ 48–56](#)
- \*\* Simon Kirby MP, Economic Secretary, HM Treasury, Katharine Braddick, Director of Financial Services, HM Treasury and Lowri Khan, Director of Financial Stability, HM Treasury [QQ 57–65](#)
- \* Xavier Rolet KBE, Chief Executive, London Stock Exchange Group [QQ 66–74](#)
- \* Daniel Morgan, Head of Policy and Regulation, Innovate Finance, Bruce Davis, Managing Director, Abundance Investment and Giles Andrews, Chairman, Zopa [QQ 75–80](#)

Evidence was also taken from the following witness off the record:

Lord Hill of Oareford

### Alphabetical list of all witnesses

- \* Giles Andrews, Chairman, Zopa ([QQ 75–80](#))  
Association of Foreign Banks [BFS0004](#)

- \* Professor Sir Charles Bean, Professor of Economics, London School of Economics and Political Science ([QQ 1–9](#))
- \*\* Katharine Braddick, Director of Financial Services, HM Treasury ([QQ 57–65](#)) [BFS0005](#)
- \* Anthony Browne, Chief Executive, British Bankers' Association ([QQ 10–17](#))
- Bruegel [BFS0001](#)
- \* Miles Celic, Chief Executive, TheCityUK ([QQ 48–56](#))
- \* Elizabeth Corley, Vice Chair, Allianz Global Investors ([QQ 18–26](#))
- \* Sir Jon Cunliffe, Deputy Governor, Financial Stability, Bank of England ([QQ 38–47](#))
- \* Bruce Davis, Managing Director, Abundance Investment ([QQ 75–80](#))
- \* Huw Evans, Director General, Association of British Insurers ([QQ 48–56](#))
- \* Professor Eilis Ferran, Professor of Company and Securities Law, University of Cambridge ([QQ 1–9](#))
- Financial Conduct Authority [BFS0003](#)
- \* Douglas Flint, Group Chairman, HSBC ([QQ 18–26](#))
- \* Simon Gleeson, Partner, Clifford Chance ([QQ 27–37](#))
- \* Andrew Gray, Global Financial Services Brexit Leader, PwC ([QQ 10–17](#))
- \* George Hay, European Financial Editor, Breakingviews, Reuters ([QQ 10–17](#))
- \* Stefan Hoffman, Head of European Affairs, Swiss Bankers' Association ([QQ 48–56](#))
- \*\* Lowri Khan, Director of Financial Stability, HM Treasury ([QQ 57–65](#)) [BFS0005](#)
- \*\* Simon Kirby MP, Economic Secretary, HM Treasury ([QQ 57–65](#)) [BFS0005](#)
- \* Daniel Morgan, Head of Policy and Regulation, Innovate Finance ([QQ 75–80](#))
- \* Xavier Rolet KBE, Chief Executive, London Stock Exchange Group ([QQ 66–74](#)) [BFS0006](#)
- Scottish Financial Enterprise [BFS0002](#)
- \* Peter Snowden, Partner, Norton Rose Fulbright ([QQ 27–37](#))
- \* Alex Wilmot-Sitwell, EMEA President, Bank of America Merrill Lynch ([QQ 18–26](#))

### APPENDIX 3: PASSPORTING AND THIRD COUNTRY ACCESS FOR FINANCIAL SERVICES

Legislation	Type of EU firms/ products	Passport right/mutual recognition	Third country regime for non EU equivalent
MiFID2/MiFIR	Investment firms	Cross-border provision of investment services	Yes but only for wholesale clients and counterparties*
	Investment firms	Establishment of branches to provide investment services	No
	Investment firms	Right to remote membership of market infrastructure	No
	Trading venues	Right to provide terminals on Member State territory	Yes*
	Trading venues	Permitted execution venue for shares and OTC derivatives subject to trading mandate	Yes*
	Trading venues, CCPs	Non-discriminatory access to trading venues, CCPs, benchmarks	No
	Data services providers	Single authorisation for EU	No
CRD	Banks	Cross-border provision of banking and investment services	No for banking services. See MiFID2/ MiFIR for investment services
	Banks	Establishment of branches to provide banking and investment services	No for banking services. See MiFID2/ MiFIR for investment services

Legislation	Type of EU firms/ products	Passport right/mutual recognition	Third country regime for non EU equivalent
EMIR	CCPs	Single authorisation for EU	Yes
	Trade repositories	Single registration for EU	Yes*
	CCPs, trading venues	Rights for non-discriminatory access to each other	No but see MiFID2/MiFIR
CSDR	Central securities depositories	Cross-border provision of services and branches	Yes*
Prospectus Directive	Prospectuses	Prospectus approved in a Member State can be used across EU	No
UCITS Directive	UCITS funds	Distribution in other Member States	No
	UCITS management companies	Cross-border provision of management and advisory services (and branches)	No
AIFMD	AIFMs	Can market EU AIFs across EU	No
	AIFMs	When “switched on”, can market non-EU AIFs across EU	Yes*
	AIFMs	Cross-border provision of management and advisory services (and branches)	No
CRA Regulation	Credit rating agencies	Single registration for EU	Yes but may require an EU affiliate to endorse
Benchmark Regulation	Benchmark administrators	Single authorisation/registration for EU	Yes*
CI(WUD)	Banks, some investment firms	Home state insolvency regime applies in other Member States	No

Legislation	Type of EU firms/ products	Passport right/mutual recognition	Third country regime for non EU equivalent
BRRD	Banks, some investment firms	Recognition of resolution action in other Member States	Yes*
SFD	Settlement systems	Protection from insolvency law in other Member States	No
Brussels Regulation	Judgments in a Member State	Enforceable in other Member States	No

\*New regime, no examples of use of data

Source: AFME and Clifford Chance, *The UK Referendum—Challenges for Europe's Capital Markets* (March 2016), p 8: [http://www.afme.eu/globalassets/downloads/afme-reports/afme\\_referendum2016\\_final.pdf](http://www.afme.eu/globalassets/downloads/afme-reports/afme_referendum2016_final.pdf)

## APPENDIX 4: GLOBAL FINANCIAL CENTRES INDEX 20: TOP 30 CITIES

City	GFCI 20 Rank	GFCI 20 Rating
London	1	795
New York	2	794
Singapore	3	752
Hong Kong	4	748
Tokyo	5	734
San Francisco	6	720
Boston	7	719
Chicago	8	718
Zurich	9	716
Washington DC	10	713
Sydney	11	712
Luxembourg	12	711
Toronto	13	710
Seoul	14	704
Montreal	15	703
Shanghai	16	700
Osaka	17	699
Dubai	18	698
Frankfurt	19	695
Vancouver	20	694
Taipei	21	692
Shenzhen	22	691
Geneva	23	689
Melbourne	24	687
Los Angeles	25	685
Beijing	26	683
Munich	27	680
Cayman Islands	28	676
Paris	29	672
Casablanca	30	671

Source: Long Finance, Global Financial Centres Index 20, September 2016

## APPENDIX 5: EXAMPLES OF FINTECH SERVICES

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FinTech is by nature an innovative industry and the types of services provided by companies described as 'FinTech' will inevitably evolve. Any service currently offered by the traditional financial services industry could in theory be offered by a FinTech company. The following is a non-exhaustive list of some of the major services currently offered by FinTech companies.

### *Peer to peer lending*

Peer to peer websites bring individual borrowers and lenders together, bypassing traditional banks.

### *Crowdfunding*

Crowdfunding is a way of raising finance by asking a large number of people for a relatively small sum of money each. The internet enables start-up companies or other ventures to reach a wide range of potential investors. Investors may receive a financial return, such as a share of equity, another type of reward, or nothing at all if they have invested purely because they believe in a certain cause.

### *Money transfer*

A company such as TransferWise operates a peer to peer money transfer service by matching people wishing to transfer funds from one country to another with counterparts wishing to do the opposite. Rather than transferring funds directly from one country to another the service transfers funds from a sender in one country to the recipient of an equivalent transfer going in the opposite direction. A corresponding transfer takes place in the other country.

### *Payments*

FinTech companies provide alternatives to banks or credit cards for those wishing to make online payments.

### *Robo advice*

These are online investment services that assess a user's risk profile and match it with suitable investments. The investments are thereafter managed by algorithms.



**APPENDIX 6: GLOSSARY**

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AIFMD	Alternative Investment Fund Managers Directive
Article 50	Article 50 TEU sets out the procedure by which a Member State can leave the EU. Formal notification under Article 50 starts a two year period in which withdrawal negotiations can take place.
Basel Committee	A forum for regular cooperation on banking supervisory matters.
Brexit	The United Kingdom's withdrawal from the European Union.
CCP	Central counter-party, also known as a clearing house.
CETA	The Comprehensive Economic and Trade Agreement. Canada's free trade agreement in the EU.
Clearing	The process of reconciling purchases and sales of various options, futures or securities, as well as the direct transfer of funds from one financial institution to another.
CRD	Capital Requirements Directive
Derivative	A security with a price dependent upon one or more underlying assets, such as stocks, bonds, currencies or interest rates. The value of a derivative is determined by the underlying assets.
ECB	European Central Bank
Ecosystem	In this report, ecosystem refers to London as a unique financial and technological structure.
EEA	European Economic Area
EFTA	European Free Trade Area
EMIR	European Market Infrastructure Regulation
Equivalence	Provisions in certain pieces of EU legislation allow market access to firms from non-EEA countries judged to have an equivalent regulatory and supervisory regime to the EU.
EU	European Union
European Commission	The executive of the European Union
Eurozone	Monetary union of European Union Member States
FCA	Financial Conduct Authority
Financial Stability Board	International body that monitors and makes recommendations about the global financial system.
FinTech	A wide range of activities in which companies use technology to make financial services, enable financial services or drive technological innovation of financial services.

GATS	General Agreement on Trade in Services
GDPR	General Data Protection Regulation
Great Repeal Bill	The Prime Minister announced in October 2016 that a ‘Great Repeal Bill’ would be introduced in Parliament in the 2017–18 Session. The bill is intended to annul, at the point of the UK’s departure from the EU, the European Communities Act 1972, and ensure that EU legislation given effect domestically will continue to apply until specifically repealed.
IMD	Insurance Mediation Directive
MCD	Mortgage Credit Directive
MiFID	Markets in Financial Instruments Directive. The MiFID II package also includes the Markets in Financial Instruments Regulation.
OTC	Over The Counter. This refers to securities traded in a context other than on a formal exchange.
Passporting	The right for a firm registered in the EEA to do business in any other EEA state without needing further authorisation.
Peer-to-Peer lending	The practice of lending money to individuals or businesses through online services that match lenders directly with borrowers.
PSD	Payment Services Directive
STEM	Science, Technology, Engineering and Maths
TEU	Treaty on the European Union
UCITS	Undertakings for the Collective Investment of Transferable Securities
WTO	World Trade Organisation