HOUSE OF COMMONS

Treasury Committee

Oral evidence: The UK's economic relationship with the European Union, HC 473

Tuesday 29 January 2019

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Watch the meeting

Members present: Nicky Morgan (Chair); Rushanara Ali; Mr Simon Clarke; Charlie Elphicke; Stewart Hosie.

Questions 1245 - 1296

Witnesses

I: John Glen MP, Economic Secretary to the Treasury; Andrew Bailey, Chief Executive Officer, Financial Conduct Authority; Sam Woods, Deputy Governor for Prudential Regulation, Bank of England and Chief Executive Officer, Prudential Regulation Authority.

Examination of Witnesses

Witnesses: John Glen MP, Andrew Bailey and Sam Woods.

Q1245 **Chair:** Good morning to the three of our witnesses this morning. We are confining this session, literally, to the Draft Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019, which are in draft form at the moment and still to be laid. I am really grateful to the three of you for being here at pretty short notice. I know that the Minister in particular has the joy of Treasury questions later on in the House.

John Glen: This is the warm-up.

Chair: This is a warm-up. Okay, we will do our best to warm you up. I am going to ask the three of you to introduce yourselves. Then we will get straight into it.

John Glen: I am John Glen, Member of Parliament for Salisbury, Economic Secretary to the Treasury and City Minister.

Sam Woods: I am Sam Woods, chief executive of the PRA.

Andrew Bailey: I am Andrew Bailey, chief executive of the FCA.

Q1246 **Chair:** Thank you very much. John Glen, let us start with you. The Treasury has already laid a large number of statutory instruments relating to Brexit. Without going into the detail of all the SIs, or we will be here for a long time, could you explain how this SI relates to the overall strategy of the statutory instruments laid already?

John Glen: Certainly. Thank you for the opportunity to be here, Chair. In the Treasury, we are laying 53 statutory instruments for financial services. We have laid 45 of them; 17 of them have been laid and debated; we have 20 more to debate and eight more to lay. This follows the note we put out on 27 June last year, which set out our approach, followed up with a technical note in August, and then, on 8 October, an explanatory note.

What we have done with all these statutory instruments is work with regulators and industry, primarily through TheCityUK, which has convened a cross-sectoral representative group, to look at what would be needed to onshore regulations to ensure that, in a no-deal circumstance, we would have a fully functioning regulatory regime across all sectors. As part of that, we obviously have temporary permissions regimes in place.

One of the key powers, which was mentioned back in June and has been open for scrutiny, is this temporary transitional power. That would be given to the regulators, in order to mitigate the heavy burden of the overall effect of all these regulations coming at the same time. I sense that this unprecedented session of pre-scrutiny of an SI is because this is an unusual power. It is an unusual power in an unusual circumstance, one we do not want to have.

It gives the regulators the appropriate authority, given their role as national competent authorities—and historically they have always translated what has come from the EU into the City and into regulations—to make that judgment in different sectors about what would be appropriate. That means giving the power to delay the implementation of certain requirements for up to two years. That is broadly consistent with the implementation period we hope to secure. That is the context. Essentially, this power sits over but alongside the other 53 statutory instruments that I have been taking through committees every week for several weeks, with seven more to go.

Q1247 **Chair:** It is particularly in a no-deal situation.

John Glen: Yes, it is exclusively for a no-deal situation. One other aspect of our no-deal planning is the in-flight files Bill, which is going through the Lords and we think will come to the Commons next month. We need a mechanism to onshore, or to consider whether to onshore, regulations that are in flight and in discussion within the European Commission.

Q1248 **Chair:** Do you want to just break down "in flight"?

John Glen: "In flight" means, essentially, they are not concluded. They are directives and outcomes that are not yet secured, but they are under consideration. We have been part of, in fact in many cases we have been leading, that discussion at EU level.

If we leave in a no-deal situation on 29 March, there will be bits of legislation, some of which we will be hotly anticipating and will nearly have landed, and some which will be in an earlier stage of gestation. That provision in legislation, if passed, which we hope it will be, will give us the discretion of whether to introduce some or all of those different directives.

That is the Treasury's approach really, and we have done that in a very collaborative way, working with the PRA and the FCA, but also with representatives of the different financial services industry members, so that we actually do this in the right way. Typically, we have published them for scrutiny before we have then laid them in Parliament and debated them under the powers of the European Union (Withdrawal) Act.

Q1249 **Chair:** I think we can understand why the powers are needed, but, as you say, these are unprecedented, which is why this is an unprecedented session of the Treasury Select Committee. Perhaps I can turn to the FCA and the PRA. You have heard the Minister's explanation and particularly this issue about mitigating, as I think he put it, the heavy burden of rules being onshored all at the same time. Perhaps, Andrew, if I could start with you, without going into miniscule detail, what would be the broad sweep of changes that the FCA would need to make to your rulebooks in that situation?

Andrew Bailey: To give you an example, today, as a member of the EU, typically under EU legislation there are a set of rules that govern, say, the

transaction between an institution in the UK and an institution in another EU country. Those can be different and often less burdensome than the rules that govern a transaction between the UK and an institution outside the EU. The effect of the onshoring is to make the EU—sorry, this sounds like a stupid thing to say—a non-EU entity, i.e. it makes it a third country.

The reason that is important is because it means the burden of, say, transaction reporting in something like a funds transfer recognition procedure for an EU institution today becomes much greater. That affects the systems firms have, because they have to make changes to those systems to change the reporting that is captured. They will need time to do that.

In some of the SIs, particularly the ones that came in earlier, we have been able to put that into the SIs themselves. Quite a lot of what we are debating today is already in the MiFID SI, although actually it is often the same in substance. It is a very similar effect; it gives powers to waive and vary the application of these requirements.

There are three things we are concerned about. One is that firms need time to adjust, whether it is their own systems or whether they are using third-party suppliers. They have to get third-party suppliers to do things. Secondly, some of these changes are now very late in the day, were there, as the Minister says, the case of a hard exit. Thirdly, there is also what I would call the unknown-unknown, unpredictable stuff. We have done this work. We think we have a pretty good view of the landscape, but I am afraid I can pretty much guarantee you some stuff will come up. Often, we need to have the ability to deal with that quite quickly.

Q1250 **Chair:** Sam, how about from your perspective?

Sam Woods: Our general approach is exactly in line with what Andrew just described for the FCA, so I will not repeat that. Maybe I can just add two bits of colour.

Q1251 **Chair:** Do you have any examples?

Sam Woods: Yes, so I will give you one example, but also give you a sense of the scale of what we are doing here. That is important and it is part of the motivation for the unusual nature of the power. If you look at all the onshoring changes across the statutory instruments, the rules we are changing ourselves and binding technical standards, we are not talking about hundreds of changes. It is thousands and thousands of changes. If we look at the PRA side and we isolate only six of those statutory instruments that the Economic Secretary mentioned, between those and the changes we are making to rules and binding technical standards, that is 850 pages of changes, each of which will have many changes on them. If you bring in Andrew's side, even leaving aside the statutory instruments, it is another 1,600 pages of changes.

This is a massive operation. The reason we think we need such a power is partly in view of the scale. Because of the Brexit timetable, necessarily, and despite very fast and hard work by everybody involved, those changes are going to land quite late before exit day. We would never normally make changes on that scale and say to firms, "You have a few weeks to change". We just would not do it. The level of operational risk from that is very high.

To add one more example from the prudential side, one of the things that will change, a bit like what Andrew was describing in his context, is the treatment of exposures of UK banks and insurance companies to EU 27 institutions of one sort or another, including sovereigns. That changes because it moves to a third-country basis. That decision, the move to third country, is for Parliament. It is in one of the statutory instruments. We think it is absolutely right it should move to third country, but making that change in firms has to be done carefully. It has to go through the proper risk processes, proper governance, all that kind of stuff, because they do not want to get their numbers wrong. This affects their reported capital ratio. It seems to me that, in the no-deal scenario, the very last thing that we need is for banks and insurance companies to be uncertain about what their published capital ratios are.

Q1252 **Chair:** We are going to come back and look at some more specific details. Charlie, Minister, I have written to the Leader of the House asking that this SI is debated on the Floor of the House, the main Chamber, as opposed to up in one of the committees through the usual delegated legislation procedure. Setting aside this session, does the Treasury have a view on the level of parliamentary scrutiny that is needed?

John Glen: The level of parliamentary scrutiny will be a matter for the House to determine. I have taken numerous statutory instruments and I have, I think, five more next week. I have another one on Wednesday. I take them where I need to take them. The bottom line is that there is a clear rationale for this. Industry wants it. If you look at Miles Celic's comments, they are very supportive of this process. There has been a degree of collaboration and co-operation between the regulators, me, representing the Government, and industry players to try to get this right, although I accept Andrew's observation that there are always unforeseen outcomes.

Q1253 **Chair:** One of the other things we are aware of is perhaps a broader point. The MEPs, Members of the European Parliament, at the moment have a veto over EU regulator rule changes, and that includes UK MEPs as well. If the UK has to implement changes made in future as a result of changes made by EIOPA or ESMA, potentially MEPs in Brussels will have a vote on those changes, but UK politicians will not. Are you concerned? Has there been discussion in the Treasury about whether that creates a democratic deficit?

John Glen: We need to be clear about what we are talking about here. These SIs are referring to onshoring regulations that we are already subject to, through the EU.

Q1254 **Chair:** They have already been scrutinised by MEPs.

John Glen: They have already been scrutinised by the process you have described. What you are describing is the challenge we would face in the event of a no-deal hard Brexit, in terms of how we would do that scrutiny in future. That is really outside the scope of this exercise. I think last Friday your Committee set out that you planned to look at future financial services regulation. I will be very happy to come back for my 10th Select Committee appearance, if you wish, on that.

Chair: You cannot stay away.

John Glen: But that is a separate matter. It would be fair to draw an equivalence from that description to the UK Parliament if we were doing anything new. We are not. We are just onshoring to create a steady state consistent with where firms are at the moment. You are right to say we would need to resolve that.

Chair: Think about the future.

John Glen: That would need serious and urgent work from the Treasury, working with the regulators on that basis.

Andrew Bailey: I agree with John. First, as John said, the guiding principle here is, if we have to use these powers, to keep the system where it is today. It is very interesting. I was looking at the debate around the medical procedures, which is, to my mind, more radical than what we are doing, because that is changing things. We are actually trying to hold it where it is until we can put the changes through in onshoring.

The second thing goes exactly to your point about the European Parliament. To my mind, the controls in this process, which involve both Government and Parliament, in terms of transparency and us having to get your consent for what we are doing, are actually stronger, I have to tell you, than what we would do in rule-making in the non-EU space today.

Q1255 **Chair:** We will look at that too then.

Andrew Bailey: That goes to John's point about what the future is. That is what the future is going to look like.

Chair: No, exactly.

Andrew Bailey: This is fixing the emergency, as it were, or the contingency. There is a much broader point, which we have touched on occasionally in these hearings, about what the future looks like, but that is a much bigger point.

John Glen: On that, there is a considerable amount of work going on in the Treasury to look at all scenarios. I am not in any way reluctant to come before your Committee to talk about that. It is linked to the scrutiny of the five-yearly process. Given that we have not secured parliamentary time and we have not got to conclusions on that discussion yet, I do not feel now is the time to discuss that.

Chair: No, we have all those future discussions to look forward to. We would never say, John, that you would ever be unwilling to appear before this Committee. I will put that on the record.

Q1256 **Charlie Elphicke:** Good morning. The regulators are obviously independent of the Treasury, rightly so. What checks has the Treasury put into the system to ensure regulators are not making material changes or straying into areas that are more the competence of the Treasury?

John Glen: This whole process has been underpinned by deep co-operation between industry representatives and representatives from the PRA and the FCA, with the Treasury. TheCityUK, I mention again, has been absolutely instrumental in that. We have worked collaboratively to understand the concerns, to respond to them, to lay them for consideration. In terms of the legal drafting and so on, there has been a process where there has been space to comment and to improve that.

I would just point out that the FCA and PRA are not free to act without parliamentary scrutiny. They were set up with statutory objectives and there is no sense that they are allowed to move beyond that. Indeed, we can say that when it comes to the FSMA threshold conditions, company law or accounting standards, or, for example, the Financial Services Compensation Scheme, they will not be able to be suspended in any way. There are basic statutory obligations.

We have seen a deep collaboration and dialogue to get this right for the industry. That has been my objective, that in a no-deal situation we will not have vast parts of financial services saying, "We did not know what was happening". Though I have always pressed the desirability of a deal, and I still maintain that, my job as a junior Treasury Minister is to deliver this for the financial services sector.

Q1257 **Charlie Elphicke:** Sam, section 203(2) of the draft SI, as I am sure you have read in detail—

Sam Woods: I have.

Charlie Elphicke: —states that the regulators do not have to publish the changes to a transitional direction if the regulator is satisfied that it would be inappropriate. How could the publication of changes be inappropriate? If you do not publish, how will people who are affected know?

Sam Woods: I would like to answer that directly, and then add a tiny bit of colour to what the Economic Secretary said on how it looks from the regulator's end of the pipe. First, my expectation is that we are going to

publish all these. That is where we are most likely to be. I would be very surprised indeed if we do not publish, in draft form, all the directions that we make currently scheduled for the end of February, which is the upfront use of this power. It may be that that is the only use we make of this power, or it may be, as Andrew says, that there are bugs we need to iron out later.

The reason there is a possibility allowed of non-publication is that that follows directly the convention that is already established in law for what we do for waivers. When firms apply to us for waivers for rules, we typically publish the waiver that we grant them, if we grant them a waiver, but we have the ability not to publish. The reason that ability is there is just in case there is some commercial sensitivity that could prejudice the interests of the organisations involved, or some other malign effect of that kind.

Although I am not expecting to have to do that, the thought experiment here is to imagine, in the way we use the transitional power, if granted it by Parliament, we find out there is a little bit of a bug in it, it does not work for a subset of firms and we need to make a little tweak. If it became known in the market that that problem was there, they could be traded against. That is the sort of situation in which we might need to do it. It is, however, clear on the face of the SI, to my reading of it, that we have to make that position clear to the firms involved. We are bound to do that, and we would obviously do that in the same way as we do with a waiver.

At the risk of it being too long an answer, could I possibly add a tiny bit in terms of the constraints on us? Although this is a very unusual power, and therefore of course there is a strong degree of parliamentary interest, from the regulator's point of view it feels very constrained, appropriately constrained. Most importantly, the main thing we are doing with the SIs and the changes to our rules and binding technical standards is getting from A to B, B being the onshored rules, and these things being all the tweaks we need to make, just to make it operable.

Parliament is deciding all the important bits of that, what B is, through the statutory instrument process. The Treasury will approve, if it chooses to. It has the right to approve or reject all the changes we are making further down in the stack of regulations. The transitional power is only about the journey from A to B and how we, effectively, phase that in, which, in the vast majority of cases, will simply be to delay and say, to take the EU 27 exposure example, "Okay, you can stick on that for now and change further down the track". It is narrow in that respect.

Q1258 **Charlie Elphicke:** Andrew, I briefly want to ask you about a case that has affected one of my constituents, who has lost £500,000 in the collapse of Premier FX. The firm was able to misrepresent its authorisation, which was for remittances, and effectively presented itself as a deposit taker. How was it able to act beyond its authorisation?

Andrew Bailey: First, if that is indeed what they did, and there is a strong suspicion that it is what they did, it is illegal. We are, as I think you know, carrying out an investigation. I am very concerned that the money of individuals has been lost in this activity. My team has so far, I can tell you, looked at nearly a quarter of a million transaction records to try to trace this money, and we will not stop doing that. You probably know the principal involved in this activity is said to be dead. I think it is incumbent upon his relatives, his business partners, to tell us where the money is.

Q1259 **Charlie Elphicke:** In 2017, the Bank of Portugal fined—

Chair: No, today is about—

Charlie Elphicke: No, this matters to the regulations. I will explain why it affects the regulations.

Chair: Really?

Charlie Elphicke: Yes. In 2017, the Bank of Portugal fined Premier FX for trading outside the regulations and compliance with its licence in Portugal, and reported that to the FCA. There was no follow-up by the FCA under safeguarding regulations. Why was the breach not detected? Under these regulations, in a no-deal scenario, how would we make sure that there was such independent international supervisory co-operation?

Andrew Bailey: I have said we will look thoroughly at the record of this case, but the first priority is to find the money, frankly, because that is what we owe to the victims. That is my first priority. If we missed clues in this case, particularly in the reauthorisation process under the European payment services directive, we will look at that. I have to also say, as you rightly point out, I do not know which jurisdiction some of this activity went on in yet, because it crosses over between the UK and Portugal, but we will look at that.

The gist of your question then comes back to how, in a transitional regime, we would have the safeguards in place. We learn the lessons from what has happened in the past. We will have to work very closely. Both Sam and I are currently in the business of negotiating MoUs with the EU authorities, in the event that this situation comes to pass, to enable us to access information and do our job. We take that very seriously, and we will obviously continue to take it very seriously. The effect of the transitional arrangements is to recreate the passporting system for a period of time while we can sort things out. I can assure you that, during that time, we have to take our supervisory responsibilities very seriously.

Q1260 **Charlie Elphicke:** Do these regulations look at extending the Financial Services Compensation Scheme, so that where people lose money, in cases that are not currently covered, it might be extended?

Andrew Bailey: No, these regulations do not extend the FSCS. As the Minister said, it is very clear that we cannot use the SI we are talking about to reduce the coverage and the effect of the FSCS. We have to meet the objectives that are given to us, of which the FSCS forms an important part, so let us be clear on that. Any decisions on the scope of the FSCS beyond that are a matter, frankly, for this Parliament. I would just come back to the points that I mentioned earlier. On the face of it, this is illegal activity.

Q1261 **Charlie Elphicke:** Andrew, under section 203(2) of the draft statutory instrument, on this issue about whether you publish or do not publish, without publication how can other stakeholders, not just those directly impacted, be aware of changes that regulators are making to UK legislation?

Andrew Bailey: I would reinforce the point Sam made. The presumption is that we publish. That is my strong presumption, personally. I would have to have a very strong argument put to me to not do so. As Sam said, the strong argument would have to be that we were cutting across other legal obligations that we have in the UK statute. Sam made the point about revealing commercial confidences, which we are not allowed to do, under the UK statute. I can tell you, in the same spirit, the bar is very high to not publish.

Q1262 **Stewart Hosie:** Minister, you have said this SI is designed to be used exclusively in the circumstances of a no-deal Brexit. In part 1, right at the beginning, "citation, commencement and interpretation", 1(2), this regulation, parts 7, 8 and the following list of regulations come into force the day after the day on which these regulations are made, but the bulk of it does not kick in, or come into force, until what is known as exit day. If it is designed exclusively for a no-deal Brexit situation, why do some of the regulations kick into force potentially earlier than that?

John Glen: The situation is that, until we get a deal, we need to make provision to lay all these statutory instruments. In a situation where we secure a deal, they would all fall away, because we would not need to use them.

Q1263 **Stewart Hosie:** Sorry, would they fall away, or would they simply not need to be used, because these are different things?

John Glen: That would be a matter for the Government to decide, to find a collective way of dealing with all the statutory instruments we have laid.

Q1264 **Chair:** Was it not decided that we would repeal them?

John Glen: That is my expectation, yes.

Q1265 **Stewart Hosie:** Okay, but that is not clear yet because we do not know the circumstances.

John Glen: Yes, we do not know the circumstances. Basically, I have to deliver all this by the end of March, and that is what I am doing.

Q1266 **Stewart Hosie:** I understand that. The powers can only be used for two years. Why is that?

John Glen: It is broadly in line with the implementation period that would have been anticipated under securing a deal. That is a reasonable period also for us to secure, in a no-deal circumstance, what the end state would need to be. We have to take a view about what is proportionate and reasonable. Clearly, we would be in uncharted territory if we had no deal. I accept that and that would mean, as I say, urgent work to establish an alternative.

Sam Woods: Can I add briefly to that? It also comes back to the scale of what we are looking at here. We have had to make a judgment. Usually, when we are making changes of this scale, we allow quite a long time for firms to get used to them.

Q1267 **Chair:** I was going to ask you that. How long is it for that scale of change?

Sam Woods: Let me give you two examples. There is obviously no perfect analogy, because we have never done anything exactly like this before. The ring-fence, which we discussed when I was here last week, came in on 1 January. That is, effectively, a four-year process, actually an eight-year process from the recommendations of the independent commission. Some of Basel III, which is a set of prudential changes going through right now, has an eight year phase in.

I do not think this is analogous to those two. It is very big, but it is a high volume of quite small things, mostly. Our view has been that it would be reasonable within a two-year period to require firms to get there. It might even be possible for them to get there a bit sooner, but it might be sensible to have a little bit of runway at the end in case we have misjudged it.

Q1268 **Stewart Hosie:** I really want to probe consistency, using the EEA Passport Rights (Amendment etc.) (Transitional Provisions) (EU Exit) Regulations 2018 as an example. There, explanatory notes show that EEA firms have temporary passports for up to three years after exit date. The Treasury has the power to extend both the length of the regime and those deadlines by no more than 12 months at a time, but not simply restricted to one year. Why are these powers, which are substantial powers, effectively fixed at two years, when the starting point for other related legislation is three years with annual extensions as required? There is an inconsistency there.

Sam Woods: They are different, but there is a reason for that. The reason is that the temporary permissions regime is doing quite a different thing from the transitional power in relation to the onshoring. The three years in the temporary permissions regime—by the way, from our point

of view at the prudential end, this is the single most important thing Parliament has done to derisk the cliff edge—are to give those firms who are currently trading here using passporting, and which wish to stay in a significant form, time to get ready for the full process of authorisation to be here in the UK permanently. As you would expect, that is a heavy duty process. We have taken the view that three years is an appropriate time to give firms to get ready for that. Some will of course be able to get there quicker.

The transitional SI is about giving all firms—it is a much larger number of firms—time to get ready for that number of changes. As I say, we formed the judgment that two years would be enough. We have been consulting on this, by the way. I would say the responses we have had have been very supportive. Some were perhaps pushing for a bit longer, but in my judgment two years will be enough.

Q1269 **Stewart Hosie:** You said that the Basel implementation lead-in of eight years was not really analogous with this. You are right because we are talking about negotiations rather than delivery. I suppose it is more analogous to negotiating a trade deal. What happens if we have not negotiated a trade deal on financial services with the EU within the two-year period? What happens to this temporary regime?

John Glen: This whole architecture is around no deal. As I said earlier, we are in an unprecedented situation.

Q1270 **Stewart Hosie:** Sorry, I do not mean to interrupt. Yes, you are right, it is about no-deal, but let us be generous and say it is an uncompleted deal and it is going to take three or four years to negotiate. You have a gap at the end. What do you do?

John Glen: You are asking us to explore circumstances that are not yet clear. So far, we have actually worked with industry, collaboratively with the regulators, to establish an appropriate mechanism to bring as smooth a transfer as possible in a no-deal circumstance. If we find that we are in need of further changes later on, that will be a matter for those circumstances. I am not going to be drawn into speculation of two or three years hence.

The Government's position is that we wish to secure a deal with a transition period of 20 months, and that is what we are working towards. This discussion this morning is about the no-deal scenario. As Sam set out, there is a reason for that differentiation in timeframe. It is not muddled thinking. It is based on an assessment of what the market can stand and needs in order to minimise friction and uncertainty during this rather undesirable outcome.

Andrew Bailey: If I might, the key point here is that uncertainty around any subsequent negotiation does not actually have a bearing on how long it takes to fix the technical issues, to complete the onshoring of EU

legislation into the UK. Those two things, as Sam was saying, are separate.

Q1271 **Stewart Hosie:** That is prejudging the outcome of the negotiations.

Andrew Bailey: No, it is not prejudging. It is separating the two things. It is saying the completion of the onshoring is not connected to whatever the UK's future relationship might be.

Q1272 **Stewart Hosie:** Let me ask about the onshoring then, once we get to that point. Is it the intention that all EU-based firms will have set up a UK-domiciled entity prior to these new powers expiring, or that they will simply stop trading here?

John Glen: That will be a matter for them. The regulators' job is not to determine a desirable configuration of EU firms. The fact is that the City of London is a global centre of finance and a highly desirable place to be. It is inconceivable that that will not continue. What we have seen in Sam's assessment of contingency arrangements is borne out to be true, and they are very modest, based on the fact that the need to retain presence in London is absolutely paramount for most and many EEA firms, despite pulls to Frankfurt, Luxembourg or wherever else. We will do everything we can to maintain the competitiveness and desirability to locate in London.

Sam Woods: I think firms that want to be here in big form with an established presence will largely use the temporary permissions regime. There is one exception to that, which is where we have required firms to be in a subsidiary, which is basically retail business, and some of those have already been authorised. Then there is another statutory instrument, which is actually a very important one. It is probably the next most important one for us after the one we are discussing today. It is for run-off schemes. If you have firms that basically want to get out but need to run down, we have two different versions of that. That, again, is coming to you for a decision in due course.

Q1273 **Stewart Hosie:** I have one final question for Mr Bailey and Mr Woods. Once this SI is approved, if it is approved, how long will it take for both your agencies to make all the necessary changes to deliver the intent of this?

Andrew Bailey: It depends on completing the rest of the SIs. We need to see the whole picture. We are on course to have all this ready by—

Q1274 **Stewart Hosie:** What is the single biggest point of risk, then, if there is an SI uncompleted? Which one would it be?

Andrew Bailey: I have to be honest with you; the single biggest point of failure is that Parliament does not make all the SIs, but I have complete faith in John and in you. We actually have 62 SIs in all, which is John's 53 plus nine with other Departments. The whole edifice has to hang together in that sense. That is probably the single biggest risk. If all that follows,

as Sam was saying earlier, we will make the necessary directions in time for the end of March, on the basis it goes ahead obviously. That is the point John was making earlier.

Sam Woods: Our planning date is the very end of February. That is when we think we can get it done. If we hit that, on that day we will be dropping draft directions under the use of the power we are discussing today, if that power is granted; our position on all the detailed things we have been talking about, which we have been consulting on with the industry; and, crucially, some plain English guidance to explain to firms, looking through all this complexity, the main things they need to be aware of.

Q1275 **Stewart Hosie:** That work is underway.

Sam Woods: That work has been heavily underway for the best part of two years and is a truly ginormous exercise. What you are seeing is more than the tip of the iceberg. It is the top third of the iceberg through the statutory instruments, and there are another two-thirds underneath that.

Andrew Bailey: I am slightly amused that in every debate on an SI John gets asked if we have enough resources. In one sense, that was a good question two years ago.

John Glen: You have 158 people on Brexit from 28 March last year, so you have obviously ramped up.

Andrew Bailey: We have sunk a lot of resource into this one.

Q1276 **Chair:** As we have already said, Brexit is good for the lawyers. I want to return to something from a question that Stewart asked about the intention that all EU based firms will have to set up UK domiciled entities. I fully appreciate that it is a matter for the firms to make the decisions, but you would agree that this SI is important in sending out a signal that London and the financial services sector in the UK is prepared for all eventualities. That is part of the reason for having all this, deal or no deal. I feel like Noel Edmonds there. Having the SIs in place is an important message to the world.

John Glen: The dominant message I have is that we need to secure a deal. That is desirable. Equally, it would be imprudent and irresponsible not to have a fully functional regime in a no-deal situation. We have had a programme of work, as Sam just said, over two years to make sure we have done this in as collaborative a way as possible, with as much common sense. We have been proactive as well, in giving permissions to the EU, regardless of what it has done.

Chair: Absolutely, yes. A number of us are working on getting that deal in place.

John Glen: I heard you on the radio, yes.

Q1277 **Chair:** I have a question for the regulators, so Andrew and Sam. Sam,

you mentioned earlier on about waiver powers for some things. Did you look at whether, in fact, those powers might be sufficient? There is a new SI, additional powers. Are there powers you already have that could have done the job?

Sam Woods: We looked at that question and we concluded they were not sufficient, for two main reasons. One, and by far the most important, is that of course we cannot use our waiver power to make changes to legislation as you would in Parliament. That is why this power is unusual. That is probably the most important point. We do not really consider it practicable to tease apart, in the use of such a transitional power, the bits that are coming through the parliamentary process and the bits that are going on further down the stack. Unfortunately, the nature of EU rule-making is such that these things are all heavily intertwined. That is one difference.

The second reason is back to the scale point. In particular, you will see in one of the clauses in the statutory instrument that this is described as an own-initiative power. This also goes to the point of resourcing. This means we can use it of our own initiative, so we can take the step to use it. There is that possibility within the waiver power, but we want to avoid firms having to apply for the right to have this. Frankly, we will then be completely swamped in that process, which serves no purpose. For us, it was very clear, for consistency, because of the volume and to capture the bits that we are not normally in control of, that we needed to do that.

Andrew Bailey: It would also create uncertainty if firms had to apply for it. We want to make it quite clear at the outset that this is what the landscape looks like.

Q1278 **Chair:** By analogy, in September 2017, the FCA chose not to enforce all of MiFID II immediately, by not taking a strict liability approach. Again, was that an approach that was feasible?

Andrew Bailey: That is not unusual. This is really a comment on the EU. The EU does not have the ability, formally, to take no action under its rules. When you are introducing something as big as MiFID, and we discussed this in the ESMA board quite a lot, you have to make what I might call pragmatic choices about how quickly you introduce the supervisory regime. There has been quite a lot of commentary on this, and quite strident commentary on this, in public.

Let us be clear: we are not disapplying MiFID. As I said in the last hearing we had, two weeks ago, we are going to come out very soon with our own assessment of what firms have done, and it will be critical in places. Let us be clear on that. Our whole approach is to work with firms to get the arrangements in place. MiFID is the biggest change in wholesale financial market regulation in my memory certainly, so our approach is pragmatic in that sense. Not everybody agrees with that. I am well aware of that, but we think that is a sensible way to do it.

Q1279 **Mr Clarke:** Good morning, everyone. In terms of the scope of these regulations, the wording is that the changes are going to be limited to those needed to prevent or mitigate disruption. John, how will the Treasury be assessing whether a change does indeed prevent or mitigate disruption? What is the definition of that?

John Glen: We will be notified of decisions made. Copies of the directions laid will be made available for Parliament to see. There will be an annual report that will report on that. We will listen very carefully to the observation of this Committee with respect to the sufficiency of that. I go back to the basis by which this power has been conceived, to deliver, in unique circumstances, an appropriate intervention that suits the market needs, not giving discretion on the basis of convenience for market actors, but in terms of the optimal outcome that keeps the obligations of the regulators for competitiveness, detriment and systemic risk to the market.

The system we have created in this country relies on the regulators taking those decisions in the market. The people who work in those environments are much better capable than I or individual MPs to make a judgment of what is necessary. We can then say, "Through primary legislation we set these objectives". We can then look at the experience on the ground, having tasked the regulator to take that decision. There is no real sense, in my mind, that we are not having an appropriate level of scrutiny through seeing what has been laid through the report. It would just be impractical on a case-by-case basis. We would not be able to evaluate. We would not have the functional skills to do that.

Q1280 **Mr Clarke:** That is helpful to have on the record. In terms of new issues, because, as we know, it is not a static environment, if new rules are issued by the EU that could provide such disruption, will the regulators be able to use these new powers to address those concerns, even if they do not exist at the moment?

John Glen: Again, in a situation of a no-deal, the in-flight files Bill would then apply. That is, essentially, as I said earlier, this mechanism to give us the power to decide what to implement, or what parts to implement. That is a decision that we would make, but I cannot overemphasise how different the world would be in a no-deal situation. At the moment, such a vast majority of our regulations in financial services derive from the EU and ESMA. They permeate through to the Treasury and to the regulators. With that block taken out at the top of the page, we have a significant challenge. I am sure we will be able to find a way, but we are turning our back on something that has been fundamentally part of the way we deliver regulations.

Andrew Bailey: On the in-flight legislation, as we always do, we would consult on the implementation of that legislation. Part of any consultation we do is to bottom out exactly how long it reasonably takes to implement it. That is what we always do.

Q1281 **Mr Clarke:** To be clear, is the in-flight legislation restricted to material that is literally in flight at the point of our departure, or is it all material going forward?

John Glen: They are listed on the face of the Bill. When it comes to the Commons, I hope in a few weeks, you will able to see on there.

Sam Woods: Briefly on the former point, it is clear on the face of the SI that we can only use this power, if granted it, where it attaches to relevant obligations—those are defined as onshoring changes; that is already a huge narrowing—where we are satisfied there is a reasonable risk of disruption if we do not use the power, and where it does not adversely affect our objectives. We are going to apply those tests.

Indeed, one example of something we are not going to use this for is for bail-in debt. Bail-in debt is what we need to stand between the taxpayer and losses in banks. Having looked at that, we see no reason why, from exit day, for new bail-in debt, banks should not insert the clause that allows us to bail it in, even if the EU is a third country. We do not think that is particularly disruptive, and we think it not having that could adversely affect our objectives. That is the spirit in which we will approach it.

Q1282 **Mr Clarke:** John, as part of—this is a wonderful name for an SI—the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 SI, passed in October, the Payment Systems Regulator was given additional powers to fix deficiencies within its remit. Why has it not been given the same powers as the Bank and the FCA are in this latest SI?

John Glen: You have a whole set of SIs pertaining to different parts of financial services regulation. What we are talking about with this one today is an overall power to mitigate the combined impact of those coming into effect at the same time. I am not sure that I can recollect that one in particular today.

Andrew Bailey: It is possibly worth adding that, unlike the PRA and the FCA, for which the governing legislation is FSMA, the Financial Services and Markets Act, the Payment Systems Regulator is under FSBRA, a different piece of legislation. I am now going to have to read this out; I am sorry for my ignorance: Financial Services Banking Reform Act 2013. You need a slightly different process for the PSR than you do for the PRA and the FCA.

John Glen: Thank you, Andrew.

Andrew Bailey: That is okay. I am a member of the board of the PSR, so it is incumbent on me to—

John Glen: I am not.

Mr Clarke: I cast absolutely no aspersions for not having that on the tip of your tongue.

Chair: We see a true collaborative effort going on there, yes.

Andrew Bailey: The wheels were grinding gradually.

Q1283 **Mr Clarke:** In terms of the consultation process that is envisaged as part of all this, a regulator, before it gives a transitional direction, must consult the Treasury on a draft of the proposed direction. I suppose that goes back to your point, John, about the fact that you do not necessarily have all the technical expertise at the Treasury to assess everything, but there is a consultative element. What would happen if the Treasury disagreed with a regulator on the need to make a transitional direction? I appreciate that is probably an unlikely contingency, but nonetheless.

John Glen: It is an unlikely contingency, because there is usually an iterative process. There is consultation with industry and then the Treasury and my officials would work with me and the regulators to work out what the right outcome is. That is the way it works. It works in a consensual way. It is not a question of black and white ideological differences.

Q1284 **Mr Clarke:** It is designed never to get to that position.

John Glen: It is designed to create maximum consensus to find the right solution for the market. There are differences of emphasis. I meet with Sam and Andrew regularly on a whole range of matters. They are appropriately independent, as Parliament has defined, but there is a dialogue on the matters that are live.

Q1285 **Mr Clarke:** That is really helpful. There is a caveat to that, which is that section 202 of the draft SI states that regulators do not need to complete a consultation prior to giving a direction, if they assess that the urgency of the situation is such that the direction should be given before a required consultation is begun or consulted. The Bank of England issued a consultation on these powers in October. The Treasury's plans have apparently been known since June last year. Why have those consultations not been finalised at this point?

Sam Woods: I can say a word about that. We have had two consultations. One is the October one, in which we talked specifically about the approach we intend to take to the use of the transitional power approved by Parliament. There was then a much more detailed consultation in December, covering all the changes we are making. You will readily see that, in order to finalise that before exit day, we have had to compress timescales somewhat. We have had a lot of responses. We have had 40 responses and a lot of engagement on those. We are currently considering it. As I said, the plan is to get to the endpoint on that by the end of February. Frankly, that is as fast as it can go. That gives firms reasonable visibility and reasonable notice of what is going to happen.

Q1286 **Mr Clarke:** How will "urgent" be defined for these purposes? I appreciate that is perhaps a plain English reading of it, but I am just trying to understand the extraordinary circumstances in which no consultation would be required.

Sam Woods: To be honest with you, I think we would take it in its plain English reading, because we are not going to know until it hits us. It is basically there for if we have missed something, so there is just something that we somehow did not capture, or we captured it in a way that turns out not to work. You have a problem that is going to crystallise at the end of the day and you just need to do it fast. We are obviously not expecting that, but, given the scale of what we are doing here, it is wise to allow for that possibility.

Andrew Bailey: I will give you an example from last year, if it would help. It is actually a MiFID example. It is a so-called Swiss tick size issue. Almost on the first day that MiFID was implemented, we realised there was a problem: MiFID was overly rigid on the so-called tick size of equity trading, and the Swiss market would have had to migrate out of London almost intra-day. We went in intra-day. Actually, the Germans did the same thing. We did it in collaboration and fixed it intra-day. Fortunately, you do not do that most days, but occasionally things just happen.

Mr Clarke: No, indeed. That is really helpful. Thank you all very much indeed.

Q1287 **Chair:** John, you mentioned before the annual report and the publication. To get this on the record, you wrote to me, as you say, on 17 January. Can you confirm that you intend copies of the directions to be laid in the libraries of both Houses of Parliament? I think you have just said that, actually. You are right to bring any direction to the attention of this Committee, but you have also talked about an annual report to Parliament explaining how the powers have been exercised. Between the three of you, have you given any thought to how that will be reported and when the first report would be? Is there any further detail you can give on that?

John Glen: We want to be as helpful and transparent as possible, within the context of the use of the powers, as we have discussed this morning. That seems to me a reasonable way forward. As I say, if the Committee has some observations on the frequency of that, we will address that. There is no desire to hide anything. We have covered situations where immediate urgent interventions are needed and why it would not be appropriate for decision-by-decision scrutiny in Parliament. We feel that is a reasonable way forward. If there are any further changes, we would look at those constructively.

Sam Woods: I have been looking at this. My reading of the SI is that, in the way it attaches our annual reporting obligation to this particular piece, it is therefore hardwired into the SI. My understanding of how that bit of law works is that it attaches on a calendar year basis, so we would

have to provide an annual report after the end of the first calendar year in which we had the power. Having said that, by far the most important publication we will do on this is likely to be the thing at the end of February. That will set out how we plan to use it, and we may not need to use it again after that. If we do, hopefully it will be for infrequent issues. Maybe that first, very broad, publication will actually be the more important one.

Q1288 **Chair:** That is the question, is it not? How often do you think you will have to use this? I suppose, would the annual report perhaps be an opportunity to give a summary of when requests have been made, whether there are actions, rather than listing each direction.

Sam Woods: Yes. We would want it to be an intelligible account of what we have been doing. We aim for that standard in all our annual reporting. It may be that, as I say, the only use we have to make is the upfront use, but then we have the ability to use it subsequently. There is also a very important clause within the SI that allows us to vary a direction once we have given it, which, again, would be public, subject to the caveat I was discussing earlier. That is also important, just in case the way we have done it turns out to not quite deal with the issue we have been concerned about.

Andrew Bailey: The only thing I would add—to John's point, we would welcome your thoughts on this, frankly—is that, as Sam says, the initial report should cover most of it. I would be surprised if we get much thereafter. The second issue is how we report on when it sunsets, effectively, so how we are taking each of them off. As we said, it is two years, but we may not use the full two years. We are going to take a view on how long it takes. We are not going to leave it out there for excessively long periods of time.

Q1289 **Rushanara Ali:** I want to start with a positive. I just want to record my thanks to the Minister on the mortgage prisoners issue. I know there are a couple more outstanding issues we raised with Mr Bailey, but thank you for taking that up, and to your officials.

I have one question outstanding related to SIs, which is whether the Treasury will produce an impact assessment for this SI. You will know from the last committee we were on that there was not one. I am quite concerned that there is an issue about Members of Parliament having enough information to be able to scrutinise, whether it happens in committees or on the Floor of the House. Can you give a commitment that there will be an impact assessment for this SI?

John Glen: All I can say is that my officials and I are committed to doing everything we can to meet the requirements. The Regulatory Policy Committee is responsible for approving impact assessments. It rightly expects us to fulfil certain standards. This is an unusual process. I would say it is a unique process to do this volume of SIs, legitimately under the

power we have been given. I think it is right to say we have secured green rating for all those we have done.

You are right to say that you were on a committee where we did not have one in that instance. I have one tomorrow afternoon. With this last batch of 20 we have tried to submit, I think, five overall impact assessments. Each of those covers the individual SIs. It is not in my gift to determine whether the impact assessment is ready. All I can say is that we are in dialogue with the RPC and are doing everything we can to secure that. It is highly undesirable for us to take these SIs through committee without an impact assessment. That is something I conceded in the committee and I have done subsequently on one or two occasions where that has happened again.

This is about trying to make sure we get that balance of doing what is necessary in the timeframe. I accept the point you made before that this is not aiding proper scrutiny, but we are trying to get that right and doing it as quickly as we can. There is no desire to conceal anything, but across Government 354 SIs have been laid, out of 600 that will be laid. There is a lot of work going on.

Q1290 **Rushanara Ali:** The RPC has managed to turn around requests for impact assessments, has it not? If we are talking about transparency in this unusual set of circumstances, we need an undertaking that Government Departments will produce the SIs. Otherwise, it makes a mockery, frankly, of us going to committees. Papers are being submitted very late in the day and it is just not possible to scrutinise adequately. It needs to be taken seriously.

John Glen: I hope I have conveyed that I am taking it seriously.

Q1291 **Rushanara Ali:** Yes, but I need a commitment that you are going to make sure there will be an impact assessment for this Committee. Otherwise, with respect, I do not think the issues I raised in that committee we both attended, and what you are saying now, are going to give us enough assurance that we will have the adequate information on the impact assessment to be able to scrutinise Government, especially given you are now going to have incredible amounts of power to do as you please, Minister.

Our constituents and the British people will want to know that we are armed with the information we need in order to hold you to account, in order to scrutinise appropriately. I do not think that is a lot to ask. I do not think the argument that Whitehall is under pressure is good enough. The Government are recruiting a lot of people to do the extra work. You are spending a lot of money planning for no-deal Brexit. You should spend some money making sure these impact assessments are available for Members of Parliament, for us to do our jobs properly.

John Glen: Indeed, we have spent £4 billion since 2016, with an addition £500 million being spent for 2019-20.

Q1292 **Rushanara Ali:** How much are you spending on making sure that impact assessments are provided to us in time, so we can do our jobs properly?

John Glen: I cannot give you that figure.

Q1293 **Rushanara Ali:** That is what is at stake here. It is complete waste of time talking about transparency and accountability to Parliament if that basic duty by the Treasury cannot be fulfilled. That is what I need an assurance on from you today.

John Glen: I can only tell you what I have said before. I and my officials are doing everything we can to meet the appropriately exacting standards of the Regulatory Policy Committee to complete impact assessments in time. I will do everything I can to ensure that, in unprecedented circumstances. I will also take my lead from the industry representatives, who tell me that the risks of not having in place an appropriate set of regulations in a no-deal scenario would be far worse for industry. That is really important.

Q1294 **Rushanara Ali:** I think we can all agree on that.

John Glen: It is just a practical reality of an unprecedented circumstance. It is not in my gift to determine the time of publication, but I am very well aware of the timetable of the debates I have ahead, and I am doing everything I can to ensure I meet the requirements you have rightly set out.

Q1295 **Chair:** Minister, are you able to perhaps write to us on this when there is an update on the situation or not?

John Glen: Of course.

Q1296 **Chair:** If the issue is around timetabling or speed of getting impact assessments cleared, that is something else to have on the record.

John Glen: I just want to be absolutely clear that I am not even making any hint or suggestion that I regard that the Regulatory Policy Committee is responsible in any way. It is my responsibility and my officials' responsibility. I take that on board, and I am very happy to write to the Committee to update you in due course.

Chair: Thank you very much indeed, all three of you, for being here this morning. We are very grateful for your time and the thought. We fully appreciate that, although this is unprecedented, these powers are needed in order to make sure our financial services sector works, whatever might happen in the course of the next 59 days. Thank you to all of you, to all your staff and everybody behind the process who is making this happen. That does not mean we will not have more searching questions, but we appreciate the work that has gone into this. Thank you.