European Affairs Committee

Corrected oral evidence: UK-EU financial services

Tuesday 22 March 2022

3 pm

Watch the meeting

Members present: The Earl of Kinnoull (The Chair); Lord Faulkner of Worcester; Lord Foulkes of Cumnock; Lord Hannay of Chiswick; Lord Jay of Ewelme; Lord Lamont of Lerwick; Lord Liddle; Viscount Trenchard; Lord Tugendhat; Lord Wood of Anfield.

Evidence Session No. 4 Heard in Public Questions 48 - 62

Witnesses

I: Sam Woods, Chief Executive, Prudential Regulation Authority; Nathanaël Benjamin, Executive Director for Authorisations, RegTech and International Supervision, Prudential Regulation Authority; Edwin Schooling Latter, Director of Markets and Wholesale Policy and Wholesale Supervision, Financial Conduct Authority; Richard Fox, Director of International, Financial Conduct Authority.

Examination of witnesses

Sam Woods, Nathanaël Benjamin, Edwin Schooling Latter and Richard Fox.

Q48 **The Chair:** Welcome, everyone, to this hybrid House of Lords and to the European Affairs Committee in a public evidence session. This is the fourth session in our inquiry into the future trade in financial services between the UK and the EU. I should welcome our four witnesses. We have two from the Prudential Regulation Authority in the shape of Sam Woods and Nathanaël Benjamin, and two from the Financial Conduct Authority in the shape of Richard Fox and Edwin Schooling Latter. When you speak for the first time, we know exactly who you are, but it would be very helpful if you could just say a few brief words about you and your role within your organisation for those who are watching.

As it is a public session, a transcript will be taken and we will send the transcript to you in due course. We would be grateful if you could check it because it is the basis on which we will be writing our report; we will be taking quotes out of it and everything. If there are any things that need to be corrected, let us know and we will do that.

We are set down for 90 minutes, but there is a huge amount of ground to cover and I would be very grateful if we could try to keep questions and answers crisp so that we can get through everything. I am going to begin, and I wondered whether it would be possible for you to briefly explain the role and remit of the two regulators that you represent and how you differ from each other. I was going to ask Sam to kick off with that.

Sam Woods: Thank you very much for having us. I am chief executive of the PRA and deputy governor of the Bank of England. The Prudential Regulation Authority is charged with the safety and soundness of UK banks and insurance companies, so that is about 1,500 firms. We are interested in things such as whether they have enough capital to absorb losses, whether they have liquidity for runs and whether the people running those firms are competent and know what they are doing.

The Chair: That was certainly very crisp. Thank you very much indeed. Perhaps, Edwin, you could take up the running.

Edwin Schooling Latter: I am the director of markets and wholesale policy and wholesale supervision at the Financial Conduct Authority. Our objectives are consumer protection, market integrity and competition in the interest of consumers. We are the conduct regulator of the dual-regulated banks and insurers, but also the conduct and prudential regulator of a lot of other firms that are relevant in the context of the debate we are going to have, from asset managers to exchanges, benchmark providers and many others besides.

The Chair: Thank you for that also admirably short answer. I wondered whether you could very briefly comment on the role that you perform in the making of new policy when the UK Government are thinking of doing that and how you interact with government while policy is being made. Perhaps, Sam, we can begin with you.

Sam Woods: I will have a stab at that. The answer is somewhat complicated because the process that we called nationalising the acquis, which was the onshoring of all the rules from Europe, which you here in Parliament effected, brought in the rules in the shape in which they exist in Europe. That means that quite a lot of the rules are currently up in legislation and are controlled by you here in Parliament, advised by the Government, and quite a lot of the rules are down with us in the regulator. For that latter category, we just get on with it the same as we have before.

As you know—and we are going to come on to this, I think—the Government are going to propose to you, through what they are calling the Future Regulatory Framework project, that more is brought down into the regulator's rulebook to make that a more coherent process. Our role at the moment is confined to those rules we have. The other half of what we do is supervision. That is not rule-making; that is overseeing firms. If I may, I will bring in Nat for a brief moment to say a word on that.

Nathanaël Benjamin: I am the Executive Director of Authorisations, Regulatory Technology and International Supervision. To put my role in context, I am responsible for the part of the PRA that supervises the UK activities of banks that are headquartered overseas. Given that the UK is a global financial centre, a big part of what we do is to co-ordinate with supervisors in a range of jurisdictions.

The Chair: That is very helpful. We will be going into the detail of a lot of what you have said later on.

Q49 **Lord Foulkes of Cumnock:** You have bamboozled me a little so far. For someone such as me who is not as au fait with the whole structure as my good friend Lord Wood, for example, how do you relate to each other? Do you meet regularly? Do you have joint committees? Is there an overlap? How do you deal with that? I am still not quite clear about that before we go on to the substance of our inquiry.

Sam Woods: Sure. That is a very good question. I am sorry for bamboozling you. It was not intended. Lord Wood was involved in the creation of all this, so he can probably answer the question too. Why do I not have a stab?

Lord Wood of Anfield: I will leave it to you, Sam.

Sam Woods: You can think of it as sister regulators. We are responsible, primarily, for firms not going bust in a way that is uncomfortable. Edwin and his colleagues are responsible for the conduct and behaviour of those firms, so making sure they do not rip people off and things like that. They also have a much wider range of smaller firms that they oversee, for both the prudential and the conduct sides. We are interacting across the two organisations daily in high volume. So, to give you just two examples, there is also a memorandum of understanding between us that says how we do all this, on which we report regularly.

We have an annual stocktake. Nat oversees the UK end of the American banks and, every year, we will have a stocktake on one of those and say, "What's going on and how's it going?". We will always invite the FCA to attend that meeting. They tend to come so that we can compare notes and co-ordinate. A more formal part of the structure is that I am on the FCA board even though I am chief executive of the Prudential Regulation Authority. Nikhil Rathi, who is Edwin's boss and chief executive of the FCA, is on the Prudential Regulation Committee, so there is a lot of connection of that kind. Edwin, do you want to add anything?

Edwin Schooling Latter: You have answered it very well. For the banks and insurance companies, which we both regulate, although we regulate different parts of their operations, yes, Nat and I, for example, speak very regularly about the supervision of the banks because we are respectively responsible for that. As Sam said, there is also a big universe of what we call solo-regulated firms, such as asset managers, hedge funds and trading facilities, which are regulated by just the FCA.

Lord Foulkes of Cumnock: You said in your earlier answer, Edwin, that consumer protection is one of your objectives. Is that not also your responsibility? If I as a consumer have a problem, how do I know whom to go to?

Sam Woods: In short, you should go to Edwin and the FCA. We do, though, have a policyholder protection objective. Specific to insurance companies, if you are a policyholder, that is relevant to us as well. You could think of us as more in the background. We are meant to make sure that the system is stable and does not blow up, and that firms can keep going. Where firms have difficult interactions with their customers, that is more for Edwin and his colleagues to deal with. That is basically it.

The Chair: Is the MoU between the two of you, which you just referred to, a public document?

Sam Woods: Yes.

The Chair: It would be very helpful if we could have a copy of that.

Sam Woods: We can send it to you, as well as the most recent report we drew against it. We mark ourselves. You might say we are marking our own homework, but it is useful and we call out things that have not worked well.

The Chair: Edwin, I do not know whether you want to have a go at my question about how you interact with the Government on the creation of new policy.

Edwin Schooling Latter: I will be short because my answer is just a variant on Sam's. The regulatory framework for financial services that we onshored from the EU is split across parliamentary legislation, what the EU would have called level 1; technical standards that regulators write, which the EU used to call level 2; and then a variety of other guidance beneath that. The intention of the Future Regulatory Framework is to bring all the firm-facing bits of that regulatory framework into our respective handbooks so that the regulators can keep them up to date without consuming parliamentary time. That is the model we have for other bits of the financial system that were not subject to the EU acquis. A lot of the retail business in the UK was never part of the EU framework.

Q50 **Viscount Trenchard:** I want to ask about the other MoU. The TCA was accompanied by a declaration that committed the UK and the EU to agree to establish structured regulatory co-operation on financial services. A memorandum of understanding was intended to be agreed by the end of March 2021. At that time, both parties confirmed that a text had been agreed in principle, but it has not been formally agreed. Perhaps I could ask the PRA first and then the FCA. Why has the MoU been delayed for so long? Our understanding was that the MoU would primarily be a forum for the Treasury and the Commission rather than for the regulators. Is this correct?

Sam Woods: On your first question, I think Commissioner McGuinness has been pretty open that it is held up because of wider things to iron out in the wider Trade and Cooperation Agreement, which I think is code for the Northern Ireland Protocol. I am not aware of any specific problems with the MoU itself. I think both sides are content with that. I would defer to the Treasury and the Commission. I think that is why we are where we are on that. We can perhaps come on to whether that is a problem.

On who would be involved, you are approximately right, in the sense that it would be an MoU between the Treasury and the Commission. They would lead the structure that came from it, but we would expect both our organisations to be heavily involved in those discussions. By the way, we have those sorts of structured dialogues with India, China and the US. It is quite normal to have this economic and financial dialogue, and this, to my mind, has always been the UK-EU version of that.

Richard Fox: I am the interim Director of International at the FCA. Our job does, a little bit, what it says on the tin. My teams look after our engagement with our partner regulators around the world. As I am sure we will talk about today, quite an intense part of that is with the EU, but it is much broader than that. We deal with our counterparts around the globe. I must admit, as I think will become a bit of a theme today, I have not much to add to Sam's answer. We are going to tend to agree today, I think. I will only stress that, as Sam said, we already play a very active role in these kinds of dialogues with other jurisdictions. There was a recent regulatory dialogue with the United States not long ago that I and a colleague from the Treasury chaired, so this is a pretty well-trodden path once it gets up and running.

Viscount Trenchard: This time, could I ask the FCA to answer first, please? How significant do you think finalising the MoU would be as far as your work as regulators is concerned? Some of the witnesses we have heard from have argued that finalising the MoU would be advantageous but not essential as the sector has largely moved on. Do you share this view?

Richard Fox: I would broadly agree with that. We would certainly welcome the finalisation of the MoU. It would set up the kind of structured dialogue that we have talked about. As we have said, this works well with other jurisdictions, and we expect and hope it would work well with the European authorities as well. On a technical level, as regulators, the more important set of relationships we have is arguably with our direct counterparts doing the regulation and the supervision in the different countries across the European Union and, indeed, with the number of authorities that span the European Union.

We will go on to talk about these a bit more later, but we have already signed and have had in place for some time memorandums of understanding with all those relevant authorities. They allow us to transfer data and discuss confidential matters. Day to day, it is those MoUs that form the bedrock of the work we do supervising markets. We would certainly welcome and support the overall dialogue. It would be a good signal to markets but, day to day, there is no immediate impediment to us doing our jobs well.

Sam Woods: I would agree with that. The thing we rely on for day-to-day supervision are these regulatory MoUs. We have already signed 33 of those with our counterparts all across the EU. In fact, I signed one with the Bank of Greece yesterday, and it is now going to Greece to be signed. The one that is remaining is for Portugal, which is held up for various non-sinister reasons. That is really what we rely on.

We do not rely on that broader MoU for day-to-day activity, but it would be a useful forum to create, for both sides, a more strategic dialogue, particularly on things that sprawl across authorities. If you think about crypto, climate change and things like this where some of the tools are with Governments and some are with regulators, that is where those fora are really helpful. It would also just send a good signal that the EU and the UK are now having a proper structured dialogue about regulatory things. That is a normal thing to have in life, and it would send a good signal if we put it in place.

Lord Hannay of Chiswick: I was rather intrigued by your reference to having links, similar to the MoU, with India and the United States. Did they date from when we were a member of the European Union? Did they exist then?

Sam Woods: Yes.

Lord Hannay of Chiswick: They were not debarred by any European Union rules.

Sam Woods: No.

Lord Hannay of Chiswick: Presumably, judging from what you said to Lord Trenchard’s questions, you find them useful and valuable; you would not do them otherwise.

Sam Woods: They absolutely are, and that is what we are trying to convey. This would be a good thing to have, for both sides. Do we need it for day-to-day supervision? No. Would it be a good thing to have? Yes.

Lord Foulkes of Cumnock: My question is similar. You described other jurisdictions. Do you have something with almost every other country? Is that the arrangement normally?

Richard Fox: No. That kind of structured dialogue is not with all jurisdictions. India and America are good examples of where we do have them in place. As Sam has said, they add value to the day-to-day co-operation we have through the more technical MoUs we have signed with our partners.

Lord Foulkes of Cumnock: What about the other non-EU countries of Europe? Do you have similar MoUs or structures?

Edwin Schooling Latter: We will probably talk later about Switzerland in particular, where we are in the process of negotiating a Mutual Recognition Agreement.

The Chair: It might be valuable, because this is coming up in some detail later on, if we could move to Lord Wood.

Q51 **Lord Wood of Anfield:** You have sort of answered this already, but I was going to ask you to give us a couple of examples of what exactly these individual regulatory mini–MoUs cover. Are there any gaps where there are still second-tier deals and MoUs that need to be done below the level of the large MoU? There is another question arising from that exchange just now. Is one of the practical problems of not having an overarching MoU that, if there was a shock to the international financial system that affected institutions across the piece, for example, although you could do technical day-to-day regulations, as you said, there would not be the capacity to have a more co-ordinated response? Is that one of the more functional areas where an MoU would be necessary?

Edwin Schooling Latter: We have a pretty complete tapestry of MoUs with the European Union Member States and the European institutions, ESMA—the European Securities and Markets Authority—and its equivalents. There is not a big gap. Those MoUs allow us to exchange information with them confidentially. When there is a shock or an event to deal with, and we have obviously had a really major one in the past few weeks, those channels of co-operation between us are open.

We have had a lot of really important conversations with our EU counterparts about issues of common concern in the face of those events—for example, the need for funds with Russian assets in them to suspend or the need to change, potentially, the policy framework for how those funds operate to allow them to separate them out, and how credit rating agencies or benchmark providers that rate Russian securities or have Russian bonds and shares in the indices they produce should respond to that, given that their business models span both the EU and the UK still. Lots of practical co-operation can and does take place and is taking place.

Sam Woods: Lord Wood, the answer to your second question is no, the reason being that we have all those bilateral relationships. We also have very strong international fora where we get together. I just came to this hearing from a meeting of the Financial Stability Board, where we were talking about the crisis that we are currently facing in Russia-Ukraine. I wonder whether I can bring in Nat because he is on the front line of this interaction, both crisis and non-crisis. He can give you a bit of a flavour of what is going on, as it were, within the ambit of these MoUs.

Nathanaël Benjamin: We almost forget that the MoUs are in place because we have got into a mode of interacting quite openly, regularly and constructively with our counterparts, both in normal times and in crisis times. The type of information we exchange is indeed data on the firms we supervise either individually or jointly. We also exchange our supervisory judgments on the key challenges and key risks to which our firms and other firms are exposed. That is particularly important in cases where there are cross-border issues for individual firms or across firms when different firms have relationships with each other. These types of things are particularly helpful to be able to discuss very openly and freely with our colleagues, especially in times of crisis when we all need to be joined up. In the current situation, this is particularly precious.

Lord Wood of Anfield: It sounds, from what you are both saying, as if all of you are at pains to point out that, functionally, you have the territory covered with these sector-level agreements or issue-specific MoUs. Is there anything functional that an overarching MoU would add or is it purely a political, diplomatic cherry on the cake?

Sam Woods: It would add something quite important. It sounds a bit soft when I describe it, but it is actually important. It is that wider strategic discussion. You would have the Commission, the Treasury, the FCA and us, and you would probably have the SSM in the room from the ECB. You would have that group of people, all of whom are closely engaged on these issues, talking about issues of common interest. The intention is also that the MoU should allow discussions about equivalence, which is another important topic, and potentially, where feasible, alignment in international fora. That would all be very useful, in fact. It is just that it is at a more strategic level than the day-to-day stuff that we are talking about.

Q52 **The Chair:** I am afraid we are back to me as I am covering for a colleague. They wanted to know, at a high level, given the retained acquis that has now come into law here, where the problem areas really were. I do not know whether we should start with Sam. Where do you perceive the problem areas to be?

Sam Woods: The first thing is about the structure of it, as Edwin was describing before. What we did in the onshoring was a necessary way to do it at speed, and it has created a viable framework that we are both operating today, but it is extremely complex and unwieldly because of the way in which the rules spread across these different parts of our rulebooks and different layers of law. That makes it difficult to update and very hard to navigate.

Actually, on the prudential side, we are going to provide a guide for firms that our team calls the prudential policy index, just to help firms know to which rules they are currently subject. That needs to be sorted out, or rather it would be very desirable to sort it out. That is the proposal that the Government are bringing you in the Future Regulatory Framework. There are then specific areas where we are bringing forward reforms. I do not know whether you want to go into those, but perhaps I will pause.

The Chair: That is a good place to pause because we are coming on to the specific reforms later on. Edwin, I do not know whether you want to comment.

Edwin Schooling Latter: Again, I can be brief in that I agree with Sam. The overarching framework works. It functions. We made sure it did when we onshored it into UK legislation with the Treasury, but it is clunky because bits of it were designed for a multilateral world and a whole EU market, whereas we have a single country and a differently shaped market. The issue we need to solve is its flexibility going forward, making sure that we have the ability to change it, amend it and keep it in line with what UK-based international markets need.

The Chair: It sounds as if you both have a fair view as to what a good framework really is for the future. It also sounds as if that is a view you feel is shared by the Government. Have you all been feeding off each other to obtain that? Am I right in feeling that you have a fair view as to what the future framework should look like?

Sam Woods: I think you are right in that. We put forward proposals of this kind in public and in an informal way through speeches as far back as 2019. I think there is broad agreement across the regulators and the Government about the basic idea of asking you in Parliament to push the rules down. When we have made rules here in the UK, that is the way we have done it. It is moving away from the EU system where a huge amount of detail gets put up into legislation for the main reason of making sure that everybody does the same thing. If you come out of the EU, that imperative falls away.

If you would indulge me just for one minute, I would like to make a specific proposal, which is beneath that level of generality about pulling the rules down. If you look at the last two decades of how we have done financial regulation in this country, at the beginning of that, you had FSMA 2000. That is the very delegated model. Some members of the Committee may well have been involved in this; I was not. Effectively, the law set the objectives for the regulator and the general approach to rule-making, and then it was over to the regulator to do everything.

At the other end of the spectrum is the high watermark of recent EU rule-making. If you take Solvency II or MiFID II, there is a lot of detail in law for the reason that I just gave. In between those, you have two other things. You have ring-fencing where Parliament, through primary legislation, set the main contours—for instance, the scope of the ring-fence and the change to our objectives. Treasury then did quite a lot of detail through statutory instruments. Of course, Parliament effectively does that. We then did some detail on our rules.

Then, to the left of that, if you like, between that and the FSMA 2000 model, was the way that Parliament decided to introduce the senior managers and certification regime. That model, in my personal view, is the one we should go for, where Parliament, in that case, set the very important things in law such as the need for conduct rules, the statements of responsibility and the key planks, giving that underpinning, and the regulators then filled in the rules. It would not be appropriate to go back to FSMA 2000 because we need more of a democratic underpinning for what we are doing, but that specific model would be one to go for.

Edwin Schooling Latter: There is substantial consensus on what the future model should look like. The model in which Parliament sets objectives for us is a powerful model that works well. I set out our current three operational objectives at the beginning. They are written through everything we do like in a stick of rock, and we are then held accountable for delivering on them.

Lord Hannay of Chiswick: I see what you are saying about Parliament simply setting a framework and you then taking over—an approach that might not receive universal enthusiasm in parliamentary circles, but nevertheless. I have rather lost the Government in all this. Where do the Government come in? Can the Government tell you what to do? Can they tell you how to operate the powers that Parliament has given you? In those circumstances, Parliament has lost control completely.

Sam Woods: You are very right to focus on that point. I would make two comments. First, broadly, the answer to your question is no. There is really no point in having operationally independent regulators if the Treasury can just tell us what to do. That would be a pointless arrangement. We would never support such a thing, and that would be a sham. That is not what the Government are proposing.

The Government are proposing, though, to retain some powers, and the most relevant one is the Government rule-making proposal that they should have the ability to direct us to make rules in a certain area. The Government might say, "Okay, we need rules for crypto. You, FCA, make rules there". That is fine. What is not fine is if there is a further power where the Government can say, "When you make those rules, you must do exactly X, Y, Z", because then we are back into the problem that you described.

Secondly, it is incredibly important that it is Parliament that sets the objectives and Parliament that holds us to account, because that is what aligns the system and makes sure that the regulators do not either get captured, which is an obvious risk, or, as the industry sometimes worries about, pursue their objectives to a ridiculous degree.

Q53 **Lord Lamont of Lerwick:** You may have touched a little bit on my question in the answers you have just given. The Government are exploring a range of significant reforms to both the structure and the substance of the regulation of financial services. Which proposed or suggested regulatory reforms would bring the greatest benefit to the UK's market for financial services in the short term and the long term? Given the disparate nature of many of the suggestions that are around, what can the regulators and government do at the policy and operational levels to ensure that reforms do not turn into an endless process of piecemeal implementation? Perhaps we could start with the PRA.

Sam Woods: Thank you, Lord Lamont. I will make two comments. In terms of specifics, distinct from the wider structure we were just talking about, of the two on the PRA side—and I know Edwin will have others on the FCA side—one is that we are devising a regime that we call "strong and simple" for smaller banks. We want to have a simpler regime but not a weaker regime for our little banks. It was always impossible to make enough headway on that in Europe because one country's big bank was another country's small bank. Now that we are out, it is a great example of something we can do that we think is good for our secondary competition objective but also for safety and soundness, because you should not have rules that are more complex than they need to be.

By the way, schemes of that kind are normal all over the world. The EU is rather an exception in applying the full weight of more or less everything to all firms, and that is driven by the understandable desire to harmonise. That is one thing we are doing. The second thing we are doing is our review of Solvency II, but I will not go there because, once I do, we may lose much time.

Edwin Schooling Latter: We do not have an agenda to have low standards. We do not think that would meet any of the Government's objectives in the long term. Within the overall context of wanting to keep standards high, we are talking about evolution rather than revolution of the rulebooks and still achieving the same outcomes in terms of consumer protection and market integrity. There are some specific areas where we are prioritising some change as we have now left the EU, and, again, there is consensus with Treasury on what those areas are.

One of those is in what we call primary markets, where new shares or bonds are issued. There, we have inherited a regime from the EU in which admission of shares to trading on a stock exchange is lumped together with offerings of bonds to a limited set of investors by a non-financial corporate. That is an area where actually, in the UK, in the past, we had different regimes for those two things because we thought we could have better-calibrated disclosure requirements if we separated them out. We are moving towards separating those out again and returning to previous UK market practice.

Another area is around secondary market trading, the buying or selling of shares, bonds or derivatives that have already been created. There, we have inherited from the EU an immensely complicated structure under MiFID, an acronym you will all have heard before. There is a variety of aspects to that where we some simplification think is possible. There is a risk that I will get into a lot of jargon if I go into too much detail.

Systematic internalisers, thresholds for pre-trade and post-trade transparency, exactly what the operators of trading platforms can do, and whether firms are free to try to sell or buy certain shares outside the order book of a stock exchange are all things where we think there is a case for some change. There is actually consensus in our market that there is a case for change, and we will look to take that forward.

Lord Lamont of Lerwick: Can I ask on that very point about MiFID? How much of MiFID do you think we would have done on our own? Is it, as is sometimes said, that MiFID was something that was very much influenced by UK regulators in the EU? There is huge resentment about parts of MiFID in financial services. Is this something that, perhaps, was overdone in a big way?

Edwin Schooling Latter: MiFID, of course, is a huge and sprawling piece of regulation that covers many areas. In some of those areas, the reforms that were introduced with MiFID II are unambiguously a good thing. For example, we have improved the way that transactions are reported, which makes it easier for us to detect market abuse. There are other areas of that package where we ended up with an overcomplicated and somewhat unnecessarily restrictive regime, which is a bit different from what we would have chosen unilaterally.

For example, we are more disposed to let market participants choose exactly how they buy and trade certain securities rather than set very precise rules for that. We think that leads to better outcomes for the customers of those firms. In the end, the outcomes are common to us and our EU partners. We all want investors to get a good deal at the end of the day. We want markets to be fair and effective.

Lord Lamont of Lerwick: If I could just turn to those buzzwords of "green finance" and "FinTech", I assume you think we ought to be establishing some sort of regulatory framework for novel areas such as these to get a first-mover advantage and, possibly, to set the standard for future international regulation. Shall we start with the FCA on that, please?

Edwin Schooling Latter: Perhaps I can do the ESG, in particular the climate change part of that, and then bring Richard in on fintech. Exactly as your question anticipates, we have sought to move quickly and take a leading position in ESG matters. I think we were the first jurisdiction, at least with a global financial centre, to ask listed companies to make disclosures in line with the global model set out by the Task Force on Climate-Related Financial Disclosures. We have now established a whole chain of disclosures that will be required there, from listed companies to asset managers and the pension funds that invest in the funds run by the asset managers.

Again, exactly as your question suggests, we think there is a very strong case for global standards here. After all, the climate is a global issue. We have taken the lead in work at IOSCO—the International Organization of Securities Commissions—to establish a baseline of corporate reporting standards under the IFRS Foundation's International

Sustainability Standards Board. Doing that internationally is the right thing where possible, but in the meantime we cannot wait and do nothing, so we have been doing that in the UK. Richard, do you want to add on FinTech?

Richard Fox: We are not complacent about this because innovation, by its nature, moves very quickly, but we have some reason to think we enjoy a degree of first-mover advantage already in the UK on the regulation of fintech. For example, we were one of the first authorities in the world to set up a regulatory sandbox. Peers may well have heard of this. This allows early-stage companies to test, in a real world but within a safe environment, new innovations that might help markets and consumers. If imitation is the sincerest form of flattery, that has now been replicated by regulators around the world. Sandboxes are now common to regulators across the globe.

We then took a further step, and we were the first authority to do a digital sandbox. A bit like Solvency II, I can disappear down into the detail quite quickly, but fundamentally this was about helping companies at an even earlier stage of their development and innovation. Again, that is a model that the UK market has welcomed strongly. Frankly, bringing these two issues together, we are currently running versions of this digital sandbox based on climate-related data. We are running tech sprints. I think they would be called hackathons if we were not regulators, but we tried to pick slightly more politic language. That brings industry players and innovators together to try to solve tricky problems. We are running a cohort of that right now with companies trying to support the race to net zero. We are not resting on our laurels, but we think we build from strong foundations on the fintech agenda.

The Government commissioned an external review on this topic from Ron Kalifa. He has reported and made a series of recommendations. They are aimed at government, industry and the regulator, and we have already taken steps to implement some of those recommendations. We are not complacent but on the front foot.

On Edwin’s point about some things being better done globally, crypto is a good example of where we will simply not be able to regulate a market that is so inherently digital and global on our own. The Government are thinking about how to do that well here, but we and, I know, the PRA and the Bank of England are also spending a lot of time internationally with colleagues thinking about how to do that well collaboratively across the globe.

Lord Lamont of Lerwick: Does the PRA have anything to add there?

Nathanaël Benjamin: Let me say a few words on climate. The Bank, for some time now, has been aiming to play a key role on the climate regulatory front. We were one of the founders of the Network for Greening the Financial System, for example, but I will mention three things on the supervisory side that are particularly relevant to climate.

First, in 2019, we set out our supervisory expectations of how firms should be governing, managing and having accountability for their climate risk exposures. These expectations are now in force.

Secondly, we are currently running a major concurrent climate exploratory scenario analysis of all major UK banks and insurers. That is currently under way. It is the first exercise of its kind, and it is attracting quite a lot of international interest in what we are doing.

What are the things that we want to get out of the exercise? We want firms to size their exposures to a range of climate scenarios; to challenge their business models under these different scenarios and explore what that means for their own future path of business direction; and to understand what that means for their own risk management and what to do under these different paths. That is quite a major exercise we are running at the moment.

Thirdly, we are participating in the broader thinking, in the longer term, about climate-related capital requirements as part of international fora such as the Basel Committee. These are three areas in which we are quite active.

Q54 **Lord Tugendhat:** In the interests of regulatory flexibility, agility and desirable things of that sort, there has been talk of removing financial regulation from the scope of primary and secondary legislation and moving it on to your own rulebooks. How does that strike you? Would you regard that, on balance, as advantageous or disadvantageous?

Sam Woods: You might expect me to say this in a way, but I think it would be highly advantageous. That is not because I want the Prudential Regulation Authority to have more to do or more powers. We have enough to do at the moment. But it would give us an ability to have a much more dynamic and coherent set of rules. It is also worth noting that, when we have done UK rule-making in this country, we have largely done it this way. The question is, as we come out of the EU, where the practice was to have much more legislation, which of our ancestors we are going to follow more: the EU method or the UK method.

As I have always thought that the primary motivation for the EU method of having a lot in legislation was to make sure that all the countries in the EU do the same thing, to me, it seems more logical to move back to the UK method with more of the rules down in the rulebook. There are, though, risks associated with that, as Lord Hannay was pointing to before. The worst risk is that, if you push the rules down to regulators, there is a risk that the regulators go off and get too close to the industry and rules are not made in the way that they should be. Now, I would hope that none of our organisations or us as individuals would fall prey to that risk, but that has obviously happened in regulation in the past. That is why I think parliamentary accountability, clear objectives, public reporting and all those sorts of things are a very important control, alongside pushing the rules down.

Lord Tugendhat: About 30 years ago, I was a regulator in a very different field. I was chair of the Civil Aviation Authority. At that time, judicial review was nothing like as highly developed as it has since become. None the less, your answer spurs me. We were responsible for our own rulebook and, of course, aviation safety is a very delicate area. I remember that we were very trammelled by the prospect of judicial review. I do not know the extent to which judicial review, which is much more highly developed now, would cut across what you have just said.

Sam Woods: I do not think it would cut across it at all, and it is one very important control on unelected public authorities that those who do not like their decisions should have the ability to take them to judicial review. Indeed, it would be very dangerous not to have judicial review in that environment.

It is worth pointing out, though, that firms have another avenue of appeal for supervisory and enforcement decisions, which is up through something called the tribunal. Both our organisations have been taken to the tribunal by individuals and, in the case of the FCA in particular, by companies. Those decisions come out in different places. We have had several occasions when the tribunal looked at what we did and said, "Actually, we don't agree", and the decision was reversed. That is part of a healthy, functioning system.

Lord Tugendhat: That is a very important answer. Could I, just for clarity's sake, hear the views of your colleagues?

Edwin Schooling Latter: I agree that the possibility of judicial review adds another very important accountability mechanism, essentially. It is relatively rare to be taken to that, but, just as the experience you were describing in the Civil Aviation Authority suggests, we take that possibility extremely seriously when we prepare our policies and interventions, just as we should.

Lord Tugendhat: Thank you. That is very interesting. Here we are in a post-Brexit situation. Is there anything that could be done to, if not avoid a repeat of the regulatory lapses during the 2007 and 2008 period, make them less likely? I do not mean to sound carping in saying that. It is very difficult to avoid lapses in advance. Do you feel that you would be better placed to avoid some of the problems of that period?

Sam Woods: Perhaps I will take that, as it was a prudential failing, really, before the financial crisis. What really happened there was that we had brought all this regulation together under one roof at the FSA. This had many obvious attractions and advantages, but, unfortunately, one unanticipated side effect of that was that the conduct side, in effect the side of business that Edwin, Richard and colleagues lead on, rather started to crowd out this line of business that Nat and I are involved in on the prudential side. Being on the FCA board and on the committee that oversees the PRA, the PRC, I can easily understand how that would be the case because the conduct issues are very voluminous. Often, they are also extremely noisy.

To bring it alive for you, I believe that, before the financial crisis, the number of front-line prudential supervisors that we had for, at that point, the largest bank in the world was two or three people. Now we have 18 to 20 people on those big banks, and that is actually light by international standards, but we can do the job. The key change made following the crisis was twin peaks: the creation of two regulators. You in Parliament took the prudential part out of the FSA and created the Prudential Regulation Authority. You can make all structures work, but that twins peaks structure has the great benefit that you cannot run into the problem that we had before the 2008 crisis, which is of conduct crowding out.

You could have a different problem, because we are part of the Bank of England, of other Bank of England business crowding out what the Prudential Regulation Authority does. But Parliament also foresaw that and inserted something called the adequacy of resources statement, which the Prudential Regulation Committee has to make to the Chancellor annually to say, "We've got enough boots on the ground to do the job". That is there precisely to guard against the risk that you identify.

Lord Tugendhat: Can I come back to the first question, because I was extremely struck by your answer? If you were in this position where primary and secondary legislation were not required and it was on your rulebooks, do you feel that the authority of the chair of the body or, indeed, the body itself would require some sort of parliamentary approval of the appointees?

Sam Woods: I do not think that would be necessary. However, as a practical matter, having been through two appointment hearings myself with Parliament, I can tell you that you regard that as a practical necessity to have confidence in doing these jobs. There is no need to change the law. The practice of the Treasury Select Committee in our area, and I suppose others in other areas, that candidates for the most senior positions—the roles of chief executive, chair and all committee members—are brought before those committees and asked questions, effectively like a job interview, while not a pleasant thing to be on the receiving end of, is rather important.

Edwin Schooling Latter: Of course, it is my boss Nikhil Rathi who has the equivalent of that, but, as you would expect, he and his predecessors take that extremely seriously. It is a very important part of the overall accountability framework.

Q55 **Lord Jay of Ewelme:** It has been an extremely interesting set of answers so far. Thank you very much for that. I must say I very much agree with what you were all saying in reply to Lord Tugendhat on judicial review. I want to ask a slightly different question. I just wonder to what extent encouraging growth and international competitiveness of financial services falls or should fall within the remit of the regulators. Would that be going rather beyond your remit, in your view? I would be interested in your views on that and whether there were examples of other jurisdictions that do pursue that strategy. If so, how successful are they, in your view?

Edwin Schooling Latter: Having regard to sustainable economic growth in the UK economy is not something new to our set of aims, if I can say that, because alongside our formal objectives in statute we have had, for some time, a remit letter from the Chancellor saying what the Government would like us to pay attention to. Sustainable economic growth has been prominent in that for some time.

However, in the context of the Future Regulatory Framework, there is a debate about adding an explicit competitiveness objective. Now, if that is a secondary objective—it is in the statute but comes in a hierarchical position below consumer protection, market integrity and competition in the interests of consumers—we think that is an appropriate balance. It is quite empowering for our policy teams to be able to make changes to rules when the primary benefit of that is increasing the competitiveness of the UK financial system. We are very happy to welcome that.

If the competitiveness objective were put on equal footing with consumer protection and market integrity, there would be conflicts between those, because sometimes consumer protection is going to require, for example, having more capital in a firm so that it is better able to pay redress. It might require better disclosures that cost more money to make to be made to your customers. A primary competitiveness objective would pose some interesting dilemmas, and there would need to be a lot of thought about how we as regulators were expected to balance those.

Lord Jay of Ewelme: Just to be absolutely clear, if you were following your second proposal—in other words, that consumer protection would clearly come first and that international competitiveness would come second—you would be confident that that need not cut across the responsibility for consumer protection.

Edwin Schooling Latter: Yes, correct.

Sam Woods: It is the key distinction. I agree with Edwin, but I would put it more strongly. A primary objective to promote competitiveness is genuinely a bad idea. One reason for that, which proponents of that idea do not tend to focus on, is that we invest a huge amount up stream in international rule-making—the Financial Stability Board, the Basel Committee, the International Association of Insurance Supervisors. I am certain that, if we had a primary objective to promote, say, the international competitiveness of UK financial services firms, our authority in those fora would be quite heavily reduced, so it would be self-defeating. A secondary objective should work well and is a sensible thing to do in the context of more rules being handed down to the regulators.

Lord Jay of Ewelme: Are you aware of any other jurisdictions that have attempted to follow this path, perhaps by putting international competitiveness as a primary objective? Have they got into difficulties? Are there some bad examples you do not want to follow?

Richard Fox: Less so on the primary objective. That supports the arguments that Sam and Edwin are putting forward, but there are a number of jurisdictions that have followed the "have regard to" or secondary objective approach. For example, Switzerland, Hong Kong and Singapore all have the concept of promoting their jurisdiction as a financial centre. Australia has the concept of promoting sustainable economic growth.

Like-for-like comparisons can be tricky here. As Sam described very eloquently, the twin peaks model we have in the UK is still relatively unusual across the globe, so that makes apples-and-apples comparisons difficult, but certainly the concept is not unusual and we have not seen it lead to huge problems there. Whether this is effective is a more complicated question because, clearly, economic growth turns on a number of factors and regulation can be but one of them. Clearly, tax is an obvious one. The skills and labour market is another. That is where some of the comparisons get a bit more complicated. The Monetary Authority of Singapore, for example, which has this objective to think about promoting the jurisdiction of Singapore, also has some powers over tax and skills, so it has more levers to pull.

In short, yes, there are some models out there, but they tend to follow this secondary or "have regard" approach that, very clearly, we support as both the PRA and the FCA.

Q56 **Lord Foulkes of Cumnock:** As time moves on since Brexit, there is regulatory reform here and in the European Union, and so we have increased divergence. What kinds of risks and benefits does this provide?

Sam Woods: We think that international alignment of rules is a global public good, which is partly why we invest so heavily up stream in the way I was just describing. That is because, between regulators, even if you are not speaking the same actual language, if you are using the same regulatory language, you naturally have a higher degree of trust and a better ability to understand the risks you are jointly facing. That is also, by the way, good for firms and efficiency because it is more likely that regulators will let things flow across their borders seamlessly if they trust each other and talk in the same terms.

That has never meant that every single jurisdiction does exactly the same thing in the detail, and it is perfectly natural and, indeed, inevitable that, now we have left the EU, our framework will evolve in a way that is not precisely the same as the EU's because our markets are different. Our proposal for a simpler regime for little banks, which we were talking about earlier, is a good example. We have already done some bits of this. If I can give you one example to bring it alive, you in Parliament have already handed to the PRA the ability to implement the latest round of prudential rules with various have-regards, including competitiveness.

One thing that the EU had done was to allow a practice that we think is unsound, which is for banks to take credit for the value of their software assets in their capital. That might sound a bit technical, but the reason we think that is unsound is quite a simple one. For that to be true, you have to imagine that a bank would be able to monetise its software in a stress, which we think is highly unlikely, so we took a different path. We said, "No, we're going to stick with the full Basel implementation and deduct". You will see those things. Obviously, though, we will not diverge just for the sake of it. We will just do it where it is necessary.

Edwin Schooling Latter: You are absolutely right that, since our departure from the EU, there have been some marginal bits of divergence in bits of the financial market framework. It is important to keep those in perspective. Those are small bits at the edges, and the vast bulk of this, 99.5% of it, remains the same. As I mentioned earlier, the outcomes that we are seeking to achieve are, essentially, the same ones as those that our EU partners are still trying to achieve in terms of investor protection and markets working well and fairly.

It is reasonable to expect a few more bits of marginal change, as the EU will change things on its side and we will change things on our side, where there is a cost-benefit case for doing that. Given that we, a few years ago, had more or less complete alignment, we will see a little bit of divergence. However, in the spirit of Sam's comment, if you take a multidecade view of this and a longer perspective, because of all the work that we are doing along with others on convergence internationally by having similar approaches to the same problems through IOSCO, the FSB or the Basel Committee, you are seeing convergence rather than divergence across jurisdictions.

Lord Foulkes of Cumnock: I wonder whether you can help me with something that puzzles me about when we were in the European Union. France, as well as départements d'outre-mer, has territoires d'outre-mer, and we have overseas territories. Why is it that the French territories have not developed as offshore tax havens and ours have, particularly the British Virgin Islands, which has 45% of the offshore companies? Is that anything to do with regulation? Can you help?

Sam Woods: I am tempted to pass that to Nat in case he has some special knowledge based on his nationality.

Nathanaël Benjamin: I have dual citizenship, British and French, but I am afraid I do not have any particular insight into that.

Sam Woods: Take Bermuda as an interesting example. We have a lot of business that we oversee where companies may be based in Bermuda but do a lot of business here in the London market, and our approach is to try to avoid regulatory arbitrage and make sure that we can oversee the risks in the round. That can be quite challenging. As for tax, that is really a question for the Treasury.

Lord Foulkes of Cumnock: You do not have any responsibility at all, either of you, for regulation of financial services or any kind of financial transactions in any of our overseas territories.

Sam Woods: Let me think carefully, but I think the answer is a complete no. If it is not, it is very largely no.

Lord Foulkes of Cumnock: It is left up to them.

Sam Woods: Yes, they have their own. Guernsey, as an example, has a version of our organisation. The same is true on the Isle of Man and Gibraltar.

Lord Foulkes of Cumnock: Jersey, Guernsey and the Isle of Man are Crown dependencies. Gibraltar is an overseas territory.

Sam Woods: Yes. Gibraltar has its Financial Services Commission that does exactly what we do. The only reason I paused just very slightly is that, if you take Gibraltar as an example, there are Gibraltarian firms doing a lot of business in our general insurance market, and we engage quite intensively with the Gibraltar Financial Services Commission to make sure that that is being done on as level a playing field as possible. We cannot completely wash our hands of it, but they do have their own responsibilities and their own regime.

Lord Hannay of Chiswick: For many decades of our membership, particularly in the most recent ones, it was generally assumed that a capital market union of the 28 Member States was going to be beneficial to the United Kingdom, and that it was worth accepting some of the points you have referred to in your earlier answers about slightly clunky arrangements in order to achieve that. Now, clearly we have lost that opportunity by leaving, but I am not quite clear about the extent to which we have lost it completely or whether we lose it only if we diverge beyond a certain point from European Union legislation. If it is the latter, there is presumably still that potential benefit in keeping our different rules and methods of operating reasonably consistent with each other, which could push back against excessive divergence.

Edwin Schooling Latter: It is a good question, and a good answer to that would be multifaceted. If you take as a starting point that the capital markets union was, in large part, an initiative to reduce dependence on bank finance and have more ways of raising capital to support growth and so on through the capital markets, given that London had a particularly prominent role as a financial centre within the EU, there was clearly a lot to gain for London there, as well as for the rest of the EU.

With our departure, the EU has an approach of, as it often calls it, strategic autonomy, where it attaches some importance to having control and the ability to provide the full range of financial services from within the EU. However, our view is that there are usually efficiencies to be gained, and often risk benefits as well, from having an open financial system. If you want to manage assets in the United States or somewhere in Asia, it makes sense to draw on the expertise that exists in those countries to do that. The best liquidity, financial instruments or assets are going to be outside the EU, or the UK as well sometimes, and we want people to have access to that.

The degree to which EU firms can benefit from those services that might be provided in London more efficiently, better or with greater risk benefits will depend, in large part, on the EU's access arrangements. There are, of course, restrictions on that in some areas, although there is also openness in others, and that takes us into the issues around equivalence and so on.

Q57 **Lord Liddle:** I found your answers very intelligent and persuasive, but I am still anxious about the basic thrust of what you are saying. The first point is on regulatory capture. You have a lot of very well-paid, highly intelligent people in the City who spend their time, it seems to me, trying to work out how to get around the rules that you set. I would have thought that you have great difficulty in recruiting people, particularly in the medium rank of your organisation, who can actually get a grip on what people are saying. That is the first point. How equipped are your regulators?

I am not disputing your abilities at the top, as it were, where I think high salaries are paid and you have a strong sense of public service, and all the rest. How big is the FCA? You have something like 4,000 people. These are vast organisations. In the middle ranks, can you put your hand on your heart and say, "We have able people, and we can avoid regulatory capture"?

Sam Woods: We have a budgeted headcount for the PRA of 1,340 FTEs. It is actually around 1,420 individuals because we have some part-time staff. In the big picture, that is enough to do the job. We have around 1,500 firms to oversee. We obviously have a lot of other things to do as well, but we can do that job. We have shown that over the last decade. We could of course use more staff, and you could do some version of the job with fewer staff. That is the nature, particularly, of supervision.

We do, though, need to staff up if Parliament approves this proposal to give us a bigger rule-making responsibility. We have started making plans for that but, to give you a sense of it, I think we will need to staff up over the next year or two by roughly 100 heads on that 1,340. The bulk of that is for this rule-making responsibility, but there are other things. We are in a very challenging environment from a recruitment and retention point of view. It is a very tight labour market, which goes exactly to the concern that you have. Our exit rate has ticked up. The most recent number I have from a few days ago is 8.8%. That is back to pre-Covid levels, but I am worried that it could go further. Maybe I could bring in Nat briefly to say what we are doing on that front to recruit.

Nathanaël Benjamin: I would say three things on what we are doing there. First, we are focusing on pooled recruitment campaigns where we recruit for several roles of a similar nature at the same time so that we make the most of some of the synergies that we have there. That is particularly the case for our supervisory staff, for some of our cyber specialists and for some of our operational resilience specialists. We are doing that quite intensively at the moment. We have also staffed up our own internal recruitment teams, and we have been resorting more to expert recruitment agencies on that front.

Secondly, we have streamlined our own internal recruitment processes so that the staff involved in hiring these resources can do so in a more effective and seamless way. Finally, we are also doing more outreach into the external job market. We are working with marketing firms to improve our applicant experience and to get wider advertising potential, including to get more diversity in terms of the pools of applicants we bring in. These are the things we have in train at the moment.

Edwin Schooling Latter: As relatively highly paid and more senior FCA directors, we stand on the shoulders of our hard-working and able associates, managers and technical specialists. I would like to pay tribute to the brilliant staff we have and the very hard work they do. Certainly, when I think of my own teams, we have really dedicated public servants. Yes, they might get paid less than working for Goldman Sachs, but they like working for the public good. They believe in the objectives that we have. They think that they matter for the world outside the FCA.

Yes, like Sam, we have additional responsibilities coming our way as a result of the exit from the European Union. For example, a big proportion of the policy work used to be done by staff in ESMA, the European Securities and Markets Authority. Of course, the European Commission does a lot of work on the European policy framework. With Brexit and then with the Future Regulatory Framework, those responsibilities will come down to the FCA teams that are keeping our handbooks up to date. We too will need to do some additional recruitment to address that challenge. It is very important that we have people of the right calibre. We will not achieve that in a day, but I am optimistic, on the basis of the staff we have, that that is achievable and we will continue to attract good people.

Lord Liddle: Are you saying we should not worry about any of these questions?

Edwin Schooling Latter: I am saying we in the FCA will need to work hard on recruitment, retention and maintaining staff who are fully able to do the very important job that they do, but I think that is achievable.

Sam Woods: You should not worry, but you should know that, for our management team, it is the top management challenge this year. While 100 might not sound like a lot, bringing in that many heads in this environment is going to be a stretch.

Lord Liddle: Can I ask you another question about risks, which is not quite what I have down here? In the 2000s, when I worked in the Prime Minister's office under Blair, I spent my time going around Europe saying, "It is a great thing to deregulate wholesale financial services. The last thing we want is more regulation, particularly from Brussels and all the rest", which proved to be a bad call. I remember it was always said in the financial crisis that the Treasury did not have the expertise to work out what should be done in the banking crisis.

Is there a risk that, with the line you are pursuing where all the expertise is in your area, first of all, there is some regulatory capture and, secondly, the expertise is taken out of the policy-making bodies so that people cannot report to Ministers that they think there is a real problem simply because they do not fully understand what is going on? I worry about these things because we cannot afford as a country to go through anything like the financial crisis again. One of the concerns about the politics of all this at the moment is that, yes, the Blair-Brown Government were too exuberant about the possibilities of financial services. Is there not a risk that the rhetoric of Brexit opportunities drives us, politically, in the same direction, towards less careful regulation of what is happening than we need?

Sam Woods: This is why you have operationally independent regulators and you give them very clear objectives. With the objectives that we have, we have absolutely no intention of reducing the standard of regulation in financial services. It is natural, of course: we are 14 years on from the financial crisis now, and memories of that will fade. The pendulum does swing in our world, and that is an experience, exactly as you described, that we have had before. The point of us is to be the guardians of that flame and stay on it.

It also goes back to the discussion that we were having about competitiveness. It is a good idea to keep our primary focus, in our case, on safety, soundness and policyholder protection, and in Edwin's case on the FCA's objectives, because if you have that and we are hauled into Parliament regularly to account for what we are doing, that is the main control against the risk that you are describing.

The Chair: Thank you very much. We are very slightly behind time. I hope you do not mind. It means we will overrun by about 10 minutes, but it is so interesting for us that I hope you will still be here. We move back to Lord Jay.

Q58 **Lord Jay of Ewelme:** There have been one or two tantalising references to equivalence so far in the session. I wonder whether both organisations can say what role they have in the process of determining equivalence decisions, in terms of both UK equivalence determinations and seeking equivalence determinations from the EU.

Richard Fox: Fundamentally, this starts with the Government. They have responsibility for deciding whether to seek equivalence from another jurisdiction and from whom. Indeed, the other way around, if jurisdictions are coming to the Government looking to assess us for equivalence, it starts with the Government. We in the FCA, and indeed the PRA and the Bank of England, provide technical advice to support that process.

To give an example of the kind of thing we mean, if the Government were seeking to assess the equivalence of X jurisdiction, we might be asked to give advice on whether the rules in that jurisdiction deliver the same outcome as our own. The other way around, if the other side was looking to assess us, we might answer technical questions on the effect of our rules, how they work and what that means. All this, again, is governed by a memorandum of understanding that has been signed between the authorities and the Government and, indeed, is on the government website.

Sam Woods: That covers it well for both of us. Richard put it well.

Lord Jay of Ewelme: You just provide technical advice to the Government and, presumably, the Treasury, which will make the actual decisions.

Sam Woods: Yes. That is absolutely clear. It is the same in the EU with the Commission and the role of the Treasury.

Lord Jay of Ewelme: Does that work okay, as far as you can tell?

Sam Woods: We think our end of it works okay. There is a little bit of frustration around the enormous volume of work that went into completing the European Commission's questionnaires about the UK's equivalence with the very limited results, but perhaps we will come on to that.

Lord Jay of Ewelme: I have one or two more technical questions. Our understanding is that the EU has issued 21 equivalence decisions to the US, 15 to Singapore and 13 to Switzerland, yet the UK has only one. I am not quite certain whether that is correct but, if so, what is the explanation for that imbalance?

Sam Woods: Those numbers are correct. I will say two things about it. First, it is important to remember, and I think Lord Hannay got into this a bit with Jon Cunliffe when he was here, that many of those equivalence decisions are not really about market access. Take an example from the prudential side of this, the banking regulation CRR. Most of those equivalence points are about things such as how you treat the exposures you have to another country that you find equivalent.

For instance, if the EU found the UK equivalent under those articles within the CRR, that would not make it any easier for UK firms to access the EU. It would just make it marginally easier or looser for EU firms wanting to sell their services into the UK. You should not immediately assume from the presence of those equivalence decisions that there is a very significant advantage. There is an advantage, but it is not necessarily as great as you might think for firms from those countries that have it versus the UK.

Secondly, to your question about why there is that difference, the European Commission has been quite clear that it is, in one sense, holding the UK to a higher standard because it has said it will look not only at the rules as we have them today, which is how equivalence has been done, I believe, for those other decisions, but at how it thinks our rules might evolve in the future. I think that is not unrelated to the fact that we are a very large financial services centre right on the edge of its jurisdiction and that it has an openly expressed intention to try to build up more of its own.

Lord Jay of Ewelme: You more or less said that you think the EU is holding the UK to a slightly different standard. We have been told that some equivalence decisions are more important in the sector than others are in terms of market access, for example. I wonder whether you agreed with that.

Sam Woods: I do, and Edwin may want to come in too. From our point of view, there are two that are particularly important. One is EMIR 25, which is the one relating to central counterparties where we have a temporary equivalence from the EU. That is a very important one. The other one that is potentially very important but may not come to life is something called MiFIR 47. MiFIR 47 is the equivalence decision that would give countries the ability to sell quite a wide range of investment banking services into the EU, but I should note that, on that, the EU has not found the UK equivalent, the UK has not found the EU equivalent, and, as far as I can work out, the EU has not found any other country equivalent and is reviewing that clause. It may be that that one is particularly generous, but it may actually never come to life.

Richard Fox: I have nothing particular to add to that. From the point of view of FCA firms, Sam is absolutely right that the equivalence article in MiFIR is the one that would potentially open up access to European markets for UK firms. As Sam says, there is little prospect that that is on the table at the moment.

Q59 **Lord Faulkner of Worcester:** Good afternoon. I want to ask you about Free Trade Agreements, Mutual Recognition Agreements and similar instruments. I declare an interest in that I am the Government's trade envoy to Taiwan, although that is not directly relevant to this inquiry. What input do the regulators have in the process, both in negotiating agreements and in implementing any that are achieved? Why would one be a Free Trade Agreement and another one a Mutual Recognition Agreement?

Richard Fox: It is a familiar story here. Overall, the strategy starts with the Government. They will make decisions on whom they wish to seek to negotiate what type of agreement with. Again, there is a very important role for the regulators, both the FCA and the PRA. We give advice to the Government on those agreements, grounded in our objectives. To zoom out, we fully support the Government's aim for open markets. From the FCA point of view, open markets certainly support our objectives. More people here and more people trading leads to deeper markets. That gives you better outcomes for clients, so we fully support that overall strategy.

Clearly, we have an important role to play in making sure there are the right safeguards in those agreements, so whenever the Government are proposing cross-border access, we will have an eye to our objectives. Do we have access to information? Can we collaborate and share that information with our counterparts on the other side? Ultimately, we need to have confidence that, if we saw a problem coming, we could act. To turn to your question on FTAs versus MRAs, the first point to say is both of the tools are pretty flexible. Ultimately, these are just legal agreements.

Lord Faulkner of Worcester: Are they interchangeable or not?

Richard Fox: I would say no. The Government can seek to put whatever clauses they want in them, but in general the difference is that FTAs are more focused on removing tariffs and other barriers to trade in goods or services, but they do not tend to focus on financial services other than possibly setting up the kind of co-operation forums that we have talked about previously.

I note that the recently signed Australia agreement commits us to one of those regulatory forums, whereas a Mutual Recognition Agreement is a much more detailed assessment predicated on much more deference to the other side's system of laws and regulation. Therefore, it involves a more intense assessment on our part, as the regulators, on whether those frameworks deliver the same outcomes. We would want them predicated on a much deeper level of trust and co-operation because, ultimately, this is about deferring and trusting the licensing, supervision and authorisation of the other party and letting those firms access your markets.

We mentioned the Swiss. We are in the middle of supporting the Government on their negotiations with the Swiss. That seeks to be a really ambitious agreement that allows for a lot of cross-border trade, and that is why we are in the process of quite intense assessments and advice to the Government around the regime in Switzerland and our relationships with our Swiss counterparts, which I am pleased to say are pretty good. FTAs are a good place to start, but if you really want deep cross-border trade you are more looking at an MRA, and that is much more of an intense exercise from the regulator's point of view.

Lord Faulkner of Worcester: It is an MRA that we are supposed to be going for with Switzerland.

Richard Fox: Yes, a Mutual Recognition Agreement. That is right.

Sam Woods: That is well put. Let us see how the Swiss one goes, but that is exactly the intention for that. One way of thinking about it is that that MRA process is a richer and better way of doing what is intended to be achieved by some bits of equivalence, because it is about the market access bits but, crucially, from our point of view, we call it outcome-based. We are not so obsessed by whether every single line of your rules is the same. We are trying to assess whether the overall stringency and standard of regulation in the other jurisdiction is equivalent to ours in its strength. That, we think, is a good model.

Lord Faulkner of Worcester: Would Ministers and/or officials come to you and ask, "What do you advise on whether to go for a Mutual Recognition Agreement or a Free Trade Agreement?".

Sam Woods: They tend to come to us one step downstream of that. There are discussions of that kind but, largely, they will decide what their priority is. Particularly if there is a financial services priority, it might go down the MRA route, as it is for Switzerland. Our role tends to be more about, when it comes to the actual detail of the assessment, what we think about it.

Back on FTAs briefly, we are getting used to this like everyone else, but our views are partly asked for to inform UK propositions in those negotiations. There is also quite a lot of rapid-turnaround business where the other side puts something forward and the Department for

International Trade and the Treasury want to know whether that would be a problem in relation to the objectives of the regulators. There is usually a bit of back and forth. That is how it is evolving.

Q60 **Lord Hannay of Chiswick:** The UK has data adequacy under the GDPR for the moment, but it is normally recognised that this is a bit precarious and could be put at risk if our data protection rules diverge too much from the GDPR or how the GDPR is developed by the EU. I want to ask you, within your areas, what the likely consequences would be if data adequacy were withdrawn. Sir Jon Cunliffe, when we asked him about it, said he thought that, at some stage before adequacy was granted, there had been a plan B, but he could not for the life of him remember what it was. You may be able to do better than that. Is there a plan B and how big is this risk?

Sam Woods: I would love to try to do better than Sir Jon Cunliffe, and maybe I will succeed. Edwin was involved in this too. We put a lot of effort, before we left the EU, into that plan B. That plan B was something called Standard Contractual Clauses, which are things that the firms can use and are blessed in a GDPR context to be able to move data back and forth across borders in a GDPR-compliant way. There is another thing called Binding Corporate Rules, which is a similar mechanism but for intragroup transfers.

We were absolutely not willing to rely on whether or not the Commission would find the UK adequate, so we actually got a long way down the line with firms, particularly the larger firms, in getting them to put all those mechanisms in place. We were more or less ready for that.

Sitting suspended for Division in the House

On resuming—

Sam Woods: If adequacy was withdrawn, we would go back to that plan B and reactivate it. I am quite confident, if we had enough of a lead in, based on what we did before Brexit, that that would work, but it would be undesirable. There would be a load of extra effort and bureaucracy for no great gain, so I hope we can avoid it.

Lord Hannay of Chiswick: Basically, you are saying that, if such a situation arose—and I do not want to go into how it might arise, because that is neither for you nor for this Committee to talk about—you think that a plan B could be constructed and introduced that would prevent any excessive damage from the withdrawal of adequacy but that it would involve costs, extra bureaucracy and quite a lot of other undesirable things, both in drawing it up and in operating it. Is that it?

Sam Woods: Yes. I would have two caveats only. One is that we can get the UK firms into shape, which is what we were doing before Brexit. Whether the EU firms would get into shape would rely on our fellow regulators and those EU firms. That might be relevant because they might be passing data back and forth as well. That is one uncertainty. Perhaps I will bring in Edwin because, although I can speak confidently for the largest firms and the ones that we oversee, I am not sure whether it is quite as strong for the wider population.

Edwin Schooling Latter: Sam set it out very well. The only thing I would add is that we would hope that the costs in the financial sector would be taken into account in the wider assessment of costs and benefits if a decision was made to move in that direction. Of course, that decision would not be for the FCA or the PRA. It would be for the other relevant departments of government.

Lord Hannay of Chiswick: I am sorry; I do not quite understand. You would draw up a plan B that would require the firms you work with to do quite a lot of work on it and costs. Who are you looking to, to compensate for that?

Edwin Schooling Latter: As Sam was saying, we would revert to our plan B to make sure that firms that needed to have provisions in place to transfer data across borders could keep their cross-border business going. We would go back to that plan B. That would undoubtedly, as you said, involve some costs and bureaucracy for those firms. We would hope and anticipate that those costs would be taken into account in the wider policy assessment of whether this was the right direction to go, but that wider policy decision would not be for us.

Lord Hannay of Chiswick: Have you tried out plan B on any of your continental partners, which would have to reciprocate if it was to work?

Edwin Schooling Latter: That goes to Sam's point that we have much less knowledge of how ready firms in the EU would be to respond to that challenge. I think it would be unknown territory.

Lord Hannay of Chiswick: Sorry, my question was whether you have had any opportunity to try out your plan B on them to tell them how we would try to do it.

Sam Woods: Only to a limited extent, in the context of Brexit. We had a list of things, of which this was one. It was not an enormously long list. There were about 10 or so items on it, and we both worked on our own side of that, but we also worked with our colleagues in the European Banking Authority, EIOPA and ESMA, as Edwin mentioned, to say, "These are problems that are going to arise if our Governments cannot agree a deal and we just tumble out". There was pretty good co-operation around all that, but it is only natural that we, as the one in the eye of that storm—that might not be quite the right analogy—we were very focused on it. For our colleagues, it was on their list, but it was further down. That would be likely to occur again. That is where we would get perhaps a bit of messiness. I hope it would be around the edges.

Q61 **Lord Wood of Anfield:** This is slightly off topic, but I remember, last year, the PRA was concerned at one point about ad hoc transfers of staff away from the UK with incremental decisions of relocation of staff by banks and other financial institutions to the EU. Could you give us an update? Are your concerns assuaged about that process and do you think the immediate post-Brexit phase of that process has come to an end?

Sam Woods: That is a very good question. We are mid-step on that. Nat is on the front line of that, so maybe I could bring him in.

Nathanaël Benjamin: The ECB is in the process of doing what it calls its desk mapping review on this. It has engaged well with us. From its perspective, it wants to avoid what it calls empty shells. It has indicated that it would not want to do anything that hinders sound prudential outcomes, which is obviously welcome from our perspective, or leads to fragmentation in risk management. That is welcome.

The other welcome thing from a process perspective is that it has said it would want both of us—the ECB and us—to consider proposals together before any decisions are made. It has expressed optimism that we can find a solution that works for everyone, as a result of this particular review. That is good.

In terms of the potential outcome of this review, we have so far not seen any attempt to move large numbers of staff across to the continent. However, the review is ongoing, so it would be premature to draw any conclusion at this stage. What we have made very clear is that anything not clearly grounded in prudential standards would be problematic for us. From our perspective, we agree that it is possible to find a solution that works for everyone, but we will be watching very carefully not just the direct, immediate, short-term outcome of this review but the longer-term direction of travel.

Sam Woods: That was very well put by Nat, and he has been engaging with colleagues at the ECB on that. The jury is still out a bit. "Large" is a relative term. I know you had Andrew Pilgrim here last week. EY has been trying to track the overall number. It has given you a number of 7,400. A chunk of that will be part of what Nat is talking about, so this has not been a non-event, and nor are we at the end of it. On the other hand, so far, it has been manageable.

Q62 **Lord Foulkes of Cumnock:** At a previous session, we got evidence that about 50% of the British financial sector is outwith London. Are you making any special arrangements now to improve your supervision of the sectors in Glasgow, Edinburgh, Manchester and so on?

Edwin Schooling Latter: The rules framework applies nationally, so the advantages of that should stem to all locations in the United Kingdom where there are financial centres. On the FCA side, as you may have heard, we have an office in Edinburgh. We are opening one in Leeds. We have representatives in Cardiff and Belfast as well, so we are very much of the intention to be a fully national regulator, not just a London one.

The Chair: Thank you all very much indeed. We are eight minutes over time, even with the vote, but you have been really helpful and very clear. I am sure I speak for the whole Committee in thanking you for that. I am afraid, Sam, you promised us a copy of the MoU between the two of you. That would be very helpful. If someone could send that on, we would be most appreciative of that. In the meantime, I declare the evidence session over.