HOUSE OF LORDS

Financial Services Regulation Committee

Corrected oral evidence: The FCA and PRA's secondary competitiveness and growth objective

Wednesday 9 October 2024

11.15 am

Watch the meeting

Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Baroness Donaghy; Lord Eatwell; Lord Hill of Oareford; Lord Hollick; Lord Kestenbaum; Lord Lilley; Baroness Noakes; Lord Sharkey; Lord Smith of Kelvin; Lord Vaux of Harrowden.

Evidence Session No. 6 Heard in Public Questions 87 - 106

Witness

I: Professor Kern Alexander, Chair for International Financial Law and Regulation, University of Zurich, and Director of Studies in Law and Finance, Queens' College, University of Cambridge.

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.

Examination of witness

Professor Kern Alexander.

Q87 **The Chair:** Professor Alexander, welcome to the second session today. We are very grateful to you for giving your time. Do you want to say anything by way of an opening statement?

Professor Kern Alexander: Thank you, Lord Chairman and distinguished members of the committee. I thank the staff for arranging for my visit today to speak with you on the topic of secondary objectives in financial regulation.

This is an important topic, one of the reasons being that across many countries internationally we have seen the adoption of secondary objectives in financial regulation, beginning 30 or so years ago, not just in Europe but in the US and Asia. It has been seen by policymakers as important in order to balance the application of regulation to pursue the primary objectives in financial regulations.

However, one of the problems with adopting secondary objectives is that they are not legally defined, so there is not really any generally accepted definition of what they are and what they should be expected to do, and, if we have them, what the measures are for determining whether we achieve them or not. This committee's inquiry is important, because you want to understand the nature of secondary objectives and whether in the UK, which has them in primary statute, the regulators are achieving them or doing the right things in order to do so.

So I commend this important initiative. As I said, central banks and regulators around the world have been adopting these secondary objectives to achieve a variety of different economic growth and development objectives, but there has been no real systematic way of analysing them.

Q88 **The Chair:** Looking at the UK financial services regulatory regime, what three things could be done to achieve additional growth and competitiveness? How does the approach taken by our regulators here differ from those that you are aware of in other jurisdictions? For example, we have heard a lot about how the Monetary Authority of Singapore has the completely different approach of proactively trying to create opportunities and business growth. We have not been able to take evidence about that yet, but we will. Speaking for myself, the committee finds it extremely difficult—you could see that in the last session—to get a dialogue about the practical things that could be done that would make a difference in approach.

Professor Kern Alexander: First, there needs to be a general definition of the objective, in primary or in secondary legislation. What do we mean by secondary objectives? We should not just say that we have a secondary objective to "have regard to competitiveness and growth". That is not enough. Legislators should look at that.

Once the objective is better defined, in the pursuit of that objective by the financial regulator there needs to be more enhanced co-ordination between the regulator and other government agencies for which the secondary objective might be the primary objective. In the case of employment and competition, different agencies of the UK Government would have a primary objective to promote economic growth and full employment. There needs to be more direct co-ordination between regulators and the other agencies that have a primary duty in their own remit to achieve that secondary objective.

Then, there needs to be more specificity regarding the metrics. I understand that the attempt to identify metrics and to measure them is at an early stage here in the UK. Just this summer, the PRA and the FCA produced reports highlighting what they feel are the relevant metrics that they have been using in order to achieve the secondary objectives. Nevertheless, these are rather general, and more analysis and study needs to be done to flesh out the details of those secondary objectives.

Q89 **The Chair:** Can you help me with specific examples of what might be done?

Professor Kern Alexander: For instance, one of the PRA's first metrics is policy coherence: is the regulation internally consistent and concurrently achievable? It does not give specific examples about how policy can be made coherent or how there can be enhanced pathways of co-ordination with other government agencies regarding how best to achieve those secondary objectives. It is more looking at what the regulator thinks they should do regarding the secondary objectives, but not citing more information or evidence from the relevant agency involved.

The Chair: Why do you think legislation would make any difference?

Professor Kern Alexander: Legislation would be important for providing a more general definition of what we mean, either in primary or in secondary legislation.

The Chair: What would it say?

Professor Kern Alexander: It would say that the regulator's duty is to pursue its primary objectives with a view to supporting secondary objectives without imposing unnecessary obstacles or cost on the pursuit of those secondary objectives—something general that essentially recognised the connection between primary and secondary objectives but made it clear that the regulator should still pursue its primary objectives. In doing so, it should have regard for the impact of the spillover effects of those primary objectives on the secondary objectives.

Q90 **Lord Sharkey:** It has been suggested that the UK's financial services sector would benefit from regulation that accepted a higher risk tolerance than is currently the case. The previous Government were rude about the current landscape as the savings graveyard. What outcomes would the regulators need to accept in order to promote competitiveness and growth, and who within the regulators should set and be accountable for a risk appetite? Do the Government need to play a larger role in defining the ideal or acceptable outcome of accepting a level of risk in financial services?

Professor Kern Alexander: The level of risk appetite in any market or country is the result of institutional and cultural factors. I live in Switzerland, where there is a high acceptance of risk. Retail investors have a third pillar, as they call it, for their pension investments, and it is buyer beware; they know they can lose everything if they invest in the market and it does not perform as expected. In some countries, like the US, that would not be acceptable. There would be much stronger consumer safeguards in place and even prohibitions on consumers, individuals, buying risky investments.

The regulator should not try to define the risk appetite. It is a better pursuit to try to understand the risk appetite for the British retail investor and design the regulations accordingly to give them more information on what those risks are.

Lord Sharkey: There is something I am not entirely clear about. The debate that was being suggested by the FCA, by Nikhil Rathi, was a mature debate regarding risk appetite in our economy. If risk appetite is a feature of certain characteristics of the market, what are we debating?

Professor Kern Alexander: It is more about reminding the public that there are risks in financial markets, and that when they invest in certain financial products they can lose money. I recall that when the FSA was first established in 1999-2000, consumer financial education was one of the objectives. It was meant to disseminate, to make investors, particularly consumers, aware of the risks in the market, but not to set the risk or try to balance it.

Q91 **Baroness Bowles of Berkhamsted:** To follow that up slightly, does this mean that you think there should have been a journey to educate on risk and reward, which took consumers into a greater understanding of risky areas and opened up more things to be available to them, but it has not happened?

Professor Kern Alexander: It has not happened. In some countries, Switzerland for example, in primary schools children are educated in how to open a bank account, and young teenagers are taught about riskiness in investments. This is now being done in some US states; some state legislatures have adopted legislation for financial literacy. This is something that the regulators should be concerned about generally because of the dissemination of relevant information to the market. However, there needs to be co-ordination with other departments of government on where financial education can be carried out more effectively.

Q92 **Lord Lilley:** Looking at secondary objectives, competitiveness and growth, we focused overwhelmingly on the competitiveness of the financial services sector, which is a major part of the economy. If being competitive makes that grow, then fine; that will contribute to the economy. But are there ways in which regulation can affect, adversely or positively, growth of the economy rather than growth of financial services? Maybe risk appetite is one. Are there other rules that undermine or would encourage investment in the UK, for example? Can you comment on that aspect?

Professor Kern Alexander: If we look at bank capital adequacy requirements, we see that banks making loans to small and medium-sized businesses were disadvantaged because of some of the strict application of the Basel III.1 rules. There is an issue of proportionality in the regulator using judgment. Judgment-like supervision was a very important objective of the Government that adopted the reforms and created the PRA and the FCA 14 years ago. Therefore, there needs to be a certain flexibility in the application of regulatory rules to ensure that economic growth is not undermined and does not unduly limit credit allocation in the economy.

We can see with banks that are systemic and present a bigger risk to society that the application of these capital rules would be stricter. However, we also see that for smaller-entry banks we should maybe relax some of these rules, since many of them do not present systemic issues to the financial system. We should have a certain type of flexibility for the supervisor to apply rules differently. Also, we should think about whom we are lending money to—small business versus large corporate enterprises, small start-up businesses. The EU, for example, has adopted a different capital regime for loans for small start-up businesses. That is a commendable practice. It gives the supervisor discretion in how it applies these regulatory rules.

Q93 **The Chair:** On that point, I should declare an interest as a former chairman of a small, quoted bank.

You are absolutely right about the risk rating rules putting them in a non-competitive position versus the big banks. In the housing market, for example, big banks are not interested in small builders, while smaller banks, because of the risk-rating regime, are disadvantaged. That arose because of jerrybuilding in Europe, Spain and elsewhere. Aside from there being higher risk-ratings, it is extremely difficult to get the regulators to give guidance on particular projects as to whether they fall within one category or another, so people goldplate the capital requirement. Also, the people involved in the regulators do not have the necessary experience or expertise to opine.

Are you saying that, as they do in the United States, we should just accept that Basel III.1 does not apply to small operators and, if they go phut, it is the shareholders who are the losers; the depositors are protected? Should we go that far?

Professor Kern Alexander: No, I do not think we should go that far. The capital requirements are just one component of prudential regulation more broadly. Looking at the recent crisis with SVB in the US and Credit Suisse, we see that those banks were holding compliant levels of regulatory capital. What they were not doing very well was managing the risk, and their business strategy was not optimal given the types of risk that they were exposed to. The regulator took its eyes off the bank's business strategy and its business model analysis was lost.

Prudential regulation involves that as well. Regulators should not be telling the banks what type of business model to run but asking questions of the bank management "Do you understand the risks that you are exposing your institution to? Have you thought about diversification of your exposure to different types of businesses?" That is what has probably not been adequately done for many of the start-up banks in this country. There is an objective to have more challenger banks enter the market, but on the governance and risk management strategy side, more could be done by the regulator.

Baroness Bowles of Berkhamsted: Is that practical? A start-up bank must find itself a niche, such as, like Silicon Valley, servicing a certain type of technology. If it just comes in as a general lender, it will not be able to find a niche. That is why, for so long, it was very difficult to get any kind of challenger banks until there was positive action to do so. Is that not a bit of a Catch-22; you need to find a niche but cannot because of the risk.

Professor Kern Alexander: You have to start somewhere. Once banks achieve a certain level of operation, they can think about diversifying their business model. Some banks when they are starting out have certain specific focuses. That is probably good as a start-up bank. The supervisor should be engaged with them, not really telling them what type of business to run but asking them questions about the institution's risk appetite and whether they have thought about the different types of exposures that they might have. Do they have a plan or strategy about how to diversify their business model in the future?

Q94 **Lord Hollick:** You noted that many other jurisdictions have introduced a secondary competition and growth objective. On the basis of your work and the other academic work that is being done, tell us what the different approaches and outcomes are? Are there any particular lessons that we can learn from other jurisdictions about measures they have taken that have resulted in a beneficial outcome? How much work has been done on this particular objective?

Professor Kern Alexander: There have been studies that analyse central bank mandates. A recent study shows that the central banks of 70 countries in the world have the primary objectives of price stability and financial stability, but their secondary objectives are to support economic growth, development and sustainability—climate finance objectives. These are mainly central banks in emerging markets or developing-country jurisdictions, but many of them are in the G20, such as Indonesia, Mexico and South Africa. In many countries in the world the central bank has been given more responsibility for regulation, even as a capital market supervisor; central banks play that role in many developing countries. The secondary objectives are actually more numerous in these emerging-market and developing countries.

However, there are also secondary objectives in some developed countries—the Bank of Japan has to have regard to the broader growth of the Japanese economy, for example—but the studies do not show what the measures or metrics are for achieving those secondary objectives. That is why I have been doing research in this area. The gap we have is that, in many countries where they have been using secondary objectives for 25 or 30 years, there is no policy conclusion about whether they work, how they are applied or how the secondary objectives are defined.

Lord Hollick: Are you saying that the jury is out for 25 or 30 years?

Professor Kern Alexander: It is more for political window dressing, so they can say, "We have a secondary objective to support sustainable finance".

Q95 **Lord Hollick:** You have heard today concern about capital adequacy. The other beef that most witnesses have shared with us is absolute frustration over the complexity and slowness of regulators in the UK. Is that a common problem that you have observed around the world?

Professor Kern Alexander: The UK is a more complex market. It is an international financial centre and a huge capital market, and a lot of foreign banks have offices here. That level of complexity and business presence requires a more comprehensive regulatory framework to ensure that safeguards are met and that these institutions provide support for the British economy. We should not be so concerned that we have a large regulatory presence in the UK—more than, say, other countries that have much smaller markets. With all the business comes responsibility.

Lord Hollick: Would it make sense to look again at whether there should be a different approach to regulation, and possibly a different regulator, for wholesale and retail markets?

Professor Kern Alexander: In retail markets, we should understand that having an official sector regulator is important, because we are coming on the heels of a major mis-selling crisis in this country, and most of western Europe had a similarly substantial mis-selling crisis. At the retail level at least there needs to be more appreciation of the need to have safeguards in place for retail customers.

In wholesale markets, we might think about where regulation could be applied more flexibly and which regulations are viewed as onerous or rigidly applied, and maybe about more flexible ways to apply them. That is where more work could be done or some reforms could happen.

Q96 **Lord Eatwell:** It seems to me that the growth and competitiveness objective runs into the barrier of systemic risk. As the previous witness was saying, following the great financial crisis Governments adopted a very risk-averse position—not surprisingly, because, as you will have noticed, most Governments who were in office at the time were elected out of office pretty quickly following the great financial crisis, and politicians become risk averse on that basis. Now that the risk aversion is fading away, many of the regulators, politicians and so on do not really have a memory of what happened 16 years ago.

The question then is that a lot of the growth and competitiveness story focuses on innovation. It was the innovation of trading on the margin that led to the great tulip mania, and it was the innovation of credit derivatives that led to the great financial crisis. Given that there is this process now, where is the balance between innovation and systemic risk? Where on the horizon is the innovation that will be the next destabiliser?

Professor Kern Alexander: That is a very good question. Innovation can of course be the source of economic benefits in the financial sector, but it can also be the source of circumvention of regulatory rules and the hiding of risk built-up in different parts of the financial markets. After the great financial crisis, the G20 countries, including this country, went through regulatory reforms in which the focus was shifted from microprudential supervision and regulation, looking at individual firms, to macroprudential supervision, looking at the whole financial system.

They tried to look at the so-called shadow banking market or other large institutions like BlackRock that are systemic institutions and which in the past were not subjected to strong prudential controls but that now, with macroprudential policies, are under observation by the ECB, the Bank of England and other central banks that are concerned about this.

However, we do not want to apply regulation too strictly to these companies either, because they provide jobs and are investing clients' assets, so finding the right balance for the application of these macroprudential policies is difficult. I do not think we have struck the right balance just yet, but one of the goals of having secondary objectives is to try to do that.

As you say, there is a concern that financial stability objectives have become too strong and a hindrance for economic development in some lending markets. We therefore need to pull the regulators' attention over to economic growth and competitiveness so that they do not lose sight of that. There is a respect for innovation that can be a source of economic growth, but we have to be concerned about the risk. That is why the macroprudential oversight role should be an important element in regulation.

Q97 **Baroness Bowles of Berkhamsted:** I want to go back a bit to value for money and mis-selling. Will value for money add more complexity if it enables the opening up of access to securities that are more risky? On the question of risk and reward, they just get a tick saying there is value for money. Was a driver for mis-selling just the fact that there was no scope for the right kind of products, so they were sold by pretending to be less risky than they were? Are these things linked?

Professor Kern Alexander: The regulatory investigations show that many of the banks were not engaged in processes to inform their retail customers of the risks they were exposed to. You would simply go into your bank branch and sign up for the loan. There was a document with a lot of fine print that the retail customer would normally not read, and the bank branch officer would make no real effort to inform the customer about those risks. That is the complaint that was made. In fact, I do not think that mis-selling really violated any specific regulatory rules; it was just a high-handed sales process that was not properly scrutinised.

One could say that all the fines that were applied for mis-selling were disproportionate. Claimants certainly deserved compensation, but the extent of the compensation was so substantial that it could have affected the position of some banks; they were paying out so much for these claims. The regulator could maybe think about how to balance that in the future.

Baroness Bowles of Berkhamsted: So that was very anti-competitive because the fines were so great, in that sense, or introducing instability.

Professor Kern Alexander: Yes. In several countries in Europe, some banks came under financial pressure because they had to pay out so much that their capital levels were beneath the minimum required. There was a need for a relaxation of minimum capital requirements so that they could pay out the substantial amount of fines. It became a prudential issue of concern, not just a consumer issue.

Baroness Bowles of Berkhamsted: Going back to value for money, will that introduce extra layers of tests and regulation before you can deal with the more risky products?

Professor Kern Alexander: It is not the regulator's role to inform about the value of an investment. It is more about what the risk could be and what the downside risk is. Of course, the bank or investment firm selling the product can discuss the potential in investments, so long as it is viewed as a potential, not a certainty. Value of money is therefore the more optimistic side of the business transaction. The regulator should not be involved in trying to calibrate that; it should be concerned with the downside risks. For example, does the customer know that they could lose all their principal or just the interest that they may have been earning on the investment?

Q98 **Lord Lilley:** Going back to the impact on growth in the economy, I was struck by what you said about banking rules having affected the amount of lending to businesses. It is true to say, I think, that our banks are disproportionately involved in lending on domestic mortgages. That is the bulk of their lending; it is what they do. Apparently—I know very little about this—continental banks invest in or lend to business far more.

The other distinctive feature of our financial system is that a very low proportion of our equity investment is in the UK. The vast bulk of it is overseas. Do either of those phenomena owe anything to the financial regulations and the way they are applied in this country, relative to overseas?

Professor Kern Alexander: Regulation contributes something to these developments, but it is really about the structure of the financial market. In the culture of the UK market, there is a big emphasis on home ownership, for instance, which you do not have in continental Europe.

Lord Lilley: Many countries have a higher level of home ownership.

Professor Kern Alexander: Yes. Well, Ireland does, but it had a banking crisis just like the UK did. So you have this desire to own a home, and banks are providing that service. It is big business in the UK, because a large portion of the population aspires to home ownership. That is okay—it is not a bad thing to happen—but it creates risk for the banks, because they can be overly exposed to their mortgage loan lending, like Northern Rock was.

Therefore, one of the roles of the regulator should be to advise banks on their business models. For example, are they overly exposed to certain types of businesses? In the UK, you will find that many banks have this large exposure in the mortgage market, which is a source of profit and business. That creates enormous consumer satisfaction for many people who want to buy houses, but it must be qualified with the fact that it does have risk. We have to think about whether we should have loan-to-income ratios or loan-to-value ratios in these various rules, which have been debated back and forth. The regulator has rowed back a bit on some of these restrictions, allowing the banks to lend more because it views the market as more resilient, safer and more stable now.

Regarding equity markets, what we are seeing is not so much a matter of regulation. Why is the City of London losing listings? It is more the fact that the capital markets in other jurisdictions are viewed as deeper and easier to raise capital in that the cost of capital is lower and on better economic and financial terms. Regulation plays something of a role in this, with the listings regime, the prospectus requirement and things like that, but we have seen a loosening of the listing regime in this country with the recent reforms.

I do not think that will change the game, though. The equity markets will still struggle to compete with other equity markets internationally, but more because of institutional factors and the fact that there is a lot more capital in the US. There are also the emerging markets in Asia, in China. It is not just Hong Kong and Singapore; it is Chinese money from China going into Hong Kong and Singapore that is driving up equity prices in those jurisdictions.

The Chair: On Lord Lilley’s point, it is less expensive for capital purposes to lend to someone to buy a house by multiple factor than it is to lend to someone who wants to build a house. Is that not true? Therefore, on his point about the availability of lending for businesses to grow, if you are running a bank and your capital is restricted, mortgages are a more attractive area than providing loans to small and growing businesses, are they not?

Professor Kern Alexander: Yes, I would say so. There is also a path dependency in the business model. UK banks have specialised in mortgage lending and are experts in promoting these products with their clients or customers. Small business lending has always been somewhat secondary for the traditional banks, which is why we need more entry and competition. It is not really the regulator's role, but some critics of the UK banking system would say that the retail banking system is more of an oligopoly—that is, four or five large banks control 80% of the retail banking market—and that we should think about having more entry into this market, with more competition from small and medium-sized banks. That is why I think that the regulations could be relaxed and not applied as strictly to these new challenger banks.

The Chair: Would you agree that the consumer duty is perhaps driving in a different direction?

Professor Kern Alexander: As far as making more mortgage loans available is concerned?

The Chair: No, as far as making for more competition in the retail market for lending to consumers is concerned.

Professor Kern Alexander: Yes. The ability of challenger banks to enter the market creates competitive pressures. Consumers are able to access financial services not just in the traditional format—having a bank branch office to go to—but through many other online banks and digital finance opportunities for customers.

Q99 **Baroness Noakes:** Can I come back to metrics? Earlier, you painted the picture of a lot of jurisdictions having these additional secondary objectives, but you said that a lot of them were not measuring, so the jury is out on whether they have been successful policies. That is the general picture. Are there any good examples of territories that have accompanied secondary objectives with clear measurement surrounding them?

Professor Kern Alexander: Not that I know of. I have looked at 70 jurisdictions, and they do not have metrics. I have looked at the legislation and the regulatory rules that were written—to have regard to economic development and things like that—but they do not have supervisory reports about whether they are meeting the secondary objectives. There are many reports about the primary objectives and a discussion about whether achieving primary objectives can hinder the broader economy, but not about the specific secondary objectives.

Baroness Noakes: So we are breaking new ground.

Professor Kern Alexander: Exactly. This is a very worthwhile initiative that the regulators are doing. Your scrutiny of what is happening is very important. It is needed, because we do not have a lot of data on how we define secondary objectives, how we should pursue them and how we measure the spillover effects—positive as well as negative.

The Chair: The committee would be very grateful if you felt able to give us some subsequent written evidence on how we might approach that.

Professor Kern Alexander: Okay.

Q100 **Lord Hill of Oareford:** That would be helpful. Also, do you have any thoughts on how long one needs to look at some metrics before changing the metrics? I am sure that they will need to evolve, but I do not know whether you have any thoughts on how long one needs to look at them before one concludes that they need to be changed. Do you have any thoughts on that?

This is the question I wanted to ask. Earlier, you made the point that, so far as we can judge, the secondary objective has had a limited effect in changing behaviour. Do you have any thoughts on whether the broadened remits of the regulators over the past 10 or 15 years, where more and more has been added to their remits, has contributed to the problem of the focus on thinking about competitiveness and growth?

Professor Kern Alexander: Certainly, in terms of the increase in primary objectives. Some countries in Europe had only a price stability objective for a while. Then, after the financial crisis, they added the financial stability objective. Under the Bank of England Act 1998, for instance, the Bank of England did just price stability, but after the Financial Services Act 2012 that was expanded to include financial stability. So adding these primary objectives, as many countries have done, has spillover effects, both positive and negative, on the economy, affecting competitiveness as well as growth. That is certain.

However, what we do not have in any jurisdiction I am aware of is an effort by the regulators to co-ordinate with other government agencies for which the secondary objective is their primary objective. If there was more co-ordination and more exchanging of data and information, we could understand a bit more about some of the negative spillovers from the pursuit of the primary objectives by the financial supervisor, but we just do not have that information yet. I hope that these metrics will evolve and provide a framework so that there is more inter-agency co-ordination between the various UK government departments that are responsible for economic policy, the PRA and the FCA.

Q101 **Lord Vaux of Harrowden:** I have a couple of questions about metrics, I suppose. One of the metrics that we constantly get told is a problem is the speed of authorisations—that is, how operationally efficient the regulators are. Is there anything that shows us that? Our previous witness said that there are tables showing how long it takes to get approved in different jurisdictions, I think. Do you have anything on that sort of metric? Is that something you could provide to us? Do you have any views on how we perform at the moment as compared to other jurisdictions such as Singapore, which you mentioned?

Secondly, a few weeks back, we heard some fairly compelling evidence from Marsh McLennan about the costs of dealing with regulation in different jurisdictions; there are some fairly alarming differentials between America and here, for example. Again, are there any studies that show the different costs of doing business in regulated activities in this country versus in other countries?

Professor Kern Alexander: Regarding authorisations, from what I understand from talking to practitioners, approvals of individual appointments take longer in this country in comparison to, say, in Ireland, but I recently learned something at a seminar I went to two nights ago with a group of practitioners from medium-sized banks, who said that they can do approvals for many of their staff without getting the regulator's external approval. The regulator gives them the guidelines and the procedure, and they can grant approval. They cannot grant approval for senior management and the members of the board, so they have a slowdown on board appointments, but they can do mid-level appointments fairly quickly. They have many more employees working at the mid and upper levels.

I would like to explore that more to see whether there is any empirical evidence about the extent to which banks appoint and what types of positions they approve. They report to the regulator on whom they have approved, of course, but, after hearing that, things do not seem as dire in the UK as some people have complained, because they seem to have more flexibility in their own internal approvals.

Authorisations for foreign firms are a problem, because many foreign banks want to do business here, but obtaining authorisation sometimes takes longer if you are not an institution with local experience. Leaving the EU has also presented big obstacles, because EU-based banks that would have easily passported themselves in now cannot do that; they have to get authorisation for a subsidiary in many cases. Authorisations and approvals are important and should be looked at more closely.

Lord Vaux of Harrowden: So there are no metrics that you are aware of showing that.

Professor Kern Alexander: No.

Q102 **Lord Vaux of Harrowden:** On the costs of dealing with regulation, as I say, the Marsh McLennan evidence was pretty solid. Has any study looked at the size of compliance departments, or whatever it might be?

Professor Kern Alexander: Various studies estimate the costs of regulation, but they tend to be consulting reports. They do not have what I would call a scientific basis; they are more about surveying the institutions in question, and it is a more subjective assessment of costs.

Lord Vaux of Harrowden: Anything that you could provide for us in that respect would be helpful.

Q103 **Baroness Donaghy:** The FCA has to look at the overview, but it also deals with what are detailed as consumer issues. Is there a danger that it has been used as a political dustbin, going back to Lord Hill's question? Do you think there is an argument for devolving those consumer inquiries to a different body in order to give the regulator a much clearer role in overseeing the financial services industry?

Professor Kern Alexander: That is a good question. We have to think about what the objectives of the FCA are. They include consumer protection, which is a broad remit. It is not simply about investor protection. If we do that, there is an argument to be made that the FCA is overwhelmed with all these various responsibilities; we have heard about funeral services and financial provision in the past hour. If we are not happy with that—if we think that the FCA does not have a proper focus, for example—we need to go back and change the primary or secondary legislation to define the parameters within which the FCA operates. For now, as you say, we have created a sort of dustbin. It picks up everything else that the PRA's prudential supervisors are not picking up. Of course, you could exclude certain areas of the financial markets, but then there would be a scandal or mis-selling.

Another thing that we should consider and not lose sight of is the fact that the US does this with the SEC. A lot of securities regulation in the US is done by FINRA, a self-regulatory organisation that is authorised by the SEC and does most of the investor consumer complaint investigations. It has regional bodies and arbitration panels, all of which are set up by the industry. There is a partnership between the official regulator and the self-regulatory body.

That should be explored more here. As we all know, there is great experience in the UK, with the SROs from the 1980s and 1990s. Self-regulatory organisations sometimes have a great role to play. The participants have insights into the market. If I were to redefine the remits, I might propose the creation of some type of self-regulatory body for different financial industry sectors. We might not necessarily go back to the 1980s with eight or nine SROs, but we could still think about how we might blend that idea with the dual regulatory framework that we have.

Q104 **The Chair:** On that point, my understanding of the role of the ombudsman and the FCA is that the ombudsman can make a judgment and is then binding on all the participants, which can be in conflict with the guidance and the rules provided by the FCA. You can see that playing out at the moment on the issue of motor commissions. So the ombudsman appears to be operating as a quasi-regulator, which creates a degree of uncertainty. That has had pretty drastic consequences for a number of firms because of the uncertainty that has been being created. Do you see that as a problem? How can it be resolved while at the same time maintaining a proper level of consumer protection?

Professor Kern Alexander: The ombudsman's role is important. We need a place where consumers can file complaints, and the procedures and the administration of it need to be user friendly so that consumers do not have to pay huge legal fees in order to go before the ombudsman. The scope of the ombudsman's binding decision-making authority should be looked at, as you correctly point out.

The Chair: When you say, "looked at", what do you mean?

Professor Kern Alexander: Maybe there should be a consultation. There should be some binding authority for the ombudsman to make decisions where there has clearly been an infringement of consumer rights and the consumer has to complain before the ombudsman to bring a case. There is an example that I would not want to copy. Switzerland has an ombudsman framework that the banks pay for. The ombudsman does not have any legally binding authority—it is just like mediation—and 95% of the time the ombudsman in Switzerland rules in favour of the banks. That is not something I would want to have. Maybe the pendulum has swung a bit more in one direction in the UK.

The Chair: I get it if that is about a particular case, but the fact that it then applies across the board means that it is operating as a quasi-regulator.

Professor Kern Alexander: The ombudsman has been given legal authority to do that, so if that is viewed to be suboptimal, maybe we should change the legal authority. As I understand the procedures here, one can appeal an ombudsman decision, but the scope of judicial review is very narrow.

We should look at the extent to which our ombudsmen exercising their authority is to be viewed as a type of abuse of authority, and whether that is too strong, but I would not want to take too much power away from them, because they provide a vital platform for consumers to bring complaints. Regulators seldom help the common individual person. If you call the FCA, you will not get much help.

Q105 **Lord Smith of Kelvin:** If you have the time and are willing to do so, I would like to hear what we should be doing about financial literacy. That was touched on earlier with regard to Swiss schools telling teenagers how to open bank accounts and so on. There are millions of people who could save and invest but are not doing so, and a lot of that is due to them not understanding. If you have any thoughts, please send them in.

Professor Kern Alexander: The regulator could play a role by having an accessible website that consumers could access in order to understand basic investment products and the financial markets. A lot of it should start in secondary school, because it is not just in Switzerland—where, culturally, they like to save money—where you might have a lot of savers. In many US states now, the state legislatures have enacted financial literacy statutes requiring that high schools in the US have a mandatory requirement for a financial education course: the basics of opening a checking account, investing in the market, the basics of risk-adjusted returns and things like that. That is not a panacea, of course, but it allows us to use different parts of the Government to reach out to the public to help to build more financial capacity. Just relying on the regulator to do that is probably not the most optimal way of doing it.

Q106 **Lord Sharkey:** You told us that there are no examples of meaningful assessments of performance of secondary objectives in financial services regulation, but secondary objectives are common outside of financial services. Do you know any examples of meaningful assessment of performance in other sectors?

Professor Kern Alexander: Not of secondary objectives in sectors other than the financial sector. I know of primary but not secondary objectives.

The Chair: On that note, we thank you for this very interesting session.