



Financial Services Regulation Committee

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

Wednesday 30 October 2024

10.10 am

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

Evidence Session No. 12

Heard in Public

Questions 177 - 189

Witness

[I:](#) Sir Howard Davies, Former Chair, NatWest Group, and Former Chair, Financial Services Authority (FSA).

USE OF THE TRANSCRIPT

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

Examination of witness

Sir Howard Davies.

Q177 **The Chair:** Welcome to today's meeting, which is the eighth oral evidence session as part of the committee's inquiry into the FCA and PRA's secondary competitiveness and growth objective. Thank you to Sir Howard Davies for attending.

A list of Members' interests relevant to the inquiry is available online. The session is open to the public, broadcast live and subsequently accessible via the parliamentary website. A verbatim transcript will be taken of the evidence and will be put on the parliamentary website. A few days after this session, you will be sent a copy of the transcript to check for accuracy. It would be helpful if you could advise us of any corrections as quickly as possible. If, after this evidence session, you wish to amplify any points made during your evidence or have any additional points to make, you are welcome to submit supplementary written evidence to us.

Sir Howard, do you wish to make an opening statement?

Sir Howard Davies: I will just say briefly where I am coming from and what I am doing now that is relevant to this consideration.

First of all, I left NatWest in April and now I am chair of a company called Inigo, which is a private-equity-owned insurance company based at Lloyd's. It is a rather rapidly growing company which is regulated by Lloyd's and the PRA, though barely by the FCA because we have almost no UK clients. I advise a large hedge fund in New York, which also has a large operation in London. It has a regulatory advisory board, including the former chair of the SEC and that sort of thing. That is called Millennium.

I chair the international advisory council of the Chinese securities regulator and I am a member of the international advisory council of their prudential regulator. They have a split that has some similarity to ours here. Those are honorary positions that I have been doing for the last 20 years.

I teach a course on global financial regulation at the French political school, Sciences Po, which I have done for more than 10 years. That is based on my book on global financial regulation, published in 2009, which I am engaged in revising for next year. I am reviewing the changes in the regulatory system in the last 15 years.

As I said, I cannot speak for NatWest. I am always reminded of what my mother used to say: "W-O-N-T spells 'can't'". Maybe that is the case today, but I can speak from my experience, which is eight years as a regulator and 40 years—not consecutively but in parallel—on the boards of regulated firms here and in New York. It is from that longer perspective that I am speaking today rather than specifically on behalf of NatWest.

The Chair: Thank you very much. Listening to that CV, we are jolly lucky

to have you. We really appreciate you making the time to be with us. Our questions will be focused on the long experience you have had both as a regulator and a regulatee, if there is such a word.

I would like to open by asking you about what Nikhil Rathi said in his speech on 17 October, in which he called for a mature debate about risk and discussed how, in order to achieve growth, there will have to be trade-offs, which the Government and the industry need to accept. Do you agree with this characterisation? If so, should the Government or the regulators be leading the conversation in making these trade-offs and setting the risk appetite?

Sir Howard Davies: Yes. I broadly think he is right to say that the existence of this new duty, or parallel duties, does require them to make some trade-offs. The question, though, is predicated on the assumption that you have this growth and competitiveness objective. It is probably helpful at the start, though it may not be exactly helpful for your inquiry, to say that I do not agree with it, really. It is not a good idea to have this. You risk the cross-eyed controller phenomenon, whereby the regulators have too many things to aim at and therefore end up aiming at none of them in particular. Furthermore, it gives the impression that regulation can do more for competitiveness and growth than I believe it can do.

The third point is perhaps the least welcome I will make. It in fact ignores the observation that most of the things I would regard as difficult from a regulatory point of view—in other words, difficult for firms—over the last 10 years or so have come from Parliament rather than from the regulators. The cynic in me says, “Well, there’s a fine thing. Parliament has legislated a lot of very inconvenient things from the financial sector’s point of view and now it says, ‘Good gracious me, what a terrible mess. The regulators must sort it out by paying more attention to growth and competitiveness’”. I can go into some detail, if you would like, about the things that are inconvenient.

The Chair: Yes, please do.

Sir Howard Davies: On the second part of your question, about whether it is Ministers or the regulators, the answer to that is an empirical one. There are certain things where the regulators clearly have to make judgments. Obviously, since Brexit they have made judgments on capital requirements and how to implement Basel; that is in the gift of the PRA. I know there is a technical complexity about the fact the Government have to switch off the old regime before they can switch on the new one, but after that has happened the PRA is the lead on that. Clearly, it is for the PRA, in the light of bank capital, to make that trade-off.

In other areas, such as the consumer duty, which comes out of a piece of legislation, if that needed to be softened in some way, Parliament would have to do something about it. Another example would be ring-fencing, which is in primary legislation. The regulators cannot, on their own, remove the tiresome aspects of ring-fencing. It is a question that is

capable of a rather detailed answer. You have to look place by place and say, "Is that in the regulator's gift or is it in Parliament's?" The answer varies depending on what you are looking at.

The Chair: You should not necessarily think the committee might be disappointed if it was to conclude that it was not a good thing to have this duty on the regulator. We are completely open-minded. The question is how best to achieve growth and competitiveness. Whether the duty is the right answer or not is a separate point.

May I just ask you about one thing? It may very well be that the politicians are to blame, but we have got ourselves into a situation where people with comparatively large sums of money—say, less than a couple of hundred thousand pounds—are unable to get advice because the market has pulled back due to the costs and burdens of providing that. One could point to other examples. Is there a sense in which the regulatory requirements are to the disadvantage of the most vulnerable customers?

Sir Howard Davies: Yes, I believe that is true. If I run back a little way on that, when I was running the FSA, we twice reviewed the advice market. There was a lot of pressure on the regulator at the time, in Parliament but also from outside, to say that the practice of paying commission to financial advisers was a bad thing that biased them in certain ways. There was some truth in that, but the question was, "Should one outlaw advice and tighten up the regime in a significant way?"

When I was at the FSA, we twice reviewed this and concluded that we should not do that, because we felt that, if you did, you would reduce the availability of advice significantly and make it so difficult for firms to give advice that they would, essentially, withdraw from the business.

Later, in 2013—I left in 2003—the retail distribution review reached a different conclusion. The conclusion of the RDR at that time was effectively to outlaw commission and really tighten up on fact-finding, due diligence and everything. That caused a number of firms—NatWest would certainly be one—to reduce very significantly the advice they were prepared to give customers. The compliance burden of doing so was so difficult that effectively, you could not meet it except at quite high cost, and you could not recover that cost unless the client had quite a decent amount of money to invest.

It had the consequence that was expected. It was interesting that subsequently, the Singaporeans, who follow very closely what the UK does—I mean "follow" in the sense of "monitor"; they do not necessarily do exactly the same—carried out their own review on the basis that the FSA had decided to outlaw commission, et cetera. They concluded, once again, that they should not because they thought the availability of advice would be reduced and the net consumer benefit of that would be negative. That remains my view.

Q178 Lord Sharkey: Good morning. It would be a good thing to be able to assess the progress the regulators make in delivering their secondary objectives for growth and competitiveness. We have been told that many countries' regulators have similar growth and competitiveness secondary objectives, but there are currently no meaningful methods anywhere for measuring progress against the objectives. Will the metrics proposed by the FSA and the PRA deliver any real assessment of progress, or should, or could, they be improved or added to?

Sir Howard Davies: I am not sure that many international regulators—this is something I am looking into—have a growth and competitiveness objective, albeit a secondary one, in the way that ours have. Indeed, I was in Basel doing research for my book a couple of weeks ago and I came across quite a bit of nervousness among the international regulatory secretariats of the committees—the Financial Stability Board, the Basel Committee, et cetera—about the implications of this. They were very nervous that this might cause the UK to want to diverge significantly from international agreements in pursuit of this. Our objectives are rather different from other people's. Where the others have such a thing, it is mainly a kind of "have regard to" notion, which is what we used to have under the FSA.

Some elements of it are measurable. Indeed, the way we used to think about it 20 years ago, when the FSA was set up, was to say, "Here is our objective on stability and here is our objective on consumer protection. This is what we think we need to do in order to meet those two objectives, but, in doing so, have we produced something that is super-equivalent to international standards?" That is usually a question capable of an answer. There have on occasion been cases where the regulators here have said, "Yes, it is tougher than what other people are doing, but it is right". Sometimes, international agreements are lowest common denominators.

I would personally regard that element as the most important thing. As I said in answer to the Chairman's question, I am somewhat sceptical about the ability of the regulators to promote growth and the competitiveness of the sector. What they can do is ensure that their regulation is not anti-competitive, in the sense of imposing burdens on UK companies, or companies in the UK, that are more difficult to meet than the ones they would find elsewhere, and that would shift business out of London.

That is a perfectly reasonable consideration for the regulators to have, and it is measurable. You can look at the way in which people are implementing Basel 3.1 and say, "Is it tougher here than it is in Europe or in the US?" That is a question capable of an answer. The answer, by the way, is that it is tougher here than in the EU, and it might or might not be tougher in the US because the US is in a bit of a mess as to what they are going to do.

That, which I would regard as the most important thing, is very measurable. Some of the other stuff is much fluffier. Whether you can

take outcomes in terms of the amount of activity taking place in London or moving from London and ascribe that to particular regulatory measures is a tougher ask.

Lord Sharkey: What are the main inhibitors to growth and competitiveness under the current regulatory regime?

Sir Howard Davies: Of the ones that have affected the businesses I have been involved in, the first that comes to mind is ring-fencing. That was introduced through primary legislation in 2010 and enforced an artificial split within the UK banks. It particularly affected NatWest and Barclays, and Lloyds to some extent, and required you to have a separate entity for your UK commercial and retail operations. That was extremely costly to implement. It adds nothing to financial stability and makes UK banks less competitive.

I can speak about NatWest here, because this is in the public domain. NatWest had to split itself in two twice. The combination of ring-fencing and Brexit was a nightmare: you had to have a separate bank here for your corporate lending and a separate bank for any investment banking activity, and then you had to have separate subsidiaries in Europe for those two different entities.

Imagine trying to explain this to a corporate customer in continental Europe. The bank had some quite good corporate customers with whom it did good business, particularly ones who had big operations here, such as EDF. EDF is a massive investor in the UK. We can all argue about the cost of some of those investments; none the less, it is a massive investor. NatWest naturally wants a relationship with it and to lend to it, et cetera. I have been to Paris to try to explain ring-fencing to them, in French. After about 10 minutes, they pour me another drink and say, "Never mind".

The Europeans looked at ring-fencing. They had a review by somebody called Liikanen, the former governor of the Bank of Finland. They concluded, "Do you know what? No, we are not going to do that". We are the only ones in step in the world on ring-fencing. That is clear, and that requires primary legislation. There is no way that the Bank of England can massage that away in its rulebook.

A second one is the consumer duty, which creates extreme nervousness among overseas investors because they do not know quite what it means. Again, this came out of Parliament. If you press the FCA on it, it says, "We're just doing what Parliament told us to do; that's all we're doing". It requires a view of consumer outcomes. It all seems, in a way, quite sensible when you discuss it with the FCA, but then you have the ombudsman, and the record shows that the ombudsman produces judgments that sometimes go well beyond what the FCA recommended.

There is a combination of uncertainty about the meaning of outcomes on consumer duty, the role of the ombudsman and now the Court of Appeal, which, on motor finance, for example, has taken a different interpretation

that has caused a lot of anxiety and significant share price moves. That whole uncertainty about the consumer regime puts people off quite considerably.

Those are probably the two biggest examples. There are some others in the fraud and anti-money laundering area, which we might get into, if you want.

Q179 **The Chair:** Just on that last point about the court judgment, some people, such as Close Brothers and MotoNovo, have said they are going to stop all lending, which clearly would have a huge impact on retailers up and down the country. In your experience, how is this best resolved? What does the regulator need to do?

Sir Howard Davies: Because this has happened since I left this particular business in the last few months, I am not completely sure I know the right answer to that. I am disappointed that there has not been sufficient regulatory clarity on the rulebook, which has meant that the court has been able to step in with its own interpretation.

My general experience in this area—we had these kinds of things when I was a regulator—is that, if a regulator is very clear about the expectations on firms, the courts are usually reluctant to substitute their judgment for that of the regulators within a statutory context. If the regulator has said, “This is what we think the rules mean”, the courts normally back off. The fact that they have taken this case and interpreted it in a particular way suggests to me that there is not enough clarity in the FCA’s rulebook. As I say, that is a general observation. I cannot say I have looked at the detail.

The Chair: Nature abhors a vacuum.

Q180 **Baroness Bowles of Berkhamsted:** I have a little follow-on from that. Does the presence of the consumer duty provide an incentive for the rules to be a bit less clear? The obligation is then pushed on to the firms to decide where the line is and as a consequence, there is more potential for litigation.

Sir Howard Davies: Yes, that is probably true. The whole shift to an outcome-based assessment, where the outcomes may be different for different types of customer, creates the opening for a lot of different interpretations. I am probably saying the same thing you are.

Q181 **Lord Hollick:** Good morning. You said in your opening remarks, and we have just discussed some examples, that the Government have been unhelpful in their legislation and guidance. If we take the issue of risk—we will come to a specific example of how it could help the UK—is the discussion about risk in banking being properly and effectively conducted? The Treasury would say, “It is an independent regulator”. The regulator would say, “We get guidance, nudges and winks from the Treasury as to what we should do”.

Taking a specific example, there is an unmet need of funding to the SME community. Many SMEs now receive their finance, their credit, outside

the banking and regulated area. That has been a trend over the last decade. We see it particularly in the housing market. The Government have big ambitions to see a lot of housebuilding, but the small and medium-sized companies find it very difficult, if not impossible, to get money.

Now, this is in part to do with risk-weighting. It is presumably through choice because it is more complicated to do lots of small lending. How do the apportionment of risk and the discussions between the Treasury and the regulator help to increase the supply of credit to the SME market, which would be an important motor for growth?

Sir Howard Davies: First, as I understand it, bank lending to the SME sector is growing again. The last few years has been a slightly unusual period because you had a massive increase in lending, government-backed in various ways, during the Covid time and then a pullback as people had to try to recover those loans. It is now going back up again. You have to look at a fairly long-term trend here.

On the specifics of your point, the amount of lending and the terms on which that lending is made is undoubtedly affected by the way the Bank of England interprets the Basel agreements. If you look at the last year or two, in the European Union the pen is held by the European Commission and not by the ECB because Basel agreements go down through directives in the EU, for reasons that we know. In a single financial market, you have to have very common rules because banks have the ability to undertake business cross-border without any restrictions domestically.

In the EU, the Commission has introduced an SME-supporting factor, as it is called. That is positive from a small firms lending point of view. It does mean the EU will be regarded as materially non-compliant with the Basel agreements, which may have some international disadvantages for its banks. It is a slightly unusual position for it to get itself into.

The PRA decided not to introduce an SME-supporting factor in its initial proposals for the rules. The banks pushed back on that, arguing that this was in effect introducing higher risk weights for small firms lending and that the incidence of loss in relation to that lending was not sufficiently large to justify that additional capital.

The PRA had a rethink and came out with a new proposal, which, without wanting to get too complicated here, has a pillar 2 adjustment to compensate. It has kept the purity of its pillar 1 regime with no SME-supporting factor, but it has allowed for an adjustment in pillar 2A, which it believes will produce something rather similar to what Europe has. Without getting into too much detail about that case, it shows the way in which the regime operates. There is a consultation; people push back; people argue about it; and then eventually a compromise is reached.

It is interesting, however, to observe that in the future there will not be a specific role for the Treasury in this. It can respond to consultation, which the PRA does because that is delegated to it. The Treasury no doubt has

the phone number of the PRA and can call it if it wishes, but it does not have any formal override on the PRA's proposals—or will not in the future.

If you compare us with the EU now, you have politicians and regulators. In the EU, the politicians hold the pen. The ECB does not like this. If you ask them, they do not like these SME-supporting factors or infrastructure-supporting factors because they would rather be implementing the pure milk of Basel doctrine. In the UK, the PRA has the pen because that has been delegated to it. It will be an asymmetrical relationship between us and Europe.

Lord Hollick: In this regard, the Chancellor has no way of influencing competition and growth through the readjustment of risk appetite.

Sir Howard Davies: She has an influence. She can no doubt appoint and dis-appoint people at the Bank in order to make her views clear—and I imagine that the Bank will listen—but the formal position is that it is its responsibility.

Q182 **Baroness Bowles of Berkhamsted:** From time to time—it has gone on for a long time—there are concerns about it being difficult for regulators to get high-level staff because there is a bit of one-way travel, in that you get your experience in the regulator and then you go off into the industry on a much higher salary. There is not too much going back the other way, bringing the practical experiences into the regulator.

Is there a role for secondment to the regulator and that kind of thing, as they do in the US with industry secondments to the SEC? Would you have liked that when you were there?

Sir Howard Davies: This is a bit of a recurring issue. It was presented exactly in this form when I was there. Secondments do not work terribly well. They do not work at all well in the SEC. When I was a regulator, I went to the SEC in New York and was told that the annual staff turnover in the New York office of the SEC was 70% because they just had people coming in and out endlessly.

If you look internationally, we are in a middling position. In the US, regulators are paid abysmally. Of course, that is true of lots of aspects of the US public sector. It is very badly paid. All the senior regulators in the US are people who have spent most of their career in the industry. They come in for a few years and they go out, but they are not on secondment, mainly, because secondment is complicated—they cannot do anything to do with a firm they have had anything to do with.

The firms that are not seconding people do not like it either. They say, "The guy is coming in from Goldman so he cannot deal with Goldman, but he can deal with Morgan Stanley. We do not want a Goldman person dealing with Morgan Stanley". When I was on the board of Morgan Stanley, we were very serious about that. We would not have anybody in the Fed or the SEC who was on secondment from another firm doing us.

You say, "Just a minute. They are going to be screwing us to the advantage of their firm".

It is very complicated to manage. Secondments do not work at all. If you have very low pay for regulators, inevitably, you have a revolving door. In the US, people complain bitterly about the revolving door. I do not like that structure and it is not the way our public sector works.

At the other extreme, you have Singapore and Hong Kong. Hong Kong may be slightly changing, but in Singapore they take the view that their regulators and public servants should be paid competitive rates compared to the private sector. They have a panel that says, "If you are in charge of the Monetary Authority of Singapore, you get paid the average of the pay of a senior partner in an accounting firm, a senior lawyer in a legal firm or the managing director of part of a bank, et cetera". They have several comparators. They do not include bonuses, but they take an average figure and they say, "That is what you get paid", and everybody is below that. That produces a very competitive and excellent public service, particularly in the regulatory area.

We are a bit betwixt and between here. We are better paid than the US and better paid than most of Europe. The view taken 20-odd years ago when the FSA was set up was that, since the FSA was funded by the industry, it should have freedom to set its own pay without public sector pay constraints, and therefore it was constructed as a company to keep it out of public sector pay constraints.

My understanding is that over the intervening period, this has rather changed. The Bank of England has been subject to certain pay constraints in the public sector as well. A recent report by New Financial, which I am sure you have seen, says that real pay in the regulators has fallen by 25% in the last decade. That is unfortunate. The best answer here, given our culture, is to make sure regulators are paid respectably.

Secondment is never going to work, for the reasons I have set out. You will get people coming in and out, but they cannot come in and out on the basis of having a return ticket. They have to say, "I am going to spend part of my career in the regulator, which I will monetise subsequently", and you let people do that. That is completely understandable. Your CV is attractive if you have had five years at the PRA and then you get bought out by NatWest. That is okay, but secondment I would not go for.

Q183 Lord Lilley: I take your point about the whole existence of a secondary objective being questionable, which leaves the question, "What is the primary objective as far as the FCA is concerned?" What should it be, first in respect of wholesale markets, and secondly in respect of retail markets?

In terms of dealing with risks that people face—I am talking about the FCA, not the PRA—is there not a big difference between people taking a risk with their money and investing in some new widget, which may be a

failure, and people having their money stolen by fraudulent operators? Which sorts of risks should their primary objective deal with?

Sir Howard Davies: Yes, there has been a bit of a blurring of the line between wholesale and retail in recent years. I remember making endless speeches saying, "The FSA is not concerned with what consenting adults do in private". In the wholesale markets, if Morgan Stanley was being legged over by Goldman Sachs, that was its problem. It should not be in that position.

You cannot completely back off, because the market does like some rules of the game and it likes to appeal to the regulator when it believes these rules have been contravened blatantly, but there has been some blurring of the objectives.

In wholesale markets, you are aiming to produce a fair contest, whereas in the retail markets you know it is not a fair contest because there is a significant information asymmetry problem between the consumer and the firm. Therefore, as a regulator you have to be significantly biased in favour of the consumer. You have to try to ensure that your actions correct, as far as possible, the fundamental information asymmetry you are dealing with. At the moment, the rhetoric from the FCA perhaps does not clearly enough distinguish between what it is trying to do in the wholesale and in the retail markets.

Lord Lilley: Does that lead to an excessive burden of regulation that ought to be or could be diminished, and which presumably the secondary objective is supposed to encourage it to diminish?

Sir Howard Davies: It could, but I am not sure that in wholesale markets I would identify any particular problem that is causing business to disappear. There is some data that suggests that the growth of international business in London has not been as dynamic recently as in the past, but it is quite difficult to disentangle the reasons for that. Some of them are to do with Brexit. In some areas of euro business, that is probably true.

Are they really to do with any particular FCA rule? I am not sure I have seen any evidence of that. There is not a huge problem in the wholesale markets at the moment. I am not aware of the big wholesale banks moving their business because of an FCA rule. I have not heard that from people I know. As I say, I have heard that in relation to Brexit, because of certain types of business that are drifting back into the eurozone.

Q184 **Lord Grabiner:** Good morning, Sir Howard. Can I ask you a big-picture question? You have already mentioned some of this in passing, but I just want to get the point under one umbrella.

The assumption in my question is that London is the second most important financial centre in the world. That is a fair assumption at the moment. Is there any risk that London's status in that respect will decline in the medium to long term, by which I mean five to 10 years? If so, why is that? If that is so, is there anything we could be doing on the

regulatory front that might deal with that in an effective way? I appreciate your point about the significance of politicians and the possible limited ability of the regulatory structure to deal with this, but if you have any suggestions on that front, we would be interested to know what you have to say.

Sir Howard Davies: There are two surveys that do comparisons of international financial centres. One is done by an outfit with the slightly odd name of Z/Yen, which is a firm created by Michael Mainelli, the current Lord Mayor. It has produced 36 versions of the Global Financial Centres Index, which typically has New York as number one and London fairly close behind as number two. The cynic would say these are largely based on opinions. They write to you and say, "Which centre do you like being in?" It is not that solid, although there is some data on business volume.

There is another one that New Financial, a think tank, did recently, which also factored in the absolute volumes of business transacted. It had the same ranking but a much bigger difference between New York and London. I am not sure I attach huge significance to that, because New York has a huge domestic market. It has a much bigger domestic market than the UK, so it is not surprising that banks in New York are doing more business in bonds and equities than ours are.

If you look at the trends overall, what you see is that the rising centres are mainly in Asia, particularly Hong Kong and Singapore now. Because of the problems in Hong Kong, Singapore is coming up very strongly. In Europe, there has been a bit of a narrowing of the gap, but one thing that helps London is that the French and the Germans spend most of their energy knocking spots off each other.

If you look at the rhetoric of Paris Europlace, which is the lobbying organisation for Paris, and Finanzplatz Deutschland, the lobbying organisation for Frankfurt, it is all attacking Frankfurt or Paris, basically. They have come up a bit and Geneva has come up, but not really enough to threaten London's position as the number one financial centre in Europe.

Looking at longer-term trends, I would be astonished if, given the relative growth rates of the economies, one of these Asian centres did not get above London at some point. What we can do about that, except moving several thousand miles, I am not totally sure. The weighting of the Asian economy is such that we probably have to be relatively relaxed about that.

We have to be realistic about the business that we can expect to keep in London. What can we do there? There is a Brexit-related risk. Brexit has not produced as large a shift of business as some people had forecast, but there are some elements of the business in London, particularly the clearing and settlement of euro-denominated derivatives, that the European Central Bank and the European Commission would dearly love to get out of London and into the eurozone. I can understand that; if you

are a central bank, the fact that a large chunk of the dealings in your currency is taking place outside your jurisdiction is not something you would necessarily be comfortable with.

However, the banks—this includes the French and German banks—do not want to move this activity because they say the liquidity will be lower in Frankfurt, which is where it probably would go, and it would be more costly. If they are forced to move, they may well move to New York. You may say, “That’s a bit weird. Why would they move to New York?” New York negotiated equivalence with the Commission in the past. It cannot refuse to allow a transaction in New York to be, as it were, credited in the eurozone.

Given the history and the way in which the Brexit negotiations proceeded, I doubt whether we would be able to negotiate something as good as equivalence, but at the moment there is an irresistible force and an immovable object. The only way through that is by negotiation.

There is a memorandum of understanding, which was finally agreed by the last Government, and the regulators have quite good relationships. There could be a way for the Bank, as long as the Government were happy with this, to give the European regulators complete access to all their information about these derivatives trades, so that the fact they were taking place in London was not really significant, and it did not mean there was any lack of transparency. That is one thing that would make quite a difference, because otherwise we are going to see a grinding of gears and a fairly important chunk of activity shifting outside London.

In other respects, I doubt the different Basel interpretations are going to make a huge amount of difference to the location of business. The Solvency II reform is significant in the insurance area, but the London market is doing pretty well in insurance. Solvency II really affects more the investments of life companies. Our life companies are now basically not international; they have given that up. Aviva has got rid of most of its businesses overseas and Prudential has moved overseas and left its European businesses.

Lord Grabiner: If I may I will ask a very quick supplementary arising from what you have been saying. Is there anything we could learn from Singapore, regulatorily speaking, that we would benefit from that we are currently not doing?

Sir Howard Davies: The pay point is one you could learn from. Having more competitive pay for regulators would be one positive thing. I do not want to re-litigate this one, but the big thing that distinguishes Singapore is that it has a unified regulator. The regulator is therefore able to balance its financial stability objectives with its competition and consumer protection objectives, which was always available to the FSA.

The FSA could say, “We could pursue this consumer objective to its limit, but we will not because we worry about destabilising the whole sector”.

This was the case with personal pensions mis-selling, for example. We explicitly concluded that the scope of the review would be somewhat restricted because, if we required every contract to be reviewed, even the administrative costs would have bankrupted the life insurance industry. We were able to do that. We were challenged on it, there was a judicial review and we won, because we had these two objectives. That would be the other thing you might think about, but I am not sure there is an appetite to go back in that direction.

The promotion bit is a bit difficult. The Singapore Inc model, where the regulator is a promoter of the financial centre, would be quite difficult for us to do. You would get quite a lot of people crying foul in Europe and the US if we had a regulator that was also going around the world trying to persuade people to set up business here, which is what the Singaporeans do.

Lord Grabiner: The regulator there has the advantage of also being able to use the national wealth fund, does it not?

Sir Howard Davies: Yes.

Lord Grabiner: That is quite an advantage.

Sir Howard Davies: Yes, it is quite an advantage. There is nothing comparable that we could do.

Q185 **Lord Kestenbaum:** Good morning. I wonder, Sir Howard, whether you could go back to one of your opening remarks, which Lord Lilley asked you to expand on and I am going to ask you to expand on again.

You described yourself as a sceptic on the secondary objective. I am paraphrasing slightly but I think you used the word "sceptical". I wonder whether I could press you on that and ask you to expand. Is that a scepticism of its nature or a scepticism of its design? In other words, a scepticism of its nature would say something along the lines of, "Look, this is not just an issue of mission creep and expansion of scope. It is a fundamental misunderstanding of what a regulator can and cannot do. It fundamentally does not possess the tools for such an objective. It is a laudable aspiration of politicians, but a regulator cannot do it". Is it saying, "By nature, the objectives are so different in temperament and in culture and so inconsistent that it would make it impossible to deliver and you will end up compromising and contaminating both"?

Are you saying, "My scepticism is not of its nature. My scepticism is of its design. Under the right circumstances, a regulator with a practical programme, the right staff, appropriately remunerated, and an appropriate culture would be able to focus on a secondary objective. Right now, it does not have any of those things, but it is an achievable aspiration"?

Sir Howard Davies: I understand that I have perhaps not been completely clear. Let me tell you what I would favour. It should not be a secondary objective, which is a slightly odd political compromise, but a prominent "have regard to". In other words, you are trying to achieve

financial stability and consumer protection, but you have to have regard to the impact on the competitiveness of the sector because, of course, if you do something that regulates the sector out of existence, you are probably not helping the consumer either. You would then have the financial stability of the graveyard.

There should be a prominent “have regard to”, which is primarily about whether what you are proposing is super-equivalent to other international agreements. That is a safer place to be. I am conscious of the fact that other people are somewhat suspicious of this. We all think this is to do with stimulating growth in the UK and of course we do not want to give up financial stability, et cetera, but when you sit in Basel and you look at this, you think, “Hello, they want to undercut. This is a regulatory race to the bottom. That is what they are doing. They are trying to move business back into London and out of other European centres”. That is the way it looks, which is the downside.

- Q186 **Baroness Bowles of Berkhamsted:** On this point about a multiplicity of objectives and so forth, if you go back to FSMA 2000 in the first place, Parliament did add to the number there, although some come from government. Is the reason why Parliament tries to add not because there is not enough accountability of the regulator? We have committees like this one and the Treasury Select Committee, but the regulator does not want to pay heed to the cautions that Parliament gives it about the direction it is taking. Over time, that means that some kind of objective gets born. Is not the real problem that there is inadequate accountability, meaning that no change can be effected in regulatory behaviour?

Sir Howard Davies: I would not underestimate parliamentary accountability. If you are a regulator, going to the Treasury Select Committee is not a highlight of your year but it is an important moment. You took a lot of notice of the tone of the Treasury Committee at that time.

I will say, if I may, just in parenthesis, that, in my time as a regulator, every time I went to the Treasury Select Committee the tone of the attack was that I was judge and jury in my own court—an overmighty regulator constraining the animal spirits of the wealth creators of the City of London. Then, of course, there was a period from 2008 to 2020 when the regulator was accused of having let all the animals out of the zoo and the whole thing was completely different. Now the pendulum has swung back again. Some of us with long memories have a degree of cynicism about this because it has come back to where we were in 2006, and the regulators have to try to steer through this.

I believe it is possible to strengthen accountability to the Houses of Parliament. My own view, which I expressed when I was asked about it but it was not attractive to Parliament, was that a well-staffed and properly supported Joint Committee of the two Houses would be appropriate in this area to hold the regulators to account.

I look back at the period when the Financial Services and Markets Act 2000 went through. There was a Joint Committee of the Lords and Commons at that point. It was chaired by Lord Burns at the time. That was a very tough committee and a very effective committee in teasing out the issues behind the legislation. You could have something like that. If it could reach consensus views and produce a report saying, "We think the regulator is being too tough in its interpretation of Basel 3.1", to take a current example, the regulators would pay a lot of attention to that. You could beef up the parliamentary accountability of the regulator.

The Chair: Just by way of information, the legislation did provide for a Joint Committee. When the House of Lords set up this committee, we did try to make the case for a Joint Committee, but the then chairman of the Select Committee was not enthusiastic about the idea. In this committee, we try to draw on expertise and we are much more polite, as you have discovered this morning. I hope it has not been an ordeal.

Q187 **Baroness Noakes:** Earlier on, you pointed the finger at Parliament in terms of making it difficult for financial services companies to thrive and prosper, citing the consumer duty and ring-fencing. It clearly is not within the power of the regulators to amend those significantly in order to improve competitiveness and growth in the UK.

Leaving those items aside where you can point the finger at Parliament, there remain a large number of things within the control of the regulators, and there will be more as they get more rulemaking capacity, as we switch off the EU legislation and give more powers to the FCA and the PRA. Could you identify areas where there is a significant impact on competitive growth of the financial services sector, for example—where the regulators could amend what they do to improve competitiveness and growth in the sector?

Sir Howard Davies: The debate that I described about Basel 3.1 is one example. The PRA was persuaded to move on that; otherwise, that would have been difficult. Solvency II is still an area where most insurance companies would believe the PRA has been very reluctant to reform and there is scope for it to do more.

Without getting too complicated, this is to do with the way in which the rules affect long-term investment in infrastructure and things like that. They could be reformed. They are being reformed in the EU at the same time as well. That is another area that creates a lack of competitiveness and where the industry is unhappy.

There is a lot of activity that preoccupies boards—things such as corporate governance and diversity and inclusion. One does not disagree with those in themselves, but they create an extraordinary compliance burden. They impose single solutions on a range of different firms, large and small, that are inappropriate. There is a compliance burden there that is quite significant.

The costs borne by financial firms on the reimbursement of fraud have been remarkably high. You saw recently the Payment Systems Regulator

coming out with a remarkably high number up to which banks should compensate. That is being pushed back on. That area is still of great concern to the industry.

According to the latest estimates, the industry spends some £30 billion a year on various aspects of anti-money laundering and financial crime. There are remarkably burdensome customer due diligence procedures, and there is a willingness by the regulator to intervene after the event with either aggressive litigation or very large fines. Even when it is one case at issue, or it is quite clear that mistakes have been made, there is significant punishment. People are very concerned about the responses to any error in the money laundering area. AML is an area that really needs fundamental reform.

You will be aware, Baroness Noakes, that financial firms produce huge volumes of suspicious activity reports that go into some mysterious computer hopper somewhere and nothing ever seems to come out the other end. There is a massive cost on the industry, but it seems to result in remarkably few prosecutions, except of the firms that are trying their best to do these processes. I hear constant complaints from foreign firms in London that this is remarkably more burdensome here than elsewhere.

Baroness Noakes: Is it more burdensome than the US?

Sir Howard Davies: It is possibly not more burdensome than the US, but it is more burdensome than continental Europe.

The Chair: Lord Hill, I am conscious of the time.

Q188 **Lord Hill of Oareford:** On the theme of overlap, which we touched on a bit in Lord Lilley's question about the overlap between retail and wholesale, there is potentially an overlap in terms of the effect on a regulated entity—the FCA, the PRA and FOS. Where are these boundaries? Is there any double involvement? There is a sort of overlap for the regulators themselves between statutory underpinning, own initiative and custom and practice, in terms of feeling like it is pushing out the regulatory perimeter.

I was interested in your comments about not wanting to relitigate things. Is there any wisdom in considering different structural ways of thinking about retail and wholesale? More generally, are there things we could do to simplify, clarify and delineate more clearly different roles, so that companies are not feeling so much like they are hit in multiple ways?

Sir Howard Davies: Yes, it is true, particularly in certain areas of economic crime and conduct, that you find yourself dealing with a lot of different regulators. I am not convinced of the added value of the Lending Standards Board and the Payment Systems Regulator. I am not quite sure why that was set up as a separate regulator. That could be folded back into the FCA. We have already seen the FCA put somebody in there to try to sort it out, but I am not quite sure why it existed.

I know this is a difficult area—I have stubbed my toe on it in the past—but the extent to which the FCA can give guidance to the ombudsman about what the rules mean is an important area that could be clarified. There do seem to be cases where the FCA appears to say one thing and the ombudsman interprets things differently. That has the effect of changing the rulebook. That does not seem to be what Parliament intended, really. Parliament intended that the regulator should set the rules. It should consult on them, hear everybody's point of view and then set them; it should not have an individual case then changing those rules, which is unfortunate. Those are the areas I would be looking at.

Q189 Lord Vaux of Harrowden: One of the bits of evidence we have had over the course of the inquiry has been on the capital requirements for banks and whether we are in the right place compared to other areas, particularly on MREL requirements. We have been told that the UK levels where MREL kicks in are much lower than in the US and Europe, which has cost implications for our industry and creates a cliff edge for the smaller-growing parts of the banking market, which see themselves butting up against that level and decide that growth becomes too expensive. I just wondered whether you had any thoughts on those two aspects.

Sir Howard Davies: On the whole, I am not unhappy with the MREL regime. As one of the responses to the financial crisis, it made a lot of sense.

I am not an expert in the position of the small banks. At NatWest, although it went down in size a little bit, for reasons that were driven by regulation, we never came up against these cliff edges. I have heard arguments that suggest there should be some smoothing of that path. That could well be looked at, but I cannot say I am an expert in that.

Lord Vaux of Harrowden: In terms of the levels where it kicks in compared to the US and Europe, are we in the right place or the wrong place?

Sir Howard Davies: I have to say that, after the experience of 2023 and the failure of three US banks that were regarded as small banks but that caused a big mess, I am not at all keen. I would be looking at pulling the thresholds down in the US, rather than pushing them up in the UK.

The Chair: Sir Howard, thank you. That has been a fascinating just over an hour. I am very conscious that it is Budget day. We could go on for another hour easily just listening to you. We are very grateful to you for having dealt so well with the questions and bringing your experience of a number of years. It is very helpful to the committee. Thank you.