HOUSE OF LORDS

Financial Services Regulation Committee

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

Wednesday 20 November 2024

10.20 am

Watch the meeting

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

Evidence Session No. 16 Heard in Public Questions 214 - 219

Witnesses

I: Jack Inglis, Chief Executive Officer, Alternative Investment Management Association (AIMA); Cuan Coulter, Executive Vice-President, Global Head of Asset Managers, and Head of UK and Ireland, State Street.

Examination of witnesses

Jack Inglis and Cuan Coulter.

Q214 **The Chair:** Welcome to today's meeting, which is our 10th oral evidence session as part of the committee's inquiry into the FCA and PRA's secondary competitiveness and growth objective. Thank you, Mr Inglis and Mr Coulter, for attending.

A list of members' interests relevant to the inquiry is available online. The session is open to the public, is broadcast live, and is 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 the session, you will be sent a copy of the transcript to check it for accuracy; we would be grateful if you could come back to us as quickly as possible.

If, after this evidence session, you want to clarify or amplify any points made during your evidence, or you have any additional points to make, you are welcome to submit—we would encourage it—supplementary written evidence. Would either of you like to make a short opening statement?

Jack Inglis: Good morning, and thank you very much for that. Today, I can speak from the perspective of AIMA's segment in the market, which is the alternative investment management sector; within that, I can address hedge funds and private credit specifically.

The important point I would like to get across is that the vast majority of client assets under management in this sector come from institutional investors, so our interests are at the wholesale end rather than the retail end of the market. We would certainly like to see more of a distinction in that wholesale versus retail part when it comes to the application of the rules by the FCA.

I hope that I can be useful in an international context this morning. We are a global trade body. Our members are across 60-plus countries, and we have offices in 10 locations around the world. As such, it may be helpful for you to hear from me about the relationships that we have with regulators in multiple jurisdictions around the world.

If I may, I would like to venture an opening opinion of the FCA, which has historically been regarded as a very pragmatic, constructive and approachable regulator. As its CEO pointed out from the results of its own survey, that is matched by registered firms as well in the sense that 70% said they found that the FCA enhanced the UK's reputation, so that is a good starting point.

I would also say that, when it comes to alternative investment management, over half of the assets under management in the European time zone are managed here in the UK, so we are already in a strong position. A lot of the focus is on how we should preserve that as well as, at the same time, thinking about whether we can make that more competitive and get more growth from it—particularly when other

jurisdictions are really focusing on growth coming from their financial services at the same time.

Those are just some opening comments. Really, what we need, in order to maintain what we have here, is an ongoing, pragmatic, consistent, coherent and somewhat predictable set of rules that inspire confidence, in order for the firms that are already here to remain here, in an increasingly competitive global environment, and to encourage new firms to enter.

The Chair: Can you give us an example?

Jack Inglis: I pointed out wholesale, for example, as a key thing. There are some things that the FCA could specifically do to make a clearer demarcation and distinction between the application of rules to the wholesale sector as opposed to the retail sector in asset management.

The Chair: What are those things?

Jack Inglis: We will put a lot more detail in our response to you in the call for evidence, but those things can be done mainly by the FCA through changes to both the AIFMD and the MiFID rules that currently apply. There are some duplications there; we will certainly provide the details of that in our letter to you. Much of that is in the remit of the FCA to do, but there are certain things that the Treasury needs to do first, particularly as it scopes out the changes to both of those directives.

A second thing I would like to highlight is that securitisation reform is under way, but it can go a lot further than is currently envisaged. I know that the FCA will be continuing its consultation on this in 2025 but, if we are looking at unlocking capital that can be deployed in the UK, there is further opportunity for securitisation reform.

The third element is where we can certainly reduce some of the regulatory burden that firms here in the UK currently feel. Much of this is because of the application of EU rules. There are many duplicative reporting requirements in the various rules that are out there under AIFMD, MiFID, EMIR and MiFIR; there is a lot of scope there to reduce the regulatory burden that firms are feeling.

Cuan Coulter: Thank you for inviting me to comment this morning and give evidence on behalf of State Street. Ensuring that the UK remains competitive and preserves its leading position as a major financial services centre is important for growth, productivity and welfare in the UK. It is also important to my employer, State Street, since the UK is an integral part of both our strategy and our global operating model. We have had an established presence in the UK since 1972. We have offices in London and Edinburgh, and we employ more than 2,000 people in the country.

As a business, we provide safekeeping and related securities services to about 11% of all the investable assets on a global basis. We are considered a globally systemically important bank. Here in the UK, we act

as the custody bank to more than £2.5 trillion, and we are classified as critical market infrastructure. We are also dually regulated by the PRA and the FCA. We are the fourth-largest asset manager in the world; we have about $3.5 trillion-worth of assets under management, about half a trillion of which are managed here in the UK.

My commentary today is probably informed by the fact that I have operated in regulated roles in both the US and the UK. My roles at State Street have covered both asset management and banking. Needless to say, State Street supports the introduction of the secondary competitiveness and growth objective. We believe that it is a noble cause and has significant social utility.

My personal experience of the UK regulatory framework and UK regulators is such that I think we have very good technocrats. The UK principles-based outcome orientation to the regulatory framework is superior to other frameworks and operating models that I have seen in my career. That said, the secondary objective has to be applied robustly and consciously on day-to-day activities, both in the regulators and in the supervised firms. It takes time for both regulators and supervised firms to understand and adapt to the secondary objective.

To cite some examples of where we have made but continue to need to make progress, I would say that, in the senior manager administration process, if you go back three years, only 11% of our applications were making their way through the application process in the published desired service level times. Over the last 12 months, 88% of our applications have made their way through the process in that same standard timeframe. Significant improvement has been made in the last three years, but those administrative processes and the overhead associated with the burden of them could still be improved.

A second example that I might cite of areas where improvement could be made is that, similar to Jack's comments on wholesale versus retail, our business is almost entirely an institutional business. Although we believe that the consumer duty framework is a very important piece of regulation, we, as an organisation, had to spend a significant amount of time—in the order of several thousand man-hours—developing an articulation of why the consumer duty framework did not apply to our business model, notwithstanding the fact that we do not have any retail presence.

I point those out as two examples of the work rate that has to go into organisations. In the efficient use of resourcing, if you are applying resources to what is, in essence, in the second example, proving a negative, you are not applying those resources to more efficient means, in my opinion.

That said, providing that the regulators allow management teams to employ their operating models efficiently and to manage the risk accordingly, and providing that the regulators focus on principles-based

rule-making and outcomes orientation, we are on the path to success in achieving the secondary objective.

In summary, State Street welcomes and supports the secondary objective. We are very pleased by the work of this committee, which we think is very relevant and important.

The Chair: Thank you very much. Both of you have emphasised how professional and pragmatic the regulators are. If that is the case, why have you not been able to persuade them that there is a clear distinction in terms of the consumer duty between the wholesale market, where you are dealing with a very different clientele, and the retail market? Where is the pragmatism and flexibility? Why has it taken so long to make very little progress in this area?

Cuan Coulter: I would make two observations. There is a natural timeframe required in getting stated principles or intents at the senior levels of the organisation into the organisation then into the field practitioners. A lot of my administrative time is spent educating field supervisors; that is a reason why there is a lag between intention and execution.

The Chair: Is that a polite way of saying that they do not understand your business?

Cuan Coulter: In the field, you spend quite a bit of time educating field supervisors. There is a distinction between your most senior technocrats and the people in the field.

The Chair: You said you welcomed the duty. The duty is not a goal in itself. It implies being concerned about how regulation is inhibiting growth and competitiveness. How would you say the record on this is so far?

Cuan Coulter: I would repeat the thematic of intention needing to be followed by execution. If I was asked to grade it, I would say that it is still a work in progress. There are areas that I would highlight as being indicators of success, such as the work on capital markets reform or the work that we did on the long-term asset fund. I should declare an interest: I was on the asset management task force when the long-term asset fund was developed. We have several examples of where the right progress is being made; I would articulate the report card as being "in progress".

Q215 **Lord Smith of Kelvin:** You have mentioned securitisation and unlocking capital a couple of times. I am interested in what government, or regulators more specifically, should do to help unlock that capital.

Jack Inglis: I will address my response specifically to the securitisation market, which I referred to earlier. We all recognise that there is a huge amount of capital sitting with insurance companies at the moment. Due to the rules of Solvency II—do we call it Solvency UK these days?—as well as some of the bank capital rules and some of the existing

securitisation rules applied by the FCA, there are disincentives, if I can call them that, for those insurance companies to invest in securitisation.

Let me put some numbers around that to help you think about it. For equivalent credit risk, an insurance company would have to put up anywhere up to 12 times the amount of capital investing in a non-standard securitised product as it would for a publicly issued corporate bond. That is a massive disincentive for insurers. Who can change that? Part of it stems from the Basel rules but the PRA and the Bank of England—although not the FCA in this instance, since it is about capital rules—could address this. That could free up some of the capital for it to be invested in securitised products, which are a significant opportunity for capital to be deployed towards businesses and projects here in the UK and elsewhere.

Lord Smith of Kelvin: Do you have any idea why it is 12 times the amount?

Jack Inglis: I am afraid that I do not set the rules, sir. It is something that we have been presenting. Unfortunately, it stems from the Basel rules, so it is not necessarily a UK-only situation. It is something that is felt around the world, but prudential regulators in individual countries can take a different interpretation of that and apply them differently.

Q216 **Baroness Donaghy:** Good morning. We have heard from various witnesses that it is vital that the regulators understand competition and growth, and that they struggle to get the right talent in order to do that. Should there be more opportunities for people in your sector to spend time—some people have expressed it as if it is serving time in jail—with the regulator to share that expertise and awareness? Other witnesses have said that this is not a vital thing, but what is your view? Would this help to get a better understanding of the challenges that your industry faces?

Cuan Coulter: My short answer is yes: I agree that it would be beneficial. It may not be fundamental but having practitioners come from commerce into regulatory authorities, then potentially back out again, provides insights into the practical realities of running an operation. It gives them better insights into the impact that regulation has on operations and, potentially, the unintended consequences of operations. Overall, I would support secondment arrangements, if that is a way of describing them.

There are several considerations associated with that, not least of which is that you do not want a one-way street. You do not want the most talented technocrats all being stolen by the industry, for example. There would have to be reward and recognition mechanisms, and perhaps employment constraints, to ensure that the system was cyclical. In summary, having a pragmatic understanding of the machine of commerce would be a good thing.

Jack Inglis: Whenever we look at regulators around the world, they are always complaining about turnover in their staff. It is a fact of life that the private sector tends to be able to offer more compensation, so the UK and the FCA are not unique to that.

I would also observe that, interestingly, in the United States, the SEC tends to see more people coming in from the private sector than perhaps the FCA sees here. I am trying to think about why that is the case. Throughout the government machinery of the United States, there has been a culture of people in the private sector feeling that they want to go and spend time in those roles, but we do not appear to have that here.

Baroness Donaghy: How would you make it more attractive for members of staff in your industries to go to the regulator for a period?

Jack Inglis: One of the biggest challenges that I see—particularly if you are suggesting that they might be seconded there, or think about going for two or three years then going back to their employer—is how they can get commitment from their employers that they will come back to a meaningful role in their organisation. That is a very difficult thing to achieve, but it is one where employers would need to give commitment.

The same happens when people go from the FCA and get seconded out to, say, another regulator. My colleague sitting behind me joined us from the FCA a couple of years ago. He was seconded to Brussels for three years by the FCA. It is good for the FCA to go and get that experience and have that participation but, again, an employer such as the FCA needs to give some sort of commitment to people that, when they get reintegrated, they have a role that is commensurate with the expertise they have increased.

Lord Vaux of Harrowden: You have both mentioned the international aspects of your activities. Can you give us some views on where we sit in the global league table of regulation, particularly from the perspective of regulators either stymieing or encouraging growth and competition? Which countries are doing it better than us and what can we learn from them? Related to that, we have had some evidence that the costs of compliance in the UK are considerably higher than in other countries, such as the US. I just wondered whether you had any views on that as well.

Cuan Coulter: In terms of policy thinking and supervisory topic generation, I would put the UK at the very top of the league tables. It is ironic: people talk about other jurisdictions having good structures but, when you look closely, they tend to be copycat structures to those that the UK initiated. Singapore gets articulated in quite a lot of commentary. When you think about mechanisms that the UK initiated, such as sandboxing or working groups, Singapore tends to get credit but they are a UK invention.

The Chair: The UK is very good at having inventions that other people take forward and make happen, not least in financial regulation.

Cuan Coulter: I would give the UK regulators a fair amount of credit for being leading thinkers in the world.

Lord Vaux of Harrowden: Is there anything that we can learn from other countries?

Cuan Coulter: You mentioned the US, which is a difficult comparison because, at some levels, there are fundamental differences between a rules-based approach and a principles-based approach. It is hard to make "apples and oranges" comparisons.

Jack Inglis: I can add to that; I will come to the cost of compliance as well, which I know you asked about. In short, the UK ranks really quite highly. Are we at the very top? No. But are we near the top? Yes, I would say we are. I referenced the historical perspective that firms have of the FCA; to a certain extent, that continues to be the case today.

It is quite interesting when you look across the world. All of our member firms are facing regulators. They always have some sort of complaint about their specific regulator; it might be about the amount of reporting they have to do or the nature of the supervision. In certain countries, such as the US, it can change quite dramatically depending on which Administration we face. If I think about the past four years in the United States, we have faced a regulator, the SEC, which has been pursuing an aggressive agenda of new rule-making, much of which could be described as being damaging to the industry and its competitiveness if those rules were to come into power. Some of them have, and some of them have been challenged and beaten in the courts.

It varies from time to time, which brings me on to the cost of compliance issue. I know that this committee has really been trying to get to the bottom of this in terms of getting some real numbers and detail on it. I am sorry to disappoint you that I do not come laden with data to improve that situation but, some years ago, we ran and published a survey of our members on the cost of compliance being seen globally. When we asked the question, "Where is that cost highest?", 10 years ago, it was in the United States rather than in other parts of the world. The reason it was high then is that new reporting requirements were coming into play in the US; getting ready to implement those required an awful lot of work, so the US featured as the place of highest compliance. If we had asked that question two years later, when AIFMD was coming into play in Europe, it would have switched. The highest cost would have been in Europe as people prepared themselves for that new directive and new regime.

The point that comes out of that is that the cost of compliance varies over time. When new rules are coming into place, there is a lot of implementation work to do, and that sucks up a lot of resources from firms. We want a stable framework—not never changing, but we do not want change for change's sake because that brings additional compliance costs as you implement your processes to comply with them.

As a final point, one of the other questions that we asked of our members when we ran that survey—we are thinking about doing this again; I hope that, in future, we will be show this committee more up-to-date, modern evidence—was: "Is the cost of compliance leading you to consider moving the jurisdiction of either your manager operations or your fund jurisdiction?" The majority of the answers said, "No, it's not". Although the cost of compliance is important, I am not suggesting that it drives people out of the country. It is seen as a cost of doing business, and we want to see that kept to a minimum.

Q217 **Lord Hill of Oareford:** I am a bit confused from listening to your evidence so far. You have said that the FCA is either the best in the world or nearly the best in the world, yet you have said that you have concerns about the dividing line between wholesale and retail. You are both strongly in favour of the growth and competitiveness objective. If it is doing such a great job, why are you so in favour of the growth and competitiveness objective?

Jack Inglis: I am not saying that it is doing a great job, but nor am I saying that any regulator is doing a great job in the eyes of the firms that are regulated. I made the comment that everybody has a gripe with a regulator somewhere around the world. I am not scoring it an A* in this respect; there is still room for it to make some improvements. Sorry, Lord Hill, what was the second part of your question?

Lord Hill of Oareford: I am trying to get at whether you think everything is broadly fine. If it is, why are you so supportive of the growth and competitiveness objective, the purpose of which is to try to encourage our regulators to think more about their impact on the market?

Jack Inglis: I will add one more point, if I may, then hand over to Cuan. I think I made the point earlier—I hope I did—that, across all the major economies around the world that operate in the developed capital markets, it is hard to find a Government who are not trying to pursue a growth agenda and to use financial services to help them achieve that aim. The world is getting more competitive. The ability to work in any jurisdiction has never been easier. Although we have a very dominant position, certainly in our sector of the industry, as it currently stands, there is a risk that, if we do not remain competitive and continue to seek to be more competitive, we could get left behind by other jurisdictions.

Cuan Coulter: The only thing I want to add is that all these measures are relative. On a relative basis globally, most of the major regulatory authorities spent the better part of a decade after the global financial crisis in what could be oversimplified as risk elimination mode. We are at a bit of an inflection point on a global basis: it is maybe less oriented towards risk elimination and now a much more balanced view around risk management and risk mitigation. I stand by my comments that it is the best in the world but I also stand by my comments that now—we could have an argument about whether it is now or slightly earlier—is a rational

time to start thinking about the fact that it is about balancing risk and decision-making, as opposed to pure risk elimination.

The Chair: I call Baroness Bowles—sorry, Baroness Noakes.

Q218 **Baroness Noakes:** As we go through this inquiry, we are trying to find specific examples of ways in which changes from the regulators could improve competitiveness and growth for both the financial services industry and, through that, the real economy. I am interested in what you would say are the biggest specific things that could be changed.

Can I ally that with a question? Picking up on the example you gave earlier of securitisation requiring 12 times capital, to what extent have those with an interest in that had a conversation with the PRA and said, "This is impeding our competitiveness and holding up growth in the UK"? What was the PRA's response to that? It has changed the Basel rules for other purposes but, obviously, not in this case.

Jack Inglis: When one is considering the growth question, the interesting thing is where the biggest opportunity for growth is—that is, in which segments of the industry. Private credit is far and away the fastest-growing segment of the asset management industry as a whole globally at the moment. That is one area I want to focus on; I will come back to the securitisation part in a second. The other is digital assets, which, in our view, represent a massive growth opportunity. There are two areas there.

Baroness Noakes: What should the regulators do specifically?

Jack Inglis: Specifically on deregulation, coming on to private credit, the main part of that is securitisations, which are used an awful lot by the private credit industry. Have we had conversations with the PRA and the Bank of England? Yes. We have also had conversations with the Treasury. Last week, I met the City Minister and highlighted this as the main part of the meeting; I am happy to say that she fully understood it and wanted more detail on it. As a trade body, we are having the right conversations. We need to continue to provide sensible rationale, particularly with the example I gave you earlier, where the cost of capital for an insurance company when it invests in a securitisation—as opposed to some other form of credit instrument—is extremely punitive. There is still a lot of work to be done but, yes, those conversations and discussions are ongoing.

On digital assets, we are still in the very early stages of regulatory frameworks being built out across the world. Where does the UK currently stand vis-à-vis what is happening in other jurisdictions? We are a bit behind certain jurisdictions. The Europeans have got ahead of us. Switzerland, Singapore and the UAE are ahead of us. We are ahead of the United States as of today but, under the new Administration, we could fall behind very quickly.

There is a great opportunity there; that is understood. There is a very good co-operative exercise on tokenisation going on between the FCA

and the MAS at the moment, called Project Guardian. I know that the CEO of the FCA has already spoken about the need to get better frameworks in place that can encourage tokenisation here. There is a big opportunity there, and it is still early days, but we are behind at the moment.

Cuan Coulter: I do not mean to duck the question. You are looking for specific examples. I will give you a framework that I might use. I would say that there is a body of work where there is an administrative burden, and it is questionable as to whether there is risk-mitigating value to that. The FCA has recognised that an example of that would be the senior managers and certification regime and its administrative burden. That is very low-hanging fruit. You could take that and streamline the administration of it, and there would not be any risk implications to that.

There is a second body of work around what I will call pre-established areas, where there is well-trodden ground. In that area—I am certainly speaking self-interestedly—from a multinational point of view, there is some value in global co-operation and co-ordination. Being cognisant of what is going on at the Basel Committee and in IOSCO, there is value in some level of either conformance or at least recognition.

Then there is this third category of topics, of which digital assets is one. In those more nascent areas, I would give the regulators quite good credit. There is this kind of deliberation: "Just because there is a novel topic, does it require a whole new regulatory framework or a whole new set of rules?" AI is an example of where the direction of travel seems to be good in the UK; and where, by and large, we are ending up saying that we do not need a whole new framework because we have pre-existing frameworks that handle it particularly well. I would suggest using some kind of framework within those three categories to decide what to do and what not to do.

The Chair: Baroness Bowles, do you have anything to add?

Baroness Noakes: I am Baroness Noakes.

The Chair: It is just that I think of you and Baroness Bowles as being particularly effective on the committee.

I thank both of our witnesses. We have run out of time but there are a number of points on which we would be very grateful if you could follow up. We have not been able to ask a number of questions today; we will send them to you so that they can be taken as part of our evidence.

Lord Lilley: May I sneak in a question?

The Chair: Of course.

Q219 **Lord Lilley:** You mentioned that thousands of hours were spent proving you do not deal with retail customers. Why could you not just phone up Nikhil and say, "Call off your troops. This is obviously absurd". Are you afraid to do so? Do you feel that he might retaliate if you told him that he

was doing something totally absurd?

Cuan Coulter: No. That is one example of those lower-end categories where we are stuck in a convention of having to document all this decision-making. In that scenario, it is a convention that can be broken. It is not a fear of retaliation that causes that; it is the convention that exists.

The Chair: Thank you so much.