HOUSE OF LORDS

Financial Services Regulation Committee

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

Wednesday 20 November 2024

11 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. 17 Heard in Public Questions 220 - 226

Witnesses

I: Michael Moore, Chief Executive Officer, British Private Equity & Venture Capital Association (BVCA); Lionel Assant, Global Co-Chief Investment Officer, Blackstone.

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Examination of witnesses

Michael Moore and Lionel Assant.

Q220 **The Chair:** Welcome, Mr Assant, and welcome, Michael Moore. It is nice to see you back in this building.

Michael Moore: Thank you very much.

The Chair: Would either of you like to make a short opening statement?

Lionel Assant: Thank you for your invitation to take part in this session. I serve as European head of private equity, as well as global co-chief investment officer, at Blackstone. I have worked at Blackstone since 2003 and London has been my home for the last 30 years. I thought it might be useful to briefly set out two points: who we are and why we are here today.

Blackstone is the world's largest alternative asset manager, with $1.1 trillion of assets under management. We invest across four divisions in multiple strategies: corporate private equity, real estate, credit and insurance, and multi-asset investing. We are a global firm headquartered in New York, with around 5,000 employees and 20 offices around the world. It is only through the trust that we have built with our investors by delivering outstanding returns through market cycles that we have grown from a small advisory boutique with $400,000 of our two founders' capital 40 years ago to the global institution that we are today.

Why are we here? The UK is a particularly important market for Blackstone, where we began investing 25 years ago. Today, it is our second-biggest global market for investments, behind only the United States. It is also our European headquarters, where we employ around 500 people, and you may have seen that we began construction of an expanded headquarters on Berkeley Square this year, which demonstrates our commitment to the country and the economy.

Since 2010, we have invested over £60 billion of equity and debt in the country. This investment has helped grow UK companies, create jobs and support communities. Today, our portfolio companies support around 40,000 jobs nationwide. Examples of these companies include the UK's leading live events business, the NEC in Birmingham, and becoming the largest provider of affordable housing in England with Sage Homes. These investments, in turn, provide long-term returns to our investors, generating further benefits to the real economy, as these investors are, typically, public and private pension funds and, in turn, pensioners, endowment funds, insurance companies and, increasingly, individuals.

When we think about investing in the UK, we think about it in the international context. That means that we have a particular interest in ensuring that the UK remains internationally competitive and that we see growth. The committee's inquiry is, therefore, particularly timely.

We are regulated by the FCA via our UK entity, Blackstone Europe LLP, and because we do not hold clients' money we have very specific regulatory permissions. Given this, compared to banks or, say, broker-dealers, we may not have the same extensive list of suggestions for the regulators.

I should also make it clear that my role is principally to invest in businesses and make investment decisions. I am not a regulatory and compliance expert, and would not pretend to have in any way the same level of knowledge and expertise on these issues as, not least, Michael next to me. That said, I am keen to be as helpful as possible to the committee in its inquiry, particularly in talking through the way that we think about the UK as a place to invest, and the opportunities as well as the barriers that we see. Thank you.

Michael Moore: Thank you very much for the opportunity to be here today. I am appearing in my modern role as the chief executive of the British Private Equity & Venture Capital Association. We represent everything from the largest global asset managers, such as Blackstone, to the smallest emerging managers in the venture capital space. Actively managed private capital is at the core of who we represent and on whose behalf we provide the industry forum to develop thinking and develop the industry.

This inquiry, with its focus on this objective, is timely and resonates greatly with the industry. To give you a sense of the size of the modern industry, which is about 40 years old in the UK, we represent about 300 fund managers, private equity and venture capital firms, a small, distinct group of private credit fund firms, about 150 institutional investors who invest in the funds, and a similar number in the ecosystem—the advisory community and the like.

UK managers raised £60 billion in 2023, £20 billion of which was deployed in the UK in that year. Our estimate is that the ecosystem is in the order of 140,000 people, so we are a really important and key part of the financial services hub here in the UK—indeed, it is the largest hub of private capital expertise anywhere in the world outside the USA.

The FCA is a key regulator for us, and it is important that we have the right balance in its responsibilities. I suggest that, as a positive starting point, it is part of the UK's international draw. We need macro stability for global allocators of capital, such as Blackstone, to say that the UK is the right place to have our capital managed on our behalf and, potentially, deployed there.

We need world-class regulation. We do not aspire to Singapore-on-Thames, whatever that is meant to mean. We want something that means that people have confidence in our system, but it needs to be proportionate and targeted regulation that fits well with the broader investment environment.

Growth is what mobilises, motivates and drives our industry and its investments in the underlying assets in the funds. That is a risky business, with different types of risk in different places, and it is the attitude to risk that is critical in this conversation about growth, because unless there is a risk appetite at the regulator and, dare I say, even Parliament is willing to tolerate the consequences of risk, in that sometimes it does not work out the way we hope, we really will not advance very far.

The regulator, Nikhil Rathi, who was at a conference of ours yesterday, has said in terms that the FCA wishes to embrace this growth objective, in the context of knowing the risk parameters it is allowed to work within. We would like those to be as clear as possible.

There are three themes for us where things could improve. Undoubtedly, we want a good, constructive relationship. There needs to be more evidence of the competitive mindset being developed. There is always room for improvement in operational efficiency, and a requirement, frankly, to have closer co-operation with or understanding between government legislators and the regulators about their respective remits. In the context of the proposed UK AIFMD review, knowing when that might start and its scope would be a great starting point, for instance.

The Chair: Just picking up on that point about Nikhil Rathi's original speech and the Chancellor's speech in Mansion House, with the emphasis being placed on taking more risk in order to achieve growth, who is going to call the shots on that and define exactly where the parameters lie? In your previous life, you would have been very familiar with what happens when something goes wrong and politicians cry foul. Equally, if the regulators take a more aggressive approach in the interest of growth and nothing goes wrong, there is no credit for it. To what extent does the revised remit, which has come from the Chancellor to the regulators, address this point convincingly?

Michael Moore: The documents are written in very delicate language and do not exactly strike you as being designed to put the fear of God into anybody in particular. Why should they? Are they specific enough? In our self-interested way, we would always like a little more definition around that. It is progress, and the previous Government started this, but I welcome the fact that the new Chancellor has underlined it.

Unless we have a public debate about the growth element alongside the overall supervisory agenda, you will end up with a culture that says, "The downside for me is if I do not get risk right. If there's any failing on my watch, I, as the regulator, am in trouble". Equally, when you are looking at how you do this, from the point of view of where people are focused outside, they will look at cost rather than value when they look at the environment in which we operate.

This is a good conversation to be having. Candidly, we will need to work it through a bit. A defined list of what good and bad risk look like is

probably not possible, but we want to push the regulator to understand the realities for us, and for Lionel and his colleagues.

The Chair: You used the phrase "Singapore-on-Thames". We have had quite a lot of evidence that the Monetary Authority of Singapore does quite a good job in terms of hand-holding.

Michael Moore: I am sure that it is quite offended by the suggestion that comes with that term.

The Chair: It comes across as being very proactive in the evidence that we have received so far. "Singapore-on-Thames" implies a completely different, free-for-all approach, which is not what applies to the Monetary Authority of Singapore. What I am struggling with is where a higher risk tolerance would be beneficial and where it would be counterproductive.

Lionel Assant: I mentioned that the UK is our second-largest investment market, which represents about 5% to 6% of where we deploy our money. We raise only 1% of our global money in this country, so you have that imbalance between where we invest and where we raise our money. That in itself tells you that individual investors but also pension funds are underweight alternative asset management, which you can define as riskier assets—even though, historically, they have been shown to be less risky in terms of volatility and returns. Therefore, there is a cultural issue, where maybe the appetite for risk is less.

The Chair: The Chancellor would have an interest in pension funds continuing to invest in gilts.

Lionel Assant: Sure, but the fact of the matter is that, in her Mansion House speech this week, she mentioned that the direction of travel was to try to consolidate these pension funds for them to invest more in private assets, which, historically, have yielded better returns with less volatility. As an example, our controlled buyout strategy over 40 years delivered 15% net IRR, which is 600 to 700 basis points above the public market's equivalent.

Michael Moore: I will turn to some useful examples, if I may. Sixteen times as much pension capital is invested through our member funds in the UK, raised from international sources, particularly North America, compared with UK pension capital. The risk appetite of regulators towards UK pension schemes investing in our private markets is quite different.

We have been working very closely with the pension industry since the original Mansion House compact under the previous Chancellor, Jeremy Hunt, for the last year or so to try to understand as much as we can about what is going on there. There are things such as the permitted links arrangements that the FCA has oversight of, which, essentially, limit the amount that can be put into unlisted securities, of which we are a subset. There are areas such as that where a different mindset as to how risky this is, or otherwise, could be taken.

The trustees and others take on onerous responsibilities when they join pension schemes, but if the sense is that the regulator is always watching to see where you make a bad set of investments then you will avert yourself from those risks. We want to make sure that is the case.

Turning to other kinds of regulation, some, such as AIFMD, are directly targeted at our industry, as they should be. Equally, there is broader regulation, which is primarily designed for banks and is not as well suited to our industry.

In terms of the remuneration malus and clawback provisions that apply to our industry, which are an understandable type of regulation to prevent institutions failing, the nature of the long-term investment and the remuneration of our industry means that it is really not a big issue, but it is affecting the amount of bureaucracy and cost that go into the industry. There are quite a lot of operational things that could change to address risk at a very practical level.

Q221 **Lord Grabiner:** Can I ask you about the way that you use the words "risk appetite"? In terms of your business and your membership, do you see this as a political or a regulatory question?

Michael Moore: I dare say it is a bit of both. I think back to the Chair's original points. I understand the need to inquire after there has been failure and to find out why, but that certainly will tend towards risk avoidance, particularly if you are the regulator. You can sometimes be conscious that statements are made about concerns in a particular area about risk before the data has been collected otherwise.

In terms of the firm-level risk, it is in the nature of the investing that our industry does that risk is right at the heart of it, but it is risk that is professionally managed and assessed and has, as in the examples that Lionel has already offered, delivered great returns to investors down the years. Getting the right culture is a good starting point. Making the specifics back that up is an important follow-through.

Lord Grabiner: Is the FCA good at coping with assessing risk appetite in relation to your membership? Does it regulate in a way that meets your requirements?

Michael Moore: We regularly submit a whole range of suggestions for change to regulators and to government for Budgets or the King's Speech, so there is clearly a whole range of areas where it might improve. It is demonstrably more risk focused, as in trying to reduce risk to the system, than it is focused on growth.

Lord Grabiner: It would be very helpful to us, although not now, if you could give us some detailed examples of where the regulatory arrangements that are currently in place could be improved in that regard. We currently lack good working examples and we would find that very helpful.

Michael Moore: There is no single measure or area of regulation that, if abolished or changed, would change this overnight. There is a kaleidoscope of different issues, so we are very happy to provide those details.

Q222 **Lord Lilley:** You gave us the proportion of funds coming from foreign pension funds versus UK pension funds. In a way, it would be more interesting to know the proportion of, say, Canadian, Australian or other Anglo-Saxon countries' funds that go into things such as private equity compared with the proportion of UK pension funds that go into private equity, and then to analyse the extent to which that is due just to the laziness and risk avoidance of the pension fund managers or to the result of regulatory factors that inhibit the proportion of funds that they can put into private equity or other supposedly high-risk areas.

Lionel Assant: If you look at the 2023 statistics for the seven largest pensions economies, the UK is second lowest in terms of allocation to alternative assets at 14%. Canada is by far the largest at 43%. Switzerland is number two at 34%; Australia and the Netherlands are at 23% and 24%; the US is at 18%; and the UK and Japan are at 14%.

Lord Lilley: That is very helpful. Are there specific regulations in the UK that inhibit a higher proportion? If so, what are those regulations? Do you imagine that the new secondary growth objective will encourage the FCA to change those regulations?

Lionel Assant: I will give you a concrete example. The FCA implemented the LTAF—long-term assets fund—about a year ago, which enables individual and retail investors to invest in alternative asset management funds. In one year, only 13 LTAFs have been created. The equivalent EU number is 160 funds, with €13 billion. As I said earlier to the Chair, there is a cultural element to it, but there is also a democratisation that needs to happen. We can work hand in hand with the regulator to make that happen and seize the opportunity.

A statistic that I always love sharing is that nine out of 10 companies worldwide with more than $250 million of revenue are private. Some 96% of UK companies with more than 50 employees are private. The fact that individual investors in this country are not invested in 96% of these companies is wrong. We can accelerate that and help the regulator, and we are happy to come back to you with suggestions on this.

Michael Moore: We were genuinely delighted when Jeremy Hunt launched the Mansion House compact, in so doing drawing attention to how small the allocation of the default funds in the UK DC market is. The great commitment that was made was to raise their allocation to 5% in unlisted equities by 2030. I would have to make sure to correct this if I have got it wrong, but the starting point was some 0.36% when they have done their first year.

We have welcomed the way the pensions industry has begun to get alongside us to understand our industry better. That is on both of us to

do that. I would say, therefore, that there is some cultural stuff about industries understanding one another, but there is no question that it is way more part of the expectation in North America. It could be done through the permitted links or making the LTAFs more appropriate for different ways of investing in these industries and giving access to people in an appropriate way. We are not asking to become the biggest stake that people have for their pensions; that would be wrong, but we reckon that there should be more in private assets across a diversified portfolio.

The direction of travel is good. The pension reforms that the new Chancellor announced—I know that you were there last week, Lord Forsyth—at Mansion House are hugely significant. We need to see them delivered.

Lord Lilley: Is there not still some rule around the fact that private equity involves higher management costs than an index-linked fund? Is that rule inhibiting them?

Michael Moore: The previous Government lifted the charge cap. We were very pleased. Did it unleash a flood of investment? No. That goes back to the fact that it is about not just the regulation but investment interest and culture as much as anything else.

Q223 **Lord Eatwell:** One thing that has emerged in discussing the relationship between financial services industries and the growth and competitiveness objective is that the term "investment" is used ambiguously. Sometimes, it means just buying assets in secondary markets and has no definite impact at all on real investment. The mortgage market is very much like that: money pours into it, and it is spent on houses that are already there. The flow of new houses is tiny compared with the stock.

What is really interesting about your bits of the financial services industry is: what proportion you would say of your investment ends up as real investment, and what of it is really buying assets in secondary markets? I understand that it is the private sector that we are talking about.

Lionel Assant: I do not have the statistic that you are looking for to hand, but I am happy to look into it and come back to you in writing. I will give you three recent examples that should give you the direction of travel, in my view.

I have been in the industry for 30 years. It has changed dramatically over that period from one that was small, where the vast majority of the value creation was, effectively, in cutting costs and hoping for a multiple expansion, to one that tries to buy assets and grow them more quickly than the economy, because, ultimately, the next buyer is going to look for that growth to pay you a premium multiple.

We invested £250 million in a small drug discovery company called Autolus to help it fund the R&D of a leukaemia drug, which was approved last week by the FDA. Autolus is going to produce that drug in Hertfordshire for years to come and it will save thousands of lives.

The current Government have made some headlines saying that we are about to invest up to £10 billion with our data centre company, QTS, to develop the largest data centre, near Newcastle, over the coming years, creating thousands of jobs. That is an investment that is coming.

During the Covid pandemic, I was involved in buying a business called Bourne Leisure. One of its three divisions is called Haven, which operates 40 caravan parks in the country, with 40,000 pitches. We have invested £500 million of capital to develop new pitches, new entertainment, new bars and new venues, creating jobs along the way.

We did this to accelerate the growth that, again, is necessary to create good investments. Today, cutting costs is not the way that you are going to make the returns. There is a self-fulfilling prophecy and a good cycle of more capital going into these deals, which provides more growth.

Lord Eatwell: My reaction to that is that that is great, but if things are so good, why are they so bad? A recent report by the Treasury Committee on funding for SMEs in this country argued that the situation, not for initial angel funding but for second-stage funding, is still dire in this country. It is very difficult, and many SMEs fail at the second stage because they simply cannot raise £50 million to £100 million—not very big in your terms, but not tiny either.

It was striking, when we had a fintech company here last week talking about what it did, that it said that it had just raised $150 million of second-stage funding. Where did it come from? It came from the United States, not from a British venture capital company. So, if it is so good, why is it so bad?

Michael Moore: I am going to try to get away with describing this as a problem of success, in that, over the last decade or more, the venture capital industry in the UK has developed hugely. The good news is that the demand for investment from the UK has grown at least at that pace or further. We were almost, in one respect, an emerging industry until about 10 years ago. It has come on leaps and bounds. Whether the industry is fintech, healthcare, deep tech or security tech, which is increasingly important and relevant for public policy makers, the appetite to make great use of UK IP and expertise, whether out of our universities or otherwise, has grown hugely.

As an industry, we have a really successful set of VC firms that have a particular place in the market and understand that they have certain amounts of capital at their disposal. The success of the UK and the rest of Europe over the last decade or more has been to attract more and more interest from US and other investors to come to and be based in the UK, and to see what is available from here. They have seen that the returns from VC in the UK have been very good. There is no question that, if you have been at it at a higher scale for decades longer, you have that infrastructure or, often, the ecosystems sitting around it that are necessary for the business to develop further.

Another angle on this is that, often, one of the key inflection points for these businesses is not just that they have commercialised and made something profitable but the markets they can gain access to. The US market is so huge that that is an obvious next stage.

That is the world as it is, and we live with it. The really exciting thing is that, if we can change the conversation and get more UK-sourced capital available from our pension funds or elsewhere to deploy into these great British ideas, we will have fewer of those examples.

Q224 **Lord Sharkey:** I start by thanking the BVCA for its written submission, especially the 25-page scorecard that came in.

Michael Moore: I realised afterwards that it did not have a single score on it, but you knew what we meant.

Lord Sharkey: I wanted to ask first whether you have discussed that—or at least the appropriate bits—with the regulators. If you did, what was the response?

Michael Moore: We have. We introduced this a year ago, because we were trying to create a halfway house between the incredibly technical details, which I am not going to pretend to understand myself, and those that policymakers and the senior strategic leadership of these different regulators would see. I have had enough anecdotal feedback in meetings with different regulators to know that they have paid attention to it.

It is very useful to us just to keep us thinking, "What is going on?" If we have several hundred managers based in the UK, there are a thousand or more funds that they may be responsible for. A lot of them may be domiciled somewhere else in Europe now.

We have a great hub of expertise here, but we need the fund domicile arrangements, as well as the regulation affecting the managers, the advisers and everybody else, to remain competitive. Otherwise we will lose what is the crown jewel from our industry.

It has been a useful discussion topic. Sometimes there is a bit of pushback, but it has absolutely framed this conversation as one about competitiveness.

Lord Sharkey: Can I ask about measurement as well? One of the difficulties we have encountered is that PRA and FCA metrics have occasionally been characterised to us as process oriented and not outcomes oriented. Outcomes-orientated metrics are surely the best way of trying to measure progress. Would you agree that we need more outcomes-based measurement?

Michael Moore: The difficulty sometimes is defining what the outcome is and then really nailing how much a regulator might be responsible for that. If our outcome is that we have sufficiently altered the balance between the risk and supervisory primary objective and the secondary one on growth and competitiveness, such that we now have a booming

fintech sector, there are 1,000 businesses where there were 100 and they all have the capital that they want, who is going to take the credit for that? Is that the regulator?

I do not wish to suggest that you are wrong to ask the question. There is just a little more difficulty. However, some of the measurements have been there for a very long time and, in a world of AI and faster processing generally, they still feel quite slow. There are issues that are not measured that we would like to be.

On the flip side, our industry gets asked for a huge amount of data by the regulators. Most of it is legacy requests that were part of original things such as AIFMD back in the day. We hope that, as part of the AIFMD review process—it is as yet uncertain when that will start—all of this can be seriously approached, and that the competitiveness and growth objective will frame some of these data requests.

Lionel Assant: I agree with Michael on this point.

Lord Sharkey: Can I just ask one more question about measurement? In the end, we are going to have to make a judgment, reinforced, we hope, by objective measurement. I think Michael mentioned in passing that there may be some things that we want to measure that are not contained in the current list of metrics. What are they?

Michael Moore: I am now hoisted by my own petard. I will come back to you with a list, if I may. My broader point, if I am allowed to escape to that, is that we are stuck with a legacy set of questions on a particular set of issues that may or may not still be relevant or proportionate to the way the UK industry is. There are other areas that are not measured, which might give more of an outcome focus. It is an important challenge and I regret not being able to give you a specific answer.

Lord Sharkey: Writing will be fine.

Q225 **Lord Vaux of Harrowden:** By its nature, the venture capital industry is almost entirely institutional money. Where it is retail, it tends to be high net worth individuals. It is an area of the financial services industry that seems to be right for relatively light-touch regulation. You talked about regulation needing to be proportionate. Do you feel the regulation of your industry is in the right place at the moment in terms of overall proportionate-ness, if that is a word?

Michael Moore: It can improve, and it could get better. The extent to which the full force of AIFMD applies to every business above £500 million of assets under management has not changed since the outset. We hope that might be looked at in this review. Looking at regulatory capital requirements, it is deeply frustrating to the industry that we have had something that we can see was envisaged for the banking sector brought to bear on our industry, where the management firm and the funds it is responsible for have very clear and strong legal boundaries between them. Essentially, we have ended up with a lot more cost in the

industry than is necessary, and there is a danger that we have gone further than our European Union counterparts in those areas.

There is plenty of scope to revisit, although not the principles. I apologise to our friends in Singapore; I used a term of art that is often kicked around as a shorthand for lower levels of regulation. Having been there on a number of occasions, that is not the way I see it either. We are not driving lower regulation. It is important, because the people Lionel and others go to, who entrust billions of pounds to invest, do not want it to be somewhere where they do not have the right balance of protections. Let us get it fit for purpose for the investing climate that we now have, not the one of 10 or 15 years ago, just after the GFC.

Lionel Assant: We have a good and pragmatic relationship with the FCA. I venture to say that on behalf of my colleagues, since I do not interact day to day with it myself. We want to make sure that we continue the dialogue in areas of our industry that are growing quickly.

I will give you a concrete example, which is private credit. The people before Michael and me talked about private credit as one of the highest growth areas in the market. It was a £100 billion industry 20 years ago. It is several trillion today. It is growing quickly for a number of structural reasons. It is a good product. It delivers great returns. It helped save companies during the Covid pandemic, for instance. I remember having to scramble a loan for the NEC, which we turned into a Nightingale hospital. If I did not have private credit and its flexibility, I am not sure the NEC would be in the shape it is today.

The only ask to the regulator is to make sure that it has an open mind. We understand that, when things grow very quickly, we need to be transparent and have a dialogue, but we want to make sure that that dialogue goes both ways and that the regulator understands that the growth of an asset class does not necessarily mean that there is a lack of transparency or something fishy behind it. It is a good asset class and we should be encouraged to grow it.

Q226 **Lord Hill of Oareford:** On that last point—the extraordinary growth of the sector that you referred to—has that happened in large part because of overregulation in another part of the financial services sector?

Lionel Assant: I am not sure this is necessarily the case. The analogy of the same product with two different providers of that product, and therefore the same regulation needing to apply, is probably overly simplistic. Banks are inherently levered animals that have depositors' money. Private credit funds are committed for the long term. There is no asset-liability mismatch. There is no depositors' money behind it. That is inherently the reason why they were able—in my case with the NEC, but there were other cases during the Covid pandemic—to come to the rescue. They hold these loans until maturity, as opposed to syndicating them in the market. These are two very different animals. I am not here to comment on the banking regulation, which I leave bankers to complain about, but private credit is not analogous to bank loans.

Lord Hill of Oareford: To something you said earlier, then, would your biggest fear be that regulators do equate the two and think of you more as performing the role that banks used to perform, so they need to regulate you in an analogous way?

Lionel Assant: We ought to convince the regulators, as we have up to now, that we cannot and should not be regulated like banks, because inherently we have very different products, which, again, are committed for a long duration by institutional investors. We are not putting depositors' money at risk, and the back leverage on these credit funds is typically 1:1 as opposed to 13:1, which is the classic leverage of a bank.

The Chair: On that note, we have to conclude this session because we have run out of time. We are very grateful to you for answering these questions and providing us with further information. There are a number of questions we have not been able to cover but which we will send to you. If you could respond to us in writing, we would be very grateful. Thank you so much.