



Financial Services Regulation Committee

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

Wednesday 27 November 2024

10.05 am

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

Evidence Session No. 19

Heard in Public

Questions 232 – 241

Witness

[I](#): Bim Afolami, Former Economic Secretary, HM Treasury.

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Examination of witness

Bim Afolami.

Q232 **The Chair:** Welcome to today's meeting, the 11th oral evidence session as part of the committee's inquiry into the FCA and PRA's secondary competitiveness and growth objective. Thank you to Mr Afolami for attending.

A list of the interests of Members 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 it for accuracy, and it would be helpful if you could advise us of any concerns as quickly as possible. If you wish to clarify or amplify any points made during your evidence or have any additional points to make, you are welcome to submit supplementary written evidence to us.

Can I begin by asking the first question? You were a Treasury Minister and very much involved with the post-Brexit transition of quite considerable powers to the regulators, and you chaired a committee that made a number of recommendations. What is your view on how effective both the FCA and the PRA are at meeting this secondary objective, and what would you say were the main issues that ought to concern the committee?

Bim Afolami: Thank you, Lord Forsyth. It is a pleasure to be here, to be back—not in the Lords, but in the Houses of Parliament.

Lord Lilley: Something to look forward to.

Bim Afolami: Yes, exactly. If we start with the PRA—the key question at the heart of this whole issue—my assessment is that it has taken and does take the secondary objective quite seriously.

When I was in post, I recall Sam Woods, head of the PRA, explaining in quite a lot of detail how he was driving proper consideration of the secondary objective, not just at the senior level but through the organisation. He did that without significant prompting from me—he was very keen to demonstrate how he was doing that—therefore conveying a significant degree of confidence on my part and the part of Treasury officials that he was doing so and taking that into account. The way he approached the Solvency II debate that occurred at the time around regulations is practical evidence of this, as well as the debate around the final Basel package, which I know has now been announced subsequent to the election but was being prepared to be announced before the election was called. So I am pretty confident that the PRA has taken it seriously and is doing what it can within its remit.

In relation to the FCA, the picture is more mixed. I do not know how many thousands of firms the FCA regulates. It is under significant pressure from consumer groups and Members of Parliament, who are

often channelling consumer groups and from the media. It has a very difficult job and a very big remit.

Having said that, I did not see particular evidence of the FCA wanting to make the secondary objective a reality in the ways the Government had intended, the core reason for which is that it fundamentally saw its role as trying to stop bad things from happening. That was what all the senior people thought about first thing in the morning and before they went to bed in the evening. When it came to promoting growth, innovation, dynamism and competitiveness in our markets, they very much saw that as secondary, and I did not see sufficient evidence that they were taking it seriously in the way the Government had intended.

The Chair: I have begun to feel slightly sorry for the regulators in the course of this inquiry. Nikhil Rathi has made a speech about the importance of being given guidance on risk. On one hand, when something goes wrong, the politicians immediately blame the regulator for not having done enough, but then say—almost in the same breath—the regulators are too hands-on and too protective. Do you think perhaps some blame lies with Members of the House of Commons?

Bim Afolami: I am very keen on blaming Members of the House of Commons for all sorts of things.

The Chair: Now you are not there.

Bim Afolami: Exactly. In all seriousness, your point is well made. A fundamental difficulty—something your committee should consider very seriously—is the overall structural framework and the incentive structures given to every actor in that framework because they seem out of whack.

I remember having a discussion with both Nikhil Rathi and Ashley Alder at different times that there is not a particular incentive for the regulator to make a decision that will promote the benefit of everybody if it may lead to a perception that there are losers, however small in number. When I was in office—I said this not just privately but publicly—I was very keen on changing the mindset we have both in Parliament and the regulators throughout government around risk, as was my predecessor, Andrew Griffith, who I know you will be speaking to later on today. The regulator could quite easily say, “But you guys aren’t going to be there for ever, and we have to operate on a longer-term basis”. The overall structure does not necessarily incentivise the FCA to take the steps I was setting out.

The Chair: How could that change? There has been a particularly egregious example this week from an all-party group being very unfair to the regulators.

Bim Afolami: The PRA is broadly in good shape and can continue what it is doing. In relation to the FCA, you should effectively have two different and distinct bits of the FCA. There should be effectively a wholesale bit

that thinks about wholesale markets and firms—for example, big banks or insurers—and you should have a retail bit.

If you were to separate those things more formally and clearly, there may well be a conflict between those two different bits on certain issues, but that is perfectly all right. It is reasonable for the retail bit of the FCA to be worried about certain things and the wholesale bit to be saying, “No, we need to promote growth”, and that dynamic would help get to the right outcome, whereas, at the moment, the FCA thinks of itself as the retail bit, which is why we are not quite getting the changes we should see.

Q233 Lord Sharkey: Good morning. I have one or two questions about the remit letters. Do you think the new remit letters provide enough of a steer to the regulators to bring about any meaningful change to the risk appetite in the system?

Bim Afolami: Honestly, I do not think they do, not because they are bad or wrong or do not say the right things in the thousands of words in them, but they are just not sufficient a hook to force a change in behaviour. I remember looking at a redraft of the remit letter when I was in office and asking my officials to do a red line to compare it to the last one. I saw all sorts of changes, and I thought, “All right, we’re changing it all and it’s all going to be very different”, and it actually amounted to the same thing in the end. I am not blaming anybody; it was my responsibility. I just do not think the remit letters themselves do enough for the regulators to say, “You know what? In the remit letter on line 57, it says we need to do this, therefore, we are going to do that”, because they are not specific enough and they cannot be because of the sheer breadth of what the FCA in particular has to deal with.

Lord Sharkey: Can they be more effective than they currently are?

Bim Afolami: They probably can, but I am not sure that would do the trick in and of itself.

Lord Sharkey: Can I ask you about a comment that was reported in the *Financial Times*? Emma Reynolds, who is at the Treasury now, said the Government was open to mandating the pension funds to invest in UK assets should their take-up slow down. I wanted to ask what you thought about that statement. In particular, where does that leave the fiduciary duty of pension fund trustees?

Bim Afolami: First, I would like to say Emma Reynolds is very good and we are lucky to have her as a Minister. In relation to that precise point, I have long been sympathetic to the view that we need two principal reforms when it comes to pensions, and I think the current Government are continuing along the lines that myself and Jeremy Hunt, the previous Chancellor, were on. One is increased scale; the current Government have continued along that track and I urge them to try to do so as quickly as possible.

The second is to try to get more domestic investment from pension funds. Over recent weeks, I have seen a lot of commentary in the media of some people saying, "Oh, well, it is not the job of pensioners to pay for a politician's or the Chancellor's economic policy". That is true, but it is the job of pension funds that get significant tax relief to have regard to the overall benefits of the UK economy. When you compare the UK pension funds to other countries' pension funds, our pension funds are significantly underweight in their home market compared to almost every other competitor. That does not make sense to me because even comparatively small increases in flows of capital into the UK would have a significant, positive benefit to the capital markets, which raises valuations for everybody, and in areas like infrastructure and other areas in private markets.

Your point about fiduciary duty is incredibly well made and very important because it does not work for the Government on high in Parliament to say to thousands of hard-working pension trustees all over the country, "You need to do something that you don't think is in the fiduciary duty"; that is never going to work. A more detailed review is required by the Treasury and the Government to look at the nature of the fiduciary duty and what needs to be taken into account, thinking about what tax incentives can be given in order to help encourage and incentivise pension funds to do the right thing.

In a country like ours, mandating and forcing somebody to do something they do not think is right is unlikely to succeed in the long term. We need a combination of providing some more incentives, maybe financial or otherwise, and changing the fiduciary duty to make sure it takes a broader account of what is required.

Q234 Lord Hollick: I want to come back to risk, which you referred to. The risk weighting currently mitigates against a lot of SME lending, particularly in the housebuilding market.

Bim Afolami: It does.

Lord Hollick: Housebuilders get a much higher risk weighting than mortgages, and yet the Government, like the previous Government, want to build a lot of houses. How do you bring about a change of mind? Nikhil Rathi talked about a more mature approach. What can the Government do and what should regulators do by themselves to change the risk rating so that it opens up a lot more SME lending in the economy, which is badly needed at the moment? We understand 59% of total lending to SMEs comes from non-bank sources, which suggests the market is working in one way but is not working efficiently in another way.

Bim Afolami: That is a very important question and one that has frustrated me for a long time. The Bank of England and its mandate is responsible for setting those risk weights when it comes to the UK balance sheets; it is not in the hands of the Treasury or Parliament in any direct way to effect that. That needs to be changed because you end up with a situation where there are comparatively small tweaks to risk

rates—that are often made in other jurisdictions, such as the United States—which, if we were to make them, would mean fiscal policy would not have to do so much heavy lifting on the demand side in order to make it affordable for people, particularly first-time buyers, to afford houses or for SME housebuilders to be successful. These things all came in post-financial crisis. We all understand the context in which they were put, but we need to look at those carefully, and the Bank of England needs to look at that again.

The second point around the broader issue of SME lending is very important. I forget the precise numbers, but I am sure the Bank of England will provide them for you. If I recall, it is more expensive to lend to SMEs than to other businesses of certain sizes for the broadly sensible reason that SMEs are more likely to fail than bigger companies.

A big part of the discussions about the Basel package were around this particular thing. I remember being very clear—privately and probably publicly, although I should not have been—that, as part of the Basel package, we should do absolutely nothing that would disincentivise banks from lending to SMEs. The overall package broadly got to a reasonable place; it did not change very much from the rules before. I am making this point in detail for the committee to appreciate that this very technical thing has such an outsize influence on what is such a core part of economic fiscal policy, which is provision of lending to SMEs.

In relation to the point you made about so much going off balance sheet to non-bank lenders, some people may say, “Well, that’s fine; we don’t want banks doing it. We can allow credit funds, private funds or hedge funds to do it”. That is much riskier for the British economy because that money is hotter and goes in and out with increased velocity, and banks, which are very strongly regulated and scrutinised, are a good place to lend to SMEs. I just think that balance needs to be redressed somewhat.

Lord Hollick: How do you address that? What mechanism is there to change it?

Q235 **Lord Eatwell:** Could I just add a rider to that? The Treasury is a member of the Financial Stability Board. The Financial Stability Board in Basel sets the rates. The Treasury has a role in setting those weights; it is not just the Bank of England. So why is the Treasury not making the case on the Financial Stability Board that there should be a rearrangement of weights which would then be reflected in UK weighting structures?

Bim Afolami: Like so many other things, that was part of an ongoing, very detailed, complex dialogue between the Treasury and the Bank. But you are right, and forgive me if I was not clear enough about this: of course the Treasury has a role, but ultimately this was something the Bank felt very strongly about in the context of the Basel discussions.

The Chair: The reason there is a higher risk weighting on building as opposed to mortgages for the small banks is that the risk weightings of the small banks are set, whereas the large banks set their own because

of their track record and volume of business, so there is a competitive disadvantage. The reason there was an additional 150%—I think it was—risk weighting was that the European Central Bank increased it to reflect the jerry-building in Spain and Ireland.

Now we have left the EU—and the Government of which you were a member made great play of how we were now able to set our own rules—we are stuck with risk weightings which, as Lord Hollick has pointed out, result in more expensive funding, and less funding, being available to small builders as opposed to people who are building 1,000 houses, which may explain why some have disappeared. In Europe, under the European regime, special arrangements are also now being made within Basel in order to promote SMEs. So why are we in this mess?

Bim Afolami: You have made the point very well. That is something that should have been fixed and should be fixed presently.

If I may, I shall add one thing I forgot to mention around the provision of finance to SMEs more broadly, not just in relation to housebuilding. Another thing that frustrated me around some capital rules on risk-weighted assets was the MREL rules in relation to challenger banks or mid-sized banks. It effectively makes it very difficult indeed for a challenger bank to scale up once they hit that MREL threshold; they end up being taken over by one of the big banks, and then we effectively solidify the oligopoly of big banks. I have nothing against our big banks; they are good institutions. The point I am trying to make is having more competition would help that provision of finance to SMEs, as we are describing, but we are not going to get that if the MREL rules kick in where they do. That is another area where the Treasury and the Bank need to bang heads together and get something sorted.

Lord Hollick: Did you try to do that when you were there?

Bim Afolami: I did, but I was not successful.

Lord Hollick: Why?

Bim Afolami: As I say, there are so many different things going on at any given time between the Treasury and the Bank of England and you can only have so many debates and arguments about so many things. Ultimately, I was not successful in that, but it is a debate that definitely needs to be had.

Lord Vaux of Harrowden: I am slightly puzzled. There seems to be a conflict between what you are saying now and what you said earlier about how Sam Woods has done such a good job of embedding the competition objective into the PRA, and yet we have these fundamental things where you were not able to make any progress. What is the dynamic there?

Bim Afolami: I do not think there is a conflict. Sam Woods is a very key player in the system; he is not the only player in the system. Part of this

discussion so far is outlining just how complicated our set-up is now between the FCA, the PRA, the different impulses of the FCA that we described, the Bank of England's role overseeing the whole thing, the Treasury, and indeed the oversight of all these things that this committee plays a very key part in. Much more clarity, much simpler responsibilities and roles, and a broader acceptance that we need to orient the whole system towards economic growth, innovation and risk in the most positive sense of that word are so important.

Q236 **Lord Eatwell:** Good morning. A few sessions ago, we had evidence from an academic who had looked at growth and competitiveness objectives, which apparently are quite common among regulatory organisations around, say, the OECD. He attempted to identify whether they had had any impact, and he said basically they had not, or, more accurately, he could not identify any impact they had had. Are we really barking up the wrong tree here? Are we somehow trying to achieve a goal that really will not work?

I have two ways of looking at that. One is that when we put the competitiveness and growth objective to people working in the financial sector industries, they see it as their growth and their competitiveness and we have to push them to say, "No, it's supposed to be of the British economy". One characteristic of their reaction is they say how much they are investing in Britain, and when you ask, "Well, what are you doing?" they say they are investing in the secondary market. They are not actually investing in what could be called real stuff, such as the sort of things that Lord Hollick has just been talking about.

There will obviously be elements within any complex structure of regulation where you could tweak things and make them a bit easier for those who are investing in real investment; there always will be, but is this really significant? If so, do you have a couple of things that you would like to do with respect to financial regulation that you think would make a difference for the UK economy?

Bim Afolami: Let me give you a couple of specific examples because that is useful. Before I do that, I just say I agree with you that getting to the heart of it is important. Are we even barking up the right tree with this whole process of these secondary growth objectives and the like?

Let me give you a couple of examples, and this will help to illustrate some difficulties that Ministers have when approaching these questions. The first example is what one might describe as the advice guidance boundary when it comes to individuals being given advice in order to make investments with their own money, not just in pensions but for their own personal investments. This has long been an area where the British people have been very poorly served compared to other comparative markets.

In essence, if you are wealthy—if you are somebody with sufficient cash—a private bank or other advisers will help you, you will get very good advice, and people will sit with you and discuss the nature of your

investments with you in immense detail. If you are not wealthy, the regulatory regime makes it too difficult for anybody to give you any proper advice in a way that is affordable and could actually be helpful—for example, the amount of money sitting in cash ISAs, which is far in excess of what it should be according to any reasonable investing strategy. This was accepted by the Treasury quite a long time ago, and we were working on trying to clarify and deal with this boundary before the election so we could shift it in a much more risk-on rather than risk-off way. I very sincerely hope the current Government continue with that and make some real practical progress.

Another problematic area in terms of where I would change things is the action, powers and remit of the FOS, the Financial Ombudsman. I know you will all be aware of the motor finance issue; I suspect there will be another session to deal with that, so I know this is not the place for us to go into that area in detail. However, we now have a situation where you have a Financial Ombudsman that can make determinations that supersede or change rules that were in place at a time when the FCA had already made rules and there is primary legislation that underpins the secondary legislation under which the FCA makes rules.

This messy situation effectively means there is more of a discount on financial services businesses in the UK; people do not want to invest in the UK because they think, at any given point, the Financial Ombudsman can come and make a determination completely outside what the rules were at any time. To finish this, I want to be clear: I am not criticising the individuals at the top or anybody in the Financial Ombudsman; I am criticising the framework and the remit they have, which urgently needs to be looked at.

The third thing I would say—a very practical thing, which I am sure you are all familiar with—is the sheer death by consultation in the financial services sector. It is maddening that we have people such as Lord Hill, a member of this committee, who sweat for months, if not longer, on a fantastic piece of work and review that broadly has the support across the industry. That was in 2020 or 2021, and we still have not quite finished the implementation of all that work. Why is that? Because of the sheer slowness with which we have consultation, then Parliament, consultation, then FCA, and that process taking so long is a significant problem in terms of changing the dynamic. Because it takes so long, even when people recognise that something is wrong, the incentive for people to invest and actually move on those recommendations is much lower.

The last thing I will give as an example is the role that the Competition and Markets Authority has in financial services. The CMA does not sit under the Treasury; it sits under the Department for Business and Trade, so I know there is a bit of plumbing there that can make things slightly difficult. But the role the CMA plays is a significant weight on how financial services businesses operate, and they are choosing not to

include the UK in things they want to do in many cases because of fear of being caught in the CMA remit.

Q237 **Lord Lilley:** I agree with both Lord Eatwell and Lord Hollick that the primary, most important aspect of the secondary objective is the growth of the whole economy, of which financial services are only a part. In so far as it affects the financial services sector itself and its growth and competitiveness, do you think a better application of the rules—speedier, more user-friendly and helpful, helping new people come into the City, telling them how it all works, and giving them a friendly hand—is required, or is it changing the rules, making the rules more streamlined and user-friendly, and abolishing rules if need be?

I remember when I had your job and subsequently, whenever I got briefs to go to Brussels about these new rules, it would usually begin, “We don’t really want this rule, Minister, but let’s try to make it a bit less bad”. There were rules that we did not want, but we do not seem to have ever abolished any. Which side of the equation is it, or is it both? If the latter, what are we doing about it?

Bim Afolami: If I may, I would say to my predecessor in my constituency in the Commons, I will cheat and say “Both”. We are clearly overregulated in many areas of financial services that are not directly related to financial stability. The former Secretary of State for Business and Trade had this issue when we were dealing with the translation of EU law into UK law: when you go to industry and talk to them, they will quite often not propose getting rid of any rules, and that is the difficulty because Ministers and Members of Parliament do not have the time/expertise to go through the rulebook themselves and work out which ones make sense and which do not.

A very practical example that I faced was rules around investment trusts put in in 2017, which some people here will be very familiar with. Before, they had no rules, there were no crises, scandals or difficulties. I proposed, “Look, the investment trusts have faced significant difficulties. We should get rid of those rules; just bring us back to the status quo before 2017”. Naively, I assumed that this would attract some positive views from among many people in the City. It did from the investment trusts, but lots of other people seemed to say, “Oh, well, we can’t possibly do that. That’ll be different from what they’re doing in Europe, it’ll be different from here, or it’ll be very dangerous, Minister, if you propose to do this”, and I was saying, “Well, were there any issues before this rule was put in?” “Oh, no”, and this was only 2017; we were all around and we remember, and yet even that was very hard to do.

A structural problem we have is that a lot of industry themselves have become imbued with this same mindset that you find in the regulators and aspects of Government as well, so it really requires more Lord Hills doing reviews—

Lord Hill of Oareford: No.

Bim Afolami: Not more Lord Hills—I do not mean that—but thinking about things in a much more fundamental, zero-based way and saying, “What does a good regulatory regime look like? And let us go for that”.

The Chair: Baroness Bowles was unable to be here today, but your words will be music to her ears.

Q238 **Lord Grabiner:** Many of your answers have made reference to the structural issues, and that is what I want to ask you about. In answer to the first question from the Lord Chairman, you suggested it might be better for the FCA to have some split between the wholesale and retail side of what they do. Is that something you discussed with the CEO and the chairman of the FCA when you were in office?

Bim Afolami: I did not discuss it. Judging by where the broad political environment was at that time, I knew the ability for us to then do new primary legislation would have been very limited.

Lord Grabiner: We have had some evidence, at least from one significant witness, to the effect that there was actually a strong case for merging some regulatory bodies. I just wonder what you think about that. You have talked about the need to simplify the structure that we currently have. If you had a clean piece of paper and if you had the power to do something about it—you certainly have the ability—what would that piece of paper look like?

Bim Afolami: First, the nature of the oversight drives quite a lot of the stuff lower down, and some of you on the committee may be aware that something I have previously talked about is for there to be a joint Lords and Commons committee that does exactly the job you are all doing here today, but including Members of the Commons. The only reason for that is giving the democratic legitimacy, alongside the expertise of the Lords, would help broadly with oversight.

The Chair: For the record, when we set up this committee, we did actually suggest to the chairman of the Treasury Committee that that should happen, but your former colleagues in the Commons were not enamoured by it, and it is still the view—

Bim Afolami: Some were—that is, me and many others; some were not.

The Chair: That is why it did not happen.

Bim Afolami: Yes, I agree. In terms of a blank sheet of paper, I would not merge everything into one super-duper regulator because that looks a bit like the Bank of England, which is already sitting above everything. We need to be much clearer about the areas in which we will allow more risk into the system.

In my view, that has to be mostly on the wholesale side. I am not talking about bank capital rules per se; that is part of the wholesale dynamic but not the entirety. We need to be clear where those are, and where they are on the retail side. You can feel a bit sorry for the FCA because it gets

it from all angles at all times, but a fundamental difficulty is it has in part a wholesale role—which is ultimately about large scales of capital moving into the system or coming out of the system and that investment drives economic growth—and that very retail role, which Members of Parliament and the press, et cetera, focus on. In my view, you would have a wholesale regulator and a retail regulator, and the remit for each would be clearly different.

Going back to Lord Sharkey's question about the remit letters, I think they would be shorter, more concise, and easier to read; you could probably put it on one side of A4 and everybody would know what their job was. That way, we would be clear in the areas where we do not want people taking more risk. In the areas where we think, "No, we want to take more risk. Your remit says you need to take more risk; why are you not?" that would be clearer, whereas, if you have the head of the FCA in front of you, he almost certainly always has to balance these two things off in absolutely everything he does, and that makes his job very difficult.

Lord Grabiner: Who would be responsible for setting the risk appetite?

Bim Afolami: Parliament. I have long been an advocate of this. If there was one area where Parliament could play a really significant role in this sector over the coming years, it is on the work you are doing here in this committee, trying to clarify and change—or persuade the Treasury and the Commons to change—the risk appetite as written down.

The problem with politicians or others just saying we need to change a mindset is it does not necessarily do the trick. It needs to be written down in ways that people are held accountable by Parliament—not just the Treasury but by Parliament. It is such an important stage, and my view is that the Treasury has almost guarded that oversight role too closely and should allow Parliament to do that. I made this point to my officials and I am not quite sure if they agreed or not; they would sometimes just politely stay quiet. Quite often, Parliament can say things that the Treasury officials in their day-to-day dealings find it difficult to say, and that is a very powerful role.

Lord Grabiner: Finally, would the ombudsman feature on your piece of paper?

Bim Afolami: The Financial Ombudsman has a place, but it should always be underneath and not exceeding in any way the role of Parliament, the FCA or the courts. I cannot resist touching on the motor finance thing briefly. It is a ridiculous situation that we are now in, that the courts are effectively having to clear up—or attempting to clear up—this gap between what the ombudsman is doing and what the FCA rules at the time said.

The Chair: Is the problem not that the rulebook is in conflict with the common law as set by the courts, and businesses have been following the rulebook and are now left with ambulance chasers piling on pressure and making lots of money at the expense of the consumer?

Bim Afolami: Yesterday, I was with a particularly big investor who was making the point that his propensity to invest in UK financial services has evaporated now that he is aware of the dangers of when things go wrong with the Financial Ombudsman.

The Chair: There is also the problem of the extent to which retrospection applies.

Bim Afolami: I think you are only meant to keep records for seven years, and yet this is going back to the mid-2000s; that just strikes me as an odd scenario to be left in.

Lord Grabiner: I did say finally; I apologise, your last answer encourages me further. In your view, does that mean the FCA has failed in the drafting or supervision of its rulebook because it is inconsistent with the common law position?

Bim Afolami: I suppose it is difficult for me to pronounce that because the Supreme Court is going to look at this.

Lord Grabiner: It will, but it is going to get the same result. Just assume that for the minute.

Bim Afolami: You know a few things about law, so I will take what you say as read for the record.

Lord Grabiner: Is that your sense on the face of it?

Bim Afolami: If we are in a position where the rulebook is deemed inconsistent with the common law—I want to stress “if”, because I am not saying that we necessarily are—that is a big failure that probably is not just the FCA’s. Presumably, all sorts of other people looked at that rulebook at the time and never said that this was the case. Ultimately, the people who will pay the price are not the people in this room but businesses doing their best to follow the rules and consumers who are going to probably have years of much higher premiums as a result of this.

Q239 **Lord Hill of Oareford:** I want to nail down a point following what Lord Grabiner was saying about the idea of a wholesale/retail split and the point that current attitudes towards risk in wholesale markets do not appear to be right. We are not sufficiently risk-accepting, and we do not have that right on the consumer side either.

You said earlier there is a structural solution that would require primary legislation and the splitting of the two or the reconfiguration—the white piece of paper approach. In your very first remarks, you speculated it might be possible within the FCA as it is currently structured to get it to organise itself on a wholesale and retail basis. Am I right to assume that would not require primary legislation?

Bim Afolami: It would not, but it would be up to Parliament and the Government as to how they chose to do it. The reason it is always neater

to do things by primary legislation if you can is that officials and people in the FCA do not think they will weight you out. If you want to make a proper change, you have to do it in a way that it has to be done, not just a management change or a surface-level change. If somebody were looking at it, they may say, "Well, that's maybe a first step. You separate the rulebook into the bits this part will look at and the bits that part will look at". If it is possible to do it in that way, that is an interim step that people may choose to go down.

Q240 Lord Kestenbaum: Good morning. I would like to take you back to two words that you used right at the beginning of your remarks. You spoke about behaviour change, which has underpinned everything you have said in all sorts of ways, and the kind of behaviour change that would be needed for a regulator to move from seeing itself as an enforcer of sanctions to a meaningful driver of competitiveness and growth. You have spoken about incentives and structure, primary legislation and other such things, all of which suggest nothing short of an organisational transformation.

I just wonder if this will ultimately take us back to the culture of the regulator. With the best will in the world, culture eats structure for breakfast, separating various functions. I would love your assessment of the underlying culture and whether some sceptics might feel, "Look, that underlying culture is just so stodgy and turgid". I am being unfair, as sceptics would have it. No amount of restructuring or clever incentives in the world would ever overcome a culture that is fundamentally committed to the slowness that you described, and others who would feel differently, so I would love you to say a few things about that.

Bim Afolami: That is possibly true, but that is why I also mentioned oversight because the oversight helps to hold people to account. I used to use this phrase that we do not want the UK to just be the safest graveyard. The difficulty is that, if you just keep telling somebody, "You have to be more positive towards risk", people will nod and say, "Yes, I completely agree", but faced with any decision, they will go back and say, "Well, what am I going to get fired for?" If they are not going to get fired for doing something—or the other way around, for not doing something—that is what will drive their behaviour.

So you have to change that thing that they will or will not get fired for, or better still, "What will I get promoted for?" Knowing that I can get promoted or have a better career if I can demonstrate these things is the bit where the legal and technical work would have a positive benefit. As long as the oversight is sufficiently there that means that when you call whoever it is up to your committee in X months' or years' time and you say, "Well, hold on. I've taken a look at this. We're going to go through these five big decisions you've made against this framework, and you haven't delivered on four of them", that then becomes a real problem for the head of that organisation. So the heads of that organisation—who are all very clever, able people—drive down through their organisation the need to make sure that, when they appear in front of that oversight committee, to go for their reappointment or whatever it is, they can

make sure they tick all those boxes. Across all the institutions, there is a ubiquitous tick-box culture—a bit of a culture of making sure that nobody can second-guess you afterwards and making sure that you can get your promotion or your next role. That is just the way these bureaucracies and most bureaucracies work, so understanding that and trying to work with it is probably better than just saying, “Well, that’s a bad culture”.

Q241 Baroness Noakes: When the secondary objective was set up in the Financial Services and Markets Act 2023, it rightly included the ability of the Treasury to specify metrics, and you eventually did sign off a set of metrics. How satisfied were you with those metrics? There was a lot of process measurement in there about the time taken to approve certain things. There does not appear to be anything about growth anywhere in the metrics and not much about competitiveness, so I am just interested in your reflections on how significant that package of metrics is.

Bim Afolami: I remember this very well. The difficulty with how the Treasury often interacts with the FCA at an institutional level is that the FCA often strongly resists attempts by the Treasury to mark its homework, and it did so in that case. I recall that, when it came to the international competitiveness point that you mentioned—something of immense interest to Members of Parliament, Members of the House of Lords, et cetera—the FCA was not terribly keen on that sort of metric on the basis that, “Oh, well, you’d be comparing apples and oranges; it wouldn’t quite be the same. You can’t compare us with this country because they have a different environment, and you can’t compare us with that country because we have a much bigger financial services sector”, and the like. Ultimately, the decision was pragmatically made that we just needed to publish these things, get most of what we wanted and get it over the line.

Baroness Noakes: Did you get most of what you wanted? As I say, there are great gaps in the metrics in terms of focusing on whether they are helping to deliver the secondary competitiveness and growth objective.

Bim Afolami: We got most of what we wanted, but that does not mean that we got most of what we should have wanted, so you may well be completely correct that those need revisiting and rethinking.

The Chair: On that note, we have a lot from you this morning and we are extremely grateful.

Bim Afolami: I used to be filled with fear when those words were said but less so now.

The Chair: You are a free man now. That has been a really useful session, and we are very grateful to you for the clarity with which you have answered our questions. Thank you very much indeed.