



Financial Services Regulation Committee

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

Wednesday 5 February 2025

10.15 am

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

Evidence Session No. 29

Heard in Public

Questions 346 - 363

Witnesses

[I:](#) Emma Reynolds MP, Economic Secretary to the Treasury and City Minister; Catherine McCloskey, Deputy Director for Financial Services Strategy, HM Treasury.

USE OF THE TRANSCRIPT

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

Examination of witnesses

Emma Reynolds and Catherine McCloskey.

Q346 **The Chair:** Welcome to today's meeting, which is the 17th oral evidence session as part of the committee's inquiry into the FCA and PRA's secondary competitiveness and growth objective. Thank you to Ms Reynolds, the Minister, and Ms McCloskey for attending. A list of members' interests relevant to the inquiry is available online. The session is open to the public and broadcast live, and is subsequently accessible via the parliamentary website. A verbatim transcript of the evidence will be taken and 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. It would be helpful if you could advise us of any corrections as quickly as possible. If after this evidence session 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. Minister, do you want to make a short opening statement?

Emma Reynolds: Good morning. I thank you, Lord Forsyth, and members of the committee for inviting me to give evidence to this inquiry. The regulators' secondary objective to facilitate economic growth and international competitiveness and the central role of the financial services sector in driving economic growth are priorities for me in this new role. It is vital that regulation supports growth in our economy and that the regulators focus on their growth and competitiveness objective, while also continuing to advance their other objectives. You will be aware that this is an issue that the Government have taken up with regulators beyond financial services, and you will have seen that the Prime Minister and the Chancellor wrote to all regulators in December on this very issue.

I should note at the top that this is my third full week in this role, so it is still relatively new, but I am familiar with some of these issues, and have been working on them from other perspectives, including when I was Pensions Minister directly before this role. I have been very impressed by the breadth and depth of the responses and evidence that you have received to this inquiry. I thank you for doing the inquiry, because it is going to make a significant contribution to our thinking.

Overall, I have three key messages for the committee. First, I would like to stress that this Government are strongly committed to the secondary objective for the FCA and the PRA, which was introduced in the previous Parliament, and that I, as a Minister, am aware that we face stiff global competition.

The second is that we welcome the progress that has already been made, and we have seen some early steps to embedding the objective, but there is still more to do. My third key message is that there is still work to do to fully embed the secondary objective throughout each organisation. We are ambitious about this. You will have seen that the Chancellor set this out in the remit letters late last year. It is our view, and her view, that there is still quite some work to do and that we want

to see a step change, particularly in driving cultural change in the regulators, away from risk elimination to a system that encourages informed and responsible risk-taking. To reiterate, my approach is ambitious for change, aware of the global competition, and collaborative with the regulators and Parliament to ensure that we are working with regulators, Parliament and industry to drive this cultural shift and, more broadly, to ensure that we realise the benefits of having one of the world's leading global financial centres, and that it continues to grow in the UK by making a direct contribution, such as employing more people, but also that its enabling role is deepened. By that, I mean its enabling role in facilitating the movement of capital and investment in the wider economy.

The Chair: That will be music to the committee's ears. Having had so many sessions looking at this as a new committee, we have great sympathy for the breadth of the task with which you are faced in looking at this. We have heard from some witnesses that the regulators are really only paying lip service to the secondary competitiveness and growth objective, and that most of the initiatives are ones which have been pressed upon them by the previous Government. I am impressed to hear you talk about the importance of culture. What tangible changes do you want to see in the FCA and PRA's culture, with respect to meeting that secondary competitiveness and growth objective?

Emma Reynolds: I want to see that change being driven at a policy-making level and at a speed of execution level; both of those things are important for the industry. When the FCA and the PRA are developing new rules around the policies that we have agreed, we want to see that they are proportionate, effective and do not seek to eliminate risk in the system, and that they seek to take a proportionate approach to that. In terms of speed of execution, I know that there has been some discussion in the committee about authorisations. We know that that is still a live issue. We think there has been some good progress there, but there needs to be more. As I said in my opening, one of the reasons we know that there needs to be more progress is that we look at international comparators, as you have done, and obviously the industry is global in its nature and experiences different regulators in different parts of the world, and some of those tend to do these things far more quickly and efficiently.

The Chair: We have heard people making the point that the regulators defer to their statutory objectives and the Governments defer to the regulators. The consequence is that there appears to be no coherent oversight of financial services regulation. Do you think that the framework obfuscates oversight of financial services regulation? How can we have oversight without breaching regulatory independence?

Emma Reynolds: That is a very difficult question.

The Chair: That is why we ask it.

Emma Reynolds: We are committed to FSMA 2023. As you will all be aware, that was a very big piece of financial services regulation, to which you will have contributed, and it really set this architecture up. It had been in the works for some time. We are not proposing that we change the architecture around how it all works. But, from my perspective, sitting where I am now, I certainly think that the Treasury will keep up the pressure on the regulators to ensure that we have a regulatory approach that is in line with our number one mission as a Government, which is to drive economic growth. That requires cultural change all the way through the organisations that we are talking about, not just at the top.

The Chair: The issue of democratic control is important. The previous Government just handed the whole corpus of regulation to the regulators; previously, it was subject to oversight—indeed, Baroness Bowles played an important part in that in Europe. This issue of oversight and control is very important now. Perhaps this is putting it too strongly for the Treasury, but the laissez-faire regime that operated previously was reinforced by the fact that there was some political involvement at a European level. There does appear to be a bit of a vacuum now—would you agree?

Emma Reynolds: I do not think there is a vacuum. I am very well aware of how it worked in the European Union because I worked there for six years at the start of my career, and I am very well aware of the experience that you have around the table. With regard to the former chair of the ECON and the importance of that committee in the European Parliament, and how it works, I have seen it at first hand. We do not have that kind of Parliament. It is much more modelled on the French parliamentary tradition, where you essentially have standing Bill committees. We do not have that here, so it was always going to be a challenge to set up an architecture that was relevant and appropriate for our circumstances. Otherwise, we would have had to re-establish the way Parliament works, which I do not think there was much appetite for. I do not think there is a vacuum; there is a fair amount of oversight—look at the drum beat of evidence that is given by the chief executives of both the regulators, not only to your committee, but to the Treasury Select Committee, and sometimes to other committees as well. It is obviously up to Parliament how it wants to organise itself, and I know that there was some discussion about having a Joint Committee at one stage. I think Parliament is doing a good job in holding the regulators to account. We are part of that, making sure that the regulators are accountable.

The Chair: It is just that the sheer volume is enormous, with the constant extending of remits and all that.

Emma Reynolds: I appreciate that.

Q347 **Lord Smith of Kelvin:** We have heard in the evidence we have been given that, since the great events of 2008, regulators have adopted a risk-averse culture, which is reinforced by what some see as a lack of

political cover if anything goes wrong. The Government are now telling regulators to adopt a higher risk appetite. How can you reconcile those two things?

Emma Reynolds: To be fair to the regulators, after the financial crash both Parliament and the Government were asking them to recalibrate, while setting up the FCA and the way it works now, so the regulators were being given a very different message back then, and the reasons for that are obvious.

How do we reconcile asking them to change their culture? I think there is recognition that, by seeking to eliminate risk—for example, why do we have hundreds of billions of pounds in cash ISAs?—we have failed to drive an investment culture, as we see in other places, that allows people to invest their money. That is actually part of consumer protection; in a way, we have regulated so much that we are not protecting consumers against inflation. I read closely the evidence you were given by Chris Cummings of the Investment Association, and I think he said there were 15 million people with over £10,000 of cash.

What can we do together? I do not think this just about the regulators. What can we do together in Parliament about trying to drive an investment culture that realises cash is not a good investment, especially in a high-inflation environment? I feel like we have regulated ourselves into zero risk, and that is bad for consumers as well as for firms. So we are asking for recalibration, but we are not asking to go back to where we were in 2007-08.

Lord Vaux of Harrowden: You just asked us the question, “What can we do together?” May I ask you that question?

Emma Reynolds: We are starting to have a discussion with the regulators, with you and with others in the other place about how we can create an investment culture. I personally prefer to talk about an investment culture, because if we have a risk-averse society then just talking up risk is not going to really help us. That is my personal view. We should talk about risk with the regulators, but if we are to create an investment culture then I think that has to sound much more positive.

You have taken examples of other regulators around the world. To take examples of investment culture around the world—here I draw on my experience in pensions—in Australia they talk about “my super” and in the States they talk about “my 401(k)”, but we do not really talk about our pensions here. Can we, together, encourage an investment culture that recognises that if you are prepared and able to take a bit more risk then you could get more return? That is essentially what I would like to do. I do not know how, although I have had some thoughts. Maybe we could commission some work on how we do that together. We certainly lack such a culture.

Lord Grabiner: I would like to pursue Lord Smith’s point a little further. A possible explanation for too much red tape or sluggishness—call it what

you like—is that the FCA does not want to carry the can when things go wrong, and as a result it becomes overly cautious and risk averse. That, I suppose you would agree, is a natural human reaction. Do you agree with that?

Emma Reynolds: Yes. If you are going to be hauled in front of a committee and blamed for failure then perhaps you would think again.

Lord Grabiner: In those circumstances, is there not a justification for the Government taking more responsibility for setting risk appetite and giving more publicised direction to the regulators in respect of what would or would not be acceptable in terms of risk appetite? That might encourage the regulator to be less apprehensive and more successful in its work.

Emma Reynolds: I agree, and I think we are at the start of that process, but, because this is a sort of triangle, that requires Parliament to shift too. I say that with a bit of trepidation, but I think it requires the three parts—the regulators, the Government and Parliament—to move together.

Q348 **Baroness Donaghy:** I want to ask a bit more about the architecture that you indicate is not going to change. Following on from Lord Grabiner's question, do you think there is something to be said for making the remit letters more meaningful, discussing in detail with the regulators which "having regard" issues might be eliminated, consolidated or whatever you might call it? Do you think—this has been said by some witnesses—that the FCA in particular has been used as a political dustbin and has contradictory roles that it runs around in circles trying to fulfil?

How do you feel the Treasury and the politicians in the Treasury should react to a risk that goes wrong? A hands-off relationship with the regulator is fine, but not if that means completely letting it swing in the wind. How far will the Treasury back a regulator that has done what it is told? Lastly, and this is a bit of a cheeky one, after 40 years of a lot of these issues being dealt with in Europe, does the Treasury, both politically and Civil Service-wise, have the knowledge and expertise to spot the tsunamis?

Emma Reynolds: Gosh, that is a series of difficult questions. Thank you for that. I shall try to answer the first couple of questions that you asked. I am not sure I would describe this as a hands-off approach; I would describe it as proportionate. There are always risks of things going wrong; that is the nature of capitalism. We cannot strip out that risk entirely and we should not try to, but we also do not want to see a system where there are bad actors and bad practice. So please do not think I am coming here with no regard to consumer protection, because I am a Labour MP and I have constituents. I think we are saying that the risk must be proportionate to the actors that we are talking about. Do sophisticated investors need the same kind of protection as a retail investor? Probably not, so let us be proportionate about that. I do not want to give you the impression that I somehow do not care about

consumer protection, or that we are saying it should be a completely hands-off approach. We are saying that there needs to be a recalibration that looks at some of the trade-offs here.

How far will we back the regulators? I see this as an iterative process. We are working very closely with regulators. As I say, I am new to this job and I have seen this from the outside and from a previous joint ministerial role. Actually, I have been impressed with the level of contact and collaboration between officials, Ministers and the regulators; it is daily, which will not surprise you. How far will we back them? We will back them and we are trying to get them to go further, but it is a recalibration; it is not hands-off.

Do we have the experience to spot tsunamis? Only time will tell. Does anyone?

The Chair: Do you want to comment on that, Catherine, as that was aimed at your department?

Catherine McCloskey: Since the financial crisis, the Treasury has hugely increased the amount of resource that it has working on financial services and financial stability. It has massively increased its capability in that area and made changes to the regulatory framework through the introduction of the Financial Policy Committee et cetera to make sure that we are getting good information from the absolute experts in that area.

While I would not want to be complacent and say that of course we will see the next issue coming, I will say that where the Treasury and Bank of England are now compared to that time is a complete transformation.

Q349 **Baroness Noakes:** Minister, you have talked about recalibration. Could you turn that into something concrete? What do you actually mean by recalibration and how could we spot it if we saw it?

Emma Reynolds: I will give an example and maybe Catherine can come in, too. On the consumer duty, we have asked the regulator to look at the rule book and see where duplication is. If we are asking firms to focus on outcomes, we cannot have an outcomes approach and a completely prescriptive approach, at the same time. Those two things run in contradiction. So we are asking the regulator, and the regulator is looking at its rule book and at any duplication. Do you want to say something about that process?

Catherine McCloskey: That has been an ongoing process. The FCA's consultation closed recently on whether there are opportunities to remove prescriptive rules from the rule book now that the consumer duty is in place. I know the committee has heard lots of evidence about the consumer duty; it is a new way of regulating that requires a higher level of trust between the regulators and the firms that they are regulating in the way that they are interpreting those rules. That, again, is a recalibration and a process for the firms to go through to feel comfortable under a more outcomes-based approach. But it opens up opportunities

for firms to make decisions about the best way to support a consumer and consider the type of consumer that they are dealing with in a particular situation.

Another specific I can point to, which relates back to an earlier question, is on the advice guidance boundary review. Again, it is a question of how we encourage an investment culture. The current rules on financial advice mean that firms feel that only quite wealthy individuals get financial advice because of the cost associated with it and it makes sense for only them to pay for that. That means that the majority of people do not currently have access to financial advice. We are working with the FCA to look at a more sensible approach to that, which would mean that a larger group of people can access something that would help them to make decisions about the best things to do with their money.

Lord Smith of Kelvin: I encourage you to make sure that you are looking for tsunamis. In my career, I have come across times when suddenly the market wakes up and says, "Oh, gosh, there has been a trend". Take collateralised debt obligations in 2008: "Oh, I see. Everyone's involved in this now and that is what's causing this". There was the LDI crisis not so long ago. Did we not know that pension funds were getting into these debts more and more? Interest rates go up; bonds come down: there is an effect. Look out for these things. There should not suddenly be a crash when we say, "Oh, I see. They had been moving in this direction all these years". That was just a wee encouragement to get people looking at this.

Emma Reynolds: As Catherine said, we have come a long way since the crash, with the expertise we have in the Treasury and in our regulators. We absolutely all want to protect against trends and crises, but sometimes crises happen; it is also about how you react to them.

Q350 **Baroness Bowles of Berkhamsted:** If you are relying on the consumer duty—I understand the idea of the new way of regulating—how will you ensure that firms do not end up being as risk averse as the FCA is at the moment and used to be? The evidence so far is that that is exactly what happens. If the firms overreact, what would you be able to do and what is the enforcement procedure if they get the balance on the consumer duty wrong? At the moment, they would just put their belt and braces on; every time the FCA says "consumer duty", it causes a sort of overtightening.

Catherine McCloskey: That is fundamentally a question for the FCA in considering the appropriate balance between the consumer duty and prescriptive rules. There is a general consensus that prescriptive rules will continue to be appropriate in some areas. On the question of risk-taking, people's immediate thoughts often go to consumer risk, but we mean firms being encouraged to think about where they can take more sensible and informed risks, as well, try new ways of working and try new products. We see that as part of this recalibration, and it is partly driven by the regulators and how firms feel they will be treated if they take a

risk and it goes wrong. It is also about the broader business culture, which we also see as part of what we would like to encourage.

Baroness Bowles of Berkhamsted: I do not see firms getting that kind of feedback from the regulator, at the moment. They are not given any guidance around consumer duty; they just keep slipping in their comments, "Remember your consumer duty".

Catherine McCloskey: The specific point about feeling that firms are overinterpreting their consumer duty would be an ongoing conversation between the regulators and firms. If the regulators felt that they were doing that to the point of consumer detriment, and that it was preventing consumers accessing products et cetera, there would be a discussion, but there would not be a penalty. Ultimately, it is for businesses to determine their risk appetite, but we are keen to encourage them to think about their risk appetite.

The Chair: I should declare an interest, having previously run a bank. If the consumer duty is that the customer must get a good outcome, it is not defined. If the regulator or FOS decides that it was not a good outcome, and the firms are faced with enormous costs and fines—or perhaps a Section 166, which will mean costs of several million pounds—is Baroness Bowles not right to point out that this will actually drive them into either not providing a service or being very cautious about the terms of the service?

Catherine McCloskey: That is certainly not the outcome that the FCA is looking to achieve. This again comes back to my point that an outcomes-based approach to regulation requires a different relationship between the regulators and firms, because whether or not a rule has been breached is less black and white under that approach. The consumer duty is still bedding in. The redress point is well understood in government and is something that we are actively working on with the FCA and the FOS.

Q351 **Lord Hollick:** Minister, you spoke positively about the relationship between the Treasury, officials, Ministers and regulators. That stands in stark contrast to the relationship that seems to obtain between a lot of regulated companies and the regulator. The theme that has been running through this hearing is that a large number of institutions are not prepared to go on the public record about their concerns, for fear of a punishment beating. That is very unhealthy.

I think you must have picked up in our briefing that this has made our work rather difficult, because we have heard a lot of things in private that we cannot refer to. What could the Treasury do, and what architecture could it put in place, to encourage a healthier and more open relationship between the regulators and the regulated institutions?

Emma Reynolds: I do not know about Baroness Bowles's experiences in the European Parliament, but it is quite natural for regulated firms to be somewhat cautious and nervous about criticising regulators in public. I would be surprised if that did not pertain. The relationship between the

FCA and the PRA, and the firms they regulate, varies; that is my experience. Some of the bigger firms speak of a good and positive relationship with the regulators. I know that you may have received evidence to the contrary from some of the smaller players, which is concerning, but I am not surprised that firms are nervous to sit here and directly criticise the regulator that is regulating them.

Lord Hollick: One of the points that came up is whether the independent chair and the non-executive director could play a more positive role in promoting an open dialogue.

Emma Reynolds: I want to work closely with the chair of the FCA in particular, and the NEDs on the board. As I say, I am very early in the role, but I certainly want to do more to ensure that, as with any company, the board is challenging the leadership and encouraging them to see how they can drive change through the organisation.

The Chair: It is standard, is it not, that if you have high compliance costs, which smaller firms complain about, and you are a big firm that can meet those compliance costs easily, and if it is making it more difficult for your competitors to grow, then you are going to be very pleased with the regulator in a way that those who are trying to grow, but cannot cope with the costs, may not be. They might have a different perspective.

Q352 **Lord Vaux of Harrowden:** I want to go back to what we were talking about before. In your opening statement, you referred to the central role of financial services in driving growth. We have heard throughout that the majority of financial services investment goes into assets that already exist, which does not do much to drive growth. Aside from pensions, where would the Government want to see the FCA and PRA help to increase the allocation of investment—in primary markets, infrastructure, SMEs and other productive assets that do drive growth? What are the Government planning to do to support that, and should the Treasury and regulators be measuring it?

Emma Reynolds: Let me come to your first question. It is difficult to take pensions out of the equation, because that is quite a large part of the solution. I see it as the Government's role to bring down the barriers to growth, as in the reforms that we have embarked on, which are big reforms on planning, lifting the effective ban on onshore wind, making it easier to build homes and infrastructure, the infrastructure strategy, making sure that there is a pipeline of projects for pension funds and other parts of the ecosystem to invest in. It is really important that we do not just think about it. I was the Pensions Minister and I worked very closely with Lord Livermore, who is the Growth Minister. We need to make sure that we are working together to make things easier for that investment to take place. There is a big potential in pensions to drive that. We see what happens in other countries, such as Canada and Australia, which is more instructive because they have a similar system in terms of the move to defined contributions. There is much more that can be done to encourage and nudge pension funds and other investors to

invest in the UK, rather than just putting their investment abroad—I am not saying they are only doing that, but we see a lot of it. That is always going to be the case, but we need to recalibrate it to ensure that more of that investment goes into private productive assets here, and infrastructure.

Lord Vaux of Harrowden: That is interesting. We have heard that the vast majority of lending to small and medium-sized enterprises, for example, now comes from outside the banking system. The mortgage industry is almost entirely based on buying and selling existing housing stock, rather than creating new stock. We hear that while we are quite good at the initial venture capital financing, secondary and growth financing rounds almost entirely come from America and abroad, rather than from our industry. It seems to me there is quite a hole there. Is that something the Government recognise? Do they have plans to deal with it?

Emma Reynolds: Yes, there is a recognition that we are pretty good at the start-up phase but not so good at the scale-up phase—that is well accepted. That is why we set up the British Growth Partnership with the British Business Bank to look at how it could help create some of these opportunities, and we had some pretty early movers from financial services which were interested. Do you want to say anything?

Catherine McCloskey: Financial services firms were very closely involved with the Government work on the British Infrastructure Taskforce and how the Government can create that pipeline of investable prospects that the Minister mentioned. Financial services firms are very interested in opportunities to finance the green transition and further productive investment in the UK, and we are working with them to think about how the regulatory system and wider government policy can support that. That intermediary role in the secondary market is still hugely important for moving money around the system, and making sure that the businesses that can use and invest that money can get it and transfer it. The Chancellor, in her remit letter in November to the Financial Policy Committee, asked it to look at, and advise on, how the financial services sector can further support growth in the UK economy. The way in which regulation can support economic growth is a fairly new area of focus for regulators, and they are both actively looking at it. The FCA has a live competition asking for academic input on the chain between regulation and economic growth, and how it can further support it.

Q353 **Lord Eatwell:** I am going to follow up on what Lord Vaux said. One of the striking things in the evidence is that British financial institutions do not invest in British industry. They say they invest billions, but they mean they buy assets in secondary markets; they do not actually invest in creating new things. For example, there are a group of institutions called venture capital trusts which do this. The entire venture capital trust industry in this country is 125th on Barclays's balance sheet, which is a tiny amount. We see a financial services industry that does not significantly invest in British industry. What is the point of deregulating

these people? They are not going to invest in Britain anyhow. They do not do it; they are not institutionally created to do it. That is why we see, as Lord Vaux pointed out, that most of the scale-up funds come from America. It is very striking. We had a series of small, successful fintech companies here, and we asked them how their funding went. They said, "Oh, very well"—one had got \$80 million. It was all in dollars.

We had a senior academic from the University of Zurich here who had done a study of growth and competitiveness objectives. They apparently exist in about 30 OECD countries: none of them has any discernible effect. Are we looking at the wrong aspect? Should we not be thinking of institutional reform, rather than deregulation within the current institutional structure?

Emma Reynolds: I do not know what type of institutional reform you are referring to but, as I said at the start, we would not be keen to massively change what has been set out in FSMA 2023. I do not think that is where we are. I agree with you, though, that there is a problem in driving investment into the UK, and I am focused on it now but I was particularly focused on it in my role as Pensions Minister. There are things that the Government can do to help facilitate that pipeline of investments. There is the DC consolidation that we are forging ahead with as part of the pensions review, and the Mansion House compact, which was obviously an initiative of the former Government to encourage and nudge pension funds to invest more in private assets and private asset investment having more of a home bias. There is a good process going on there. Then obviously there is a whole reform around local government pension funds and ensuring that they pool their assets. Again, there is great potential there to ensure that more of that investment goes into the UK. But it is not easy; we are in an internationally competitive environment.

Q354 **Lord Lilley:** Thank you, first of all, for your replies, which have been very forthcoming and much better informed than mine would have been when I had been Economic Secretary for only three weeks. Mercifully, I was not put to the test. We Economic Secretaries should stick together.

I want to ask you a question that goes a bit beyond the bulk of what we have been doing up to now, which has been about whether regulation can be made more user-friendly, speedy, efficient, less cumbersome and less onerous. It suddenly dawned on me very late in the day that, actually, a huge issue is just how much lending there is in this country to industry. You mentioned the financial crisis. After the financial crisis, growth of lending in America resumed its old path and growth of the economy resumed its own path. On this side of the Atlantic, growth of lending has remained very stagnant and our economies have remained very stagnant. The interpretation put on it by people like Sir Adam Ridley, and Tyler Goodspeed in a recent lecture, are that on this side of the Atlantic we interpreted the Basel rules very onerously, requiring banks to increase their reserve requirements, which meant they either had to find more capital or lend less in relation to their capital. It seems to me to me that this could be the single most important factor accounting for the slow

growth on this side of the Atlantic since 2008. Is this something which the Treasury is looking at, or—since you were not given any forewarning of this question—will you look into it and let us know?

Emma Reynolds: We are working very closely with the PRA and the Bank of England on Basel III.1 and, actually, that has been a very productive relationship. I think that the industry generally supports the fact that the regulators have been quite agile here. I do not know, Catherine, if you want to say more about that.

Catherine McCloskey: We are obviously aware of the broader picture that growth in the UK economy and in the financial services sector has not recovered since the crisis—

Lord Lilley: I am talking of growth of lending to business rather than the financial sector in the way we often talk about it.

Catherine McCloskey: That is one of the issues that the Government are seeking to tackle through the growth mission and the industrial strategy. Access to finance is absolutely a core part of what we are looking at there—what is the availability of finance to support growth, and is it meeting needs? That is absolutely something that the Treasury and the Government are looking at more broadly. Capital requirements do impact on the cost and availability of lending. The regulators need to balance that. Now that the PRA has a growth and competitiveness objective, that is something that it will explicitly consider when it is considering appropriate capital requirements, alongside making sure that firms remain safe and sound and are able to withstand economic shocks.

The Chair: When the PRA—Sam Woods—was before us, he made a great thing on how it had gone beyond Basel III.1, but we pointed out that everything actually just remained the same. We have also had evidence from some of the smaller banks that the effect of the MREL provisions, which are way out of line with Europe and the United States, is to create a ceiling beyond which they are unable to grow and puts them at a competitive disadvantage. Is that the sort of thing that you are going to be discussing with the regulators? The evidence is that that could release many, many billions into the economy in line with what Lord Lilley was saying.

Emma Reynolds: Yes, and I know that this is an area of concern for the committee. There was an exchange of letters about this, and we are engaging very closely with the Bank on this. It is considering feedback that it has had on it. I cannot really say much more than that, but it is a live issue.

Q355 **Baroness Noakes:** Minister, can I switch to metrics? The competitiveness and growth objective was accompanied by a set of metrics which the Treasury promulgated. None of those metrics dealt with the broader part of the competitiveness and growth objective, which is growth in the UK economy. In fact, they did not really deal with growth in the financial services sector. They were focused on process issues—

operational issues. Are the Treasury, or are you as a Minister, satisfied that the metrics that have been set go any way towards measuring whether or not the competitiveness and growth objective is actually being delivered?

Emma Reynolds: The objective is that the regulator should facilitate international competitiveness and economic growth. Obviously, there are a number of levers. Actually, Lord Lilley's question sort of referred to this. There are many levers that the FCA does not hold with regard to growth in the economy—for example, our low levels of productivity, which are not a political thing, because we have had them under Governments of many different colours.

The metrics are important. I take your point as something that we can reflect on, but I know that you have had some evidence about measuring the speed of execution. When I say speed of execution, I mean authorisations. Measuring those things is important, and there has been more emphasis on that. When you shine a light on something, there tends to be more progress as well. That has been very valuable, but we should also just be realistic about what the financial services regulators can and cannot do in facilitating the growth of the wider economy. But, Catherine, did you want to say something more about the metrics?

Catherine McCloskey: I think the former Economic Secretaries gave evidence and talked a bit about that process of agreeing the metrics with the regulators. As the Minister said, part of what we discussed was requiring the regulators to report against things that they do not fully control and do not control the majority of. The metrics that we introduced are metrics that we heard from stakeholders were important for the reputation of the regulators, and the kind of attractiveness of the UK regulatory environment, which we consider an important component of growth and competitiveness. But there is a broader point for Government to consider. Obviously, we do track more widely what is happening in the growth of the sector and the growth of the wider economy, the amount of lending from the financial sector to the UK economy and to UK households. A lot of that is stuff that we look at and is published in some form. But I think the metrics conversation is an ongoing one between us and regulators to make sure that, wherever the most appropriate place is, there are good indicators out there to allow people to make assessments of how well we are doing on these things.

Baroness Noakes: What will the Treasury use to determine whether or not the competitiveness and growth objectives are being delivered by your regulators?

Catherine McCloskey: This is to some extent my view rather than a settled Treasury position, but obviously the objective covers four areas: the growth of the wider economy, the competitiveness of the wider economy, the growth of the financial services sector, and its competitiveness. We consider each of those elements. We are thinking about metrics in the context of the financial services growth and competitiveness strategy that we are developing at the moment. One

aspect of that is thinking about what success will look like and what we will measure and track. We are thinking about this actively but, at its heart, it is about whether the financial services sector is growing, providing jobs and supporting growth in the wider economy, through lending, investment and other transmission mechanisms. We are thinking about the best way of representing that.

Baroness Noakes: That should have been thought about before the policy was introduced.

Catherine McCloskey: We considered it and talked about it, but we did not set a number—"We want this to go up 5%". It was largely about an attitudinal shift and the kind of culture change that we have been talking about, making sure that that lens is brought into policy-making. Prior to the introduction of the growth and competitiveness objective, the regulators did not have a clear mandate to consider some of those issues.

Emma Reynolds: On the history of this, it is worth saying that the industry was calling for this secondary objective. I know that some wanted it to be primary, but the industry was saying that regulators must have this. Given that Catherine is talking about quite different things, how you then measure whether the FCA and the PRA are facilitating growth in the rest of the economy and the competitiveness of the rest of the economy is quite a big thing to ask them to do. They have much more control over what they can do in financial services regulation that relates to that. These are not easy things to measure, but it was right that they should have an objective that looks at the broader impact of what they are doing.

Q356 **Lord Sharkey:** Following the question about objectives and measurement, many other jurisdictions have secondary growth and competitiveness objectives. Have you looked at how they measure outcomes and progress? Is there anything that you have learned or we should learn from the experience of these other jurisdictions?

Emma Reynolds: I have some experience of this from my previous role in the City. TheCityUK and Freshfields did a very interesting report on this. I know you mentioned an academic who had done some similar research; I think that a number of regulators have different objectives that are not exactly the same as the one that we have and are looking at today. However, the research demonstrated that, actually, the UK is relatively transparent compared to other jurisdictions in measuring the impact of these objectives. That was the broad conclusion of the research.

Catherine McCloskey: We have looked and continue to look at this issue.

Lord Sharkey: So were there no methodological mechanisms, which we could copy or adopt, that would help us? I am slightly puzzled and am not entirely sure I properly grasp what you were saying, Minister. I take the point about transparency, but do I interpret transparency as failure on

the part of these other jurisdictions to measure properly or are they concealing what they measure?

Emma Reynolds: Different jurisdictions have different cultures, and it is not always that easy to compare one to another. I am simply reflecting on what was found by an internationally recognised law firm, which did a lot of the work—Freshfields. It is difficult to compare the data. I am not saying that other countries were not transparent, but we were certainly not at the bottom of the pack in measuring the impact of these objectives or the metrics around them. I am not saying that other jurisdictions were not transparent; I am saying that it was difficult to compare the data and that we were certainly not behind the curve. That was the broad conclusion.

Catherine McCloskey: That is right. Benchmarking is something that we are definitely interested in and continue to discuss with the regulators, but we are mindful of making sure that we are comparing like with like. There are challenges with doing that.

In thinking about the regulators' other objectives, they are also not judged on particular metrics on consumer protection. It is assessed in the round. That again is consistent with the approach to other objectives.

Baroness Bowles of Berkhamsted: I have a small comment which probably goes back to the previous point. When you are looking at how to get more investment into growth companies, especially on the tech side, blocks of it are beyond your remit, such as where public procurement is. However, in the banking sector, especially when looking at AI generation and so forth, we need more lending secured against intellectual property. That seems rather lacking. The difference between the US and us is that we do not have as much manufacturing, so do not have the ability to secure against plant and things like that. That sector needs to be developed more and to know how it will be treated under Basel rules and so forth.

Catherine McCloskey: That is a really good point, but not something on which I have a specific answer at the moment. It is certainly something that the Government are considering more broadly, through that growth mission work about how can we support early-stage companies and get that pipeline of financing through.

The Chair: Perhaps you could give us a note on that.

Emma Reynolds: Yes, could we write to you on that one?

Baroness Bowles of Berkhamsted: Yes. I am flagging it up not so much for an answer now. I can input some more thought into this, if you wish. My original career was as a European patent attorney, so it is something I know my way around.

Emma Reynolds: That would be helpful. I would really welcome that.

Lord Vaux of Harrowden: On the metrics side, we have had some pretty stark evidence about the level of cost and burden of regulation here compared, for example, to the States and Europe. Costs here are a multiple of what they are in the States; the cost of doing business here is the same as for the whole of Europe in one example. But the regulators do not seem keen to look at the metrics around that themselves. What are your thoughts on that? Should they be trying to benchmark themselves better against international competitors and publish that?

Emma Reynolds: We are concerned about your point about the cost of regulation. I am not saying this to be mealy-mouthed, but I think it is difficult to compare data across jurisdictions. What the regulators said about this earlier was that they would then be put in an invidious position in which they are, in essence, commenting on regulators in competitor jurisdictions and their counterparts in other jurisdictions, which could be quite awkward. I think we should have regard to international competitiveness and how these things compare, but it is quite tricky. Catherine, you have been working on this for longer than I have.

Catherine McCloskey: We discussed this when we were discussing the metrics and, depending on how you do it and how far you go, you could perhaps put the UK regulator in a position where it has to do a regulatory data return asking firms how much they spent on regulatory compliance in other jurisdictions, so that they can provide that comparison. That itself would increase the burden of UK regulation on those firms, which would then need to collate information about their activities in other areas and give it to the UK regulator. You get in a bit of a loop there. We are interested more broadly in whether the burden of regulation in the UK is in line with other jurisdictions, and that is something that we discuss with the regulators a lot.

Q357 **Baroness Donaghy:** One of the bits of evidence we received was about the administrative efficiency of the regulators, as metrics might be useful there. We had comparisons with, say, Singapore, which has a concierge service. The Minister used the word "facilitation", and there is an enormous difference between facilitation and process. Some witnesses have said to us that, once it goes to the regulator, it is almost like the valley of death while they are left waiting for the outcome with no guidance, information or help. Do you think establishing such a concierge service is something we should think about as a country? Would the state be prepared to pay for it? The FCA gave evidence that its administration has improved and that its objectives are to improve even further, and I thought that was quite promising. "Facilitation" really is the magic word as far as I am concerned. If something more could be done about that and regulators could stop behaving like process administrators, we could make huge amounts of progress, even on the non-policy level.

Emma Reynolds: I shall split my answer into two related parts. First, on authorisations and metrics, we have come a long way on this. The metrics indeed require the regulator to report on the speed of execution and authorisations. Things have got better, although that does not mean

to say that they cannot be even better. I see that Douglas Flint also talked to you about Singapore. We are quite different markets. The FCA is regulating 42,000 firms, which is a big endeavour, but we should look to MAS and others to see what they do and how quickly they are doing these things, and make sure that we are not at the bottom of the pack. There has been a great focus in the FCA on that because it was a particular problem there. It has made good progress but we will continue to work with it to ensure that it is not the valley of death that you talked about.

In Nikhil Rathi's response to the Prime Minister, there was a suggestion that firms could have a dedicated case officer for the regulatory sandbox. There was a question of pre-application support to wholesale payments and crypto firms. Do you want to talk about this, Catherine? It was interesting; they said they could look at whether they could tell firms, before they got to the end of the process, whether they were minded to approve, and that could help start-ups to secure funding. I thought that was an encouraging way of thinking about it. Do you want to come in on that? I want to come back to the concierge question.

Catherine McCloskey: Yes, this is definitely something that we are interested in—how regulators can support the growth of new firms. The FCA and PRA responses to the recent letter from the Prime Minister and the Chancellor start to get into some ideas about how we could do that further, and we are discussing with them now how we can take those forward. As it is quite a long and complex process for a new firm to go through, how can they be supported through that process? To go back to the point made by Baroness Bowles and others about funding, how can the regulator help them to go through those funding rounds where their business model is contingent on them getting approval from the regulators? How can that process support them in achieving that funding as they go through that process?

Emma Reynolds: On your point about the concierge service, that is something that Sam Woods suggested in his letter that the PRA could look to set up, and I think the FCA is interested too. We have discussed that with both Sam and Nikhil. That would be for financial services firms. In terms of the broader economy, we have the Office for Investment, and we are trying to make sure that we are much more joined up in government. The previous Government made some progress in that area to make sure that we have a broader welcome mat for firms in other sectors too.

The Chair: Does it not say something about the culture that it takes an albeit welcome initiative by the Chancellor and the Prime Minister to get them thinking about doing this stuff? In your opening remarks, you talked about the culture. Should the culture not be very much one of helping people to run their businesses successfully in a compliant manner, rather than what Baroness Donaghy suggested? One aspect that has come out is that the regulators do not even see themselves as policemen; after all, policemen will help you across the road. It is a

deeply embedded cultural problem that will be very difficult to shift. How could you do that?

Emma Reynolds: I think there is commitment from the chief executives of both the PRA and the FCA to drive cultural change in the organisations. The FCA has a much more difficult challenge in that respect because it employs so many more people and regulates so many more firms. How they drive that is certainly something that we are in discussions with them about.

The Chair: The committee has published a report today on naming and shaming that is critical of the way in which that process was handled. That is all water under the bridge, but it betrays an attitude towards the industry and towards operations that we found alarming and suggests that there needs to be fundamental change.

Q358 **Lord Grabiner:** I am going to move away from the valley of death, you will be pleased to know, although perhaps it is into another valley of death. The Chancellor has asked the FCA and the PRA to allow for what she calls sensible risk-taking. Are you confident that that the regulators and the Chancellor, the Treasury or the Government have a shared understanding of what that expression means? I am tempted also to ask you what you understand by the expression “sensible risk-taking”, but I am conscious that you have not been in the job very long and it might be a bit of an unfair question. However, there is another way of dealing with it. On the first point, to what extent do you think there is a common understanding between the Government and the regulators as to what that means?

Emma Reynolds: The letter that the Chancellor sent to the PRA and the FCA talked about informed and responsible risk-taking by authorised firms and indeed by customers. It really depends on what you are talking about here. What is the customer? As I said before, is it a sophisticated investor, a firm, a high net-worth individual, a retail consumer or a member of a pension fund? There are so many different sorts of customers. We are at the start of the process of making sure that we have a common understanding of what we mean by that but, as I said before, this is about trying to recalibrate the approach away from risk elimination.

Lord Grabiner: Can you give us some real examples—not necessarily here and now—of where you would like the regulators to allow for more risk or to make trade-offs that would not have been acceptable before that letter was sent? We are trying to focus on practical matters that you have in mind and that regulators should have in mind in future.

Emma Reynolds: We essentially put the ball in the court of the regulators and then they have come back since, as you know. One of the suggestions in the response from Nikhil Rathi—I think more to the letter from the Prime Minister and the Chancellor rather than the remit letters—was to look at mortgage lending and whether we need to introduce more

flexibility into it in order to support more first-time buyers on to the housing ladder.

Lord Grabiner: Going back to the point that I asked you about at the beginning of this meeting, to what extent do you see this as the responsibility of the regulator as opposed to the Government—for example, in relation to mortgages and risk?

Emma Reynolds: There are things that the regulators could do without the Government changing the policy, so they have quite some room for manoeuvre.

Lord Grabiner: But should they? Should it be down to the regulator, or should they be given direction or guidelines from the Treasury?

Emma Reynolds: There are directions and nudges from the Treasury to the regulators all the time, but we come back to the question at the outset, which is: do we want to change the architecture? And the answer is no.

Lord Grabiner: Why not?

Emma Reynolds: Because I do not really see that there is a particularly viable alternative. Maybe it is an extreme understanding, but I suppose the viable alternative would be to completely change the set-up of our Parliament, which I cannot see that we are going to do.

The Chair: Could you explain why that is?

Emma Reynolds: If we were to try and recreate the decision-making at European level, where most of the financial services policy-making was done, then we would have to set up our parliamentary committees in a completely different way. We have come to this architecture whereby we set the broad policy guidelines and the regulators set the rules, and that is welcomed by industry. You will remember the whole discussion around whether there should be a call-in or an intervention power. There has been a lot of discussion about this architecture, over many years, and we settled on the architecture that we got through FSMA. I have no ambition to throw all the pieces up in the air again and change that.

Lord Grabiner: What you call the architecture is really a vicious circle between the government position and the regulators' position. It just forces the regulator to be much more conservative in its approach to risk-taking, for example, because the regulator carries the can. I apologise for repeating the question from the beginning, but it is a fundamental issue, is it not?

Emma Reynolds: There are things that we can do within the current set-up to try and avoid it being exactly as you describe, but I agree that that has been a tendency up until now. There is a sort of triumvirate—Parliament, Government, regulators—and the question is whether we can

start to shift the culture of the regulators working together and the way that any news of any failures is received.

Lord Grabiner: If we want to get rid of red tape or unnecessary administration, we have got to take a bit of pressure off the regulator, have we not?

Emma Reynolds: Not all regulation is bad.

Lord Grabiner: I mean in terms of the consequences of things going wrong—the regulator is then in the firing line, and at the moment is not in a position to say, “Well, actually, I am complying with instruction or guideline from the Treasury, and I’ve done my job”. If the regulator cannot say so, it will simply do whatever it can in order to create more red tape, to ensure, if possible, that that criticism never happens. That is why I call it a vicious circle.

Emma Reynolds: Okay, I understand.

Lord Grabiner: If you have some thoughts on that we would be grateful to hear them.

The Chair: Baroness Bowles, do you have a question?

Baroness Noakes: Apparently the Chair cannot tell the difference between me and Baroness Bowles.

The Chair: You are much better looking.

Emma Reynolds: You do look quite different, if you do not mind me saying.

The Chair: Baroness Noakes, do you have a question?

Baroness Noakes: I want to stay with this subject a little bit longer. When the chief executive of the FCA wrote to the Chancellor following the remit letter, he talked about having a consensus on risk appetite, and he has developed that in other speeches. When he wrote to the Chancellor and the Prime Minister, following the all-regulators meeting, he said that the metrics for tolerable failures within the overall system could help to support this. What is the Treasury’s view on metrics for failure?

Emma Reynolds: I have discussed this with him. I am cautious about this because I do not know how we put numbers on that. Lord Lilley has been in my position. To use the mortgage example, there is a trade-off between trying to ensure that first-time buyers can get on the housing ladder, which might result in more repossessions, but we are not going to put a number on that. I do not think that is something that a Government Minister would do, so I am cautious about it. I know the broader point that the chief executive is trying to make, and I do take the point that Lord Grabiner just made about who carries the can. We are painfully aware of that, and it is something that we are thinking about.

Q359 **Lord Hollick:** I want to come back to Lord Grabiner's point that it is not only a question of who carries the can, but who makes the decision. Going back to Lord Lilley's point about increasing the supply of credit to the market, particularly the SME sector, a small number of recalibrations of risk weighting—including MREL—have been mentioned for SME housebuilders, for instance. We have had a number of decisions of that nature and possibly a more gradual change in the capital requirements, rather than the step change, which we have heard from small and medium-sized banks is a deterrent to actually growing any bigger and providing more—and, by the way, they are providing 60% of the funding to the SMEs. When we discussed this with the PRA, Sam Woods made clear that it can do some calculations and provide some information, but it is looking for not only guidance but instruction from the Treasury that this is permitted. How do we break through this merry-go-round—or not so merry-go-round—of who is going to take the decision to turn a discussion on sensible risk into the practicalities of changing the capital weighting? Who is going to do the work and who is going to make the decision, because Sam made very clear he wanted a letter of instruction from the Treasury?

Emma Reynolds: I have answered a question on MREL previously. We are in discussions with Sam and others about this. We understand the point that the industry is making—that it would be better if it were a gradual rather than sudden change—and we are continuing to work closely with them on it. They have the expertise to make that change, if they consider that is what they should do, and we are in discussions with them on it.

Catherine McCloskey: The legislation is clear that it is the regulators who have responsibility for making those decisions.

The Chair: In this case, it is the Bank of England.

Catherine McCloskey: Yes, it is the Bank of England in the case of MREL. There are clear decision-makers in legislation and clear lines of accountability to Government and Parliament to explain the choices they have made and why they have made them. Where the Government do intervene for wider public policy reasons, it is done transparently, generally through legislation where we would put something over the top of that, or some constraint within legislation that the regulators need to operate within. But in the absence of that, it is a decision for them to make.

To come back to the previous discussion, we did consider this model when we were preparing to leave the EU, and the global consensus was that independent regulators making these decisions led to the best outcomes for financial stability, and stability for firms in terms of understanding the rules. That was the consideration that we took into account when making the decision, alongside the practicalities of the volume of legislation that would be required if more of that rule-making was done directly by the Treasury and Parliament.

In repealing and replacing retained EU law, we kept some elements within legislation where we think there is a wider public policy reason to do so. Where we think there is a case to do so, we have kept some elements that offer guardrails within which regulators must work, rather than removing everything.

Lord Hollick: Are you saying that the responsibility lies on the regulators to come up with the detailed calculation of what the risk weighting should be, and it is not a responsibility for the Treasury?

Catherine McCloskey: In terms of who makes the decision about what capital requirements should be, that is the case. There is a broader discussion about the level of risk that society considers appropriate within the financial services system and the different types of risk within that. Is it the risk of a customer being defrauded or of a customer suffering lower returns than they expected? It is about differentiating between those different types of risks.

Lord Hollick: I think that answer would disappoint quite a lot of banks, which are looking for the Treasury's enthusiasm for growth to cut through and make some changes.

The Chair: On this point, it is a long-standing thing with which I am very familiar, having chaired a small bank, that the Government—the previous Government and this Government—say, “We want more houses built”. The risk weightings that are applied to developing for banks are 150%. Therefore, the cost is considerably higher than for the large banks providing lending to large developers—1,000-house schemes. The smaller developers have almost disappeared, because they cannot compete.

The Chancellor says that she wants to see more growth, but issues such as MREL, which are restricting the ability of people to lend and trapping capital that would otherwise be in the economy, are crucial to the Chancellor's objectives. The Treasury's position is, “We can't possibly interfere”. The regulator's view is “Safety first, because we carry the can if things go wrong”. However, if any of these small or medium-sized banks disappeared, it would not exactly result in some kind of economic crisis. Does the Treasury not have to grip this? This argument has been going on since the financial crisis and, if it serious about getting growth and getting more lending, it requires a degree of direction, does it not?

Emma Reynolds: I will take that back. I said in response to MREL that we are working with the Bank closely on this. As Catherine suggested, it has the ultimate power of detailed rule-making and that is not going to change, but I take your point about trapping capital. We obviously want to see this target of 1.5 million homes but, on the other side of the equation, another of the frustrations of smaller developers is the planning system. It is a much more disproportionate cost for a small developer going through that process, which is often long and costly, than it is for one of the big housebuilders. When I was shadow Housing Minister, I had

some discussions with them about that. We are certainly trying to ease that side of the equation for them.

The Chair: I completely agree on that. The Economic Affairs Committee under the excellent chairmanship of Lord Hollick, on which I served, produced an excellent report making these points on housing some years ago.

Baroness Noakes: I want to come back on MREL. The chairman was talking about setting capital levels, which is within the PRA. The PRA has a competitiveness and growth objective, but the Bank does not. Do you believe that it is correct to leave MREL sitting in the context of not having a competitiveness and growth objective, because it has a real impact on the competitiveness and growth of small and medium-sized banks?

Emma Reynolds: This is a difficult issue, because the Bank's primary objective is to protect financial stability, which is extremely important. We cannot underestimate the importance of that; we all know its importance and it does not really need stating.

For the moment, no, the Bank does not have a growth and competitiveness objective. I know that there was some discussion in this place about the Bill that is just about to go into Committee next week, which I am leading—the Bank Resolution (Recapitalisation) Bill. We certainly do not believe that the objective should apply in those cases, which are crisis situations. It could be over a weekend, as it was with Silicon Valley Bank.

I take your point more broadly on the moral issue but, as I say, we will work very closely with the Bank on that and reflect some of the points we have heard this morning.

The Chair: Baroness Bowles has a question this time.

Baroness Bowles of Berkhamsted: Or Baroness Noakes, as the case may be.

The Chair: You are both equally impressive.

Q360 **Baroness Bowles of Berkhamsted:** While we are on the issue of whether or not Treasury Ministers will instruct regulators, I am seized with what happens when there is a mistake. I am sure you know that I have spent an awful lot of time over the last two years on the issue of listed closed-end investment companies and the so-called cost disclosures debacle. One of the things that many people do not realise, and that includes consumers and consumer organisations when they respond to consultations, is that costs, expenses and fees mean different things. If you ask a consumer organisation, "Do you think there should be cost disclosure for listed investment companies?", the answer comes back yes, but of course that already exists in the audited accounts. They are not costs because they are not paid directly by the investor. They are actually expenses embedded in the company and already discounted in the share

price. When the investor purchases the shares, they have already got money off because there is going to be a drag on performance because of the fact of the internal cost, just like in any other company.

We have got ourselves into this horrible mess where, through PRIIPs and, I would say, the UK's overly officious interpretation of it, consumers have been told, "Actually you're going to lose lots more money. It's going to come off your investment", which is not true. We are perhaps on our way to recovering this because the replacement CCI regime is under consultation by the FCA, and in the previous statutory instruments the Government made a legislative intervention by sending the aggregation in MiFID. But in the consultation that the FCA has done, as was confirmed by Ashley Alder to this committee, it has at last made the statement that nothing is taken off the share price. That is an early part of the consultation response but then, when you get further into it, it suggests that they are going to recommence aggregation, and that an open-ended fund that invests in investment trusts now has to recommence pulling through these non-existing consumer costs. At the same time, it says of ETFs, which are open-ended funds and which have consumer costs, that they do not have to pull them through.

So how do you correct a mistake by the regulator? If they say, "One plus one is three", and the consumer says, "I like three, that's a bigger number", then that is a done deal. We had this rather extraordinary exchange here with the chair here, and he said, "Well, it all depends on the consultation responses". I said, "So you weigh up truth and lies?", and he did not distance himself from that comment. If there is a "One and one makes three" ruling by the FCA, what are you going to do about it?

Emma Reynolds: We are still at the early stages of this. As you suggested, the Government took quite exceptional action in exempting investment trusts from the current cost disclosure requirements. While we wait for the FCA to come up with the CCI regime, I am sure that your comments today, and in the evidence session where the chair of the FCA was here, will be duly noted. I cannot really make any further comments on that at the moment, given that the consultation process is ongoing.

Baroness Bowles of Berkhamsted: But I am taking it out of that. I am taking it to "One plus one equals three". If you said "Excuse me, it is two", then that is an intervention—a correction. If we cannot have a technical correction, where are we?

Emma Reynolds: As I have said before, we are in constant dialogue with the regulators, and if we think there needs to be a correction then we will suggest that to them.

Baroness Bowles of Berkhamsted: Despite the Government's action, of course, nothing has actually changed. The platforms have said that, under consumer duty, they think they have to continue putting up these wrong numbers. The regulator does not seem minded to intervene on what I would suggest is a misapplication of consumer duty, so the £10

billion a year of lost investment into things like social infrastructure, which is usefully done through investment trusts, is still ongoing, so it will be £50 billion lost by the time we get to the end of the FCA consultation. Investors will not come in in the interim because they want confidence about what the regulatory environment is going to be. It just seems ludicrous to sit by and allow £50 billion of real investment into the real economy—primary investment into good things—to be lost due to the niceties of not giving stable guidance about something that is both technically correct and common sense.

The Chair: You have had a good go, Baroness Bowles, and I think the Minister has taken that on board. The committee feels quite strongly about this, as I think you are aware.

Emma Reynolds: Yes, I can see that.

Q361 **Lord Eatwell:** I have a three-part question about complexity. We have had a lot of evidence that there is excessive overlap between parts of the regulatory system, especially between the ombudsman service and the FCA but also between the FCA and the PRA, particularly with respect to consultations. It has been suggested that the ombudsman service should be incorporated within the FCA as a sort of division, as opposed to being separate. I wondered what you thought about that. Then of course we have had this extraordinary development of complexity. Chair, I was going to raise the motor fund issue. Is that okay?

The Chair: Bear in mind that there is a sub judice aspect to that.

Lord Eatwell: Yes, but we had the ruling from the Lord Speaker that we could raise it.

The Chair: I think that was just for the session that we had with the FCA, but I am sure you are clever enough to find a way.

Lord Eatwell: Okay. As you know, there is a problem of a clash between the common law and the rule book of the FCA. I will leave that issue out, but one of its consequences which has been raised as reducing investment in the UK is retrospective compensation. We had that in PPI, and here is another case where there might be enormous retrospective compensation. If I am an investor from America, Europe or the Far East looking at investing in UK financial institutions that promote real investment, I might suddenly think, "Gosh, these Brits, they suddenly produce enormous costs out of the blue". How do you think that we should treat retrospective compensation? It is obviously right that a consumer should be compensated in some way if the common law says that they have been treated unfairly. Yet this could completely distort and indeed ruin parts of our financial services industry. I was wondering whether you had addressed this extraordinary dilemma and what your reflections upon it might be.

Emma Reynolds: I really do not want to get drawn on any details of this, but all I can say is that it is public knowledge that the Government

have asked permission to intervene, and we are waiting to hear that we will be given that permission by the courts.

On your previous question about the FOS, as the Chancellor set out at Mansion House, we are working at pace on looking at the relationship between the FOS and the FCA and how we ensure that there is more predictability and clearer expectations, particularly for firms but for all parties, so that we have a financial services redress scheme that is a quick route to resolve disputes, because that is obviously what the FOS was established to deliver.

Lord Sharkey: Following on from that, the Chancellor, in her speech at the end of January, said that the Government would prioritise reducing regulatory barriers to growth and investment. One of those barriers, as I think was just mentioned, is the uncertainty generated by conflicting positions or judgments taken by the FOS and the FCA. We have heard proposals that in order to solve that the FOS and the FCA should be merged, or there should be some mechanisms to align the FOS with the FCA rules. What is your reflection on that?

Emma Reynolds: This is still very much an issue that we are discussing. We want to make progress on this. Where we want to land is predictability for firms so that they do not feel that they are being told to do one thing by one part of the system and another by the other. That is our objective. I cannot really tell you at the moment how we are going to get there, but maybe I could write to you when we have a better answer to that question.

Q362 **Lord Grabiner:** Can I raise another issue which we have touched upon, which is financial literacy? One of the responsibilities is to promote financial literacy. Clearly, financial literacy belongs at school.

Emma Reynolds: Yes.

Lord Grabiner: What initiatives are you taking to persuade the Department for Education there should be some prioritisation about financial literacy? It is clear from the research work that has been done that the level of ignorance is depressing. Yet, given the opportunity to have a pension explained or the nature of inflation and what it does to your savings, you readily grasp it. It would be wrong to come away with the view that somehow it is too complicated. It is just that it is not addressed. What do you think the Department for Education should be doing to actually remedy this quite serious gap in our education?

Emma Reynolds: We have got a review of the curriculum ongoing at the moment. I have not yet had chance to speak to the Schools Minister about this issue, but I will be trying to do that. This is part of the broader ambition of our Government to ensure that we have better financial inclusion. Obviously, we have a strategy and a committee set up that met late last year, which I now chair—it was not me at the time.

I am very passionate about this because there are huge inequalities here. If you come from a family that has wealth and knows how to manage wealth, you are probably being educated by your family. If you do not, then you are probably not. Therefore there are these huge inequalities in the way that people can go about managing their money. Pensions, again, are something I am very passionate about. We do not talk about pensions enough. People think they are boring—although, actually, I had a lot of people want to talk to me about pensions when I was Pensions Minister. We need to try and inculcate a culture of planning for the longer term. I think the pensions dashboards are really exciting. Hopefully that could get people more involved in their financial planning as well. But I will take the point about the education in schools away, if that is okay.

Lord Sharkey: We understand that the Government plan to publish the sector strategy in spring, I think, and we know that it is currently being developed.

Emma Reynolds: Yes.

Lord Sharkey: How do you intend to use the strategy to provide the certainty and stability that we need for economic growth without additional statutory powers to define the outcomes you want from regulation?

Emma Reynolds: I do not think we are committed to the last bit—the “without”. We will have to see where the evidence takes us, if you do not mind me saying so. Yes, this is a big priority for me and for the department. The call for evidence has now closed; we received many, many different responses from across the industry, which were very helpful, by the way—I put that on the record and thank the industry for that. Apart from that, we are also doing a lot of engagement—that is, the Chancellor and myself—with the industry and others to shape the strategy. The idea is to try and lift our heads a bit, because in politics often you deal with the urgent rather than the important. To look further down the line, where do we want to be in 10 years’ time? What do we need to put in place? What is the role of innovation? What is the role of digitisation? Are we behind a bit? What do we need to do? There are going to be a lot of strands to this strategy. We are very ambitious about it, but we are still in the process of consulting. We have done the written consultation and we are going through the written responses, but we think that engagement with the industry alongside that is also vital to make sure that we get the right strategy. Obviously, you know that, of the eight different sectors, all the sectors are going through this process on the industrial strategy.

The Chair: Lord Vaux, did you want to ask about fraud?

Q363 **Lord Vaux of Harrowden:** Well, I was just going to mention the previous question about the sort of regulatory overlap and fragmented nature. The one organisation we have not talked about is the PSR, which does not have a competitiveness and growth secondary objective. I

argued very strongly that we had to improve the rules around APP fraud reimbursement, but one could argue that they went too far and have actually been damaging to growth and competitiveness. The Government seem to be reducing the PSR's remit by putting open banking into the FCA rather than under the PSR. I just wanted some comments around the PSR's position, particularly whether it should have a secondary objective along with the other ones, and actually whether it makes sense to have the PSR separately from the FCA.

Catherine McCloskey: The PSR has been involved. The PM and the Chancellor also wrote to the PSR for its views on what it can do to support growth and competitiveness. While it does not have an objective, we discuss the same issues with it and work very closely with it where its remit touches on or interacts with the remit of other bodies, so we are very engaged with it on this. We are happy with the outcome that was reached on the APP fraud. We are continuing to work with it co-operatively on its growth and competitiveness agenda.

Lord Vaux of Harrowden: Does it make sense to have a separate PSR, with the way the open banking system is going and all the rest of it?

Emma Reynolds: I think we need to ensure there is alignment between the two institutions—we are very focused on that—and that we reduce as much as possible the overlaps that I was asked about earlier.

The Chair: Minister, we had evidence from a couple of the big banks. They have set up little groups that deal with fraud, and some of it occurs from people getting romantically engaged on the internet. They gave us evidence that people would want to send money to somebody that they thought was somebody they were not—and quite large sums—and that the banks have groups of people who monitor this and will say to them, "You are sending money to this person, but this person is not real. This is a fraud". And they still send the money and the banks are still required to compensate them. This is bonkers, is it not?

Emma Reynolds: I have received representations about this. The Chancellor has written to the so-called telcos about the role of some of the technology platforms in this and what can be done. We are in conversation with them, so this is an issue that we are well aware of.

Lord Vaux of Harrowden: It is not just the telcos and the tech companies, although that is obviously an area that needs to be looked at and they need to be brought into the equation. It is also the fact that the bank that is going to send the money, your own bank, has done everything reasonably it could and should have done to prevent the fraud, yet it is still on the hook. There has to be some element of risk for the consumer, otherwise you get into sort of moral hazard grounds. Similarly, that money is going somewhere. At the moment we have a 50:50 share between the bank that sends the money—your bank, which you have told to send the money even though it has said that it is a fraud—and another bank, which is going to receive and process the money on behalf of the fraudster. It does seem to me that that 50:50 is

entirely arbitrary at the moment and does not necessarily set the incentives in the right direction.

Emma Reynolds: This is one that I have to take away, if you do not mind.

The Chair: It also opens, of course, the possibility of collusion.

Lord Vaux of Harrowden: It creates entirely new frauds, actually, because two people who know each other create a fake fraud and then go back to the bank and say, "Give me my money back". This is now happening.

Emma Reynolds: Okay. I have not really had chance to dig into this.

The Chair: Perhaps you could send us a note about that. We have had a good two hours of your time. If I may say so, I think the committee is hugely impressed by the way that you have gripped this brief. You are so knowledgeable about it, having been in office for such a short time, so you have obviously been sitting up burning the midnight oil very vigorously.

Emma Reynolds: I was last night, actually.

The Chair: We are really grateful to you for the very forthright answers that you have given us and, on those where you could not answer the question because it was not possible, we very much appreciated that you felt able to write. Thank you, Catherine, for providing support and taking the flak for the criticisms of the Treasury. That concludes this public session.