House of Commons

Treasury Committee

Oral evidence: Future of Financial Services, HC 147

Monday 21 February 2022

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Anthony Browne; Gareth Davies; Dame Angela Eagle; Emma Hardy; Kevin Hollinrake; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 533-616

Witnesses

I: Sheldon Mills, Executive Director, Consumers and Competition, Financial Conduct Authority; Vicky Saporta, Executive Director, Prudential Policy Directorate, Prudential Regulation Authority; Edwin Schooling Latter, Director of Markets and Wholesale Policy, Financial Conduct Authority; and Christina Segal-Knowles, Executive Director, Financial Markets Infrastructure, Bank of England.

Examination of witnesses

Witnesses: Sheldon Mills, Vicky Saporta, Edwin Schooling Latter and Christina Segal-Knowles.

Q533 **Chair:** Good afternoon and welcome to the Treasury Committee and today's hearing on the future of financial services regulators. We are very pleased to be joined by four witnesses this afternoon. I am going to ask them to very briefly introduce themselves to the Committee.

Christina Segal-Knowles: Good afternoon. I am Christina Segal-Knowles, the executive director of financial markets infrastructure at the Bank of England. That means that I supervise, regulate and formulate policy related to systemic payment systems, which are the firms that enable households and businesses to make payments; central securities depositories, which enable people to buy, hold and record the ownership of shares and bonds; and central counterparties, which allow financial firms to manage risk by guaranteeing that transactions will be made whole in the event that a firm defaults.

Sheldon Mills: I am Sheldon Mills, the executive director of consumers and competition at the FCA.

Vicky Saporta: Good afternoon, and thanks for having us here. My name is Vicky Saporta, and I am the executive director of prudential policy at the PRA and the Bank of England.

Edwin Schooling Latter: I am Edwin Schooling Latter, the director of markets and wholesale policy and wholesale supervision at the FCA.

Q534 **Chair:** Thank you, and welcome all. Can I start with you, Vicky? Then I will open it up to everybody.

Some feel that, with all the reviews that we are having around the direction of regulation, the pendulum might be swinging too far towards light-touch. Is there a danger of that? What is your assessment at the moment?

Vicky Saporta: My assessment at the moment is that it is too early to say whether that is the case. This is a risk that could happen because, although there are clear benefits to the UK's getting back rule-making powers in order to take advantage of the opportunities and to meet our objectives as we want—we are taking back control, if you like, of our rulebook—we also have the possibility that there might be pressure to lower standards.

Q535 **Chair:** What would that look like, and what is the risk like? Which areas, from where you are sitting, are you keeping a closer eye on than others, in that respect?

Vicky Saporta: One risk is in relation to the future regulatory framework, which, as you know, the Government are consulting on, and which you have written a report about. Within that, the Government have suggested that the PRA and the FCA have a secondary objective in terms of long-term growth and competitiveness. There have been calls from some parts of the industry—a minority, I should say—for this objective to become the primary objective. That would be a clear risk, because it would create a trade-off between safety and soundness, financial stability and potentially other considerations, which could lead to a regulatory—

Q536 **Chair:** Which areas of regulation, when you look at that risk, do you focus on in particular or are you thinking of? Are there particular areas across the terrain here where you think, "Yes, this could be more of a problem than other areas"?

Vicky Saporta: The honest answer is that it could materialise in many of the workstreams.

Chair: Will you give us some examples?

Vicky Saporta: I can give you some examples of areas that we are currently working on, to illustrate the point. As you know, we are doing a joint review with the Treasury of the Solvency II rules. This is a real opportunity because, as Governor Andrew Bailey has been reported to say, there are problems with this regulation—it does not fit our markets—and for a long time we have wanted to fix the problems.

Q537 **Chair:** What is the risk?

Vicky Saporta: The risk is that this goes too far.

Chair: In what way?

Vicky Saporta: In not giving sufficient protection to policyholders by lowering capital resources beyond the risk appetite that is consistent with policyholder protection.

Q538 **Chair:** Do you have another example of an area where there is a risk of going too far, which you are thinking about?

Vicky Saporta: We are currently implementing in the UK—for the first time on our own—the latest set of the Basel reforms, the global financial crisis reforms, which in the jargon are called Basel 3.1. There could be pressure not to do the best thing for maintaining strong standards, and international standard setting is really important to maintain regulatory credibility.

Q539 **Chair:** Are you thinking about simplification for smaller companies in that context?

Vicky Saporta: Not in that context—the Basel III regulations will apply to internationally active firms.

On the simplification—this is a third workstream—I am less concerned about pressure to lower standards beyond risk appetite. What is clear there is that we need to simplify the regime for these firms, the smaller banks and building societies, in order to make them more dynamic and give them lower compliance costs, while maintaining the resilience that they have currently. At the moment, the regulation is far too complex for them. We have received quite a lot of support from all stakeholders in that field for that direction of travel.

Q540 **Chair:** Thank you very much, Vicky. May I ask the other panellists whether there are particular areas where you think at the back of your mind that there is a danger of not getting the balance right between being prudent and freeing things up to be competitive?

Sheldon Mills: Sure, I will jump in, and Edwin and Christina may want to as well. The starting point is that I think that we have a strong and independent financial services regulatory system, which has definitely been improved since the last financial crisis. It is important that we always ensure financial soundness and stability and that we think about prudential regulation to protect consumers and to enhance competition.

The debate around competitiveness and adding an objective related to competitiveness has a few elements. First, the FCA in its "have regards" already has a regulatory principle around long-term economic growth. We think it is important to maintain that. You can think about how much emphasis to place on that sort of principle. Elevating it to a secondary objective or, as some argue for and as Vicky mentioned, elevating it to a primary objective will have different consequences for how the regulatory systems plays out.

For us at the FCA, some of the potential consequences—I don't have a view on them, negative or otherwise; that is for Parliament and you to think through—could be how you balance enforcing consumer protection versus bringing down costs on the producer or supplier side. Those are things that we would have to think about.

We support, because it all hangs together very well, a long-term economic growth-type objective for the financial services industry. It is quite clear—for consumer protection, competition, and market integrity—that a stable, confident and prosperous financial services industry makes sense in light of our primary objective.

Q541 **Chair:** I am wondering, within all of that, which I think we would all agree with, whether there are any specific areas of regulation where the FCA is sitting there thinking about where more danger lies than in other areas. Is there any particular category of regulation?

Sheldon Mills: It depends on the definition of competitiveness. If competitiveness is effectively around short-run costs, there will be areas of risk to other of our objectives.

Q542 **Chair:** Which objectives in particular?

Sheldon Mills: All of them—market integrity, consumer protection and competition. I can take you through each of them. On market integrity, if you have a short-run-cost type of competitiveness objective, you may well reduce the prudential requirements for the safety and soundness of the organisations that we regulate. That could impact, in crisis, some of the things that we have seen in the past.

On competition, if you favour certain firms, either on entry or development and so on through a competitive objective, you can harm the long-term competitive market that drives innovation and also helps consumers. On consumer protection, you might take choices that prefer suppliers and their growth as opposed to consumers. However, it is important to note that you always have to balance those objectives and balance the need for long-term economic growth. It is not one or the other. We have to be experts in balancing those things.

Q543 **Chair:** Does anybody else want to come in on this point?

Edwin Schooling Latter: I will add, very briefly, that there is a very strong conviction and consensus among the regulators that long-term growth and competitiveness is not achieved by having low standards; that belief is reflected in the conversations that I have with my counterparts in the Treasury as well.

There is nothing specific on the table where I am worried that the Treasury, for example, is pressing us to have lower standards than we think is appropriate, but I think colleagues are right that, for example, if there were a primary competitiveness objective alongside consumer protection or market integrity, there would be trade-offs between those. Asking a firm to have higher capital is costly for the firm, but it means they are more likely to be able to pay redress to consumers. Disclosure is expensive for the firm, but usually—hopefully—beneficial for the consumer, and so on.

Q544 **Chair:** Lloyd's of London gave written evidence to the Committee, and they very strongly pushed the point that deregulation in itself comes with a cost because firms have to adjust to the new less regulated world, and those costs, in their view, in the short to medium term can often outweigh the apparent advantages of the change. Is that a view that you subscribe to, and to what degree do you take that into account when you go through your deliberations?

Sheldon Mills: As a regulator, you should always be reviewing the cost of regulation. It is really important to both put in place new rules and sometimes take them away. It is important that we do that. Regulation exists now. If you suddenly remove certain aspects of regulation, that effectively is a shock in the system and in the market, and can have significant consequences for the way in which that market might operate. So we have to carefully assess deregulation as well as putting into place regulations, which is something that we do on a regular basis.

Christina Segal-Knowles: On the competitiveness point, to clarify, the Government is not currently proposing an objective on competitiveness in the financial market infrastructure space for CCPs and CSDs. I think that is right, and it does not necessarily conflict with what my colleagues have just said, because the financial market infrastructure firms, CSDs and CCPs, are quite different from the firms that the FCA and PRA regulate. That is in two respects.

One is that the financial market infrastructure firms are, in many cases, serving market segments where it is natural for them to serve potentially the entirety of the market segment in one firm, or to have potentially only one or two of those firms in the world providing that type of service. It is a very different environment for competitiveness, and what they are doing is fundamentally different.

We like to call them systemic risk managers. That means they are making sure that other financial market firms can transact safely with each other, and they are also placing rules for those other financial market firms that reduce risk, so the members have rules, and it reduces the risk in the system. That means that a competitiveness objective does not sit with our actual objective, which is allowing UK firms to export their services, because financial firms around the world, as well as the regulatory authorities that supervise them, trust UK infrastructure. It is quite different, so I wanted to clarify that.

In that context, the Government rightly proposed that we instead have an innovation secondary objective. We support the idea that we, as UK regulators, need to think about how we ensure that there is a thriving financial market infrastructure sector and how we support the firms that

Sheldon, Edwin and Vicky are regulating, by having innovation in the financial market infrastructure that connects those firms. It is a bit of a different situation. I think that we are supportive of the Government's approach.

Chair: That is a helpful contribution—very clearly put. Thank you very much.

Q545 **Anthony Browne:** My questions follow up in some detail on the competitiveness and economic growth issue in your new proposed secondary objectives for competitiveness.

I want to follow up first on the point that Sheldon made. You said that competitiveness could be a risk to financial stability if it was about short-run costs, but surely there is no competitive advantage to having financial crises every 10 years or so, or having markets without integrity or consumer protection. How would you judge competitiveness from that point of view? Surely it is not just about short-run costs; there is a wider issue there.

Sheldon Mills: No. We have done some work on trying to work through if we elevate the competitiveness objective to secondary or primary, how would we assess and measure the outcomes of any activity that we have in that area. It is not easy. It is the same as trying to work through how economic growth works.

You can look for productivity measures in terms of the financial services industry. You can look for comparative measures. The World Economic Forum looks at that in terms of our financial services industry versus others. You can look at what is the reported experience and perception of the firms and others in the market, which can be important, and then you can look at inward investment, so you can see whether the UK remains a place where people come and innovate and invest. You can look at listings, IPOs and so on.

There is a range of ways in which you can start to think about how competitiveness works. The point I am making around the short-run costs is that it works on both sides. You give something now and you get quite a massive kick later. I think that that works on both sides. It works on the firm's side and—Members might not like my saying this—it also works on the consumer side, so you can have multiple impacts on markets for continuous redress for consumers, too. Trying to balance those two things is part of our role.

Q546 **Anthony Browne:** From the point of view of the Bank or the PRA, how do you assess the issue of competitiveness? If you have this secondary objective, how will you know whether something is more competitive or not?

Vicky Saporta: It will also depend very much on how the objective is formulated. The Government's consultation paper talks about competitiveness and economic growth objective, subject to meeting international standards, but it does not actually say whether we should be pursuing long-term growth and competitiveness separately, or whether we should be pursuing long-term growth and acting to make financial services more competitive to maintain long-term growth. The actual formulation of the objective is very important.

If one wanted to avoid short-term boosts in financial services exports that might result in busts that are not good for long-term economic growth, one would nest competitiveness into the long-term economic growth objective, and therefore the exact formulation of the statutory objective would be very important. That is how we approach our objectives. When Parliament introduced a competition objective, that is what we did—competition is different from competitiveness, as we have discussed. We looked at the words and developed a way to ensure that each time we considered making a rule or policy proposal that advanced our primary objective, we looked at the menu of options that advance our primary objective—safety and soundness—to see which would facilitate competition in line with the precise way that the statutory objective is formulated. The words do matter. That is what we plan to do when we get the words.

Q547 **Anthony Browne:** What difference would it make as a secondary objective? I will stick with the Bank now, with Vicky first. You still have your primary objectives. Can you foresee any circumstances in which you would end up with a different policy as a result of this secondary objective? If not, what is the point of it?

Vicky Saporta: Absolutely. When Parliament gave us a "have regard" on competitiveness in the Financial Services Act 2021, which allowed us to implement the penultimate Basel III reforms at the PRA, we took that into account. From the menu of choices, we chose one that we would not have chosen if we had not had that explicit "have regard". It is quite arcane—it was in relation to the gold market. We were introducing a liquidity requirement and, if we had taken the international standard, it could have had quite negative effects in the market for precious metals in the UK.

When we approached it then, we did not have a secondary objective of competitiveness, but we had a "have regard" on competitiveness and three other "have regards" that we did not have before. We assessed each of the policies that we proposed against those "have regards" and took them into account. We published that in a detailed annexe to the consultation paper. Clearly, we would do that as we go forward with whatever we get.

Q548 **Anthony Browne:** Thanks for the detail on the process that you go through. That is very helpful. From a practical point of view, what difference would there be between having a secondary objective and a "have regard to", as you have at the moment? One can clearly understand the difference between a primary objective and a secondary objective.

Vicky Saporta: The way that secondary objectives work, again, depends on the exact formulation. If it works in the same way as our current secondary objective on competition, with the exact legal formulation, then, each time we look at a policy that engages safety and soundness—the primary objective—we are obliged to look at options that facilitate that secondary objective. Among those, we have to consider the ones that—

Anthony Browne: Yes, to choose—

Vicky Saporta: But with a "have regard", and in the remit letter, we need to cast our mind to this.

Q549 **Anthony Browne:** You do not have such a formal or systemic process.

Vicky Saporta: This is a systemic process. Also, at the moment, depending on how you count them, we have 15 or 19 "have regards", whereas we have far fewer objectives.

Q550 **Anthony Browne:** I want to give the others a chance to come in, so over to Edwin for the FCA point of view. This is really the penultimate question I asked Vicky: what difference is it likely to make? Can you foresee any policy difference as a result of having a secondary objective of competitiveness?

Edwin Schooling Latter: Let me answer that in a very practical way. Like the PRA, we have had a "have regard" for economic growth and competitiveness; it is in the FSMA regulatory principles, as well, so it is not wholly new. Of course, we have had an eye to those things. When my teams make and propose a rule change, unless it advances one of our primary objectives—consumer protection, market integrity or competition—we cannot make the change. If there were a rule change that was only going to improve the competitiveness or attractiveness of UK markets and have no other benefit, we could not do it in the current structure. A secondary competitiveness objective would be quite empowering in that regard.

Q551 **Anthony Browne:** So you could make a rule change not because it affects any of your primary objectives but just because it improves competitiveness.

Edwin Schooling Latter: Exactly.

Q552 **Anthony Browne:** Can you think of a practical example of that?

Edwin Schooling Latter: I thought you would ask that. I cannot put my finger on something that I have really itched to do in the past few years but not been able to. You will have seen that in response to Lord Hill's listing review, we have usually found reasons why doing something to help competitiveness will also help the market in other ways. It is hard to prove the counterfactual; going forward, being explicit that we can do something just because it is good for the UK's markets is a good thing.

Q553 **Anthony Browne:** I am running out of time, but I will give a few seconds to Christine to answer the same question. Can you see anything in your area? Although you said that competitiveness objectives do not really affect you so directly.

Christina Segal-Knowles: No, but instead the Government have proposed an innovation objective, so I will answer from the perspective of how the innovation objective will change things. We are starting from a slightly different position because we currently do not have statutory secondary objectives and we do not have "have regards"; we simply nest under the Bank of England's overall objective for financial stability. Right now, we are grappling with this in a space where we, as a regulator, already see, as part of that objective, that there is a reason to want to ensure we are open to innovation, and that financial stability is not the same as preserving the status quo. We want to make sure that, if there is new technology or innovation in financial market infrastructure that could potentially serve financial stability, we are not unnecessarily blocking it.

There is currently nothing explicit in the way that we work to recognise that and force that conversation, in the way that Vicky described would happen with the secondary objective. Like Vicky explained for their competitiveness objective, the formulation is nested under financial stability. Financial stability is still the primary objective, but, when we are making those decisions, we are looking at whether we are unnecessarily blocking the use of new technology in FMIs and whether we are facilitating something that would provide better services to other financial market participants when we are making or reviewing our rules.

I think there are existing rules that could be clarified; for example, making it clear that you could use distributed ledger technology for this type of FMI service. The secondary objective would give us a stronger basis to do that. We already try to do it because we see it as consistent with financial stability, but that would bring it to a different level in terms of our own internal processes.

Anthony Browne: Good. I would love to carry this on, but I have run out of time—we are short of time today.

Q554 **Dame Angela Eagle:** I wondered whether having a competitiveness objective would lead to more lax enforcement policies, effectively?

Sheldon Mills: I would say no. We will still have a significant enforcement division that will continue to do quite a lot of significant work. There are three elements that I think are important that we continue with in terms of enforcement, and you have seen us do that in the past couple of months. Financial crime and fraud are important parts of our enforcement; we are working across the network of regulators and enforcement agencies in relation to that. You will see a bigger focus from us on that.

Q555 **Dame Angela Eagle:** It would be hard to have much of a lower one—for all the talk about enforcement against fraud.

Sheldon Mills: It is my starting point.

Q556 **Dame Angela Eagle:** You are at a very low starting point. Fraud has exploded, so I am astonished that you use that example.

Sheldon Mills: I do not think that competitiveness will affect the way in which we tackle fraud, and fraud is a priority.

Q557 **Dame Angela Eagle:** You are not tackling it at all, at the moment, so this is not filling me with hope.

Sheldon Mills: With respect, we have recently taken action against NatWest in relation to fraud; that was one of the first criminal prosecutions we have had.

Q558 **Dame Angela Eagle:** The first and only bank—as fraud has soared. You should look at the report that we published a couple of weeks ago.

Sheldon Mills: We take the criticism, and we will improve. I am mentioning it because it is a clear policy of ours to improve in enforcing fraud. Your question was about whether competitiveness will impact that; I am saying that it will not, and that we have a strong policy in relation to fraud.

Another area that it will not impact on is enforcing relating to consumer issues. We have just put out our new consumer duty, which will hopefully be implemented in the next couple of years. I think it is important that we are able still to enforce against firms that do not effectively achieve good outcomes for consumers. That is an important area. To ensure that firms are doing the right thing, we have our senior managers regime, and it is important that we also enforce against them in relation to individuals.

Q559 **Dame Angela Eagle:** Right, okay. Growth, Vicky. Do you see this as growth in the UK economy, or growth in financial services? Following the financial crash in 2008, Lord Turner famously said that most of the growth that banks and the financial services sector had managed to achieve in that period was "socially useless". How do you think that having a secondary objective like this would impact on useful growth, rather than socially useless growth?

Vicky Saporta: The way that I think about it in terms of the first part of your question is how the financial services we are responsible for regulating contribute to long-term economic growth for the whole economy, because that is what matters.

Q560 **Dame Angela Eagle:** So it is not growth in bankers' bonuses or growth in socially useless things—that is fine, that can carry on and you do not take any account of that; you are just looking at the long term and whether we can achieve 2% or 3% going forward in growth in the economy.

Vicky Saporta: Ultimately, it will depend on how the objective is actually formulated. At the moment, the objective does not exist, but if you want to avoid the boom and bust that we have seen in the past with financial crises, where financial services and credit have expanded unsustainably, which has then led to very bad growth outcomes, you would want to take into account what long-term sustainable growth is, rather than focusing on short-term economic outcomes. That is the point I am trying to make.

On the socially useless/socially useful point, to some extent as a citizen I can see it, but as a regulator, our objective is not really to make judgments about social choices and what particular activity might promote general usefulness and welfare. We have to do what our objectives tell us to do: to promote financial stability in our case and to ensure that firms are safe and sound and so on, rather than ensuring that each product that firms come up with has a particular usefulness in society. It is just not part of our objectives.

Q561 **Dame Angela Eagle:** Abstract from the society that you live in—fine. In terms of competitiveness though, if you are going to increase competitiveness, surely in general in a market such as financial services that increases the danger of there being lower levels of regulation. That increases the chances over time—perhaps not immediately—of the gathering up of a potential overreach and a crisis of the kind that we know markets are very prone to. Are you not worried about this idea of competitiveness without better assessing what it actually means?

Vicky Saporta: It is very important, as I have said. If society—with all due respect, it is elected politicians who represent society—

Q562 **Dame Angela Eagle:** You are a pretty important and influential aspect, as regulators, of how our society works. You are not elected, and therefore you are here to be accountable for your opinions now, which is why I am being quite robust. I happen to think that socially useless growth is not something we should be aiming at, like I do not think that growth that ruins the climate is something we should be aiming at, and we are getting to a crunch point in both those areas if we want to preserve democracy. You have to have some regard to it; it is not all technocratic.

Vicky Saporta: Sure, and we also have to have some regard to the broader context in which we are living; you are making very valid points. In answer to your question about whether I am concerned that a focus on competitiveness might lead to a gradual decline in standards and then another crisis, of course I am concerned. I would not be doing my job as a regulator if I were not concerned. The primary risk one faces is that you end up with weak or inappropriate standards, or weak and inappropriate supervision—

Q563 **Dame Angela Eagle:** Or fantastic standards that are unenforced, if we are coming on to fraud.

Vicky Saporta: Or fantastic standards that we do not supervise against properly. That is why it is very important. I understand, as Edwin said, that this is the Government's intention, but if we are going to have a competitiveness objective, to be subjugated and secondary to our primary objective, it must be formulated in a way that prevents the kind of behaviour that you have just described.

Q564 **Alison Thewliss:** I have some questions on the financial services compensation scheme. Can we start with Vicky Saporta, please? When he gave evidence to the Committee in October, Nigel Terrington, the CEO of Paragon Banking Group, suggested that the £1.5 billion annual cap on the money that the FSCS can reclaim through the banking system was "requested by the PRA, to ensure that there is no contagion risk that runs to the banking sector as a whole." Is what he said accurate?

Vicky Saporta: May I write to you on this? Off the top of my head, it sounds broadly correct, but I will have to check it and write to you.

Q565 **Alison Thewliss:** That would be helpful; thank you. Do you think that removing the cap would present an unreasonable degree of potential risk to firms by exposing them to high costs in the event of other firms failing?

Vicky Saporta: Caps are there to protect precisely that—that is the design function of a cap. Obviously, if a very large firm fails and we end up having to pay out depositors using the FSCS, the costs would ultimately need to be recouped over time through the industry. In the first instance, there would be a loan funded by the Government but, over time, the costs would need to be recouped and that could, in principle, put some firms at risk.

Q566 **Alison Thewliss:** Sheldon Mills, the Committee received written evidence from the FCA practitioner panel that larger firms providing financial advice face a disproportionate burden, including in paying FSCS levies. Could the system be reformed so that financial firms contribute in proportion to the risk that they pose?

Sheldon Mills: We have launched a review of the FSCS redress levy in order to look into these issues. The issue that we have is that harm or mistakes occur today—or, in this case, 10 years ago—and they come through the system today, so it can be difficult to work through and have a sensible levy that effectively follows the principle of the polluter pays.

In relation to investment firms, we recognise that the larger firms—not all, but by and large—have been meeting the standards and complying, but some smaller firms might not contribute as much, because of their size, and might have failed consumers. That is putting a significant cost on the levy. I think the intermediaries' and investment firms' part of the levy is around £300 million at the moment, out of a total £717 million levy overall. So, we are reviewing that.

The other point to note is that we need to tackle that harm. Our consumer investment strategy, which we published last year, seeks to improve standards in that area and tackle that harm now. So, it is something that we are looking at.

Q567 **Alison Thewliss:** That is useful; thank you. In written evidence to the Committee last year, the FCA also told us that the biggest driver of increasing costs of regulation at the current time was the increasing levies from the FSCS. Is that still the case?

Sheldon Mills: What tends to happen is that the FSCS will make an estimate of levy. Last year, it made an estimate of just above £1 billion for the total levy. In fact, what happened was that fewer firms failed and then consumers did not need to call on the FSCS to get compensation, so the actual number for 2021-22 is around £717 million. However, we expect that will probably increase in the coming years. Those firms still might be at risk of failure, particularly in self-invested personal pensions and a few other areas, so it is a continuing issue.

Q568 **Alison Thewliss:** How much of a buffer does that build up within the scheme?

Sheldon Mills: I think what happens is that the money is forecast and then effectively it doesn't get called upon, so you do not end up with a major buffer.

Q569 **Alison Thewliss:** That makes sense. The FCA practitioner panel suggested that one way to ensure that the polluter pays could be to use fines collected by regulators from rogue firms to help fund the compensation, rather than taking it from the firms that are doing what they ought to. Would that be a more sensible approach, or would it lead to other kinds of behaviours to try to avoid our catching that money?

Sheldon Mills: It is always a difficult one with having an enforcement division; people often put calls on what those fines should be used for. Obviously, they go into the Treasury's consolidated fund, but we get calls that they should fund the organisation, the FSCS or the levy. In a sense, that is a matter for Government to think through. My only caution about things like that is the incentives that it can drive in terms of the agency and its activities. I am always personally cautious about those sorts of suggestions.

Alison Thewliss: Okay, that makes sense. If none of the other witnesses have anything to say on the FSCS, I will hand back to the Chair.

Chair: Thanks, Alison. We will have a very quick question from Kevin and then move on.

Q570 **Kevin Hollinrake:** Nigel Terrington of Paragon suggested that if we moved to a pre-funded scheme, as I think the World Bank and IMF have suggested, mid-tier banks would be able to lend more to SMEs. Would that not be the case? I will put that to Vicky. That is what gives you all your MREL problems, isn't it?

Vicky Saporta: To be frank, I do not see an immediate connection between the way that the FSCS is funded and the way that the MREL threshold has been set by the Bank of England as the resolution authority. The £15 billion/40,000 transactional accounts threshold that has been set is more of a judgment, done by my colleagues who run the resolution authority to ensure that if there was a failure, basically, there would not be a disruption that could impact financial stability, public funds and critical functions. I do not think the funding actually—

Q571 **Kevin Hollinrake:** That is not what he says, though. Paragon has worked with EY, and he says that with a pre-funded scheme, "the cost to us would be one quarter of the interest bill that the MREL cost would bring." He is saying it is much cheaper for them to do it through a pre-funded scheme.

Vicky Saporta: Yes, but I am not sure why the way that the FSCS scheme is actually funded could change the disruption that a big mid-tier could cause to the system.

Chair: Because of time, Vicky—you have made your point, and thank you—we might drop you a quick note on that for a fuller reply. I am just aware of time and the need to try to get others in.

Q572 **Gareth Davies:** I will ask some quick questions about trade and the level of co-operation with other regulators around the world. First, Vicky, may I ask for your perspective on how our regulators are interacting with the Treasury as we look to expand international trade agreements?

Vicky Saporta: Obviously, and completely appropriately, it is a Government initiative, but to give you an example, the Government have announced a mutual recognition agreement between the UK and Switzerland. As part of this agreement on financial services, we will give advice to the Treasury on the extent to which Swiss standards in the areas where market access will be sought are equivalent—outcome equivalent—to UK standards. That is what we will have to do as part of supporting this initiative, but in a way that ensures that we have strong standards. That is in the area of mutual recognition agreements.

There are also areas—I think they are more prominent, actually—in financial infrastructure, which Christina is responsible for, where we, as the Bank of England, will be responsible for making equivalence assessments of non-UK infrastructures operating in the UK. Christina can talk about that.

In the banking and insurance world, we give advice to the Government each time a rule that we might make may have an impact on the equivalence determinations that they have already made of other jurisdictions as part of effectively onshoring EU regulation on to the statute book.

Q573 **Gareth Davies:** What other priorities might you have as a regulator in dealing and interacting with regulators in other jurisdictions? What are your key priorities there?

Vicky Saporta: This is very important. Without it, it is basically impossible to do a regulator's job in a large financial system such as the UK's, where almost half of the banking assets are internationally owned and a large number of international firms operate in both subsidiary and branch form and so on. It is incredibly important to maintain regulatory and supervisory co-operation, including data sharing, in order to be able to supervise these firms.

We, the PRA, have signed MOUs with almost all EU member states—there are just a couple that we are still trying to finalise, including with Portugal, I think—and with all the European supervisory agencies, including EIOPA, EBA and ESMA, to ensure that there is data sharing and supervisory co-operation. That is all at the MOU level. Of course, we continue to talk to them on a daily basis; when you are supervising an overseas firm that is operating in London, one of your primary priorities is to have a close relationship with the home supervisor—the group supervisor—so that is continuing.

Q574 **Gareth Davies:** That is very helpful. Christina, can I ask you about the Treasury's consultation on CCPs and CSDs, which said that you have to be mindful of, or to take regard of, the financial stability risk on other jurisdictions? From your perspective, is that about being mindful of spillover risks to the UK financial market system, or is it about looking at the risks to other jurisdictions in their own right?

Christina Segal-Knowles: For context, the space that we are talking about—CCPs and CSDs—is inherently international. When you think about the firms that are headquartered in the UK, they are providing services to firms all around the world. Some 63% of UK CCPs' members are outside of the UK already, so in that context, what the Government is proposing makes sense.

That is because in order for other jurisdictions to be comfortable that the UK is an appropriate place to allow their financial services firms—their banks, their major investment companies—to use UK clearing services or UK CSDs, they need to have confidence that we are regulating not just with regard to narrow UK interests, but also maintaining the appropriateness of UK financial market infrastructure as something that anyone from around the world could rely on. I think the intention there is something that we are supportive of, because we think that is the sound basis for a global system in which UK infrastructure can be provided cross-border, and also the UK financial system can use global infrastructure. These infrastructures are inherently better if they are able to serve a large market, which means that they are not going to correspond to national borders. You have UK infrastructure that is providing services around the world.

Similarly, we want UK financial participants to be able to safely access infrastructure in other jurisdictions. To make that work, you can't have every individual jurisdiction each regulate each piece of financial market infrastructure: it will crush them. Thinking about how you make a system that makes the world safer work, you need to be able to convince other regulators that the appropriate way to handle this is to look at what we are doing, recognise that we are doing it to a very high standard, recognise that we are going to take into account their interests, and then expect them to operate a similar system that allows UK infrastructure to be provided cross-border, if that makes sense.

Q575 **Gareth Davies:** That makes sense. I understand that there are three CCPs and only one CSD in this country. Can you give us a perspective on the other big financial markets that have lots of clearing houses that are leading in this area?

Christina Segal-Knowles: Really, when you think about the big global clearing houses, there are only a handful globally that have these very large footprints. There are other jurisdictions that have major CCPs: the US has major CCPs, there are a few clearing houses in the European Union that provide significant services cross-border, and there are a few CCPs in Asia that are fairly significant, but it is not a very large population of firms. CCPs work best when they have very deep pools of liquidity and when they are able to net risks, and that means netting risks across currencies and across jurisdictional lines, so you have this handful of firms that are providing cross-border. When you think about the markets that UK infrastructure is serving, you have a very significant amount of services to the United States, as well as a significant amount of services to Europe, so it is quite balanced in that respect.

Q576 **Gareth Davies:** Are you confident that those other financial centres that are operating in this quite small part of the market are considering, or being mindful of, the financial stability risk in other jurisdictions like we are suggesting you do?

Christina Segal-Knowles: We are actually in a position right now where we as the Bank of England are consulting on what our rules will be when we look at whether foreign clearing houses can serve the UK market, because we have onshored the high level of regulation for that from the European Union, but they were in the process of making that as we were leaving the European Union, leaving us to make the rules on that.

What we have said in our proposal is that we would evaluate that: we would evaluate whether we think we can trust a foreign regulator to appropriately regulate a CCP in a foreign jurisdiction, and we can have that relationship of co-operation. Then, if we had that level of co-operation and trust, we think the right thing would be to allow them to regulate the CCP, and we just monitor that that keeps going—that it can keep the UK financial system safe. We are hoping that we set an example that also allows UK infrastructure to enjoy the same system going the other way. We are modelling what we think is a system that allows infrastructure to serve across borders and allows a system of openness that allows this infrastructure to continue to thrive.

Q577 **Gareth Davies:** That all makes sense, but you are not aware of any other financial centre that is asking its regulator to be mindful of other jurisdictions?

Christina Segal-Knowles: In terms of the regulator-to-regulator conversation, which I have on a daily basis—I am talking to the EU, I am talking to the US—I think we have quite a bit in terms of recognising the importance of infrastructure and the importance that infrastructure should not be discriminatory in the way that it applies its rulebook. There is quite a bit when it comes to having those conversations at the regulatory level.

When you look at others' objectives, in many cases, they are not quite so centred on their jurisdiction. Sometimes they are—it depends on the authority that you are looking at. I am not aware of a specific example where there is a formulation exactly how the Government is proposing it, but I think there is a lot of rationale for what the Government is proposing, not least because we have always been quite ahead when it comes to financial market infrastructure regulation. The UK is home to some of the most significant financial market infrastructure in the world—

Q578 **Gareth Davies:** You are hoping that we are going to set the standard and it will be replicated.

Christina Segal-Knowles: We are hoping that we can set an example.

Q579 **Julie Marson:** I would like to ask a few questions about innovation. Christina, you mentioned that you are in favour of the overall approach, but I want to focus on your views on how the proposed innovation objective will be made operational and implemented. How will it differ, in practical terms, from an objective on growth and competitiveness?

Christina Segal-Knowles: It is a good question. When I said I was supportive, I think it is specifically around the way it is worded. Right now, the proposal is worded in a way that, as we are advancing our financial stability objective, we would seek to promote innovation. Under that, there is an objective that the innovation is for the purpose of making sure that there is a high level of service and that it is able to benefit the users of financial market infrastructure.

I think that is quite different from thinking about the context we were just talking about of trade. I am trying every day to have a conversation with the United States, with the European Union and with other jurisdictions to convince them that we are overall providing financial market infrastructure that is of a standard that they can trust and that their financial institutions can trust. Competitiveness implies that, rather than a very small set of firms and regulators having this conversation—I think a competitiveness objective has an awkwardness. An innovation objective allows us to say instead, "Actually, as best practice in this space, what we do not want to do is make our regulations in a way that prevents innovation that could make financial market infrastructure better for its users, less expensive and safer." I think the innovation objective, in the way that it is framed, would force us to look at our rules—proposed new rules as well as rules that are already on our books—through that lens: "Are we blocking innovation? Could we do things that would allow innovation in the UK?"

I think that is helpful, ultimately. It may interplay. It may make the UK more competitive, but in a way that is more appropriate given the conversation and the context when it comes to what financial market infrastructure is providing, which is really risk management. That is quite different from the comprehensive services that an investment fund or bank is providing.

Q580 **Julie Marson:** Thank you; that is very useful. Sheldon, on some of the innovation around consumer data, the Committee has heard evidence that maybe you could use consumer data to discriminate price-wise—that certain groups might be at a disadvantage and that you could discriminate to more profitable consumers. How can we make sure that that does not happen, but that the data is used across the board in a fair and equitable way?

Sheldon Mills: That is an important question. I think there are two or three things that we need to do and will do. First, as firms increasingly use algorithms, machine learning and other forms of providing services, we need the right sort of data standard, ethical use of that data and liability frameworks around that. We have precursors to that—Edwin may speak to that in the markets area—where we ask people to record the use of their algorithms. We need to start looking at expanding that into other areas of our regulation. We are working with the Bank of England on a discussion paper in that area.

On the other points around discrimination, clearly it is different in different sectors. One area that often comes up is the general insurance sector. One of the issues around data is that it has the opportunity to personalise the provision of services. You can go into services and say, "That person is less risky; that person is more risky." The problem comes that insurance is based on risk pooling, so basically—cross-subsidy is not the right word, but I will use it—you are cross-subsidising these higher-risk people and these lower-risk people and you are pooling that to provide some form of insurance for all. There are complex issues in terms of how one starts to use data in certain types of sectors.

If we look at other common forms of financial services such as banking, where there is not as much risk-based pooling, the issue in retail banking is how you use that data. Banks have significant amounts of data on their customers. Open banking has been fantastic; it has opened and shared that data to provide different types of services that third parties can offer consumers. There is also the prospect of monetising that data in a particular way.

It is important that we work closely with the ICO, the CMA and Ofcom as part of the digital regulation co-operation forum. As part of that, we are looking at how data can be used and monetised, and what level of transparency you need with customers in terms of how they provide that data. There is lots of work that we need to do in that space in order to have the right framework, so that with some of those potential harms, which are probably already occurring, we can tackle them and have the right approach to them.

Q581 **Julie Marson:** Thank you very much. Vicky and Edwin, do you want to add anything to that?

Edwin Schooling Latter: My area is wholesale data rather than retail data, and there I think the key thing is to make sure that everyone can access the data at the same time, hence the very extensive disclosure requirement in prospectuses and hence the rules around disclosure of the prices at which shares and bonds are traded, so that everyone who owns them or wants to buy or sell them can see some of that data.

Q582 **Julie Marson:** In a more general sense about the risks involved with innovation, we have had evidence before about the Greensill events. Is there a danger that, as we encourage innovation, financial service providers and regulators cannot keep pace with that innovation and do not understand some of the risks involved in innovation?

Edwin Schooling Latter: Anything new is going to bring some new risks with it, so we have to be super-vigilant towards innovation. However, we do not want to stop innovation or be so cautious that the innovation cannot happen, which goes back to the conversations around innovation objectives. Of course, there is an innovation "have regard" in our remit letter from the Treasury, which is the right thing, but innovation means vigilance as well as support.

Julie Marson: Thank you. Vicky, did you want to add anything?

Vicky Saporta: Nothing; I agree with what has been said.

Q583 **Emma Hardy:** Afternoon, everyone. I want to talk about financial inclusion. We had some incredibly powerful testimony from Martin Coppack of Fair By Design about this issue. I think that we are all aware that the poverty premium exists and is real. Sheldon, there is a broad coalition of campaigners and civil society groups all asking for the FCA to have a cross-cutting "have regard" for this issue. I note your earlier comment on the 15 to 19 "have regards" that were mentioned, but there is the desire for this "have regard" in relation to financial inclusion. What is your assessment of the state of financial inclusion at the moment in the UK?

Sheldon Mills: The starting point is that whether we have an objective on financial inclusion is a matter for Parliament and for Government to propose or not. We recognise throughout our work that there are major challenges for many people in this country. We have a cost of living crisis that is about to ensue; inflation is going up; wages are not increasing as highly as inflation and energy costs et cetera, so we recognise that some people may struggle in the coming years.

There are a few aspects to our work that already seek to support people. One is that we have issued guidance on treating fairly customers who are in circumstances of vulnerability, and all firms should have the right systems and controls in place, both to identify that and target it, to ensure that they are treating those sorts of customers well. That is something that helps.

However, the challenge that I think Martin Coppack and colleagues are raising relates to things that are deeper and more challenging—societal challenges beyond the services that are already provided—issues around access, including to basic banking accounts or bank account access to something that allows you to accept a payment. Some people do not have access to a bank account or access to insurance, as we go into issues of climate change et cetera, and some small businesses do not have access to accounts and value et cetera. There are those sorts of issues.

One of the challenges is that if the market can provide that, and can be stimulated to provide that, and we can provide the right conditions for that, then, absolutely, as regulators we should be engaged in ensuring that those provisions can be readily accessed. If the market and commercial providers cannot provide those things, then I think our role is to work as closely as we can with Government, Parliament and other agencies, and industry, to try to see whether there are opportunities to ensure that you can gain access to those sorts of services.

In addition to that, for specific issues like access to cash, the Government are consulting on that and we may get specific powers to ensure access to cash; a combination of ATMs in-store et cetera, and branches. Ahead of that, we are trying to do work with the banks to ensure that they are thinking about customers in vulnerable circumstances when they close branches, to make sure that they are thinking about people's needs and the alternatives open to them.

In summary, it is a serious issue. We try to go as far to the edge of our perimeter as we can in order to help, but some elements of this will require a coalition of a lot of people to tackle some of the issues.

Q584 **Emma Hardy:** Absolutely. Martin talked about what happened in the market to the people no one wants. Where do those customers nobody wants go? Where do they get support? Talking about the poverty premium, it is interesting that you mentioned the data and insurance. He raised the issue of someone with car insurance: if you live in an area where there is likely to be more car crime, you—as someone taking out car insurance—are then penalised. Do you think that the approach we have at the moment is effective in reducing the number of people in the UK experiencing this poverty premium?

Sheldon Mills: I think that there is more that we can do to analyse it and to see the effects of it in areas like insurance and access to banking, and working with industry to get the will to tackle some of those issues. As I said, there is complexity in insurance, given the risk-based pooling model and how that works in practice. I will be open and honest: I come from a community where people get very high car insurance quotes, because in that community the risk is much higher. From a commercial perspective, that makes sense; from a poverty premium perspective, it is an issue that needs to be considered. We have to start to consider those issues while being sure—I am sitting next to the prudential regulator—that, ultimately, the financial soundness of the system is paramount.

Q585 **Emma Hardy:** Absolutely. You mention access to cash, which again Martin was talking about. He alluded to the fact that it is not that the FCA or anyone making these decisions is deliberately adding to this problem of the poverty premium, but that they might not really be listening to the people with the best experience. He told us that when he was advocating for consumers, he was bounced back between the FCA, the CMA and the Treasury. It felt like no one was prepared to take responsibility for addressing the issue he was talking about around the poverty premium. He went to one, they would say, "Oh, it's a social policy issue, go to the Government", and the Government would say, "No, it's a regulatory issue, go back there." Do you recognise that as a problem, that it gets bounced around and becomes no one's issue?

Sheldon Mills: I read Martin's comments. I recognise that to a degree. What he is reflecting is the powers that those various agencies have. In our role, as much as I would wish to help in some of these areas, the powers that I have might not be used appropriately in some of the areas. While I will have conversations with Martin and colleagues, the extent to which I can deliver on some of the things that he is asking for is limited. That is why I say that, in some senses, we need to get into the issues, see what they are and find sensible taskforces to tackle some of them.

Q586 **Emma Hardy:** It does feel a bit like David and Goliath. We had Martin telling us that the balance between industry and consumer representation is, as he described it, "woeful". Consumer organisations like Fair by Design are staffed by a couple of people—the resources are extremely limited—and they are up arguing for things like the poverty premium against the industry, with all its power and might. They simply do not always have the money or ability to represent consumers properly, in the way that they need to be represented. Again, do you recognise that? Is there a role that the FCA can play to support that consumer voice, taking into account the needs of people in poverty?

Sheldon Mills: That bit of his submission I did not recognise. I recognise the difference in means. Sadly, it will be the case that they have fewer resources than some others, but we have our consumer panel and we sit on the financial inclusion taskforce, which John Glen the EST chairs.[1] Many consumer groups refer to that. We have been engaged in many bits and pieces of activity that support financial inclusion. I am also conscious that many industry leaders seek to think about how they can invest properly—thinking about the ESG obligations—in more stakeholder capitalism and more responsible capitalism. They are thinking through how they can widen access and have sensible policies that mean that they are serving society as well as shareholder interest.

Q587 **Emma Hardy:** As Martin said, we are asking an amoral industry to act in a moral way, which is a bit of a difficulty when it has different drivers. Do you think that having regard to financial inclusion would help, accepting that you cannot make policy, if that was mandated by Government?

Sheldon Mills: It would be a significant change to our approach and our objectives. One of the challenges would be what our relationship would be with firms in order to effectively ask them to use their funds, et cetera, to support potentially non-profitable activity. We have to be honest about the challenge in some respects. Between that and where we are currently, I think there is an opportunity for the market to provide in a profitable way certain groups that they might not necessarily be serving. I think that there is more innovation and activity that firms can go into in order to serve some of the groups that we are talking about, so we would like to foster the right environment for investors to come in and for firms to tackle some of these challenges and still effectively make a profit.

Q588 **Emma Hardy:** To dig into that a little more, you recognise that there is a need. I think you are saying to me that "having regard" may be too large a step, so what would an intermediate look like? What would that mean in terms of changing the situation for those people on the ground, suffering from the poverty premium, unable to get insurance, and having difficulties with access to cash? Again, Martin mentioned that it is not just about the distance of an ATM; he gave the illustration that you can say, "Well, the ATM is only a mile away," but if you have no car and you are relying on public transport, how are you going to get to that ATM? That is why we need to really understand how different communities work. Give me some

[1] Note from the Financial Conduct Authority: This is a reference to the Financial Inclusion Policy Forum, which is chaired by the Economic Secretary to the Treasury and by the Minister for Pensions and Financial Inclusion.

practical examples of what the FCA could do.

Sheldon Mills: On insurance, we have changed regulation to allow for social landlords to think about having block insurance policies to help people with home insurance. That is a way in which we can change our guidance and rules to try to facilitate that. On access to cash, the group led by Natalie Ceeney is looking very closely at the individual needs within geographies. There are a lot of different approaches to that. One is the use of the post office. Another is the use of mobile things that go to people's homes. Getting cashback with purchases, or without a purchase, is also an important part there. I recognise the issues, but I think that the industry and the regulator are seized of a few of those and are trying to support people in relation to them.

Q589 **Emma Hardy:** Finally, is there any more that you think that the FCA could do to support people suffering with the poverty premium right now? What would you like to see happen in the next six to 12 months?

Sheldon Mills: There is always more that we can do. I would say two things. First, our board is thinking about our business plan for the next year, and they have said to us, as an executive, that we should be focused on the cost-of-living crisis, customers in vulnerable circumstances, and on harm and solving that. We are committed to seeking to support all customers. I would still have to say that our powers and regulations do not go as far as providing access to each and every customer.

One thing that I would like to see is stronger communication and engagement with certain groups—from firms, from ourselves and from the regulatory family, such as MaPS and others—and that we speak in a language that meets those communities' needs and that they can understand. There is a poverty premium, but sometimes access is not about the poverty premium; it is about fear, and trust in financial services. It is about understanding what sort of financial services and things are available to people. We have a task as the FCA of ensuring that financial services as they stand are accessible to everybody.

Q590 **Rushanara Ali:** Picking up on those points, it would be really helpful to get an analysis that involves both the FCA and the PRA on market failures in relation to insurance, and in terms of access to cash, because during the pandemic we saw multiple banks close branches. In my case, in one ward a number of branches closed. If you could come back to us on what you have done across both institutions to address this that would be helpful, because it keeps coming up in our constituency workload.

My questions are around capital and proportionality, primarily. We have heard from insurers that the risk margin is too high and too volatile, and that a wider pool of assets should be eligible for the matching adjustment. Vicky Saporta, do you think that the current level of capitalisation for insurance companies is too high? Should we expect capital requirements and the risk margin to fall in the process of the Solvency II review?

Vicky Saporta: I will be brief because I am conscious of the time. We do think that the risk margin is too high and too volatile, and we anticipate that the reforms will lead to a reduction for life insurers—particularly those that offer long-term products.

On the other aspects that you asked about, we are looking at whether the eligibility of assets that could benefit from the matching adjustment benefit could be expanded, including to include assets that might have features that could be good for broader investment. However, we are concerned that currently the matching adjustment benefit itself—by the way, that stands at a staggering £81 billion as at the end of the year 2020, above the total capital requirement for the life industry, which is £76 billion—might be too high. There is no time to go into that, but there are all sorts of technical reasons about how it is calibrated. We would like to see an adjustment to the matching adjustment benefit for the sake of protecting the annuitants and the policyholders.

As to where all this will end up in terms of the overall capitalisation of the life industry, we are doing impact assessments and analysis on that. When we consult, we have to consult the Government first because of various reasons to do with who has the powers, and we will then have a full cost-benefit analysis.

Q591 **Rushanara Ali:** When will you have that by?

Vicky Saporta: Unfortunately, we do not control the timing of this—it depends on when the Government come in; they need to come in first—but we are aiming to be able to consult this year, around the mid-year.

Q592 **Rushanara Ali:** In a recent speech, the Governor reiterated that the case for reform of Solvency II was clear. However, we know that regulators have previously warned against reform that could increase risk for policyholders.

Can we have an assurance, from both regulators, that consumers are not going to suffer and lose out? Can we have a guarantee that that will not happen? Obviously, there is political pressure as well, given the investment opportunities. On the face of it, of course we all want more competitiveness and investment, provided that it is the right kind of investment and return—that has been picked up on before.

Talk us through the risks to consumers and how you can mitigate them. Perhaps others can come in quickly on this as well.

Vicky Saporta: Very quickly, the PRA is responsible for securing policyholder protection, in the sense that we need to ensure that a company that we regulate has enough resources to be able to pay out on obligations. Conduct—ensuring the fair treatment of policyholders—is for Sheldon and the FCA.

Q593 **Rushanara Ali:** My question is for both of you.

Vicky Saporta: From our perspective: absolutely. We want the reforms to ensure that policyholders can get back their money, basically.

Q594 **Rushanara Ali:** The question is whether you are going to make sure that that happens. There are stories about closed-door deals being made—in the *FT*, for instance.

Vicky Saporta: I have read the stories. Whenever we get the powers—as I said, we do not have all the powers to make reforms; at the moment, they reside with the Government and Parliament—and it is time to consult, we will be clear about the cost-benefit analysis, focusing on our primary objective, which is safety, soundness, and policyholder protection. You will see the analysis and you can make a judgment as to whether we have done our job.

Sheldon Mills: From our perspective, if Vicky and colleagues do their job well—I am sure they will—to ensure that policyholders' money is protected, our job, in a sense, is the way in which that process occurs when people make claims etc. We continually work with our firms to ensure that their claims processes deliver well for consumers and small businesses in the country.

Q595 **Rushanara Ali:** We received evidence from smaller banks such as Starling and Aldermore Bank about the internal ratings base models for assessing credit risks. That presents challenges for them, and it takes too long to get approval and so on from regulators. They feel that that penalises smaller, newer firms. Is there more that can be addressed to support small and medium-sized companies while maintaining standards?

Vicky Saporta: We are on the case, and we have been on it for some time. There used to be a perception that small, medium and challenger banks could not get approval from the PRA to use their internal models to calculate capital charges. That is not the case, and over time we have approved more internal models for those mid tiers. We have also made changes. At the moment, particularly for the mortgage market, there is an advantage if you have an internal model approval, versus the standardised model, which you have to use if you do not get approval. We have taken measures to close that gap, which should facilitate competition between challengers and the rest of the market.

Q596 **Siobhain McDonagh:** I am hoping to seek your views on the accountability of regulators to Parliament and to examine the merits of the Treasury's proposals relating to accountability in the latest future regulatory framework consultation.

My first question is for you, Vicky. The Government's latest future of financial services consultation proposes the introduction of a host of new statutory requirements and activity-specific regulatory principles for the PRA and the FCA, on top of existing obligations and "have regards". Is there a risk that regulation becomes a box-ticking exercise, with stacks of requirements, none of which alter the substantive decisions made and merely add pressure to regulators' resources?

Vicky Saporta: The direct answer to your question is that there is a risk. However, as Edwin explained, I do not sense from my frequent discussions with Treasury colleagues that they do not recognise that risk, or that they will keep adding "have regards" and regulatory principles. They recognise that the impact of that would be exactly as you described. Yes, there is a risk.

Q597 **Siobhain McDonagh:** Could I ask you, Christina, to what extent do "have regards" slow the pace of regulation?

Christina Segal-Knowles: It depends on exactly what the formulation is and where we end, as Edwin and Vicky have described. Currently, "have regards" are part of the process and are something to which we have to pay attention. Potentially, the more we have, depending on how they are framed and how we are held to account on them, they could slow the process. I do not think that that is the case at present. In the current formulations, especially as long as these things stay as "have regards" and we do not end up with additional objectives, which increase the weight and process associated with them, I do not think that there is an urgent case that "have regards" are likely to slow down regulations, certainly in financial market infrastructure, but it is certainly something in terms of how they are implemented and how they are accounted for to which we should pay attention.

Q598 **Siobhain McDonagh:** Sheldon, the Government have said that they intend to introduce a new power for the Treasury to require the FCA and the PRA, or an independent person, to review FCA or PRA rules where the Government consider that that is in the public interest. Does that pose a risk to regulatory independence?

Sheldon Mills: The background context is important. We are clearly going to be transferred a lot of power, in a sense, to make detailed rules that set the framework for the financial services system. To put that in context, when we were a member of the EU, that was done by the 27 or so EU member states with a Council and Parliament. We are being provided with powers and asked to do quite a lot of important things, so an accountability framework and a change to that is likely to be sensible. However, you still need to be able to do that at pace, with agility and expertise, in order to move forward in a sensible way. One needs to look sensibly at the overall impact of all the proposals together.

In relation to the rule review in particular, I think it depends on the triggers. We would want to see when the trigger would be, and how often it would be likely to be used. If it were to be used on a weekly or monthly basis, that could challenge not only our independence, but our ability to do our day-to-day work, as that would be quite an extensive amount of work for us to do. If there were sensible triggers, and a sensible description that recognised implicitly our independence, it could work. Naturally, there are many people who have different views. I think they have been reflected in our consultation process, but there are different views about the impact of different aspects of our rules and the regime. In a democratic society, it is important to have mechanisms to be held to scrutiny as a regulator.

Q599 **Siobhain McDonagh:** Edwin, does this effectively impose a public interest requirement on your regulations? How would that be defined?

Edwin Schooling Latter: I understand that one of the proposals is that there could be a public interest test to apply that rule review clause. I think that that is sensible in itself; the review should be done because it is in the public interest, and not because it is in the private interest of one particular lobby group. We obviously have no issue practically or in principle about reviewing rules. We do that as a matter of course. If the Treasury asked us to review a particular area of the rulebook under a statutory mechanism, we would clearly prioritise that. My concerns would be practical. I think Sheldon touched on it; with relatively small teams of people who are specialist in any particular bit of the rulebook, if someone comes along and says, "We now want you to do this," we would probably have to give up on various other promises or streams of work that we had undertaken in that area, because we would run out of people to do the work in the short time period.

Q600 **Siobhain McDonagh:** One of the Treasury's proposals is for a new statutory requirement for the PRA and FCA to publish a framework describing their approach to cost-benefit analysis and the creation of a new statutory panel dedicated to supporting the development of the regulator's cost-benefit analysis. Do you think that these proposals would fundamentally change how you approach cost-benefit analysis?

Edwin Schooling Latter: I do think it is right and proper that we should be completely transparent about the way in which we approach CBA analysis. It is obviously incredibly important that we get that bit of our rule-making responsibility right. I am a bit nervous about potential duplication. We already put a lot of time and resource into CBA work. The core part of that is, of course, the CBA requirements in FSMA, the Financial Services and Markets Act 2000. We have to publish our CBA assessment as part of proposing a rule change. It gets challenged, and we have to then justify our position in light of the evidence we receive. That is the core.

We have to persuade the independent members of our own board that we have got that right. We have six existing panels that can and do take an interest in the cost-benefit elements of our rule proposals. My teams have to spend quite a lot of time doing enterprise impact assessments of the costs imposed by any rule changes that they make, and of course there is already an ability for external parties who think that we have got it wrong to challenge us through judicial review. It is rare for them to do so, but we certainly take that possibility incredibly seriously in terms of getting the CBA work right at the beginning. If we can make sure that whatever we come up with does not duplicate but adds to the mix of existing mechanisms, that would be in the best interests of our stakeholders.

Q601 **Siobhain McDonagh:** Finally, could anybody on the panel give me an example of where you considered the cost-benefit analysis for a proposed policy and, on doing the full exercise, came to the conclusion that the costs were disproportionate to the benefits?

Edwin Schooling Latter: This week, we are going to collect some additional information on potential changes to the PRIIPs rules, in terms of the risk indicators that firms put on their documents. We got a lot of feedback that it perhaps would add a cost that was more than the benefit, so we are re-looking at that.

Vicky Saporta: We collected information, data and analysis as part of a consultation. We wanted to floor the risk weights—the capital—of large firms that use internal models to calculate the capital against mortgages, because it had been falling for some time. We did some impact analysis, but we just did not have sufficient information to be confident that we had got it right. Once we got the information and the data, which we had to collect from the firms, we changed our view.

Christina Segal-Knowles: My example was going to be more general. Consistently, we are thinking about where exactly we draw the line. It may not be as binary as taking a policy forward or not—for example, determining which firms are systemic and should be brought into the remit of the Bank of England, or exactly where we should draw the line on the types of model changes. We are constantly making cost-benefit-based decisions. Some of them go through the formal rule-making process, but our teams are constantly challenging ourselves to be able to justify to our committees that the costs of doing something do not outweigh the benefits. It is part of everyday rule-making, and everyday regulating, that you are constantly having those conversations. I can think of myriad examples of where we have stepped back or have not quite drawn the line where we originally thought as a result of making that determination.

Chair: When that question was asked, you looked slightly like a panel on "University Challenge". Somebody got there, and then everybody got there.

Q602 **Kevin Hollinrake:** I want to ask Sheldon some questions on the regulatory framework. You have had some rave reviews from some of the people you regulate. Richard Dudley at Aon said that our system "is envied around the world", and Philip Reed of Independent Franchise Partners said that our regulators had "a reputation for technical excellence". Is it good to have people you regulate giving you such rave reviews?

Sheldon Mills: I do not think that they give us rave reviews in private when we are supervising them day to day. They certainly push back on bits and pieces of what we ask them to do, and that is right and proper. I will not say private things for those two firms, but I can certainly think of incidents where they have done. If within your question is whether we are too close to the firms that we regulate and are therefore not acting in the right way either to protect consumers or small businesses or to ensure that they are protected, we try to have the balance as best we can. As Emma Hardy was saying earlier, there is a potential imbalance in terms of the means and ability of people who represent consumers or small businesses versus those firms.

It is right and proper that we have the consumer panel, that we also have a consumer network that meets regularly, and that we are always open to correspondence from representatives of people who support and validly try to protect or deal with the interests of those people. I think that is what we do: we seek a fair and even balance between those two constituent parts.

Q603 **Kevin Hollinrake:** So it does not indicate regulatory capture.

Sheldon Mills: No, I wouldn't say that. Going back to the earlier part of the conversation in relation to competitiveness, it is clear that some firms would welcome a competitiveness objective, with that being something that might be primary, in order to have an international approach to their operations and to support that. Our own view, as we have said, is that we think there is value in having that sort of objective and having long-term economic growth, but we think that might well be secondary to some of our primary objectives. If we were captured, our response might well be different from that live debate. That said, whatever objectives we get, we will deal with that and we will operate as to what the law says.

Kevin Hollinrake: Any other views on the same thing? Does everybody concur with that position?

Edwin Schooling Latter: I concur with that. I don't think we are in a scenario of regulatory capture. In the end, our firms need us to be a robust regulator, because having a robust regulator is fundamental to trust in the financial sector, and I think they all know that.

Q604 **Kevin Hollinrake:** On how you regulate when things go wrong, Philip Reed said that, too often, we have a knee-jerk response—perhaps sometimes precipitated by a parliamentary outcry to put new rules in place. Isn't it really about regulating more effectively rather than putting new rules in place all the time? Is that fair?

Sheldon Mills: I think the whole system sometimes reacts quite quickly when there is an issue or a crisis, but sometimes it needs to. If we take the Greensill example that was raised earlier, there was a need for us as a regulator to think about the appointed representatives regime, and it was right and proper that we introduced, reasonably at pace, a different approach to that. It is right and proper that we are at pace trying to bring that in and tackling that. Sometimes they are not knee-jerk reactions. An event can highlight—let us be frank—weaknesses in the regulatory system, and it is right and proper that we go to that, we put the searchlight on it and we start to tackle it.

Where I do worry about knee-jerk reactions is where we as regulators end up radically seeking to change the way in which we operate or do things in response to external inquiries and so forth, and where that does not sit with what the long-term approach might be for regulation. I think we need to be a bit cautious sometimes. It is difficult when you are in the spotlight, but even if something has gone wrong and we might be at fault, the answer to that might not necessarily be a wholesale change; it might just be that we operate our system more effectively. Actually, our CEO Nikhil Rathi's strategy of building on our operational effectiveness is sensible in relation to that.

Christina Segal-Knowles: Your question is a good one in terms of whether we can be more pre-emptive. I think that is actually the spirit in which the Government are proposing this future regulatory framework. Removing barriers that allow regulators to be more agile can be supportive of exactly that—not having to wait until things boil to a head, but being more able to look at risks as they come and make adjustments to the regulations. It is in that spirit of our wanting agile regulators that are not waiting until after the fact. I think Sheldon is exactly right to say that sometimes we have learned things in crises. There is a period of stress, it is a real-life stress test, and we need to address it. We need those powers too, but moving in a direction where we can be more agile and more bespoke to what we are seeing on the ground does help us, to your good point around how we should be looking at this.

Q605 **Kevin Hollinrake:** Okay. I think you have both used the word "agility", which is very relevant.

Obviously, the FCA has come under some criticism: on the one side for authorisations being too slow, for example, and on the other side of the equation for enforcement not being proactive enough—London Capital & Finance and Woodford have been a couple of good examples. How do you strike that balance? Are you striking it better now than you were a year or two ago?

Sheldon Mills: Personally, I think that while we always need to prioritise, we also need to have a sensible gateway and strong enforcement. So, you need to do both. We have operational challenges at the moment in authorisations; I would not come to this Committee and say anything other than that. The facts speak for themselves: there are delays and challenges. We have put in place measures both to recruit—we have consultants helping us while we are recruiting—and to get through some of that backlog.

One issue we have is that the gateway is really important to keep the standards and ensure they are high. Some of the challenges we have seen have links through to some of the harmful effects that happen for consumers or markets and firms, in terms of what we have let through the gateway, so it is important for us to have a robust gateway. Sometimes, in that transition of changing the approach to the gateway and the standards that we have there, we need to get the operational mix right so that the flow-through happens a bit more efficiently, but we are working closely on that.

On enforcement, I take the points and the criticism about flawed and about pace, but I am a lawyer by background and enforcement is not easy to do. You have to make sure that evidentially your case is going to stand the test of either the court or our internal tribunals, and the enforcement team do a good job of doing that.

In the future of financial services, we need to think about what we focus on in terms of enforcement and how that supports us in achieving our outcomes in the financial services sector. I wonder if sometimes we might be too broad in terms of our enforcement activity, and if we could be more focused. That might help in being able to tell the story of our enforcement activity.

Q606 **Kevin Hollinrake:** You are onshoring a huge amount of regulation and that has to go through all kinds of processes, as well as the Treasury, consumer groups and that kind of stuff. How tough is that going to be? What kind of timescale has it all got to work within?

Edwin Schooling Latter: It is going to be a very big job. There are hundreds of thousands of paragraphs of MiFID and MiFIR, for example, and that is just one of the 40 or so files that will need to be onshored. So, it is going to take quite a lot of time.

On your question on the precise timing, that is not under our control as the Treasury will make the decisions on which bits it will pass through this process at what time. They will also have resource considerations on their side.

As you know, the idea is that there will be a statutory instrument to say, "This part of the onshored EU rule book will now be transferred"—to the FCA, the PRA or whatever it might be. At the same time, we will go through the usual consultation processes to explain which bits we will keep or amend, because they need better tailoring to the UK market conditions.

That is a very extensive process. It is very important that we get it right and get the stakeholder input from you and others during that process.

Q607 **Kevin Hollinrake:** Sure. You mentioned consultations, but there are so many stakeholders in this, consumer groups being just one. There is a fear this will all be done behind closed doors, between you and Treasury, and that Parliament does not see what is going on or consumer groups do not get the chance to feed in. How are you going to mitigate against that?

Edwin Schooling Latter: It definitely won't be done behind closed doors. That is the FSMA consultation process. As a result of the future regulatory framework, it will also take place in the context of the objectives that the Treasury and Parliament have chosen as the right ones to fashion the decisions that we take during that process.

Q608 **Kevin Hollinrake:** On competition in the financial services sector, we had a bit of difference of opinion, you might say, between one of our witnesses—Anne Boden from Starling bank—and members of the fintech industry. She said that open banking had not been a success and was not a material factor in the decision people took to change provider. What is your view?

Sheldon Mills: I read that, and with respect to Anne, the brilliant leader of the bank that has really changed competition in the industry and with respect to the fintechs, I think they are talking about two different things.

Anne is talking about current account switching. The challengers and microchallengers have been very successful; the figures are that they have 8% of current accounts, and the current accounts held by the big four or big five are going down. So there has been success in attracting those customers. She will be correct that that success is unlikely to have come from open banking; it will have come from their ability to attract a customer base, particularly younger generations. For Starling in particular, the small business banking offer has been innovative—their ability to innovate and attract new custom.

Where I might disagree with Anne, although we would have to discuss it, is that what open banking has done is to unlock a different set of responses to customer need that you would not have if you did not open up the data sharing element, such as apps that allow you to think about where to put your savings or apps that allow you to manage your money better—financial health apps. I am quite keen that we maintain open banking—the CMA's order is what started it, plus PSD2. It is important that, as we move to the next phase of open banking, that successful mechanism is maintained.

Likewise, it is important that the business Department is looking at smart data, and it is important that we expand the use of open data sharing into other forms of financial services as well, in what is commonly thought of as open finance. Again, for me, when it comes to the future of financial services, on Julie's point about the risks around data, there are also massive opportunities around data that perhaps, from Anne's perspective, are not at the forefront.

Q609 **Kevin Hollinrake:** Do you see it as a success?

Sheldon Mills: I see it as a growing success. Open banking now has 5 million active users. That is quite phenomenal. And it is still growing.

Q610 **Kevin Hollinrake:** You mentioned open finance. Some time ago, I think the Bank of England was talking about SMEs using legal entity identifiers as a way to improve competition choice for SMEs. That seems to have fallen by the wayside a little. Where are we with that?

Christina Segal-Knowles: The Bank of England continues to be a champion of using LEIs as a way to improve payment services and to have potential benefits for SMEs and businesses. We continue to champion that both domestically, in terms of using it in our own systems, championing a move to LEIs, and in terms of international work, where we are trying to increase cross-border opportunities. It has not fallen by the wayside.

The Bank of England has also continued to work with HMT on a number of other initiatives, where we have been very supportive. It is ultimately for HMT, but they are initiatives to support better identification, better legal identifiers and better digital identity for small businesses, which will then facilitate their access to financial services.

It has not fallen by the wayside. Perhaps it has fallen out of the public view, but we continue to work on the LEIs, which remain core to some of the innovation we are doing in the services the bank provides, and some of the other initiatives we have continued to take forward.

Q611 **Kevin Hollinrake:** Are LEIs in place and need improving, or are they not in place but will be in place?

Christina Segal-Knowles: LEIs are currently being adopted. Many LEIs exist. The question is: are payment systems and financial industry participants using them? Can we encourage their adoption in a way that allows better facilitation of payments and other services for businesses?

Q612 **Kevin Hollinrake:** Okay. Where can I read more about what you are doing on that?

Edwin Schooling Latter: Perhaps I can comment. LEIs are in place in some bits of the regulatory framework, such as the transaction reporting obligations under MiFIR—you have to include the LEI of the firm on either side of that transaction.

There are other areas where I think there is market interest in having more and greater use of LEIs, because that could help reduce costs and increase certainty about exactly which entity you were dealing with in different situations. In terms of putting in place more regulation saying you have to use them, we obviously need to be cautious about exactly the cost-benefit issues we were talking about earlier, because that is likely to impose some cost, particularly at the smaller end of the market. So we need to proceed with the usual caveats on making sure benefits are worth the cost.

Q613 **Kevin Hollinrake:** This is something you are taking forward? Okay. In terms of the challenger banks—the people like Starling and the rest of them—there is nobody yet who has become big enough to challenge the big players. Obviously, you have the competition objective. What is the difficulty with the scaling of the smaller banks? I think Rushanara asked you before about the internal ratings-based model. You didn't seem to think it was a major problem, but Anne Boden said it was a big problem for her, I think, in the evidence that she gave. She said that "those models take years to develop. The regulator is very strict on getting you through that process…until you get those models you cannot compete head on with the big banks." There seems to be a problem for her, and that is obviously an important voice.

Vicky Saporta: It is true, particularly in the mortgage market—this is a particular issue in the mortgage market—that for low-risk mortgages, low loan-to-value mortgages, 50% and below, if you are a bank and you have an internal model that has been approved, you can receive substantially lower capital than you would under the current, standardised regulations, which apply if you don't have the model.

What have we done about this? First, we have streamlined—we have basically made it easier for firms that want to adopt internal models to understand what we need from them. So we work much closer, if you like, to the challenger bank than before in trying to see what they need.

Q614 **Kevin Hollinrake:** Is that a recent thing you have done, then? Because our evidence was quite recent, Chair, wasn't it?

Vicky Saporta: No, it's something that we have done—we took an initiative quite a few years ago. I don't remember the exact date—I could come back to you on that—but it was quite a few years ago.

The second thing, which was in 2016 or 2017, if I remember correctly, was that we reduced, effectively, the capital requirement. If you are a challenger bank or smaller bank in good standing and you have these mortgages and don't have this internal model, and if we consider that the risk under the standardised approach, which we actually couldn't change at the time, because it was part of the EU regulations and it was hard-wired—we would lower it through another component of the capital system, called Pillar 2; Pillar 1 is what is hard-wired in the statute book.

That has led to a reduction, on average, across the market of about 140 basis points in capital. And we have done an evaluation exercise, an impact analysis, that suggests that after we introduced it, which was a few years ago, the smaller banks that were subject to this measure actually did get more into this market than before.

Finally, we are looking at the "strong and simple" regulations; we are going to look at what the appropriate requirements are for the mortgage market. And we persuaded Basel to lower the international standard that we had applied and which was hard-wired in our regulations. We persuaded them to lower it from 35% of the capital requirement to 20%, and this is going to come through when we implement Basel later this year.

All these things show that we are aware of the issue and we have been taking action. Beyond that, approving an internal model is effectively, as the Committee knows, approving giving the power to the bank to set its own capital. Capital is the major way in which we ensure safety, soundness and policyholder protection for insurers. We cannot just wave in internal models.

Q615 **Kevin Hollinrake:** One of the other barriers is MREL, to which I alluded earlier. Lots of mid-tier banks say that the changes that you propose do not help at all, because they are only a glide path, rather than a change in the threshold. Is that not a problem? Is it something we should look at to let those Aldermores and Paragons and so on grow?

Vicky Saporta: I should say for the sake of clarity that this is not my area of responsibility; it relates to resolution authority proposals, and is the responsibility of an executive colleague. I am involved, as there are so many interactions I have followed and participated in the debates on this, but it is not my direct area of responsibility.

As you said, the judgment was that we should stick with the current threshold: above £15 billion or about 40,000 transactional accounts, if you fail, you should not go through the insolvency procedure. You should have a stabilising mechanism, otherwise it will be disruptive to those 50,000 current account holders and potentially to public funds if it is deemed unacceptable for broader reasons to leave such a bank to go under through the insolvency procedure.

As you say, the policy is to smooth significantly—potentially up to eight years—the path to setting the point at which discussions start on the MREL requirement, which will ensure stabilisation if you fail. You have six years to get there, and you can apply for an extra two years later on. On top of that, colleagues in resolution have said that they will look at the definition of transactional accounts and whether, given some of the technological innovations that have come through, that 40,000 number is still appropriate. They have said that they will look at that in future.

Q616 **Kevin Hollinrake:** The final question is for you, Sheldon. You spoke about insurance companies pooling risk, which is currently the case. As we get cleverer and cleverer with open banking and open finance and whatever else, might it be the case that some people are left behind and their risk is priced differently? Some people have a more precise calculation of risk, so basically no one wants them. Is that a concern?

Sheldon Mills: It is a concern. I do not think that it is a major risk now, but it is a risk as we move into models that are based much more on personalisation of data. At the moment, most insurers use data to be more precise in their risk-based pooling and the prices and premiums that they offer. I imagine that that would continue. It is a risk that we need to monitor and continue to understand.

We have to recognise—this is my personal view, rather than an FCA view—that data is going to change the way in which many of our financial services are provided. We have to find ways to ensure that we go with that sensibly. There will be some challenging choices as we move forward in society. The thing I worry about more in insurance at the moment is the significant risks that are too costly on a personalised basis or a risk-based pooling basis to insure. We have seen those grow with issues around climate change and other issues in society. Those are areas on which we all need to focus and try to tackle.

Chair: That brings us to the end of this session. Thank you very much indeed for appearing before us.

I apologise for the fact that we have been reduced to three Committee members. For our viewers, I hasten to add that that has nothing to do with the quality of what you have provided this afternoon, which has been outstanding; it is to do with the fact that the Prime Minister is making a statement about covid in which a lot of people are interested. It could have been worse, because the quorum for the Committee is three, so we could not go below three members. You never ran the risk of it being just you and me. Thank you very much indeed for coming today—we really appreciate it. That concludes this session.