



Treasury Committee

Oral evidence: [Financial Conduct Authority, HC 515](#)

Wednesday 21 October 2015

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Members present: Andrew Tyrie (Chair); Mark Garnier, Helen Goodman, Stephen Hammond, George Kerevan, John Mann, Chris Philp, Wes Streeting

Questions 1-85

Examination of Witnesses

Witnesses: **John Griffith-Jones**, Chairman, and **Tracey McDermott**, Acting Chief Executive, Financial Conduct Authority, gave evidence.

Q1 Chair: Thank you very much for coming in to give us evidence this afternoon. Can I go straight into one point of detail, and then maybe there will be some more general questions? Just to get it clear and on the record, Tracey McDermott, you expressed a view about the draft Bill's introduction of a duty of responsibility, which appears to be somewhat different from that of the PRA. You have basically said that it would have been helpful, but it was never a panacea. How helpful would it have been, and what have you lost?

Tracey McDermott: As I said last week, and indeed as I said when I was before the Parliamentary Commission on Banking Standards, the presumption of responsibility would have been a helpful starting point shift in an investigation, but ultimately we would still have been required to prove that the person had not taken reasonable steps. It simply would have reversed some of the order of the early investigation.

Q2 Chair: I am sorry to interrupt. Just on that point, you are confirming what was told to us yesterday—you will have seen it, I am sure—by Andrew Bailey.

Tracey McDermott: I have seen a summary of what Andrew said.

Q3 Chair: He made that exact point: that that duty of proof would still lie with you, ultimately.

Tracey McDermott: Ultimately, in the independent tribunal, it would still be necessary for us to show those steps were not reasonable, but the starting point in an investigation would

be from a different place, which is why I always said that it was not a panacea. The much more important part of the Senior Managers Regime is actually around having clarity of responsibility and clear lines of accountability, which is something that was missing in the past. That part of the regime very much survives, and not only that but it is expanded across financial services, which I think is useful.

The most important point is that this is not taken as any indication that the regulators are less interested in individual accountability, because that is definitely not the case, and what I hope this will do is ensure that people concentrate on actually implementing the regime in accordance with the spirit in which it was intended, rather than thinking about the letter of the law.

Q4 Chair: Do you agree that the duty of responsibility may, in some cases, lead to senior managers escaping sanctions that they would have faced under the reverse burden of proof, or are you really answering that with your point about a need for the legal work ultimately to prove that the person had been responsible?

Tracey McDermott: The difference it may make is that it may make investigations in the early stages slightly more onerous for the regulator. The ultimate decision made by the tribunal is very likely to be the same, regardless of where your starting point is.

Q5 Chair: Are you going to investigate less, because of the burden?

Tracey McDermott: No. Our current position, without the burden, is that, if we think there is a case where there are reasonable grounds to believe that a senior manager has failed in their duties, then we should investigate that. That is a priority for us. One of the things I said when I gave evidence on this question before was that one of the biggest challenges in that was the lines of accountability and being clear about responsibility, and that will be resolved by the Senior Managers Regime.

Q6 Chair: Have banks been lobbying you to reverse the reversal of the burden of proof?

Tracey McDermott: They have not been lobbying me. It has been very clear and very public that the banks have not liked the presumption of responsibility, and they have not hidden their dislike for it. A lot of people commented on it very publicly.

Q7 Chair: Can I turn to you, John Griffith-Jones? You are running an outfit without a chief executive. His term was not renewed. It is widely held, and it has been held by this Committee, that the FCA has a great deal to do to get itself back into shape, in a sense that the FCA itself has been in special measures for some years, that culminating in the catastrophe of the serious breach of the FCA's own listing rules. Of course, there are a lot of mitigating circumstances. It is a legacy institution from the crisis. There were many other problems. Some of your best staff were probably poached by the PRA or went into the private sector and so on. How confident are you

now that you really have got this outfit pretty close to or in shape to do the legislative job that you have been asked to do by Parliament?

John Griffith-Jones: I am feeling reasonably confident. It is certainly not the case that the job is finished, and, because of the circumstances surrounding Martin Wheatley's departure, we find ourselves with a considerable number of new and I think very talented people having joined the squad, but, like all squads, we need time to get them to work as a real team. Clearly they were recruited by Martin and now working for Tracey. It is all going very well at the moment, but I would say that we are less stable than you might ideally wish, and we are working extremely hard to get ourselves into a good position. Fundamentally, we have good people and a better strategy.

Q8 Chair: A frequent refrain of the industry—and it is important, and I am sure that my colleagues, members of this Committee, do, how does one say, put at something of a discount, but not ignore altogether, complaints made by the regulated community—is that, while when they talk to the most senior management quite often they have the impression that the message has gotten through on something that they feel was blatantly nonsense, a terrible mistake or just a burden and cost to customers, at the implementation level lower down in the organisation, things carry on just as before: burdensome, box-ticking, bureaucratic and often pointless. Is this a concern you recognise, and, if it is, is it one that you think you are getting on top of?

John Griffith-Jones: It is certainly a complaint that I am familiar with and has been made directly to my face, not just behind our backs. Personally, I do not think it is altogether fair. I think, if you look at our constituency of firms, it is much more prevalent in the banking sector than it is in others—that is a personal, but researched opinion. It is something that we cannot altogether ignore, and I am very keen that our new strategy, where we have aligned people in sector teams, should grow the expertise and that the new leadership should concentrate, if this is a problem, on tackling it.

Q9 Chair: Are you always going to have this problem, partly because some of your best staff, as they train up and become good, are going to get poached by the regulated community at higher salaries? Therefore, you are always going to find yourself at something of a disadvantage, training people up, having just lost the people you wish you had kept.

John Griffith-Jones: I think it is inevitable that there will be a flow-out, and who would not? You come and get an excellent training at the FCA for three years then get offered twice as much money, and potentially that is a perfectly logical decision. We have to run ourselves knowing that that is going to happen, or likely to happen in a percentage of the cases. I would say that there are a significant number of people who want to come the other way, more senior, who maybe are not natural traders or at least discover that they are not natural traders, and who are more comfortable at the compliance end of the spectrum than at the trading end.

Q10 Chair: What about people who have made a few bob and want to put something back?

John Griffith-Jones: Certainly we find that at the very top of the organisation. Among the recent recruits, we have, for the first time, got some people like that to join us.

Q11 Stephen Hammond: To follow on from the Chairman, certainly one area of unfinished business would appear to be that you regulate both retail and wholesale, and particularly in the wholesale market—notwithstanding your comment about what regulated people might say—it would appear that you have lost the faith, trust, belief, call it what you will, of those you regulate. Would you care to comment on that?

John Griffith-Jones: Shall I go? Sorry, we are a new team. Let me just give a quick overview. From a strategic perspective, back last December, we decided to split supervision in two, not exactly retail and wholesale, but broadly along those lines, to tackle this problem. We have very kindly, by Andrew Bailey, been lent Megan Butler, whom I think everybody in the wholesale business recognises as being a true expert in the field. As a result of concentrating the resources by these specialist areas, I would hope that that will be improved.

Q12 Stephen Hammond: Before I joined this Committee, I met a number of CEOs from investment organisations and others. One of the impressions that overwhelmingly came through, and I wonder if you have a strategy to correct this, was, in a direct quote from someone, “They act as if everything we say to them they regard as a lie and they do not seem to believe anything we say to them.”

Tracey McDermott: One of the challenges over the last couple of years was that there has been a lot of focus on retail consumer, in terms of the way the work of the FCA has been reported, so there has been an element in which we have not been getting out sufficiently strongly our story around what we are trying to achieve in the wholesale markets. Part of that is clearly around engagement with senior management.

I do not think we start from the view that people are telling us lies, but we are regulators, and therefore we are inherently sceptical when people tell us something. That is what you would expect and want us to be. We have recruited some very strong people in the wholesale sector who have come from an investment banking background, and the feedback that we get on those individuals, particularly in investment banking, is that there has been a significant improvement and increase in the skills, knowledge and understanding of the people who are actually operating in supervising those sectors.

It is an area of focus for us. As John already mentioned, we have restructured supervision to ensure that we have more of a focus on wholesale and can pool the expertise that we have across work that used to be done partly in the markets division and partly in supervision. We have brought that together to ensure we have a consistent approach and are making the maximum use we can of the skills that we have. As I said, we have recruited some very good people into that area with a range of different backgrounds.

Q13 Stephen Hammond: Could I just explore one area in a bit of depth? It is one of the reasons why there is this mistrust. On the subject of dealing commission

for the purchase of investment research, can you tell us why you made enhanced commission sharing arrangements mandatory in May 2014 and then banned them in 2015?

Tracey McDermott: I am not sure that we banned them in 2015.

Stephen Hammond: You did.

Tracey McDermott: Our focus in relation to dealing commissions is that we think, where you have bundled commissions that are not classed—

Q14 Stephen Hammond: I understand that point. The point was that you gave a directive to the industry and then changed that directive nine months later.

Tracey McDermott: My recollection is that we said, in 2014, that we expected people to be transparent about the way in which dealing commission had been allocated, so the cost of dealing versus the cost of research. There is work ongoing through MiFID in relation to European-level questions about whether there should be what is called “full unbundling”. We have made it clear that that would be our preferred option. That was based partly on feedback we have had from a range of people, including our Asset Management Conference. The rules have not changed.

Q15 Stephen Hammond: The letter that the UK, German and French Treasuries sent to the DG FISMA dated 25 August this year expresses some concerns about the interpretation of emerging level 2 provisions not affecting the agreement in MiFID I. Are you clear what MiFID II should do in terms of providing a transparent regulatory field across Europe, and are you going to support the outcome of MiFID II?

Tracey McDermott: ESMA has given advice to the Commission in relation to MiFID II. The Commission is considering that. We are expecting the Commission to report back by the end of the year, and obviously that will drive what is in the provisions for MiFID II. Our starting point on this has always been that we would prefer to have a consistent European solution to this question, rather than a suggestion that is UK-specific. Obviously, when we see the detail of the Commission’s decision, we will need to look at that and decide whether that remains our position or whether anything needs to change.

Q16 Stephen Hammond: That is helpful, because one problem that has arisen is that the decision taken in January this year appeared to be a different interpretation of ESMA language by yourselves from others. That caused some great concern.

Tracey McDermott: I think that we are aligned with the ESMA advice. The advice given by ESMA to the Commission is advice that we support.

Q17 Stephen Hammond: Lord Hill had announced a review of all post-financial crisis regulation, so we can understand the impact of potentially conflicting regulation on European market participants. You have a number of

ongoing regulatory initiatives, including, obviously, a review of wholesale banking. Can you say what your reaction is to that initiative and how you are going to work with it, given that you have initiatives running at the time?

Tracey McDermott: The announcement by Lord Hill about wanting to review post-crisis legislation is an entirely sensible one. There has been awful lot of legislation since the crisis, and looking to see whether that is all having the intended effect and working together as was expected is an eminently sensible thing. We will feed into that very much through our participation on ESMA and the other European bodies. We have given some specific feedback on things like capital markets union and potential changes to the Prospectus Directive.

In relation to our own work, there are areas of focus in wholesale banking, specifically around the market study we are doing, looking at how investment and corporate banking works to provide services to its customers, including the availability of finance to small and medium-sized enterprises. That will continue. Obviously it happens in the context of a European background, but that is not specifically looking at how those rules are operating; it is looking at how those processes work from a market and competition perspective.

Q18 Stephen Hammond: So we are expecting that the FCA will fall in line behind Lord Hill's review.

Tracey McDermott: We are expecting the FCA to contribute to Lord Hill's review, and ultimately Lord Hill's review is of European legislation. If the review then recommends that there should be changes made to that, then we would be part of those changes.

Q19 Mark Garnier: Can I turn to the issue of fees levied by the FCA? John, you might want to tackle at least some of it. You have just increased your fees by 10% to £75 million for the amount you are trying to raise. Do you not worry that you are going to price consumers out of the market, as effectively these fees are going to be passed directly to the consumer? You are making it very difficult for advisers at the small end of the market to be able to provide advice at affordable cost to people. What do you say about that?

John Griffith-Jones: Our fees for the current year are up, on average, 7.9% from the prior year, which I presume is your figure of 10%.

Mark Garnier: Compared with an inflation rate that is flat.

John Griffith-Jones: Yes, it is a real increase.

Mark Garnier: A very real increase.

John Griffith-Jones: That has been driven primarily, because we are a people organisation, by additional people. The reason we have additional people is, broadly speaking, because we have been handed additional responsibilities to deal with. The competition objective, the payments systems regulator and the transfer of consumer credit are the big three. I think those needed to be done, but we took a decision at the time that

they needed to be incremental, not substitutional for other things that we did, so that has driven the increase.

But do I accept that we cannot go on increasing fees at 7.9%? Clearly, because at some point the value-for-money equation ceases to work. One other very important point that smaller firms are particularly anxious about at this moment, or many of them in the IFA space, is around the FSCS levy.

Mark Garnier: Which was my next question, funnily enough

John Griffith-Jones: I may have to hand over to Tracey for the detail, but the construct of the FSCS scheme is periodically reviewed. It was last reviewed just before I arrived by Adair Turner, just before he left. It is due for review again next year or later this year, and we will absolutely do that. The way that the scheme works is that various buckets, as they are called, are set up, and limits, and this, that and the other. There have been a whole series of claims in the bucket with IFAs in it.

Q20 Mark Garnier: Is that investment intermediation?

John Griffith-Jones: Yes. Many of them arise from SIPP advice that has gone awry for one reason or another, and, if I remember the numbers rightly, the cap on that bucket is £100 million. Last year's claims were, I think, £43 million and this year's are going to be £100 million, so they have just got bills that have essentially doubled. I was talking to an IFA last week who said that he personally is having to pay £24,000 for his FSCS bill.

Q21 Mark Garnier: There is quite an important point in this, because, by the time you have taken into account your 7.9% increase, then you have the substantial cost of the Financial Services Compensation Scheme levy, which, of course, they have to pay. At what point does it push IFAs, or indeed any firm, beyond the remit that you prescribe to them in terms of financial solvency? To put it another way, how many firms are you making, collectively, go bust?

John Griffith-Jones: The big point you make, which is obviously true, is that these people are essentially selling their own time, so this will either add to the cost of their time or take them out of business. There must be an impact on the market.

Q22 Mark Garnier: There are a couple of things that are taking them out of business, potentially, one of which is that the cost of doing business goes up so much that you cannot find customers who can afford to pay it, which, in itself, has pretty profound consequences for those people who need the advice. In particular, with pension freedom, as we go forward, people will need the advice before they put their money into the pensions, not when they take it out. That is the first important point.

The second important point is that you have very sensible rules about financial stability for these firms; they have to meet requirements. If they suddenly get hit with unexpected costs—and an unexpected cost can be a 7.9% increase in their regulatory fee; it can be the Financial Services Compensation Scheme levy—at what

point do you, by charging them so much money, put them out of business in terms of your compliance requirements?

Tracey McDermott: Just to make one point by way of introduction, the very smallest firms, just under 7,500 firms, pay the minimum fee or less, which is £1,084 a year, so they are protected from quite a large part of this. Obviously, in terms of the FSCS levy, one of the biggest problems is that it is lumpy and unpredictable. The investment intermediary and life and pensions intermediary sectors have suffered from very big increases in recent years, partly, as John said, as a result of issues around SIPPs.

In terms of the actual data on IFAs specifically, the profitability figures for IFAs as a group are actually going up at the moment, rather than down, despite those numbers. But clearly there is an impact, and one of the things we have said we will look at and part of what we are looking at in FAMR, which will feed into the FSCS review, is whether there are ways in which we can try and make that process at least more predictable. We will also look at the question of how that liability is paid for, because obviously you pay for the FSCS when firms have gone out of business having mis-sold to their clients, so the good guys are funding problems caused by the bad guys. We are going to look at that.

In terms of our capital requirements, we have not, so far as I am aware, seen a trend of people going out of business because they are saying, “We cannot meet the combination of these requirements.” What we are seeing is people saying, “Actually, I do not know whether in the long term this is a sustainable business. I am worried about what the potential long-run liability is here”, and clearly that is something we are focused on. As I said, it is one of the areas specifically being looked at in FAMR.

Q23 Mark Garnier: Can I turn to fines, because this is an important part of it? Now, as I understand it—and perhaps I can get clarity from you—up until the end of 2012 and beginning of 2013, any fines that were levied by the FCA were taken in by the FCA and formed part of your running costs. There was an argument at the time that perhaps you were incentivised to fine people, which is a moot point, and that is a very old debate. From the LIBOR scandal, it was deemed that these fines from the FCA should be taken in and used for charitable purposes, so to help various military organisations. My question is this. Is it not the case that, while this is very well meaning and the charities receiving this are incredibly worthwhile, what is happening is that we are now seeing the cost of compliance going up as a result of this goodwill gesture? In fact, you could almost argue that the cost of advice is going up partly because we are giving this fine money, which otherwise would be your revenue, to charity.

Tracey McDermott: To take us through the various stages, you are absolutely right that, post Barclays’ fine over LIBOR, the law was changed so that penalties were paid over to the Treasury, after a deduction for the cost of enforcement; effectively, the cost of running the enforcement division is taken off the top of that, so the industry does not pay for that. What used to happen was then that the fines would be applied against the fee block where the fine had been imposed. If the fine was imposed on banks, then other banks or other people within that fee block would have benefited, in the historic system. Whether or not IFAs would have benefited would have depended on which fee block it was applied to.

However, since 2012, the entire amount is paid over to the Treasury and then is allocated as the Treasury sees fit.

Q24 Mark Garnier: These fines are all pretty heroic in size, as we know, because banks tend to screw up big time these days. Is there not an argument that these fines could be used for a number of quite beneficial uses? Given the fact that they are running in the hundreds of millions of pounds each time, could they, first of all, be used to subsidise the cost of advice, by keeping your fee increase flat? That is the first idea. The second idea, potentially, is that some of these fines could be diverted to a Financial Services Compensation Scheme stabilisation fund, so, although it is probably the right thing to do that all parts of the industry are incentivised to keep an eye on each other, and the FSCS has the effect of that, we could get rid of the peaks and troughs of this.

Thirdly, of course, what we are incredibly keen on is better behaviour. Tracey and I had a private conversation about this, and I am now putting it into the public domain, if that is alright. We are trying to drive better behaviour within banks. Could part of that fine be used to finance Serious Fraud Office investigations into recalcitrant bankers? For example, where there is not enough resource to bring a criminal prosecution against a wrongdoer, this could provide that resource.

Tracey McDermott: I should start by saying that, as the organisation that levies the fines, it is probably not for us to have a view as to how the Government should then allocate that money. It is quite important that the person who imposes the fine should not be incentivised to put it in any particular area. In terms of the specific suggestions that you made, obviously the first one would be effectively returning to the pre-2012 status quo, but at that point the fines were significantly lower. I think we would be running a very significant surplus if all the fines were sitting in the FCA's bank account. It would be free to be regulated for some time.

In relation to the FSCS, that is certainly an interesting idea, and the lumpiness is one of the big issues that firms talk to us about a lot. In relation to the SFO, David Green has publicly said a number of times that, while he is the Director of the SFO, he will never turn down an investigation that he thinks is a good investigation because of money, and he has had that assurance from Government that money will be available to investigate.

Mark Garnier: Or the City of London Police, perhaps?

Tracey McDermott: Whether that could be specifically taken from the fines pot is ultimately a matter for Government, but I think the funding is available to it. As I said, this is fundamentally a question for the Government and for Parliament, rather than for the regulator.

Mark Garnier: It is always nice to have your opinion.

John Griffith-Jones: Talk about the FSCS has been dominated since the crisis by bailing out the banks, but, in "normal times", we do not expect to have to bail out the banks again. When we do our review of the FSCS, we will need to concentrate much more on the fairness of it among the IFAs than perhaps when it was structured last time around. Not that it changed that much, but all the attention was on what happens if the banks cannot

afford their bucket, rather than the IFAs. We need to turn our attention there when we do the review, which, as I say, is imminent. It needs to come after the FAMR work, only because that is going to affect the advice regime, but, once we have that settled, we need to concentrate a bit harder on the impact on the IFAs.

Q25 Chair: If you strip out the extra costs of the competition objective and the payments systems regulator, what has happened to the underlying costs for those activities that you were already doing since 2012-13?

John Griffith-Jones: Rather than guess, I would prefer to put that on a piece of paper to you. If I am allowed to give you a rough idea, we had 3,400 people on average last year, and, by the year-end, we had 3,550, so you can see the trend. The trend through last year was a very significant growth.

Q26 Chair: The FCA committed to deliver the cap on the cost of those inherited activities, a recommendation that lay in the Banking Commission report and which this Committee subsequently endorsed. Have you fulfilled it?

John Griffith-Jones: There is a coalescence of several things happening at the same time. The fundamental amount of resources remains broadly constant, but the additional tasks—and, I should add, the additional computer costs, many of which are related to European legislation—have probably taken us off course on that. I would be happy to set out a few numbers for you.

Q27 Chair: We would like an answer from you, and we would like it in detail. We want to know to what extent you have not fulfilled it and why, and we will be monitoring this very carefully. Your training, recruitment and travel costs are set to increase by a third, and your staffing costs, as you say, are up 7%. These are quite high figures, are they not?

John Griffith-Jones: The staff costs are a direct consequence of the increased number of people.

Q28 Chair: Is this mainly training, travel or recruitment, or what?

Tracey McDermott: There will be quite significant numbers in there for recruitment, because of turnover. There are also quite significant numbers in there for training, because of what you mentioned earlier on, which is that one of the challenges for us is how we make sure that we get the right staff in, get them up to speed and get them in a position where they are able to deal adequately with the complex issues that they have to do. Also, how do we make the FCA an employer that people want to work for? Our aspiration is that we want to be a place where, if you want to have a long-term career in financial services, you should have spent some time with us. Part of that is investing in training in relation to our staff.

Q29 Chair: You can come back to us with the breakdown of these numbers, and we would like it in some detail. The recommendation of the Banking Commission was for a nominal cap. Of course, unusually, at the moment we have very modest deflation, so that is a very small increase in real terms, but we do not expect that to last. It was nominal because we want to bring down pressure to bear in the long run. We want the FCA to find ways of delivering better value for money, like every other part of what amounts to the public sector one way or another, whether you are funded through the levy or directly through taxation.

I have one other point I want to clarify. Have you tried to monitor the overlap of activities between you and the PRA that has been created by twin peaks? Firms are complaining that two groups of people are coming in to collect the same information, and I am sure you have had the same complaints. How much truth is there in this? Either now orally or in writing, perhaps we had better have some detail on that too, supported by numbers.

John Griffith-Jones: I had a lot of hypothesis that this was going to happen when I first was appointed. I hear much less now. I am not saying that you do not, but I do not. I have always heard the reasonably robust argument that, broadly speaking, we are doing different things, so the prudential guys want to check their numbers and we want to check their behaviour. The place where we coalesce is around the governance structures, about which we undoubtedly do both ask questions.

My answer to the firms is that, if they can answer the question correctly to the first regulator, it does not cost that much more to give exactly the same pieces of paper to the second. While they might feel they are being asked the same question twice, that has not got any material financial cost attached to it, and we are both entitled to be interested. I think you will detect that I am a little more robust on this. I am not sure we will have numbers, but we will certainly look at what we have.

Chair: We would be very grateful if you could come back to us on that and also an examination of the extent to which we can vary the levy structure to enable something to be done about the good guys paying for the bad guys, which lies right at the heart of the complaints and concerns that many of us as MPs are getting.

Q30 George Kerevan: I concur with Mr Griffith-Jones. It is time to move on from the banking crisis. In order to let us do that, could you give us a date, a ballpark figure, a backstop of when we might get the publication of the report into the failure of HBOS?

John Griffith-Jones: As I am afraid you will all probably know, I and Ms McDermott are both recused from the process of the publication of the report, so it is not proper for me to give you a completely authoritative answer. I can say that we are very near the finalisation, as I understand the position to be, which is not closely.

Q31 George Kerevan: Utterly understood. Is “very near” this year?

John Griffith-Jones: I would certainly hope so. As you can appreciate, the organisation itself cannot wait. There is absolutely no motive in our organisation to hold this thing up,

but I am not involved in the final permissions and i-dotting and t-crossing. My colleague, Sir Brian Pomeroy, my SID and Deputy Chairman, and Andrew Bailey are jointly in charge of the production of the thing, and they are walking around as people who are near the end of their task.

Q32 George Kerevan: How does that look?

John Griffith-Jones: Better than a year ago.

George Kerevan: Do they have a smile?

John Griffith-Jones: Seriously, you all want to see it, and we absolutely want to get this out.

Q33 George Kerevan: I do not think I am going to get any more. Let me move on to more technical things. I am interested in the fees for drawing down on pension pots, if I can move on to that. There has been a degree of comment in the press, since the Chancellor announced that people would have access to their pension pots, regarding excessive fees for exiting. I wonder if the agency is concerned with excessive exit fees.

Tracey McDermott: We published some data on this earlier in the summer. The data we published show that 80% to 90% of people can draw down without having to change provider, although a number of them have to change contracts within their provider to draw down. Of those, 85% will incur no charges at all.

Q34 George Kerevan: I am concerned with the 15% of the very large number who are now coming out.

Tracey McDermott: Of that 15%, most are charges that are at the lower end, so underneath 2%, but there are 250,000 contracts where the numbers are over 2%, and those are at the higher end. The Government are looking at the question of exit charges, and there is a question out currently on whether any changes should be made in relation to that. I think that consultation may even close today. We will be looking at the results of that with the Government to see whether there are any steps that need to be taken.

Q35 George Kerevan: Does the FCA itself have any concept of what would constitute excessive? Is there a percentage?

Tracey McDermott: The question of the fees will be very specific to each of the individual contracts. You have to look at the contracts in the light of what the fees have been throughout the life of the contract, not just in relation to the exit charges, because when some of these were structured some time ago, the way in which the charges were incurred would have been in some cases front-loaded and in others back-loaded. It is necessary to look at it over the life of the contract. Clearly, we are keen to ensure that the fees that are charged overall are reasonable, and also that customers get value for their product.

Q36 George Kerevan: Could I tempt you on a definition of reasonable?

Tracey McDermott: What would be reasonable would depend on the circumstances. I am not trying to be difficult, but it is hard to say now, in the abstract, that the percentage number is X. Sometimes the percentage may be a high percentage, but actually a pretty small number. Sometimes, if you have a lot of money in your pension pot, a smaller percentage might seem unreasonable. It is a question of looking at what the fees are being charged for, what the charging structure has been over the life of the product, whether that was properly disclosed to the customer, whether they understood and whether it reasonably represents the costs that people are paying or should be paying now. It is an issue with a number of different facets to it that need to be looked at.

Q37 George Kerevan: What would be the timetable, post the review?

Tracey McDermott: As I said, I believe the Government consultation closes today, so there will obviously be a period of time when that is being looked at over the coming months, and I would expect that there will be more in the early part of next year.

Q38 George Kerevan: If it transpires that people are accessing their pension pots in a way that is proving inimical in the long run, in the broad sense, to there being adequate pension provision, I am interested in how the FCA will respond. Looking at the figures, for instance, in Australia and the United States, there is a very small market now for annuities. That would suggest to me that, if we followed that trend, we would have to fill the market with new products. For instance, is the FCA looking at the range of products and are you concerned with how the products are emerging within the market?

Tracey McDermott: We have seen an enormous drop in the sales of annuities, from around 89,000 in 2013 to 11,000 in the same period in 2015, so we have seen a very, very significant fall in the sales of annuities. Some of that may be because there were more people who were waiting to access their pensions as a result of the announcement of pension freedom, so we do need to watch a little more over time to see what that stabilises as, but we can be fairly confident that there will be a significant reduction in the amount of annuities sold.

In terms of the new products, the focus of the industry immediately after the announcement of the reforms was on getting ready to allow people to take their money in the way intended by the reforms. A number of them are starting to develop new, more flexible products, but relatively few of those have come to market yet. One of the things we are doing is working very closely with firms as they develop those to try to ensure that, in this very complex area of financial arrangements, they are properly disclosing them and really considering consumer needs and concerns.

One of the most challenging things around implementing the pension reforms is that you are expecting people to think about longevity and sustainable income, and so on. The risk warnings we require to be given make it very clear that this is the money that you have to live on for the rest of your life, potentially. One of the things, again, FAMR, the Financial

Advice Market Review, is particularly focused on is how we ensure that people have advice or guidance to help them make those decisions. The short answer to your question is, yes, we are watching the market as it evolves and we are working closely with the industry, but there has been relatively little by way of new products coming on to the market yet.

Q39 George Kerevan: Does that worry you?

Tracey McDermott: I do not think it worries us, because we would prefer people to think about it carefully and get the products right, rather than to rush products on to the market. The industry has responded well to pension freedom and has a lot to do in a very short period of time. The key at the moment has been to make sure that runs smoothly, and the industry is now turning its mind to how it innovates and develops new products to meet consumer needs.

Q40 George Kerevan: Do you feel you need to develop a range of early warning mechanisms so that, if we reached some kind of existential problem across the age cohort, people were not actually buying into new products? My worry is that we do not know how it will evolve, but, in the models that I have looked at in Australia and America, which are analogous in terms of communities and economies, a problem has emerged of people drawing down pension pots and not leaving enough. The gap between allowing access to pension pots and new products coming along is worrying to me. At what point do you think we will resolve that gap?

Tracey McDermott: One of the challenges, which is a demographic challenge, is that the population is ageing. One thing that is not completely peculiar to the UK but is definitely strong in the UK is that a lot of people's wealth is tied up in property. We have said that one of the things the industry should be looking at, and an area where they will want to work closely with the regulator, is whether there are products that would allow people to use wealth tied up in property to help fund their retirement, because one of the other challenges is that most people do not have enough money in their pension pot to support them through their life. The industry needs to look not just at pension products, but also at other financial products. Clearly, that is an area where there needs to be close working, because equity release in particular has an unfortunate history.

Q41 George Kerevan: You probably will not want to answer this, but do you think it was wise to move so quickly to freeing up access to the pension pot, without adequate products being in place to replace annuities?

Tracey McDermott: It is ultimately a matter for the Government and Parliament as to what the policy is in relation to pensions. I think 200,000 people accessed their pensions in the first quarter, so there was clearly a demand for it.

Q42 George Kerevan: There was demand to access the cash, but the absence of new products is what is worrying me. Just very briefly, since you have entered into the issue of property, I am intrigued that Lynda Blackwell, your mortgage manager, is quoted in the press as saying, "There's lots of questions about whether it is right that

the Government should focus on the first-time buyer when we've got a real issue with the last-time buyer. There's older borrowers who basically pay off their mortgage and sit quite happily in a very big house." That would be me. Does the FCA have a policy of thinking people should move?

Tracey McDermott: No. Those comments were made as part of a panel discussion at a trade conference, and were somewhat taken out of context and reported in a rather sensationalist way by the newspapers, a way that all of the trade press said was not really a fair representation of the debate. The point Lynda was making was the one I have just referred to, which is that we do need to think about whether the financial services industry is providing the sorts of products that people need at different stages of their lives to enable them, if they wish to move home, to make that choice, and, if they wish to stay put, to enable them to make that choice, but to have access to cash as a result of doing so.

Q43 George Kerevan: Here is the real question. Forgive me; I have had a bit of fun with you, but the real question is: do you think the mortgage market adequately serves older borrowers? If you want to deleverage your house and move down south, then there are issues. Do you think the mortgage market is properly attuned to older borrowers?

Chair: I think that really is the last question.

George Kerevan: Yes, sorry.

Tracey McDermott: I will be brief. The traditional way the mortgage market operated was that you took out a 25-year loan to pay off, to buy a property at the end. What we are now seeing, as the demographics of the country change, is that people have wealth tied up in property. Therefore, you need to think about whether there are ways of releasing that, which may be mortgages or may be other products, but clearly something that is secured on property may be part of the solution.

George Kerevan: Thank you, Chair, for your indulgence.

Q44 John Mann: Mr Griffith-Jones, the Chancellor wants to make a new settlement with the City, and your previous chief executive, Mr Wheatley, described the approach to us as shooting first and asking questions later. It would be helpful if you could encapsulate what the ongoing approach is now, so that we can be clear where the FCA is heading.

John Griffith-Jones: The Chancellor made clear, and certainly it is very clear in our building, that our overriding objective and our three operational objectives have not changed. They are to protect consumers, encourage competition and ensure market integrity.

Q45 John Mann: We know that, but I am trying to get your phraseology so we can have a clear feel of what this organisation is now about.

John Griffith-Jones: The answer is that it is about exactly what it was about before. There were some style issues, it is fair to say, and we already touched on some specific

things earlier in this session, but, fundamentally, our job has not changed. I think it is really important that it has not, because there has been nothing said by anybody to suggest that consumers should be less well protected by the FCA in 2016 than they were in 2014. I really mean that. That is what we are talking about internally.

Q46 John Mann: So the colour of the coat may have changed a little, and the fashion, but the coat is exactly the same—as what?

John Griffith-Jones: The regulatory objectives and the tools required to ensure that customers get treated fairly are, broadly speaking, unchanged, yes.

Q47 John Mann: Why, then, Ms McDermott, are you saying, “Enforcement is not the only tool at our disposal”? Are you going to be shifting things away to a range of vaguer tools?

Tracey McDermott: I have said for many years that enforcement is not the only tool at our disposal, and, while enforcement tends to get a lot of attention, and I obviously know enforcement very well, it has always been a relatively small part of what the organisation does. An emphasis on enforcement will stay. As a conduct regulator, it is important that, where people or institutions are in breach of the rules, they do face the consequences of that, so I do not see that changing.

But that is very far from the only thing that we do. One of the things that John touched on earlier is the competition powers that we were given as part of the changes in legislation, where we want to use those as tools to drive better protection for consumers as well, so there are a range of tools that we have. We are very fortunate among regulators to have such a range, and we want to use all of them to try to achieve the outcomes.

Q48 John Mann: In 2014, you used a recruitment ban on a firm. Can we expect more novel and different approaches?

Tracey McDermott: We used a recruitment ban. We also, in another case concerning failings around anti-money laundering controls, imposed a restriction on taking on new clients for a certain period. Those were powers given to us in the 2012 Act, which applied to conduct after that point, and we are very clear that sometimes using those restrictions, restricting the business of a firm and preventing them from doing things, can be more effective than simply a financial penalty, in terms of changing behaviour.

Q49 John Mann: So we can expect more restrictions.

Tracey McDermott: This is very specific to the enforcement context. We look at what the thing would be that is most likely to have an impact on that firm and the wider sector in terms of the incentive not to do something being greater than the incentive to do it. We also, through our supervision work, regularly use things like restrictions on business and so on if we think there needs to be a temporary cessation in a particular area of business while the firm gets its house in order. Those tend not to be publicised because they are not part of the enforcement process.

Q50 John Mann: You are not being that precise. Your ethos was shooting first, so are we going to see less enforcement in the future than we have had in the past?

Tracey McDermott: That was never our ethos. That was a comment that has been discussed many times in this Committee and other places and which I think Martin regrets having made. Our approach has always been to say that, if we think there is an emerging problem that needs to be nipped in the bud, one of the things that we think is expected of us as a regulator is that we intervene earlier than we have done in the past, or than regulators have done in the past, to avoid the problem growing. That has to be done in a proportionate, evidence-based way.

As an example of how we have used that, in December, we introduced rules, without consultation, in relation to credit-broking, where we had seen evidence through consumer complaints and so on of very, very poor behaviour in the credit-broking market, which was taking fees from people's accounts without putting them through to loans and so on. That is an example of us acting in a pre-emptive way in order to protect consumers. That is what we want to do and that is what we will continue to do.

Q51 John Mann: Can we expect the approach of credible deterrence to remain?

Tracey McDermott: Yes.

John Mann: We can.

Tracey McDermott: Yes.

Q52 John Mann: Take an example from today. The US authorities have overnight fined Crédit Agricole \$800 million, and the misconduct incorporates the role of the London branch. Should we anticipate an investigation into that by you?

Tracey McDermott: That penalty is in relation to sanctions, and the US sanctions regime and the European and UK sanctions regimes are not on all fours. There may have been breaches of US law that will not necessarily also have been breaches of EU law.

Q53 John Mann: So we will not be, then.

Tracey McDermott: We do not normally comment on whether we are going to investigate specific firms or otherwise, but the point I am making is that there is not a direct read-across between something that is illegal in the US and something that is illegal here.

Q54 John Mann: Put Crédit Agricole to one side and let us take a scenario with another such company, nothing to do with them. What changes are there in how you would take action if you found a bank guilty of misconduct?

Tracey McDermott: What changes from what?

John Mann: From the past; from before your review.

Tracey McDermott: In relation to the enforcement? The Treasury did a review of enforcement, and we published revised referral criteria in relation to enforcement. Those set out in a much more transparent way the processes that we already go through internally, in terms of how we decide which cases to choose for enforcement. In the large part, they are not substantive changes to the assessment, but they are a much more transparent explanation to people of how we take the factors into account and how those decisions are made between supervision, markets and enforcement, considering the range of tools that are available to us, of which enforcement is one, but not the only one. It is really to help people understand how that process works.

Q55 John Mann: No substantive changes, but clear transparency, then, is what you are saying. After the Senior Managers Regime is operating and an offence takes place, what will the changes be that we will see then, precisely?

Tracey McDermott: We currently consider, in each case that is being discussed for enforcement, whether we should look at individuals, either at the early stages or as part of the course of the investigation. What the Senior Managers Regime will give us is a much clearer starting point in relation to who the senior management are that may be on the hook here, and who should be looked at, and a starting point to say, “This is a clear definition of their responsibilities”, and to say whether or not we should look at them and whether they are involved. We would expect to see more people being looked at closely under that.

Q56 John Mann: I have one final question, then. Am I right, from what you are both saying, to presume that, when we look at the statistics in two or three years’ time, we will not be seeing a reduction in the number of enforcement actions you are taking?

Tracey McDermott: It is very difficult to predict exactly what will happen in enforcement actions, because it depends on behaviour that happens in the future.

John Mann: With everything else being taken as equal.

Tracey McDermott: Certainly, we are not reducing the size of our enforcement division. We are not reducing our focus on enforcement as one of the important tools we use.

John Mann: That is very clear.

Chair: Thank you for those clear, short and direct answers to some important questions.

Q57 Chris Philp: I would like to ask specifically about the growing peer-to-peer lender sector. The reason I would like to ask about it is that it has grown from nothing to £1.3 billion a year in a very short space of time. It is likely to continue growing quickly, and I am concerned that it might be the next big regulatory or financial services scandal, given that individual consumers’ money is being placed

with these peer-to-peer lending outfits and it has historically had a very light touch in a regulatory sense. That is why I am asking about the area.

First of all, I understand that 114 firms have sought full FCA regulation, as of August this year. Could you tell the Committee how many of these have been authorised, how many have been declined and how many are pending? If you do not have the exact number, then just approximately would help.

Tracey McDermott: The number I have is slightly lower on that. It is that there are 56 loan-based crowd-funders who are either authorised or going through the authorisation process, and that there are 35 investment-based crowd-funders who are either authorised or going through the authorisation process. I am afraid I do not have the number of withdrawals or refusals. We can write to you with that.

Q58 Chris Philp: Have you caused any applications to be withdrawn?

Tracey McDermott: As with all of our authorisation cases, we find that, quite often, during the authorisation process, as the result of discussions, people will withdraw. That does not necessarily mean they withdraw forever. It sometimes means they withdraw because there are changes they think they need to make to their business models or systems in order to meet our requirements.

Q59 Chris Philp: Of that 90 or so, between loans and investments, do you have a feel for how many have withdrawn? Are we talking about only one or two, or the likes of 10 or 20?

Tracey McDermott: I am afraid I would be speculating. I am very happy to write to you with that number.

Q60 Chris Philp: That would be helpful. The reason I am asking that is to get a feel for how rigorous this process actually is. Do you have any figures you could share with the Committee on the level of bad debt or investment losses suffered via peer-to-peer platforms in general, and whether consumers have suffered losses so far?

Tracey McDermott: On loan-based crowd-funding, the default rate is currently at around 1%, which is relatively low.

Q61 Chris Philp: That sort of sounds too good to be true, given that they are making unsecured personal loans to people they have never met.

Tracey McDermott: Indeed, but that is the current rate. One big growth we are now seeing in the sector is that the loans are moving from what you might call prime into sub-prime, so our expectation is that that number would be likely to increase. But that is the number we have at the moment.

Q62 Chris Philp: It is also a maturity point. If these loans are, say, three to five-year loans, given how young this sector is, then the loans made will not yet have reached maturity, so you will not yet have any reliable default data. The data is that people are lending, probably, this year, £2 billion to £3 billion, without the benefit of having good default data.

Tracey McDermott: We will not have default data on the ultimate loan, but obviously payments are made, typically, monthly as interest, so there will be some maintaining of the loans in that period. In relation to investment-based crowd-funding, which is effectively investing in start-ups, equity, we do not have a current figure there for what the losses are, but one thing that we have made very clear—and it is part of the risk warnings—is that the vast majority of start-ups fail, and, if people invest in that, they should expect that there is a risk that they will lose all of their money. It is very clear that, if you are going to invest in equity-based crowd-funding, you do that with your eyes wide open.

Q63 Chris Philp: That brings me on to my next point. When people invest with these crowd-funding platforms like Zopa or indeed others, there is probably some sense that they are in some way investing with the institution and they may have the benefit of a portfolio effect. Of course, with peer-to-peer lending, that is typically not the case. They are effectively facilitating bilateral loans between Mrs Smith in Brighton and whoever the end borrower is. If that one end borrower happens to default, then Mrs Smith in Brighton will suffer a loss. There will be no pooling effect, which you would have in, effectively, a bank or a fund. Do you think consumers properly understand that they are taking one-to-one, bilateral counterparty risk?

Tracey McDermott: Quite often, they will have a number of loans that they are giving smaller amounts to, so not just Mrs Smith, but Mrs Brown and whoever else in Brighton. Do I think customers completely understand the risks in relation to crowd-funding? We have tried to make it very clear that this is not covered by the FSCS, that, particularly with equity-based, it is very risky, and that loan-based crowd-funding is not the same as having a deposit at a bank and therefore should not be advertised in a way that compares its returns to deposit accounts and so on.

It is, in some ways, almost too early to tell how good customers' understanding of that is, because, as you rightly point out we have not yet seen the defaults and we have not seen reactions.

Q64 Chris Philp: Given those comments, I read that the amount of capital these funds have to put to one side is £20,000, which sounds like a laughably small amount of money, given the scale of their operations. Do you think it should be a requirement that these crowd-funding platforms establish what I suppose you might crudely call a “sinking fund”, so put to one side a certain proportion of their profits each year into a fund that would absorb the first loss in the event that some of the loans go bad? Do you think it would be sensible to have that kind of requirement?

Tracey McDermott: A number of the larger ones do that on a voluntary basis.

Q65 Chris Philp: I bet it is quite skinny. I bet they do that for marketing purposes and the actual substance is not very substantial. I am speculating

Tracey McDermott: I do not know off the top of my head. We probably have that data, and I may be able to tell you that. If you proposed a requirement to create a sinking fund, that would effectively mean the equivalent to an FSCS-type arrangement, so there would be a question as to why you would create another thing, rather than bringing them within the FSCS. The reason they have been outside the FSCS so far is that, as I have said earlier, we are saying these are risky products and you need to know that going in.

John Griffith-Jones: With any new market, there is this “to intervene or not to intervene, that is the question” moment. While one wants to encourage alternative sources of lending, one does not want to open up to a risk. I believe that, if we see a development of this, sooner or later these platforms will tend to offer packages. Rather than you investing directly to Mrs Smith in Brighton, in practice, they will say, “This is the default package, which spreads it across all or many of our investments.” At that point, they become awfully like a bank, and it is very important for the regulator not to allow regulatory arbitrage into the system. What I can assure you is that we are not asleep at this wheel. What I cannot tell you is when the right moment is to either intervene or to say this is okay, but it is being kept under constant review. People will have slightly different opinions as to exactly where, when or whether we should intervene.

Q66 Chris Philp: I would err on the side of caution, given it involves individuals’ money, and often people who have not got a great deal of it. To that point, when you authorise these people, what level of checking are you doing prior to issuing the authorisation? Are you just checking the principals to make sure they are not criminals, or are you, for example, going into their credit decision-making, to make sure they are making sensible and prudent lending decisions? Are you reviewing their historic credit files, taking a sample of 20 loans and making sure they have gone through a proper approval process?

Tracey McDermott: As part of our authorisation assessment, we look at the business model of the firm, so we look at how it says it is going to make its money, and we test that to see whether or not it has considered the risk to consumers. As to the exercise you describe in terms of looking at historic lending, firms that have a track record you can look at, but obviously some of them are start-ups, so you might know what they are theoretically going to do, but you will not know what they will actually do. That is the job of the handover to supervision. One thing we have done, recognising the risk of this, is to put additional supervisory resource into looking at how these firms are operating in practice, post-authorisation.

Chair: With colleagues’ agreement, we will regroup in exactly 15 minutes.

Sitting suspended for a Division in the House.

On resuming—

Q67 Chris Philp: I have two very brief questions. First, finally on the point of peer-to-peer lending, I think people who subscribe to peer-to-peer lending products have to self-certify that they are a sophisticated or an expert investor. If they are not sophisticated or expert, how would they know that?

Tracey McDermott: That is in relation to investment-based crowd-funding, not in relation to peer-to-peer lending. We have not introduced any restriction on that. Most of these are web-based, and you typically go through a set of questions, which are approved by us, to say whether or not you are sophisticated, which is dependent on things like your investment experience or your job. Your net worth is also an exclusion criteria, depending on your salary and income.

Q68 Chris Philp: With the inclusion of peer-to-peer, I think this is a potential area of future problems, and, if there area losses suffered by small, individual investors in this area, then people will come to the FCA asking questions. I would strongly urge you to take a very careful look at this area and err on the side of caution, given that people's money is involved and this does have the potential to be the next big regulatory scandal.

My very brief final question was on a different topic. For loans made to small businesses, particularly in complex areas like factoring and invoice discounting, do you think there should be a representative typical APR to help those small businesses understand the cost of the finance they are taking out? It is often extremely opaque.

Tracey McDermott: The first point is that business lending is not a regulated activity, so it is not something within the remit of the FCA.

Chris Philp: I was asking for your opinion.

Tracey McDermott: More generally, the CMA has been doing a piece of work on banking for personal current accounts and small business accounts. I know that some of the areas they have been looking at are the level of customer understanding, the ability of customers to switch accounts and so on. They will be publishing their findings shortly. That is something that is more likely to be picked up as part of the CMA work.

Q69 Helen Goodman: I just want to flick back to the point about the fees you charge. Presumably—you will have to forgive me—your legislative basis was that you would be financed by the industry through fees.

Tracey McDermott: Yes.

Q70 Helen Goodman: The alternative, which is the way the regulators used to be run, was through a straightforward grant from the Treasury.

Tracey McDermott: Yes.

Q71 Helen Goodman: I want to ask you mainly about advice and the new consultation you are doing jointly with the Treasury. You have done a lot of work in this area up to now, so why do you think this review is needed?

Tracey McDermott: The review is looking at what has been described as an advice gap, in terms of people who do not have significant amounts of wealth, but who do need some support to help them make financial decisions. A couple of years ago, we introduced the Retail Distribution Review, which we think has significantly improved the level of professionalism and removed product bias in terms of IFAs giving advice to people. But there is a large pool of people who we think are currently underserved in terms of being able to get some basic advice or support to help them make some of their investment decisions.

The focus of the review is on why that gap exists and recognising that changes such as the introduction of pension freedom make it even more important that people should have access to such information. We are trying to look at the root causes of that gap, some of which may be on the demand side. Do customers really understand what advice they might need and how to access that advice? We are looking also at the supply side. Why do firms not offer this? The FSCS we touched on earlier. The question of liability is a relevant question there, as is the question of whether technology can help. Can we get to a position where, potentially using a mix of technology and face-to-face, we can provide much more cost-effective services to customers?

It is a very wide-ranging review, looking at how we make sure that those people who do not have large sums of money to invest still have some support to help them save or make wise decisions about their pensions.

Q72 Helen Goodman: The focus is largely on the lower half of the income and wealth distribution.

Tracey McDermott: We have said in the consultation paper that that is where we believe our focus should be. We have also said that we believe the gap is most likely to be in relation to investments and pensions, but we have asked an open question in the consultation of whether or not we are focusing on the right areas. Our current presumption is that that is the area where we are expecting things to go.

Q73 Helen Goodman: The Retail Distribution Review stopped people from getting commission on the basis of products that they sold if they were also giving advice and introduced a fee system instead. That was presumably in order to raise confidence that the advice was unbiased.

Tracey McDermott: Yes.

Q74 Helen Goodman: Would you think of going back on that?

Tracey McDermott: We think that the Retail Distribution Review has achieved its aims. One of them was around unbiased advice. We did a post-implementation review last year, looking at how the Retail Distribution Review had worked and what difference it had

made to the sorts of products being sold. We saw significantly more trackers being sold, which typically have lower charges. We also saw a reduction in the number of high-charging investments being sold, down from 60% to 20% of the highest charging classes, which indicates that it is removing the commission bias that may have been causing that. The other aspect of the Retail Distribution Review was to increase professionalisation, so we require IFAs to have a higher standard.

Q75 Helen Goodman: Sure, I understand that. When I looked at the consultation document, I was struck by the fact that, although there was a reference to a lack of trust in advisers on the part of consumers, there was no reference to mis-selling, and that, I have to say, surprised me. In particular, I am wondering if there is any connection between failing to address that in the consultation document and revisiting the Retail Distribution Review.

Tracey McDermott: The intention is not to revisit the Retail Distribution Review. If things come out of the consultation that mean there are aspects of that we need to look at, then we will have to look at that, but the starting point is not that this is revisiting the Retail Distribution Review. Not specifically referring to mis-selling was not intended to suggest that mis-selling is not a factor that has impacted on trust, because clearly a whole range of conduct issues have impacted on people's trust in financial services, and people tend not to make a distinction between banks, IFAs and asset managers when they are thinking about financial services.

Q76 Helen Goodman: I am sure that is true, yes. That sounds absolutely right. At the moment in this space, what are the Government-backed sources of advice?

Tracey McDermott: The statutory forms of advice include the Money Advice Service, which provides both money and debt advice. There is Pension Wise, which is provided through the Pensions Advisory Service and Citizens Advice. Those are the two main areas.

Q77 Helen Goodman: Do you think it is conceivable that it simply is not economically feasible for the private sector to operate in this very low-income or low-transaction part of the market, and maybe these things just need to be beefed up a bit?

Tracey McDermott: There is a separate review being done by the Government, run by the Treasury, into the public guidance service, which is running in parallel to FAMR, and obviously we will look at the read-across of that. The question of whether or not this can be provided commercially by the private sector is an open one. The economics of providing advice can be significantly impacted by technology, which can make it significantly cheaper to provide advice or at least parts of advice. One of the questions we are asking in the consultation is: we can talk about the cost of providing advice, but let us break it down into the various aspects and see which of those are stopping people getting into the service.

Q78 Helen Goodman: I have a suggestion, but I will put it in the form of a question. Have you thought of looking at the overlap between people who are financially excluded and digitally excluded? If you have not, could you?

Tracey McDermott: We are doing a piece of work currently on access, because one of the things we have to have regard to under our objectives is access. We are looking specifically at that question as part of that work, which is ongoing currently. We absolutely recognise that a digital solution is not a solution for everybody, but it may well be a solution for quite a large proportion of the population.

Q79 Helen Goodman: I just want to ask you a general question. The Chancellor has set out his plan for permanent budget surpluses. By definition, that means continuing indebtedness in the household sector. At the same time, the work that you and other institutions are doing is designed to make people more cautious about where they put their money and about not borrowing too much money. Has there been any consideration of how to manage the tensions between these two policy objectives?

Tracey McDermott: The policy objective we have is to ensure that there is an appropriate degree of protection for consumers and that the markets work well for consumers. Affordability assessments are something that we have seen evidence, in the mortgage markets historically and also in the consumer credit market, have not been given enough focus, which has led to over-indebtedness and significant problems for consumers. Our focus is on making sure that people have access to credit that they need on an affordable basis. That is our focus.

Q80 Wes Streeting: Thank you for bearing with us during the vote. My questions are largely related to technology. I want to start by asking about the emergence of messaging platforms, which could encourage misconduct and allow financial sector firms to evade regulatory scrutiny. Were the FCA following the inquiry launched in July this year by the New York Department of Financial Services into the services offered by Symphony Communication, which is an instant messaging platform?

Tracey McDermott: Yes, we were and we are. I know you wrote a letter to the agency yesterday, to which we will formally respond. Yes, we are aware of those discussions. We are aware of the discussions that are currently going on around trying to ensure not only that those messaging services are not promoted in a way that suggests that their purpose is to avoid detection, but also that the system is built in such a way that it does not impede law enforcement.

Q81 Wes Streeting: That is reassuring. My understanding was that, in the case of the NYDFS, they came to a settlement in September with four of the banks that had invested, requiring them to maintain records. For the benefit of context, statements in Symphony's promotional materials included, "In the past, communication tools designed for the financial services sector were limited in reach

and effectiveness by strict regulatory compliance [...] We're changing the communication paradigm." Their website boasted of tools to prevent government spying, that there are no back doors and that Symphony has designed a specific set of procedures to guarantee that data deletion is permanent. The promotional video for Symphony stated that use of the system would help firms avoid or address the risk of billions of dollars in fines.

You can understand why I am slightly concerned, not least given that Symphony was established in October 2014 by a group of 14 banks and hedge funds, and they all have a global presence and footprint. Given you are following this, what assurances can you give the Committee that there is not a deliberate attempt, effectively, to avoid quite proper regulation?

Tracey McDermott: There are two things that I would like to say. First, one of the stated purposes of why Symphony was being set up was as a competitor to Bloomberg, in terms of a different way of providing information services within institutions. That, in itself, is not an objectionable thing to happen.

Wes Streeting: No, that is right.

Tracey McDermott: In terms of the DFS, you talked about a settlement. It is not actually an enforcement investigation. Symphony was not up and running. It is something where there has been a discussion with the DFS as the regulator to say, "Is this something that is going to work?" Clearly, we will ensure that, before it is used in anything that touches the UK, it meets the regulatory requirements in the UK.

Q82 Wes Streeting: Could you just say a bit more about that, in terms of whether you think you have the right tools, resources and framework available to give us an assurance that we will not have a return to the bad old days of the culture of misconduct that led to the rate-fixing scandals and a lack of proper oversight and transparency?

Tracey McDermott: One of the things that is absolutely critical in terms of doing any investigation or, indeed, doing compliance monitoring within firms is that you have records of what your traders are doing. One of the things that has become very apparent through both FX and LIBOR was that the use of chatrooms had become a much bigger part of the way traders do business over recent years, compared to in the past, when they may have done it over the phone or whatever; and that monitoring systems within institutions, which are the primary way in which these things should be caught, had not necessarily kept up with that. There is a lot of work going on with technological solutions to help do that.

From a regulatory perspective, the key issue for us is not necessarily so much about real-time monitoring, because that is done by somebody else, but it is about ensuring that you can access material. There is sometimes a bit of a tension between security and regulation. One of the issues in relation to Symphony is around encryption. Actually, it is not a bad thing to have encrypted messages, particularly if there is price-sensitive information flowing between individuals, but obviously what you do need to have is an ability for law enforcement, including regulators, to be able to access that material and to have access to the encryption key if they need to.

Q83 Wes Streeting: More specifically, what might the FCA be able to do in the event of that approach being taken of deliberately trying to avoid the degree of transparency and oversight that the public require, in light of the damage to the confidence in financial services?

Tracey McDermott: We have record-keeping requirements. If there was a suggestion that people were deliberately breaching our record-keeping requirements, that would be a breach of our rules and our principles and we could take enforcement action. As John Mann referred to earlier, there are a range of other steps we could take in terms restricting business and so on.

Q84 Wes Streeting: On a related note, you mentioned the importance of encryption and cybersecurity. The *FT* reported in March that 22 critical cyber-vulnerabilities were identified by the cybersecurity firm Bronzeye, and the firm notified the bank concerned and the FCA. Was the FCA aware of the problem before Bronzeye identified it?

Tracey McDermott: I do not want to comment on specific reports about specific institutions. One of the things that the FCA is doing, alongside the PRA and together with the Bank of England and the Government, is a programme of work designed to test the resilience of our institutions to potential cyber-attack. That is something that is very much Government-led, but with the relevant regulators from this sector and indeed other sectors, where we are talking about national infrastructure. We do not typically talk about vulnerabilities we find as a result of those. The focus is on making sure that those vulnerabilities are addressed and corrected and the information shared.

Q85 Wes Streeting: Moving from specifics to generalities, then, how reliant would you say the FCA is on whistleblowers and third parties identifying some of these cyber-risks? Given some of the earlier questions around your charging structure, do you think you have adequate resources to follow up on reports as they come in and the way in which technology continues to evolve and present all sorts of risks to institutions?

Tracey McDermott: Is the question specific to cyber or about whistleblowing in general?

Wes Streeting: Specifically on cybersecurity.

Tracey McDermott: The primary responsibility for cybersecurity is obviously with the institutions. One thing that is being done, as I said, under the auspices of the FPC recommendation is penetration testing by so-called ethical hackers, in relation to testing security. We do not typically get a significant amount of whistleblowing around cyber-vulnerabilities. What we do get is reporting from firms that have been subject to cyber-attacks. One thing we do is to share information and share best practice, so that people can take steps to protect their own infrastructure.

Chair: I began by referring to the fact that the FCA had been in the regulatory equivalent of what might constitute special measures. The FCA had got itself into quite a mess, and I

know from discussions with you outside this room how committed both of you are now to sorting that out and putting the FCA back in a position where it can do a thorough job protecting consumers. I hope you have sensed from the exchanges you have heard today how much commitment there is on this side of the table in order to help achieve that, and that is what we would like to see in the weeks and months ahead. We look forward to seeing more of you in our regular hearings. Thank you very much for giving evidence today.