



Treasury Committee

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

Tuesday 26 April 2016

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Members present: Andrew Tyrie (Chair); Mark Garnier, Helen Goodman, Steve Baker, Stephen Hammond, George Kerevan, John Mann, Wes Streeting, Jacob Rees-Mogg

Questions 266-359

Examination of Witnesses

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

Q266 Chair: Thank you very much for coming to give evidence to us this morning. I would like to begin by referring to something that concerned a lot of people, which was the apparent removal of Martin Wheatley and his replacement, and asking whether you feel that the new arrangements that have now been put in place do something to bolster the independence of the FCA. You will have seen the Chancellor's letter and I will be replying today to the Chancellor. You will no doubt have seen the debate about the clause that this Committee put down in an effort to bolster your independence and secure greater protection from interference. I would be interested to know what your views are on it.

John Griffith-Jones: When I was last here, I used the expression “some merit”, and I continue to think that, but, in particular in the context of us, our independence and being seen to be independent is paramount. If what has been arranged brings that to life in a way that not doing it would not, then that must be to our benefit. I would add that most important is that Andrew Bailey—and this applies to his successor—is allowed to be independent in position. It is good to be independent on the date of appointment, but it is just as important for the five years to be allowed to do his job.

Q267 Chair: It is good that we are going to have five years, rather than a shorter period. Will that help?

John Griffith-Jones: It will help a lot.

Q268 Chair: The arrangements put in place for ensuring that the appointment has, in practice, the approval of this Committee would therefore also provide for the scrutiny by this Committee of any dismissal.

John Griffith-Jones: I understand that as well.

Q269 Chair: Do you think that that supplies the independence you ask for? The reason I ask is that you said, if this supplies the greater independence you need, it is something you would support.

John Griffith-Jones: It is the beginning, the middle and the end, and the end is important. The right of dismissal or fear of dismissal is as important an aspect of independence as the fear of being interfered with while you are doing the job.

Q270 Chair: In a nutshell, is the FCA more independent or less independent than it was 10 days ago?

John Griffith-Jones: It is definitely perceived to be more independent, and perception is reality in our case.

Q271 Chair: I would like to turn to one of the road accidents that the FCA has had over recent years, the breach of your own listing rules, which led to the Davis review. One conclusion that you reached, Tracey McDermott—and I am reading now from your evidence—was: “One of the things we are already considering is whether or not we should release information in a different way”. Have you reached a conclusion as to whether or not information should be released in a different way?

Tracey McDermott: That was evidence in the context of the hearing we had in January. What we looked at, reflecting on the reaction to our decision to take forward the culture work in a different way, as we discussed at this Committee last time, was that there was, in our view, quite a significant misunderstanding about what we had done. Obviously we had to accept that we had contributed to that misunderstanding, because we had not been on the front foot with our communications. There were also a number of questions asked by this Committee about the involvement of the board—as you will recall, the board was informed that we had decided to change the way we were doing the work, but it was not a formal decision—and the linkage of that with the business plan.

The short answer to your question is, yes, we have looked to see if there are certain things that we can publicly commit to; if we decide to take that forward in a different way, should we put something on the website just to say that, even if it is only a short statement? We have also tried, in the business plan, to address not just that question, but also a question that has been asked of us by the industry in the past, which is: what do you really care about? Rather than have a long list of things we are going to do, we are trying to put that into context to say that we are going to do a series of pieces of work that are aimed at addressing a particular priority. The way we have set the business plan out this year is aimed much more

at saying what the context is and what outcomes we are trying to achieve. We will use a range of tools to get there, and they will vary.

The short answer to your question is, yes, we have learned the lesson that, if we have made a public commitment to do something and we are going to change the way we do it, we need to make a positive decision about how we communicate, whom we communicate to and when, but we have also tried to frame our communications about our work plan in a different way, so that people understand the context a bit better.

Q272 Chair: I am not going to press this point very vigorously but, as you can imagine, we have had a lot of institutions come before us in recent years, not least the banks, telling us that “Things used to be in a mess but, don’t worry, we have now sorted it out” or “we are about to sort it out”, and then further accidents and problems have taken place. It is quite important for us as a Committee to have the confidence that you have sorted it out. One query I had with respect to that is that failure in communication is not listed as a risk to the FCA in your business plan, and I was surprised by that, given that it seems to have been a massive risk in the past. Is there an explanation for its absence?

Tracey McDermott: In terms of the risks that we highlight in the business plan, we are trying to focus on the big risks to our statutory objectives, which are mainly focused on the risks to our objectives that are posed by the market and the firms within it. The risk outlook at the beginning sets out the context in which that operates. I can assure you that, in terms of our internal risk map and the issues looked at by AuditCo and the board, communications and the efficacy of our communications is a key risk that is looked at. Communications is obviously one of the tools that we use to deliver the objectives that Parliament has set us, so using it effectively is an important part of it. It is a key internal risk that is looked at very carefully.

Q273 Chair: I just throw out the thought that, since you are demanding of firms a higher level of transparency with respect to risks facing them, whether derived internally or externally, you might also consider doing the same in your business plan.

Tracey McDermott: We will take that away and consider it.

Q274 John Mann: Good morning. Mr Griffith-Jones, when did you and your panel interview Greg Medcraft?

John Griffith-Jones: It was in December. I do not have the date to hand, but it was December.

Q275 John Mann: Were all the other three interviews in December?

John Griffith-Jones: They were all in December, yes.

Tracey McDermott: No, they were not. Mine was in November.

John Griffith-Jones: I beg your pardon. They were all together, so I may have misspoken. They were all scheduled one after one, and I cannot remember in which precise order.

Q276 John Mann: When did the Chancellor make you aware that he was not satisfied with the four applicants?

John Griffith-Jones: I am not sure that I would characterise it exactly in that manner. What I do recollect happened—in fact, I know what happened—was that there were two preferred candidates, of which Tracey was one. After that decision being made, Tracey said that she did not want to go forward, which gave the committee chair doing the selection process, John Kingman, pause for thought to say, “What shall we do here? Is the other of the two the person we want now we have no choice? We are now talking about the difference between someone we know and someone from overseas, and we need just to take stock”, and they did take stock. In fact, I was involved in a conversation with John Kingman in real time.

It was not my decision, but I was aware of the thought process that was going on. The thought process went on over Christmas, from memory, and in the new year the decision was made by the Chancellor. Again, I do not know exactly which date, but I felt as though I knew the direction of travel to consider Andrew Bailey.

Q277 John Mann: We know the date of the Chancellor’s interview in which he revealed that Ms McDermott had pulled out, which was 4 January. We know that that was told to you on 9 December. We now know that Mr Medcraft was interviewed in December and that there were two other candidates who were also interviewed at that time. Why was Mr Bailey not interviewed?

John Griffith-Jones: Mr Bailey was not a candidate at that time.

John Mann: This was all within a short period of time. You are interviewing and you are discussing. Another candidate’s name came up. You are the Chairman. Why was Mr Bailey not interviewed?

John Griffith-Jones: I think the Chancellor gave an answer to that question. I should start by saying that this was the HMT process. I was indeed absolutely comfortable with the way I was involved, but it was clear right from the beginning that it was their process and ultimately their decision. I felt fully consulted. The decision to ask Andrew in January, at a late stage in the process, was a decision that was taken in good faith and was, in my opinion, a perfectly reasonable one. By the way, I did not know which way the Chancellor would go until he went.

Q278 John Mann: You are Chairman of the board of the FCA. You have interviewed four candidates. You have told us now that you found two of them highly suitable. A third name arises and you do not interview that person. Did you ask for Mr Bailey to be interviewed and get refused?

John Griffith-Jones: It was not for me to ask. It was the chairman of the selection panel's decision, as to whether to actually interview or not. If you recall, we had a discussion of who was on the interview panel. All four of us know and knew Andrew extremely well and the decision was taken by the chairman of the panel that there was no particular need to interview him.

Q279 John Mann: Do you not regard that, in your position, as quite extraordinary? Someone is appointed to a role that has been seen as controversial over the previous year, the previous incumbent has left, not necessarily of his own volition, and there is lots of public debate on it, yet you think it is perfectly reasonable to have someone appointed and you do not, as Chairman of the board, even have the opportunity to ask any questions on whether he really wants the job or on his motivation. Can you think of anywhere else where that might happen?

John Griffith-Jones: I can only say that that was the process adopted. I did have plenty of opportunity to ask Andrew Bailey whether he wanted the job, because I was in the loop of knowing that he was being considered. There was never a question of me not knowing Andrew. He has sat on my board for the last three years. I hear the process point, but, on the substance point of whether the four people on the panel knew Andrew Bailey as well as or better than the other person remaining who had been interviewed, the answer is an emphatic yes. Was the Chancellor provided with sufficient information and advice—obviously it is his decision—as to what to do? I believe he was.

Q280 John Mann: Did you personally have any informal discussions with Mr Bailey about the job during this time?

John Griffith-Jones: I did from January onwards. I cannot remember exactly. Once the decision had been made to pursue that line of inquiry—which was after Christmas, I think, but we would have to check the exact date; let us assume that the decision was over Christmas—although I was not leading the discussions with Andrew Bailey, I was involved in talking to him about whether he was interested and/or keen and/or suitable for the job.

Q281 John Mann: At what time did the panel decide that Mr Medcraft was unsuitable for the job?

John Griffith-Jones: I am not in a position to say. I do not think it is appropriate for me to comment on individual people, as to whether they were suitable or unsuitable.

Q282 John Mann: On what date did the panel determine that there was no suitable candidate for the job and, therefore, a fifth candidate would need to be considered?

John Griffith-Jones: Sorry, that was not how it transpired. As I said, we interviewed four people; there were two who were better than the other two. The logical advice for the Chancellor was going to be, "These are the two to choose from." One of the two

withdrew, so then it was, “Here is the person to choose from.” At that moment, we asked, “Is that the suitable way to go?” That is what happened.

Q283 John Mann: We have in this country well defined laws in relation to employment and on discrimination, including discrimination in relation to employment, with plenty of case law in relation to it. At what time did you and the panel take advice in relation to the process that you decided to follow, which was to abandon interviews and appoint a candidate not interviewed? At what stage did you take that advice?

John Griffith-Jones: You will have to ask that question of the chairman of the panel, rather than me. It was his process, not mine.

Q284 John Mann: My final point on this is that it would be fair to say that you, as Chairman of the FCA, in reality had no role of any consequence in the employment of the Chief Executive.

John Griffith-Jones: No, that is absolutely not the case.

John Mann: You had no significant role.

John Griffith-Jones: No, I had a significant role, not a controlling role. Ultimately it was the Chancellor’s appointment. May I hypothesise? If I had been deeply unhappy with the concept of Andrew Bailey becoming Chief Executive of the FCA, you can rest assured that I would have made my views known privately and strongly to the Chancellor.

Q285 John Mann: You have a lot of staff who are watching, listening, not particularly at the moment but over this whole period of time, following this process, and they see that their new Chief Executive is not appointed by normal means in a normal standardised process, and is not even interviewed. How do you think that impacts on the morale of an organisation that has been through some public turmoil over the last year?

John Griffith-Jones: On this, I can speak with a little bit of confidence. The overwhelming feeling in the building on the announcement of Andrew’s appointment is one of excitement and approval. I am not saying that every single person feels that, but the announcement has gone down very well. He is a formidable operator. The effect on morale in summary is a plus, not a minus.

Tracey McDermott: I would just reiterate, on that point around staff morale, that Andrew is very well known to staff at the FCA, because of his role as a non-executive, because of his role at the PRA currently, which we work with a lot, and because he was also at the FSA for two years prior to legal cutover. John is absolutely right. I would like to think that people were a bit disappointed that it was not me but, in terms of the positive, they were actually very pleased that it was somebody who is very well respected, both within the industry and with other stakeholders, including this Committee and parliamentarians. That provides certainty and stability for the organisation, going forward.

I do not think that the staff were particularly focused on what the process for appointment was. They were much more focused on who the person is and what his role will be as the leader of the organisation.

Q286 Helen Goodman: Ms McDermott, I would like to ask you some questions about the Senior Managers and Certification Regime. You were quite eloquent a few months ago about the problem under the old regime of the trail going cold and the difficulty of finding who was in fact responsible when mistakes had been made, particularly at the top of organisations, as I understand it. Some of us opposed the change to the way that this is supposed to work that the Chancellor has decided to insert into the Bank of England and Financial Services Bill. I wondered if you could give the Committee any reassurance at all that, in the way that the process is supposed to work in the legislation—I do not know whether it has Royal Assent, but the new legislation anyway—the trail will no longer go cold.

Tracey McDermott: What I have said about what was called the “presumption of responsibility”, which has been changed in the current Bill, is that it would have been an additional useful tool for us, but it was never going to be a panacea. The real core of the problem that we have had with individual accountability over the years is the lack of clarity about who is responsible for what and the lack of clear lines of accountability. The Senior Managers and Certification Regime absolutely codifies that within each firm.

As part of the process that has been gone through—and the regime came into force on 7 March—each individual person has their own statement of responsibility, which clearly sets out the areas for which they are responsible. There is also a responsibilities map for each organisation, which sets out who is responsible for a certain number of specified responsibilities that we have put out, which enables you to identify areas of potential overlap and areas of potential underlap. There are some clear rules around the fact that you can delegate activity, but clearly you cannot ultimately delegate responsibility.

Our experience of operating the regime is somewhat limited, given that it has only been in force for six weeks, but in the build-up to the regime, and in a number of steps that we have taken as an organisation even prior to the regime coming into force, that focus on individual accountability and clarity of lines has really come to the fore of the mind. When you talk to both executive and non-executive members of the boards of these organisations, they tell you that the process has been useful, because it has identified areas where they see that their own lines of accountability were confused. It has been useful in terms of rationalising those lines and it has certainly focused people’s minds on the fact that, if they are signing up to a statement of responsibility, they are saying that they have an accountability to the regulator, not just to shareholders, not just to customers and not just to their board.

The overall regime is actually a very good regime. The presumption of responsibility would have been an additional useful bit of it, but it is not the core of it. The core of it is around this clarity of responsibility. If the price for not having the presumption is that people embrace the spirit of the regime and really focus on delivering it and making it a real, living part of the way their institutions are run, then that is a price worth paying.

Q287 Helen Goodman: When do you think it will be possible to assess whether they have done that?

Tracey McDermott: In terms of the mechanical part of the process, we can assess that now. Except for a couple of very small firms that have not submitted what they are supposed to yet, which is probably a practical question that we are discussing with them, all of the big firms have been through that exercise. As you would expect, we are now embarking on a process, through our supervision of those larger firms, of doing some quality checking, doing some cross-checking and understanding how that operates.

The real proof of the pudding will obviously come the first time something goes wrong, when we can actually say, “Okay, so who is responsible for that?” If we get the line that “Actually, my statement of responsibility says this, but in fact that was not really me; it was someone else”, or “That was changed six months ago”, then that will clearly indicate that the regime is not working as it should. The benefit of the regime is that, in that event, we would go to the person who is responsible for overall maintenance of the statement of responsibilities and say, “If the responsibilities map is not right, then you are accountable for that”. We will have to test it in anger when things go wrong, so to speak.

The Bill that is currently going through also extends the regime beyond banks and deposit takers into other areas of financial services. As part of implementing that, we will obviously be doing some testing on what has happened in this regime to make sure we can see what is working, and indeed what is not working.

Q288 Helen Goodman: I am glad you took us there. In your business plan, you say, “Conflicts of interest in wholesale banking can come from a wide range of sources” and that this is one of the things that is driving risk and one of the problems is vertical integration. Are you going to be able to deal with these conflicts of interest through this clearer attribution of responsibilities within the organisations? If you are not, what are you going to do about these conflicts of interest?

Tracey McDermott: There are a number of conflicts or potential conflicts of interest that are inherently built in, particularly in relation to wholesale firms, to a number of business models. I do not think you can completely remove those conflicts of interest just by having statements of responsibility. We do have rules in relation to managing conflicts of interest; we have rules in relation to what you have to tell clients about those; and we have rules in relation to how the firm has to have its systems in place to identify and manage those conflicts. That has been a focus for us in not just the wholesale space, but particularly in the wholesale space over the past couple of years, when you focus on things like asset management, where there are a number of people in the chain, all of whom have potential conflicts. How those are managed in that relationship is a core part of what we do, on a day-to-day basis, in terms of how we supervise.

Q289 Helen Goodman: I guess there are always two options in this kind of situation. You can either have structural change, so you are not allowed to do X if it might conflict with Y, which would be one route, or you can have a behavioural/regulatory approach, which is the path we have gone down here. It will

be interesting to see if this works and we might want to come back to it at some point in the future, I suspect.

Tracey McDermott: There is a mix of things where you will have structural issues and you will have behavioural issues. The SMR itself will not be the answer, but it is certainly part of it.

Helen Goodman: I want to ask my second set of questions. Shall I do it now or shall I hold on?

Chair: Why not fire away? We are fairly limited for time.

Q290 Helen Goodman: You have written to financial services firms to ask them to undertake investigations into their links with Mossack Fonseca. I think you gave them a deadline of 15 April, which has now past. I wonder whether you have a preliminary view of the scale of the problem that is likely to arise.

Tracey McDermott: I will say two things around what we are doing in relation to Mossack Fonseca and the Panama Papers. The first thing, as you mention, is that we have written to a number of firms. The first tranche had a reporting deadline of 15 April. There was actually a second tranche that had a slightly later deadline. In that, we have asked a number of fairly high-level questions about what their relationships are and what they are currently doing internally to assess whether or not there is an exposure there, particularly in the light of what has appeared in the media coverage.

The second thing that we are involved in is the taskforce that has been set up, led by HMRC and the National Crime Agency, which we and the SFO are also part of, which is looking at a co-ordinated law enforcement/regulatory response to any issues that come out of that.

At this stage, it is far too early to give any views as to preliminary findings. It must be remembered that there is nothing necessarily illegal about having offshore arrangements. It all depends on their purpose. It is also worth noting that the Panama Papers themselves have not yet been released by the ICIJ. At the moment, there is some material in the public domain, but not all of it. The short answer is that these are very early days. We are obviously making those inquiries, with both our regulatory hat and our law enforcement hat on.

Q291 Helen Goodman: Do you think you will need more resource for it? Is there any way of assessing how much this work is going to be?

Tracey McDermott: In the short term, one of the priorities we set out in our business plan, as it happens, was financial crime and anti-money laundering. It is one of the areas that we had already said was going to be a particular focus for us this year. Obviously, we had not anticipated that we would have a real-life example like this to focus on. We have reprioritised, so we have put together a team to review the responses we are getting from the banks in particular, which is drawn from across the organisation. We have done some reprioritisation of the resources and moving around. As the scale of the work, through both the taskforce and our work, becomes clearer, we will need to consider whether or not we need to do some further reprioritisation.

Q292 Helen Goodman: Mossack Fonseca is only the fourth largest of these law firms, so do you think this is the tip of the iceberg? Do you think that there is more of this to come?

Tracey McDermott: The challenge at the moment is actually knowing what the iceberg is, because there has been a lot of media reporting, some of which suggests some very serious issues of criminality, some of which suggests things that may not or may not be attractive, but may or may not be criminal. We need to understand a little bit more about the factual position in relation to these issues, before we can say whether this is an enormous problem from the perspective of the legal framework or not.

Q293 Helen Goodman: When you opened the *Guardian* in the morning that they published it, did you have a feeling of mal de mer and “We should have realised this”, or did you feel that this was something that you could not possibly have anticipated?

Tracey McDermott: I was on holiday in the States on the day it happened, so I did not actually read the *Guardian* the morning, but I read with an air of mild amusement and then realised, “Oh, actually we need to think about this”. The reality is that it has long been known that there are lots of offshore arrangements made by lots of people for lots of different reasons. Many of those reasons are perfectly legal, but there is the scope for arrangements like that to be used for tax evasion. There is also the scope for them to be used to hide the proceeds of more serious criminality of whatever nature. We have been very focused on AML controls. As I said, until we know the substance of what is actually in the papers and whether or not these allegations are substantiated, it is really very different to say much more about where it might take us.

Chair: Both points that Helen Goodman has raised are likely to be ones that we will be examining quite a bit more in this Committee, one way or another, in the months ahead. Mark Garnier had a quick rejoinder on the very same point.

Q294 Mark Garnier: It is just a very quick rejoinder. You have obviously now had a chance to read through the newspaper articles and newspaper reporting. Do you think that they have created a bit of a firestorm, which does not necessarily truly reflect what is going on? I am speaking specifically—why not?—of the Prime Minister’s arrangements, where in fact he was invested in a perfectly legitimate fund that was perfectly legitimately and openly domiciled in Panama. Do you think that the media and we as a whole run the risk of losing sight of what is perfectly reasonable and what is genuine criminality?

Tracey McDermott: The distinction I was trying to draw in my previous answer was that there are some allegations in the media coverage that are of serious criminality. There are allegations of potential breaches of sanctions; there are allegations of money laundering and so on. There are also allegations of things that people may or may not approve of, but they may not be illegal. Our job as the regulator and our job as law enforcement is to distinguish between the two.

Chair: Mark is asking a question about a third category, which is things that are perfectly straightforward.

Q295 Mark Garnier: It is also the fact that there is a sort of typhoon of confusion about all of this and a lot of things seem to be mixing together. Do you think perhaps one the starting points, in terms of addressing this, is trying to disaggregate this whole argument and say what is illegal, what is very normal and exactly how the investment community works, and what is kind of iffy before even starting?

Tracey McDermott: Certainly that will be part of what we are doing. If you think about it from our perspective, in terms of firms' AML controls, when we are looking at anti-money laundering controls, we look at whether there are red flags that firms should have responded to. The fact that somebody is investing in an offshore trust is not, of itself, a red flag. That is not something that suggests that their anti-money laundering systems and controls are failing, if it is a perfectly normal, legitimate sort of investment. Yes, there are a range of different things coming out, but obviously the media will focus on the things that are most likely to generate interest in their newspapers.

Q296 Mark Garnier: This is my very final question. Just out of interest, looking at many of these trusts that are listed on the London or Luxembourg stock exchanges, the vast majority of them are domiciled in tax havens, be it Dublin or the Cayman Islands. Is that not a fair comment?

Tracey McDermott: I am not sure I would be able to say whether the vast majority are.

Mark Garnier: A very significant number are.

Tracey McDermott: The arrangements that are put in place in relation to trusts and funds do tend to be set up in order to be as tax-advantageous as possible, in a legal way. Clearly there are issues, on which the Government have been focused and in which we have an interest as a regulator, on clarity about disclosure of things like beneficial ownership in offshore jurisdictions, so that you can track real criminality.

Q297 Chair: We will come back to this, but what is really being asked is what Helen was alluding to indirectly, in asking whether you were shocked when you might have read your *Guardian*, even if online.

Tracey McDermott: It was in the American papers as well, by the way.

Chair: It is whether some, or perhaps a good deal, of this business is perfectly normal business that you would expect to see anyway or not. That is the question that we would like you to give a preliminary indication on now.

Tracey McDermott: I would expect there to be a significant amount of this business that is perfectly legal business, where there is no suggestion that banks or anybody else have done anything wrong.

Chair: It is not just legal; it is whether there is anything that, as you put it, people might not like or whether this is perfectly normal business, because in your answers you have been creating an intermediate category between what is legal and what is illegal.

Tracey McDermott: The point I was trying to respond to was the point made by Mr Garnier around what is written in the newspapers, because there may be things that are perfectly legal, perfectly normal and perfectly acceptable from a regulatory and legal perspective, but actually individuals may say, “I don’t think that is right or appropriate”. That is a discussion for Parliament, not a discussion for the regulator, if there is a view that things that are perfectly legal and normal should change.

Q298 Chair: Before handing the questioning to Jacob Rees-Mogg, can I take you back to the first part of some of Helen’s questions? As you know, the Senior Managers and Certification Regime was a recommendation devised by the Parliamentary Commission on Banking Standards. One of the reasons we put those in place and felt that they were essential was because we were discovering that the people at the top of our banks did not know where the risks really lay and how responsibility for them was distributed among their own most senior management. They thought they did but, once detailed questions started to be asked, they discovered that they did not. It is rather like a firm trying to manufacture something that did not really know who was really responsible for putting in which widget, as for cars being made on a production line. That was quite an extraordinary discovery that we made. It is with that in mind that we are trying to put this right.

Your organisation has also had a series of problems. I know I have asked you this in the past, but how confident are you that you are rolling out an SMR and certification-type approach to checking your own risks among the key staff in your organisation, those who can add risks to the way you operate? I know there is something in your latest publication. It would be helpful if you could just comment on that. I know this is a long question but, if I may just add, it was quite a struggle to get the FCA to take certification seriously at the start, frankly—not only internally, but even with respect to the banks—but we have now arrived at that point. When I first asked the question I have just asked, I had the impression that not a great deal of thought had gone into that either, so we are very eager to know whether you are now alongside these issues.

Tracey McDermott: I will start and John may want to add something. We have applied the Senior Managers Regime to ourselves. We have published statements of responsibilities and a responsibilities map for the organisation. They include myself and John, and the rest of the executive and also the non-executives who are chairs of the board committees, so we have adopted the same approach to the Senior Managers Regime as has been adopted in relation to firms. Our organisation is significantly less complex than most of the firms we regulate, even though the activities we look after are complicated. Notwithstanding that, we would still say that it has actually been a useful exercise for us as well, in terms of clarifying some of the handoffs between different areas of the executive.

Q299 Mr Rees-Mogg: Good morning. May I begin by making a declaration of interest, because you of course regulate me? I remain a partner in Somerset Capital Management. What I am going to ask you about is MiFID II, which will have a direct effect on my business and on all investment management businesses. Perhaps I can start, Mr Griffith-Jones, by asking you if we do now know the final date when MiFID II will come in or whether we are still at the stage of the Commission having proposed it as 2018, but that not yet being agreed by all the other parties.

John Griffith-Jones: I am afraid I do not know the precise answer. I am going to have to ask Tracey. I believe it is 2018, but I am not sure whether it has been nailed down. I believe it is about to be, if it has not.

Tracey McDermott: Yes, it is.

Q300 Mr Rees-Mogg: That is what I just wanted to check. There are 1,000 pages of technical standards being brought in under MiFID II. How much of that would the FCA have wanted, if it had been left to its own devices?

Tracey McDermott: The FCA has been very involved in the development of the technical standards, which are developed through ESMA. We have chaired a number of the committees in relation to that. The vast majority of the things that are incorporated under MiFID are things that we would have wanted. There are some aspects of the detail—and I think I touched on this when I was here earlier as part of your EU inquiry—that are not quite as we might have positioned them. There are also some points where there is ongoing further discussion between the Commission and ESMA, particularly around things like pre-trade transparency in bond trading, so we have not yet got to a final landed stage, but the broad thrust of it is material that we would have done. Whether it be 1,000 pages or some other number, I do not know, but the broad thrust of what it is trying to achieve are things that the FCA would support.

Q301 Mr Rees-Mogg: How has the FCA found the process has worked, in terms of who has been leading it and the responses from the European Parliament that have led to some changes, as it has gone through? How much has it been led by the detailed understanding of regulators and how much has it been led by politics?

Tracey McDermott: As you know, in the European legislative process, there is a combination of the two aspects. The political agreement comes down in the form of the directive and then the technical standards, which you have been talking about, are level-two discussions that happen at ESMA. Obviously, it is comprised of regulators and there has been a very detailed set of discussions around that. Most of it is comparatively uncontroversial. There are some aspects that are more controversial. As I mentioned, pre-trade transparency is one of the big areas where there is a concern about potential unintended consequences. There has been a lot of discussion within ESMA and with market participants about that. We think that, in the way the framework is coming out, it is taking cautious steps on a graduated basis, which is the right way to approach this.

As I said, for some of the technical standards that were submitted, the Commission has said, “We would like you to think again about some of those”. Actually, the things that they have asked ESMA to think again about are sensible things. We welcome that. The FCA has been very influential in that process. As with all other negotiations, we are one of 28 people around the table, so we do not have a complete say on it, but we have been influential. Unlike the bonus cap, for example, where there is a much more explicitly political question underpinning that, MiFID has been driven more by a desire to make the markets work in an effective way.

Mr Rees-Mogg: Mr Griffith-Jones, would you like to add anything on how you found the process?

John Griffith-Jones: From the board’s perspective, we see that, as things are agreed or nearly agreed, they are coming to us for approval. It is not that we have a choice about approval but, technically, they have to come through the board. Really echoing what Tracey said, I have to say that our team involved in the ESMA work, who are very high quality people, has clearly had a very major influence on the development. The repeated message that I get in answer to the broad question of whether we are broadly happy is that the answer is yes; we would have done the same thing. What is now facing us is a major implementation task, assuming that the rules are nailed in in the way that it appears they are about to be. The real question is getting the firms in a position to be able to implement them in a reasonably cost-effective way by the start date. There is quite a big task of work there.

Q302 Mr Rees-Mogg: If the board did not approve a particular item, it would not really matter, so board approval is essentially a rubber stamp.

John Griffith-Jones: As with all European legislation, as I am sure you are well aware, we have extremely limited choice of what to do with it. On balance, we have decided that front-running has not been helpful in the past, because you front-run, but it is not exactly the same, so you then have to rear-run to put it right. Gold-plating is pretty unpopular as well. Over time—and this is my experience of the last three years—we have pretty much come to the point of view that, if it has to go into British law, it might as well go in in the same way as it has for everyone else, rather than tinkering with it at our level.

Q303 Mr Rees-Mogg: The UK and the City of London is overwhelmingly the most important financial centre in the European Union. A lot of the other member states have a little in terms of financial services. Although you are both quite positive on the influence we have had, has that been proportionate to our overwhelming dominance in this area?

Tracey McDermott: Can I give another example on the question of timing, with which you started your questions? The UK has been very influential in triggering the debate and in terms of pushing for the timing of implementation to be thought about and to be pushed back, because we had a concern about the practicality of being able to implement the measures. That is based partly on our experience and knowledge of the markets. It is also based on our experience of what we are doing here.

As I said before, we are one of 28 voices around the table. Clearly, if the other 27 decided they wanted to do X and we wanted to do Y, then by definition we would not win that debate but, in practice, in the way the discussions operate around the ESMA table, it does not tend to be quite like that. The countries that have a bigger interest in a particular set of provisions—and you will appreciate that MiFID is a very wide ranging piece of legislation, and some bits are of more interest to some countries than others—tend to be the ones that drive that discussion within the committees.

Q304 Mr Rees-Mogg: There has been quite a lot of discussion on things like commodities coming from the European Parliament, on the basis that commodities is trading food, and there is some strong political influence there. I wonder how you feel that is helping financial services regulation, when it is becoming that type of emotional argument from people who are not necessarily from the countries that are doing the trading.

Tracey McDermott: One thing that is currently being looked at is technical standards specifically around commodities. There are potentially different issues that apply to trading oil than there are to trading food, where you do get the political and NGO interest in whether it is pushing up prices. We have been quite heavily involved in that debate. I could not tell you exactly where that is, right now, and whether or not it is precisely where we might have been in relation to commodities, but it is one of the areas that is currently being looked at again.

Q305 Mr Rees-Mogg: Have you done any calculation of what the expected costs will be for fund managers, traders and other participants to implement these rules? As you may know, it is estimated that AIFMD cost each fund management house \$200,000 to implement. I just wonder what the similar cost might be for this.

Tracey McDermott: Some estimates have been done by the European Commission on the costs of implementing MiFID. From memory, they talk about something between €500 million and €700 million as a one-off and then something similar on an ongoing basis. I am not sure what separate analysis we have done, but I would be happy to come back to you on that.

Q306 Mr Rees-Mogg: The higher figure, €700 million, as a continuing annual cost, is quite a big cost. My concern would be particularly for smaller companies. There are a couple of specific points that I would raise. According to a Stock Exchange study, each individual trade will require 81 pieces of information to be put in, as opposed to 24 now, including the date of birth of the trader and the trader's national insurance number. It is not difficult for large companies that have complex IT systems to upgrade. It may be expensive, but it is not difficult. Combined with the extension of the governance regulations to all participants, just thinking back to when I set up with three colleagues, I wonder whether this is a reasonable and proportionate burden that is going to be placed on new businesses coming into the financial services sector and, therefore, whether this is not effectively a protectionist measure for existing participants.

Tracey McDermott: It is certainly not intended as a protectionist measure.

Mr Rees-Mogg: I am an existing participant. It is great for me in this respect.

Tracey McDermott: The key driver is clearly not about protectionism. It is about market integrity and about ensuring that there is suitable information. The issues around unique identifiers for traders are to enable you track trading done by different traders in different places for market abuse purposes, as much as anything else.

One of the specific points we made to the Commission in response to their call for evidence, which closed earlier this year, was that we have a concern that there are slightly different reporting requirements under MiFID, under MAR and under various other pieces of legislation. We think that something could be done to rationalise that.

Now, I recognise that that may not be much comfort to you right now, when you are implementing this, but it is a perfectly fair challenge to ask if we are creating a system where the barriers to entry will prevent competition. This is obviously not something we want and, indeed, the FCA has an objective to promote competition. As part of this exercise of looking across the various pieces of legislation, looking at reporting requirements, timing, detail and so on is a really important part.

Q307 Mr Rees-Mogg: My other worry is that some of the regulations that are coming in are essentially knee-jerk regulations about things that people are a bit suspicious of, but not necessarily with good reason. I am thinking particularly of dark pools. The dark pools are going to be very much harder to operate under the MiFID II regulations, as I understand them, and yet dark pools provide a very useful market service. They increase liquidity and ease of trade, and reduce transaction costs across the board. One reason broker fees are so low is because of dark pools, but people have a sort of unspecified suspicion of them. I just wonder whether this is not necessarily getting regulation for detailed factual reasons, but is dealing with people's emotions and suspicions of markets.

Tracey McDermott: Both dark pools and high-frequency trading might fall into that kind of category, where there is a lot of suspicion as to how they operate. Some of the MiFID provisions are about limiting the amount of trading in dark pools. Broadly, if you are working in an environment where you want to encourage greater transparency, in terms of both pre and post-trade, you can see why you would not want all of your trading to be done in dark pools.

There are some very practical questions, which are areas that we would like to continue to look at, around the practicality of the measures that are being suggested for dark pool trading, such as the triggers for a maximum allowance of trading being done in a dark pool. If you look at that across the EU, how are we actually going to monitor that and how are firms going to avoid falling foul of it? There is substance in saying that there is a large amount of trading that goes on in these dark pools. It is still smaller than in the US, but it is over 10%, I think, so we should know about that as a market regulator; it is an important part of market functioning. You are right to say that it is important that the measures that

are put in place are ones that can deliver what we are trying to deliver, which is more transparency, without reducing the benefits.

Q308 Mr Rees-Mogg: I have just one final point, if I may. If this is happening in the City of London, both with high-frequency trading and with dark pools, but is not happening in New York, is there not a strong incentive for high-volume trading to therefore develop a greater expertise in New York and dark pools to be accessed via New York, increasing their strength in this area?

Tracey McDermott: I do not think we have seen that. We have not seen a shift of business to New York. In fact, there has probably been more intervention by regulators in dark pools and high-frequency trading in the US, partly because of their market structure being different. I do not think this is a situation where we are saying that there is an unregulated space over here and a heavily regulated space over here.

Mr Rees-Mogg: There are different regulations, yes.

Q309 Stephen Hammond: Good morning. Mr Griffith-Jones, commendably, since we last met, I know you have been meeting a number of parliamentarians. You will remember that, when we met, we spoke about the asset management review and you set out a timescale for board review and for publication, both interim and final. Could you tell us if you are still likely to keep to that timescale?

John Griffith-Jones: I cannot remember precisely what I said to you.

Stephen Hammond: This was late February. You said to me that the board would review the asset management review in March, with interim publication fairly quickly thereafter and final publication in the autumn.

John Griffith-Jones: I am not trying to duck the issue here. We did publish the investment banking one.

Stephen Hammond: That is right; you have published that. I want to come on to the investment banking one.

John Griffith-Jones: The asset management one is coming shortly. It is not out yet, but it is not unduly delayed, as far as I am aware.

Tracey McDermott: I may get my dates wrong, but I think our date for the asset management one has always been the interim report in the summer, rather than in March. The investment and corporate banking one was published in April. That sounds like the timetable that John was describing.

Q310 Stephen Hammond: I think he was actually saying March for the board review, summer for the interim review and then potentially a final document in autumn. I just wanted to be sure that we were still on that timescale. There were two issues that I really wanted to explore. One was that, and then obviously you published your terms of reference for the asset management review on 18 November, which was a relatively tight timetable, if you were expecting to see

it at the board in March. Can you run through what processes you undertook to ensure proper investigation with the industry and also give some indication of how many submissions you have had?

John Griffith-Jones: In terms of governance, these reviews come to the board with conclusion, i.e. finished, but for what you might call cross-examination by the board, so more than rubber-stamping, but not asking the board to decide what the answer should be. Our competition department is relatively new, so this is the process we have adopted and so far, so good. Clearly, one is heavily reliant on the underlying work, but we have enough people on our board to ask some sensible questions, particularly if we have been alerted to them by our friends in the industry who have been making the submissions. I think the process works okay. I do not know how many responses we have had to the asset management one, but I could let you know.

Stephen Hammond: Might it be possible to let us know?

John Griffith-Jones: Yes, sure.

Q311 Stephen Hammond: I would be quite interested. Clearly, one of the parts of the review was commission-sharing agreements. Is it still the intention to ban those?

John Griffith-Jones: The commission-sharing derives in part from MiFID II, rather than from our study. The latest position on MiFID II—and, again, I stand to be corrected by Tracey if I get this wrong—is that there has been some compromise on the wording of the detailed technical standard but, in essence, the principle of disclosure and segregation of what is payment for research and what is payment for transaction remains in place.

Q312 Stephen Hammond: It is on that technical point, because you made a comment about gold-plating earlier on, but you are clearly aware that there is quite a difference between your organisation and almost everybody else in the securities industries across Europe about the language and the interpretation of that language. The principles were there and that is widely accepted, but there were some real differences between the way you chose to interpret the language and others. Do you think that has been resolved?

John Griffith-Jones: I hope so and I believe so. What I absolutely know is that we will go with whatever the final language is. To answer Mr Rees-Mogg's question a few moments ago, the idea of us writing an extra clause is not what will happen.

Stephen Hammond: Your friends in the industry will be delighted to see that you are following the ESMA language, rather than any particular interpretation of your own.

John Griffith-Jones: I do not know whether they will be delighted.

Stephen Hammond: I think they will be.

John Griffith-Jones: They will no doubt be suspicious of us as well, as to how we interpret what is written.

Stephen Hammond: That is the core of it. I think I have just heard you say that you intend to follow that language and the widely accepted interpretation, rather than change the interpretation.

John Griffith-Jones: We will certainly follow the language. The language will be the language. How our supervisors interpret it on the ground is a matter for our supervisors. Industry will be on inquiry about that, I suspect, until such time as it is clear.

Tracey McDermott: The policy question, which has been underpinning this debate, has been a policy position where the FCA has said, “We would prefer full unbundling”, as it is called. The pushback from some of the industry, at one extreme, has been no unbundling at all. Actually, it is not the whole industry that is in that bucket; some of the industry is actually very much in favour of full unbundling and there is a range of views across that spectrum.

Following the discussions and negotiations, as John has said, ESMA has come out as not going with full unbundling, but it is going with separate disclosure of research and transparency. Those are the rules that will be implemented in the UK. On that particular policy issue, that is an area where the UK did not completely get its way. That is something that those who have been speaking to you will be pleased about, but there will be other bits of the industry that will not be so pleased about it, because it was not a universal position.

The asset management market study is not looking specifically at whether you change rules. It is looking much more at how competition is operating across the whole of that chain and, at the various stages in the chain, which as you know is a lengthy one, whether everybody is incentivised to deliver the best value for the end consumer.

Q313 Stephen Hammond: I was hoping to ask you about all the recommendations in that review, but I am assuming that there are a number that, as you have not published it, you are not going to reveal too much about today. Commission-sharing has been in the public domain.

Tracey McDermott: It is fair to say that we have not yet got to the point of making the recommendations in that review. We will publish an interim report, in the same way as we have done with the investment and corporate banking market study. We are consulting extensively. I cannot give you the specific numbers in relation to asset management but, in relation to ICB for instance, we talked to over 90 people directly and we reviewed 10,000 transactions, so there is a very detailed analytical underpinning.

Q314 Stephen Hammond: Can I now come on to the capital markets interim report? I have two questions really. As I understand it, you are intending in terms of the IPO market to move to a more American system, effectively. I can understand the benefits of the opportunity for greater scrutiny and potentially

transparency. While I can see that it may be desirable, I am not entirely clear that the evidence is there that this is going to foster a whole load of independent research.

Tracey McDermott: This is the discussion paper part around changes to the IPO process, which responds partly to evidence we gathered during the market study, but also to a number of other reports that have been done over recent years, with which you will be very familiar. The key thing we want to achieve—and we have put this in the discussion paper as a range of options—is where the prospectus becomes the core document on which investors rely. At the moment, you have some connected research, a blackout and then the prospectus. If you are a potential investor, all you have to rely on is the connected research. The core part of it is that we want the prospectus to be the main document.

Stephen Hammond: You are proposing that first.

Tracey McDermott: Yes. We would also like to have the opportunity, if the market thinks it would be useful and we are told the market thinks it is useful, for people to be able to produce unconnected research in that period as well. We have set out in the DP some ideas that we have as to ways that might be encouraged. Whether or not those would actually come to fruition, as a practical matter, will depend on whether there is demand for them in the market.

Q315 Stephen Hammond: I can absolutely see the benefits of the document being the core research, but it is quite difficult to foster independent research around it and I am not sure of the benefits. I take your point and have seen your recommendations. My final question therefore is: debt is already a lot cheaper as a way of raising capital than equity. It seems to me that one of the possible consequences of this review is that it will be even more difficult for small caps to raise equity, because of the potentially more onerous requirements of the IPO document, which in itself may or may not be a good thing. What about the sense of proportionality? Are you going to look at different sizes of documentation for different sizes of capitalisation? Otherwise, you may well find that the small-cap IPO market dies completely.

Tracey McDermott: I am not sure that the changes in relation to the timing of the prospectus should necessarily have a particular impact on the size of the document or otherwise. As I have said, this is a discussion paper. If people think there is a potential concern in relation to small caps, my initial thought would be that I am not sure whether they would be helped any more by the current framework, with connected research and the prospectus at the end, than they will by having the prospectus at the beginning, but obviously we would look at that in the context of the responses to the discussion paper.

Q316 Stephen Hammond: Are you clear that the costs of this new system would be broadly similar to the costs of applying elsewhere internationally?

Tracey McDermott: We are told by market participants that this is what market participants want and that they want a bit of a nudge and a push to help them deliver it, so that is what we are trying to do.

Q317 Chair: We are not going to end up just protecting the big players.

Tracey McDermott: That is not our intention, no.

Chair: That is what often happens when market participants say they want something.

Tracey McDermott: When we talk about “market participants”, I am talking about issuers as well. We are not just talking about the investment banks. Unconnected research, at least in theory, should help the smaller players.

Stephen Hammond: That is if they can establish a reputation for the quality of their research.

Q318 Mr Baker: Good morning. Just briefly on MiFID, to what extent does engaging with the European regulatory process extend your timescales? You said you were closely involved but, even if you had everything you wanted, to what extent does going through that European cycle extend the timescales of getting the rules that you want?

Tracey McDermott: It is quite difficult to answer that without the counterfactual. It is certainly the case that MiFID has taken some time from its initial inception through to the point of implementation.

Chair: That is to put it mildly.

Tracey McDermott: It has taken a lot less time than Solvency II.

Chair: I am just trying to decode “has taken some time”. It has taken a hell of a long time and much longer than you could have done it yourself.

Tracey McDermott: There will be aspects of it that would be slower than we would have done ourselves, I am sure. The process of the Parliament, the Commission and the ESAs involves three stages in the legislative process, whereas within the UK system, as you well know, there tends to be legislation and then it is pushed over to the regulators. We have an extensive amount of delegated rule-making power to do that. Yes, it will have taken longer, but I do not have a comparative.

Q319 Mr Baker: Before I move on, heaven forbid that a regulator should ever make any kind of mistake in 1,000 pages of rules about products, but how agile is the system at correcting any kind of regulatory mistake?

Tracey McDermott: In terms of the level-one text, the system is not very agile at all, because that is legislation. In terms of the technical standards, I would say that the system

would be less agile than if it was simply our own rule-making, because obviously it would need to go back through ESMA, but there is scope to change the technical standards. I would have to come back to you on precisely how agile and how often that has happened, because I do not know the answer.

Q320 Mr Baker: Can you give any sort of ballpark as to how long it would take to change regulation that proved to be obviously flawed? Is it weeks, months or years?

Tracey McDermott: Is that in terms of the regulation or in terms of the technical standards?

Mr Baker: The technical standards.

Tracey McDermott: I do not know. Can I come back to you after talking to the experts?

Mr Baker: I would be delighted if you would.

Tracey McDermott: Obviously, if it was a regulation itself, then you would be talking years, because that is a piece of legislation.

Q321 Mr Baker: On money laundering, I realise my first question can only ever attract an imprecise answer, but what do you think the scale of money laundering is overall in the UK?

Tracey McDermott: It is such an imprecise answer that I do not know the overall scale. There have been various attempts, by bodies such as the NCA, to give some numbers. Other non-government bodies, such as Transparency International, will give numbers but, almost by definition, we do not have a number for the amount of illicit cash in the system. It is fair to say that, given that London is a global financial centre and many billions of pounds flow through London every single day, a proportion of that will be illicit money and that number is likely to be quite a large number, but I could not give you a sense of that.

Mr Baker: You could not even say whether it is hundreds of millions, billions or tens of billions.

Tracey McDermott: I would be purely speculating.

Q322 Mr Baker: Presumably it would also be purely speculative to try to give some indication of the causes of that money and some sort of proportionate breakdown between drugs, terrorism and corruption.

Tracey McDermott: The Home Affairs Committee did a study a couple of years ago trying to identify that, particularly around drugs and so on. You can use proxies by saying that there will be a certain amount of drugs that are seized; law enforcement has a view as to

what proportion that is. You can then extrapolate up from the street value of the things that were not seized, but it is an area that we do not specifically look to quantify and it is a challenge for law enforcement generally.

Q323 Mr Baker: The causes and the scale of the problem are fundamentally unknown.

Tracey McDermott: The causes of the problem are not unknown. Money laundering is about transferring the proceeds of crime into legitimate business.

Q324 Mr Baker: Sorry, it was a poorly worded question. Let me just rephrase the question. Of course we know in broad terms the causes, but, in terms of trying to target particular causes, trying to prioritise where you put your effort is going to be very difficult, because it seems to me that you are in a position where you can only speculate on the scale of each category of money laundering cause.

Tracey McDermott: Of the broad categories, drugs is obviously a significant cause. Human trafficking is an area of considerable focus, not necessarily because it is the biggest number, but because the amount of human suffering that results from it is obviously enormous. Clearly, the more routine crimes are also a big part of it, but drugs, corruption and human trafficking are probably the three big areas that we focus on. This is probably more of a question for the NCA.

Q325 Mr Baker: Under “Outcomes we seek”, the business plan says: “The UK financial system is a hostile sector for money launderers”. It is page 26. The outcome is that the UK financial system should become a hostile sector. That is what one implication could be. Are you saying that we are currently not a hostile location for money laundering?

Tracey McDermott: We could do better. There have been relatively few prosecutions for actual money laundering in the UK, over recent years. It is very much a focus of the NCA, as I said. We work with the NCA on that. We have been working very closely across government on things like the Joint Money Laundering Intelligence Taskforce, where we are trying to bring together law enforcement, regulators and the financial institutions to pool sources of intelligence to enable us to disrupt money flows better. The UK is a hostile place for money launderers, but should we be satisfied by saying that we are doing okay? No, we should be aspiring to ensure that we are very much at the forefront of this, given our role as a global financial centre.

Q326 Mr Baker: In terms of prioritising scarce resources and effort, are there any particular parts of the UK financial system and any particular kinds of business that you think should be prioritised for action?

Tracey McDermott: In terms of the FCA’s work in relation to this, our main focus has been and remains on banks, as a core part of the financial system. We do look at money laundering in other areas as well, but the banks are probably where we devote most of our

resources. We also put a considerable amount of resources into working with other law enforcement agencies, so being a part of a UK-wide response to AML issues beyond our regulatory framework.

Q327 Mr Baker: Just looking at your website and the page on de-risking, it says, “We are aware that some banks are no longer offering financial services to entire categories of customers that they associate with higher money laundering risk”, and you go on to name money transmitters, charities and fintech companies. You are due to publish soon or you may internally have completed an impact assessment. Is that impact assessment complete and might you publish it?

Tracey McDermott: We are in the late stages of that impact assessment. It will be published. It is not ready to be published yet, but we are in the final stages of doing our evidence gathering on that.

Mr Baker: It will become a public document.

Tracey McDermott: That is our intention.

Q328 Mr Baker: Is there anything that you can say about the London property market, its vulnerability to money laundering and your willingness to get involved in it?

Tracey McDermott: I am not sure that I can say much that is useful about the London property market. We are obviously not responsible for the regulation of estate agents, solicitors and so on. Our responsibility is in relation to the regulation of the banks and our focus is on whether or not they are identifying potential suspicious transactions going through. Harking back to the questions at the very beginning of this, there are potentially entirely legitimate reasons why people choose to acquire property in London in a corporate name, rather than an individual name, and so on. Questions about the property market are probably more for other people.

Q329 Mr Baker: That is a very good point. I was just looking for the number here, but I think there are 27 supervisors in the UK responsible for money laundering. It seems to me that you have not quite answered the question about whether you think the London property market might be a place within which funds are laundered. Do you think that there are possibly too many supervisors? Do you think there should be a degree of consolidation, in order to more be proportionate and more effective?

Chair: Maybe there should be 25 or so.

Tracey McDermott: So long as one of them is not the FCA and it gets the 26 others. The Treasury is responsible for identifying who is the AML supervisor in relation to each area. The Government’s recent call for information on this has asked whether there should be a rationalisation from the 27 AML supervisors. It needs to be thought about carefully, in the context of what you are trying to achieve by rationalising those supervisors, because there

are benefits to having industry and sectoral expertise, which makes you more lightly to be able to be proportionate, rather than less likely. The balance has to be weighed up. Yes, 27 is a lot and they have very different powers. That is potentially an area that could be looked at, but an assumption that the right answer is one is not necessarily right.

Q330 Mr Baker: To what extent can you co-ordinate action amongst all of those supervisors?

Tracey McDermott: We do not co-ordinate action across all of those supervisors. We work with some of the supervisors, the HMRC in particular, on money service bureaux, for instance, where we both have an interest. We work with others in different contexts that are specific.

Q331 Mr Baker: What do you think should be done about this large number of supervisors in an area of considerable public concern, potentially involving large sums of money, involving some of the worst kinds of crime? At the moment, it sounds like we have this great cloud of unknowns and a sea of regulators involved, some of which are public and some of which are private. Surely you are the lead authority in these matters of financial conduct. What do you think should be done to rationalise this mess to create a proportionate and effective system, so that we become a hostile sector for money launderers?

Tracey McDermott: I am not sure that we are necessarily the lead on this. If you look at HMRC, in terms of the number of organisations they supervise, they have at least as much of an interest in this. The National Crime Agency is currently doing some work looking at how we approach money laundering. I touched earlier on the Joint Money Laundering Intelligence Taskforce. I am not trying to duck your question, but it is really important that we are very clear about the root causes of what we are trying to address by reducing the number of supervisors. Is it inconsistency of powers? Is it multiplicity of people? Before we come to the answer, we cannot say that it is obviously X.

Q332 Mr Baker: If I may finally ask my last question, last week the Chancellor accepted an amendment to the Bank of England Bill, which would require you to bring forward guidance on what was proportionate. Charles Walker has done a great deal of work on this. He has suggested that not only politicians, who of course will get no sympathy, but their families, perhaps to quite a considerable extent, and also civil servants and members of the armed forces could all end up, it seems, disproportionately affected by this fourth money laundering directive. How ready do you feel you will be to bring forward robust guidance that means that people in quite ordinary jobs will be able to get on using financial services?

Tracey McDermott: Clearly the legislation will put an obligation on us to give guidance and we will give that guidance. It is really important that we recognise a couple of things. The first is that the fourth money laundering directive derives from the recommendations of FATF, which is the international organisation that looks at money laundering controls. The second is that we do have an organisation in the UK, as you will probably know,

called the Joint Money Laundering Steering Group. It issues guidance that is then approved by HM Treasury. That guidance has a specific status in the law; it has a specific status in the Proceeds of Crime Act and in the money laundering regulations, and provides people with a defence to certain criminal offences, if they follow it.

What we will need to do is to ensure that what we issue, pursuant to the legislation, is consistent with the JMLSG guidance and is, to the extent necessary, given JMLSG guidance status, so that it attracts those legislative proposals. To be fair, this was something that came on relatively late in the day, so we are in the early stages of working out how we will deliver it. Clearly, if that is what Parliament wishes, we will deliver it.

Q333 Chair: I think you should be aware that there is great concern about this in Parliament. There is considerable concern about the effects of the fourth money laundering directive. There is considerable concern about banks and the approach that they are taking to de-risking, and there is an enduring concern that we have blanket provisions in place, which put hundreds of thousands of people to a great deal of hassle, trouble and cost. It is at their expense on the rare occasions that they may go to a professional adviser. One wonders how many money laundering episodes have been picked up by this vast bureaucratic apparatus. Perhaps a more targeted approach might secure something more effective in clamping down on what is clearly a good deal of very serious crime, some of it going on in London, under our noses.

Tracey McDermott: Can I just mention two things in relation to that? First, as we have set out in the business plan, one of the things that we are very keen to explore is the possibility of using technological solutions to significantly improve the process aspects of identification and so on. We are very keen to explore that, to see if there is a way that that process can be made smoother, quicker, cheaper and so on. The second issue is in relation to the de-risking phenomenon more generally. As your colleague Mr Baker referred to, we have given guidance on this, but we are aware that this is a concern.

Chair: It is a considerable concern.

Tracey McDermott: It is a considerable concern. One of the issues is that there are a number of drivers for this, some of which are around anti-money laundering, some of which are around profitability, some of which are around exposure to risk from agencies overseas and some of which are around exposure here. The solution to this is going to require more than just some guidance from the FCA. It is actually going to require a cross-government approach.

Chair: That puts it mildly. When she served on this Committee, Rushanara Ali did a good deal of work on this and exposed one aspect of the unacceptability of the current arrangements. There is a great deal to be done. The Committee is extremely concerned about it and I hope that that has been heard. Where we are at the moment just cannot continue indefinitely.

Q334 Wes Streeting: Good morning. I wanted to pick up on the issue of de-risking. Your business plan acknowledges that de-risking by banks is causing problems for some groups of consumers. Could you give us an idea of how many consumers will be affected or the scale of the problem?

Tracey McDermott: This goes back to the question that Mr Baker asked about the research we have commissioned to look at this. A lot of the information about this is quite anecdotal, so we have been trying to get into some numbers. It is fair to say that that is not a task without its challenges. The bigger proportion of people is probably those who never get a bank account in the first place, rather than get one and get it closed. In terms of a proportion of the population, it will be quite small, but, in terms of the impact on that proportion of people who are excluded, you will appreciate that it is very significant. It will have a massive impact on them as individuals. I cannot give you a number right now, but that is part of what we are trying to look at.

Q335 Wes Streeting: One concern that has been raised, particularly by charity finance directors, for example, is what they describe in their briefing as “hyper-vigilance” leading to some charities, particularly those working in countries where there is significant risk, having quite significant problems in carrying out their vital work, particularly as aid organisations. Have you given any thought to what a solution might look like to the problems facing that particular group? More broadly, what sorts of solutions is the FCA considering?

Tracey McDermott: One of the best examples of this has been in relation not so much to charities, but in relation to money service bureaus transferring to Somalia, where the biggest source of foreign income is in fact expats sending money back. There was a series of closures of accounts for money service bureaus. There was then a cross-government working party to look at ways in which they could ensure that money remittances to Somalia could continue. Part of the reason for the concerns around transmitting money to Somalia was obviously around the potential for terrorism funding to be driven through that.

What that underpins is that this has to be a response that is not just about the regulator. We clearly have a role but, actually, this is a cross-government issue and there is also a matter for you as parliamentarians about the extent to which we expect our banks to provide services to charities, MSBs and individuals that may not be profitable for them on an individual basis, but are part of their overall obligation to society. The core answer is that I do not think that this is something that the FCA will ever be able to fix on its own, but there has to be a discussion that involves industry, government and the regulators.

Q336 Wes Streeting: Could you expand a bit on your discussions with Government and with the banks? How productive have those conversations been and to what extent do you think that both Government and banks have a handle on the issues and are working effectively to resolve some of the challenges?

Tracey McDermott: Everybody recognises the problem, which is a start. As I mentioned a moment ago, the potential to use technology to help reduce some of the cost is significant and is something that is of great interest to the banks and of interest to us. The challenges are that you then have a range of different issues—the question of commercial interest and profitability versus the question of the social function of the banks—and I would say that there is still a considerable amount of further work that needs to be done to say what we think the solutions need to be and how we resolve them. Different parts of Government will be driving in different directions, to some extent, because the people who are focused

on terrorist financing will have a different agenda to the people who are focused on access. Having those discussions in a group is the core part of this.

Q337 Wes Streeting: You just alluded to some of the understandable tensions that might arise within Government, with people having overlapping but sometimes slightly competing interests. This is one of those areas where there might be a conflict for the FCA, in terms of your statutory objective to uphold the integrity of the financial system but, on the other hand, your statutory objective to protect consumers. Do you feel that tension in this area and, if so, what takes priority or how do you work through that sort of tension?

Tracey McDermott: I do not think that there is a tension between market integrity and the consumer protection issues here. In relation to competition, we also have a duty to have regard to the availability of access to financial services. The framework in which we operate provides us scope to look at this. The bigger challenge, as I said, is that a lot of these are commercial decisions by banks. They are not actually decisions made on the basis of an assessment of risk. They are made on the basis of whether or not these are profitable accounts to hold, which is partly to do with the cost of checking, but it is not solely to do with that. We, as a regulator, do not have the ability to say to people, "You must take on unprofitable accounts". That is a Government issue.

Wes Streeting: Thank you. That is interesting, but we are tight on time so I will pass back to the Chairman.

Q338 George Kerevan: Still good morning. Ms McDermott, I would like to ask some questions about customer redress. Let me start off with interest rate hedging products. In 2012, the FCA found that there was a serious failing in the banks in selling interest rate hedging product accounts, particularly to small businesses. As a result, for the last three years, individual banks, including banks like Clydesdale, have been conducting customer reviews and making offers of redress, which now total something like £2 billion. Last year, this Committee asked if, when that process was completed, the FCA would collate the results, look at in summary the kinds of complaints that were made and identify systemic failures in the banks. In particular, we asked if you might take any action that might be appropriate to ensure that all customers received fair and reasonable redress. Are you committed to that process? If so, where are we in it?

Tracey McDermott: In terms of where the IRHP process is, the redress scheme is coming to a close. There are around 350 cases that have not yet been determined out of a total of around 18,000. As you said, £2 billion has been paid out in relation to redress. Around 300 customers have complained about the outcome and feel that the outcome is unfair to them. We set in place a scheme that we thought was a fair and reasonable scheme. We put in place mechanisms to ensure independence, with the use of independent reviewers in Section 166, so our broad sense is that we think the scheme has delivered.

There was a judicial review challenge to the determination of one of the skilled persons, which was recently decided in favour of the institution concerned, and commented positively on the fairness of the scheme. That is potentially subject to appeal, so it is not really appropriate for me to comment further. We have committed that, once the scheme

is finally at a conclusion and any associated litigation is at a conclusion, we will do a lessons learned exercise to see if there are things we need to look at and things we need to do differently in the future. I do not think we are currently intending that, as part of that, we would revisit decisions made in relation to individual consumers, but I would not want to prejudge whatever the findings of that might be.

George Kerevan: I appreciate that, but I am just trying to clarify your response to the request from this Committee, as of last June, that, beyond the individual banks and the process for individual redress for this classification of product, you are going to do an overarching lessons learned. That is the case.

Tracey McDermott: Yes.

Q339 George Kerevan: Do we have a timescale?

Tracey McDermott: As I mentioned, there is a current live judicial review. In the first instance, that was decided in favour of the bank, but the small business has applied for permission to appeal that to the Court of Appeal. There are a number of other pending cases, depending on the outcome of that. We have said that we would not do the lessons learned review while there was court litigation ongoing, because obviously the subject matter overlaps. Once that litigation is finally determined, then we will do a lessons learned review.

Q340 George Kerevan: What is to stop you doing an interim report of a broad-brush character? It seems to me that the individual court cases deal with the specifics of individual sets of circumstances. They do not relate to the generality. It seems to me that, after three years and 12 or 13 banks doing these studies, there is enough evidence available to begin the process of an overarching review.

Tracey McDermott: The specific court case I am talking about does deal with the generality. This particular one dealt, for instance, with the role of the skilled person, so that is something that applies across the scheme, not just in relation to that individual case. We are not saying that we have to wait until the end of any individual piece of litigation between a customer and its bank for anything that actually cuts across the piece.

Q341 George Kerevan: Can you give us any kind of indication of when this broad-brush report will be available to us? Is it years?

Tracey McDermott: I would hope it would not be years. We should be able to give an indication of starting that depending on what happens with the court proceedings. If leave to appeal is given and then it goes through the court process, then obviously that timetable would be very different. I am not trying to avoid the question, but the problem is that it is not in our hands at the moment.

Q342 George Kerevan: Just to clarify, we asked that, as a result of such a study, you would “take any action that might be appropriate to ensure that all

customers receive fair and reasonable redress”. Are you saying that that is not a part of what you are offering?

Tracey McDermott: In terms of the scope of any review that we do, the focus would be lessons learned on what has worked well and what has not, in relation to that. As I have said, our current assumption or belief is that, actually, the scheme has worked well overall and that there are other mechanisms available for customers who are not satisfied with the results of the scheme, whether through the Financial Ombudsman or through the courts.

I would not envisage that this would involve reopening individual cases to adjudicate those, but I am somewhat reluctant to bind the future decision of the board of the FCA about the scope of that review. Obviously, if the findings of the review said that there was a fundamental flaw, then that would lead to a different route.

Q343 George Kerevan: I am happy that we have that little bit of wriggle room, because part of the problem is that many of the smaller businesses that have, for instance, gone through the Financial Ombudsman and still feel aggrieved by the settlement they are being offered simply do not have the resources to go to litigation. That would be the end of the process. From talking to my constituents, and as many other MPs have said to me, there is a clear body of smaller businesses that are still not happy with the redress that they are getting. I just want to make sure that the FCA has not closed the door to them, in some sense.

Tracey McDermott: It is important to recognise that, in any scheme, particularly when you are talking about small businesses, which are often people’s livelihoods, there are always going to be people who do not think that they got the right outcome for them, but that does not necessarily mean that they did not get fair and reasonable redress. It is important that the FCA is not involved in determining those individual disputes. The scheme was set up to provide an alternative means of redress. Independent checks were built in and, broadly, our current view is that the scheme has worked as intended. As I said, we cannot prejudge the outcome of what we might do in terms of looking at a review in the future, but I would not want to give the impression that we expect the outcome to be that we go back and revisit 18,000 cases or even a smaller number.

Q344 George Kerevan: I appreciate that. I am just pressing you on whether the door is still open. If you felt, in doing the final review of the process that the banks have been through, that there were issues, would you be willing to come back and consider whether customers had had proper redress overall?

Tracey McDermott: If the overall outcome of the review was to suggest that there had been some fundamental flaw in the way it had been dealt with, then clearly we would need to look at that. The reason that I am not giving you more—and I could quite easily leave the door more open and say that it will all go into the future—is that is important to be fair to those small businesses, so that they recognise that they should not be assuming that there is going to be another scheme at some point in the future. That may happen if our review of the scheme indicates that there is a problem, but I would say that it is probably less likely, rather than more likely. It is important that people understand that and that we are transparent about it.

Q345 George Kerevan: We will leave it there, but the whole point is that no one has been fair to these businesses to date, and it has cost the economy, those businesses and their families a great deal. That is why I am not going to close the door on it. Another issue of redress, briefly, is that at the end of last year the Complaints Commissioner found in favour of Nicholas Wilson, who had been pursuing an issue against OFT and then subsequently FSA and FCA, regarding overcharging on credit cards and recovery of credit card debt. The Complaints Commissioner was latterly very critical of the FCA's involvement in this case. As a result, the FCA issued a statement saying that it was willing to reconsider the decision not to look at the debt collection practices of HFC Bank and its owner, HSBC. Where do we stand on that reconsideration?

Tracey McDermott: We have requested information from the firm, from HSBC, which we are currently reviewing in order to look at that decision again. That work is ongoing.

Q346 George Kerevan: That is understood. Do we have any sort of timetable for when you might have made your mind up?

Tracey McDermott: I am afraid I do not have a precise timetable on that, but there is active work going on at the moment.

Q347 George Kerevan: Given that in previous cases, particularly with HSBC's court cases in Switzerland, the FCA took decisions not to proceed with a particular review or investigation, but then did not bother to publish that, can we have an assurance from you that, when you decide one way or the other whether you are going to reconsider your decision not to look at the debt collection processes of HFC, you will publish that or at least let the Committee know what decision you have made?

Tracey McDermott: Given that it is in the public domain that we are relooking at this, we would be happy to let the Committee know what our conclusion is.

Q348 George Kerevan: Thank you. The final question concerns RBS and its Global Restructuring Group. For the last two and a half years, you have been conducting a review into what actually happened and the allegations that Global Restructuring Group had forced clients into insolvency in order to realise the assets. Can you update us as to where that review is?

Tracey McDermott: We are in the latter stages of the review. We have received from the skilled person, Promontory, a draft of their final findings. We are now in the process of looking at those and we will be discussing those with the skilled person and with RBS. We would expect to publish something following those discussions. The timing of that is not yet determined. We have some internal discussions in the next couple of weeks about the processes that we need to go through between now and getting to something that is published.

Q349 George Kerevan: When did you have the draft report internally?

Tracey McDermott: I think we had it on 24 March or the beginning of April, so just a couple of weeks ago.

Q350 George Kerevan: Does this process of internal review involve letting RBS see the findings?

Tracey McDermott: We have had a draft report with the findings of the skilled person. Yes, RBS will be entitled to see that. We are also looking at those findings ourselves. This is quite a complex and detailed matter. There has been an enormous amount of work done and it is very important that we understand exactly where this comes out. It is also important that the firm has an opportunity to comment on those findings.

Q351 George Kerevan: Can we take it that you will change the report on the basis of what RBS says?

Tracey McDermott: The report of the skilled person will be the skilled person's report. The findings that the FCA concludes will be based on our assessment of all of the inputs, of which the skilled person's report is one. If we think that the firm makes good points, we will reflect them as well.

Q352 George Kerevan: Forgive me; this is just for my clarity. Do you publish both the skilled person's report and your findings?

Tracey McDermott: We have not yet made a decision as to exactly what we will publish and when. That is in part because there are a number of legal questions about the basis on which we would publish this. We have not worked through those yet and that is currently a consideration that is ongoing. We are very conscious of the significant interest in this and the significant desirability of being as transparent as we possibly can be, within the legal framework, in terms of what we publish. I am not in a position to give you a definitive answer now, because we have not worked through all of that process yet.

Q353 George Kerevan: We potentially might never see the skilled person's report.

Tracey McDermott: I am not in a position to give you a definitive answer on that now, as I said.

George Kerevan: You could reject their findings and come up with something different.

Tracey McDermott: We could. That would be possible.

Q354 George Kerevan: Is RBS paying for this report?

Tracey McDermott: Yes.

Q355 George Kerevan: Could we have some idea of how much it has cost?

Tracey McDermott: I cannot give you that number off the top of my head, but I would be happy to tell you what that number is separately. I am afraid I just do not have it with me.

Q356 George Kerevan: Are the authors of the report satisfied that RBS was fully compliant in answering their questions and providing information?

Tracey McDermott: That is probably a question you might want to ask the authors of the report, in due course. It is fair to say that this has taken longer than any of us expected it to, whether the skilled person, the FCA or the firm. Part of that has been because of challenges in gathering the necessary underlying information. That is not necessarily because of a lack of co-operation, as opposed to the way in which the files for business customers were organised. There is a vast amount of material. They have looked at around 2,000¹ cases and there are between 10 and 60 lever-arch files per customer case, when you pull it together. The process of information-gathering has been a lot more difficult than anticipated, but that is not necessarily to say it is because the firm was not co-operating. It is to say that it has actually taken a lot longer.

Q357 George Kerevan: My final question is to Mr Griffith-Jones. In my short experience as an MP, I have been amazed by the degree of public hostility to the FCA. Simply so many people, in so many circumstances, feel aggrieved that the agency does not champion consumer interest. How would you reply to that?

John Griffith-Jones: I think we do champion consumer interest. We were set up so to do. It is one of our three objectives. I can assure you that there is an absolute mind set within the staff who work there that that is one of three hugely important objectives and possibly the most important, in the opinion of the staff.

George Kerevan: Is it possibly or is it?

John Griffith-Jones: I have not done a poll, but I know it is for the people who come and work there. When you ask them in our staff survey, one of the things they like most about us is the importance of the work we do, which is essentially a reference to that. We have an expectation gap issue here that everyone wants us to deal with their issue when it goes wrong. That is an absolutely desirable state of affairs. The problem is actually achieving it. By the way, some of the people who were convinced that we got it completely wrong we have convinced that we got it completely right, so all the people who are happy go quiet and all the people who are unhappy make noise.

¹ Tracey McDermott subsequently clarified that the Skilled Persons Review in fact looked at 207 cases.

We have a very good safeguards system in place. We are accountable to you. We have the Complaints Commissioner who, unfortunately in the case that you refer to, can call us out for having got it wrong. We have the newspapers on our backs if we are seen to fall down on an obligation. We do have some difficult choices to make, both as to resource allocation and about who is right and who is wrong in specific circumstances.

On the questions you asked about lessons learned on the IRHP, one of the crucial things that Andrew Bailey and indeed the board will look at, when he arrives, is how we deal with these redress exercises. It is not about the individuals, although they have an important point, but it is how we get a scheme to begin and end to the satisfaction of everybody that we are doing the job. If you look at PPI, IRHP and other difficult cases, it is still a work in progress. It is very easy to start these things, but it seems a lot more difficult to finish them.

George Kerevan: Sadly, if your life has been ruined there is no closure.

John Griffith-Jones: I would not be as pessimistic as that, but I take your point.

Q358 Chair: John Griffith-Jones, you mentioned resource allocation a moment ago. One of the recommendations of the Commission and also of this Committee in the last Parliament was that this be brought under greater control at the FCA. I am not going to raise the issue in any detail now, but there is dissatisfaction and concern that we might not be getting value for money for the levy. The levy is always paid for by consumers in the end, so it is a cost that we are all bearing and we need to make sure that we do get good value for money for it. It might be helpful if you set out in a letter to us, in your own time, how you are attempting to achieve that at the moment, given the recommendations that we have made to you in the past on this.

Of course, getting best value for money is particularly relevant with respect to the skilled person's reports, under 166. They are in a sense a free resource for you, because they are passed directly to the firm and do not come out of your own annual budget. We have just had an exchange about the skilled person's report in one case and what benefit we can get from it. Have you set out or thought about setting out what criteria, beyond commercial confidentiality or the discovery of criminality, might lead you to want to withhold the publication of these reports?

John Griffith-Jones: As a general principle, the reports are a means to an end of us doing a phase of work, when a firm has prima facie done something wrong. They are not being used as a publicity device. What tends to happen, of course, is that people become very interested in what they say, but they are a tool of investigation for us. In theory, we could have hired people and gone and done the work ourselves.

Q359 Chair: That is true, but I am just sitting here reflecting on the thought of what merit there is in non-disclosure. This is a report that has been published at considerable expense. It may be incomplete, you may have criticisms of it and you may set out your criticisms or feeling that it has shortcomings whenever you want, but what is the disadvantage in having a predisposition in favour of transparency with respect to these reports?

John Griffith-Jones: The disadvantage is that it is a subset of the work we do and that Section 348 covers the generality of work we do. Just because you subcontract it, it does not make it any different. It think you have to have a better reason than that.

Chair: You are pulling in someone from outside to do it. You have referred to 348.

John Griffith-Jones: The reason for bringing someone in from outside is either volume or skill set.

Chair: I am not going to prolong the exchange now. I am just picking up on a point that George Kerevan made, with respect to this specific report, which seems to me to have some merit. I would be grateful if you could also reflect on that. Thank you very much for coming in to give evidence today. It has been extremely interesting. We have left you with one or two thoughts, on which we would be grateful for further information. We look forward to seeing you very shortly, Tracey McDermott, for some more evidence, perhaps your last in your current capacity.

Tracey McDermott: I would like to say I hope so, in the nicest possible way.

Chair: Thank you very much.