

Treasury Committee

Oral evidence: The work of the Financial Conduct Authority, HC 475

Wednesday 13 June 2018

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Members present: Nicky Morgan (Chair); Rushanara Ali; Charlie Elphicke; Stewart Hosie; Mr Alister Jack; Catherine McKinnell.

Questions 289 - 373

Witnesses

I: Andrew Bailey, Chief Executive, Financial Conduct Authority; Charles Randell, Chairman, Financial Conduct Authority.

Examination of witnesses

Witnesses: Andrew Bailey and Charles Randell.

Q289 **Chair:** Thank you both very much indeed. Apologies for starting a bit late and that we are slightly depleted, but there is obviously a debate on some significant issues going on downstairs, which I suspect the FCA has an interest in, although I am not going to ask you how you would choose to vote on the amendments this afternoon.

Just for the sake of the record and those watching elsewhere, can I ask you both to introduce yourselves? I should say, to Mr Randell, welcome to your first Select Committee in your new role.

Andrew Bailey: I am Andrew Bailey, chief executive of the Financial Conduct Authority.

Charles Randell: I am Charles Randell, chairman—of the Financial Conduct Authority.

Chair: Is that the new leadership challenge that the City is going to be reporting? I am going to start with the subject of the day, which is Brexit. In March, Mr Bailey, you said, “Now is the time for a much deeper regulatory engagement” to address the cliff-edge risks of Brexit such as uncleared cross-border derivative contracts and cross-border insurance policies. Perhaps you could give an update on how much deeper that engagement has got.

Andrew Bailey: If I can go back over the last year very briefly, it has been, at times, frustrating. The FCA, the Bank of England and the Treasury have spent quite a lot of time developing our own thinking on how these cliff-edge risks work as well as seeking a common understanding with continental authorities. The reason I say that—I have said it a number of times—is that they are symmetric. In essence, if the passporting system falls away without any replacement or any substitution in a disorderly fashion, that takes away the legal basis of authorisation of passported firms and servicing of contracts. In quite a lot of countries, including the UK, legally—and I make the point about legality, because some people will debate whether the practice is different—it depends upon the authorisation. It is symmetric because the passports go both ways. That is the key point there.

In many quarters now, there is a reasonably common understanding of these issues. The big next step is to say, “Okay, what do you do about them?” Here, I would say that you can deal with these at three levels, in this order of preference. The best way to deal with them would be an agreed form of words, probably in the withdrawal agreement, which essentially established contract continuity and did so symmetrically.

The next level down would be essentially, at the governmental level, for each side to take action but it would not be co-ordinated. It may achieve the same effects, but it would not be co-ordinated. Now, the Treasury



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and the Government have, as you know, committed to introduce legislation, as part of the further process of this piece of legislation, to establish what tends to be called a “temporary permissions regime” in the UK. We were strong advocates of that and worked very closely with the Government on that. That is good but, of course, it only covers one side, because you can only legislate for consumers in the UK or users of contracts in the UK receiving them from firms that passport into the UK, and the EU does not have anything like that for the other side.

The third level down is to leave it to firms. Now, I am certainly not alone, and I think I am in a fairly large majority on our side of the argument, in thinking that that is very difficult. It is a huge undertaking. You may have seen the thing that the Bank of England Financial Policy Committee published at the last meeting in March, which was a summary of the scale of these things. Moreover, they are complex processes so you would need novation agreements or, in the case of insurance, court processes, so there is a court process to do that. Of course, in the most extreme case, there is very little time to do this. We do not think that is viable.

On the continent, there are people at the moment who you will hear say, “No, we should leave it to firms”. I do not think that that is very realistic. Of course, there is an agreement to have the transition period and that is very good, because that creates important time. However, what you will hear if you are in Brussels quite often is the old phrase, “Yes, but nothing is agreed until everything is agreed”, which is what you are doing at the moment. That residual uncertainty, such as it is, even though there is strong commitment on both sides, means that, while the EU needs the transition period as much as the UK does, we are not there in an unconditional fashion yet.

Q290 Chair: You set out very helpfully what would be ideal and the challenges ahead but, to be clear, who are you discussing this with? Are you getting to discuss this with your equivalent numbers? Are your equivalent regulators in Europe getting political permission from their Governments to discuss the detail in depth?

Andrew Bailey: That is a very good question. Up until the March Council, the answer to that was “not really”. On the UK side, we have worked very closely with the Government and I think that the Government’s attitude here, at least as I have observed it, was that they were encouraging us to be out there and to do that, but there was clearly a reticence on the other side.

That has changed a bit post the March Council, particularly with the announcement you will see of Mark Carney and Mario Draghi on some of the technical discussions, which we are also part of. We are seeing some change there but it is still quite early days, frankly, to come down to a conclusion on where that will all lead to.

Q291 Chair: That is fine. I want to ask about the powers that the FCA and the Bank will take on after Brexit, the powers that currently sit with the



European supervisory authorities, including the power to make and amend binding technical standards. How do you think the FCA should be held accountable for these new powers? Do you think it is appropriate for MPs to scrutinise, for example, the binding technical standards that would be issued by the FCA and the Bank?

Andrew Bailey: As you may have seen, the proposal that is around at the moment is essentially in two stages. The first stage is very interim, which is the power to make amendments. Some of the statutory instruments that are passed do what we tend to call the “onshoring”, which I see as the big piece of the iceberg that sits under the thing you are debating at the moment, which is very important and sits above the water. If some of that does not work, as I am afraid will probably be the case because of the sheer volume of this material, those are the powers to correct it on the run, and that has a certain set of constraints around it. The second phase, which is more the steady-state phase, is the power to make the equivalent of binding technical standards going forward.

The way I would describe what is on the table at the moment is that it attempts to map the EU process into the UK process as best you can, in the sense that it puts us in the position of the European supervisory authorities—it would be ESMA, in our case—and it puts the Treasury or the Government in the position of the European Commission. There is then a question about transparency to you.

There is a bigger question that I will come back to in a moment. To my mind, this element of accountability has been very little discussed to date. I have had a couple of discussions with the House of Lords Committee on it, but it seems to me relatively little discussed. My broad answer to your question is that it is in our interest to be accountable, so we would want that. On binding technical standards, there are currently 10,000 pages of them. They are very technical because they sit under the level 1. If you do not mind me saying so, it is a slight case of “be careful what you wish for”. I do think this is a serious question. I am open to transparency and accountability, so coming up with a sensible approach.

There is a bigger question, if you do not mind me saying so, but we cannot discuss it definitively until we know where the settlement is coming out, so it is the level 1 question. The EU, as a rules-based system, creates level 1 legislation at a much more detailed level than is the case in the UK system. The European Parliament is much more involved in that. You meet people in the European Parliament who, with all due respect, will say, “I am a technical expert on a swap execution facility”, and that is great, but do you want to take that on? It is a really important question, but it hangs a lot on this big issue about rule-taker versus rule-maker. That is important because this will change the system and it will change, if you do not mind me saying so, the amount of scrutiny that Parliament has to do.

Q292 **Chair:** It is a point that the MEPs in the European Parliament are currently doing this. We are going to move on to some questions around



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enforcement by the FCA. I particularly want to ask about MiFID II and the FCA's attitude to enforcement where firms are not following MiFID II. Perhaps you can talk us through how much leniency you are showing them. Is the FCA operating an informal grace period or not?

Andrew Bailey: MiFID II came in at the beginning of January. I have been very transparent about this. This is a very big change. It is probably the biggest piece of financial market legislation that there has been, in that sense. Our approach at the outset was to prioritise efficiency and the functioning of markets. I was very clear that, if we had to choose between bringing the MiFID II rules in in detail over a slightly longer period of time versus having markets that functioned, we wanted markets that function. We do not want disruption to markets. Now, in the end, markets functioned effectively and we were quite happy with that.

We do this generally; we bring these things in and we want them observed from early on. We tend to not enforce immediately. The first tool will be supervision rather than enforcement. But I want to be clear because I know that there is some talk about this. Firms have to obey MiFID II. It is not that we do not care about MiFID II—we do—but we were balancing getting it introduced with markets functioning effectively and giving some time for things to settle down. We had to deal with a few things on the run in the early days and weeks, which is not terribly surprising, frankly, where we had to make some adjustments, but we have a programme of supervision that is underway. Of course, after a while, yes, we will enforce.

Q293 **Chair:** Briefly, do you think that firms that are not compliant should state that at this stage to customers to make it clear? There might be reasons for noncompliance.

Andrew Bailey: No firm should say it is not compliant. There is, however, a second issue. As you may know, there are two things that came in: MiFID II and then the so-called PRIIPs regulation. PRIIPs is more problematic, and there was coverage of some comments I made yesterday. One of the problems we are experiencing with PRIIPs—and this is a binding standard, because it is a maximum harmonised regulation, rather than a directive—is that, frankly, some of it is not well designed.

We are trying to come up with a solution. By the way, we are not the only authority; we have quite a bit of support on the continent for this. If firms follow some of PRIIPs literally, you get very bizarre outcomes such as negative costs for instruments being marketed to customers and you think, "That cannot be right". We are also working on that, and I said yesterday that we will have a call for evidence in the next month or so on that. There will be a review of it in the EU. We issued a statement quite early on going as far as we thought we could, given it is a maximum harmonised regulation, to give people some flexibility to be sensible. That is a second element of some tension in the system at the moment.



Q294 **Charlie Elphicke:** I want to ask about reporting by the FCA, Maxwellisation and those issues, as well as enforcement. I will start on Maxwellisation. As you know, the Committee asked Andrew Green and his colleagues at Blackstone Chambers to produce a report on Maxwellisation. Can you summarise your thoughts on this report?

Andrew Bailey: I will. Charles will probably want to come in on this as well, because we were both heavily involved in the HBOS report and Andrew Green's work. First of all, I thought it was extremely sensible and I welcome the fact that the Committee—it was the Committee before the election—commissioned it, because we have all had the frustrations of Maxwellisation. Having said that, I start from the principle that the underlying reason for doing it is a good one, which is in order to give people a right of comment and response on what is proposed in these reports.

I was very broadly in agreement with what Andrew Green said. From my own experience, I have to say that there would be benefit in putting it on a firmer footing—Maxwellisation, that is—and giving it more solid foundations. One big reason for that, going back to the HBOS report, is that it would be very helpful to have a firmer basis for setting a time limit on it. One of the things we found with HBOS was, because it is not formally time-limited, you have to work out, in a sense, what is reasonable, because you do not want to get the wrong side and be challenged in court. If I was doing one thing, that probably would be it.

Slightly trivially, I wish somebody could come up with a better name and not name it after an infamous person. You were heavily involved in this as well.

Charles Randell: Yes. During the HBOS process, I met with Andrew Green, so I have a view on the person as well as the report. It seemed to me that both the person and the report were very thoughtful and extremely robust. I welcomed the report. It provides a really good roadmap for the efficient conduct of that phase of any investigation. It helps challenge lawyers, both at the FCA and elsewhere, not to be overly cautious in the Maxwellisation process. Particularly with things about giving people a second bite of the cherry when the report changes and so on, it is really important that the people conducting the process ask themselves, "Is that really necessary?" because it can add hugely to the timescales.

I thoroughly welcome the report, and God forbid we should have anything to do that is comparable in scale and length to the HBOS report in the future, but the lesson is there for other things that we do and we must make sure that we apply it.

Q295 **Charlie Elphicke:** The HBOS report took about 14 months to do. If you were to adopt Andrew Green's proposals, how much more quickly do you think it could have been done?



Charles Randell: That is an almost impossible equation because, as I have said previously, Maxwellisation was not the only thing that was going on during that 14-month period. Some other changes were made as a result of further fact-finding, testing and verification of the report. All I would say is that the report could have been concluded more quickly had a slightly different approach been taken to Maxwellisation. That is a fair comment, but I could not give you an exact period of time.

What is helpful in Andrew Green's report is that he lays out a schedule of a whole load of different reports on how long the Maxwellisation process took on those. That gives you a really useful benchmark to measure yourself against.

Q296 **Charlie Elphicke:** The FCA is prohibited under section 348 of FSMA from publicly disclosing information about firms and individuals acquired during the course of work without their consent. What are the merits of this provision? Has it given rise to problems?

Andrew Bailey: Again, if you do not mind, we will both come in on that one. The reason it is so important to us, in my estimation—by the way, the PRA has exactly the same, so both regulators are in the same place here—is that, to do our job and to be a particularly effective supervisor that wishes to stop things from going wrong, we need a lot of access to commercially confidential information and we need to get it quickly. I do not want to be in a situation where we have to go through court processes to get information, for instance. To have a system where we can get that commercially confidential information and use it effectively and quickly depends on having a confidentiality regime around it. In that sense, I am a strong supporter of it.

Where it becomes problematic—and we have seen this, after all—is that it restricts our ability to disclose things in the broader sense of the term, particularly where there is a public interest. There is a line that you can define in words, but it is harder to be precise about it ex ante, where you want to say, "Look, the public interest in this issue is so substantial that that confidentiality requirement should not be the obstruction to satisfying the public interest". The question then becomes: is that best addressed by some modification of section 348 or is it best addressed, as we said before, by saying that there are some things that should be subject to a public inquiry rather than using a tool within our legislation, which has complications of confidentiality?

Charles Randell: To my mind, the trust that firms will have in our confidential treatment of information they give us, very often voluntarily, not always because we have demanded it, is a critical part of the supervisory relationship. Although it is not an excuse, the fact is that that is very firmly embedded in most of the European directives and regulations that we proceed under. MiFID I has a professional secrecy requirement. The capital requirements directive has a professional secrecy requirement. Solvency II has a professional secrecy requirement. Our rulebook says that, when firms become aware of something that they



think we would want to know about, they should come and tell us openly. To maintain the effectiveness of that, we need them to trust that we will treat that information appropriately. That bit is easy.

The bit where I have more questions in my own mind is about the application of section 348 in particular to individuals. To put the question another way, the exam question that at some stage it might be useful for the Committee to come back to is: why is it that individuals in the financial services sector uniquely, among all sectors, have this right? It does not exist for individuals in other very important regulated sectors, whether it is aviation, other aspects of transport or utilities. It is unique to financial services. Why is that? Is it right that it is as untrammelled as it is in section 348? I just pose the question that way. In my experience, getting consent from firms under section 348 is rarely the big problem. The big problem is having to go to multiple sets of individuals.

Andrew Bailey: To be honest, that is also because, when you are dealing with something that has gone wrong, the dynamic in firms is quite different. Typically, with a firm, in all my experience, the management has gone, the board has changed and the new management board just want to get rid of it and put it behind them as quickly as possible. With individuals, they are protecting their reputation for good, so it is a very different dynamic.

Q297 **Charlie Elphicke:** I will come to whistle-blowers and all that in a minute, but the risk is that you have a situation where you have done a detailed report and a detailed investigation; you have properly heard each side and what everyone has to say; you have looked into it; and, having followed natural justice and the rule of law, you have come to a conclusion and you have decided that Bloggins is a bad egg, but you cannot tell the market that, so Bloggins can go on with his career and just carry on regardless. Is that what troubles you, Mr Randell?

Charles Randell: Not really, funnily enough. It is a much more complex question and it calls into question, in some of the very difficult cases that you are concerned about, whether we should have led much more with the investigation leading to enforcement than with the report. I can think of a number of cases where, because the investigation and enforcement did not really land first time round and then we found ourselves in a report, we found that the report was subject to this section 348 problem in individuals who then thought, "Actually, maybe they will come back and enforce". What we need to do, in nearly all cases, is lead rapidly with enforcement, determine on that, and then it is possible to write useful reports afterwards. It is very difficult to write reports where individuals still feel that they are subject to jeopardy.

In terms of getting their consent, I am not sure it would be right for us to be issuing reports saying, effectively, "This person should never work in the financial services industry again". We have a process for doing that called prohibition, and we should go through that process if we want to prohibit someone. We may make statements that fall short of that but



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individuals are still objecting to. The exam question is why they have that protection uniquely in financial services.

Q298 Charlie Elphicke: My colleague Alister Jack would like to follow up on 348. Moving on to enforcement, questions are asked about the consistency of the FCA on enforcement. Mr Jonathan Burrows was banned from the financial services industry for life for fare-dodging; he did not pay for his railway tickets so you banned him. However, on the other hand, people then say that Jes Staley got a slap on the wrists and got off lightly. How is that fair? What do you say to the people who write these things in newspaper articles?

Andrew Bailey: I have seen it. I have to say that I cannot comment on the Burrows case because it predates me, and it predates you as well. I cannot comment at all on the detail of it but I can comment relatedly on it by using the Staley case and extrapolating from it. We spent a lot of time in the Staley case on this question because, if you think about it in levels, the real question is that there is a level of what is called negligence, and then there is a level that I will loosely call dishonesty. That is the next level up. Frankly, if it is dishonesty, you are out.

Now, what is it therefore about that test that distinguishes those two cases? Let me start with the Staley case because this is a thing we spend a lot of time on. It came down to this. Was the behaviour concealed? No, it was not. Was it sustained? No, it was not. Was it negligent, stupid and grossly wrong? Yes, it was. Was there a misunderstanding in there? This gets to do with one of the letters and the fact that the whistleblowing rules changed in September 2016, and this case happened in June 2016. This is all about whether it was reasonable or not to assume the first letter did not come from a member of staff. After a lot of time spent on this with a lot of lawyers and a lot of evidence, the evidence did not make that case to take it up to the next level.

Now, I was not involved in the Burrows case but I can imagine that, if you think about whether it was concealed and whether it was sustained, on the face of it, it looks like it was. That is the difference. I say that with the huge caveat that I am not in any sense an expert on the Burrows case.

Q299 Charlie Elphicke: Looking at the case of Jes Staley, it seems to me his concern was to know who was saying these things about him. That brings me to another issue, which is: whistleblowing is important in order to protect someone so that they feel that they can come forward, but what do you do about a malicious person who makes nasty false allegations just to damage someone?

Andrew Bailey: There are two points there, one of which I have already somewhat covered, which is this technicality that, by the way, no longer exists, because the definition of whistleblower has now been expanded so it is not about whether the person is assumed to be a member of staff or



not, and whether it is reasonable to make that assumption or not. That has gone.

The second point is whether it was a malicious whistle-blow, as it were. Barclays did have in its policy that that was the one exemption, where it was obviously malicious. In both these things, you have to be very cautious. You cannot go in on day 1 and say that it is obviously malicious. That only emerges from the benefit of examining it and reviewing it, and that should be done by independent people, not by the chief executive. There, he clearly was at fault.

Q300 Charlie Elphicke: As a follow-up question, if you are going to have whistleblowing, should there be whistleblowing to banks or should there only really be whistleblowing to regulators, so that regulators can investigate these things properly and not have the risk of this tension arising?

Andrew Bailey: There should be both because, frankly, if a bank cannot run a whistleblowing process—and, by the way, this is why we ran the second case, which was on Barclays itself, and why it is under a reporting requirement—because its governance and its controls cannot support it, that is a very bad indictment of any firm. You are right—and we put a lot of importance on this—that there has to be a second route for a whistleblower, which is to us, and that has to be robust as well.

Q301 Charlie Elphicke: In that situation, how do you ensure natural justice to the institution or person being whistle-blown against?

Andrew Bailey: That is important too, but the right thing to do was for there to have been an independent review within Barclays of the evidence. The right thing to do was to hand the evidence over for an independent review within Barclays, to ensure that there was a separation at that point and avoid a conflict of interest, to get exactly to your point, which is: was this a genuine whistle-blow or was it a malicious attempt to effectively destroy an individual?

Charles Randell: You either have whistleblowing or you do not. If you have whistleblowing, you need a system that starts with an absolutely clear assumption that the whistleblower's complaint needs to be investigated in good faith that the whistleblower is acting in good faith. You cannot have a system where you get into the mindset that some whistleblowing complaints are malicious, connected with HR disputes and so on. You just have to have that and the system around it has to safeguard that. That is why, to the extent that I have had involvement in the implementation of policies in this area, in both the FCA and some of the organisations we oversee, I have said, "If in doubt, treat as whistleblowing and make sure it is completely independently reviewed". Now, it will be a very unpleasant process. If the person who has been complained about is innocent, it will be a very unpleasant process for them, and you have to try to give the maximum fairness you can to them, but you must start from a position of neutrality.



Q302 **Charlie Elphicke:** Commentators cite the Staley case as evidence that the SMR—the senior managers regime—is a kind of paper tiger. Going forward, how will you make sure that people realise that the SMR is serious and that the FCA will be robust?

Andrew Bailey: First of all, it is important that we explain the facts of the case. Some of those commentators made those observations before the notice was published. That is okay, but it is important to set out why I do not think it fell into that category, because the evidence and the interpretation of it led us to the conclusion that it was negligence rather than dishonesty. If, on the other hand, the evidence had led us to dishonesty but we had in fact found negligence, you could obviously make that case, but I do not believe it.

The second point—and we are reviewing this, and Charles may want to come in on this as well—is that it is always important to keep the penalty in mind. You can take a number of views on that. The penalty, by the way, is set through a formula, so it is not something that we make up as we go along. It is a formula based on his earnings. One important thing that I should have said earlier on is that there is a higher standard expected of senior people than there is of those lower down. That is built into the system as well, and that is what led to the eventual outcome, which was from us and the PRA. If you put our fines and Barclays's action together, it is somewhat over £1 million, £600,000 of which was the two fines.

Charles Randell: I will just mention the fact that, as it happens, we have a routine review of our penalties policy, which we are turning to later in the year. This will provide an opportunity both for us to re-examine the penalties policy and ask ourselves the question of whether the outcomes that we see pass the test of common sense, and for others outside of the FCA to comment on that, and I will welcome people giving us their views.

Q303 **Charlie Elphicke:** There may be an upcoming opportunity for regulatory investigation under the SMR, and indeed speedier report-writing, coming up. Will you seize such an opportunity to make sure that the public can see how swiftly and how robustly you can act?

Andrew Bailey: I can tell you that I would love to do speedier report-writing. If you think that we get any pleasure from the length of time these things take, I am afraid that that is very wrong. Yes, we welcome both of these two things.

Q304 **Mr Jack:** Can we turn to the ongoing investigations of RBS GRG, HBOS, et cetera? In a letter to the Chair on 30 May, you committed to publishing a full account of the findings of the FCA's investigations into RBS GRG and into HBOS Reading, "as the law permits". We have touched on section 348 of the Financial Services and Markets Act 2000. Is that what is constraining you?



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Andrew Bailey: If you do not mind, let me take both of them separately and then bring them together. Let us start with GRG. My expectation is that we will finish the investigative part before the end of July. We will then face a fork in the road, as it were, where it could go one of two ways. If it results in an enforcement action against a party or parties, I have to be honest with you that I cannot, at that point, give you an accurate prediction of the time, because it depends upon the process and whether there would be a contested case or not.

If we go down the other fork in the road, which is that there is not a case we could bring—and I should reiterate a couple of points here that we made before: first, this activity is outside the regulatory perimeter and, secondly, we are dealing with the approved persons regime here, not the senior managers regime—we will, as you said, produce an extensive report, which will describe what we have done and found.

Q305 **Mr Jack:** Will it be a full account?

Andrew Bailey: Of the case?

Mr Jack: Yes.

Andrew Bailey: That is the intention, yes.

Q306 **Mr Jack:** Nothing will be redacted.

Andrew Bailey: I was going to come to that, if you do not mind.

Mr Jack: Okay.

Andrew Bailey: The intention is “no”, but we come back to the discussion we had earlier really around consent and Maxwellisation. I am afraid that, at that point, we may have to come back and have another discussion with you as to how that is going, but we are not at that point yet.

Q307 **Mr Jack:** Do you intend to seek consent from individuals and firms for their confidential information to be disclosed?

Andrew Bailey: Yes, because we would need to follow that process in order to disclose confidential information.

Q308 **Mr Jack:** I picked up on Mr Randell’s points earlier about section 348 in relation to individuals. Should that clause be reviewed to make it easier for these reports to be published and for individuals not to bar them from being reported in full?

Charles Randell: It would be good for the Committee to discuss that question. It is a legislative question, so it is not for us to take a firm position on it. I am mindful of the fact that a review of section 348 was conducted by the Treasury, I think in 2012, which recommended no change at that stage. But—

Mr Jack: There is a new sheriff in town.



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Charles Randall: There is a question about, in particular, its application to individuals. That is the point that I would make there.

On what I might describe as the RBS GRG findings, if the case does not go down the enforcement channel, clearly the aim of the FCA, and the determination of the board in supporting Andrew and his team, would be to get that process done in whatever manner enables the public to have confidence in the decision with the maximum amount of information. That may mean that it affects the way in which the notice is written. It may be necessary to steer away from information that would require an individual's consent under section 348, but I do not think that that would necessarily make it a less useful document, if that was the route. I just want to stress that the FCA is not at the point where it has made that decision.

Q309 **Mr Jack:** This is a question for Mr Bailey, just to go back to the point you made earlier. If individuals or firms do not give their consent, do you have the right to tell the Committee which firms or which individuals have withheld their consent? Would you be able to write to us and tell us that?

Andrew Bailey: Would you mind if I wrote back to you on that? Given the process that we went through last time, I would rather give you a definitive answer on that. As you know, we get into this interesting difference between "request" and "require" on your part and so, if you do not mind, could I come back to you on that?

Mr Jack: I understand. It is just that there is a balance here between privilege and sharing output. The former can be a hindrance to the latter, in terms of investigations and accountability.

Andrew Bailey: If you do not mind, I would like to give you as definitive an answer as we possibly can to this question because it is a very important one and there is a reasonable chance that we will be having this discussion at some point. If you do not mind, I would rather like to write to you with a definitive answer. I am conscious that I have not done HBOS yet.

Mr Jack: Go on then.

Andrew Bailey: I wrote to the Chair at the end of May. Of course, as you know, there are two HBOS cases; there is the one that came out of the main report, and then there is the Reading case, which came somewhat later because of the completion of Thames Valley Police activity. There are two things to add to that. One is that the National Crime Agency issues a statement saying that, with our support and the support of Thames Valley Police and the Serious Fraud Office, it is investigating a number of other allegations that have been made around Reading but were not in the scope of the Thames Valley Police case. That is very sensible. We support that fully and we are participating in that fully, and I am pleased that the NCA is doing that.



The second thing I would say—and I said this in the letter to the Chair—is that we are going through extensive amounts of evidential material. Since I wrote the letter, we have had contact from a representative party suggesting that there may be extensive further information that had been held privately. I have to say that this is somewhat dismaying, but we will have to go through this and find out what the basis of this further evidence is. We have spent a long time on this, so the idea that there is more material out there that had not been made known to us previously is not something that we wanted to hear. Again, I will let you know—this is the simplest thing to do—where we get to and I am happy to keep you updated as regularly as you would like on this.

Q310 Mr Jack: Okay. I just want to shift the line of questioning to the concerns raised by the Complaints Commissioner regarding the Connaught Income Series 1 Fund. Basically, this review of the regulation cannot begin until the FCA's investigations into Connaught are complete. My question to you is: when will this be? When will you complete your review?

Andrew Bailey: There is further ongoing investigative activity. Let me just tell you where we have got to. Connaught is, again, a very old case that goes way back before my time. However, in the last two years, we have reached a settlement in a case with Capita that has resulted in funds being available to the victims of Connaught. Previously, there had been no funds available because Connaught is bust. Our expectation—well, it is more than an expectation—is that, now those funds are available, that will cover the principal amount of investments in Connaught. We have appointed an administrator to essentially run the process to make those payments out to the investors. That is a big step forward.

We have one or two remaining cases. Obviously, that is the principal; that does not cover forgone interest over this period of time. I cannot tell you, because, frankly, we do not know, the probability as to whether we can recover any more funds, but that is the intention behind it. We always get the advice that it potentially jeopardises a case if we conduct a review of a case at the same time as we are conducting an investigation and a legal process, which is unfortunately the answer as to why time goes by. At the moment, our judgment is that we would like to see if we can recover any more moneys for the investors. We will have to see where that case gets to.

I do not want to call it a success, but the big achievement is that we have a large sum of money now for the investors in Connaught, which two years ago was just not on the table.

Q311 Mr Jack: When do you foresee a review taking place? Do you have a date in mind?

Andrew Bailey: I do not. Again, I could write to you. I cannot give you a date but we can give you some assessment.



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Q312 **Mr Jack:** As a board, have you agreed a remit for a review or a candidate to run the review?

Andrew Bailey: This has not been discussed by the board in recent times.

Q313 **Mr Jack:** The review is quite a distance out there in that case. You want to sort out the money and do what you can with the administrator before you even think about a review.

Andrew Bailey: The material for the review is gathered together because we have had to do that for the enforcement cases. We should be in a pretty good position to give the reviewer the material.

Charles Randell: There are a couple of places where we have committed that we will do a review once things are concluded. I have been speaking to our head of risk about how we will handle those processes so that we can start designing the processes and have them ready to go as soon as the opportunity arises. I do not want there to be a further delay between the conclusion of any process and our starting of an independent review. If it is any comfort, I am on to the point you are making.

Andrew Bailey: We have recovered 50-odd million pounds.

Q314 **Chair:** I want to revisit a couple of points on enforcement, in relation to GRG and the full report. You said that it will be the end of July before there is a report. Obviously, the time is uncertain if there is enforcement action to be taken. If there is no enforcement, you talk about the full report. Can we just be clear about what you mean by "full report"? Would it be helpful to have the Andrew Green process for Maxwellisation or suggestions in place before that full report?

Andrew Bailey: It cannot hurt; let us put it that way. The answer to that question is "yes".

Q315 **Chair:** Okay, and what does "full report" mean, in the FCA's book?

Andrew Bailey: Subject to the points that Charles was making about how we balance time and what is in the report, I want this to be as full as we can make it, in terms of the material that we have covered in this further phase of the investigation.

Q316 **Chair:** That is half an answer. On the Jes Staley point, Charlie was talking about the different types of cases and decisions that are taken. Even though the FCA's findings are what they are, there was still some quite serious conduct by Mr Staley, which goes potentially to this integrity point. Was there a difference of view internally at the FCA as to the decisions that were taken? Was there quite a lot of discussion before you got to that point?

Andrew Bailey: There was a very long discussion. I would not describe it so much as a difference in view as a very long discussion as to how you evaluate this evidence. Bear in mind, as you said, this was the first case



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really under the senior managers regime. It goes to the point I described about the balance between whether it was dishonest, sustained or concealed and the thing that goes on the other side, which is that he is a chief executive, so there is a higher expectation. That was the subject of substantial deliberation on our part. We went around quite a few angles on that, as you can probably imagine, with people saying, "We have looked at this, but what if there was something else going on there?"

In the end, and with a lot of legal advice, as you can probably imagine, it was not a contentious decision in that sense, but it was a—

Chair: It was not a decision easily come by.

Andrew Bailey: No, not at all. It should not be. I would agree with that.

Chair: No, absolutely. It is a decision that, presumably, the people making it were aware would set a precedent.

Andrew Bailey: Yes, definitely.

Q317 **Rushanara Ali:** Good afternoon. I have some questions about mortgage prisoners. Your interim report discusses how you can help mortgage prisoners, and there are proposed solutions for those who have mortgages with an active lender, but not a great deal of information on what happens with inactive lenders. The report also notes that the FCA will "begin discussions on possible solutions" for these customers. What are those possible solutions and have the discussions started?

Andrew Bailey: This is for inactives.

Rushanara Ali: Yes.

Andrew Bailey: The challenge we have with inactives is another of these regulatory perimeter issues, in that the mortgages can be held by people who are outside the perimeter in that sense. We have had, in recent times, discussions with a number of inactive lenders about their policies, and we will need to have further discussions with Government as to what we do about this, because we are at a perimeter issue again. I can assure you that we want to get to the same solution for inactive lenders. It is not fair that, by no choice of their own, people find that their mortgage has been transferred to an inactive lender or the party has become inactive, and they are then put in a difficult position. You are getting at another important point: there is a higher probability that that will be the case for people who are with a slightly marginal mortgage lender, which could get into trouble and become inactive for one reason or another. You have my commitment that we will look through every way we can to try to solve this issue.

Q318 **Rushanara Ali:** What is the timescale? We all know, if we have mortgages, how tough it is to make the difference.

Andrew Bailey: I do not know at the moment. I would be happy to come back to you on that and see what we could send out.



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Q319 **Rushanara Ali:** Can you give us some idea? Is it three months, six months or a year? How are people meant to plan ahead with their finances if they are paying potentially hundreds of pounds more per month for their mortgage? Is that something that those people are getting advice on? Is anyone giving them advice on that? At the moment, they are in limbo land.

Andrew Bailey: Can I come back to you on that one?

Rushanara Ali: Sure.

Andrew Bailey: There may be a number of potential angles we come at that from. As you say, one is advice and the other is, frankly, having a code of conduct among the inactive mortgage lenders to assist in this. The third one is an issue that we have encountered before, in that there is a curiosity in the EU mortgage credit directive.

Q320 **Rushanara Ali:** Is that in the interpretation of it? Is the UK interpreting it correctly? Are there examples in other countries where it is not being interpreted in the same way?

Andrew Bailey: Both we and the Treasury have been around this question several times, because the point gets made about whether we are over-interpreting it. We have not managed to get ourselves into a position where we think we are. The challenge at the moment—it is really bonkers—is that you can remortgage with an active lender. If you are with an active lender, you can remortgage with your existing lender, even though you have failed the test of affordability for a new mortgage. By definition, you are only going to remortgage if it is better than your previous mortgage, so it must be beneficial to you. All the advice we and the Treasury have had is that, if you are trying to remortgage with another party, you run into this trap. Now, this is just silly.

Rushanara Ali: Yes, it is completely illogical.

Andrew Bailey: We have been around it a number of times. I am happy to come back and say, "Look, we can do the following things". I will probably have to get the Treasury involved in that.

Q321 **Rushanara Ali:** There is a great urgency to this. I have constituents who are in this position, as I am sure others do. You mentioned that you have had discussions with the Government. Have you made an ask about legislative changes, by statutory instruments if necessary, to clear this up quickly? Have you also discussed whether there is a need for resources to insulate people against being trapped in a situation where they accumulate mortgages that they cannot afford, or they end up in debt from elsewhere in order to keep the mortgage going?

My third question is partly related to this point about what to do to protect people. Has anyone done any assessment of how many of those 30,000 people might be at risk of having their homes reposessed because of this issue? Another 120,000 are referred to in the report.



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Would you be able to shed some light on those questions?

Andrew Bailey: Another way to get at this question is to introduce, or to get the co-operation of the inactive lenders to introduce, a code or standard for their own behaviour, which would effectively not require legislation but would get them to commit to it.

Q322 **Rushanara Ali:** How many have committed to it?

Andrew Bailey: Well, we do not have it at the moment.

Q323 **Rushanara Ali:** When are we going to get it and how many do you expect to commit to this? There just does not seem to be a sense of urgency. I recognise that you have done a lot of work on the interim report. I know that, if I was in a situation like that where my mortgage was a few hundred pounds more per month, I would struggle, and I earn a very high salary as a Member of Parliament. Even for those with good incomes, this would be a struggle. How are people meant to handle the situation? It is not a small number of people; it is 30,000 people, plus the 120,000 referred to in the Money Saving Expert article, likely other consumers with mortgages that have been sold to firms not authorised for lending who also face barriers to switching. I do not know if any work has been done on that.

Andrew Bailey: I am not aware of it but I will let you know. The point they make is the relevant one: it is outside our perimeter at that point. As you said, through the work we have done, we have some view of the total size of the market. We do not have as good a view at all of the individual firms, unfortunately. Let me take that away and I will come back to you, if you do not mind.

Q324 **Rushanara Ali:** What about in your discussions with the Treasury? Have you explored the possibility of legislation if you do not get the voluntary sign-up by those who are not active lenders?

Andrew Bailey: Here is one of the frustrations.

Q325 **Rushanara Ali:** Have you asked them for money, as we have done on welfare policies to mitigate the worst effects, as in the hardship fund, for instance? Is there a fund that should be created so that people do not end up having their homes repossessed?

Andrew Bailey: Can I just bring it back to the discussion with the Treasury? Here is one of the frustrations, if you do not mind me saying so, about the Brexit vote. Up until the point where the referendum happened, we were reasonably optimistic that we could probably get a change in the EU to this regulation, which would have allowed us to get at the issue. That has become very difficult in the post-referendum world because it is a UK-specific thing.

Q326 **Rushanara Ali:** It has been a while since the referendum, has it not?



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Andrew Bailey: My point is not about the elapsed time, but about the negotiating. It is about what leverage we have in the system. That is the challenge. I understand your point.

Q327 **Rushanara Ali:** Sure. This is what I am getting at: it has been a while so, given we no longer have enough influence to be able to influence, what is plan B while people wait?

Andrew Bailey: As you know, the second thing, which is not easy at the moment—it is not on, actually—would be to ask whether we could introduce something post the exit.

Q328 **Chair:** In the debate we are having at the moment on this Bill—perhaps it is not a debate for today—about retained EU law, is this one of the areas where you would be suggesting to the Treasury that we need something to be changed to do what we want to do?

Andrew Bailey: This introduces a much bigger point. We all have a list of top 10 bits of EU legislation that we would love to change. This would be in my top 10. But the rule of engagement with you, Parliament, is that we do not do this because it is strict onshoring, and the only changes we make are what we call “inoperables”, where it will not work in the UK legislative framework if you do not do something. It is strictly not that we have always had this list of things that we would like to change and now is the moment. Your point is right: going forwards, what do we do about that? But that does not solve the timing issue.

Q329 **Rushanara Ali:** Can I just ask one final question? How have other EU countries dealt with this situation? Do they not have any comparable challenges to this one?

Andrew Bailey: I have not come across a comparable issue, and I do not think the Treasury has either.

Rushanara Ali: Where people might be trapped in mortgages.

Andrew Bailey: We usually try to do this, because we are usually looking for allies, and I do not think we have found any.

Q330 **Rushanara Ali:** So there is not an equivalent of mortgage prisoners in other EU countries.

Andrew Bailey: I am not aware of it but I will talk to the Treasury as well about that.

Q331 **Rushanara Ali:** If we are trying to influence this at EU level, one of the key questions would be to understand who else is in a similar boat.

Andrew Bailey: Yes, the first question is always where our allies are.

Q332 **Rushanara Ali:** Yes, but we do not know the answer to that. I am just wondering whether it is because it is a non-issue for other countries because their mortgage system is different, or whether we just do not know because we have not asked the question.



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Andrew Bailey: Put it this way. It is not an issue that I have ever heard being raised by other countries. That does not mean to say that it is not there—I could not tell you that definitely—but it is not something that I have come across. I will come back to you. I agree with you that, one way or another, we have to find a way through this.

Q333 **Stewart Hosie:** Andrew, in March you published new rules on defined benefit pension transfers. Given some of the poor advice that seems to be present in this area, was there any temptation to issue a temporary ban on such transfers until you could properly stabilise the market rather than just stopping the transfer of certain funds?

Andrew Bailey: That would be quite challenging. This is the dilemma. Take the British Steel case, for instance. Put aside what you think about pension freedoms for a moment. In cases where people have to make a decision because the terms of the DB scheme that they had are changing, it would quite challenging to say “you cannot transfer”, because you are therefore, in a sense, tying them down to whatever is offered—either that or the back-up fund, which is not as good—so that is quite challenging. However, we are very much aware. Probably the most challenging and complicated financial decision an individual can take in their lifetime is a DB/DC pension transfer. After all, you have to come to a view on what you think about the future discount rate, future asset prices and your own longevity, none of which we know.

These are hugely challenging judgments to ask people to make, which is why we have a lot of focus on this issue, from the point of view of what guidance we give, but also what supervision we do. It is one of the things that have concerned me—and British Steel illustrates this, but it is going to be the only case or the last case of this, I suspect, in this country—as to how we get to the advisory population that is out there giving advice on these things.

Q334 **Stewart Hosie:** We will come to the advice a little later, but have you any idea of an overall figure for how many poorly advised pension transfers have been made?

Andrew Bailey: We have some views on percentages from samples, and we have used those. We have views on those firms that we have taken action against. In the case of British Steel, I am trying to remember, but I think we have stopped seven or eight firms operating in the market, where we have found a concentration of poor advice. That can be two things. Broadly, it can be either poor advice in terms of the investment strategy, or poor advice in terms of the fee levels.

Q335 **Stewart Hosie:** I know you are also considering further changes around contingent charging for transfers.

Andrew Bailey: Yes.

Stewart Hosie: When will the results of that work be known?



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Andrew Bailey: The next big step in this—we have a lot of work going on—is that we have what we call our Retirement Outcomes Review work coming out. That will be out in the next month. We are out for consultation at the moment on a number of issues raised by DB/DC, and that will come back before the end of the year. We want to make the rules on that. We have a lot of moving parts on this front at the moment.

Q336 **Stewart Hosie:** It is helpful to know that that report will be out in a month or so. The interim Retirement Outcomes Review found that there was little product innovation since pension freedoms were introduced. Given that the market for conventional annuities has shrunk sharply since the freedoms were introduced, is it your view that the pensions market is currently viable without new products being introduced?

Andrew Bailey: One of the important things that underpinned that work was a concern that, particularly for smaller pots, people were defaulting to drawdowns. There are people for whom drawdown is a sensible product, but our concern was that it was becoming almost the only show in town for some of the market. It gets to your point on innovation. The Retirement Outcomes Review, which we will publish in the next month, will have our recommendations for tackling that issue, of which how to encourage innovation is one.

Q337 **Stewart Hosie:** Let me move on from that. You said that the drawdown products had become the default. There is a side issue there, which I want to touch on, of individuals who wish to cash out or cash in very small pots. It is related, but not the same. I am aware of at least one case, possibly two cases, where individuals have not been able to cash in small pots, because their provider has said, "The FCA cannot advise what a small pot is or how it should be valued". Are you aware of those sorts of issues rolling around in the background at all?

Andrew Bailey: No, but could we follow that up?

Q338 **Stewart Hosie:** I will happily send you the information on that, yes.

Andrew Bailey: I would welcome that.

Q339 **Stewart Hosie:** Are you concerned that the collapse in sales of annuities since the introduction of pension freedoms has impaired the pooling of longevity risk?

Andrew Bailey: Arguably, you can say it has. On the other side of the balance sheet, there were a number of problematic elements with annuities, which were partly to do with the slight randomness of the point at which compulsion came down. In a world of increased longevity, in many cases people's working lives are going to be different to the ones that they expected them to be. That is the logic of the pension freedom argument, it seems to me. The question is how it is put into practice. You are right, in that, if you think that there has been too great a switch towards drawdown products, your point about pooling longevity risk is correct.



Q340 Stewart Hosie: Is that likely to have some medium to long-term consequences? By that, I mean: will the money simply run out? Will people's expectations simply not be able to be met as that pooling of longevity risk diminishes?

Andrew Bailey: This is one of the biggest issues we face. If we put Brexit to one side, heroically, this is the big issue: what I broadly call the lifecycle model of borrowing, saving and pension drawdown. It is a very serious issue. What you have in the mix here is a combination of lower retirement saving rates, higher indebtedness at a younger age, which we demonstrated in the Financial Lives survey, people going into the housing market at a later age and therefore having mortgages to a later age, and a prolonged period of low real interest rates. We have now had almost a decade of low real interest rates.

A combination of low real interest rates and stable inflation is a very unusual combination in economic history. If you put those together with greater longevity, this is a huge structural change in the model, which goes directly to your point of much greater uncertainty about retirement saving, at the same point at which the level of saving has fallen and the level of long-term indebtedness into older age is growing. It is a very big issue.

Stewart Hosie: We could hold an entire three-hour hearing on that.

Andrew Bailey: At least.

Stewart Hosie: I am not going to do that.

Chair: Not today.

Q341 Stewart Hosie: Let me finish with a couple of outstanding areas. The Retirement Outcomes Review also found that over half of the annuity purchases and a third of the drawdown purchases were made without advice. Does the industry have the capacity to provide appropriate cost-effective advice in an age of pension freedoms, and is there a particular area—I believe there is, but I would just like to have it confirmed—for those who have modest annuities and modest pension pots?

Andrew Bailey: We also found in that work that there was a concentration of these drawdowns in smaller pots, often with people who had another source of income, and that is logical in a way. However, it gets again to another big point. If we go back to the days of the Retail Distribution Review, again somewhat before my time, the logic behind it was entirely correct, which was to reveal, in a sense, the hidden commission. However, in combination with sustained low real interest rates and therefore sustained low real returns, once people could see what they were paying for advice—and particularly advice for smaller transactions, given that there is ultimately a diseconomy of scale in traditional advice—it led to a fall in the take-up of advice, particularly for the somewhat smaller transactions that you were referring to. That is



what lies behind the point you make, which is that we have moved to a world where a lot of these transactions are unadvised.

I still hold to the view that moving from a world of hidden commission is a good thing. The answer to this is not in the commission, but it poses a challenge, which comes back to the innovation point. What is the answer to the question of how you get low cost advice for relatively small transactions? A lot of innovation is taking place there in the so-called robo-advice market. It is still early days to conclude where that is all going to lead to. Another route will be to have a stable of more highly standardised, relatively cheap investment products, for which you do not need great advice. That is where we are going to come back to because, to come back to the original question, there is still a gap in this market.

Q342 Stewart Hosie: I have one final question, and it is not going to touch on whether that gap is filled with an annuity product or a state-based product; let us leave that for the time being. I know you are currently considering mandating default investment pathways for consumers who do not actively engage in choosing the pension investments. Where are you with default investment pathways and, likewise, with default guidance for people? We want to avoid the situation where, at 70, an annuity was bought, whether or not it was the best time in the market, irrespective of circumstances. Clearly, for those who are not investing properly or engaging, something needs to be done. Where are you with the default investment pathways and the default guidance?

Andrew Bailey: We will have more on that during the work we are going to do in the rest of this year. The other thing that we have been doing a lot on is what has come out of the so-called advice review. We had to go round this course twice, because this is about where the advice/guidance boundary comes into play. This was one piece of the post-RDR work started by the Treasury and the FCA, which I inherited when I came in. It was a very sensible thing to do, because one of the consequences of the work we have done on the RDR is that firms were aiming off the boundary of the advice/guidance world for fear that they would trip over it without realising that they had done it. The problem with that aiming off was that it left this gap in the market.

We have done a lot with the industry over the last two years to try to firm up the definition of the boundaries and give firms greater confidence that they can go to the boundary. The industry says to us that it feels more confident now, but we have to keep assessing those questions as to whether it is really working in that sense.

Q343 Chair: I am going to bring in Catherine in a moment on high-cost credit, but there are a few unrelated issues, which I am going to take the advantage of having you sitting there to ask you about. The first you have mentioned a couple of times, which is the regulatory perimeter. You have mentioned a couple of things that are outside the regulatory perimeter. Also, in relation to funeral plans, which the Treasury is consulting on, I think the FCA had indicated that it thought funeral plans



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should come within. Is that something on which you passed on your concerns to the Treasury, and that prompted the consultation?

Andrew Bailey: Yes, because at the moment it depends how you structure a funeral plan. If you structure it one way you are inside the perimeter, and if you structure it another way you are not, so—blow me down—what happens is that most of them are structured in a way that sits outside the perimeter, and there are concerns about the way those things are structured. That is what the Treasury is doing and we are supporting with that.

Q344 **Chair:** On the regulation of commercial lending, which is relevant to a number of inquiries and reports, there is a bit of an unsatisfactory loop going on. The Treasury states to us that, if the FCA sees merit in bringing commercial lending within the perimeter, you should ask for necessary legislative change. The FCA has said to us, and you have said to us, Mr Bailey, on a number of occasions, that while there would be merit in regulating commercial lending, changes to the perimeter are a matter for Parliament. I am going to invite you to put on record your view on whether bringing commercial lending within the perimeter would be desirable.

Andrew Bailey: At the moment, we have two other things going on; well, one is done. One is the Senior Managers Regime, which is a whole-firm regime, not a perimeter regime. That on its own does not do it. We have had a consultation out, which is now completed, and we will move on to making that into policy, which is essentially about using where we think there are robust industry standards and codes, but hooking them up to the Senior Managers Regime. We were great supporters of the Senior Managers Regime, but where it is operating outside the perimeters you have to ask the question: what are you judging? What is the standard here?

One way to do this in the wholesale markets, but also in areas such as commercial lending, is to say, “We will take a standard issued by the Lending Standards Board”, for instance. We may want to see some changes to those standards, then hook those up to the Senior Managers Regime and ask, “Does that give us the set of standards that we can then enforce against, if we need to?” That would be a way to get to the same place.

In the wholesale markets, in areas like FX, for instance, that is very sensible and I would envisage that the global FX code, which the central banks have put together, will probably be the first one that we adopt in that regime. The second area is this one, and the question for us—and I hope the answer to this is yes—is whether we can take those standards and turn them into things that we can hook up.

Q345 **Chair:** The answer is, no to an extended perimeter, but maybe another way of getting to the same place.



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Andrew Bailey: Yes, but if the other way does not work we really are back to extended perimeter, at that point.

Q346 **Chair:** Would you agree that, where there are things that people think are within the regulatory perimeter but are not, and something goes wrong, that can be reputationally damaging to the FCA, for example? Mr Randell is nodding his head. Mr Randell, do you want to answer the question?

Andrew Bailey: Off you go.

Charles Randell: Funeral plans are the classic example where we see effectively the same product being arbitrated out of the regulatory perimeter and huge confusion, no doubt, on the part of consumers. If something goes wrong with their unregulated funeral plan, why is it that we are not involved? It does not work for us either. That would be the best possible example.

Andrew Bailey: In many ways, that is straightforward regulatory arbitrage. The other areas are unregulated, whereas this is really arbitrage.

Q347 **Chair:** The Financial Policy Committee has the power to request a change in the regulatory perimeter, if it thinks necessary. Do you think the FCA should have a formal power to request?

Andrew Bailey: I am fairly attracted to this. When you asked us to write the letter that we wrote about six months ago, it was rather useful from our point of view. I hope you found it as useful as I did. I am quite attracted to the idea that we do something in the way of a review of the perimeter. One of the things that can get a bit depressing is that there is a correlation between some of the most difficult issues we face and the perimeter: funeral plans, crypto assets and GRG. These all have one thing in common, which is unsurprising, in a way.

Q348 **Chair:** The reason they are controversial is because they are on the edge of the regulation. Moving on to the Financial Ombudsman Service, you have a consultation on expanding SME access to the ombudsman service. The proposal is that changes take effect from December this year, but some stakeholders have told the Committee that that timescale is too ambitious. Do you think that December is still a reasonable target?

Andrew Bailey: I might get Charles to come in, because he has a strong view of this as well. We want to be ambitious here. We have had this discussion quite a few times in the Committee. Secondly, I know I have said this before, but I will say it again: this will require a change in the way the ombudsman does this sort of complex case. They are not currently in a position to do these sorts of cases. It requires, in my view, mediation. It is not PPI, in the sense of ex-post handling of bulk cases; there is rather more mediation. Caroline Wayman, whom I have had this conversation with several times, agrees with this. This needs to be done. That is a challenge, to the point you make.



Charles Randell: I would absolutely agree. It is right to regard this as a new activity that the ombudsman would be carrying out. They would need a different set of processes. They would possibly need some different people to carry it out. That probably would require a different element to the oversight that both their own board and we perform in relation to the ombudsman service.

Nevertheless, it is clear that this is a big gap and there is a real case of justice denied for a lot of small business complaints. You will be familiar with the old saying that the High Court of Justice is open to everyone, like the Ritz Hotel. That is what we face when it comes to High Court litigation, so we really urgently need a better way of handling some of these disputes, in my view. Clearly, we are out to consultation on that and we will look at the responses, but I am keen that we get on with it.

Q349 **Chair:** December sounds quite ambitious.

Charles Randell: It is ambitious. It has to be quality assured, and that is really important.

Q350 **Chair:** Moving on to the changes announced last week on the premium listing rules, there has been quite a lot of pushback. There is an appearance that potentially the changes weaken the rules to achieve greater business for the City. Are you surprised at the level of disquiet that has been expressed about the new changes?

Andrew Bailey: No. We had fairly balanced feedback, but it was quite clear that there was some very well-staked-out ground on this when we put the original proposals out. For me, the heart of this is that we have two levels of listing rules in this country: what is called standard, and what is called premium. Standard is the EU minimum. Premium is what, in another world, we call gold plating, but everybody likes this a bit of gold plating, it turns out. We think standard is quite a weak regime. We do not want companies defaulting into standard. We want them in premium, because premium is a higher overall standard.

At the moment, there is not an adequate route for partial privatisation of a company for it to be in the premium listing. It is not easy. We have had one or two cases in recent years. They are not the one that everybody talks about—because that has not come to pass, as it were—where it proved, as my colleague said, a little before my time, extremely difficult to make it work. In our view, there were two things. Is there a minimum number of changes that you could make that would accommodate that issue? Secondly, as part of that, are they reasonable changes? Thirdly, if you put it into a separate section of the premium listing—there are several sections already; it is not homogenous—does that sufficiently differentiate it such that people say, “I know I am in this other piece of the landscape”?

When we put the original proposal out, we proposed four changes to the premium regime. We have narrowed those down to two. The two changes



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we did not go for were independent shareholders voting on independent directors and, secondly, the approval of related-party transactions, as opposed to disclosure, which we did go for. We think that is sensible. We do not think it undermines the premium category. I have to say I was unsurprised by the reactions. If anything—I may be guilty of wishful thinking here—I thought the initial reaction was a bit kneejerk and some of the stuff that came afterwards was a bit more considered. The initial reaction of the Institute of Directors missed the fact that it was asking for something that no company in a premium listing has. That is a little wide of the mark, but we think it is a sensible thing to do. We were expecting a reaction. We do not know who is going to use it, by the way, if anybody.

Q351 **Chair:** We shall wait and see.

Finally, I wonder what the response has been to your “dear CEO” letter about companies providing clarity on cancellation of irredeemable preference shares, and how many companies have provided clarification.

Andrew Bailey: That is part of the work on pref shares. What we were seeking to do there was to create greater transparency. I think we wrote to 16 issuers of pref shares, which I think is the universe, and essentially wanted them to make clear and to publish their articles of association and the prospectuses. These are all old; they are not new issues in that sense. If I am right in saying this, around 14 or 15 of them have done it, and we are pursuing one or two to get it done.

That is good, but there are some other quite big issues that we are seeing with pref shares, some of which are in our world, and some of which will be, if they are taken forward, in the Government’s world. The underlying thing that concerns us is that there was quite reasonable confusion among investors. If you use the word irredeemable and then say, “Ah, but I have found a way to cancel my capital”, it is not surprising that investors say, “What? You are doing what?” We saw the reaction, and it was unfortunate.

Q352 **Chair:** Do you think there is a need to potentially change the rules on regulatory capital, which I think was the reason why Aviva made the decision it did, or do you think an amendment to the Companies Act is needed to fully resolve this?

Andrew Bailey: They are two slightly different issues. There is a question about the Companies Act, and that is obviously one for the Government. The other issue really arises out of Solvency II, because these things are not capital under Solvency II, except that there is a very long transition. If my memory is right, 2026 is when they cease to be capital. There is no question that there is an issue that needs sorting out. It is not the most pressing issue, frankly, from a Solvency II point of view. Although it is really for the PRA and not for the FCA, that is an issue that needs to be addressed for the industry, rather than tackling it piece by piece among firms.



Q353 Catherine McKinnell: Good afternoon. The FCA launched its High-Cost Credit Review back in November 2016, if you cast your mind back. I wanted to ask a few questions about that. The consultation findings will not be published or concluded until August this year, so when do you anticipate the measures coming out of that consultation will be introduced?

Andrew Bailey: We have two stages to this. This is very closely guided by lawyers, particularly from a public law point of view, and I will try to explain why. We have a first set of measures that we are consulting on immediately, which we will put into effect. The consultation will finish at the end of August and we will move on to rules quickly. Those are issues around alerts, notifications, information, rent to own, not selling extended warranties alongside the product when the customer does not really know what they are getting. We will move quickly on all of those things.

Then the second sets of issues are really twofold. One is around fees and charges for overdrafts, and the other is around the cost of rent to own. Those are economically big interventions. We have to go through the process of getting the evidence and doing a cost-benefit analysis. I would emphasise that, because if you take the case of overdrafts, 10 years ago, the OFT lost this case in the Supreme Court. It was a bigger issue than that at the time, but I do not want to go there again, because frankly we see the harm here. I hope the paper we issued set out the harm. I have to be very careful to be clear that we have not therefore pre-packed the solution, because we have to do this work; otherwise, we are vulnerable to legal challenge.

Q354 Catherine McKinnell: I am sorry. When you say "harm", do you mean harm to consumers or harm to the banks?

Andrew Bailey: Harm to consumers, definitely. This needs addressing. I will say two things. First of all, you have my absolute guarantee that we will not let this harm just go along. We have to be open-minded about the solutions at the moment, for legal reasons. We are genuinely open-minded. We have put proposals on the table. People may come forward with other proposals; that is fine, but this needs dealing with. We are doing that work.

You will get a second piece of this in July, which is the first product of the work that we are doing on retail banking business models, which comes out of the CMA's work. We took that over. We had quite a lot of conversations with the Committee before the election on this. That will be an important piece of evidential base about how overdraft earnings fit into the overall business model of retail banks. That will be the next piece of the picture and that will be in July. That will give us a big piece of the picture to put together the measures that we have said we will put together. We will do this during the rest of this year. We have a lot of work on those two issues, and we have to grind through that quickly to get it done. You have my promise: we will tackle these harms. It is not acceptable that they are still out there.



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The other piece of the work that we cannot deal with on our own, which is not a perimeter issue—it is way beyond our perimeter, but we are trying to do all we can—is to encourage open thinking about what alternative sources of credit are. One of the things that I always say is that this section of the population needs some access to credit. It is not a good solution if it is cut off from credit.

Q355 Catherine McKinnell: I am going to unpick some of that. You were talking about harm to consumers, which is obviously the priority, but overdraft fees are an important revenue-raiser for banks. Any changes that are imposed are potentially going to create some shift in the system. The fees that are charged subsidise the cost of credit at the moment. If banks are no longer able to generate those fees from overdraft fees, how do you envisage those business models shifting?

Andrew Bailey: The paper we will put out in July, I hope, will give you a much better view of where those charges fit into the overall income position of banks, and the distribution of those charges. This is a very important issue about the distribution. We already said something about this in the paper, but there are two things. There is a very skewed distribution of charges on overdrafts. Secondly, and this is the point about unarranged overdrafts, there is no relationship between the use of overdrafts and the amount you pay for them in the unarranged world, because of the fixed fee system. We have charts for one institution where we were plotting the use against cost, and it is just random. You look at it and you think, "This is just random".

There are two ways into this: one is the overall level of charge, and the other is the distribution of charging and what is fair. There is a very big and difficult judgment behind this, and this goes to the overall work on business models, because we are not going to get to a world where there are no cross-subsidies between products in banks. That would be a very difficult world to get to, but there is an important judgment about what are acceptable cross-subsidies. That really is a very important judgment. The paper we will put out next month will help to illustrate this in ways that I do not think I have seen before, but you are posing a big challenge. There is no doubt about that.

Q356 Catherine McKinnell: I presume they are not just random charges. I presume, at the moment, they are designed to maximise return.

Andrew Bailey: There are two different contexts for using the word. They are random in the sense of the relationship to usage.

Q357 Catherine McKinnell: Do you mean in the sense of being unpredictable for the consumer?

Andrew Bailey: Yes, they may not be random in terms of the overall effect. My point was that about relating them to usage, for unarranged. It is not the same for arranged; that is different.

Q358 Catherine McKinnell: You also referred to rent to own. Is that



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something that you will be looking to implement immediately, or is that something that is more complicated and is in the July report?

Andrew Bailey: We have some things immediately, and then what sometimes gets called the price cap issue. Is that the solution to the harm? That is the bit that comes second.

Q359 **Catherine McKinnell:** Yes, I want to ask you about that because, in September 2017, you were quoted in Reuters as saying that an interest rate cap in some parts of the credit market would not work, and the obvious case for that is rent to own. Yet it has now been seen to be beneficial by the FCA and you are working on detailed proposals out to consultation.

Andrew Bailey: I have said it in the context of credit cards, and the reason for that is that a credit card is a revolving credit. To borrow a phrase, it is a bit like nailing jelly to a wall, trying to price cap the revolving credit. If I said it in the context of rent to own, I apologise. I do not think that was necessarily intended. I will check that. Certainly in the area of revolving credit, which is credit cards and some of the car products where the credit revolves, we do not think that is the right approach to take.

Q360 **Catherine McKinnell:** Do you think there has been some delay in the decision-making process of bringing in a rent to own cap? Has that all run the course, as in all these measures have been consulted on? We seem to have come to it late in the day and it seems to have had quite a detrimental impact on consumers. What I am getting at is whether it should have been identified earlier as something where change could be very beneficial.

Andrew Bailey: That is an interesting question. We have taken quite a lot of steps already with rent to own. The market has shrunk. We have had supervisory action with redress payments to people. We have introduced quite a few rules on price disclosure because it was, in our view, a bad situation on price disclosure. There is an interesting question that we debate quite a bit: is the price cap, which is quite a heavy tool to use, something you use as a last resort when you do not think the other tools that are more directed are going to work; or do you bring it in early? It is interesting. If you go back a couple of years and look at the philosophy—I was on the board of the FCA when the payday cap was brought in—it was very much viewed as a last resort. If you cannot design a package of more targeted measures, that is what you do.

Interestingly, what is regarded as the success of the payday cap has probably changed the debate around the price cap. Whether that is the right thing to do is a difficult question. Is it still right to think of it as the tool you use when others do not work, or do you say, “Look, it has worked for one thing; why do you not use it for another thing”? That is a hard question.

Q361 **Catherine McKinnell:** One of the questions I had in my mind is the



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timing around what would appear to be a change of heart on this issue in terms of rent to own. You seem to suggest there has not necessarily been, but the proposals for consultation did not come out until May 2018. They did not come out at the same time as the others, so it is just the thinking behind that. Is it to do with the success of payday lending?

Andrew Bailey: Yes, it is because we still do—and I do not discourage this—go through this thought process: can we use other tools that will get there in a more directive and, frankly, slightly more subtle fashion?

Q362 **Catherine McKinnell:** The review now seems to be indicating that the FCA will look to cap on rent to own.

Andrew Bailey: I have to be a bit careful.

Q363 **Catherine McKinnell:** The timeframe has been proposed as April 2019. Is that correct?

Andrew Bailey: For rules, because we have to consult.

Catherine McKinnell: Yes.

Andrew Bailey: We have identified the harm. We have to be open-minded about the solutions at this point, but proverbially the cap is on the table. We will do the work. We will consult. We have made a commitment to start that consultation before the end of the year and to make rules by April.

Q364 **Catherine McKinnell:** Do you think that is a realistic timeframe?

Andrew Bailey: My staff will tell you it is a hard-driving timetable, but I am afraid I am back to your point: we have to tackle this harm.

Q365 **Catherine McKinnell:** What do you foresee as the potential hurdles? Presumably, there will be pressure from within the industry. Is that a pressure that you are confident you can withstand?

Andrew Bailey: Yes, the hurdle is having the evidential base to do this, which we are working very hard on.

Q366 **Catherine McKinnell:** The citizens advice bureaux have also raised particular concerns about home-collected and catalogue credit sectors as well, as a big area of concern. But these seem to be being treated differently. Could you explain why?

Andrew Bailey: The way we have thought about this is to essentially design measures that fit what we observe to be the problem we are dealing with. With home-collected credit, the thing we have proposed and are consulting on is particularly the process around renewal and extension. We observe harm in that world. It is not from the rates that are being charged so much as from the process of automatic renewal and, frankly, hard selling in people's homes, in these transactions. That is why we targeted that element. The citizens advice bureaux are with us in saying, "Yes, that is important", but they would take the further step, I



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think. We have to justify that and we are not convinced that at the moment we could.

Q367 **Catherine McKinnell:** You will be aware, though, that Citizens Advice has asked you to reconsider your decision and that customers are being severely impacted. What is your response to that?

Andrew Bailey: Our response is this. On the basis of the evidence and the assessment we have done so far, we think the measures we have proposed are designed to tackle the harm we have identified, so we will go ahead and consult on those. In that consultation, we would expect Citizens Advice and others to put their views forward.

Q368 **Catherine McKinnell:** You have highlighted that it is an issue that you will revisit when you assess the effectiveness of the changes to home-collected credit.

Andrew Bailey: We will always review the measures that we have put in place, yes.

Q369 **Catherine McKinnell:** How long a period will pass before these issues will be reconsidered?

Andrew Bailey: We would need to get a base of evidence with the new arrangements in place, so I would not do that in under a year.

Q370 **Catherine McKinnell:** There is already concern about the impact, so I would hope it would not be any longer than that.

Andrew Bailey: Yes, we need to be a bit open-minded about that.

Q371 **Catherine McKinnell:** One of the other concerns that have been expressed is that the proposed remedies for doorstep lending in particular seem to rely very heavily on changing the behaviour of lenders, but this does not go far enough to protect 1.6 million consumers, many of whom we know are very financially vulnerable. Are you confident that this is going to work or is there still more work to do on this area?

Andrew Bailey: That will be driven by the evidence. We think that the measures we have proposed on home-collected credit tackle the harms that we have seen. We will gather the evidence in the consultation and, once we have made the measures, we will observe it.

There is one thing I would observe about this, and it is quite interesting. I do quite a lot of visits around the country, particularly to debt management charities. I have sat in at call centres, and I have also talked to people who have had high-cost credit. Interestingly, people do view home-collected credit differently to rent to own and payday. This may be in the model, as it were. I often think it is because the difference with home-collected credit is that the borrower knows the lender; the agent of the lender, that is. It is a different, almost social relationship that goes on and that creates different attitudes, but attitudes towards



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home-collected credit among borrowers are different. There is no question about that.

Q372 Catherine McKinnell: What is the significance of that, in terms of regulating it and ensuring that these vulnerable consumers are not exploited?

Andrew Bailey: It is part of the evidence base we have put into designing the solutions. That is what it leads to.

Q373 Catherine McKinnell: I have one final question about alternative credit options. You mentioned yourself that we need to find more ways of improving credit options. Credit unions are one example. Is this something that there should be wider availability of? What do you think needs to happen? The Government have invested £38 million in their expansion, but is this sufficient? Is there more that Government need to do? Is there more the FCA can do?

Andrew Bailey: We have come up with a few things we can do, in terms of guidance. Outside Northern Ireland, this country has a relatively underdeveloped credit union sector, compared to quite a lot of other countries. Ireland is different, on both sides of the border. Why is that? It is probably historical, to a considerable degree. There is legislation governing credit unions. It is also important that they are not, on their own, the only solution, because the purpose of a credit union is around a common bond of members, rather than specifically social lending. But a larger and more effective credit union sector could help a lot. There are also community finance institutions. You can pick good examples. You can go to parts of the country and say, "That is a nice example", but they are not very big. They are not very national, in that sense.

I really hope that, out of all this work, we can stimulate a better supply of credit on more affordable terms to these people, because it would be a great mistake and great loss if we cut people off from credit. Why do people go to rent to own? One of the reasons we say is that you get your social housing, but there is nothing in it. Then you have to get a washing machine, a fridge or whatever, and you need credit for that because you need to spread the cost of that. Where is it available from? That is a big question.

Charles Randell: We are also keen to clarify the position, under our rules, of local authorities that choose to supply some of those essential goods and then to effectively "rentalise" the cost of them through the rent on social housing. It seems to me that there are some very good examples of that, but it is not widespread. I am very keen that we make our position absolutely clear on that and encourage those authorities that can do that to do it, because it is an obvious solution.

Chair: Thank you both very much indeed for your time this afternoon. It is very good to see you. Thank you for answering our questions. I have



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no doubt that we will be seeing you again, whether it is before the summer recess or after.