Charles Randell CBE – Written evidence (SCG0035)

I was grateful to the Committee for the invitation to give oral evidence on 23 October 2024 as part of the Committee's inquiry into the secondary competitiveness and growth objectives of the FCA and the PRA. The Committee has asked me to respond to a number of further questions and I am also taking this opportunity to supplement my oral evidence. The views I express to the Committee are personal and do not represent the views of any organisation.

1. Mansion House announcements

On 14 November 2024 the Chancellor delivered her Mansion House speech. The Committee has asked for my views about the reforms announced by the Chancellor and in particular:

- "whether any of the proposals in the upcoming Mansion House reforms materially improve the UK's competitiveness and growth, as well as [helping] financial services [to responsibly] facilitate growth in the wider economy"; and
- "whether there are any changes in risk appetite in Mansion House which you consider to be counter-productive in the medium to long-term."

The announcements made by the Chancellor were quite extensive, so I will only comment on a limited number of aspects.

Financial Services Growth and Competitiveness Strategy

In my oral evidence to the Committee, I said that it would be "a good idea for there to be a much clearer financial services strategy that is set through government and feeds through into specific actions by the regulator, and by others". I therefore welcome the Chancellor's announcement that the first ever Financial Services Growth and Competitiveness Strategy will be published in the Spring. I hope that this Strategy will take the opportunity to look beyond the immediate interests of the financial sector to identify where more can be done to ensure that it serves the needs of the real economy. As I explained to the Committee, while there may be some increase in tax revenues and employment when financial services firms grow, a financial sector that does not serve the real economy will not produce sustainable growth for the UK as a whole.

I also hope that the Strategy will help to convert the general ambitions of the Remit Letter into more specific and actionable Government policy choices. For example, the latest FCA Remit Letter encourages the FCA to consider how to enable more risk-taking by customers whilst at the same

time tackling financial crime, two objectives which may need to be reconciled. Similarly, the latest Remit Letter encourages the FCA to ensure that UK financial services firms are supported to play a significant role in the Net Zero transition whilst ensuring that the UK's capital markets are competitive, objectives which may need to be reconciled, particularly if the United States rolls back its sustainability disclosure requirements for issuers and asset managers.

It will be important that the regulators are involved in the setting of the Strategy whilst maintaining the appropriate degree of independence in pursuit of their primary objectives.

Financial advice and guidance

In my oral evidence, I told the Committee that as Chair of the FCA I set the organisation the task of closing the "advice gap". I therefore welcome the Chancellor's announcement that the FCA will shortly consult on transformational changes to financial advice and guidance to ensure that people get the right support. I hope that this consultation will go further than the previous consultations, which have focussed on the market for investment advice. Commercial advice markets will never serve customers who do not have enough money to make it worth their while. There is an opportunity to support a range of non-commercial organisations, including healthcare organisations, social housing associations, local authorities and debt charities to be more confident in guiding consumers to make better financial decisions.

In the commercial advice market, it will be important to ensure that consumers with smaller amounts of savings are guided to invest in low-cost, well-diversified investments rather than being exposed to high-cost, concentrated risks.

Financial inclusion

Access to financial advice and guidance is one aspect of the much broader issue of financial inclusion. I was pleased to see that the FCA Remit Letter issued by the Chancellor refers to "reinforcing financial inclusion … to enable individuals to access the financial services and products they need to fully participate in the economy". Greater financial inclusion can drive economic growth through at least five pathways:

- **More people able to work:** There are currently over 2.75 million adults in the UK who are economically inactive due to long-term physical and mental health issues. The IPPR has estimated that if employees in the UK were as healthy in 2023 as they were in 2018, the UK economy would achieve gains worth £30 billion; it suggests that improving the health of the UK economy and of people in the

UK requires a “virtuous circle” which is defined, among other things, by “whether people … are free from debt and financial insecurity”. Studies have found that people with problem debt are more likely to suffer physical and mental health problems as a result and far less likely to seek work, start a business, study or retrain or change jobs. Reducing people’s risk of falling into problem debt or financial insecurity by addressing the “poverty premium” experienced by people on lower incomes, promoting precautionary savings and supporting better access to affordable debt, essential insurance products and help (including debt advice) would reduce the incidence of money-related health problems and thereby increase labour participation rates.

- **More productive workers:** For those in work, financial stress has a significant negative effect on their productivity. Studies have shown that financial distress causes both absences from work and lower performance in the workplace as it imposes a “bandwidth tax” on those affected. The same interventions as described in above - precautionary savings, better access to affordable debt, essential insurance products and help (including debt advice) - would reduce the money worries of workers and enable them to be more productive. The workplace also provides an environment for the efficient delivery of some of the support that people need, including workplace-based savings schemes and information and advice to build financial capability.

- **Stronger small businesses:** SMEs form an important part of the UK’s economy but often lack the confidence to take on borrowings to invest. Community Development Finance Institutions are locally rooted social enterprises which can help SMEs get the finance that they cannot obtain from banks. A 2010 independent report for the government found that on average a £1 investment in a CDFI would return £3.57 of gross value added, providing strong evidence that supporting CDFIs as part of a broader strategy to increase the amount of affordable lending available in communities would bring economic gains.

- **More resilient consumers, able to spend in their local communities:** Consumer demand is a key driver of economic growth. Research demonstrates that an unequal society in which people struggle to get by results in lower aggregate demand. Giving people access to the financial services they need to build resilience and reduce financial distress will result in stronger households, better able to spend money on the things they need – and often spending that money in their local community, boosting regional growth.

- **Reduced health and social expenditure, increasing the headroom available for public investment:** Financial distress is a double drain on the economy: in addition to the impact on people's participation in the workforce and their productivity when they are in work, financial distress increases the pressure on our health, social care and social security systems, increasing the levels of current government expenditure and reducing the headroom available for public investment. With a financially healthier population, the UK would have more scope for public investment to support economic growth.

Pensions consolidation

I believe that the proposed consolidation of pension funds announced by the Chancellor pursuant to the first stage of the Pensions Investment Review will start a process of mitigating the economic damage that has been caused by pension policy over decades. I note that the Chancellor has not, at this stage, proposed that pension funds be compelled to make investments in the UK in circumstances where the trustees would not consider it in the interests of their members to do so. Instead, the supply side approach set out by the Chancellor has the potential to increase the supply of projects where investment can benefit pension scheme members.

Risk

The Chancellor made a number of comments about risk appetite in financial services.

Prudential regulation

Given the leverage inherent in a fractional reserve banking system, it is important that prudential regulators continue to be vigilant to protect the economy from the kind of disruption experienced in 2008. The UK's four largest banks have an average debt to equity ratio of more than 17 to 1. In March 2023, high standards of prudential regulation in the UK were an important factor in ensuring that UK banks were not affected by interest rate risk in the banking book to the same extent as some US banks. There are also, as the Committee will be aware, continuing concerns about the exposure of the banking sector to sectoral and geopolitical risks, including sub-prime commercial real estate, which the PRA addresses through stress testing, asset quality reviews and continuous supervision.

Conduct regulation

The UK is already far more accommodating of retail investment risk than many other developed jurisdictions. The following table sets out the thresholds in different jurisdictions for accessing unlisted securities and other high-risk products:

Jurisdiction thresholds (including £ equivalent)		
Jurisdiction	***Annual income***	***Investable assets***
UK	£100,000	£250,000
USA	US$200,000 (£158,000)	US$1,000,000 (£790,000)
Singapore	S$300,000 (£176,000)	S$2,000,000 (£1,179,000)*
Australia	AU$250,000 (£128,000)	AU$2,500,000 (£1,283,000)* ++

Notes:
* Includes value of primary residence (limited to S$1m in Singapore)
++ Under review with a view to significant increase

UK consumers already trade or hold many high-risk financial products, including retail minibonds, unlisted equities, "meme stocks", leveraged contracts for difference and speculative crypto and, as I explained to the Committee, there are continuing Government incentives to hold some of these high-risk products through the Innovative Finance ISA.

As far as I am aware, there has been no assessment of the costs and benefits to consumers and the wider economy of the promotion of these risky investments to retail consumers, although the UK remains in the grip of a "scamdemic". The previous Government accepted that the £250,000 investable asset threshold referred to above was too low (it has remained unchanged for 23 years despite its real value being nearly halved by inflation over that period), but then reversed course following the intervention of certain special interest groups. The FCA continues to consider that the threshold should be substantially increased, as it states on its website at https://www.fca.org.uk/publications/annual-reports/perimeter-report#lf-chapter-id-consumer-investments-exemptions-in-the-financial-promotion-order-

In the Remit Letter, the Chancellor has set out her ambition that consumers engage in more sensible and responsible risk-taking. Many consumers would benefit from higher investment of long-term savings into low-cost, well-diversified equity funds. However, if other areas of increased risk-taking by consumers are contemplated, it will be important that the Treasury explains precisely where it considers that consumers should be exposed to more risk, basing its position on evidence of the costs and benefits.

SMCR and remuneration rules

I welcome the Chancellor's announcement that there will be a consultation on removing the current Certification Regime. This was implemented as a result of the Parliamentary Commission on Banking Standards rather than as a regulators' initiative. It can be burdensome. Nevertheless, it will be important to continue to address the way that "bad apples" can often roll from one financial services firm to another.

I also welcome the proposed consultation on reducing the length of pay deferrals. Shorter deferral periods may have a stronger incentive effect.

Financial Ombudsman Service review

I told the Committee that the Financial Ombudsman Service was often the binding constraint on firms' risk appetite, rather than FCA rules. I highlighted the fact that the jurisdiction of the Ombudsman goes beyond the law and FCA rules and includes an ability to decide cases on the basis of what it considers to be fair and reasonable, resulting in uncertainty for firms. I therefore welcome the Chancellor's announcement of the joint Call for Input by the FCA and the Ombudsman to significantly improve the operation of the service. One question which might be addressed is whether it is desirable to continue the "fair and reasonable" aspect of the Ombudsman's jurisdiction, now that we have the far reaching FCA Consumer Duty, although change would require primary legislation.

2. Market structure and underserved areas of the market

The Committee has asked me to elaborate further on my answer to Lord Eatwell's question about the impact of regulation on market structure, and underserved areas of the market.

SME lending

Small business lending is already given prudential support through the SME supporting factor. Although the PRA is withdrawing this, it is counteracting the effect of the withdrawal by an offsetting adjustment to Pillar 2A. I do not think that it would be prudent to weaken the prudential regulation of SME lending beyond this.

Additional measures to strengthen lending to SMEs would need to address other drivers of the problem: these include low demand from SMEs which in turn reflects low confidence in the post-Brexit business environment as well as, in some cases, a distrust of banks; the withdrawal of large banking groups from the high street and the weakening of ties with local communities; and the limitations of government support schemes. There

may be an opportunity to drive partnerships between large banks and community development finance institutions to support more SME lending and to extend government support schemes.

Advice and guidance

As set out above, a change to the regulation of advice and guidance is needed in order to close the advice gap. If UK consumers invest more, some of that investment will reach the real economy and they will also be less reliant on the State in retirement.

Simplified advice or guidance should, however, be designed to ensure that consumers are not exposed to risks they cannot manage. For that reason, I would focus on simple, low-cost products and services that are inherently likely to be beneficial to the majority of consumers.

Insurance

Regulation, and possibly legislation, may be needed in the coming years to address financial exclusion that results from the increasing personalisation of pricing and coverage in insurance. For example, people living in certain postcodes now face prohibitive motor and home insurance premiums, as larger pools of data enable insurers to underwrite more selectively. A lack of motor insurance makes people less able to access employment opportunities; a lack of other forms of insurance exposes people to economic shocks which may result in them withdrawing from work or falling back on the State. Affordable protection is, therefore, an important issue for economic growth.

Intermediation

Financial regulation was originally based on the concept of well-informed consumers engaging in a free market to maximise their welfare. However, it is now clear that many consumers are not well informed and may be time poor or impaired by stress or biases. As a result, it is often difficult or impossible for consumers to get the best deal. Where intermediaries are involved, it is not always clear whose interests they are pursuing and intermediation costs can be high and opaque.

I hope that in due course we will see the emergence of business models which seek to guarantee the consumer the best available deal when their products expire or reach renewal, using data available through Open Finance, with shorter chains of intermediation and lower commissions. The more money that is left in consumers' pockets, the higher the aggregate demand supporting the real economy.

3. FCA operational metrics

The Committee asked questions about the performance of the FCA's Authorisations function. The latest metrics published by the FCA, covering the quarter ended September 2024, show that 99.6% of senior manager approvals were completed within the statutory deadline and that the median time to a determination was 39 days. The data also show the slowest and fastest quartiles of performance; the median time to determination in the fastest quartile was 28 days and in the slowest quartile was 56 days.

While the FCA will, no doubt, be looking at ways of improving its operational performance further, these are good results.

4. FCA remuneration and staff retention

I should like to supplement the comments I made during the oral evidence session when I was asked about FCA remuneration and staff retention.

I would say at the outset that the FCA has many highly skilled and dedicated staff members. The FCA is able to recruit competitively for many roles on the basis of its public service purpose and ethos and the challenging and interesting work it undertakes.

Remuneration

I explained to the Committee why I do not support the payment of bonuses to FCA staff: it is difficult to relate bonuses to long-term regulatory and supervisory outcomes; and bonuses in public service organisations often lead to distracting media and political criticism. FCA pay is already very competitive with other comparable public service organisations. I supported the work of Nikhil Rathi and his executive team to intensify the performance management process at the FCA and to reward high performance with career, and therefore pay, progression. I believe that this is a better approach to regulators' pay.

Staff retention

During the oral evidence session, I was asked a question about staff turnover at the FCA. In common with many other organisations, the FCA experienced unusually low staff turnover rates during the Covid-19 pandemic and then higher rates once the pandemic ended. The latest published staff turnover figures, set out in the FCA's Annual Report for the year ended 31 March 2024, show a voluntary staff turnover rate of 7.2%. This is a low rate of turnover, so the Committee's reference to high turnover is out of date.

5. Comparing "Compliance Costs"

In response to a question from the Chair during the oral evidence session about compliance costs, I explained that it was not easy to compare costs in the UK system with those in the United States, but that it was important to compare like with like. The United States is characterised by multiple systems of supervision at both State and Federal level, relatively high levels of enforcement penalties and significant Federal, State and private litigation. The UK is characterised by fewer enforcement cases, lower enforcement penalties and less litigation.

The Committee can see for itself the level of penalties and damages in the US incurred by a range of US financial institutions since the year 2000, using the Violation Tracker website at www.violationtracker.goodjobsfirst.org. This shows that the penalties and damages paid out in respect of financial services and related antitrust issues over that period by the two largest US commercial banks, the two largest US investment banks and the two largest US insurance groups total a staggering US$ 182 billion.

Thus, while it may or may not be the case that "compliance costs" (in a narrow sense of the cost of compliance personnel and processes) are higher in the UK, it seems probable that compliance costs in a broader sense (which includes the costs of failing to comply or defending allegations of non-compliance) are higher in the US.

It should, however, be noted that in the UK system, a potentially significant "compliance cost" is the contribution that a firm makes to the Financial Services Compensation Scheme. When I was FCA chair it was clear that market participants wanted more stringent and active supervision in order to detect and deal with bad actors and reduce the burden of FSCS levies, which had reached a high of £1.14 billion in 2014/15. This was one of the reasons for our decision to tighten the Authorisations gateway and intensify the strategy of proactive supervisory intervention, and I am pleased to see that the levy is now at a 10-year low. Cutting regulation and compliance costs (narrowly defined) might result in an increase in firm failures and an increase in the FSCS levy, so care needs to be taken in selecting the regulation and compliance costs to be reduced.

6. Concluding remarks

The Committee was particularly focussed on the costs to industry of regulatory compliance (in the narrow sense), the efficiency and responsiveness of the regulators and the need to expose users of financial services to more risk. Those are certainly issues that are relevant to the

secondary objective and I agree that compliance costs should, wherever possible, be reduced to the level which is necessary to deliver the regulators' primary objectives; but there is a danger that more fundamental questions about the objective will be eclipsed.

When I suggested during my hearing that the Committee should consider where regulators can affect the provision of financial services to parts of the real economy that are currently underserved, I was told that "it's not the work of this Committee". That is surprising: economic growth requires a financial services sector which serves the real economy, helping households and businesses to transact, save, borrow and insure themselves against risks. In that context, the Committee may find it helpful to discuss with the regulators where they see gaps in the provision of services to the real economy and to what extent the regulators can help to close them. It might also be instructive to take evidence from those who can speak for consumers.

There is also a danger that a focus which is limited to compliance costs and regulatory efficiency misses the important relationship between the primary and secondary objectives. Economic growth requires a financial sector which does not transmit shocks to the real economy, as occurred in 2008, and a sector which does not expose households and businesses to risks they cannot manage, as has occurred with numerous investment scams and extractive business models.

The greatest contribution that the financial regulators can make to the growth of the UK economy is to deliver their primary objectives: in the case of the PRA, the safety and soundness of authorised firms; and in the case of the FCA, market integrity, consumer protection and competition in their interests.

20 November 2024