Sir Nicholas Lyons – Written evidence (SCG0067)

1. What reforms or trade-offs between the regulators' primary and secondary objectives would materially improve the UK's international competitiveness, or increase investment into primary markets and productive assets?

The Financial Services and Markets Act 2023 has been in force for over a year. Both the FCA and PRA have published reports outlining how they have complied with their new duty. The legislation obliges the FCA and PRA to report after 12 and 24 months. We have heard reassuring promises from the CEOs of the PRA and the FCA but the cultural change required to embed these new objectives deep within their organisations will take some time, so Parliament and HM Treasury should decide how it wants to continue to monitor how the regulators are facilitating their objectives on a yearly basis. It might be argued that the PRC which oversees the activities of the PRA is too closely aligned with the primary objective and is marking its own homework. A second, independent body, might be set up to hold the PRA to account in its secondary objective.

It is widely viewed that the supervision of large regulated financial institutions has become too intrusive, too time-consuming for management teams and is distracting Boards from focusing on creating value and growth at the expense of ever more overbearing compliance. The increasing use of S166 skilled person reviews in recent years is a case in point. Regulated firms have to absorb the cost of these with often limited input into the scope of the reviews. In order to bring more discipline to bear on the use of S166s, there is a strong case that the PRA and FCA should be required to bear 50% of the cost. Whilst it is understood that this would end up ultimately being borne by the regulated entities in the form of increased annual fees, there would be more integrity about how skilled persons are chosen and more discipline about the scope of the reviews. They are undoubtedly a useful tool for both regulators and Boards but they have become ubiquitous and too broad in scope, with some remarking that these are used as fishing expeditions.

Phoenix Group put forward a range of outcomes-based metrics during the consultation phase of how success could be measured in financial services, such as monitoring the allocation of pension and insurance capital to UK assets, and the number of new products brought to market. By adopting more outcomes-based metrics, policymakers would be better able to judge whether or not customers and the economy are benefiting

from the full potential of sector activity. Importantly, regulators by themselves are not responsible for all of these outcomes, so any analysis of the metrics must consider the legal and regulatory architecture, as well as market behaviour, and other contributory factors in the ecosystem.

Increasing investment into primary markets and productive assets is an objective of government policy. The new Solvency UK (SUK) regime is an improvement on Solvency II, however, during my time as Lord Mayor, many insurance firms felt the UK was missing an opportunity to fully unlock the potential of the sector and shape the regime more to the specifics of the UK insurance industry. The PRA resisted many attempts to make the regime more flexible. The SUK regime took five years to implement, which some firms believed hampered domestic investment. Moreover, many insurers felt that they should have been well placed to increase productive investment through SUK, given that life insurers can allocate substantially more to illiquid assets because of the nature of their business, where assets are bought and held, sometimes, for many decades. The SUK regime remains a constraint on investing in certain classes of illiquid assets.

Over the last two decades, globally, there has been a substantial shift in allocation of pension and insurance funds from public to private markets. This is a reflection of managers seeking better risk-adjusted returns for pension savers. The UK is seen as an outlier with a much lower allocation to private markets than all other developed pensions markets – 6%[1] in the UK vs 20% average of seven largest pension markets.[2]

A metric which considers 'capital formation' would oblige the regulators to actively consider what more they can do to facilitate investment in productive assets, and provide capital access to both SMEs and those on the listed markets. The Securities and Exchange Commission in the US has three missions, one of which is 'facilitating capital formation'.

The challenge is considerable. The UK has over 28,000 scale-ups, but a £15bn per year funding gap[3] and we have the second highest number of VC-backed companies at £25-100m revenue stage – more than France, Germany, Sweden, Holland combined. Moreover, the recent Capital Markets of Tomorrow report quantified an average of £100bn per year *extra* is required to meet the UK's demand for capital.[4]

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[1] 20240909-ppi-pension-scheme-assets-main-report-final.pdf
[2] The seven largest pension markets are known as the P7 – UK, US, Canada, Australia, Netherlands, Switzerland and Japan
[3] The Future of Growth Capital Report - ScaleUp Institute
[4] Capital-Markets-Of-Tomorrow-report.pdf

2. Has London's attractiveness as a financial services centre changed since your time as Lord Mayor? Which centres do you consider to be London/the UK's main competitors, and what could the UK learn from them?

During my mayoralty the fundamental attraction of London as a global financial centre was largely undiminished in spite of the backdrop of political chaos. The strength of our financial centre is based on three critical institutions: a system of parliamentary democracy that is admired around the world; our independent judiciary that underpins the sanctity of the rule of law; and financial regulators that are regarded by their peers as gold standard.

The City would not want to compromise on those strengths. However, we need to distinguish between gold standard (intelligent, risk aware, quick to respond, forward-looking, consistent) and gold-plated (ensuring that everything we do here goes at least one step further than other markets, making perfect the enemy of the good).

18 months ago I would have observed that Paris was attracting talent and assets (especially from US investment banks), and Singapore was consistently demonstrating that it was more responsive to inbound FS firms, especially in insurance and reinsurance, basing its competitiveness on its proximity to huge Asian markets. But in the wake of political developments on the continent and the Trump victory, the odds have shifted significantly towards New York and the US in general.

The decision by Andreessen Horowitz to close its recently opened London office in-part reflects the policy reversal in the US on AI and crypto markets. When the UK set itself up as a potential leader in the regulation of crypto and AI, there was a lot of interest from US players to relocate to the UK and many of them came to see me in the Mansion House. Britain appears not to have capitalised on that momentum and is now sending mixed messages about its stance on AI. With Trump's Stargate announcement, not only do we face the threat that US and Middle Eastern investment will turn to the US, but we risk a brain-drain of some of our brightest technologists and quantum engineers to America who will follow the money.

Although the US is our biggest competitor, we need to pursue some opportunities which are opening up for the UK. Other European markets may respond to a Trump administration in ways that could create the

chance for the UK to engage in meaningful discussions about how we reestablish London as the scale player in our region and time-zone. The City continues to have a massive market share in the trading of bonds, derivatives, currencies (more dollars are traded in London than New York) and the clearing of Euro securities. Europe needs deeper, more liquid, capital markets so all European companies can raise capital efficiently and provide investment for the growth economy this side of the Atlantic. The UK will need to demonstrate that it is more "risk-taking" than it has been since 2008. As the PRA says, if that is to be the case, we have to be ready to accept that there will be failures and we can't blame the regulators for every firm that goes bust.

Trump's actions to pull support on some international climate change initiatives may reopen the door for the UK to be thought-leaders in green finance. As the new president repeals Biden's IRA, that leaves a space for the UK to step in to what will be a significant market. The UK should push forwards more robustly in developing the carbon credit market, for example, by facilitating collaboration between LSEG and HKSE. We can play a constructive role in working with China and India on their journeys to net-zero. That will have a much more beneficial impact on global warming that fine-tuning the UK's own journey to net-zero as we produce less than 1% of the world's carbon emissions. The City of London convened the UK-India Infrastructure Financing Bridge which is a good model to replicate across markets.

3. The Committee has heard that other centres have a concierge culture, for example Singapore. What are your reflections on what a concierge culture looks like in practice, how the FCA/PRA could adopt this, and are there changes to the regulatory environment that could help the UK to become a more attractive place to invest?

In my experience, regulatory fundamentals make a jurisdiction attractive to international firms. I understand that the Bank of England is considering a 'concierge service' following a push to enhance growth by the prime minister.

Ultimately, when foreign firms take advice on legal and regulatory frameworks in potential new jurisdictions, they want regulators to be responsive, act with speed and demonstrate a healthy degree of flexibility in authorisations. For example, senior managers having an abbreviated process if they have already been approved by another UK regulator. We

should not, however, compromise the integrity of our checks for overseas entities to become UK-regulated in the same way. We should apply a common-sense approach. I remain unconvinced that any worthwhile entity will favour being authorised in Singapore over the UK, based on a concierge service alone. But, we need to remove the sense that we are unwelcoming to foreign entities per se and have the ability to fast-track firms that are regulated by respected overseas regulators.

4. In your time as Lord Mayor, you emphasised the importance of addressing low levels of financial literacy in the UK. Can you share your reflections on how financial literacy affect the UK's international competitiveness and growth, as well as how stringent regulation and supervision need to be? Are the regulators, or Government, doing enough to understand the spectrum of needs when it comes to consumer protection, and what more can they do?

My focus on financial literacy and numeracy was driven by the need to ensure that all individuals can be better informed in order to make good financial decisions about their future. The FCA should be commended for their work in this area. Private sector firms support initiatives in many ways. This is admirable and much needed, but it is not addressing the fundamental problem that our education system fails to provide the basic level of skills and knowledge to help children get a fair start early on in life.

In Northern Ireland, Wales and Scotland, six- and seven-year-olds (key stage 1 and key stage 2) get some basic assistance with financial literacy. We know from the growing body of evidence that this is the age you need to target in order to make a difference later in life. But successive governments have failed to tackle this problem, often citing an already busy curriculum and overworked teachers. These should not be barriers to such a critical life skill, which has left the UK with 48% of adults with the numeracy skills of an 11-year-old. We need to deal with this challenge now and at an early stage in order to arrest this decline, and equip future adults with the skills better to manage such a critical resource.

The UK should make much better use of technology to raise our game. One PHSE lesson per month based on numeracy and financial literacy skills would be game-changing for many. Some have argued that that lack of qualifications in the teaching sector make changes difficult to implement, however, online modules and technology can offer smart tools

to overcome these barriers. This would also help financial exclusion in our society. A technology-based government initiative in India has brought 400 million within the financial system that were otherwise excluded. Our secretaries of state for education claim that this is adequately catered for within the mathematics curriculum. It is demonstrably not.

From a competitiveness perspective, the UK has some of the most brilliant mathematicians and scientists in the world. Moreover, we have historically been able to attract the best and brightest to relocate to the UK and work in our financial services industry, with around 19% of the FS workforce coming from outside of the UK. We run the risk of losing many of these brilliant minds to the US unless we accelerate and significantly expand the amount of capital flowing into listed and unlisted productive asset classes. The regulators need to be part of this discussion if we are to make tangible progress. A failure to do so will have catastrophic consequences for the companies and industries upon which our future economic growth depends. Without GDP growth, and in the absence of a reduction in interest rates, our debt servicing costs will consign us to escalating our debt-to-GDP ratio and, eventually, a bond investor strike.

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