PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

First Sitting

Tuesday 17 November 2020

(Morning)

CONTENTS

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not later than

Saturday 21 November 2020

The Committee consisted of the following Members:

Chairs: †Philip Davies, Dr Rupa Huq

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
† Eagle, Ms Angela *(Wallasey)* (Lab)
Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison, Nicholas Taylor, *Committee Clerks*

† attended the Committee

Witnesses

Victoria Saporta, Director of Prudential Policy, Prudential Regulation Authority

Sheldon Mills, Interim Executive Director of Strategy and Competition, Financial Conduct Authority

Edwin Schooling Latter, Head of Markets Policy, Financial Conduct Authority

Simon Hills, Director, Prudential Regulation, UK Finance

Daniel Chichocki, Director, LIBOR transition, UK Finance

Paul Richards, Managing Director, Head of Market Practice and Regulatory Policy, International Capital Markets Association

Public Bill Committee

Tuesday 17 November 2020

[Philip Davies *in the Chair*]

Financial Services Bill

9.25 am

The Chair: Before we begin, I have a few preliminary announcements: please switch electronic devices to silent. Tea and coffee are not allowed during sittings. Can I emphasise the importance of social distancing? Spaces available to Members are clearly marked. As you can see, not all Members can fit around the horseshoe. Will Members sitting at the side of the Room or in the Public Gallery please use the standing microphone if they wish to ask a question?

Today we will first consider the programme motion on the amendment paper. We will then consider a motion to enable the reporting of written evidence for publication, and then a motion to allow us to deliberate in private on our questions before the oral session begins. In view of the time available, I hope we can take these matters without debate. I call the Minister to move the programme motion standing in his name, which was discussed yesterday by the Programming Sub-Committee for this Bill.

Ordered,

That—

(1) the Committee shall (in addition to its first meeting at 9.25 am on Tuesday 17 November) meet—

(a) at 2.00 pm on Tuesday 17 November;

(b) at 11.30 am and 2.00 pm on Thursday 19 November;

(c) at 9.25 am and 2.00 pm on Tuesday 24 November;

(d) at 11.30 am and 2.00 pm on Thursday 26 November;

(e) at 9.25 am and 2.00 pm on Tuesday 1 December;

(f) at 11.30 am and 2.00 pm on Thursday 3 December;

(2) the Committee shall hear oral evidence in accordance with the following table:

Table

Date	Time	Witness
Tuesday 17 November	Until no later than 10.25 am	Prudential Regulation Authority; Financial Conduct Authority
Tuesday 17 November	Until no later than 10.55 am	UK Finance
Tuesday 17 November	Until no later than 11.25 am	International Capital Market Association
Tuesday 17 November	Until no later than 2.45 pm	The Investment Association
Tuesday 17 November	Until no later than 3.30 pm	TheCityUK; City of London Corporation
Tuesday 17 November	Until no later than 4.00 pm	The Association for Financial Markets in Europe
Tuesday 17 November	Until no later than 4.30 pm	The British Private Equity and Venture Capital Association
Tuesday 17 November	Until no later than 5.00 pm	StepChange Debt Charity
Thursday 19 November	Until no later than 12.15 pm	Spotlight on Corruption
Thursday 19 November	Until no later than 2.45 pm	The Association of British Insurers
Thursday 19 November	Until no later than 3.30 pm	Transparency International
Thursday 19 November	Until no later than 4.15 pm	The Finance Innovation Lab; Positive Money
Thursday 19 November	Until no later than 5.00 pm	Hon Albert Isola MP, Minister for Digital, Financial Services and Public Utilities, Her Majesty's Government of Gibraltar

(3) proceedings on consideration of the Bill in Committee shall be taken in the following order: Clause 1; Schedule 1; Clause 2; Schedule 2; Clauses 3 to 5; Schedule 3; Clauses 6 and 7; Schedule 4; Clauses 8 to 21; Schedule 5; Clause 22; Schedules 6 to 8; Clauses 23 and 24; Schedule 9; Clauses 25 to 27; Schedule 10; Clause 28; Schedule 11; Clauses 29 to 44; new Clauses; new Schedules; remaining proceedings on the Bill;

(4) the proceedings shall (so far as not previously concluded) be brought to a conclusion at 5.00 pm on Thursday 3 December.—*(John Glen.)*

Resolved,

That, subject to the discretion of the Chair, any written evidence received by the Committee shall be reported to the House for publication.—*(John Glen.)*

The Chair: Copies of written evidence that the Committee receives will be made available in the Committee Room. I call the Minister to move the motion about deliberating in private.

Resolved,

That, at this and any subsequent meeting at which oral evidence is to be heard, the Committee shall sit in private until the witnesses are admitted.—*(John Glen.)*

The Chair: We will now go into private session to discuss lines of questioning.

9.26 am

The Committee deliberated in private.

Examination of Witnesses

Victoria Saporta, Sheldon Mills and Edwin Schooling Latter gave evidence.

9.31 am

Q1 The Chair: We now resume our public sitting. We will hear evidence from Victoria Saporta from the Prudential Regulation Authority and Sheldon Mills and Edward Schooling Latter from the Financial Conduct Authority, all remotely. Before calling the first Member to ask a question, I remind Members that all questions should be limited to matters within the scope of the Bill and that we must stick to the timings in the programme motion that the Committee agreed. We have until 10.25 am, at which point I must cut off this session. Do any members of the Committee wish to declare any relevant interests in connection with the Bill? No. In which case I call the first witnesses. Could you please introduce yourselves for the record?

Victoria Saporta: Good morning everyone, and good morning, Chair. I am Vicky Saporta, executive director for prudential policy in the PRA within the Bank of England.

Sheldon Mills: Good morning. I am Sheldon Mills, interim executive director of strategy and competition at the Financial Conduct Authority.

Edwin Schooling Latter: Good morning all. I am Edwin Schooling Latter, director of markets and wholesale policy at the Financial Conduct Authority.

Q2 The Economic Secretary to the Treasury (John Glen): It is good to have you before us for this first session. I have a question for each of you, but I will start with Vicky. Obviously there is a strong working relationship between the regulators and the Treasury. It would be really helpful if you could explain how your organisations worked with the Treasury on the preparation of the Bill.

Victoria Saporta: Thank you for the question, Mr Glen. Yes, we worked closely together, as you would expect for a Bill that proposes to revoke elements of the acquis and give the regulators specific powers. Ultimately, of course, it is for the Government to introduce the Bill and for Parliament to take it forward. However, the working relationship was very close, and because of that we are content with the content of the Bill and the proposed measures.

Q3 John Glen: Shall I move to Sheldon? One of the themes that has already come out in early observations is around the commitment, or not, to maintain our highest international standards. I just ask you to make any observations about that, in terms of that commitment and how you will ensure that that continues.

Sheldon Mills: We have had close interaction with you and your officials throughout the drafting of this Bill, and also the preparations for a new UK financial regulatory system, as we move to exit from the EU. We think it is important that there is an agile and confident UK financial services regulatory system, which will support the UK financial services industry and, importantly, also protect consumers and ensure market stability. We feel that the Bill is a good first step in that direction, to enable us to play our role in those goals and objectives for the UK financial services industry.

Q4 John Glen: Thank you, Sheldon. If I could move to Edwin, one of the 17 measures in the Bill deals with the wind-down of the LIBOR benchmark, which is an incredibly complex process by which we are giving the FCA power. Could you explain to the Committee how you see the FCA executing the power and using it in practice?

Edwin Schooling Latter: Yes, of course. Committee members will be aware that LIBOR is a benchmark that has had a troubled past. It is also a benchmark that probably does not suit the needs of its users as well as some alternatives; but it is very deeply embedded in the financial system, so while we think it is the right thing to move towards the end of LIBOR and its replacement with better alternatives, we need to be able to do that in an orderly way. The provisions in front of you contain some important measures to enhance the FCA's powers to manage an orderly wind-down—for example, to identify the point at which the benchmark is no longer sustainable and to take measures to ensure that its publication ceases in the least disruptive way possible for the many hundreds of thousands of contract holders who have mortgages or more complex financial instruments that reference the benchmark in some way.

John Glen: Thank you. That is all.

Mr Pat McFadden (Wolverhampton South East) (Lab): Before I begin, can I get some sense from you, Mr Davies, about whether we can have a few questions?

The Chair: Yes, absolutely. Fire away.

Q5 Mr McFadden: Thank you. I would like to begin with you, Vicky. The Bill goes through a process of onshoring a number of EU directives that are concerned with financial services. Can you tell us conceptually whether there is a difference between the way the UK regulators tend to go about their business or think about these things, compared with the way the various EU directives have been drawn up, debated and discussed in the EU institutions until now?

Victoria Saporta: Yes, I am happy to do so. The way the EU tends to function in terms of regulations—particularly banking regulations, which are part of the provisions of the Bill that relate to the PRA—tends to be quite unique relative to other non-EU regulators. Essentially the Commission proposes very technical regulations, which in banking are often agreed by technocrats in the Basel environment—in the Basel committee—and then these are debated in the European Parliament and the Council of Ministers, and become directly-applicable law. The reason for that way of doing it relates to the single market, so that every EU member state has exactly the same regulations. As I said, that is very unique. Every other member of the Basel committee, for example—all the G20 jurisdictions with the exception of Switzerland, which is another federal democracy—would have its regulators applying these technical rules that they have themselves negotiated internationally.

Pre the treaty of Lisbon and before the single market rulebook, this was the way that regulation was done in the UK through the Financial Services and Markets Act 2000. Primary legislation set out the objectives, framework and constraints through which regulators would operate and the regulators would then go about implementing the rules for the purpose, so that they could achieve the objectives that Parliament would have set for them.

Traditionally, UK regulators have done that in the prudential sphere, which is my current sphere. To preserve safety and soundness and contribute to financial stability, the PRA currently has a secondary objective of facilitating competition, but with the remit that the Government give them and always with an eye to preserving responsible openness and dynamism.

Q6 Mr McFadden: If you are a bank that wants to lobby about the rules or a trade body representing financial institutions, do you think there is any advantage in your lobbying in one of these systems or the other—the more rule-based one or the more flexible one that you have outlined? Which is the more open to lobbying?

Victoria Saporta: There is a considerable body of empirical research that suggests that regulatory independence is strongly correlated with stronger financial stability. Particularly in the banking system, there are lower losses under stress. One of the reasons for that is because regulators—at least in theory, but I happen to believe from my experience that that is the practice—potentially have longer horizons than Governments, and therefore regulatory independence tends to be more robust to such lobbying in the longer term, subject, of course, to accountability and objectives set by Parliament.

Q7 Mr McFadden: Thank you. Sheldon, I want to ask you about the accountability framework in the Bill. It asks you and the PRA to take account of various things. In going about your work in the FCA of regulating conduct, products and so on that financial bodies distribute, what account is taken of wider Government objectives? I am thinking most obviously of things such as the net zero commitment and the legislation that has been passed for that. Do you consider those things or do you say: "Look, our day job is the fairness and stability of financial products and it's somebody else's job to worry about that"?

Sheldon Mills: It is a good question. The starting point is our statutory objectives. We set our priorities for the year and also over three years on the basis of our statutory objectives, which are consumer protection, competition and market integrity. We then work out whether, serving those objectives, certain types of activities will help protect consumers, and help us ensure market integrity or further competition.

If you take the example of net zero, it is quite clear, regardless of where Government's ambitions are in relation to net zero, that the move towards net zero forms a part of the issues that we face globally in terms of climate change. Those are risks in the economy and therefore impact the firms that we regulate and in turn may impact the consumers that we seek to protect. In a sense, we have little choice but to consider and be cognisant of Government's aims in relation to net zero, because if we are not thinking about those climate risks and challenges, which our firms face, we would not be doing our job and serving our statutory objectives.

Quite often, you find that the aims of Government are merely looking at some of the risks that are impacting markets, impacting the firms, and therefore it is right and proper that we have work in relation to those areas, and we do have work in relation to net zero and climate change.

Q8 Mr McFadden: Thank you very much. My final question is to Mr Latter. In the onshoring of all these EU directives, where do you see, if you like, the main opportunities not to do things that the directives currently mandate us to do? Where are the divergence opportunities for the UK financial services sector?

Edwin Schooling Latter: In answering that question, I think that an important starting point is to recognise that the UK regulators, including the FCA, played a very large role in designing a lot of that EU regulatory framework. So the overall picture is definitely one where we support the nature of that framework and the provisions within it. There are a few areas where compromises to span 28 countries perhaps do not suit as well as they might the particular circumstances of UK markets. I think that there are some areas, for example in the MiFID regime, where we could look at an approach that was better calibrated to the UK's capital market infrastructure, but areas where we would diverge are the exception rather than the rule.

Mr McFadden: Thank you.

Q9 Alison Thewliss (Glasgow Central) (SNP): I have a couple of questions, first to the FCA. Can you explain a wee bit more why you feel that you need a change in primary legislation in order to remove companies from your register?

Sheldon Mills: We have an obligation under FSMA such that all authorised firms will sit on our financial services register, and that allows a sense of public transparency as to who is authorised and what they are authorised to do. As the Committee may or may not know, we regulate tens of thousands of firms, upwards of 60,000 firms, so the register is quite large. The current rules allow firms that are authorised on the register to maintain their registration even though their activities are, in effect, dormant and they are not actually carrying out certain financial services. We need to give them rights to be heard in order to remove them from the register, and that takes time. Therefore, having a different regime, whereby we can give notice to firms that their removal might be pending unless they prove to us that they are active, is going to be a much more efficient and effective way of operating the register. This is important because harms are occasioned by the presence on the register of dorman firms. There is the activity of cloning, whereby firms use dormant names on the register to practise certain fraudulent and scam activity, which is a significant problem that we are seeking to tackle. We are committed, of course, to removing people from the register as swiftly as possible, but the provisions in the Bill will really help to accelerate that for us.

Q10 Alison Thewliss: Thank you. Is there a reason why you cannot just remove them now? Is that more a resourcing issue than a legality issue?

Sheldon Mills: It is not a resourcing issue as such. The process that one needs to go through in order to remove somebody from the register is time and resource-intensive and requires quite a lot of back and forth to execute, so this will be a more efficient process, which still respects the right of the person on the register to explain to us that they are using their licence or authorisation, but which will allow us to move forward a bit more quickly.

Q11 Alison Thewliss: I think that you referred to 60,000 firms. What proportion of that 60,000 would you expect to remove from the register by using this process?

Sheldon Mills: I will need to come back to you on that.

Q12 Alison Thewliss: Okay, thank you. Let me move on to other issues, about capacity. It is a huge amount of regulation coming back to the UK. Do you feel at the moment that you have sufficient capacity to deal with this, given the huge amount of responsibility that you are taking on, in addition to the pandemic and everything else that is happening?

Sheldon Mills: We can always do with more resources—that is a common refrain of regulators. Naturally, we will have to reorder our priorities in order to ensure that we are able to take on the onshored rules, to provide them with the right level of attention and make the right decisions. They will fall into two categories. Some we will be able to accept quite quickly and onshore reasonably easily, but others will have areas where we will rightly need to work through how they sit within the specifics of the UK market in a post-Brexit world, and they may take a little more time. All of them will require some form of consultation with the public, so that will take some time. I feel, however, that we have the expertise, experience and knowledge that certainly help us to have the head start on onshoring.

Q13 Alison Thewliss: On the risk of a cliff edge, Nausicaa Delfas of the FCA said that financial services face a cliff-edge situation in January. She raised particular issues with derivatives trading, the transfer of personal data and offering services to customers in the UK. Are there any improvements that could be made to the Bill in order to smooth that transition and make that process a bit simpler and easier?

Sheldon Mills: I do not think so. What Ms Delfas was referring to is the need for firms to ensure that they are making efforts to be ready for transition. We have worked with firms and the Prudential Regulation Authority to ensure that firms are ready for transition. When we describe a "cliff edge", what one is describing is the need to ensure that we are prepared for what we know is coming. We are working closely with firms and putting the right sort of pressure on them to be ready for that point.

Alison Thewliss: Okay. I will leave some questions for colleagues.

Q14 Ms Angela Eagle (Wallasey) (Lab): Mr Mills, I wonder whether you could say a little more about the resource implications of the Bill. An awful lot of our financial services regulation—well, all of it—used to go on in the European Union, but now that is ending and all these complex and technical issues are being onshored. That must be the cause of a huge amount of extra technical work for the FCA, and in fact for the PRA. Is the FCA getting any extra resources? Are you trying to import all the people who used to live in Brussels back into the FCA?

Sheldon Mills: As I said, we have a significant amount of expertise in the United Kingdom. The reason we have that expertise is that—I have to be careful how I put this—much of the financial services legislation that has come about in the EU, the UK has fully participated in, often leading on the legislation. If we take the investment firms prudential regime, which is in the Bill, our colleagues at the FCA were leaders in that space, setting the pace and direction in the EU. So I think we have the expertise and the experience.

When I think about resources, there are areas where we will need to consider hiring more people, in particular the area of prudential expertise—that is a specific area within the FCA where we will need to hire. We will need to consider our resourcing carefully, as more parts of the acquis are onshored, but currently, where we stand, we think we are capable of moving around our resources in order to meet the demands.

The impact that it could have is of course the speed at which we are able to turn to the different pieces of legislation. If the ask was to do everything on day one, there would be an impact on resources; if we have a sensible framework and approach, I think we can manage.

Q15 Ms Eagle: Mr Mills, I am glad you think you can manage but, given that this onshoring is happening, we have already seen the beginnings of some quite fierce competition—if I may put it in a non-technical way—to nick some of the financial services that we have in this country and to take them abroad. We have already seen quite a competitive and non-co-operative environment develop, seeing who can get what when we are outside the European Union. That is an entirely new form of activity that somehow you have to take account of, and that has not had to be taken account of in the past.

Are you sure that will not cause your resources to be stretched in a way that you had not anticipated? For example, if we have to approve new ways of doing things, onshore all these things and get new systems up and running, those who might wish to carry on can just shift to the internal market and carry on doing things, without having to wait for all the consultations that you and your colleagues will be doing to try to re-establish a UK-based regulatory system.

Sheldon Mills: The starting point is that the foundations of the system are clear to all financial services markets in the UK, so there will not be a gap that means organisations will not know the type of regulatory system that they expect when they are authorised a licence to operate in the UK. We will ensure that that is maintained and is clear throughout the transition and into the future.

On what I think you are referring to as the competitive regulatory system that we might enter into, I can assure you that we are engaged internationally through all international bodies. We play leadership roles in the ESB, the Financial Stability Board and all sorts of international bodies in financial services. Therefore, we are key actors in regulatory systems and the latest approaches to regulation across the world, and that will also support our being a sensible regulatory environment in which firms wish to operate. We are clearly engaged with negotiations and discussions with the European Securities and Markets Authority in relation to a range of regulatory activity, so I am confident that we will not have any significant gaps or issues that would cause issues for the UK financial services industry or for those who wish to come and play an active role in that industry.

Q16 Ms Eagle: Thank you. It appears that the EU will not be in a position to offer us any equivalence, or to certify any of the things that we are doing as equivalent, until at least the middle of next year. There are noises that we will be diverging in some of the areas that we are re-onshoring. You said that would be the exception rather than the rule. Can you give us a bit more information on how divergence will work? I am concerned that the Bill has its Committee stage this side of the transition, and then its Report stage the other side of the transition, when we might be in a different situation. Are you planning for there to be big importations of new stuff into the Bill at the last minute?

Sheldon Mills: The Bill is a matter for Government to take through Parliament. The important thing for us, as regulators, is that the Bill provides us with sufficient flexibility to meet the needs that we face as we move through the transition and into the future. In a sense, the Bill is silent on whether we are divergent or equivalent. Equivalence is a policy matter for Government, as opposed to a matter for us. All we need is sufficient flexibility to ensure that we have an appropriate regulatory system, depending on how Government policy emerges in relation to equivalence.

Q17 Ms Eagle: Just to make that clear, you are basically saying that you are neutral on the amount of divergence or equivalence, and that you can cope with whatever is thrown at you?

Sheldon Mills: Neutral is too strong a word. My point of view is that we are interested in what I would call outcomes-based regulation. Equivalence can be done in one of two ways within the bounds of equivalence: it can be done line by line and letter by letter, or it can be done on the basis of seeking to meet equivalence objectives within an outcomes-based regulatory system. We are moving towards the position of the latter. Overall, equivalence is a matter for Government.

Q18 Ms Eagle: Finally—I am conscious that I have put questions only to you, but I am sure colleagues will put questions to other witnesses—you were saying at the beginning that part of what the FCA has to do is protect financial services in this country and create a good environment for them, as well as protect consumers and ensure market stability. There is only so much bandwidth, so will all the work relating to onshoring compromise consumer protection?

Sheldon Mills: I do not think so at all. To give an example, it may look like it would take an army of 50 or 60 people to do the work of the investment firms prudential regime, but in reality it takes around 10 people to do that work. These are significant specialists in the technical architecture of designing prudential regulation. We would not ordinarily use those people in our consumer protection work, and they have different skills and are involved in different activities. I do not think that we will be any less vociferous in protecting consumers. During the crisis, those who watched us saw that we were at the forefront of ensuring that we tried to provide relief to consumers during the pandemic. We will continue in that vein. As the FCA's conduct regulator, I am committed to ensuring that the consumer is at the heart of everything we do.

Ms Eagle: Thank you, Chair.

Q19 Abena Oppong-Asare (Erith and Thamesmead) (Lab): Thank you for taking the time to speak to us. I know that you are in favour of the Bill, as it will give you greater agility and flexibility to deal with things. Going back to some of the comments you made earlier about the consultation process, in which you were clearly fully engaged, one of the things I want to find out relates to the consultation discussions, and obviously you have more responsibilities. Will you shed some light on what came out of those discussions in terms of making sure that there is effective accountability and oversight in relation to the additional powers that you are likely to be given?

Sheldon Mills: I will go first and then pass over to Vicky. It is useful to start with our current accountability, because the Bill and future regulatory frameworks being consulted on by the Government deal with that issue. We wish to be accountable. As an independent regulator, an important part of our process is for us to have public accountability. We serve the public and ultimately are scrutinised by Parliament. Our main form of scrutiny is that of the Treasury Select Committee, but we attend many other Committees. Explaining our activity to Parliament is an important part of our work. Below that, within the Financial Services and Markets Act for the FCA specifically, are our statutory panels. They are there to scrutinise our work in a much closer engagement with the organisation. Then we have the consumer panel, the practitioner panel and the small business practitioner panel, as well as the advisory panel on markets and listings. They are able to make public their views, and—believe me—they do very often make public their views on our activity. In addition to that, we will consult on our policies when we do policy-making work ourselves, as do other public authorities. We will also provide access to non-confidential information and data so that all interested parties can make their views known to us.

We also evaluate our work to ensure that it meets its intended outcomes. We already have an existing accountability framework that would sit well with the additional rule-making powers we may get through the Bill and as we move forward with the proposed reform to the financial services regulatory regime. The future regulatory framework is out for consultation, so I will not say much in relation to it, but we of course acknowledge that there may need to be adjustments to the accountability framework to accord with the additional powers that we are getting. We look forward to seeing the responses to the Government's consultation in relation to that.

Q20 Abena Oppong-Asare: Just for clarification, during the consultation period there was no analysis looking, in terms of the additional powers, at how the accountabilities need to be changed. My understanding, from what you have just told me, is that it is very much reliant on the processes you think you have got already, which I have concerns about, if I am honest, because the current processes do not appear to take into consideration the additional powers.

Sheldon Mills: As I said, we acknowledge that we will be getting additional powers and there may need to be changes to that accountability framework. Within the Bill, you see the foundational approaches in terms of how things may change. Within each of the specific policy areas, if we take the investment firms prudential regime review, there are certain "have regards" obligations that we will need to take account of in that regime. I think that is a sensible approach to take as you bring in onshored regulation. There are specific needs that Parliament considers it is appropriate for us to consider for that onshored regulation. Then, that "have regards" mechanism of pointing that out to us and us being accountable for meeting those "have regards" in accordance with our statutory objectives is a sensible approach and adds an additional layer of accountability and scrutiny for us.

There are other mechanisms within the future regulatory framework, which is out for consultation. Again, I do not have a strong view on them. I recognise that we are getting more rule-making powers and we may need to have more strengthening of the accountability framework.

Q21 Abena Oppong-Asare: I put the same question to the other witnesses.

Victoria Saporta: To response to your question directly, yes, from the very beginning we had discussions with Treasury colleagues about how, within the narrow confines of this Financial Services Bill—I can talk about the related but quite distinct issue of the future regulatory framework—we could be more accountable, given that the Bill effectively gives the Government powers to revoke particular narrow areas of what will become, on 1 January, primary legislation, and then asks the regulators to fill in those particular gaps. The Government were keen that the process should be part of an enhanced accountability framework.

As Sheldon has said, within the confines of this Bill, the enhanced accountability framework applies to the updating of the rulebook to take into account the new Basel III provisions and the investment firms regulation, and three new "have regards" regulatory principles, which are set out in the relevant schedule and refer to us having to take regard of relevant standards recommended by the Basel Committee on Banking Supervision. That applies obviously to the PRA. We need to take the likely effect of the rules on the UK's relative standing as a place for internationally active credit institutions and investment firms to carry on activities. Also, we need to take into account the likely effect of the rules on the ability of firms to continue to provide finance to households and businesses. This is an enhanced accountability framework, and the Bill also obliges us to publish how we have taken into account these "have regards".

Those measures are within the proposals in the Bill to enhance our accountability publicly. There is the separate issue of the consultation that the Government are currently doing on how the future regulatory framework will look, what the enhanced accountability provisions within that are and how they should apply. I would not want to pre-empt that consultation but, clearly, the Government are interested and are trying to look at ways of keeping our feet to the fire, and that is absolutely appropriate.

Q22 Harriett Baldwin (West Worcestershire) (Con): My questions are for the FCA. In terms of the impact of the Bill on the end consumer and the end user of financial services, what impact assessment has the FCA done on the potential regulatory cost and how that might affect the consumer? We hear a lot from financial services firms about the cost to them, not only of regulations, but also of the fees that they have to pay to the FCA. What business plan and cost assessment has the FCA done on the impact that the measures and the responsibilities in the Bill will have on the industry, which will then be passed on to the consumer, or will it be a reduction in cost?

Sheldon Mills: We have not undertaken a cost-benefit assessment of the Bill. That would be a matter for the Government. We have considered, as we discussed in response to earlier questions, the impact on resources within the FCA. Our current intention is to keep that within our current financial envelope, so we are not predicting at this stage an increase in fees or levies to take account of the Bill. That is all I can say at this stage.

In terms of the impact of the Bill and the onshored legislation, when we review the regulations on the investment firms prudential regime and so on, we will do a cost-benefit analysis of the rules and regulations that we are proposing at that stage. At this stage, we will not be doing that—that would be a matter for the Government, not for us.

In terms of the impact on consumers more generally, as I said, there are aspects of the Bill that are very consumer enhancing. I do not think they came up very much on Second Reading, but the provisions in relation to breathing space will be very helpful for consumers facing issues around statutory debts, which we are interested in as a financial regulator. The issues in relation to the register will be extremely helpful for us in terms of tackling fraud and scams. There are many elements of the Bill that are helpful. It is complicated, but the investment firms prudential regime is also consumer enhancing; currently, the capital requirements facing investment firms are those for the systemically important banks, and they are not fit for purpose. This regime will help us have a capital and prudential regime that is fit for investment firms. So there are a whole host of aspects of the Bill that are supportive of consumer interests and will not necessarily increase costs in a way that will be inimical to their interests.

Q23 Harriett Baldwin: The FCA has not prepared anything specific demonstrating that—it is a hunch based on what is in the Bill—but has it done any cost-benefit analysis of the breathing space measures that you mentioned?

Sheldon Mills: All these measures are Government proposals, so the cost-benefit analysis that is required will be carried out by the Government and not by us. Once the Bill has been passed, in whatever form—we are bringing forward rules and regulations—we will undertake a cost-benefit analysis. I am giving an indicative view, as opposed to one based on a cost-benefit analysis that we are not required to carry out at this stage.

Q24 Stella Creasy (Walthamstow) (Lab/Co-op): I should like to explore what you have said, particularly about how the Bill will benefit consumers—after all, we are all concerned about the regulation of financial services markets. You set out your interest in the debt respite scheme. We all agree that that is very welcome, but debt prevention is an ultimate aim. How do all three of you think that this way of regulation will help businesses and households with debt prevention?

Sheldon Mills: It is a broader question than the Bill, but I will answer by giving our approach to debt.

As a regulator, our approach is not to have a policy on whether people should be able to access credit, but we are concerned about the impact on people of firms providing credit. We want firms to be able to provide credit in a way that treats individuals fairly, takes account of their needs and circumstances and, in particular, supports vulnerable customers if they are in debt.

We work closely with debt charities. Some of the issues that we are seeing, which we all face and of which the FCA is cognisant, include the accumulation of debt among certain parts of the population, which is why it is important that rules and processes are in place to support people with debt management and why a breathing space policy forms an important part of that. I think that answers your question, but you might have more specific questions.

Q25 Stella Creasy: I do, but I should like to hear about one of the roles that the FCA has tacked on to the Financial Services Act 2012—investigating regulatory failure. The Bill is about how we address that regulatory regime and the things to which you have regard under that regime. Your colleagues might have a view on whether explicitly having regard to whether a product or a firm is likely to cause debt—unsustainable, unaffordable debt—should be built into the new regulatory regime, given some of the investigations that have, or have not, taken place over the past couple of years.

Sheldon Mills: I think it is for Government to decide whether we should have that "have regard" regime, but there are current rules that firms should take account of the needs of customers. If customers are clearly displaying signals that they are taking on debt that is not affordable—and, in that sense, is not sustainable—firms should have in place mechanisms to ensure that they do not provide further credit or loans to them. There are rules in place on unaffordable lending.

It is for Government to decide whether we have "have regards", but I do not think that we necessarily need them. I agree that there are issues with debt throughout society that we need to tackle, but I believe we have the right rules in place to ensure that firms make appropriate lending decisions.

Q26 Stella Creasy: Perhaps I can come at that question from another angle, because the FCA has been performing this role for several years now. Are there any examples of where the Financial Ombudsman Service has stepped in? I am thinking particularly of the high-cost credit industry, where a lack of proactive regulation in the past could be addressed by having stronger, robust, and clearer direction from us that we wish to see the FCA intervene to protect consumers from unaffordable debt, and to have regard to firms that may be promoting unaffordable debt.

Sheldon Mills: You will have seen that we have done a significant amount of work in relation to high-cost credit and unaffordable lending. We have put caps in relation to forms of high-cost credit; we have tackled payday loan operators; we have a business priority that relates to consumer credit; we have introduced a review, which our former interim CEO, Chris Woolard, is undertaking in relation to aspects of unsecured consumer credit. We are extremely proactive in this area, and the overall system—in terms of the regulatory system—works well. The fact that consumers are able to go to the Financial Ombudsman Service, where they have had certain issues and the service is therefore enabled to give redress to those customers, is an important part of the system. However, I would not want you to think that that we are not proactively seeking to tackle the issues in this area.

Q27 Stella Creasy: A final question to you and colleagues. With that in mind, in moments where there has not been as strong an intervention and early in the process of new products coming to the UK, could you tell us a little bit about what you see coming ahead? We are all very aware of FinTech coming to these shores, and you will be dealing with an awful lot of legislation, as my colleagues pointed out, that you will be onshoring. When you do your horizon scanning—this is a question to all three witnesses—are there any particular products or markets that we should be aware of when thinking about how this legislation will be applied in the coming, say, five years?

Sheldon Mills: I will let my colleagues go first, then I will come in.

Edwin Schooling Latter: Let me raise one area where work is under way. FinTech was mentioned, but the area of crypto-assets has been popular in some quarters. That is an example of an area where we have taken a very proactive approach to putting limitations on where those can be marketed to retail investors who may not fully understand the difficulties of valuing those, the risks attached to them, or the possibilities that they would lose all of their money the more speculative end of that product range.

Sheldon Mills: I would agree with Edwin. The main area which we will see in relation not just to financial services, but to any product, is the continued development of digital means both of accessing and of providing products and services. Our approach to that is twofold: one approach is to encourage innovation. These products and services can bring efficiency and lower cost, and they can bring different levels of access for consumers, including vulnerable consumers. However, while doing that, we ensure we are clear on the ethics and consumer protection aspects of these new forms of products and services. Those are some of the areas where we will see future opportunities and challenges within the financial services system.

Q28 Stella Creasy: Do you regret, then, not moving more quickly on the buy now, pay later industry, because that is not regulated by the FCA at the moment, yet that is exactly an industry which we all now recognise is causing consumer detriment to people on low incomes?

Sheldon Mills: With respect, I cannot regret not acting on something which I do not regulate. However, what we are doing is looking at that area through the form of this review. As you know, and as is implicit in your question, that does sit outside our specific regulation.

The Chair: Victoria, I think you were about to say something.

Victoria Saporta: Sorry, I am conscious of the time. I have basically one comment to make in our particular area. I agree very much with Sheldon on digitalisation and with Edwin on crypto. Another particular area that we are looking at—

The Chair: Order. I am afraid that brings us to the end of the time allocated for this session. I thank our witnesses on behalf of the Committee for their evidence.

Examination of Witnesses

Simon Hills and Daniel Cichocki gave evidence.

10.25 am

The Chair: We will now hear from Simon Hills and Daniel Cichocki from UK Finance, who are joining the sitting remotely. Can you introduce yourselves for the record?

Daniel Cichocki: Good morning, Chair. I am Daniel Cichocki. I am the London inter-bank offered rate transition director at UK Finance and, as such, am focused on the benchmark elements of the Bill.

Simon Hills: Good morning. I am Simon Hills. I lead the prudential policy work at UK Finance, so my particular area of expertise is the prudential regulation of banks.

The Chair: I remind colleagues that we have until 10.55 am for this session, so it is much shorter than the previous one. I hope that colleagues will be mindful of that.

Q29 John Glen: Simon, I want to focus on your responsibilities with respect to the Basel rules and the expertise of the regulator. Can you set out the competence that you have within your organisation to do this, and could you comment on the suitability of the UK to implement its own approach to the Basel framework, perhaps with reference to what happens in other jurisdictions to give the Committee a sense of how we fit alongside international comparisons?

Simon Hills: It is important to recognise that the Prudential Regulation Authority has been a strong supporter of Basel 3.1. It has been very influential in the way it was finalised, and I think that it is committed to implementing the Basel 3.1 framework in an internationally aligned way. That is important for our members, particularly if they are internationally active, because they want a coherent and harmonised regime across the world. If you are a UK bank operating in the UK, North America, Europe and Asia, you want one version of Basel 3.1 and you want it to be implemented in a coherent way. If not, and if there are different approaches to regulatory reporting, to how credit risk is assessed and to liquidity requirements, you have to implement a number of different versions of Basel 3.1, which will be more difficult.

In terms of UK Finance's competence in, if you like, holding the PRA to account, we have a wide range of members for whom Basel 3.1 implementation is very important. I am pleased to say that I have good working relationships with Vicky and her colleagues at the PRA.

Q30 John Glen: I am conscious of time, so I will allow others to come in, but I wish to ask Daniel about the work that you are doing on LIBOR. This is an incredibly complex area with lots of challenges, and the key issue is around the wind-down of the benchmark and the move to deal with the tough legacy contracts. Could you comment on what the Bill achieves with respect to that, whether there are any alternatives to it, and what the implications would be if we did not do what we are planning to do in the Bill?

Daniel Cichocki: Certainly, the issues with the lack of sustainability of the LIBOR benchmark are very well documented, and it is important, as the Financial Stability Board has acknowledged at an international level, that we move away from LIBOR on a smooth and timely basis. It is also very important, certainly from an industry perspective, that as a result of moving away from LIBOR on to more robust reference rates, customers who have contracts referencing LIBOR are not inadvertently affected by that transition.

What this Bill seeks to do—and we are very supportive of its provisions—is to make sure there is a safety net in the form of powers being granted to the FCA, to ensure that those contracts that cannot be migrated on an active basis before LIBOR ceases have a solution so that the customer has a clear outcome for the contracts beyond LIBOR cessation.

These powers are important because before 2017, and the acknowledgement that LIBOR would cease, many contracts did not have clear, robust terminology setting out what would happen if LIBOR ceased. They may include terminology addressing if LIBOR should be unavailable for a day or two, and that might be the reference point those contracts would take. In that instance, without these powers, we may have seen customers falling back on to the last available LIBOR rate to the point of cessation, essentially becoming a fixed-term contract. We may have seen customers falling back on to cost of funds, which would create very diverse and disadvantageous outcomes for them. Equally, we would have seen fairly significant levels of contractual disputes beyond the end of 2021. These powers, in preventing all those negative outcomes for both customers and market integrity, are absolutely critical as part of the transition.

John Glen: Thank you very much. I shall pass over to my colleagues.

Q31 Mr McFadden: Thank you both for coming along this morning, virtually. Could I begin with you, Simon, and ask about onshoring and divergence? The Bill onshores significant bodies of EU legislation and directives. From the point of view of UK Finance, where would you like to see the Government and regulators diverge from that body of EU law in the future?

Simon Hills: I am not sure that we would want the UK Government and authorities to diverge significantly, if at all, from other standards. We are not sure yet what Europe will do in respect of Basel 3.1. We do not expect draft legislation from the Commission until around Easter next year. That said, from the way in which the Commission has implemented previous iterations of Basel, I would expect it to stick quite closely to that Basel 3.1 framework, for the same reasons I have mentioned: international coherence and harmonisation, and easing the comparison of different banks and jurisdictions.

Q32 Mr McFadden: We have had the Chancellor's announcement on equivalence from the UK end of the telescope last week. Do you think there is a relationship between the degree of divergence we pursue in the future from the EU rulebook and equivalence decisions from the other end of the telescope, that is, by the EU or EU member states to UK companies selling into their markets?

Simon Hill: Yes, I think there is likely to be work to be done there. Of course, one of the accountabilities the Financial Services Bill gives the PRA is to take financial services equivalence and international competitiveness into account, and, importantly, the banks' ability to continue to provide finance to UK businesses and consumers on a sustainable basis. I think we will all want to understand how different regulators around the world—not just in Europe—look at the PRA's implementation when it gets down to those technical standards, which is why it is important for both Parliament and UK Finance to make sure there is no inappropriate deviation from international standards. I can assure you that if UK Finance members see that there is, we will speak up about it.

Q33 Mr McFadden: May I ask you, Daniel, a question about LIBOR to fill in a small gap in the knowledge of those of us who have not followed every twist and turn of this? The measure became a scandal because it was being manipulated for the benefit of the traders who were submitting information. That information was based sometimes not on actual trades but on their estimates of what trades would cost. What changes have been made to the administration of LIBOR in recent years to stop those things?

Daniel Cichocki: It is absolutely right to acknowledge the issues with conduct around LIBOR in the past and the reforms that have taken place to make sure that those things are prevented. That includes the FCA oversight of the LIBOR benchmark, the introduction of the benchmark regulations at a European Union level, and transcribed into UK law, and broader reforms since the financial crisis, including the senior managers regime to ensure that the issues with LIBOR are not repeated. As the Committee will be aware, the fundamental reason why it is important to move away from LIBOR is that the underlying markets on which the rate is based have largely dried up. Therefore it is right to move us on to robust reference rates based on markets that are highly liquid and not reliant on expert judgment.

Simon Hills: It is important to remember that individuals in banks who are responsible for benchmark submission and administration are classified as so-called certified persons under the senior manager certification regime and they have to be certified as fit and proper every year by their firm. If they are not certified as fit and proper, they will lose their job and will find it very difficult to find a role in financial services again.

Q34 Mr McFadden: One more for you, Daniel. As things stand with LIBOR today, is it still possible for traders to submit information based on their estimates of what trades would cost rather than actual trades that have taken place?

Daniel Cichocki: LIBOR as it is formed today includes both elements of actual transactions and expert judgments of firms. These expert judgments, as a result of the issues in the past, are subject to those very high levels of governance control that I have talked about being introduced as a result of the benchmark regulation—absolutely appropriate as a result of the issues with LIBOR in the past. The underlying reason why we need to move away from it is that we want to be internationally on rates that do not require that expert judgment.

Mr McFadden: So no more cases of champagne? Thank you.

Q35 Alison Thewliss: Are there any further measures that you expected to see, or would have liked to see, in the Bill?

Simon Hills: Shall I go first and talk about the prudential regulation of banks? The Financial Services Bill achieves what it sets out to do: to implement a coherent version of Basel 3.1 in the UK. It is quite important to our members that we do Basel 3.1 the same in all the major financial centres in which firms operate. If a firm that is regulated by the UK operates in a different host country and the host country says, "That UK firm operating on our patch is supervised by the PRA and the PRA has introduced a watered-down version of Basel 3.1", then they would add extra supervisory levels to bring it back up to the Basel 3.1 standard. That leads to a bifurcated approach with different regulatory standards in different countries, which makes life very difficult. A coherent approach, which is what the Bill seeks to achieve, is what we and our members want.

Q36 Alison Thewliss: So when the EU makes its regulations, and it goes ahead with what is in its interests, essentially you would want us to mirror the EU wherever possible?

Simon Hills: We would not want to see wholesale deviation from Basel 3.1. Of course, Europe itself may choose to deviate from Basel 3.1, and that is a matter for its legislative process. I would not want to see the UK deviate from the agreed framework for Basel 3.1.

Q37 Alison Thewliss: Are there any international competitors that you think have struck the correct balance with a regulation that you would want to see us take on here?

Simon Hills: I think there is a difference of approach in some G7 countries. Some perhaps apply a graduated or targeted approach to regulation. Canada, Japan and the US apply different iterations of the Basel standards to different sorts of firm. A large, internationally active bank would face the full gamut of Basel 3.1 in all its glorious granularity—in my view, that is right and proper—but a smaller, less systemic bank might face a different approach.

Of course, Basel 3.1 is applied by Europe—and that is what we are bound by at the moment—to all banks, not just those internationally active banks that are the target of Basel 3.1. The EU took the decision back, I think, in 1992—before even I got involved in this space—to apply the Basel III framework to all banks, from the smallest local Sparkasse in Germany to the largest, internationally-active bank.

I feel we must ask ourselves whether that is right; should there not be a risk-adjusted approach to safety and soundness? A sub-regional building society operating in the UK, for instance, has a vanishingly small probability of bringing the whole financial services system crashing down if it fails. Is it right to ask that firm to comply with all aspects of Basel 3.1? Maybe not.

Q38 Alison Thewliss: That is useful, thank you. Can you give any particular examples of how far you think divergence could go before you risk withdrawing equivalence?

Simon Hills: We don't know yet how Europe will determine equivalence. I hope that our colleagues in the EU will look at our implementation of Basel 3.1, compare it with their own implementation and ask themselves the question, "Does this achieve what Basel 3.1 is seeking to achieve?" If they do, I hope there will be a form of equivalence—however we term it in the future—determination.

Alison Thewliss: Thank you very much.

The Chair: Do any other Members have any questions?

Q39 Ms Eagle: I was wondering, Daniel, whether there are any dangers in the move away from LIBOR. Obviously, we know about the dangers of staying with it, but are there things that keep you awake at night about the transition?

Daniel Cichocki: As the Committee can imagine, from an industry perspective, we are absolutely focused on ensuring that the transition away from LIBOR—which is the right thing to do—is done in a way that treats customers fairly and consistently.

There is an awful lot of work being done at both an international and domestic level to agree standardised approaches to transition, where possible, but also to ensure that there are clear expectations from our regulators—here in the UK, it is the Financial Conduct Authority—about how that transition should be done.

Lots of work has been done and lots of work remains to be done, and, as you can imagine, we are speaking very frequently to the regulators here in the UK, and also working through the national working group to ensure that customers are transitioned on a fair and transparent basis.

Q40 Ms Eagle: Obviously, LIBOR is a benchmark. Any benchmark is a sign of some of the profit that can be made on a transaction. If there are differences of approach or changes, there are areas where customers can be fleeced or left out of pocket without, in some ways, even realising it because of the very technical nature of these kinds of transactions. To what extent do you have a consumer protection voice helping you with these changes? Do you think that the protections for consumers who may be disadvantaged during this transition are strong enough?

Daniel Cichocki: We are one voice from the perspective of the banking and finance industries, but it is important also to recognise that, within the overall national working group in the UK, there are voices that, rightly and properly, represent the end users of LIBOR, be they corporates themselves or the representatives of corporates. Although those voices are important in our national transition working group, it is equally important to address the concern that you articulate, which is absolutely right: the guidance that the FCA has provided to all firms that are transitioning their customers that the process should not be used to move customers on to inferior terms or rates that would be expected to be higher than LIBOR would have been. After speaking to our members in the industry, that message from the UK conduct authority has been heard loudly and clearly. All of us who are focused on moving away from LIBOR are acutely aware of the history of the benchmark and committed to ensuring that we move away from it in the right way and in a manner that treats customers fairly.

Q41 Ms Eagle: Obviously we will be keeping an eye on that as it happens.

Mr Hills, the industry has been lobbying the Government, Parliament and regulators to design regulations that will make UK firms more internationally competitive. Indeed, all of us in the room would share the aim of protecting our financial services industry. Do you think that the Bill achieves that?

Simon Hills: Yes, I think it does. The important thing is that the Bill achieves that by setting expectations of how the Basel 3.1 framework is implemented in an internationally coherent way. The PRA has to think about not only international competitiveness, but financial services equivalence, and the Bill achieves that.

Q42 Ms Eagle: So you are not too worried about divergence because you do not think there will be very much of it.

Simon Hills: I do not think that it is in the interests of the UK financial services industry and banks to introduce a divergent regime. We are talking about the importance of the City, and we want people to bring their money to the City for the right reasons, not the wrong ones. UK Finance members are certain that it is in no one's interest to diverge from internationally agreed frameworks because that creates the risk that we bring in the wrong sort of people.

Ms Eagle: Thank you very much.

The Chair: If there are no further questions, I thank the witnesses for their evidence.

Examination of Witness

Paul Richards gave evidence.

10.48 am

Q43 The Chair: We will now hear from Paul Richards from the International Capital Market Association, who is here in person. I remind colleagues that we have until 11.25 am for this session. Paul, would you please introduce yourself for the record?

Paul Richards: I am Paul Richards. I am a managing director at ICMA, which is the international bond market association. I am here to give evidence on the transition from LIBOR. I am involved in the transition from LIBOR to SONIA—the sterling overnight index average—because I chair the bond market sub-group, which consists of issuers, banks, investors and four major law firms. We work closely with the FCA and the Bank of England. If you will permit me, I shall make a short introductory statement.

I hope to be able to give you a bond market perspective on the Bill but, for the market as a whole, we are all trying to move away from LIBOR to risk-free rates while minimising the risk of market disruption and litigation. The Bill is welcome and very important for the bond market because it will give the FCA extra powers to deal with tough legacy LIBOR contracts and wind them down in an orderly manner.

There are three main points on which it would be very helpful if the Committee was willing to strengthen the Bill. First, the Bill needs to provide continuity of contract between the current definition of LIBOR and the new definition of LIBOR for legacy transactions once LIBOR is prohibited for new transactions. Legacy contracts referencing LIBOR under the current method of defining LIBOR need to be read as references to LIBOR under the new definition as determined by the FCA, so that there will be continuity there—this is sometimes called a deeming provision. This will reinforce the message that LIBOR will continue to appear on the same screen page, and it should also help to remove uncertainty and minimise the risk of a legal challenge on the basis that the current definition of LIBOR and the new definition are not the same and one party or another is worse off.

This is particularly a risk in the bond market in cases where LIBOR is specifically defined in legacy bond contracts in terms of its current definition. Continuity of contract or deeming provision like this was used when the euro was launched in 1999, and it worked well. Clearly, it would need to be drafted with the help of the Treasury and it would probably need to be drafted in terms of an article 23A benchmark in the way that the Bill is looked at. That is the first point.

The second and related point on which I hope the Committee will help is that the provision of the continuity of contract under the Bill needs to be accompanied by a safe harbour against the risk of litigation. This would provide that the parties to contracts would not be able to sue each other as a result of the change in the definition of LIBOR, and it would allow them to make conforming changes to bond market documentation.

The third point on which I hope the Committee will help is that the safe harbour and contract continuity provisions in the Bill need to be drawn as widely as possible, to protect any entity that uses the new definition of LIBOR for legacy transactions in place of the current definition of LIBOR. This would need to cover not just supervised entities in the Bill, but non-supervised entities, as the range of institutions involved in the international bond market is very wide.

Finally, I would like to draw your attention to two other points where there are significant legal risks under the Bill. One is that there needs to be equal treatment between legacy LIBOR bonds when the new definition of LIBOR takes over from the current definition, so that some legacy bonds are not preferred to others and there is no discrimination between them; otherwise, legal problems may arise. This would be a matter for the FCA under the Bill.

The other point is that there needs to be alignment internationally between the Bill and the similar legislation that is being introduced in the US and the EU, so that the rate used for legacy dollar bonds under English law and legacy dollar bonds under New York law is the same. Thank you, Mr Davies. I would be very happy to do my best to answer your questions.

Q44 John Glen: Thank you, Paul. The Committee will be very aware of the breadth and depth of your experience in this domain. You have gone into three quite specific issues. Could you set out, at a higher level, the LIBOR challenges that you think this Bill does not deal with, and where you think it is going to be defective? Obviously, a lot of work has been done with regulators to get to this point and we have had evidence previously about the nature of this change and the more general desire for it. Perhaps you could contextualise the specific issues you talked about with respect to continuity and the other matters you raised.

Paul Richards: Thank you, Minister. First, as I mentioned, we welcome the Bill. The only question is: can it be improved to minimise disruption and litigation? The essential point is that, in the bond market, we have moved to SONIA as the risk-free rate, and new issues have been in SONIA for over two years now. That is the first step in the process.

The second step in the process is that we actively convert as many bonds as we can from legacy LIBOR to SONIA. We are making some progress there, but the third point is that we will still have tough legacy contracts that cannot be converted, either because they are too difficult to convert or because there are too many to convert by the end of 2021. In those circumstances, the provisions in the Bill are extremely helpful, because they provide for an orderly wind-down of tough legacy contracts. From that perspective, the Bill is very helpful. My questions relate to when the current definition of LIBOR is replaced by a new definition. Will there be contract continuity and a safe harbour to minimise the risk of disruption in the market and litigation?

John Glen: Thank you for clarifying that. That is very helpful for the Committee.

Q45 Mr McFadden: Thank you for appearing before us, Mr Richards. Can you set out for us, in as simple terms as possible, the difference between how prices are set under SONIA and how they were traditionally set under LIBOR?

Paul Richards: LIBOR was set by a panel of banks. As the market no longer uses the underlying information that it used to use for banks, it has now changed, or will change, with the admission of SONIA, to a different definition. SONIA is essentially an overnight rate. It is a robust rate, because it is used widely in the market, whereas LIBOR is no longer used in the market as it was 30 or 40 years ago. That is one difference. A second difference is that LIBOR is a term rate—it is expressed over one month, three months or six months—whereas the liquidity in the SONIA rate is focused on the overnight market, which is therefore a much more representative selection and does not require expert judgment, unlike LIBOR.

A third point, perhaps, is that it is not just a UK proposal to replace LIBOR with risk-free rates in SONIA. A similar change is taking place globally. In the US, USD LIBOR is being replaced by the secured overnight financing rate, which has a similar sort of construction, and the situation is similar around the world. Those are the main reasons for the change.

Q46 Mr McFadden: Can I just focus on the point about expert judgments? That is quite a polite term for some of things that happened with LIBOR. They were not really expert judgments in some cases, were they? They were effectively deals between different traders to put in submissions at particular prices, to the individual advantage of the traders, based on the trades that they were doing. To what degree is SONIA insulated against that kind of manipulation?

Paul Richards: As you say, LIBOR depended on expert judgment in many cases, because the market was no longer using LIBOR in the way it had been constructed. With SONIA, it is a much more liquid market and there is no need for expert judgment at all. That is one of the reasons why it is being preferred as the replacement for sterling LIBOR, and similarly around the world in other currencies.

Q47 Mr McFadden: Can I take you back to the second point you made about the danger of litigation? We might all agree that moving away from LIBOR is a good thing, partly because we do not want to see a benchmark manipulated in the way that LIBOR was. However, as a consumer, I might have agreed trades or contracts based on a particular price set by LIBOR. What is the situation with potential litigation from a consumer who says, "You're telling me that SONIA is a more honest benchmark because it's based on actual trades and actual prices in market transactions, but now I'm being told that instead of paying x%, I will be paying x% plus y%"? What does the Bill say about that kind of situation at the moment, and what would you like it to say?

Paul Richards: A significant difference between LIBOR and SONIA is what is called the credit adjustment spread, which takes account of the difference between

LIBOR and SONIA. In the consumer market, the proposals are, at a general level, to treat customers fairly. In the wholesale market, the aim is to have continuity of contracts between the old definition of LIBOR and the new definition that will be used for legacy transactions. This will be determined under the Bill by the FCA. It is not specified how it will determine it. There are market assumptions about that, but it is not decided yet how they will determine it. It is thought that it will consult the market before making a decision, but the end result will be that the rate that arises under the new definition of LIBOR will take over from the old definition of LIBOR, and there will be continuity of contracts between them. If that is emphasised in the Bill, that will give legal protection for all those involved, which is one of the main reasons for providing it. It needs to be accompanied by a safe harbour provision, which would protect all the different market participants involved. I would like to be able to tell you that this will eliminate the risk of litigation, but I cannot tell you that. What I can tell you is that it will minimise the risk of disruption and litigation that might otherwise occur because of the huge volume and value of transactions.

Q48 Mr McFadden: So how would this safe harbour provision that you are advancing work? Why is it needed beyond the FCA acting to ensure continuity for legacy contracts, as is I think is already envisaged in the Bill?

Paul Richards: They are both needed, I think. The FCA's judgment about treating customers fairly relates primarily to consumers. The protection that a safe harbour would provide, so that parties would not sue each other as a result of the change from the old definition to the new definition, is essentially designed for the international markets. So they are both needed. The FCA is already making statements about treating customers fairly, but the Bill should include both the continuity of contracts provision and a safe harbour protection to accompany that. The broader the safe harbour protection is drafted in the Bill—the Treasury, I am sure, could help on this—the better and more effective it will be in minimising disruption and the risk of litigation.

Q49 Mr McFadden: Have you already made these arguments to the Treasury only to be rebuffed, or is this the first chance you have had to make them because the Bill was published only a few weeks ago?

Paul Richards: These are points that law firms that work in the City are acutely aware of from their previous experience. The law firms have been looking at what needs to be done to ensure that there is continuity of contract and a safe harbour protection. Of course, I hope that the Treasury will take account of that, as your Committee will take account of it before reaching a final conclusion. We should do everything we can to minimise the risk of market disruption and litigation, within the context of the overriding point, which is that we do need to move away from LIBOR to risk-free rates. That is, of course, what we have done, with new issues in the bond markets and with the conversion of legacy contracts from LIBOR to SONIA. We have a tough legacy problem for the future, which needs to be dealt with. The Bill helps to deal with that.

Q50 Alison Thewliss: I have some follow-up questions. You mentioned how the FCA will determine these things. Do you feel that that needs to be set out quite explicitly in the Bill—how the FCA will make those determinations around benchmarking and LIBOR contracts?

Paul Richards: Sorry, I did not quite catch the last point.

Alison Thewliss: You mentioned the uncertainty of how the FCA makes decisions around LIBOR contracts and benchmarking. Do you feel that needs to be set out more explicitly in the Bill so that you can know what to anticipate?

Paul Richards: I think it would be helpful for the Bill, specifically, to make provision for continuity of contracts—the deeming provision—and also for protection against litigation through a safe harbour, to be drafted as broadly as possible. That is not because the move away from LIBOR is not something that we should do—on the contrary, it is something we must do and we have made great progress in doing it already—but because, to deal with the tough legacy contracts in the Bill, we have to make sure that the new definition and the old definition are treated in the market as the same.

Q51 Alison Thewliss: Okay, that is useful. I have been looking through some of the lawyers' statements and I would be grateful if you could clarify something for me, as this is not an area of expertise for me but it is for you. You mentioned article 23A benchmarks, and something else I read mentioned the types of contracts that would fall within the article 23C exceptions. Can you tell me a wee bit more about what that would mean?

Paul Richards: I think that we are talking about 23A benchmarks in general in the Bill. What I have been talking about is specifically relevant to LIBOR. When the Treasury looks, as I hope it will, at whether anything is needed to advise you to strengthen the Bill, it might need to draft that in terms of benchmarks in general and not just LIBOR in particular.

Q52 Alison Thewliss: Thank you. You talked about the costs of litigation and the impact that that would have. What is the extent of these legacy LIBOR contracts—their value, their number and the cost that that litigation might entail?

Paul Richards: In the bond markets, we have to convert legacy contracts bond by bond, so it is the number of the bonds that is important, not just their value. In the sterling bond market, we think we have about 520 different legacy bond contracts, or 780 if you include the different tranches of securitisations. We have converted just over 20 of those so far in the market, but we know that we will not be able to convert all of them because some are too difficult to convert and there are too many to convert.

The FCA has an international role and English law applies in dollars as well as in sterling, so we need to take account of dollar legacy bond contracts under English law. In terms of number, we understand that there are more than 3,000 of those. In terms of value in bonds, we think we have around 110 billion in sterling outstanding.

The critical point for us in the bond market is that we need to convert them bond by bond. You will notice that that is different from the derivatives market, where there is a multilateral protocol that enables the market to do everything at once, which is currently in course. We cannot do that in the bond market.

Q53 Alison Thewliss: And the potential cost of litigation?

Paul Richards: It is impossible to estimate the cost of litigation. The great thing is to avoid it wherever you can, and the Bill presents an opportunity to minimise the risk of it.

Alison Thewliss: Okay. It sounds like a good time to be a lawyer in this area. Thank you.

Q54 Ms Eagle: Do the provisions of continuity and safe harbour apply in America as it converts away from LIBOR? Are the things that you are asking the Committee to consider putting in the Bill happening in other jurisdictions?

Paul Richards: In the US, the alternative reference rates committee, which is the group equivalent to the sterling risk-free reference rates working group, has proposed legislation that is not identical to the UK's but has the same effect, and so the concepts of continuity of contract and protection through safe harbours in the UK context will be recognised, we think, internationally as well.

Of course, we are not dealing here just with the proposals under New York law. We are having to look more generally. The EU has a proposal for legislation as well. It is important to recognise that the FCA has an international role, because the FCA is the regulator of the administrator of LIBOR, so what the FCA, through this Committee, decides in the UK will have an international impact.

Q55 Ms Eagle: Okay. You did not answer the question from my right hon. Friend the Member for Wolverhampton South East earlier about whether you had asked the Government for this and they had said, "No, the FCA can do it; we're not putting it on the face of the Bill," and so you have come here to make the argument again, or whether it is work that you are in the process of doing and you have got to the stage where you want to make these proposals, as the Bill has arrived. Have the Government considered this and said no, or is it something that you have just proposed?

Paul Richards: No, I hope that the Government will consider this and say yes. I hope that that will happen, but it needs to be looked at in the context of the Bill as a great help to the market. It needs to be looked at in this context: can anything be done to strengthen the wholesale market?

Q56 Ms Eagle: I understand your point about how those things would calm things down in the changeover, but why do you not trust the FCA to do this? Why does it have to be in the Bill?

Paul Richards: The FCA has great powers under the Bill and I am sure that it will exercise them wisely, but we are dealing here with law internationally, and anything that can be done to strengthen that—and the Bill has the capacity to do that—will be helpful. I hope that it will also be helpful to the FCA.

The Chair: If there are no further questions from Members, I thank the witness for his evidence. That brings us to the end of our morning sitting. The Committee will meet again at 2 pm in the same room to take further evidence.

Ordered, That further consideration be now adjourned. —*(David Rutley.)*

11.13 am

Adjourned till this day at Two o'clock.

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

Second Sitting

Tuesday 17 November 2020

(Afternoon)

CONTENTS

PBC (Bill 200) 2019 - 2021

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Saturday 21 November 2020

The Committee consisted of the following Members:

Chairs: PHILIP DAVIES, †DR RUPA HUQ

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
† Eagle, Ms Angela *(Wallasey)* (Lab)
† Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison; Nicholas Taylor, *Committee Clerks*

† attended the Committee

Witnesses

Chris Cummings, Chief Executive, Investment Association

Emma Reynolds, Managing Director, Public Affairs, Policy and Research, TheCityUK

Catherine McGuinness, Deputy, and Chair of the Policy and Resources Committee, City of London Corporation

Adam Farkas, CEO, Association for Financial Markets in Europe

Constance Usherwood, Prudential Director, Association for Financial Markets in Europe

Gurpreet Manku, Deputy Director General, British Private Equity and Venture Capital Association

Peter Tutton, Head of Policy, StepChange

Public Bill Committee

Tuesday 17 November 2020

(Afternoon)

[Dr Rupa Huq *in the Chair*]

Financial Services Bill

2 pm

The Committee deliberated in private.

Examination of Witness

Chris Cummings gave evidence.

2.2 pm

The Chair: I remind members of the Committee sitting on this side of the room, or in the Public Gallery, to use the standing mikes when posing their questions. Our first witness this afternoon is Chris Cummings from the Investment Association. Mr Cummings, welcome.

Chris Cummings: It is a pleasure to be here. Thank you for your time.

The Chair: We have until 2.45 for this session. Mr Cummings, can you first of all introduce yourself for the record?

Chris Cummings: Good afternoon. My name is Chris Cummings. I am chief executive of the Investment Association, the representative body for UK-based fund managers, an industry now of some £8.5 trillion pounds, based here in the UK. Our products and services are used by three quarters of UK households, and we are deeply grateful for the opportunity to give evidence to your Bill session this afternoon.

The Chair: Thank you. We will start with the Minister, John Glen.

Q57 The Economic Secretary to the Treasury (John Glen): Chris, it is good to see you. Thank you very much for addressing the Committee. Obviously, the Bill has a large number of measures, some of which will be of more interest to your members than others. I think it would be useful for the Committee if you could set out the significance to consumers of introducing a more proportionate regime for overseas funds to access the UK based on equivalence, and why it is important for consumers to be able to access funds based outside the UK. Perhaps you could tell us what your members feel about that measure and whether you have any reservations about it.

Chris Cummings: Thank you for the opportunity to speak to one of the most central parts of the Bill. May I take a moment to congratulate you and your team on introducing the Bill? It provides much-needed reassurance to my industry, so thank you for that.

The industry is very pleased to see the overseas funds regime introduced as part of the Bill. Around 9,000 funds are currently available to UK investors as a result of the current regime. The reason we feel it is in the interests of UK savers and investors to have access to such a variety of funds is that it brings to the market not only choice but much-needed competition. It means that individual investors have greater choice and an ability to tailor their portfolio in a way that makes sense to them and reflects their risk profile. It is really the foundation of why the UK is the pre-eminent fund centre, not just in Europe, but globally. As the Minister knows, the UK has long enjoyed a reputation for being an attractive centre for fund management. That is built on the ability of UK investors to access an innovative and ever-adapting fund market.

We support this measure in the Bill wholeheartedly. At the moment, as the Minister knows, we manage around 37% of Europe's assets, which is enabled through measures such as this. It is important for UK savers and investors; having such a variety of funds goes to the heart of having such a sophisticated savings environment in the UK.

It is important to note that if there was a cliff edge—if UK investors were not able to access these funds—that would constrict consumer choice. In trying to replicate something akin to what we have at the moment, we would bring a heavy burden of extra costs on to the industry and greater bureaucracy. It would reduce significantly the number of funds to which UK investors could have access. That is why we believe that the overseas fund regime is material.

It is worth contrasting that with what we see at the moment. In order to help navigate these turbulent waters through the Brexit period, I was delighted that the Government heard our calls to introduce a temporary permissions regime with the Financial Conduct Authority. I am pleased to note that the Bill extends the period from three to five years for that requirement, which is very good. It also allows us to tackle two particular issues wrapped up in the overseas funds regime.

First, there is a review of section 272, which is the current structure by which a fund sponsor or investment management company would seek to have their fund recognised by the FCA—our regulator here in the UK. Section 272 is okay, but it is rather cumbersome. It does not stand up well compared to international comparators. It is a rather lengthy form, which takes a while to complete and gives the FCA a six-month period to look at approving that particular fund.

The proposals in the Bill take us to a completely different level, where the FCA is able to look at fund structures across the piece rather than at each individual fund. We feel that is a big step forward. While section 272 could be reviewed and reformed, there is a different category of opportunity presented by the Bill and that is why our industry is so keen to see the Bill come forward and have the overseas fund regime baked into it as a measure that goes ahead. I will pause there in case there are comments before I move on to comment on equivalence, as you were kind enough to mention.

Q58 John Glen: It would probably be worth talking about equivalence. I am keen at this point to get an explanation of the measure for the Committee. I am sure others will want to probe some of the weaknesses or disadvantages that they may perceive.

Chris Cummings: Currently, we enjoy unfettered marketing right across the whole of Europe and the EEA. Post Brexit, naturally, that will come to an end. The way that the regulatory authorities assess whether a particular fund is suitable is to judge the equivalence of the regime of the sponsoring organisation or where the organisation is based. Having that judgment of equivalence has been one of our industry's clear calls throughout the Brexit process.

We were pleased that the Chancellor took a step forward in recognising and granting equivalence to a limited measure in the House of Commons in his statement last week. We think that was absolutely in the right direction. We have been unstinting in our calls for the European Commission and our European regulator, the European Securities and Markets Authority, to respond to those in kind and move forward so that the equivalence determination could have been made by now and be working. We were sorely disappointed that in June ESMA decided not only not to make a decision on equivalence, but to defer it for a period of time until after the IFR comes into effect.

We feel that that was a missed opportunity to settle the fact that the UK and the EU would be equivalent, which we currently are, having adopted, rather in full vigour, the European rules under which our industry labours. We are hopeful that continuing industry efforts to encourage ESMA and the European Commission to recognise the UK as equivalent will come through, but we are more than pleased with the steps that the Chancellor announced and the comments that are carried forward in the Bill. At the moment, we see that as a first step, but we look forward to greater work being done on this in the months and years ahead.

John Glen: Thank you very much, Chris, and thank you, Chair.

Q59 Mr Pat McFadden (Wolverhampton South East) (Lab): Chris, good afternoon and thanks for giving evidence today. I want to continue to ask about the same things.

The Bill does lots of different things, but I would like to mention two. First, it onshores or incorporates a significant body of EU law through different directives into UK law and gives the governance of those to the UK regulators. Secondly, it sets up this overseas fund regime, by which it grants equivalence on a country-by-country basis. It says that the Treasury will make these equivalence decisions as well. The Chancellor announced the direction of travel last Monday.

How do you see the relationship between these two different parts of the Bill? In theory, in future, having onshored the body of EU law and the directives, we are now at liberty to depart from them if we so choose. Do you see a relationship between that debate around divergence and the degree of divergence that the UK decides to opt for and the equivalence decision that we now need from the rest of the EU?

Chris Cummings: It is worth reflecting on the good work that has been done so far in trying to bring the different regimes together and match equivalence. Looking to the future, there is a strong argument for the UK to continue to bolster its presence in the international standard-setting fora, whether that is the Financial Stability Board, the International Organisation of Securities Commissions, Basel, and so on. Our authorities can continue to play a very strong role in arguing for what our industry would prefer, which is global and international standards.

We continually push for international standards as a global industry because that allows us to operate with reduced bureaucracy and by taking costs out of the organisation so we can really focus on looking after client needs. The UK has an outstanding track record of having its policymakers and regulators taken seriously in those international fora, because of the scale of the market that we have in the UK and the sophistication of our capital market in particular. At that level, if we can push for international standards in an international environment, that reduces some of the potential friction between the EU and the UK or other jurisdictions about where divergence may or may not be happening. That is the first thing we would like to stress—the international nature.

Secondly, something that has become part of the discussion in terms of the future relationship of the UK and the EU, and which our industry thoroughly supports, is a much clearer focus on outcomes and outcome-based regulation. It is noticeable that across the EEA there are different approaches in different European jurisdictions, all of which have been judged equivalent so far. Recognising that different jurisdictions will walk up to the same issue from different directions, yet seeking to achieve the same thing, that is the material part.

The third area I would just point to, if I may, is the depth of relationship between the UK authorities and those across the EU, not just in ESMA, our European regulator, but in the national domestic regulatory authorities. It is still absolutely the case that the UK policy-making apparatus—the UK regulatory bodies—is seen to have considerable expertise to offer. So just because we start in different places, it does not mean that we should not see the UK taking a little leadership and the EU tacking towards us in terms of lessons learned because of the sophistication of the market that we can offer. That was one of the reasons why we in the IA, among many other organisations, through the Brexit process was keen to press for a regulator to regulate a dialogue, which could be technically oriented, focused on bringing market and regulatory understanding to bear and making sure that there was a no-surprises, keeping-markets-open focus through the process that we have been through.

So I do not see equivalence and divergence as axiomatically pulling in different directions. I think what we will undoubtedly see is a period where the definition of equivalence needs to be—we need to have a thoughtful discussion, actually, about the substance of equivalence, moving away from its ephemeral nature and the fact that it can be granted or dismissed within a 30-day notice period. We need to have a much more joined-up and mature discussion about how two major markets can keep on doing business together, particularly in investment management when, as I mentioned earlier, 37% of Europe's assets are managed here in the UK and when, for certain member states, whether it is the Dutch pensions industry or something else, the quality of investment management conducted here in the UK is seen as a prized asset and something that they want to learn from and continue to enjoy the benefit of.

Q60 Mr McFadden: What would be the practical implications for UK-based investment companies—your members—if we stayed where we are now, with the UK having granted equivalence recognition to EU-based companies but not having a reciprocal recognition in return?

Chris Cummings: We have been helping our members prepare for all shades of Brexit outcome over the last four years. Firms have taken the decisions that inevitably they would take, so they have set up extra offices, they have recruited further staff, they have gained the necessary permissions and licences from the national competence authorities. At the moment, even with, perhaps, no deal or a rather thin deal, we are as well prepared for that outcome as it is possible to be. We are giving much more thought to the companies that we invest in—everything from life sciences to technology, to transport and infrastructure, to make sure that those companies are well prepared for the Brexit outcomes, but from our industry's point of view, recognising the equivalence decisions that have been made today, we are set as fair as any industry can be. I am trying not to over-promise, but suggesting to you that the industry has thought long and hard about potential outcomes, and we are as prepared as we can be for immediate issues.

Q61 Mr McFadden: Thanks. Can I slightly switch subjects now, to ask you about packaged retail investment and insurance-based products? The Bill removes the requirement for performance scenarios on PRIIPs. Could you just set out for us, in as simple terms as possible, what is wrong with these performance scenarios, and why there is a desire to remove them? If they are removed, what kind of information should be provided to consumers to help them make as informed an investment choice as people can?

Chris Cummings: Thank you for the question. You have touched on such an important issue for our industry. Through the consultation on PRIIPs we highlighted to EU policy makers and regulators, to our own Financial Conduct Authority and others, the dangers that we saw in the PRIIPs key information document, the PRIIPs KID. Because of how the methodology for PRIIPs was created—taking a rather avant-garde view of the calculation basis—it meant that we could have negative transaction costs. Somebody could trade in the market and it would not only not cost them any money; they could actually lose money by making a trade. That led to some perverse outcomes that were pro-cyclical in the presentation of the information they gave.

Let me give you an example by reflecting back on a new fund that has had just two or three years' experience. Imagine if, over the course of its life, that fund had had a very strong performance; it had done very well over a three or four year period. Because of the pro-cyclicality of how it had to report performance scenarios—looking to the future—it would have to present a potential investor with scenarios that were entirely positive and that generated levels of return that nobody in the industry would seriously put in front of a retail investor to suggest that this was what they could actually get. They were being forced to do it because of the methodology—the calculation basis—which reflected only that, if you had a few good years of performance, your fund would continue to have good years of performance. Similarly, if your fund had had a few bad years of performance, all you could project was that that bad performance would just continue and continue. That was because of the calculation basis and the way that the rules were written.

As an industry, we kept drawing this issue to the attention of the policy-making community in order to say that, if nothing else, when it comes to disclosure and investment, we have managed to convey the central message that past performance is no guarantee of future performance. Please let us keep on reminding people that past performance is no guarantee of future performance. Sadly, that requirement was taken away. The new calculation basis was introduced, which led to the industry ultimately being forced by its regulator to produce this pro-cyclical—and deeply misleading, in our view—information.

We continued to lobby against the wider introduction of the PRIIPs KID, arguing first that it should not be introduced. Secondly, having lost that argument and seen that that it was introduced only to closed-ended funds, we argued that it should be kept there until the wider implications were seen and not extended into the world of undertakings for the collective investment in transferable securities, because of the scale of UCITS and how many millions of people across the UK and Europe rely on them.

We were genuinely heartened when the Treasury announced that, post Brexit, it would be undertaking a review of the PRIIPs KID. What we hope to see, actually, is a wider-scale review of disclosure, whereby we can start from a different position. Given the technologically advanced world that we are living in today—the greater use of mobile phones, applications and computers, and just understanding that people engage with financial services in a very different way—could we have a rounder discussion about how we can do the thing that we want to do as an industry? We want to have a more engaged client base and to help them understand the different funds that are available and the different risk profiles of those funds, so that they can invest with more confidence, and certainly with more clarity about likely outcomes, rather than having to give false performance scenarios that simply nobody trusted in the industry.

Q62 Alison Thewliss (Glasgow Central) (SNP): I have a couple of questions on equivalence. Equivalence is a bit of a point in time. How far do you feel that the limits of equivalence could go? How much change would happen before that was withdrawn?

Chris Cummings: I think this is a "two ends of the telescope" question, if you pardon the analogy. We tend to think a lot about the UK changing rules and changing approaches, and there are one or two examples of that in the Bill—we have just mentioned PRIIPs KID. There always seems to be a sense that it would be the UK moving away from the central European view of regulation. Of course, that need not be the case. There are a number of regulatory reviews that are timetabled to be considered by the European Commission. There is the alternative investment fund managers directive. There is the review of PRIIPs and so on. Looking two or three years out, there are quite a few opportunities where, actually, the UK may stay still because the rules work in practice and it could be the European Commission that is drifting away from the central scenario that we are in today. That is perhaps almost inevitable, looking 10 years out; there are bound to be changes to the regulatory architecture and the regulatory regime, because the UK will need to modernise its approach to regulation, and not only here and across Europe, but more globally, every economy is thinking about growth-oriented policies as a result of the covid crisis.

That is why, for us, we approach the discussion around equivalence very much from a point of view of saying, "Okay, even if the words on the page change, how can we make sure that the bandwidth is agreed by all sides, so that minor degrees of divergence from equivalence are not the straw that breaks the camel's back?" That is why I come back to the point I was making just a moment ago about having a regulator to regulate a dialogue—a set, established forum where the FCA and the Prudential Regulation Authority can meet the European Securities and Markets Authority and the European Central Bank and so on, in order that information can be shared, regulatory approaches can be discussed and data can be shared as well, on a "no suprises" policy, so that we can make sure that in the UK and Europe there is a commonality of view, or a commonality of outcome certainly, that is being laboured towards.

I am confident that that would make sure that any discussions on equivalence are structurally much more sound and that we remove the political overlay. Across the industry, there is a concern that equivalence could be used as a political process rather than a regulatory one, which perhaps does not really lead to an outcome that is in the interests of savers and investors.

Every time a new rule is introduced that is different in the European Union from the UK, that adds costs to the industry, because we have to navigate our way through two sets of rules, which might not contradict, but simply do not join up. There are different reporting deadlines for data and so on. That is why we would really like to make sure we move to an outcome-based approach, rather than to a prescriptive, words on the page, exact phraseology, which will simply prove a headache for all.

Q63 Alison Thewliss: That is a good point about equivalence working on both sides; even though we have got off the bus, we might need to try to catch up with the bus to make sure we are still going in broadly the same direction. In your earlier answer, you mentioned other jurisdictions having more experience, having dealt with this for longer. Are there any particular examples that you feel would be useful, which the UK could learn lessons from?

Chris Cummings: Our friends in Switzerland have been navigating these waters for a period of time. The Investment Association continues to cultivate deeper relationships with our Swiss opposite number to see how it has mapped the terrain. We should make sure that we learn the lessons from how the US and the EU have negotiated when it has come to major directives. We have had a few instances where either the US was trying to apply its rules extraterritorially, into the EU, or where the EU sought to apply its standards and approaches outside the EU.

A really noticeable one was around costs of research. The EU, as part of the MiFID approach, suggested that all research had to be paid for. Investment managers had to pay for research produced by investment banks; in effect, we had to hand over cash. In the US, those payments were illegal. So the two regulatory regimes, both trying to protect consumer interests, found themselves at loggerheads.

Through industry intervention and working very closely with the regulatory authorities in the UK and in Europe and the SEC in the US, we were able to come up with a reasonably uncomfortable but workable compromise that has lasted over three years now, which gets reviewed on an ad hoc basis, but which allows both markets to function, even though the rules do not align. It is that kind of approach that makes you think, well, it works but it is sub-optimal. It feels ephemeral and, from an industry point of view, it is something else that is a distraction from the work of looking after our clients and investors. That is why we think that an openness and transparency around regulatory initiatives and regulatory thinking will help cement relationships into the future.

Q64 Alison Thewliss: Thank you. That is useful. Is there anything else that you expected to see in the Bill or that you would like to see in the Bill?

Chris Cummings: Actually, I think the Bill is a rather comprehensive document. I would defer to others who may have different opinions, but from the investment management industry, there is a good discussion about the overseas fund regime, which was essential for us; the future of passporting; a review of section 272, which we felt very strongly about; and of course equivalence. If anything, it goes towards what is most essential for our industry, which is protecting the delegation of portfolio management, because our industry in the UK is underpinned by an ability to manage the clients' investments—yes, from the UK, but across Europe and much more internationally. Ensuring that ability to protect and preserve delegation is simply mission critical for the investment management industry, which is one of the few UK growth success stories that we have seen really expand over the past decade.

Q65 Alison Thewliss: Thank you. Lastly, are you clear enough on what happens for existing investors if equivalence is withdrawn?

Chris Cummings: This is a matter that we have been working on very closely with our regulator, the FCA, and talking to Treasury about. It is part of the reason why, in firms' preparations for—forgive the terminology—a no-deal or a hard-deal Brexit, the industry had to do the thing that we exist to do, which is look after our clients. So that has led to more substance, regulatorily speaking, being established in other jurisdictions, particularly in Luxembourg and Ireland, which have traditionally been the places where most investment management back-office work has been done, with the UK, of course, being the centre for fund management and the actual investment aspect of the industry.

Alison Thewliss: Thank you.

The Chair: I have second the shadow Minister, Abena Oppong-Asare.

Q66 Abena Oppong-Asare: Thank you, Chair. Thank you for coming to speak to us. There are four audit firms and one of the allegations is that they are very close to each other and cosy with big companies. What are your thoughts on that? In the Bill, it is not very clear that that has been addressed.

Chris Cummings: I am terribly sorry. I was having an IT glitch and I missed your question. I do apologise. Can I ask you please to repeat the question?

Q67 Abena Oppong-Asare: The four audit firms: there are concerns that they are very cosy with each other and are very close with the big companies. The Bill does not essentially address that kind of issue. It does not seem very clear to me. Do you have any thoughts on how that could be addressed in the Bill to strengthen it so that there is better transparency and the relationship is less cosy?

Chris Cummings: Thank you for the question. We take the very strong view that we, as investors, rely entirely on public information. The quality of information produced by management is pivotal to the investment decisions that we make as investors. That has led to the point now where the investment management industry has a stake in more than a third of the FTSE. We think long and hard about investing in any particular company, listed or unlisted, and that is why we believe that it is the investor who is the client of the audit. A company pays for the audit, but it is the investment community that is the client of the audit. That is why we are so outspoken in pushing for better quality audits, and ensuring that the chairs of the audit committee take their responsibilities towards their investors seriously.

We absolutely worry about too close a relationship between an auditor and the company that they are auditing. That is why we feel that audits should be reviewed and we are constantly striving to have a more competitive ecosystem in the audit world, so you raise a very good point. If I may, I will offer to review that section of the Bill in more detail, and if we see anything that strikes us as being too weak or in need of strengthening, I will write to you with our proposals on that very quickly.

Q68 Abena Oppong-Asare: I want to follow up on that, because I recently read your comments about a new audit regulator in the *Financial Times.* The proposals gave me the impression that you felt that it would be able to ensure better reporting, and essentially hold the governance authority accountable to Parliament. Are you able to explain further about that?

Chris Cummings: Indeed. The audit profession has been through three major reviews recently. We entirely support the proposals to bring ARGA into existence. The work the FRC has been doing to prepare for the transition to ARGA has been commendable, but we need to go one step further and actually encourage policy makers to ensure that ARGA is brought into being as quickly as possible. Personally, I have been impressed by the new head of the FRC's ability to convene and cajole the audit companies to exercise some soft power, to encourage them to improve the quality of audit. Still, it is not the same as having that statutorily recognised independent regulator, and we encourage this Committee—and other parliamentarians—to push for the establishment of ARGA as soon as possible.

Abena Oppong-Asare: Thank you, Chair.

The Chair: I call Gareth Davies. Gareth, I think you will have to move to the microphone over there.

Q69 Gareth Davies (Grantham and Stamford) (Con): First, Mr Cummings, thank you for your comments about the extended permissions and the overseas regime, which I would agree with. However, can I specifically ask about these 9,000 funds? My understanding is that around 75% of all EU-domiciled funds are a SICAV vehicle, and I have two questions on that. First, what is your assessment of the demand level from UK investors for the SICAV vehicle, given that typically, historically, they have been much more expensive than the UK-domiciled equivalent? Secondly, can you explain more about the complementary nature of these funds to our market, specifically as relates to money market funds?

Chris Cummings: You are right in saying around 75% are UCITS. UCITS have become a global brand. It is a high watermark, at least currently, in an investor-centric investment vehicle, and rightly recognised by jurisdictions across Europe and internationally. In thinking about how the UK develops its own UK fund regime, which is some work that the IA has put forward to the Treasury and the FCA, we have taken the UCITS regime as our benchmark to think about how it can be expanded upon; how can it be modernised given the experience with UCITS over the last few years.

One of the core issues that the industry takes very seriously is better governance of funds. That is one of the reasons why we supported our regulator, the Financial Conduct Authority, in stipulating that, at fund level—not at company level—there must be an independent, non-executive director who asks the big questions about governance of the fund, and ensures that there is a clear value for money assessment at least annually, to drive down costs for investors and to ensure that investors are getting a better deal out of those funds. In terms of modernisation, we think that a great deal is already happening in the industry, with more to come.

Although money market funds are used by some retail investors, they are seen more as a capital markets instrument. Given their brevity, they tend to attract a lot of overnight money. Their particular structures are perhaps for more sophisticated professional and institutional investors. They are a useful counter, but really for us UCITS are the gold standard at the moment. We are naturally keen to extend the UCITS regime, especially post Brexit.

That is why we brought forward our own proposals for a long-term asset fund, which we think will not only modernise the UK fund regime but draw together some of the more interesting parts from other fund regimes. It has the benefits of an open-ended fund, and some of the advantages of a closed-ended fund, with an extra layer of governance. It will allow UK savers and investors, institutional as well as retail, to invest more in infrastructure, taking a longer-term view, and in what traditionally have been higher-growth companies—technology companies, life sciences, biotech and so on—taking a much longer-term perspective. We think that the long-term asset fund will be a great complement to the existing UK and European fund family.

The Chair: Does anyone else on the Committee wish to catch my eye in the remaining four minutes? In that case, thank you very much, Mr Cummings, for your evidence.

Examination of Witnesses

Emma Reynolds and Catherine McGuinness gave evidence.

2.42 pm

The Chair: We move on to our second panel of the afternoon, and the fifth in total. We have Emma Reynolds, formerly of this parish, now at TheCityUK, and Catherine McGuinness from the City of London Corporation. We have until 3.30 pm for this panel, and I will pull the plug if it goes over. Emma and Catherine, could you first introduce yourselves for the record, please?

Emma Reynolds: I am Emma Reynolds from TheCityUK. We represent the UK-based financial and related professional services industry, which employs 2.3 million people, two thirds of whom are based outside London. We are the largest taxpayer, biggest net exporting industry and contribute over 10% of the UK's total economic output.

Catherine McGuinness: I am Catherine McGuinness, policy chair at the City of London Corporation. We are the local authority for the square mile. In addition, we work very closely with the UK's financial and professional services sector, which carries our name even though, as Emma says, it is a UK-wide sector.

The Chair: Thank you. We will start with the Minister, John Glen.

Q70 John Glen: Emma, I will come to you first. Obviously, TheCityUK represents, as you said, a range of institutions and firms. It would be helpful for the Committee if you could set the context by summarising the industry's reaction to the Bill, and try to give us the widest possible view of the industry's reaction to the measures in it and what the consequences would be if we did not pass it. Afterwards, I will come to Catherine separately.

Emma Reynolds: Thank you, Mr Glen. We support the measures in the Bill, and both the overarching and the stated objectives. It is absolutely right that the UK Government are onshoring the regulations. There are obviously other measures within the Bill that are extraneous to that, which we support. The Bill is a welcome first step, but we look forward to working with the Government to develop an overall strategy for the financial services sector that could pull all the different strands together, building on what the Chancellor said last week, which was very welcome.

Q71 John Glen: Would you like to spell out where you think anything is missing from the Bill? The second part of your answer seems to suggest that there is a lack of an overall strategy. Is that what you are seeking to say? Obviously this has been contextualised as a first step, as we get towards the end of the transition period. I have indicated, as the Minister, that there will be subsequent legislation in future Sessions. Would you like to set out in more detail where you think there are specific gaps at this point?

Emma Reynolds: It is a very welcome first step. All I would say is that we, as an industry, have a broader agenda about our industry's long-term competitiveness going forward. I would not have expected to see that in this Bill. We had a very good relationship with Government, particularly with the Treasury, but some of the other issues that we are concerned about relate more to other Departments, whether it is access to skills and talent from abroad or green finance or other issues that are not in the Bill. It is a welcome first step.

Q72 John Glen: May I turn to Catherine? Thank you for giving evidence. One of the issues that has come up generally is an apprehensiveness about the capacity of the regulators in terms of their technical expertise to implement detailed rules such as the Basel rules. I have been fortunate enough to have been a Minister for a while and I recognise the complexity of the dynamic between the Treasury and the regulators. There is an intimate relationship, but could you give us a view on how you see the role of the regulators in the context of this Bill? Do you see any risk that they are being asked to do something that stretches them beyond what they should normally be able to do? Could you give the Committee a sense of that responsibility and how well placed they are to do what we have asked them to do?

Catherine McGuinness: Thank you for inviting me to give evidence. I cannot answer on the technical ability of the regulators in detail, other than to say that, in our experience, they are very capable of adapting and innovating. Indeed, we heard last week at Mansion House from both the Financial Conduct Authority and the Prudential Regulation Authority about their plans. Obviously, the regulators will be gaining significant powers under the Bill. It is important that we look at how those powers are scrutinised, including by Parliament.

On that front, the International Regulatory Strategy Group, which both TheCityUK and the City Corporation support, has suggested that parliamentary scrutiny be strengthened and reordered, and that the role of the Treasury Committee be complemented by setting up a joint Select Committee on financial regulation to look in detail at specific pieces of financial services regulation. That would be important to strengthen scrutiny, as we hand more responsibility to the regulators. It would also be useful—and the IRSG has recommended it—to increase the transparency of decision making by both the Treasury and the regulators, and to improve scrutiny. I am not sure if I have fully answered your question.

Q73 John Glen: You are referring to the response of both yourselves and TheCityUK to the consultation on the future regulatory framework, separate and additional to the Bill?

Catherine McGuinness: *indicated assent.*

Q74 Mr McFadden: Good afternoon, Emma and Catherine. It is very nice to see both of you. Emma, I want to come to you first. You are the fifth panel to appear and there is beginning to be a pattern to the questions that we have asked. I feel that I have asked this of a few people.

The Bill does lots of different things but two big things are that it transposes, or onshores, lots of different parts of EU regulation from many different directives. It gives powers to the UK regulators to govern all that. In doing that, as we come to the end of the transition process, there is greater freedom for either the Treasury or the regulators to diverge from that body of EU law. The Bill does that, but it also has this overseas markets vision, which is granting equivalence on a country-by-country basis, to the 9,000 funds that are domiciled overseas but which operate in the UK. I want to talk a bit about these two different parts of the Bill. Starting with you, Emma, what do you think your members' attitude is to onshoring this body of EU law? Do they broadly regard it as something that they would like to stick with or are there areas that they would quite quickly want to diverge from and, if so, what would be the most prominent areas?

Emma Reynolds: We were delighted that the Government took the unilateral decision last week to grant the EU equivalence in a number of different areas. We are still hopeful that the EU might follow suit. We have been calling for a technical outcome-based approach to equivalence for some time now. Within that, you could have different rules but the same outcomes. Even if there are pinch points around Solvency II—only some elements of Solvency II—you could have different rules in the UK that achieve the same objective.

From now until 1 January, we will remain technically equivalent. Inevitably, over time, there will be some changes in regulation, both on our side in the UK and in the EU. The EU is currently reviewing some of its own directives, MiFID being a case in point, but there are others too. We do not want to see divergence for divergence's sake. We would like to encourage a strong dialogue between regulators in the UK and the EU. There already is that dialogue, but we would like to see a framework for that plan. If you are a member of ours who trades across borders, you want similar or the same rules.

Q75 Mr McFadden: You referred to the equivalence decision announced by the Chancellor last week. That is one end of the telescope; the other end is hoping—I am sure the Chancellor hopes, too—that this is reciprocated. Do you see a relationship between the degree of divergence, which may occur and the decision-making process from the other end of the telescope on equivalence for UK firms trying to sell into EU markets? In other words, Mr Barnier talks a lot about the level playing field, but if it looks like we are departing from a level financial playing field, will that impact on those equivalence decisions you hope for?

Emma Reynolds: We are still hopeful that the EU might take a similar decision to what we saw last week. We would not like to see divergence for divergence's sake. There is no immediate appetite for great divergence from EU rules from our members. Does that answer your question?

Q76 Mr McFadden: Yes. Catherine, can I turn to you on the question of regulators? This gives a huge amount of new powers to the regulators. I have a two-part question. One, do you think they can handle it? Two, returning to what you said about a new Select Committee on financial services regulation—or whatever the exact title was—do you think that is an important part of a new accountability regime for the regulators, given the enhanced powers that the Bill gives them?

Catherine McGuinness: First of all, I do think the regulators can handle this, but I think it is important that we look at the right degree of scrutiny. Yes, when we speak to practitioners with the International Regulatory Strategy Group, it is their view that a joint Select Committee on financial regulation, which could look in detail at pieces of financial services regulation, would be a useful way of enhancing and embodying that scrutiny.

Mr McFadden: Thanks very much. I have no further questions.

The Chair: For the Scottish National party, first of all, their spokesperson, Alison Thewliss.

Q77 Alison Thewliss: Just to pick up where Pat left off on the idea of scrutiny, Catherine, I think you mentioned that the City of London has a joint committee on that. Could you tell me a bit more about how that operates and whether there is something Parliament can learn from that?

Catherine McGuinness: Actually, what I was mentioning was the International Regulatory Strategy Group, which is a cross-sectoral group of practitioners, who come together to look at a number of issues and make recommendations. We can provide the Committee with their recommendations in this space. As I said, they are suggesting that we look at a joint Select Committee on financial regulation in Parliament. I am happy to share with the Committee more details about the International Regulatory Strategy Group and its current programme of work, if that would be useful, and to provide copies of the paper in this space.

Q78 Alison Thewliss: That is really helpful, thank you. I think I share some of the nervousness that people have about all of these regulations being introduced and not having that level of scrutiny. Are there any particular areas where you feel that more scrutiny is necessary?

Catherine McGuinness: Regulation is a complicated issue. I think that if we are handing powers to the regulators to make regulation, when over the past few years we have made regulation through the EU, where there is level after level of consultation and development, we need to look at how we replicate that and put in the appropriate level of scrutiny as we take things forward ourselves.

I have to say that we very much welcome this Bill as a step in the right direction in getting the framework in place but, as people have said, it is a first step. We think it is then important to move on and look at the next round in the Treasury's consultation on the regulatory framework, as well as how to implement—to stray a little from your question—the Chancellor's statements in his announcement last week.

Q79 Alison Thewliss: Thank you. Emma, are there any particular aspects that you feel require additional scrutiny and transparency over decision making within the regulator's new powers?

Emma Reynolds: I would agree with Catherine and echo what she has said. Obviously, there are significant transfers of powers to the regulators, given that we are onshoring this regulation. In an EU context, we had the European Parliament's Committee on Economic and Monetary Affairs, which is a sizeable Committee with huge resources and an enormous amount of time to write and draft amendments in this area.

It is not in the tradition of our Parliament to have such Committees. In a way it would mean this Bill Committee sitting permanently. In Parliament, working with industry and Government, we need to work out exactly how we will do it, bearing our traditions in mind. That is why the IRSG, which is a point of contact between us and the City of London Corporation, came up with some of the ideas in the paper, which Catherine mentioned. We are very willing to share that with the Committee.

Q80 Alison Thewliss: Thank you very much. One of the recommendations within TheCityUK briefing that was sent round was around working towards implementing EU capital regulation requirements and requiring further guidance on that. Do you feel that you have clarity since the briefing was sent, or do you still require more clarity?

Emma Reynolds: Yes, we sent that briefing out. Thank you for referring to it. Yes, we would like to see more guidance and clarity from the Government as to whether the UK's version of the so-called CRR II—Capital Requirements Regulation II—is going to differ in any substantial way from the EU's CRR II. Some of our members have put resources and time into planning for that. It is just a question of ensuring that we have the most efficient planning for what comes next.

Alison Thewliss: That is useful. I will hand back to my colleagues.

The Chair: I saw Angela Eagle indicate she wanted to speak.

Q81 Ms Angela Eagle (Wallasey) (Lab): Catherine, you said that the City of London welcomes the Bill. What more would you have liked to see in it that is not in it?

Catherine McGuinness: The Bill must be viewed as part of a package with what we then heard from the Chancellor's announcement. It is a first step, but it does not set out an ambitious overarching strategy for financial services for the future. This is a critical part of our economy and we would suggest that we need that strategy as we move forward. The Chancellor's announcement last week and the emphasis on openness, innovation and green seem to us to be a significant next step, but we need to look at an overall direction for this important part of the economy.

Q82 Ms Eagle: Emma, does TheCityUK have any thoughts on the same question?

Emma Reynolds: We agree entirely with what Catherine has just said. I think the Chancellor has made a start prior to the consideration on Second Reading of the Bill. He obviously set out certain key reforms in certain areas, most notably in green finance. He also launched a number of calls for evidence and taskforces. Working in partnership with Government, industry would like to see the Government come forward with a strategy that pulls all of that together. That is not an easy thing to do, but we are a world-leading financial services sector in the UK, and we want to see that continue. This is a question of partnership with the Government. We are not saying we want it done to us without us being in the room, but we do think there is probably more to do to create a more coherent strategy for going forward.

Q83 Ms Eagle: There is this tension between equivalence, which you fairly unambiguously said you wanted a few minutes ago, and the argument made that we should leave the European Union so that we can have competition and—this argument is made implicitly—make our own regulations, so that we can make ourselves more competitive. Do you think that divergence could make us more competitive, or is it more likely to be destructive to UK financial services' ability to trade globally?

Emma Reynolds: If you are a global company that trades across borders, not just in the EU but in other jurisdictions, what you really want is the same or a similar set of rules. You certainly want global norms and standards on which those rules are based. There is no clamour for significant divergence from what we have. It is worth saying that although we are technically equivalent right now, and that will not change until 1 January, there will need to be responses from regulators, in terms of new regulation going forward.

We have the rise of FinTech, which brings its own challenges, but is a great asset to the UK. We have green finance, as well as some of the socioeconomic trends that have been accelerated by covid. All of these bring new challenges, and so our regulation cannot afford to sit still. We want to avoid unintended divergence when the EU and the UK are facing some of the same challenges. We may go about making our rules in a very different way, but if we could achieve broadly the same outcomes, that could mean we were equivalent, and that would provide advantages to those of our members who trade here and in the EU.

Q84 Ms Eagle: Thank you. Catherine, we are coming out of the European Union, where we used to wield great heft in the technical discussions around this regulation. I assume that is still the case. I speak from my experience as Treasury Minister. Are you worried that, untethered, the EU will go off in a different direction and regulate in a way that makes it much harder for us to trade into the single market?

Catherine McGuinness: I would say two things here. First, if we are not at the table helping to shape the regulation, there is, of course, the risk of divergence from either side as we exercise our own autonomy. I think that global standards are going to be critical for all of us, because we are talking about markets that operate across borders. It is in all our interests—the EU's, ours and the institutions in the sector—to have a set of global standards around global issues. So, yes, there is a risk of divergence from either side. Keeping the conversation going as the regulation develops is going to be critical.

Taking the green question, for example, we have the EU, which is fairly advanced with its own taxonomy. We are now going to be looking at our own taxonomy, and I think that is a great thing that we should be doing. I also think that green finance is an area in which we can really lead the way, including in regulation. It will be important that we look at how those systems mesh together, and this is a conversation that the sector is encouraging our regulators to have with other countries, too—not simply the EU. I was nearly late because I came from a panel in the US speaking about the importance of a regulator-to-regulator discussion about some of these issues, and the role the sector might play in helping to develop thinking. It is possible that we may diverge, but it is in the interest of customers and businesses that there should be well regulated financial markets, with consistent rules and regulations over cross-border challenges.

Q85 Ms Eagle: With our leaving the EU, there has already been some competitive behaviour on the part of certain countries in the EU that shall remain nameless, which are trying to grab some of our business. Emma, do you think that that kind of dynamic, competitive, semi-predatory behaviour is going to trigger a kind of race to the bottom? Would whether or not there is a deal in the next few weeks make any difference to how you would contemplate that activity?

Emma Reynolds: I hope you do not mind if I take your last question first, because I think it sets the scene for the rest of your questions. There is very little in the deal for financial services, if there is a deal. However, our industry thinks it is incredibly important that there be a deal, because that would leave the door open for the EU granting equivalence in certain areas of financial services, and for other agreements that are essential to services more generally, such as provisions around data; frankly, if there is not a better agreement on that between the two sides, that could be very difficult, not only for our members, but for other service industries, too. I hope that answers your question on deal versus no deal.

There is nobody in our industry I could name who wants a race to the bottom. That is not the way to make yourself more competitive. We view the UK's high standards as giving us an competitive edge. We have some of the highest standards in the world. We do not think that there will be a race to the bottom in that way.

On your question about protectionism, I think there is a live debate right now in the EU. One EU interlocuter put it to us very succinctly the other day as the trade-off between location and efficiency. European business has access at the moment to deep and liquid capital markets in the UK, which they find very useful, and which they cannot find in the EU currently. We would like to see that continue—that is in the interests of businesses not only here, but on the continent—but you are right that there is a live debate about what happens next, and whether location is more important to the EU. That debate is going on not only in the EU; covid has accelerated the trend towards protectionism, which is why it is so good to see that the UK Government are taking such an open approach in the Bill. We would encourage that to continue, because we think it is one of our strengths, and it gives us that competitive edge.

Q86 Ms Eagle: Thank you, Emma. Catherine, I know this is a slightly invidious question, but I am going to ask it anyway. Do you think the FCA is properly equipped and resourced to take up the duties that the Bill confers on it?

Catherine McGuinness: Yes, but I think it is welcome that the FCA, under its new leadership, is also carrying out a review. That is appropriate. Clearly, we are asking a new role of it, and it is absolutely appropriate that it should review how it operates as it takes that on. I am very confident in our regulators, but I am also pleased to hear that the FCA is carrying out its review. Secondly, I would go right back to my point around the need for scrutiny and challenge in that space. That should involve not just the Joint Select Committee, but looking at the Treasury's role.

May I revisit the question about how the UK can retain its voice in setting standards?

Q87 Ms Eagle: Please do.

Catherine McGuinness: I feel I missed a couple of points there. It is true that part of the way we will retain our global leadership in standard setting is by bilateral dialogue and co-operation, regulator to regulator, with other countries. There is also the question of how we work with the multilateral organisations. We need to take a good look at how we engage, on our new footing, with the Basel committee—how we engage with other global standard setters. We have a good story to tell. I think next year gives us a very good opportunity, as we take up the presidency of the G7 and with COP26 coming up. I have already mentioned our potential leadership on green standards. We should really look at next year as part of this new chapter for financial services, and look at how we can make clear our place in standard setting, and in that conversation around global standards.

Q88 Stella Creasy (Walthamstow) (Lab/Co-op): My colleague, Angela, has asked most of the questions that I wanted to ask. I just want to get a bit of clarity. Clearly, there is the question of whether your members are thinking about how the Bill will affect the future landscape for their operation. Could you give us some sense of how you feel the Bill will affect the many who are thinking about whether to stay in the UK or go overseas? What issues around the regulatory framework would be the tests for them? Are there things that we could do in the Bill to make it even more likely that people will commit to the UK, and are there things that would make it less likely?

Emma Reynolds: There are measures in the Bill that do, as I understand it, reflect some of the measures that the EU has taken around prudential requirements. In the past, there has been a bit of a one-size-fits-all for different sizes of companies. For smaller companies that carry a smaller risk, you need to take a proportionate approach to regulation. That is by no means saying that we want lower standards, or a race to the bottom; it is about considering firms of different sizes and the risks that they bring.

Obviously, there are challenges every time there is a significant change such as this, and 1 January will look and feel very different, but there are some opportunities, too. For example, we will be in a position where the UK is making laws and regulations for one member state. I mentioned the fast-moving challenges coming up, involving socioeconomic changes to do with covid, FinTech and green finance; the UK will have more flexibility and agility, and so can perhaps act more quickly than before, or than the EU can, operating with 27 member states.

Catherine McGuinness: I think that is right. To add to what Emma has said, the Bill is very helpful in demonstrating the planned way forward. People will be looking for an ongoing commitment to high standards—and, yes, agility in how we make our rules, but also a rigor in that. We cannot stress often enough the importance of this country's openness to welcoming trade and business, and to high standards, against our strong regulatory backdrop.

It is very welcome that the Treasury will be looking at the strong patchwork of the bases on which people can come into the UK and operate here—the overseas persons exemption and so on. The Treasury will look at how that whole framework can be knitted together in a more coherent manner, as I understand it. What people will be looking for is an ongoing commitment to high standards and the ability to do their business.

The Chair: Are there any further questions? In that case, I thank our two witnesses on this fifth panel. Emma and Catherine, thank you for your evidence.

Examination of Witnesses

Adam Farkas and Constance Underwood gave evidence.

3.14 pm

The Chair: For this third afternoon evidence session—the sixth in total—we have Adam Farkas and Constance Underwood from the Association for Financial Markets in Europe. It is our first panel in person. We have until four o'clock for this session. Adam and Constance, do you want to start by introducing yourselves for the benefit of the Committee, and for the record?

Adam Farkas: Good afternoon. Thank you for inviting us both. We are delighted that we decided to come physically. We did not know what the other invitees would decide. I am Adam Farkas, CEO of the Association for Financial Markets in Europe. AFME is a pan-European trade group representing a broad array of European and global participants in the wholesale financial markets. Our members include banks headquartered in various jurisdictions, spanning from Japan to the United States, and inside and outside the EU. What they have in common is that they all do business in the UK and the EU. Our purpose is to serve as a link between capital markets, participants and policy makers across Europe.

My experience in the financial services sector spans over 30 years, covering both private and public sector bodies. Prior to joining AFME this February, I was executive director of the European Banking Authority for nine years, and before that, I acted as executive chairman of the Hungarian financial supervisory authority. In my capacity at the EBA, I also served on the Basel committee for eight and a half years. I should note that there are a few topics directly related to my prior position at the EBA that I am not permitted to address today because of my restrictions, but Constance will address those as appropriate.

Constance Usherwood: I am Constance Usherwood, director of prudential regulation at AFME. My experience also covers both public and private sectors. I also worked at the European Banking Authority some time ago, and have worked for a globally systemically important bank. I am very grateful for the invitation to be here with Adam today to give evidence. I hope that that is helpful to the panel.

Q89 John Glen: Welcome to the Committee, and thank you for giving evidence. Adam, may I start with you? We have heard a number of references today to the role that the UK has played in the EU financial services legislation process. Given the wide experience that you have just mentioned, it would be useful if you could explain how you see the UK, in terms of the role that it has played. In the context of the investment firms review, do you think it is right that we should be implementing a more proportionate regime for investment firms?

Adam Farkas: I will try to answer the first part of the question, but then I will leave it to Constance. because this is one area where I was personally involved, and I am not allowed to comment.

On the first part of the question, it is beyond doubt, and everybody in the public and private sector recognises it, that the UK as part of the European Union was playing a leading role in shaping and forming financial services regulations in the Union. That is clearly evidenced by the leading role of London and the UK more broadly as the financial services centre or hub of the Union. That is beyond any doubt. It was respected as such, and had a very strong voice in shaping the different regulatory initiatives. For the future relationship, it is important to have engagement and openness, and that a co-operative attitude, or co-operative setting, is retained, with two autonomous decision-making jurisdictions, in which the two sides can co-ordinate, exchange views and possibly even influence each other's new initiatives or the evolution of their respective regulatory frameworks, with the potential aim of maintaining as much consistency as possible and practicable. On the investment firms regime, I pass the floor to Constance, because I was part of the development of the standards at the EBA, so I must refrain from comment.

Constance Usherwood: With the investment firms prudential regime, the UK authorities have played a key role in the development of the prudential regime that is specifically targeted to the business models of investment firms and making sure that it is proportionate. In that respect, we fully support the approach that is being taken today. In terms of the application to the different prudential frameworks and of the regimes versus the CRR, the bulk of our membership will probably not be directly impacted by the regime due to their size and activities. That would also tally with the approach that the EU has taken.

Q90 John Glen: If I may probe just a little further, you are saying that this proportionate change for the UK is in line with your members' expectations and does not offer any serious threat to the integrity and reputation of the UK in this area?

Constance Usherwood: Yes, I would agree with that, absolutely.

Q91 John Glen: May I ask you about the LIBOR benchmark? This is a complex area, as we have already heard today. Do you agree with the approach that we have taken in the Bill? What would be the implications if we did not take this approach, and can you say what other approach we could take if you disagree with it?

Constance Usherwood: I am going to apologise, but I think that Adam is probably best placed to come in on this one.

Adam Farkas: We very strongly support the clear and oft-repeated message of the UK authorities that active transition by transaction parties to the new risk-free rate is the only way to achieve certainty of outcome in the transition. We have promoted this message regularly and we have developed market standard language to support it that can be used by investors to assist them in this process.

A very difficult part of the transition process relates to what happens to legacy contracts already in place that reference the old LIBOR rates that are being phased out. Within legacy contracts, there are the so-called tough legacy contracts, which are very difficult to repaper or change the reference in. They cause the most complex challenges for end users as well as for members of AFME or other financial services providers. We therefore very much welcome the provisions of the Financial Services Bill that give the FCA new powers to mitigate that risk by directing the administrator to change the methodology of LIBOR if doing so would protect the consumer and market integrity. That would enable the FCA to stabilise certain LIBOR rates during the wind-down period so that their limited use in legacy contracts can continue. The answer is yes, we are very supportive. None the less, we welcome the further clarity which, I think, will be forthcoming on 25 November from the FCA and the Treasury on what steps the authorities are planning to further this objective, because there are some outstanding questions that require clarification. I would be happy to go into them, but in the interests of time, I will stop there.

Q92 John Glen: Just to be clear, there is no substantively different path that you anticipate that we could have taken on this matter that would give us a better outcome than the one that we are headed for, notwithstanding the need for the further clarification that is in train?

Adam Farkas: That is a difficult question to answer because we have not speculated on different outcomes, but certainly the path that the Bill is taking is something that we can very strongly support.

Q93 Mr McFadden: Thank you for coming today. I want to start with our current situation on equivalence, where we had an announcement from the Chancellor that the UK will grant equivalence recognition to companies based in current EU member states but we have not got a reciprocal equivalence recognition for UK companies selling into EU markets. What are the practical implications for UK-based financial services companies if that situation continues to exist for some time?

Adam Farkas: Very briefly, equivalence determinations provide the major legal framework for different jurisdictions to provide access to service providers that are licensed and supervised in each other's markets. To answer your question, if equivalence determinations by the EU are not forthcoming, or not brought forward at pace or with the width that is expected, that will put limitations on the access of service providers—financial services companies and firms—to the EU market. This is really an issue of market access.

Q94 Mr McFadden: Can you give us some practical examples of what kind of barriers companies could face and of what decisions they might have to take to overcome them?

Adam Farkas: In very simple terms, if a company is licensed in the United Kingdom and does not have access, or loses access, to the EU—of course, that is completely free under passporting regimes—it will find limitations in serving clients or trading with counterparts in respect of the financial services that it provides in the other jurisdiction, which would be across the channel in this case. A lack of equivalence has been a risk throughout the process of the negotiations, so authorities have made significant efforts to prepare regulated entities—financial firms—and to force them to prepare for all eventualities. In other words, everyone is hoping for the best but preparing for the worst.

AFME members—of course, our membership is tilted towards the large players—have made extensive preparations over the years to get ready for the worst outcome, which would limit direct market access from the United Kingdom to the EU, by way of setting up entities, moving activities across the border and making all necessary arrangements to allow them to continue to serve their clients across the European market. Of course, if equivalence is granted and access is provided on that basis, it would improve the general situation of market access between the EU and the UK, so we welcome the Chancellor's announcement and the UK Government's determination last week to grant equivalence within a certain scope to third countries, including EU countries.

Q95 Mr McFadden: So the main mechanism for preparation, as you put it, is to establish an operation inside the EU if you have not already got one.

Adam Farkas: With a lack of equivalence. If no market access is provided on another basis, the main mechanism is to establish entities that are licensed, capitalised and supervised in the other jurisdiction, meaning that that entity can have access to the market, but that involves costs and operational implications.

Q96 Mr McFadden: Can I ask you about LIBOR? We have heard that the Bill facilitates a move away from LIBOR. The weaknesses and manipulation of LIBOR are well documented. The L in LIBOR stands for London—it is the London interbank rate. Are there any implications for London's status as a global financial centre from a move away from LIBOR towards different kinds of benchmarks?

Adam Farkas: It is a very difficult question. We all know the history of what happened. What is important is what happened afterwards and how the authorities decided to move away from the possibility of manipulating these rates. There is a global co-ordination effort and a long-standing global discussion on transitioning out of the old way of setting different financial benchmarks.

Regulations were put in place, changes to methodologies were put in place and public institutions took a stronger role to make sure that benchmarks are more robust and not prone to manipulation or potential distortions. I think, in that sense, this issue of reputation and the credibility of these benchmarks has been very strongly addressed by the authorities globally, and also in the UK by the authorities. I believe strongly that this will lead to a much sounder and more credible framework once the transition is completed.

Q97 Mr McFadden: Finally, I would like to ask if you a question about future direction. We have heard today about British influence on the EU directives that govern financial services—that there has been quite heavy British influence over the years in designing this set of regulations, which this Bill onshores back to the UK as a result of Brexit. That means that, come the end of the year, we will be very closely aligned with what has been developed over the years so far.

What is your view of what will happen on the EU side, absent a British influence, as financial services regulation inevitably evolves and develops? We no longer have one table, if you like. We have two tables—a British one and a European one. Does that mean, inevitably, that the two sets of regulations gradually spin off in different directions, or is that not the case?

Adam Farkas: Before I answer the bilateral question, I think that there are other forms of international co-ordination of financial services policy. One is multilateral in the form of the FSB, IOSCO—that is on market rules—and the Basel committee, which deals with prudential rules. Both the EU and the UK are significant players and participants in this global co-ordination. In the interest of having open, transparent, and well-functioning financial markets and maintaining international flow in capital movement, allowing both banks and corporates to manage their risks cross-border, these multilateral engagements are extremely important. They actually provide a very good platform to co-ordinate the major direction of financial regulation globally.

Now, the bilateral co-ordination will change, because it will take the form of the so-called bilateral regulatory dialogue—or whatever similar term the EU uses—with third countries, which provide a platform. Inevitably, if two jurisdictions take a separate course in legislation, there will be some divergence between the rules. What is very important is that if that happens, it is transparent to this multilateral setting as well as in the bilateral context; it is well-explained and co-ordinated as much as possible; and it is only done if there is a real justification for it.

Mr McFadden: Thank you. Constance, do you want to add anything?

Constance Usherwood: I would add that in the context of the Basel framework, that does allow for some adjustments or tailoring for jurisdictions when it comes to implementing that in law. That is certainly something that we would expect the PRA to look at, going forward—such things as mortgages and trade finance. There are little aspects of the Basel framework that already allow for some consideration of how that is best tailored to the market in which it is being implemented.

The Chair: We will now move on to the SNP spokesperson, Alison Thewliss.

Q98 Alison Thewliss: Thank you very much, Chair. I was having a look at the policy recommendations of the Association for Financial Markets in Europe for the EU-UK relationship. To what extent do you feel the Bill achieves those recommendations?

Adam Farkas: The Bill provides the possibility to achieve those recommendations. It provides the framework for future UK financial regulation. It provides the possibility, delegated to the respective regulatory authorities, to shape the UK's financial regulation. However, if it is going to be a transparent process, as it is expected to be under the Bill, that opens up the possibility of retaining co-ordination with the EU in a new setting. The Bill sets the foundation to meet the policy recommendations that we put forward, but it does not guarantee it.

Q99 Alison Thewliss: So we are still some way from finding out what the building looks like.

Adam Farkas: Yes.

Q100 Alison Thewliss: With regard to the point that you made about legacy contracts and LIBOR, to follow up on the questions I put to Chris Cummings of the Investment Association earlier, do you think that there is merit in having something in the Bill, rather than having FCA rules on this matter?

Adam Farkas: I am probably not qualified to answer that. I am allowed, but I am probably not qualified. I think the FCA, as an authority, has been playing a leading role globally in the whole transition process and the whole global co-ordination process. The Bill's intention to give a strong role for the FCA in defining the last steps of what happens with the legacy contracts and with LIBOR as a benchmark is pointing in the right direction, but I will not go further than that.

Q101 Alison Thewliss: That is fair enough. I was trying to get at whether there is stronger ground if it is in legislation, rather than dependent on rules, for any disputes that might arise.

Adam Farkas: That is probably a legal question.

Q102 Alison Thewliss: Constance, if I am right, you have been responsible for working on some green finance work. Do you think that there should have been more in the Bill to look at those things, rather than waiting for a later stage? Is this a good opportunity to perhaps look at some of the green finance issues, rather than waiting until later?

Constance Usherwood: The Basel 3.1 aspect, in particular, is about ensuring that banks hold capital commensurate with the risks that they take. As such, the Basel framework that it seeks to emulate in UK law does not consider climate risk as a risk. That is not to say that that work is not under way in international forums. The Network for Greening the Financial System is certainly looking at how to incorporate climate risk—or whether it can be incorporated—into prudential regulation. It is at a very nascent stage. I think the work that the PRA is doing in that forum is very positive, as well as such things as climate risk stress testing.

That is something that the PRA might want to open the door to later, once it is more considered and technically advanced. Certainly, the sustainable lending aspect is an important mandate that it has to look at. We remain interested in how it develops that mandate in its consideration of the rules.

Alison Thewliss: Thank you very much.

Q103 Angela Richardson (Guildford) (Con): Adam, in your earlier comments you said that London is the financial services hub of the EU and that it has been a strong voice in shaping the EU's regulatory framework. First, do you believe that we will continue to be a strong voice in global regulator-to-regulator discussions? Secondly,

[Angela Richardson]

do you agree that the Financial Services Bill will increase the UK's resilience to economic shocks, while meeting our international commitments on protecting the global financial system?

Adam Farkas: Answering the first question involves a bit of speculation into the future. Given the importance of the City of London as a global financial centre, and given the weight and experience of UK authorities in global standard-setting bodies, I would be inclined to confirm that yes, the United Kingdom is expected to remain a strong voice in multilateral standard-setting bodies and in multilateral discussions on financial stability, as well as in micro-financial regulation, markets, insurance and prudential banking regulation.

There is probably no conclusive answer to your second question, but the Bill certainly opens up the possibility of creating a framework within the United Kingdom that will delegate a lot of rule-making powers to the respective authorities—the PRA and the FCA. It will provide a well-defined, clear and transparent framework, and it will also define an accountability regime with that framework. In my view, that will establish the possibility—subject to the detailed rules that will then be adopted—that financial regulation as a whole will continue to ensure financial stability in a global financial centre.

Angela Richardson: Thank you.

Q104 Gareth Davies: My understanding is that the British Government have so far filled out something like 2,500 pages of questions from the European Union, all of them to strict deadlines. What do you think has caused the delay in the EU granting equivalence or making any public statement on that? Clearly the UK is equivalent, so what is causing the delay?

Adam Farkas: I do not know. What I can say is that the equivalence determination process consists of two stages. One is a technical assessment that involves a detailed assessment of the rule book for the set of regulations, with questions and interactions. In every jurisdiction there is a second stage, which is the determination itself after the technical assessment. That stage is a much more political decision, or is a decision of a more political nature; it considers other aspects in addition to the interests of the jurisdiction making the determination. The answer probably lies there, but I have no information on why equivalence decisions have not yet been made on the EU side. It is not true to say that no equivalence decisions have been made; some have been determined and published, even if on a temporary basis.

Q105 Gareth Davies: But there is still the big question mark on overall equivalence for the United Kingdom. You hit the nail on the head when you referred to the potential for politicisation of the regulatory process. Looking at what happened recently with Switzerland, my understanding is that the Swiss stock market had its equivalence removed because the Swiss Government had the temerity to put Swiss citizens first in new Swiss labour laws. My fear is that the EU will politicise the process, and I would love your view on that.

Adam Farkas: I do not think I would like to express a view. One point of correction I would make is that there is no such thing as overall equivalence; unfortunately, the equivalence decisions are very technical and made bit by bit. There are equivalence provisions in different parts of the EU legislation, and there are equivalence decisions possible in parts of the UK legislation. Looking at the announcements from the Chancellor, it is very specific and is focused on certain activities or institutions that are deemed equivalent to the domestic regime. There is no overall equivalence, and there will probably not be.

On the Swiss equivalence case, I will refrain from commenting, if you will allow that.

Gareth Davies: Dr Huq, can I ask one more question?

The Chair: We have until 4 o'clock for the entire session, so you can ask a quick question.

Q106 Gareth Davies: Given that in your opening remarks you said the UK had played a significant part in the formation of regulation as a major financial centre, to what extent are you worried that the European Union will now take a more localised, protectionist stance?

Adam Farkas: As an association, we are very strongly advocating the openness of markets, both in the United Kingdom and in the EU. We are very strongly advocating maintaining the co-ordination of dialogue and the consistent implementation of global standards. Of course, it is very difficult to speculate which way the EU will go. What I can say is that our members have a very clear view on this issue, and we are—

The Chair: Adam, can you please speak into the microphone? For the recording, you need to be in the right place.

Adam Farkas: Yes, of course.

Our position on this issue is very clear, and we have been open and transparent about our members' position on arguing for market openness, maintaining consistency and, on the basis of constituency, maximum market access and flow of capital and services between the UK and the EU.

The Chair: Constance, do you have anything to add?

Constance Usherwood: Generally, we hope that the EU and the UK will establish a close, co-operative and stable long-term relationship for financial services, and it is very important to underline that that should be the long-term goal. I think the Bill leaves the door open for doing that.

Q107 Julie Marson (Hertford and Stortford) (Con): Constance, when he was the interim chief executive officer of the FCA recently, Chris Wollard made the point that having the highest international standards of regulation and doing the best for the markets are certainly not mutually exclusive. You might even go further and say that they are actually vital for each other. To what extent do you feel that the Bill achieves those two objectives—having the highest standards and the best framework for the markets?

Constance Usherwood: It is very clear that the UK Government's intention is that the UK should maintain high, consistent and global standards. From my knowledge of interaction with the PRA, it is committed to doing that. That was also made clear last week by Sam Woods in his Mansion House speech—it is not about a race to the bottom. In so far as a jurisdiction maintains a predictable, open and transparent rule-making process—we expect the PRA to do that with consultation processes—and operates a high, globally consistent standard, that is a really good competitive base from which global banks can operate out of.

Q108 Ms Eagle: Adam, I wonder whether there is anything that you would have liked to see in this Bill that is not there, given that it is an initial first step. Is there anything that you think should have been paid attention to and dealt with in this Bill that has not been?

Adam Farkas: Given that it is providing a framework for the future regulatory architecture in financial services, I am not suggesting that these are missing, but I will list what is important for the industry: that the framework is predictable—that is key for the players—that the framework provides transparency, so that when the rule making is happening under the Bill, the process is transparent; that it is possible for the industry to engage, so when different rules or pieces of the rules are consulted on, there is sufficient accountability provided, but that is not for us to decide on; and that sufficient time is provided for implementation—that is always a critical issue for the industry.

I think that what is proposed in the Bill goes very far on all those points. In that sense, it is difficult to give a definite answer of what else would need to be in the Bill. Those are the points that we are looking at with great interest in relation to the final adoption of the Bill.

Q109 Ms Eagle: We heard earlier today about the shift away from the LIBOR benchmark—which is obviously another part of the Bill—by the bond markets, and that they want continuity of contracts to be in the Bill, particularly for tough LIBOR contracts that cannot be phased into something else. They also want a safe harbour provision to minimise the possibility of legal challenges on how LIBOR is interpreted as it exists. Do you agree with that?

Adam Farkas: I agree that this is an issue that will need to be addressed. There is a question as to whether it needs to be addressed in this particular Bill or in the context of the future rule making by the FCA, but the points raised are valid ones and we also agree with them.

Q110 Ms Eagle: The Bill also contains powers for the PRA and the FCA to create a prudential regulation; an entire new system for credit institutions and investment firms. Do you represent such companies?

Constance Usherwood: Yes, we do.

Q111 Ms Eagle: So are you happy with the framework that has been set out in this Bill? Given that it is only a framework and you do not know the details yet, I am assuming that you think the details will be fairly similar to the European directives that the UK had so much input in forming.

Constance Usherwood: Yes, I think we support it. One thing that I would note is that there are a lot of rules to implement; the Basel III framework that is going into this part of the Bill is over 160 pages long, so there is a lot of technical detail that will need to be considered. We hope that the full impact assessment is therefore done on that basis for the UK banking sector, and also that the consultation process allows the industry to have a meaningful input. I notice that there have been a couple of smaller consultations done recently by the PRA that have only required a month or two months for consultation, and certainly that is something we hope will be fully considered when they put the rules before industry.

Q112 Ms Eagle: Is that what you mean when you are talking about accountability—to the companies that are regulated rather than the consumer? Clearly a great deal of detail will have to be decided by the regulatory authorities; we simply cannot do it in primary legislation. Do you think the Bill gets the balance right between setting a framework in primary legislation and allowing the regulatory authorities to do the detailed work?

Constance Usherwood: Yes, I think that is probably the best way forward and I agree with the approach that has been taken. The other alternative is that it would all have to come before you and you would have to look at all these pages. I think that the regulatory authorities are best placed, and the most technically capable of really assessing it, and doing the impact assessment that will ensure that it is tailored to the UK banking sector.

Q113 Ms Eagle: In what period do you expect the impact assessment to arise after the rules have been specified in a consultation period? Is that the kind of process that you would like to see the FCA follow?

Constance Usherwood: Usually we would expect the impact assessment to be done before the rules are formalised, but it is a fluid process and I would not be certain what the PRA has in mind. We imagine it would take place at some stage prior to any finalisation of the rules.

Adam Farkas: Normally when detailed rules are produced there is some sort of obligation on the authority to provide an impact assessment with it, on the basis of the draft rules. Then, typically, there is a consultation, so opinions are sought from different stakeholders, and then the rules are finalised. The impact assessment is clearly a key feature of financial services rule making, at EU level and at national level. It is part of the broader accountability, which is very important.

Ms Eagle: Thank you.

The Chair: If there are no further questions, I thank our two witnesses for their evidence.

Examination of Witness

Gurpreet Manku gave evidence.

3.57 pm

Q114 The Chair: We move on seamlessly to Gurpreet Manku from the British Private Equity and Venture Capital Association, who is joining us remotely. We have until half-past four. We are three minutes early; we have made up some time. Gurpreet, could you introduce yourself for the record and for the Committee, please?

Gurpreet Manku: I am Gurpreet Manku, the deputy director general and director of policy at the British Private Equity and Venture Capital Association. The BVCA represents more than 300 private equity and venture capital firms in the UK, ranging from the smallest venture firms investing in start-ups, all the way through to growth-capital and mid-market firms investing domestically. We also have a number of larger pan-European and global fund managers.

The Chair: Thank you very much. We are going to follow the time-honoured tradition of going first to the Government, then to the Opposition, and then to other members of the Committee. We will start with the Minister, John Glen.

Q115 John Glen: Thank you very much, Gurpreet, for coming before us to give evidence. I will start by addressing one of the key headline measures in the Bill that enables the FCA to implement a more proportionate prudential regime for investment firms. I would like you to give us your perspective on that measure, how you think it could be helpful, what you are looking to see come out of it, and whether you expect to see improvements based on the discretion that the FCA will have.

Gurpreet Manku: We welcome the Financial Services Bill as it implements a prudential regime for investment firms that is tailored to the specificities of the UK market while maintaining world-class regulatory standards. To give you some context, the UK has already regulated private equity and venture capital firms. Broadly, there are two categories. First, we regulate the managers of private equity and venture capital funds. Those entities are regulated under the alternative investment fund managers directive. We also regulate advisory entities under MiFID. Those firms will be most impacted by the investment firms prudential regime. These advisory firms advise on and arrange private equity transactions for other regulated fund managers, sometimes within the same group. Those other managers tend to be based overseas, including in the US, Asia and Europe.

That is important because the fact that the UK has a lot of those advisory entities signifies that the UK is a global hub for private equity and venture capital. Many international firms choose to make the UK a base for carrying out UK, European and, in some cases, international investment and fund-raising activity. Since the inception of the investment firms review, the BVCA has been in dialogue with both the FCA and the Treasury about its implementation.

We welcome the introduction of a tailored regime that appropriately covers the activities of these firms, as well as their size, and the relative risk they pose to the financial system when compared with other banks and financial institutions. The new regime will lead to additional requirements for some of those firms, particularly the advisory entities that I mentioned, including higher capital requirements. We submitted feedback to a recent FCA discussion paper on the need to calibrate these new requirements for the risk posed by those firms. Our key ask for the FCA and the Treasury is that an appropriate transition period is available to those advisories.

Interestingly, the FCA's discussion paper acknowledges that while there are transition provisions in place for other categories of investment firms, there is a gap for the category that includes these private equity advisers. That FCA category in the UK is known as exempt CAD—capital adequacy directive—firms. That is not just an issue for private equity and venture capital firms. There are many other types of firms in this category. My understanding is that they tend to be smaller financial services firms, such as corporate finance advisory boutiques and other consultants. That reflects the UK market, which has a huge number of financial services firms at the smaller end.

We think that the omission of this transitional period in the EU text was not deliberate and was just a mistake. The category of advisers that we are referring to should also have a transition period. The benefit of the Financial Services Bill is that it will enable the FCA to correct this omission and ensure that all types of investment firms benefit from transition rules.

Finally, I welcome the confirmation that the target implementation date is January 2022, because I think that will give sufficient time for the FCA to consult on the detailed rules and we need that lengthy consultation period. It will also give firms the time that they need to implement them.

Q116 John Glen: Thank you. I will follow up with one question. You have helpfully set out the context of the range of firms and the different and proportionate levels of capital requirements that are required. Can I ask about your level of confidence in the FCA's ability to implement the appropriate regime with the degree of customisation and detail, in terms of competence? Do you have any reservations about their capacity to do that? How comfortable is your working relationship with them?

Gurpreet Manku: Interestingly, we have been speaking to the FCA about this since 2016. The need for a special investment firms prudential regime emanated out of discussions in the UK, because there was a recognition that regulatory requirements that apply to banks do not necessarily work in an investment firms context.

The FCA does understand the breadth and variety of firms that operate in the UK. The confirmation that there will be a bit more time to think through how the detailed rules will operate in practice is really welcome. If I had one ask, it would have been for more time to look at the details of what would follow.

John Glen: Thank you.

The Chair: I call the shadow Minister, Pat McFadden.

Q117 Mr McFadden: Good afternoon, Gurpreet. Thank you for speaking to us today. Does the Bill mean that your members will have to hold less capital against their activities than would otherwise be the case?

Gurpreet Manku: No, actually they will be holding more. The bulk of the members most affected are in that category known as exempt CAD. It is an odd category that exists in UK legislation. At the moment, that broad category of firms is required to hold a level of capital set at €50,000. Under the new regime, the calculation methodology will change to a quarter of their fixed annual overheads. For many firms, that will lead to an increase in capital requirements, which is why I referenced the need for a transitional period. A few years ago, we recognised that this was coming, and the transitionals were always going to be a feature of this regulation. In terms of what it means in practice, for some firms, there would have been a fixed requirement of €50,000, and that will move to several million pounds; for others, it might not be much of a jump. There is a wide variety of firms out there in the UK market. Those that might not be in my constituency could also be significantly affected.

Q118 Mr McFadden: Looking to the future and the onshoring of all this EU regulation, from your members' point of view, what do you think needs to change in order for the UK to become more competitive in the BVCA field?

Gurpreet Manku: What I have seen in recent years is that other jurisdictions have tried to emulate what we have here. That is because the UK has always been an attractive jurisdiction, because of its highly regarded legal and regulatory framework, as well as the quality and depth of the financial and broader professional services ecosystem. In practice, that means that global institutional capital can be raised from here. So when it comes to the onshoring and the development of regulation in the future, we would be looking for continued high standards, but clear and effective regulation.

Q119 Mr McFadden: What are the EU regulations that you would most like to get rid of? What is on the bad list?

Gurpreet Manku: Sorry, I had not thought about that for this session. Interestingly, one of the regulations that probably caused the most concern was referred to earlier—the PRIIPs regulation. Most of our members will market to professional institutional investors rather than to retail ones, but where that particular regulation is relevant, it has led to information that many have felt is misleading. Seeing that changed and the changes being introduced in the Bill is welcome.

The investment firms regime is probably one of the biggest changes to come—we are implementing that now. If we are looking ahead a few years, we want to look at how the alternative investment fund managers directive changes. The way it was implemented in the UK historically—through the work that our authorities and regulators have done—has meant that it was implemented in a proportionate and sensible way. We want that to continue.

Q120 Mr McFadden: Finally, we have heard about a difference in philosophical approach between the European approach of codifying lots of financial services regulation in very detailed directives—often lengthy and dense documents—and the more independent British regulator approach, which it has been argued is more flexible. From the point of view of the BVCA, what would you rather be dealing with—the UK regulators or the traditional European directive approach?

Gurpreet Manku: Throughout the past few years, we have continued to work with both the Treasury and the regulators. Given the body of legislation that has come to the UK's shores and the work that we have done historically, it makes sense for the policy-making and rule-setting process to sit within the regulator, and there is an appropriate accountability framework around it.

Mr McFadden: Thank you.

Q121 Alison Thewliss: You have talked about the importance of having clear and effective regulation, which all of us around the table can probably agree with. Have you any concerns about the transparency issues around the regulations, with the regulator taking on so much more of the responsibility?

Gurpreet Manku: I think that what will be important to see over the next year and in future is sufficient time for consultation, because that leads to further transparency. The documents that the FCA publishes are generally quite good and detailed, but I have seen some cases in recent years, and not just domestically, where there were very short windows to respond to quite technical consultations. Ensuring that there is sufficient time to review and digest any changes and to sit down and speak to the regulator about them will be helpful, and will also support the transparency objectives.

Q122 Alison Thewliss: What kind of time period would you be looking at? You mentioned that some of the firms that you represent are quite small, so obviously there might be capacity issues in making sure that they can turn responses round.

Gurpreet Manku: A typical consultation process is usually three months, which is usually enough time for us to gather the feedback from our members, whether they are large or small firms, and turn it into an industry-wide submission.

Q123 Alison Thewliss: That is useful. A lot has been reported about the impact on venture capital of the uncertainty around Brexit, with money going elsewhere and all the rest of it. Do you feel that the Bill gives enough confidence to the sector for people to continue to invest money in the UK?

Gurpreet Manku: Yes, I believe it does, because robust regulatory standards and a clear and stable legal and tax framework attract global investors. While I recognise that there are concerns about Brexit, over recent years we have seen the continued ability of our members here to raise international capital and invest it.

Q124 Alison Thewliss: Lastly, is there anything more that you can tell me about the impact of equivalence decisions within your sector?

Gurpreet Manku: Equivalence is important for us as well. I agree with all the feedback that has been provided to you throughout the day; I have been listening in on some of the sessions. Our members are prepared for all eventualities, which in practice means looking at setting up additional structures and obtaining additional licences in Europe to cover a period where equivalence decisions might not be available. Thinking about institutional fundraising more broadly, there are other ways to access EU investors, and some firms will have been looking at those routes in the absence of equivalence.

Alison Thewliss: That is useful. Thank you.

The Chair: If there are no further questions from Members, let me thank Gurpreet—who did a panel all on her own, remotely—for her evidence.

Examination of Witness

Peter Tutton gave evidence.

4.13 pm

The Chair: We will now move on to our final panel of the afternoon. It is another one-man virtual panel, with Peter Tutton from StepChange joining us remotely. We have until 5 o'clock, when we must adjourn. Peter, could you introduce yourself for the record and for the members of the Committee?

Peter Tutton: Good afternoon, everyone, and thanks for inviting me. My name is Peter Tutton; I am head of policy at StepChange Debt Charity.

Q125 John Glen: Thank you very much for joining us and giving your input this afternoon. I think that there are probably two measures that would be of most interest to your organisation—please correct me if I am wrong—in the statutory debt repayment plans and the measure to transfer the Help-to-Save bonus. May I ask you about the first one? Obviously, your organisation has been a key consultee and driver of the moratorium that we introduced in May. The statutory debt repayment plan is a key option during that eight-week period. How do you think this will work and what do you see as its challenges? How does it sit within the context of what is available at the moment for people who get into difficulty?

Peter Tutton: That is a good question. We are delighted that the two new debt schemes are going forward. We think that they will be a very important help for people who are struggling. What we think they will do is partly driven by our experience of being a deliverer of the debt advice scheme in Scotland. From when we have spoken to our clients, we know that the protections that both the breathing space scheme and the statutory debt repayment plan will offer—a sort of guarantee that if you keep up with your payments you will have protection from your debt spiralling, from collections activity, with people asking you to pay money that you cannot afford, and the threat of enforcement action—deal with the things that frighten people and make them stressed and anxious. They damage people's health and lead them to do things like borrowing more to cope with unaffordable demands. The lack of a guarantee of forbearance can really impede people's recovery from debt and financial difficulty.

We are very pleased: those protections have existed in England and Wales for insolvency solutions for some time but not for people who are able to repay their debts. Very often, clients will come to us after an income shock. As we sit here now, people are losing their jobs, having income reductions or falling ill. Their income will drop significantly for a time, but then it takes time for them to recover and get back on track. In those cases, these kind of schemes, first the breathing space scheme to help people to get advice and then the statutory debt repayment plan to help people pay their debts off within that safe space, will be really important in helping people. A lot of the fine detail about how they will work has still to be worked out. It will be important to ensure that they are accessible and that they fit together.

One thing we are interested in is when someone gets to the end of their breathing space scheme. If someone is still recovering, as we call it, from their financial difficulties, will they be able to go into the statutory debt repayment plan, where it may not be apparent that they can pay their debts within their long-stop period at that point, but where we have good reason to believe that their income will recover and that they have a good chance of getting back into work? It would be useful if the two schemes aligned so that people do not, first, get protection, then fall out of protection and only come back into it later. There could be a position where creditors could all pile in to take enforcement action or debts could begin to grow again. That is one of the things where we are keen to see the detail to ensure that the two schemes align and that we can move people from one to the other, with a long-stop on "How long is a reasonable period to repay their debts?" but one that is not worked out very strictly at the beginning while people's circumstances are still fluid.

There is lots of fine detail to work out. We are going through the process at the moment with the Insolvency Service creditors and debt advice. Agencies are working out the detail of how the scheme will work in practice. What is important for both schemes is that we as debt advisers need to be able to administer them without significant extra cost. We might come to that later. With breathing space, there is no direct funding so the cost situation is very important. If it is very burdensome for us to deliver, it may be hard to do. We then need to do some work still with the creditors to make sure that everyone is getting the information that they need to get protection quickly to people who need it. There is a bit more work to be done there. Likewise, with regard to the way in which the statutory debt repayment will work, there are practical details such as how people will go into the scheme; how the "fair and reasonable" test will work—there is a need to make sure that it is not too cumbersome, and that it is effective and cannot delay protection unduly—and ensuring that creditors do not abuse the right to object, although they must have that right, in a way that can slow the whole scheme down. These are the sorts of things we will need to work out.

Q126 John Glen: Thank you. I appreciate the work that you and your organisation have done, and Phil Andrew as well. On my second question, can I ask you about the Help-to-Save provision, under which people can save up to £50 a month for four years, and after two years, if they have saved up £1,200, they have £600 transferred to them by the Government? As you know, the provision makes sure that that money can be transferred to a NS&I account. Could you set out your understanding of why this would be necessary and how people become disengaged? Why is this measure, which may appear to some unnecessary, needed?

Peter Tutton: I think this is a necessary measure. We should cast our minds back to the child trust fund. In some ways that was similar, as it was a way of encouraging people to build up savings, although in that case the savings were for their children. As you may remember, one aspect of the child trust fund is that people got a voucher and then had to put it somewhere. A huge number of those vouchers ended up in default. We know that, especially among people who are less experienced in using financial services and in lower income households, it can be quite daunting when a choice has to be made between a number of different savings products that they do not really understand, and when they do not really know the difference.

That can create inertia. It makes a great deal of sense to give a safe way of moving people automatically into a successor product so that we do not have that problem of trying to contact them to get them to make a decision. The clause is worded so as still to allow people to make their own decision, which is quite right, and having safeguards seems sensible. We are big supporters of the Help-to-Save scheme, which is a cracking scheme. Our own research shows that having a pot of precautionary savings can significantly reduce people's chances of falling into debt. If I had one criticism—

John Glen: Go for it.

Peter Tutton: It would be that at the moment not enough people—

John Glen: I agree with that. We are trying to do what we can to improve awareness and get people to use small amounts; I think they can put by up to £1 or £2 minimum.

Peter Tutton: But it is a good scheme, and it is sensible to allow people who have saved into the scheme to put their savings somewhere else. They can make a choice if they want to, but we know that some of the people whom the scheme is designed to attract may struggle to choose between superficially similar financial service providers and get stuck in the middle. This makes sense.

John Glen: Thank you very much indeed, Peter.

Q127 Mr McFadden: Peter, we are talking about things that have broad support: the debt respite scheme, Help-to-Save and so on. The Minister and I debated some regulations about these matters about a month ago. This is really just a short question. You have looked at how these things have been set out in the Bill and you have been very warm about them today. Is there anything you would change, given what you have seen in the Bill? Are there any gaps or any changes you would suggest to the way in which these things have been set out in the Bill?

Peter Tutton: In an ideal world, we would like the breathing space period to be longer. We can understand why it has been set up as it has. It is very good that it includes, for instance, Government debt; it is a new thing that people will have protection from Government and local government debt; things like council tax are a very big problem for our clients. We can see that the Government may be nervous about a longer scheme. Perhaps if there was a way of looking again soon, once we are satisfied that it works okay, we could give that breathing space a bit more time. There are two things that the breathing space can do. There is what it does at the moment, which is largely about allowing people to get advice and get into a debt solution, but there is also time during which people need to recover.

As I said earlier, when people come to us they are often still in quite a degree of difficulty and their circumstances have not resolved themselves. We cannot always instantly put them into a stable long-term solution. One of the things that might help that would be a longer period of breathing space while they are recovering. In lots of cases, there is an obvious solution to put people into; if their circumstances are not going to improve and debt relief is the right solution, we will put them into that. We may be able to deal with that by articulating the statutory debt repayment plan and the breathing space such that there is a gap in the middle. Ideally, a longer period would be good. There may be a way of effecting that just by making sure those two things align, so that people whose circumstances are still recovering—they come to us and have a very small amount of money, but we believe that they will back into work, and for a lot of our clients that is what happens—can keep that protection going through until their circumstances improve and they can get back on the track of repaying their debts. That would be the one thing, instantly, that we would think about changing.

Another thing is that in the Treasury policy statement, including this legislation, there is a provision for funding the statutory debt repayment plan. The Treasury policy statement talks about that funding for debt advice providers being around 9% if you distribute funds as well. That is something that may need to be looked at again—not a lot, but a bit. That 9% is a bit less than the funding that we currently get from what is called fair share funding, which is *[Inaudible]* funding we get for helping clients with debt management plans. That funding actually allows us to do a lot of things.

One of the things that we are not yet sure about and are not able to model is what the additional costs of the statutory debt repayment plan will be. For instance, there is a provision in there for creditors to have a vote as a safeguard before a plan can be accepted. If we have to administer that vote in some way, for instance, it would mean an extra cost. There are some bits and pieces around that that may need looking at a bit more once the precise details of the debt repayment plan scheme are better understood.

Q128 Mr McFadden: Thank you. Covid has had a paradoxical effect this year because, on the one hand, some people have become better off as the year has gone on because they are still getting paid but are not spending as much as they would normally—that is why we have seen bank deposits going up around Europe—while on the other hand, there has been an increase in unemployment and a lot of people with increased debt burdens and so on. Does anything about the covid impact suggest to you that there should be changes in the timing order of the introduction of the proposals and their content?

Peter Tutton: That is a really good question. I agree that that is what we are seeing—we put a report out last week. We see a growing number of households struggling because of covid—those who have lost their jobs. Furlough may be picking up 80% of their wages, but if you are on low pay, that is a big jump and a big cut can put people into difficulty.

You are absolutely right: this is growing. In an ideal world, it would be great if we had those breathing space protections tomorrow so that people had a safe place to go and we could start getting them back on the road towards control of their finances and stopping their debts growing. For practical reasons, I do not think that it will be possible to put that in place tomorrow. For the scheme to work and for us to be able to do it at the scale that we think it would need, it needs to work as an online remedy.

It also needs to work for advisers, to make sure that where we capture information or when someone inputs information into our online system debt help tools, for example, we do not then have to copy that again into the Insolvency Services portal, which is incredibly expensive. That is something that happens with DROs and can be very expensive. The software and APIs need to be developed so that there is a seamless process and the cost is minimised for the scale that we need to get people into this. I do not think it is possible to do that or for us, as debt advice providers, to be organised to do it on the scale that we would need to, much before the implementation date.

Bringing the scheme forward, for practical, implementation and software reasons—all that kind of stuff—is going to be hard, but I think there are things that the Government can do, in the areas that we are really worried about at the moment, to bring forward the protections, if not the breathing space scheme. One of the things that our polling estimates, and other people have said the same thing, is that a large number of people have fallen into rent arrears. Those people *[Inaudible]* in the private rented sector have relatively little protection against eviction for rent arrears. There are longer notice periods, but that will start unfolding quite soon—it probably already is—so are there protections? Similarly with council tax, there are people falling behind who may be subject to enforcement by bailiffs, which we know can be intimidating and expensive and can make people's problems worse.

It seems to me that the Government and Parliament supported breathing space. There was cross-party support for the idea that people in financial difficulty need protection from unaffordable collections and enforcement that make their problems worse, so I think there is something the Government can do. That may not be through the breathing space scheme itself now, but it is in the spirit of those protections, particularly for key debts: things like rent arrears and council tax, and maybe other types of debt enforcement that will have lasting, harmful consequences if they are not addressed. That is something that the Government should be looking at now, to make sure that in the coming months people are not worrying more and more about what will happen to their house if their incomes do not recover, or worrying about a bailiff for council tax. Those are things that can be done by Government without the whole breathing space scheme, so I agree: with covid, there is a pressing need to look at the different things that Government may be able to do to help people through this period. Otherwise, we are likely to see some of those harsh enforcement actions starting to happen, and people experiencing harm because of covid. No one really wants to see that.

Mr McFadden: Thank you.

The Chair: For the Scottish National party, Alison Thewliss.

Q129 Alison Thewliss: Can I ask about help to save accounts? I think there is somewhere in the region of 222,000 of those accounts, with about £85 million in them, and you are dealing with people who are very much on the brink of things. Can you tell me how you think it would be best for the Government to communicate with those people about what is likely to happen to their account and what they need to do?

Peter Tutton: That is a very good question, and I am not sure I have a complete answer for you off the top of my head. First, the Government have some communications routes: those eligible for help to save are effectively those people who are in receipt of universal credit and tax credits, so these are people whom Government can identify and should be communicating with anyway.

To a certain extent, the thing about the transition is that because it is automatic, it is about ensuring that people know where their money is. I do not have an answer straight away when it comes to the best way of doing that. We know that it can be difficult to communicate and get people to engage. It is one of these things where we need a trial wording approach, communicating, and making sure that that communication is very clear that this is something that is happening to your benefit: "Here it is, and here is how you can get at it." At the same time, there need to be more comms, perhaps to recipients of universal credit—the numbers of whom have grown quite a lot recently, as you will know—about the fact that this scheme is available to help them, and that if they put some money into it now they will get a bonus, which they may be able to use quite soon to deal with their difficulties. Those are the two things that spring to mind immediately.

Q130 Alison Thewliss: Is there an argument for continuing the accounts and allowing them to keep earning some interest, rather than closing them after four years?

Peter Tutton: I think that is a good idea. There is a maximum amount of savings, so if you can afford to save the full £50 a month, you will get the full bonus. If you are only able to save £20 a month, you will not, but if you allow the £20 savers to save for longer, they would get more of a bonus. There is definitely an argument there to say, "If we want people to build up a precautionary savings pot, we should give those who have started saving the best opportunity to build that savings pot where possible, albeit by leaving the accounts open a bit longer within the scheme." That sounds sensible.

Q131 Alison Thewliss: I have had it flagged via Macmillan that they think there is a bit of a weakness in the FCA's reliance on guidance. They are arguing for a legal duty of care for all financial services providers. Do you think that would be helpful when it comes to getting ahead of people getting into trouble?

Peter Tutton: Yes, we are supporters of a duty of care as well: we have spoken with Macmillan about this, and we can see the point. It is an interesting one to attach to the Bill. The FCA said that it is due to reply to a consultation on a duty of care. That response probably will not come until Q1 next year, so it has been a bit delayed. That is a bit unfortunate, because if there is a need to legislate or it concludes that there is a need to legislate, the opportunity of doing so through this Bill will have passed.

We agree that there is a need for a duty of care. There has been a succession of problems over the years with financial services. The FCA does a good job: it does rules, and it is getting on top of some of the wide-ranging historical problems we have seen, from unauthorised overdraft charges to payday lending, other bits of high-cost credit, aggressive collections, and a whole range of things in my areas of interest. It is starting to get on top of these.

We think the measure could still be clearer. We think a duty of care, or at least being specifically required by a rule-making power to think about a duty of care and what that means, and empowering the FCA to make rules would be helpful. We have a particular take on duty of care. There are lots of definitions of it. One thing that we see is the idea of having regard to consumer protection. A duty of care could also help better define the consumer protection definition.

We still see too many cases where people who are vulnerable or face constraint choices because of lower incomes and are forced to use credit and things like that or because of behavioural biases built into products. People are in a situation where effectively there are firms exploiting those circumstances. This is the sort of thing that we think a duty of care could deal with. We need a more explicit statement in the legislation about the way firms need to understand the measure. In vulnerability guidance, we would make that more explicit and biting on the way firms have to think about their products and services, and making sure that they do not have the effect of exploiting vulnerable consumers.

We are not quite there yet with financial services, because these problems keep happening. It would sharpen that up and give a better line between what is regulatory policy and what is social policy. We would start to be able to have a better debate about when it is reasonable for someone on a low income to be on credit, the sorts of credit they may be offered that make their debt problems worse and why that is happening . That may help to stop that happening. For lots of reasons, we are supportive of the idea of a duty of care. It would sharpen the focus on vulnerability. It would sharpen the focus on the kind of detriment that people face when they are using financial circumstances as a sort of distressed purchase. For us, the measure is a good thing and something we would like the FCA to take forward.

Alison Thewliss: Thank you very much.

Q132 Andrew Jones (Harrogate and Knaresborough) (Con): Peter, thank you for your evidence and written submission, which has been circulated to the Committee. One thing you say in that is that your evidence points to the importance of statutory protections as a key way to alleviate the harm of problem debt. Could you tell us a bit more about that evidence?

Peter Tutton: We spend quite a lot of time looking at the experience of our clients, and we survey our clients and poll them to see what has happened to them. When we were looking, back in the day, at breathing space we were trying to understand what brought our clients to advice and what helped them to recover. What we found was that our clients often had multiple creditors. On average, they would have about five or six. Typically, we find that some creditors, even most, will be very good, but it only takes one creditor to defect from good practice and to push for more money to destabilise people's financial situation and restart the process of juggling bills and borrowing more to deal with a particularly aggressive, unaffordable payment demand.

There was a very strong message from clients that that impeded their ability to recover. At the same time, we spoke to our clients who were in the debt arrangement scheme in Scotland, and we got a very clear message from them that that kind of guarantee—the statutory framework that the debt arrangement scheme in Scotland gave them—reduced their anxiety and gave them a really good, strong and solid platform for recovery. They knew that if they paid what they could afford to pay and kept doing that, nothing else bad would happen to them in terms of unaffordable demands and escalating enforcement.

In that sense, we have known for a long time that people need protection from their creditors in certain circumstances. Both the experiences of clients who do not have that protection in England and Wales outside of insolvency and the experiences of clients who do have it in Scotland persuaded us that what has become breathing space in the statutory debt repayment plan was a necessary additional protection that we did not have at the time.

Q133 Andrew Jones: That is very interesting. Do you have any data that can quantify some of the anecdotal evidence that you have just been giving us? If you can, could you please circulate it around the Committee?

Peter Tutton: Yes, I will dig some out.

Q134 Stella Creasy: Peter, thank you for articulating so clearly all the different challenges that we face in trying to prevent debt as well as deal with its consequences. I have a couple of questions about the Bill and some of its provisions, and then about your sense of where we might be able to make some progress in strengthening the protection for consumers from unaffordable debt.

With the debt repayment schemes, I think all of us recognise that the breathing space is a very positive development. First and foremost, I want to ask for your view on the midway review element. Do you have any thoughts on what impact that might have as currently drafted?

Peter Tutton: It is a good question. We were very concerned initially about the midway point, simply because it could be very expensive and hard to administer the debt advice. The provision is now not quite as onerous, so we are not having to do full outbound calls and things like that. We are now reasonably comfortable with it as something that is a touching point, where clients touch in with us to ensure that they are still engaged with the process. That is something we do anyway. If someone has come for advice and there is a recommendation that the next step of a particular debt solution requires them to do further things for us to help them, we will follow up and keep in contact with them to ensure that they do not drop out of the process and that they have some help. The initial relief of having spoken to someone about it can lead people to think, "Well, I've got that out that way," whereas it is important to keep going and get people into the debt solution.

There is some element of the midway review that is not dissimilar from the kinds of things that we would do anyway. The important thing is that the way it is done in practice should not become an onerous burden that does not really have any practical use to it. I think we are sort of there. We are talking to the Insolvency Service about the guidance and the way it will work. I think we will get to a place that we can live with. My operational colleagues who are implementing this are not saying it is unworkable at the moment, so we are reasonably comfortable with it, but time will tell. *[Inaudible.]* If, six months in, it turns out to have been really onerous with no practical effect, that is something we would ask the Treasury to come back and look at again.

Q135 Stella Creasy: I ask because I wonder whether you can give us your professional opinion on whether there is a point at which a breathing space should stop. It might become apparent in the review process that somebody is in a level of debt for which a breathing space is not suitable. If it becomes apparent that the person will not be able to repay under the terms of the breathing space, do you perhaps have in mind a length of time over which it would be appropriate to look at some other form of intervention? Do you have a view about when to end the breathing space, essentially?

Peter Tutton: That is a good question. Our starting point here is that we would end the breathing space scheme as soon as it is no longer needed. At the moment, people come to us in a variety of different situations, and a number of different debt solutions are appropriate for them. If the most appropriate solution for them is a debt relief order, which is a type of insolvency for people with very low incomes or with disposable incomes and no assets, and they want to do it, we would put them into that as quickly as we can. If that can be done—sometimes it can, and sometimes it cannot—before the breathing space period ends, the breathing space will end.

There is actually a provision in the Bill that means that if you are in a debt solution before the review, it will end. It certainly is not a case of putting people in breathing space until it comes to the end of its 60 days, and then putting them in a solution. We will always try to get people into the right solution as quickly as they can. The other end of your question is that there might sometimes be cases whereby there is a debt solution but, for whatever reason, it takes a bit longer to get them into it. In exceptional circumstances, there might be a case to extend the breathing space, if for some reason it takes us longer to get someone into a DRO or something like that.

There is another question about this. One of the problems with debt relief solutions at the moment—debt relief orders and bankruptcy in particular—is that they have fees. These people are so poor and their debts are so big that they need to go into insolvency, but they have to find a fee, and the fee is hundreds of pounds for bankruptcy. Very few of our clients could afford that; they would have to save up for a year or two years to meet the fee.

There is a bit here that Government will need to think about, in relation to breathing space, if someone has come for advice and we have given them protection and worked out that the best thing for them is bankruptcy, but it will take them ages to find the fee to actually go bankrupt. They will fall out of that statutory protection, as it were, back into the mosh pit before they can get their protection in bankruptcy.

So you raise a really good question. There are two ends to it. One bit is that we would not keep people in longer than we needed to; that is a case of getting them into the debt solution they need. But there may be other people who will not be able to progress to the right debt solution for them, for a variety of reasons, before the breathing space runs out. That is something that Government may look at. Perhaps we need to build some evidence of that problem as we go along, but it would be good to do a quick review to see whether there are circumstances where the period needs to be extended or, indeed, whether elsewhere in Government we need to look at things like the barriers to accessing debt relief that mean it is not a good option, either because of the cost of getting into it or because it is still quite a stigmatising process and puts people off. There is another need, elsewhere in Government, to look at how the whole debt relief thing is working.

Q136 Stella Creasy: I am conscious that I have one other element that I want to ask you about, but just on that, let me ask this. You have talked about debt relief orders. Obviously, you can access them only if you have less than £50 left after all your outgoings. You seem to be saying that actually the cost of moving into some other forms of debt relief that might be part of this would be something that would be helpful to make the breathing space work. Is it worth looking at those thresholds, as part of making the breathing space process work, so that people can move in, rather than being stuck in a breathing space or, possibly, stuck in a position where you get to the point where you need to write off a debt entirely?

Peter Tutton: The particular issue with the insolvency schemes for England and Wales—well, one of the issues—is the application fee. That is a point that is slightly different from the threshold; that is an issue about people having to find money to pay for those solutions.

Q137 Stella Creasy: Yes, but my question was particularly on the debt relief orders, because you have to be on such a low income for them to be possible. Is there a case, from what you are saying, in terms of making this legislation work, to be more flexible about that threshold—to make it, say, the bottom two deciles, rather than the bottom one decile of income before you can access a debt relief order?

Peter Tutton: It makes some sense to look at this, because a debt relief order is so much cheaper than bankruptcy. Debt relief orders have a restriction on debt size and, as you say, a restriction on disposable income, both of which are to safeguard the creditors, because the Insolvency Service will not do a full investigation. The idea is that it is the people who have really got no money, no assets, and so if we let them into insolvency without an investigation, there is nothing squirreled away that otherwise would benefit creditors.

DROs have been running for many years now, and I think you are right: it is time to look at whether we could have an easier route into them rather than bankruptcy, which might mean lifting the disposable income threshold a bit or the debt threshold a bit, or both. There is now a bunch of people for whom we would be advising bankruptcy who are never going to get into bankruptcy because they cannot afford it, and often it is the debt size as well.

I think it is the right time for the Government to do this. Given what we might see after the fallout from covid of more households, more people, facing financial difficulty, it is a good time to review how these debt solutions work at the moment and to see what can be done to increase accessibility for those who need that help.

Q138 Stella Creasy: May I be cheeky and ask one final question? Obviously, we are talking about where debt has occurred. I would very much welcome your professional opinion about where you see debts being generated by particular products and what you think has worked to prevent that. You and I have previously talked about the benefits of capping forms of credit to prevent people from getting into debt in the first place. We have seen in the last six months concern about the "Buy now, pay later" industry, which currently is not regulated by the FCA but is a form of credit. What is your experience of where the best interventions are to prevent debt and whether there might be things that we could do in this Bill to help that in the first place, before we get to a debt breathing space?

The Chair: Order. Can we be a little briefer? We are slightly straying from the scope of the Bill. A very quick answer, please, Peter Tutton.

Peter Tutton: That is a good point. There are things we can do. There are a number of interventions, from lending rules to product features and price. Also, on the relationship between who is using high-cost credit, there is a social policy point here. Is there more to be done to give people affordable alternatives, so that they do not have to go to those products? It would be good to talk more about all of that, because it is absolutely key.

We estimate that survival borrowing under covid—people having to borrow to make ends meet—is up to about £6 billion. There is a big pile of debt building there, which people will not be able to afford to pay down. Some action now to give them an alternative and think about how to deal with that debt is timely and important. We should try to do something now before it gets much bigger.

The Chair: If there are no further questions, let me thank Peter Tutton. A few times we thought that your technology would fail us, but we got through, so thank you. I thank all our witnesses from our eight evidence sessions today. That brings us to the end of the oral evidence for today. The Committee will meet again in the same room at 11.30 am on Thursday.

Ordered, That further consideration be now adjourned. —*(David Rutley.)*

4.51 pm

Adjourned till Thursday 19 November at half-past Eleven o'clock.

Written evidence reported to the House

FSB01 StepChange

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

Third Sitting

Thursday 19 November 2020

(Morning)

CONTENTS

PBC (Bill 200) 2019 - 2021

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Monday 23 November 2020

The Committee consisted of the following Members:

Chairs: † Philip Davies, Dr Rupa Huq

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
† Eagle, Ms Angela *(Wallasey)* (Lab)
† Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison; Nicholas Taylor, *Committee Clerks*

† attended the Committee

Witnesses

Dr Susan Hawley, Executive Director, Spotlight on Corruption

Public Bill Committee

Thursday 19 November 2020

(Morning)

[Philip Davies *in the Chair*]

Financial Services Bill

11.30 am

The Committee deliberated in private.

Examination of Witness

Dr Susan Hawley gave evidence.

11.31 am

The Chair: We will now hear from Susan Hawley, from Spotlight on Corruption, who is joining us remotely. I remind colleagues that we have until 12.15 pm for this session. Sue, please could you introduce yourself for the record?

Dr Hawley: Hello. I am Susan Hawley, executive director of Spotlight on Corruption. We are an anti-corruption charity that monitors the UK's enforcement of its anti-corruption and economic crime laws.

Q139 Mr Pat McFadden (Wolverhampton South East) (Lab): Thank you for giving us your time today, Sue. You have also given the Committee some written evidence, which I will come to in a second. Before I do that, I just want to let you know that a number of witnesses on Tuesday were more clearly focused on the European end of the Bill—the onshoring of various regulations—but with you we will probably concentrate more on the later clauses in the Bill. Before I come to your written evidence and your specific suggestions about financial crime, what is your general impression of the Bill?

Dr Hawley: Than you, Pat. We very much focus on, and our expertise is on, the potential of the Bill to bring the UK into greater equivalence with the EU on money laundering and to ensure high standards of corporate governance in the financial services sector. Overall, we support some of the points made by our colleagues, which I think you might be hearing later today—from Jesse Griffiths of the Finance Innovation Lab, for example—around ensuring that there really is strong parliamentary accountability for regulatory changes.

Q140 Mr McFadden: May I come to your specific suggestions? You submitted written evidence that focuses on a suggestion for an amendment to the Bill on the prevention of economic crime. Could you talk us through your suggestion and where you think the Bill may have a gap to fill in that area?

Dr Hawley: Absolutely. We really welcome this opportunity, and many thanks for inviting us to give evidence to the Committee. We want to make the case for the urgent introduction, through the Bill, of a "failure to prevent economic crime" corporate offence. We think that could fit in the "Insider dealing and money laundering etc" part of the Bill. We want it to focus particularly on the areas of fraud, money laundering and false accounting.

Just to explain the problem we think needs addressing, fundamentally at the moment, particularly after the judgment in the Barclays case, which was the only prosecution for financial crime following the last financial crisis, there is increasing legal commentary that large financial institutions are beyond the reach of prosecutors for certain economic crimes. Legal attempts to resolve this have failed—in fact, the Barclays judgment has now made it even more difficult for prosecutors to prosecute large financial institutions—and only action by Parliament can change that.

If I may, I will say a little about the reasons why this amendment is needed. We outline in our evidence four broad areas that we think the amendment would resolve. One of them is about the protection of market integrity. The real issue is whether the current state of the law, particularly after Barclays, promotes strong enough corporate governance and deters corporate wrongdoing. The Treasury Committee has already highlighted that it does not—in its words, it is "wrong" and "dangerous".

The second issue is about fairness and ensuring equality before the law for large and small financial institutions and companies. That is particularly important, we think, in the context of the burgeoning fraud crisis, which is being exacerbated by the pandemic. It cannot be fair or right that small companies face the burden of prosecution in the UK and that large companies can be seen as getting away with it.

The third area is about equivalence, or parity with international standards, on the enforcement of economic crime. The Law Commission—I will come on to the Law Commission later in our evidence, if I may—has announced it is doing a review of corporate crime rules. It has said that one of the reasons for that is so that the UK does not fall behind. We think there is a real danger that the UK falling behind might happen very speedily. It is already quite behind the US—we have seen a lot of commentary from legal experts about how the UK, effectively, outsources its economic crime enforcement to the US, which means that some British institutions are being fined very heavily by the US authorities, and that money is going to the US Treasury.

It is not just the US, but the EU. There is a real emerging issue with the sixth EU anti-money laundering directive, which requires EU states, from early December this year, to have strong corporate criminal liability for anti-money laundering. That liability must include where there is a lack of supervision or control, and the Government recognised when they looked at whether we should opt into this directive—which they chose not to do—that the UK's corporate liability regime would not fit the directive but would need to be amended if the UK were to opt in. A real issue here is that UK companies might end up operating in the EU to higher standards than they are operating to in the UK, and that might become more of an issue of market access for UK financial services.

The final area is consistency across economic crime. We have seen a "failure to prevent" offence introduced for bribery and for tax evasion. No less harm is caused to society by fraud and money laundering than is caused by the other offences, and it creates real problems for enforcement agencies. Prosecutors have long asked for that "failure to prevent" offence to be extended to other economic crimes. We think its introduction would benefit the UK, because it would see more enforcement—higher fines—coming into the UK Treasury, and it would benefit society, because when companies have in place procedures that prevent economic crime, it helps to reduce the cost of that crime to society.

I will stop there, in case there are any questions. I am very happy to talk about how we think this amendment is compatible with the ongoing Law Commission review.

Q141 Mr McFadden: I have a couple of questions, and my colleagues might too. There are quite a lot of different parts to this, and I want to ensure that I understand properly what you are saying. You referred, I think, to a corporate offence. Is the first big point that you are making here that, although individual prosecutions may be rare—you are right that on LIBOR, for example, they were very rare—even then it tends to be the individual trader who gets prosecuted, rather than the organisation they were working for? The organisation they were working for can always say, "We didn't know what he or she was doing," and wash their hands of it. Is the first essential point you are making that you want to create a corporate offence rather than an individual offence whereby somebody goes to jail for a certain number of years for committing an economic crime?

Dr Hawley: Absolutely. We think that the corporate offence is essential, but that does not mean we do not think that individual accountability is very important. There is also a real issue about how senior executives are held to account. If we take LIBOR as an example, I think there were four convictions out of 13 prosecutions for the rate rigging in the UK, and in a lot of those cases people said, "The management knew we were doing this." That was their defence. If that is really the case, you are not going to change the culture. There are two really important reasons for having a corporate offence, and part of it is about changing the culture. If corporates know that they might face a huge fine, they will put in place procedures to stop that happening. That is really important.

Q142 Mr McFadden: The other part I want you to explain a little more is that you said that small and large companies are treated differently under the law as it stands, and you implied that there is a greater sense of liability for small companies. Can you explain that a little more to us? What do you mean by that, and why is that the case?

Dr Hawley: Under the current law, if there is not a "failure to prevent" offence in a piece of legislation, a company can be held to account only if its directing mind can be found to have intended for the crime to occur. In a small company, the directors are much more hands-on, so it is much easier for prosecutors to pin the blame on someone at a senior level—it has to be at the board level—and therefore prove that the company is guilty. That is not how large corporations and businesses work, and that is what prosecutors have been saying for a long time. They work on a much more devolved basis.

The problem is that the way the law is at the moment, not only does it make it easier to prosecute small companies—small companies bear the burden of prosecution—but it incentivises bad corporate governance in larger companies because it encourages people to insulate the board from knowledge about wrongdoing. That is the point that prosecutors and people in the legal community have been making for some time.

Q143 Mr McFadden: So there is almost an incentive for the board to be in ignorance, because that is a legitimate defence when wrongdoing is exposed in the company. Is that what you are saying?

Dr Hawley: This is what we write about in our evidence. HMRC, in its consultation on its new "failure to prevent tax evasion" offence, specifically highlighted that these laws encourage bad corporate governance. It says that they provide incentives for senior management to turn a blind eye to wrongdoing in order to shield the corporate body from criminal liability and they disincentivise the reporting of wrongdoing to senior members of corporate bodies. That is not me; that is the Government consultation on the "failure to prevent tax evasion" offence for criminal finances, but that is no different from the other economic crime offences. That is a corporate governance issue that cuts across all these economic crimes.

Q144 Mr McFadden: The final question I want to ask you is about what you said about equivalence. We had a series of bodies give evidence to us the other day, all of which said that they had no desire for a race to the bottom, that they want the highest possible standards of regulation and corporate governance, and that that is good for the UK, the financial services sector and so on. You are implying that there is a danger here of a looser standard on this issue in the UK than in the EU. Could you explain that to us a bit more? What is the difference in terms of the way that they will view corporate offences and the gap that you see in the UK?

Dr Hawley: In the UK at the moment there are two ways in which companies could be held to account for money laundering. One of them is under the money laundering regulations, and that is a minor offence. To give you a comparative example, if it is an individual being fined for that, they would get two years in prison. The kinds of fines we are seeing are around the £5,000 mark. There have been some higher marks—sorry, that was HMRC's enforcement at a regulatory level. We have not seen any corporate criminal fines in this space at all. There is no criminal enforcement going on under the money laundering regulations, but that is a different issue. To explain the law, theoretically companies could be held to account, but it is a relatively minor offence. That is very different from holding them to account for the main offences under the Proceeds of Crime Act, which, for an individual, carries a maximum sentence of 14 years. You can see from that that it is a very different type of offence, and the courts would treat it very differently.

Under the EU's sixth anti-money laundering directive, all states must have corporate criminal liability and must impose criminal and non-criminal sanctions that are proportionate and dissuasive. We are already seeing countries such as Germany taking really strong steps to implement that. It has a corporate sanctions Bill coming up, which has a clause that requires prosecutors to investigate suspicions of corporate crime. It is a very strong Bill. Before that, Germany was the outlier and had no proper corporate criminal liability. We see it in the Netherlands as well, where increasing levels of corporate fines are being imposed for money laundering, and there is a very strong corporate liability framework there as well. In Ireland, the Irish Law Commission has recommended changes to the law on corporate liability. We are seeing a raising of standards across the EU that the directive will bring in the context of money laundering.

Mr McFadden: I have no further questions, although my colleagues might have.

Q145 The Economic Secretary to the Treasury (John Glen): Thanks for giving evidence, Susan. Following the December 2018 Financial Action Task Force mutual evaluation on the UK, which was pretty positive, there were a few elements that we need to address. You will know that BEIS is taking forward a lot of that work with Companies House and looking at the registration of overseas entities as well. This Bill ensures that HMRC retains its ability to access the ownership of beneficiaries of UK-linked overseas trusts. Can you explain to the Committee how important that is, notwithstanding what you have just been talking about?

There is a Law Commission consultation going on. We have fully transposed the fifth anti-money laundering directive in line with international best practice. You gave us some perspectives on Germany and Holland in terms of future orientations, which is something that I imagine we would look at in the context of that review. How would the provisions of the Bill help?

Dr Hawley: Obviously, we have welcomed the leadership that the Government have taken on beneficial ownership and the implementation of the fifth AMLD. My colleagues from Transparency International, who are giving evidence later to the Committee, have done more work on the beneficial ownership side. They are the people to talk in more detail about how the Bill specifically relates to that.

We hope that there will be other legislative vehicles brought forward soon to introduce the property register of beneficial ownership and the Companies House reforms. It is excellent that that consultation has now come out and the Government have taken strong steps towards looking at how Companies House can be strengthened, because, as FATF noted, it was, as you have mentioned, an area of weakness.

I do not want to bang on about it, but FATF also highlighted the lack of high-end money laundering convictions in the UK and questioned whether that was really reflective of the risk within the UK. We are carrying out some analysis into what is happening with regulatory fines in this space. The number of fines seems to be going down dramatically, and we are not seeing an increase in high-end money laundering convictions. To be honest, we are a bit worried that the Law Commission review, which we really welcome, will take too long.

Q146 John Glen: To be clear, you are really arguing that we should pre-emptively bring forward measures before that review has been completed.

Dr Hawley: I am actually saying something different. That review rightly focuses on the identification doctrine that was the primary focus that the Law Commission was given, and it is absolutely right that the Law Commission does that. We monitor bribery cases as they go through the courts, and we have seen that, even with the Bribery Act, there is still an ongoing unfairness. A small company can be prosecuted for a main offence and a "failure to prevent" offence. We have heard directly from prosecutors that they can say to a small company, "Look, if you co-operate with us, we will only prosecute you for failure to prevent. But if you don't, we will prosecute you with section 1 or section 2." We also have the fact that a section 1 or a section 2 offence incurs mandatory debarment from public procurement and a "failure to prevent" offence does not. So small companies face the risk of being excluded from public procurement in a way that large companies do not. We think that that is not compatible with the Government's stated intention of levelling the playing field for small companies in public procurement.

What we would say—and it is something we have always said—is that we absolutely need the Law Commission to look into the identification principle, but we do not think it would pre-empt the review to introduce the "failure to prevent" offence for these crimes, because we already have that offence for bribery and tax evasion. That would complement the Law Commission's work. We still need the review of the identification doctrine, and that cannot be done by anyone other than the Law Commission.

John Glen: Thank you very much. I will now let other colleagues take part.

Q147 Stephen Flynn (Aberdeen South) (SNP): Thank you, Dr Hawley, for the information you have shared so far. Can I refer you point 16 of your written submission? It says:

> "However, there is no corporate offence in the FSA and it is therefore not clear that prosecutors would be able to hold companies to account were similar conduct to reoccur."

I will be open and honest with you: I do not have a legal background, so perhaps you could elaborate on that further. Either there is the ability to do something or there is not. That ties in with the remarks about Barclays in point 21, which quotes remarks that it

> "effectively removes companies with widely devolved management and functioning boards".

The term "effectively" implies that it could or could not. Can I have a little more clarity on that point?

Dr Hawley: Yes, absolutely. We have checked that with lawyers, and it is the case currently under the Financial Services Act that if you wanted to bring a prosecution for misleading statements on benchmarks—let us hope that will not happen again because financial institutions have learned the lessons from last time—the only way that you could hold a company to account would be under the directing mind principle that I mentioned earlier. You would have to show that one of the directors knew and intended for this to occur. There is no comparative offence, as there is under the Bribery Act, of a failure to prevent misleading statements being made, for which there could be a corporate fine. That would be almost impossible to do if a bank were making misleading statements.

The Barclays judgment has made that even more difficult and narrower. Prosecutors and the Serious Fraud Office can no longer say, "We've got the evidence on the CEO and CFO, and we think we can prove it, so we will take this to court." The court then turns round and says, "No, it's not just that. You have to show that the board actually delegated authority to these people." It set a whole new hurdle for how you hold corporates to account. What we are hearing from people is that this is going to lead to a massive decrease in corporate prosecutions, because the grounds for bringing a company to account are so narrow now that they are almost impossible. I cannot say that it would not happen, but I can say that it would be an extremely brave prosecutor to risk public money in the courts to try.

Q148 Stephen Flynn: Thank you for that clarity. To play devil's advocate a little, in terms of the individual versus collective responsibility, which is effectively what is being inferred here, do you see any dangers in going down that route?

Dr Hawley: The corporate route?

Stephen Flynn: Yes.

Dr Hawley: We do not see any dangers, because, generally, if you can hold the company to account, you are more likely to be able to hold the individuals to account. There is some evidence from the US, where the lack of senior executives going to jail has been contentious.

I think there is a real issue around senior executive accountability. We have seen a series of acquittals in the UK courts, in the Tesco's case and in the Barclays case. There are some quite serious issues that need to be looked at in terms of how senior executives are held to account. I could argue to bring forward an amendment to address that as well, but that is not what we have done in this written evidence. We are just focusing on the corporate offence, and we do not see any reason why it would undermine efforts to hold senior executives to account. I would be interested to hear those arguments, because I have not heard any coherent arguments about why it undermines individual accountability.

Stephen Flynn: Thank you.

The Chair: It might be helpful for colleagues and our witness to say that we have 18 minutes left and three people who want to ask questions, so people might want to be mindful of that.

Q149 Abena Oppong-Asare (Erith and Thamesmead) (Lab): I want to go back to what Mr McFadden and Mr Flynn talked about, particularly regarding this Bill, so that I have a better understanding. One of the things I am concerned about is that there seems to be more of an onus on punishing the individuals, in comparison to the companies. Earlier in your comments, when questioned about creating corporate and not individual offence, you mentioned holding a company to account, and that, to an extent, that can be done by holding the individuals to account. However, there have been concerns about holding senior executives to account, particularly with Barclays and Tesco. Do you have any direct recommendations that can strengthen the Bill so that it can hold companies to greater account so that we do not have that loophole where individuals are held responsible for this?

Dr Hawley: We actually have two suggestions. One is to introduce a "failure to prevent" offence for individuals, where, effectively, you are in a senior position and this happens on your watch. That is one way of doing it. The other way is to do what happens with the Competition and Markets Authority, where the court has the power to disqualify a director where there is a corporate offence. That is something that was put down in an amendment to the sanctions and money laundering regulations. Those are two legislative options—one of them a bit more radical than the other. The Competition and Markets Authority one is already there in law; it is just a matter of making it effective for these particular economic crimes.

We also think that there needs to be some more blue-skies thinking about whether, when there is a deferred prosecution agreement, companies should be required to claw back some of the money from the senior executives who were running the company when the wrongdoing occurred, because it is unfair that they get to move on, often with huge financial benefits. We saw that with the recent Airbus case—the director left with a massive golden handshake, and then the company and shareholders were left to pick up the fine. I think there is a way to make how the corporate fine is shared fairer. There are quite a lot of potential ways to do it, and we would be happy to provide a paper on that before 3 December, if it would be useful to the Committee.

Q150 Abena Oppong-Asare: That would be helpful. The Bill also increases the maximum sentence for criminal market abuse from seven to 10 years, in line with comparable economic crimes. Do you think that is a strong enough incentive to prevent offences? Is that something you have come across, with crimes going on for some period of time? Do you feel that the maximum sentence will deter that?

Dr Hawley: It is welcome that it has increased. Higher sentences are important, as we see in the US—there are higher sentences for white-collar crime, and people actually go down. To be honest, it is also about enforcement. Actually, quite a few prosecutions for a certain level are better than very few for a high level. It all comes down to regular enforcement, which is something that we very much hope there will be greater thinking about—enforcement resourcing for any of the laws that will be put in place.

Q151 Abena Oppong-Asare: Thank you. I have a final question, which is about your report. I know that my right hon. Friend the Member for Wolverhampton South East asked you a question about the prospect of smaller companies being at a higher risk of fines, which you said you were concerned about. Is there anything specific that could be put into the Bill to help ensure that does not happen? You mentioned earlier that it is easier for smaller companies to be prosecuted, because it is easier to identify the people involved. That seems like a massive and unfair disadvantage for smaller businesses. I am worried that if we do not address this issue, smaller businesses will be prosecuted whereas, effectively, larger companies will not. Do you have specific recommendations that could be looked into?

Dr Hawley: The basic and essential one is that if you introduce a "failure to prevent" economic crime, it immediately covers that gap; it immediately brings larger companies into the reach of prosecutors for economic crimes. We still think the Law Commission will need to look at how the identification doctrine still applies and carries on creating unfairness, even after you have introduced a "failure to prevent" offence, but it would be an immediate stopgap that would stop that happening. I cannot think of any other way of doing that.

Abena Oppong-Asare: Thank you.

Q152 Julie Marson (Hertford and Stortford) (Con): Thank you for your evidence, Susan. I think we all agree that it is such an important area, and your evidence is really interesting.

I was looking at some of the specialist fraud and financial crime law firms' response to the Law Commission's review, particularly how it relates to the "failure to prevent" suggestion. They have called the Government's desire to look at that in the round a very measured approach, and they have pointed to the fact that there have been lots of developments in regulatory and legal environments since the call for evidence. They have said that, actually, the best approach is probably to wait and see—to review, and to look at the entire issue in the round. Given the complexity and the cost to business, what is your response to that?

Dr Hawley: What has happened since the call for evidence closed is the Barclays judgment. We have also had a judgment in the Serco case, in which Serco was involved in procurement fraud against the MOJ, and it could not be the party to a deferred prosecution agreement—only its subsidiary could—because of these corporate liability rules. How it fits with the regulatory system is a really important question. As you will have seen from our evidence, we think that can be really properly thought through and hammered out at the guidance stage to the "failure to prevent" offence. That is where you would have a really good discussion with the private sector, bringing them in to show how you make those parts fit together.

I would like to add that on the regulatory side, as I mentioned earlier, we are seeing a worrying decline in the number of fines imposed by some of the regulatory bodies, for instance in the money laundering space. Creating a criminal offence—it is important to note that it is not a new criminal offence, but a different way of holding people to account for the same criminal offence—would open up a broader range of people who might bring action against a company. We have seen criticism in the paper, including from some of the law firms, about a lack of action by the Financial Conduct Authority on money laundering regulations, very few investigations and no prosecutions of corporates. If it were a criminal offence, companies might be looking at investigations by the SFO, which would really make them sit up.

I think it is about deterrence and how you ensure that compliance with the regulations is not just a box-ticking exercise, which is the risk if you take only a regulatory approach. What is really interesting about the responses to the Government's call for evidence is that the vast majority of respondents do not think that where a serious crime occurs, a regulatory approach is appropriate; there need to be criminal approaches. I was really struck by how common that was. I think there is some urgency, if I am honest, particularly in relation to the UK falling behind emerging standards elsewhere, but also with the problem of inequality before the law, which I think could become really heightened when the response to the covid crisis plays out. You might get quite a lot of resentment when large actors are seen as getting away with it.

Q153 Julie Marson: I have just one quick follow-up question. You are quite right that in that evidence there was quite a consensus on the need to act. Is it fair to say that there was less of a consensus on exactly how to act—that plays into what we are looking at, waiting for the Law Commission to respond—and that, given the length of time since the call for evidence, there might be less consensus because there have been more actions since?

Dr Hawley: Since the call for evidence, we have seen the SMCR and the money laundering regulations, but they were kind of around and being introduced—the SMCR in 2016 and the money-laundering regulations were on the books for 2017—so I do not think that there has been anything dramatically new since then. Those were on the cards at the time of the 2017 call for evidence. This does need private sector consultation and it needs to be thought through carefully.

On the consensus about where to go, another problem we are worried about is that that lack of consensus will be replicated in the Law Commission's consultation, because you have essentially two options—that is how it has been put to me, quite often by prosecutors. You go with the US model, with vicarious liability, or you have a "failure to prevent" offence. There was not really any clarity in the way the call for evidence was worded that would result in a kind of consensus. Quite a lot of law firms think we should have vicarious liability, because that is the strongest form of liability there is.

I worry about coming to the end of the Law Commission consultation with exactly the same result: no consensus about the way forward, let's not do anything, and then we will be stuck in the same place. Do you see my point with that?

Julie Marson: I do, but I will let someone else come in. Thank you.

Q154 Ms Angela Eagle (Wallasey) (Lab): You said something astonishing today. You said that, in your opinion, we have outsourced our enforcement on economic crime to the US.

Dr Hawley: That is not my wording; I think that one of the business press has used that phrase. Do you want me to explain why I think that?

Q155 Ms Eagle: I was just getting you to reaffirm that is what you meant: that essentially that is what we have done, because presumably you think that our enforcement and activity against this kind of economic crime is much inferior to what is going on in the US?

Dr Hawley: I am afraid it is widely held consensus that what we do here is significantly inferior to what happens in the US, and I do not think there can be any doubt about that. I could share some research we did in 2019, which very specifically compared only London and New York banks, so that we did not get an unfair comparison because of the much larger size of the US.

The level of fines that the US imposes, both criminally and on a regulatory level—that is, the money laundering space—is 22 times higher.

Q156 Ms Eagle: It would be very useful if you would share that information. What can we do to improve the incentives to prevent this activity? Is that more about enforcement and the almost wiping out of action fraud and much of the criminal work that goes on to prevent fraud, which—let's face it—has fallen off a cliff in terms of its success rates? You have made some very interesting points about how you think the law should be changed, but is that about the law or is this an enforcement problem? Do you think the FCA is fit for purpose when it comes to the enforcement for which it is responsible?

Dr Hawley: The law is certainly an issue with fraud, money laundering and false accounting.

Ms Eagle: By the way, without meaning to be rude, you have three minutes to answer this or the Chair will cut you off.

Dr Hawley: Absolutely, it is an issue of the law and of enforcement—law is only as good as its enforcement. We need a fairly wide consensus among the enforcement community, non-governmental organisations and academics in this space. We need a massive boost to economic crime enforcement in this country.

With the FCA, what we hear is it is much easier for them to bring civil actions, and that is what they do. For corporates, they are not using the corporate criminal liability laws that we think need to be used to ensure real deterrence, and that corporate wrongdoing, when it does occur—by the few bad people—is properly held to account and prosecuted. I know the Competition and Markets Authority wants to get rid of its prosecuting function to the SFO. Some people, such as Jonathan Fisher QC, have argued that we need one big super-enforcer in the criminal sphere, because regulators will always have more interest in taking the easier, quicker and cheaper route, taking the regulatory approach rather than the criminal approach.

Q157 Ms Eagle: Finally, because you answered that so fast, do you think that the way to deal with the larger global companies is vicarious liability, rather than "failure to prevent"? Should we be thinking of introducing a law saying that after a company gets beyond a certain size, we switch to vicarious liability, because this idea of directing mind is simply not present in larger global corporates?

Dr Hawley: It is a really complicated issue, which I am very pleased the Law Commission is looking at. One of the options is vicarious liability. Some people feel a bit uneasy about vicarious liability and say it is too strong, but that is where you need the best legal minds of the Law Commission. However, the immediate gap can be immediately filled by the introduction of the "failure to prevent" offence. Otherwise, large companies are beyond the law; the "failure to prevent" offence brings them within the reach of the law.

The Chair: Order. I am afraid that brings us to the end of the time allotted for the Committee to ask questions. I thank our witness for her evidence on behalf of the Committee. That brings us to the end of the morning sitting. The Committee will meet again at 2 pm in the same room to take further evidence.

Ordered, That further consideration now be adjourned. —*(David Rutley.)*

12.15 pm

Adjourned till this day at Two o'clock.

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

Fourth Sitting

Thursday 19 November 2020

(Afternoon)

CONTENTS

PBC (Bill 200) 2019 - 2021

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Monday 23 November 2020

The Committee consisted of the following Members:

Chairs: Philip Davies, † Dr Rupa Huq

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
Eagle, Ms Angela *(Wallasey)* (Lab)
† Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison; Nicholas Taylor, *Committee Clerk*

† attended the Committee

Witnesses

Hugh Savill, Director, Association of British Insurers

Duncan Hames, Director of Policy, Transparency International

Jesse Griffiths, CEO, Finance Innovation Lab, and Fran Boait, Executive Director, Positive Money

Hon. Albert Isola MP, Minister for Digital and Financial Services, HM Government of Gibraltar

Public Bill Committee

Thursday 19 November 2020

(Afternoon)

[Dr Rupa Huq *in the Chair*]

Financial Services Bill

2 pm

The Committee deliberated in private.

Examination of Witness

Hugh Savill gave evidence.

2.2 pm

The Chair: Good afternoon, everyone. We will now take evidence from the first of our afternoon witnesses, who is joining us remotely. I remind hon. Members on the right-hand side of the room and in the Public Gallery to use the microphone near the window when they pose their questions. We will hear first from Hugh Savill, from the Association of British Insurers. We have until 2.45 pm for this session, so lots of time. Hugh, will you introduce yourself for the record, please?

Hugh Savill: I am Hugh Savill, director of regulation at the Association of British Insurers.

The Chair: Thank you. We will start with the Minister, John Glen.

Q158 The Economic Secretary to the Treasury (John Glen): Thank you, Dr Huq, and thank you very much, Hugh, for giving evidence to us this afternoon. Thank you very much also for the written evidence that the ABI has submitted, I think through you, and for the welcome that you give to the measures, particularly on Gibraltar, the overseas fund regime, PRIIPs and money laundering.

I would like to probe your views on the measures that we are introducing with respect to access arrangements between the UK and Gibraltar for financial services firms. How do you see the issues around maintaining the same quality of regulation between the Gibraltarian and UK regimes? Do you foresee any challenges with that? How important do you think that that level playing field will be?

Hugh Savill: A level playing field between Gibraltar and the UK is essential. I think that about 20% of the British motor insurance market is in fact serviced by firms from Gibraltar so, clearly, whether people are working from the UK or from Gibraltar, that needs to be on the same basis. Given that you have two regulatory authorities, and that can always be quite awkward, we think this strikes a good balance. There is good dovetailing of the relationship between our regulators and the Gibraltarian regulators, and we really hope that the Gibraltar authorisation regime works and provides a smooth basis for business in the future.

Q159 John Glen: I understand from your written evidence that, as a body, you have some reservations about the setting of conduct rules at an international level. Would you like to say a bit more about that and explain what implications it has for how we should approach this issue going forward?

Hugh Savill: This is mainly derived from our experience of conduct regulation at the European level over the past 10 years or so. To be honest, it has not shown the European Union at its best. We have the PRIIPs regulation, which is mentioned in the Bill—well, we are having to correct it—and there have been other measures, such as the insurance distribution directive, which, frankly, have been no better. It is not entirely to do with the way that the European Union makes rules; it is because consumers expect different things in different countries. All you have to do is put together all the things that consumers want. It makes for a very heavy-handed—*[Interruption.]*

The Chair: I'm sorry, Hugh, could you please pause for a moment? We have a noisy bell. It is gone now, so please carry on. Can you start that sentence again?

Hugh Savill: Worse things might happen at my end.

John Glen: We won't go there.

Hugh Savill: The fact is that consumers expect different things; they have different traditions. Introducing conduct regulation at the international level—setting what people expect from their bank, so that it fits the conditions in Japan, Brazil and the UK—is too big an ask. You will end up with a very unwieldy rule book that is not particularly suitable for British consumers. We think the retail conduct rules need to be set with British consumers in mind.

John Glen: Thank you very much, Hugh. I will pass you on to Pat.

Q160 Mr Pat McFadden (Wolverhampton South East) (Lab): Good afternoon, Hugh. I want to follow on from the questions that the Minister asked you. I think it is fair to say that ABI has been a part of the financial services sector that has perhaps been more critical than others of the way that EU directives have applied to your sector. Given that the Bill onshores quite a lot of that regulation and gives it to the UK regulators, what differences are you hoping for in the way you will be regulated in the future compared with these directives, which you have been unhappy with in various ways?

Hugh Savill: I should say that we are equally blunt when we see shortcomings in British regulation, as well as European regulation, but, yes, we have criticised some of the European rules. In effect, the Bill sets out the first step towards a UK regime for financial services, and there will be others that follow. Really, this needs to be tailored to the needs of the British market—first to the needs of British consumers and secondly to the needs of British providers of financial services. Now that we have left the European Union, we think that is the way to go forward, and that is what we are hoping our legislators and regulators will concentrate on.

Q161 Mr McFadden: Can I go back to the issue of Gibraltar? Gibraltar has lots of friends across the parties in Parliament, and the Bill sets out a special regime for Gibraltar. Given the generous access to the UK market envisaged in the Bill for Gibraltar-based firms, is there any risk or danger that UK-based insurance companies might have reasons to relocate to Gibraltar and do their business from there?

Hugh Savill: I would be surprised. Ideally, what the Gibraltar authorisation regime sets out is the same basis, whether you are doing business in the UK or from Gibraltar. It is quite an enterprise to move your business to Gibraltar, and I am not certain you would be able to take all your skilled people with you. It is expensive to shift domicile like that. I see no big advantage in firms that are servicing the UK market from the UK moving to Gibraltar. Most of the Gibraltarian firms that have moved into the UK market, particularly the motor market, have done so as new entrants.

Q162 Mr McFadden: Is there any tax advantage to being located in Gibraltar?

Hugh Savill: I will have to let you know on that point. I believe there is a small value added tax advantage, but I will let you know that in due course.

Q163 Mr McFadden: Okay. Is there a particularly good reason for creating this sort of regime for Gibraltar, but not having something similar for, say, the Channel Islands, the Isle of Man or other Crown dependencies elsewhere in the world?

Hugh Savill: They are all slightly different circumstances. I am by no means an expert on the relationship between, say, the Channel Islands and the UK, Gibraltar and the UK, and so on. What was unusual about Gibraltar was that it was part of the single market in a way that the Channel Islands were not, so you had an existing passporting arrangement between Gibraltar and the UK, which, for the sake of the smooth continuation of the motor market, would be helpful to continue.

Mr McFadden: Thank you very much. I don’t have any further questions.

The Chair: So we go to the Scottish National party spokesperson, Alison Thewliss.

Q164 Alison Thewliss (Glasgow Central) (SNP): The briefing that you provided on the Bill mentions referring any disputes to the Financial Ombudsman Service. Can you tell me a bit more about how that works at the moment and your fears about what the proposals might mean?

Hugh Savill: There was a question about whether British consumers who were using Gibraltarian firms had access to the Financial Ombudsman Service in the UK. We think it is extremely important that all British consumers have access to the Financial Ombudsman Service—it looks at individuals’ difficulties in a way that other regulators cannot. I am particularly pleased that that has been clarified in the Bill. Let us hope that it works well.

Q165 Alison Thewliss: Are there any other risks to consumers within the UK from this move?

Hugh Savill: I never say never, but all the people who operate in the British market are subject to the conduct rules of the Financial Conduct Authority, so I think there should be the same standards for those selling from Gibraltar as in the rest of the UK.

Q166 Alison Thewliss: Do you think that consumers are aware of where their insurance policies are coming from? Will this lead to people thinking about that a little bit more?

Hugh Savill: Some of them will be, some of them will not. I am not a great reader of the small print in my insurance policy, any more than anybody else is, but if we have a similar regime, I hope that that would not be a major preoccupation of somebody buying an insurance policy.

The Chair: I open the questioning to other members of the Committee. Does anyone else have questions? I call Miriam Cates.

Q167 Miriam Cates (Penistone and Stocksbridge) (Con): You said that consumers expect different things in different markets. In your briefing note, you said that the Bill will allow the FCA to develop a methodology that is more accurate and that works for the UK market. Can you give an example of a characteristic that is specific to the UK market and how the Bill will help to meet those expectations?

Hugh Savill: If you are buying insurance in the UK, you tend to buy it online for general insurance, or you will quite often use an independent financial adviser to buy life insurance and savings policies. That does not happen on the continent of Europe. There, there is a little shop in most small towns, and people go and buy their general insurance from that shop. If they want savings policies, whether that be insurance or other kinds of savings vehicles, they will go to their bank, so it is a completely different approach and entry into financial services.

Q168 Andrew Jones (Harrogate and Knaresborough) (Con): Thank you very much for giving evidence today, Hugh. One quick question about the market access arrangements: do you think there will be any price implications from those for UK consumers? Could we see price inflation via premiums increase as a result?

Hugh Savill: Sorry, from the market access arrangements, did you say?

Andrew Jones: Yes, just generally. We are seeing a large provider have access to our markets. That could traditionally see increased supply. Increased supply tends to mean price competition, with consumers benefiting both in quality and innovation of product and in the price they pay for it, but equally it can work the opposite way. So do you think there will be any price implications for UK consumers as a result of these measures?

Hugh Savill: I do not think they would be because of these measures, in that the suppliers from Gibraltar already have 20% of the market, and it is not this Bill that is going to change that. There will be changes in price—there are always changes in price, and there will be other things that drive that—but I do not think that will be driven by this Bill.

Q169 Stella Creasy (Walthamstow) (Lab/Co-op): You suggested there was a small VAT benefit to companies being based in Gibraltar. Obviously, this legislation would remove any other bar in terms of being based in Gibraltar but still being able to operate in the UK. Could you clarify what you mean by a small VAT benefit?

Hugh Savill: That is why I offered to write. I am afraid I do not know exactly what the VAT arrangements are, and I will have to write it down. If I said any more, I would get something wrong.

The Chair: So that will be followed up by letter?

Hugh Savill: Yes, absolutely.

The Chair: We await it with impatience.

Q170 Alison Thewliss: I am happy to let other Members come in if they have questions, rather than hog the platform. There were some comments on equivalence in the briefing you put together. Can you tell us a wee bit more about your thoughts on equivalence both in the wider sense of it being used as a potential political weapon and in the narrower sense of what happens to investors if equivalence is withdrawn?

Hugh Savill: We do not think very much of equivalence as a means of arranging market access. As set out by the EU, it is extremely easy to end equivalence and to leave both provider and client hanging and not knowing where their policy is going to go. We also think that the European system of equivalence is far too open to political interference in what ought to be a technical matter.

This said, if I look back to the Chancellor's very welcome statement last week, in the supporting document to that, the Treasury set out a far more grown-up view of what equivalence ought to be—a rather more technical decision, where there is open consultation and a discussion between the two jurisdictions, that is actually looking for a long-term relationship between the two jurisdictions, and that cannot just be terminated at short notice. On equivalence generally, we really do not think much of the way that the EU runs its equivalence regime. We are very reassured by the vision of equivalence that the Treasury has put out.

Turning to the detailed point about those accessing the overseas fund regime, what is important is that, in the unlikely event that a trusted jurisdiction moves out of trusted jurisdiction status into untrusted jurisdiction status, there are, as the Bill suggests, mechanisms for ensuring that customers are not orphaned from their provider. That is extremely important, particularly when you have some long-term contracts such as annuities.

Q171 Alison Thewliss: What further information do you think would be required for people who have invested, to give them further reassurance?

Hugh Savill: I think they should have enough reassurance here. The overseas fund regime allows investors to access a much wider range of funds than would otherwise be available. As I said, choice is a good thing. It gives a wider choice and, ideally, better products and prices. I think the safeguards are there.

Q172 Alison Thewliss: I am just curious because you said that, for the regime to fully work for customers, situations such as this need to be clarified. I thought that you were asking for further detail or reassurance.

Hugh Savill: Not at the moment, no.

Q173 Mr McFadden: I had a further thought on the question of tax advantage. A quick search tells me that Gibraltar's corporation tax level is 10%. There may be some caveats around that—it was a quick search—but if that is the case, that is quite a hefty advantage for a company, compared with the UK rate, is it not?

Hugh Savill: I am not aware of the corporation tax differences between the UK and Gibraltar, so, again, I am sorry but I will have to cover that in my reply later.

The Chair: Thank you. This letter is getting longer.

Hugh Savill: Do not worry—I will not make it too long.

The Chair: Good, good. If there are no further questions, all that remains is for me to thank you, Hugh, for your evidence as our first witness this afternoon. We finished a bit ahead of time. Thank you for that.

Examination of Witness

Duncan Hames gave evidence.

2.22 pm

The Chair: We move on to our second witness this afternoon and the only one who is appearing in person today. Duncan Hames is no stranger to this place. He is now from Transparency International. Duncan, do you want to introduce your job title for the record, and what you do?

Duncan Hames: Yes, happily. My name is Duncan Hames and for more than the past four years I have served as the director of policy at Transparency International UK. Transparency International is part of a worldwide anti-corruption coalition, and because those engaged in corrupt activity need to launder the proceeds of their crimes, we have become quite knowledgeable about the practice and policies around the prevention of money laundering and the need to have effective supervision and enforcement.

The Chair: We have until half-past 3 for this session, so a good long time. Unusually, we are going to the two Opposition spokespeople first, and then to the Minister. We are shaking it up a bit. We will start with shadow Minister, Pat McFadden.

Q174 Mr McFadden: Thank you, Dr Huq, and thank you, Duncan, for coming. Let me first ask a broad question. On transparency, when you look at the regulators' duties as changed by the Bill, do you want to see any additional duties placed on the regulators on the transparency front, or do you think they are properly armed and equipped as they are?

Duncan Hames: There is much in the Bill that I am not qualified to comment on, but certainly in relation to regulatory duties around money laundering it is our contention that the challenge is as much about means of implementation and the expectations placed on the private sector in relation to supervision, which needs addressing. There is an analysis—in fact, it was probably our conclusion on seeing the Financial Action Task Force evaluation—that there are many good policy measures in place, but that they are yet to be fully implemented, and therein lies the nub of this problem.

Q175 Mr McFadden: Do you want to see more duties on companies or do you think that, at least on paper, the duties on companies in terms of corporate declarations and so on are currently fit for purpose?

Duncan Hames: We have found with the UK Bribery Act 2010, which has been in force for 10 years now, that a "failure to prevent" offence within that legislation has served to enhance corporate governance. That is not just our view; it was the conclusion of the parliamentary post-legislative review into that legislation a year or two ago. Government Ministers have expressed their interest in seeing that model—which they have described when introducing it in other areas, such as failure to prevent tax evasion, as effective—applied more widely in areas of economic crime. That is certainly something we would consider there was an opportunity for in the Bill.

Q176 Mr McFadden: We had a witness this morning from Spotlight on Corruption, who argued for the addition of a "failure to prevent economic crime" measure to the Bill at the appropriate place. Is that something you would support?

Duncan Hames: Yes, we would. That is separate to the discussions about the identification doctrine, on which, as I am sure you will be aware, the director of the Serious Fraud Office has frequently shared views and on which now the Law Commission has been invited to bring forward its own options for reform. These are complementary measures.

We now have a "failure to prevent" offence in relation to two areas of offending: one, the Bribery Act and, two, failure to prevent the facilitation of tax evasion. Applying a "failure to prevent" offence more widely, while still considering reform of the identification doctrine in regard to the substantive offence, would be entirely complementary, rather than the House having to consider doing one or the other.

Q177 Mr McFadden: I suspect if we got into this in Committee, on Report or wherever, the counter-argument would be, "Look, the Law Commission has just launched this great consultation, and we should not be pre-empting that by jumping to a conclusion. We might do this, but we have to wait for the Law Commission." What is your response to that argument, in case we hear it at some point?

Duncan Hames: If I were in the business of money laundering, I would be laughing at the glacial pace at which reform happens. So I would counsel against waiting. As I say, we have two "failure to prevent" offences, and it would be entirely possible to apply that more widely in economic crime. Sadly, it has taken the Government over three years to reach their conclusions in response to the call for evidence on failing to prevent economic crime, and Law Commissions are not generally considered to move more quickly than ministerial responses to consultations. I would not want to estimate quite how long we will have to wait before the conclusions of the Law Commission are enacted in law. I think that is plenty of time to put in other measures, which will help the corporate sector improve their corporate governance, as we have seen in the case of Bribery Act.

Q178 Mr McFadden: In terms of potential amendments to the Bill, that would be top of your list. Are there any other areas that you think could usefully be amended or added to?

Duncan Hames: I certainly think we need to look at the area of supervision. This is a regulatory function. We have private sector supervisory bodies tasked with helping the business sector to put in place the necessary preventive measures to prevent money laundering.

While we welcome the introduction of the Office for Professional Body Anti-Money Laundering Supervision a couple of years ago, its reports—these are not activist or campaigner reports; these are Government regulatory reports—have been very damning of the effectiveness of the supervisory bodies. It is very fragmented—I think there are 14 supervisory bodies for the accountancy sector alone.

OPBAS has identified conflicts of interest between the advocacy and supervisory functions of those bodies. The effectiveness of their enforcement activity is really inadequate. If we take Her Majesty's Revenue and Customs as one of the supervisory bodies, the fines imposed are barely a couple of thousand pounds and will quite possibly be less than the value of the commission or fee on any individual transaction. That is clearly an inadequate incentive for private sector actors to say no to handling illicit funds.

The quality of the money laundering defences in the private sector has also been found to be poor. The Solicitors Regulation Authority recently conducted reviews into about 60 companies. In nearly half of those cases, they are pursuing the findings they had for potential disciplinary action. A similar proportion of cases were found to be areas of weakness in money laundering defences in other sectors.

So we have a problem with supervision. The first line of defence against money laundering is tasked to the private sector, and yet the supervisory bodies that are meant to ensure that that is being done well, both in terms of guidance and in subsequent enforcement of regulations, are not effectively ensuring that those defences are good.

At the end of the day, the police estimate that the impact of money laundering on the UK economy is of the order of £100 billion a year. We can have lots of good measures and lots of good policies, which at times the Government will have been congratulated for, but the upshot is that we still have a big problem, which is not going away. That is why we think taking action where we can to improve the defences is urgent.

Q179 Mr McFadden: The last thing I wanted to ask you is about the most recent FinCEN files. This all comes out through the United States authorities. We find out about the actions of British financial institutions through the actions of a regulator in another country. How would you fix that so that the actions of UK companies are uncovered and publicised here, rather than coming out through another body in another country?

Duncan Hames: We have to recognise that the FinCEN files were a leak; I would want us to be hearing about suspicious transactions as a result of enforcement having been taken by law enforcement agencies. It has been a concern of the now Secretary of State for Justice that too often we see enforcement, effectively, outsourced to the United States authorities. I do not think that is good for the corporate reputation of UK plc, and I do not think it is how we would want things to proceed as Britain defines a newly independent role in international commerce.

Mr McFadden: Thank you. I will stop there.

Q180 John Glen: Good to see you, Duncan. You have offered a wide-ranging critique on general aspects of anti-money laundering and anti-corruption matters. You

[John Glen]

rightly draw attention to the FATF report, which was generally, in the international context, seen as a very favourable assessment of the UK. Department for Business, Energy and Industrial Strategy activities include the Companies House review, the registration of overseas entities work and the limited partnerships reform.

This Bill ensures that HMRC retains its ability to access information on the ownership and beneficiaries of UK-linked overseas trusts, building incrementally on things that have been done previously. Can you explain why this information is important? This is a key measure and, I would have thought, the most relevant.

Duncan Hames: It is certainly a welcome measure. We have found that some of the complexities of the structures and design of different corporate entities have proved difficult, in terms of the implementation of existing legislation. That was a feature of the recent Baker et al case in relation to appeal against an unexplained wealth order; there was a South American foundation, which was perhaps not the corporate structure that Members of this House had in mind when that legislation was being decided.

Addressing trustees and overseas entities, to strengthen and ensure there are no loopholes in existing legislation, is definitely to be welcomed. In the past, when the House has been considering legislation to address money-laundering risks—do not forget that another piece of legislation related to leaving the European Union is the Sanctions and Anti-Money Laundering Act 2018—it has focused on what can be done about the transparency of ownership, and not just of UK limited companies but of overseas entities, too.

Q181 John Glen: In your comments to the shadow Minister you referred to the glacial speed of activity in the UK, but we have, as you have acknowledged, now transposed the fifth anti-money laundering directive into law, in line with our international obligations. I recognise that this morning we heard evidence about what Germany and Holland will be doing in the future, which we reserve the right to look at. Last year we also published the economic crime plan, which was about bringing public and private sector enforcement closer together. Do you have any observations on which elements of that are most integral to improving the situation and where emphasis should lie?

Duncan Hames: Certainly. Although some of the things we have already discussed this afternoon are not in the economic crime plan, there is much in that plan that we welcomed at the time. It was about 15 months ago that that plan was adopted by the Government. Some of the measures in that plan require legislation, and I am sure the Minister is itching for legislative opportunities to enact his policy.

John Glen: Always!

Duncan Hames: For example, there is the reform of Companies House, to ensure it can verify the accuracy of the data that is on the UK registers.

Q182 John Glen: The consultation is under way on that.

Duncan Hames: Indeed. I think we have recently completed a consultation on it, and I hope, therefore, that it will be in the Queen's Speech.

The register of beneficial owners of overseas entities enables us to know who really owns the foreign companies that own property real estate in this country. It was a Government commitment announced around the time of the London anti-corruption summit, which was four and a half years ago. Although that legislation has already been through pre-legislative scrutiny in both Houses, the conclusions of which were, "Get on with this; we must advance quickly," it still has not been brought forward. These are both measures in the economic crime plan. It is great that they are in the economic crime plan, but it would be much better if they were implemented. I hope that that will be addressed very soon, but, equally, given how long one waits for legislative opportunities to keep up with the pace of nefarious actors in economic crime, if you have an opportunity to make progress in this Bill, in any additional manner, we would obviously be keen to see you take it.

Q183 John Glen: May I just ask one further question? You referred to OPBAS and the different bodies that regulate different entities, such as the Solicitors Regulation Authority. I have had a lot of interaction, as the Minister, with representative of those bodies, on a regular basis, during my tenure, and obviously HMRC works with them to try to identify best practice and improve what they do. Are you saying that that fundamental organisational entity is not appropriate? I am just not clear exactly what you think should be the alternative. I think the argument would be that those membership bodies contain the expertise within the different sectors, which have very specific entry points and risks, and therefore they need to be dealt with collectively as an entity. What is your view? Is just an anti-private sector view, or a measure to deal with that? What would you see as a meaningful alternative?

Duncan Hames: I think we would see the creation of OPBAS as a very helpful staging post in addressing this problem of inadequate supervision, albeit that it can address and challenge only the professional body supervisors. HMRC has been found wanting, and I have already criticised the level of its fines. OPBAS cannot do anything about HMRC, and I think we have been party to discussions about that in other proceedings of the House.

What OPBAS has found is pretty devastating. In its 2018 report, 62% of accountancy supervisors had some overlap between their advocacy and regulatory functions. Those represent a conflict of interest. There are some really choice quotes from OPBAS in that report, about what supervisors said about the impact on their membership income, were they to take more assertive enforcement action. That really is a conflict of interest in these supervisory bodies.

I think what we need, Minister, is for you or your colleagues to have the ability to respond to these reports—I think we have now had two annual reports from OPBAS—and, where necessary, to strip the supervisory duties from bodies that are failing in this regard. Obviously, all bodies should address their own conflicts of interest, but performance is a really important issue.

The report I was referring to earlier was HMRC finding that about half of the businesses it had reviewed were non-compliant with its anti-money laundering regulations. So, the changes that have been made recently to the regulatory landscape, in and of themselves, are not enough to address the holes in our money laundering defences that are overseen by this very fragmented regulatory arrangement. I said there were more than 14 accountancy sector supervisors; I think we are at 25 anti-money laundering supervisors, altogether.

The Chair: I call the third Front Bencher, Alison Thewliss, for the Scottish National party.

Q184 Alison Thewliss: Thank you, Dr Huq. I agree with a lot of what you have said, Duncan. Having served on the Joint Committee on the draft Registration of Overseas Entities Bill, I am also hugely frustrated that nothing really has happened with that, since all the evidence was given and the recommendations to Government were quite clear. Are there any other aspects you have not touched on so far where you feel this Bill is a missed opportunity, and where amendments could easily be tabled to improve it?

Duncan Hames: We might want to talk about beneficial ownership transparency. As I say, Ministers had a duty placed on them in the Sanctions and Anti-Money Laundering Act in relation to Britain's overseas territories and what would need to happen if they did not adopt public registers of their own volition, and I think they have found that duty helpful. Certainly at a diplomatic level, Ministers in the Foreign Office would celebrate the statements that have been made by those overseas territories as that deadline has approached. That is illustrative of how effective using legislation like this to convey a duty on a Minister can be, in order to rachet up the pressure for change.

The problem we have, of course, is that in some cases, those overseas territories are quite grudgingly coming around to this position. The last statement to complete the set was from the British Virgin Islands, and in his statement the Chief Minister—having agreed to the things the Government were hoping he would agree to—started to list a whole list of reservations and conditions, and concluded by saying that of course, this would only happen at a pace at which they consider deliverable. That does not fill me with hope that, without further incentive or, ultimately, the threat of action through Orders in Council, this will actually happen, which brings me back to my original point about implementation. It is one thing to have the policy—another, even, to have the laws—but if we have not had the implementation, we have not really changed anything. I would encourage you to look at what levers you might be able to grant Ministers through additional measures in a Bill such as this.

Q185 Alison Thewliss: Indeed. I remember from previous conversations about the overseas territories and Crown dependencies that they were essentially turning things back on to us and saying, "Get your own house in order as well", in terms of Companies House and other accuracy issues and registers here. Is there anything further on that that you think ought to be in this Bill?

Duncan Hames: That is a creative tension, isn't it? I think we should welcome international scrutiny of the effectiveness of our own measures. As the Minister said, there has been a consultation about new powers and duties for Companies House, in relation to the quality of the data we have. We are already beginning to see signs of a cultural change in Companies House as a result of the directions it is being given and the anticipation of future legislation. We need it to be a partner in preventing crime, not just a registrar—not just providing a service to companies that wish to be registered.

As I say, we recognise the pattern of change there, but ultimately it has to work within the law, and if the laws do not empower it to take the actions necessary, we need to change that. We are anticipating that the Government will bring forward legislation, so that when we are trying to persuade other financial jurisdictions to address their own contribution to money laundering, including in Britain's family of offshore financial centres, we are able to hold our head up high and know that we are doing everything we can to ensure that the quality of our own defences is adequate.

Q186 Alison Thewliss: I absolutely agree. You talked about the outsourcing of regulation. Do you think Parliament needs to have more of a role in terms of scrutiny, rather than handing things over to regulators? My concern is that once we hand everything over to the FCA and the Prudential Regulation Authority, we will not really know that there is a problem until something gets too big.

Duncan Hames: I suspect that it is Parliament's role to hold Government to account for acting on what those regulators are finding. They are often quite forthcoming in their criticisms of where things are going wrong, but they need the frameworks in which they can act on that. As I have said, I think the powers rest with Government to strip supervisory bodies of their duties where they are failing, but I cannot think of a time when it has happened. I believe OPBAS has provided plenty of evidence—indeed, unattributed in some reports—but I am sure it could point the finger for Ministers where necessary, in order to be able to take action.

Q187 Alison Thewliss: Is there more that could be done in the Bill to open up trusts and make them more open to scrutiny?

Duncan Hames: I think trusts are intended to be in the scope of the registration of overseas entities Bill. That is definitely something required by the fifth anti-money laundering directive as well, so we should consider them within scope. Whether we have yet got that working, I am not so confident. For example, if we take something that I am sure is of interest to you—Scottish limited partnerships—the Financial Action Task Force report, which the Government are very pleased with, noted that there remains a weakness in terms of scope for abuse of that corporate structure. I should acknowledge that those are regulated by UK law, not by decisions made in Scotland. Those partnerships can be partnerships with two corporate entities—so, no human personality. If those two corporate entities are registered in jurisdictions where beneficial ownership is not clear—it is not public—we essentially have a UK entity that has got around all of the strictures that the Government are very proud of, in terms of the transparency that the UK's own registry demands.

There are other issues with having corporate partners of a legal partnership. Obviously, it all comes down to accountability. It is very important if we want to be able to hold corporate entities accountable for their role in economic crime. I am afraid that many such complexities remain to be addressed. We cannot just take the bits we like when a report like that is presented.

The Minister is correct: the UK outcome was very favourable compared with other FATF evaluations. I hope, by the way, it will give the Treasury the confidence next time around to invite civil society representatives to give evidence to the FATF assessors. None the less, FATF came up with a number of things that it identified needed to be addressed, and the Government have a plan, but we seem to lack a timetable for implementing a number of these things. If the Minister is able to give us a timetable for when the legislation to introduce measures such as robo, which is in the economic crime plan, will be introduced, I think we would all be very glad of it.

John Glen: The point is, as Duncan well knows, that a whole range of interventions have been provoked by that FATF report. I am glad he acknowledges its world-leading nature for the UK. It is good that we should be pleased about that, but there were significant elements that need to be worked on. They are obviously taken in different ways across Whitehall, and there will be more to be said about that in due course. I am responsible for what I am responsible for in this Bill, and the purpose of this conversation is about that.

Q188 Alison Thewliss: An issue that I have around SLPs and enforcement is the fines. Is there work to be done within the scope of the Bill to increase fines in any of the parts mentioned? You mentioned earlier that the level of the fines is minuscule compared with the profits made.

Duncan Hames: I doubt you need primary legislation to fix that. I expect that secondary legislation giving direction to Ministers and regulatory bodies to ensure that fines are commensurate with the level of offending would be helpful. I suggested that the level of fines by these professional bodies supervisors and by HMRC is just not commensurate with the financial advantage of taking part in these transactions.

Indeed, if you are a solicitor, and someone complains to the Solicitors Regulation Authority about you because you have been holding up a transaction, that will still be investigated. You will still incur quite a discomfort in responding to that investigation. That is quite a powerful incentive just to go along with the transaction, whereas the fine you might receive for having gone along with a transaction that you should not have could well be less consequential for you. That needs to be addressed.

Fines wielded against trust and company service providers by HMRC, for example, are pitifully low. We were told by the trade body that its experience of fines imposed by HMRC on trust and company service providers was typically no more than £1,000.

Q189 Alison Thewliss: Even when fines ought to be due, they are not enforced. I ask periodically about Scottish limited partnerships and how many people have been fined for failing to register a person with significant control. Every time I ask, it is not in, which is ridiculous. My last question is about the issues to do with Gibraltar. Do you have any concerns about that, or anything that the Committee ought to know?

Duncan Hames: I do not think that the measures with regard to Gibraltar particularly focus on money laundering. Obviously, Gibraltar is covered by the fifth anti-money laundering directive. I think they would consider themselves to be among the earlier adopters of the measures required under that directive. What we see in the Government's language is an emerging global standard. That has been recognised in the past year or so by the Crown dependencies and, increasingly, by British overseas territories.

Although the US starts from a very far-back position on public beneficial ownership transparency, on the basis of bipartisan—as I think they call it, or on both sides of the aisle—working on this issue, even with a Republican Senate it seems set to advance new regulatory requirements around a central register of beneficial ownership. The tide is definitely moving in the direction of greater transparency. I think it would help British overseas territories to be encouraged to keep up with that direction of change.

Q190 Julie Marson (Hertford and Stortford) (Con): Thank you for your evidence; it is really interesting and this is an important area. We have heard reference to—you used the phrase—the UK outsourcing the prosecution of financial crime to the US. I am sure you will correct me if I am wrong—I do not have it in front of me—but on Transparency International UK's own list of corruption, the UK comes out 12th out of 198, whereas the US comes out at 23rd, so by comparison with the US, the UK does very well.

I am interested to hear your reaction to the criticisms of the report that that phrase came from. It was felt that the scope of the report did not include, for example: the bribery and corruption statistics, including on the "failure to prevent" provisions; the period after the financial crisis, which meant that much implementation was not included in the report; or the way prosecuting in the US often involves plea bargains, which are used to extract fines, so the measurement of the extraction of fines is not necessarily a justified comparison between the UK and the US. What is your reaction to that?

Duncan Hames: The corruption perceptions index measures views of the prevalence of corruption in public sectors, whereas for the most part here we are talking about enforcement of corporate wrongdoing. None the less, you are right to record where those countries are in the index.

"Exporting corruption", our recent report produced for the OECD anti-bribery working group—part of a series of reports published every other year—is the one in which the UK is recognised to be an active enforcer of anti-bribery laws and laws to prevent foreign corporate bribery. None the less, the US is top of the table and, while it is good that Britain remains an active enforcer, the calculation that grants that assignation is such that the UK hung on by a hair's breadth this year and there is no room for complacency.

The statement that I reference from the Secretary of State for Justice was made when he was Solicitor General, at the Cambridge International Symposium on Economic Crime. His words were that these differences in how the law operates

> "result in other jurisdictions holding British companies to account where ours has not."

He said he was making that observation in an argument in favour of moving towards the "failure to prevent" approach to economic crime.

For all of America's challenges, I do not think anyone would criticise it for being less assertive in enforcement of the law that it has. Even at a time when one might have feared political interference or the undermining of the Department of Justice, its level of enforcement has remained high, without signs that it is falling back. I think we have to reflect on why that is. It is partly to do with resourcing, but it is principally to do with the challenges of our arrangements for prosecutors.

Lisa Osofsky, the director of the Serious Fraud Office, describes what we have as "a very antiquated system". She said:

"We are hamstrung right now by the identification principle".

She explained to the Justice Committee that she can "go after Main Street"—forgive the American references; I am sure you will be able to translate them—but she

"cannot go after Wall Street, and that is unfair".

When we think about the businesses that each of you represent, you would want there to be a level playing field, where traditional businesses with perhaps traditional ownership models are not facing a greater requirement to uphold the law than much larger, perhaps more anonymous, conglomerates in complex corporate structures spread over many jurisdictions.

Q191 Julie Marson: You mention Lisa Osofsky. I was looking at various practitioners who work on fraud and corporate fraud, and they have welcomed the fact that the Law Commission is going to conduct a review. It is easy to scoff, I suppose, about, "Let's wait to the end of the review," but this actually has huge cost implications for business. It is a very complex area. Those practitioners have actually said that it can only be a good thing that the Government are not amending the current law without full consideration and that the Government are taking a very measured approach.

Duncan Hames: I think Ministers observed that responses to the consultation were mixed. It is regrettable that responses to the consultation are not public and people can form their own views about them. If you conduct a consultation about enforcing criminal law and those who might be subject to that enforcement, in a way that they are not currently, are able to make submissions in response to that proposition, then one would hope that in evaluating those responses they would not carry the same weight as more objective respondents. If we were asking how much chicken wire we should put around the hen coop, I would hope that we would largely disregard the foxes' views.

Julie Marson: That is an interesting comparison.

Q192 Stella Creasy: I was thinking more of asking turkeys whether Christmas was a good idea. I want to follow up on this, because I have been waiting for the Law Commission on another piece of work that I worked on, which is already a year and a half overdue. It is not connected to financial services, but it indicates some of the challenges of waiting for the Law Commission to follow up on the FATF report, which makes some specific requirements about Gibraltar. This legislation is about the ability to trade between Gibraltar and the UK.

I want to ask your opinion on whether we might be able to learn from the specific proposals in that report. In particular, it recognises that although this does tend to happen, there is no legal requirement to reject applicants with a criminal background in Gibraltar. If we will allow Gibraltar and the UK to operate in the way that this Bill does, do you think we could make it a requirement in the Bill to look at the criminal background of people applying for financial services?

Duncan Hames: I should acknowledge that Gibraltar is not within the scope of the work that I do. I will not profess expertise on the rules as they apply in Gibraltar. I think Bloomberg reported today on a bank in Luxembourg and some of its practices. You ask a good question about the personal credentials that enable one to take on responsible roles in our financial system, whether in banks or other institutions.

I note, for example, that the proposals in relation to Companies House are not that it should be more discerning in the acceptance of the directors of companies registering, but rather that it should simply verify the accuracy of the identity and the information provided. Current initiatives do not go as far as you are suggesting would be reasonable. It seems hard enough just to get us responsible for ensuring the accuracy of the data, which is provided as a piece of our economic infrastructure, without getting to a position of demanding some kind of individual assessment.

Q193 Stella Creasy: I am just following up on what the Minister said. He was looking at what he could do to address some of the things that came out of that report. I appreciate that you are not particularly sighted on Gibraltar, but the FATF report also says that there is no dedicated supervision of accountants and tax advisers in Gibraltar, which means that they are perhaps not as cognisant of where people might be trying to launder money. Given that the Bill gives us powers of lines of sight into Gibraltarian firms, do you think that is something we should consider in this legislation, so that when we allow Gibraltarian firms to operate in the UK environment in the way that this Bill does, we could build in some of those safeguards now, with a view to then extending things when the Law Commission eventually reports?

Duncan Hames: Dedicated supervision of the accountancy sector is part of what has got us into this mess of having 25 supervisory bodies. I think one must weigh the benefits of particular sectoral knowledge and some of the issues I raised earlier around potential conflicts of interest and incentives to supervise assertively. As we explained in our report "At your Service", which was published about this time last year, it is definitely the case that the non-financial sector is very much touched by the money laundering problem. It is not enough to rely on the requirements of banks without raising our defences in other sectors—whether that is accountants, solicitors, estate agents, trust and company formation agents and so forth. In some areas, such as private education or charitable giving, an educational training supportive approach might be appropriate to try to raise standards, but in other areas, as I have outlined, clear financial incentives need to be addressed. A firmer approach to supervision is proving necessary given the findings of, for example, the studies that I cited from HMRC, the SRA and OPBAS.

The Chair: If there are no further questions from the Committee, I thank Duncan Hames for his evidence and we can move on to the next witnesses.

Examination of Witnesses

Jesse Griffiths and Fran Boait gave evidence.

3.11 pm

The Chair: We will now hear from Jesse Griffiths and Fran Boait, who are from Finance Innovation Lab and Positive Money. We have until 4.15 for this session. Jesse and Fran, do you want to introduce yourselves?

Fran Boait: I will go first. I am the executive director of Positive Money, a non-profit organisation that campaigns and researches on reform of the money and banking system to enable a fair, democratic and sustainable economy.

Jesse Griffiths: I am the CEO of Finance Innovation Lab, a charity that helps people to try to transform the financial system for people and the planet.

The Chair: Thank you. We will return to the traditional format with questions first from the Minister and then from the two Opposition spokespeople.

Q194 John Glen: Thank you, Jesse and Fran, for your willingness to come before the Committee. One of the key elements in the legislation is the need to give our regulators significant delegated powers to implement and enact some of the technical standards. From your perspective, as civil society organisations influencing policy in financial services, how do you engage with the regulators and how do you find that process?

Fran Boait: Shall I kick off? This is definitely one of the key issues in the Bill that I wanted to raise. Although I understand that the Bill is about regulation and tidying up a few things, it does set the framework and direction for future financial regulation. It is important to say at the outset that we are only 11 years on from a global financial crash that resulted from deep regulatory failures. Neither my organisation nor Jesse's existed 10 years ago—they were formed since the crash. Without a number of amendments to the Bill, it could pave the way for a repeat of that failure.

To put it in context, I remind you that, according to the Bank of England's chief economist, Andy Haldane, the banking cash cost Britain about £7.4 trillion and it would take the financial services sector's tax contribution about 100 years to make up for that. It is a really important Bill that sets the direction, but accountability and transparency are severely lacking in its current form. The civil society sector is tiny, relative to the industry lobby. Although we have engaged in FCA and PRA consultations, the fact that we are onshoring so much legislation right now means that we need to think about the balance of input from the industry and civil society. It is worth noting that the EU, which obviously to date has been where the scrutiny for much of this legislation has been, funded civil society consumer, environmental and social groups in order to provide a balance to the industry lobby, because it recognised that this area is severely complex and critical.

The substantial transfer of power to the financial regulators—the Treasury, the FCA and the PRA—is concerning if there are not increases in parliamentary scrutiny and more detail about the accountability framework. I noted this morning that a number of amendments have been put forward, and I think a lot of them enhance accountability and require parliamentary scrutiny and reporting. I would really welcome that. I could list them—I have some of the numbers. An MP put forward a suggestion for a new specialist financial services Joint Committee between the Commons and the Lords, and that would be welcome, especially if it engaged with civil society.

From where we are starting, in its original form the Bill really is quite concerning in relation to accountability and transparency, but we would welcome all the amendments being put forward—and more—to improve those aspects.

Q195 John Glen: Can I come back on that? Obviously, on 19 October the Government put out the future regulatory framework review, which looks holistically at the options for putting the future constitutional relationship between the Treasury, Parliament and the regulators on a firmer basis. The measures in this Bill have an accountability framework.

The Financial Services and Markets Act 2000, introduced under the previous Labour Government, was about setting an approach for how the regulators worked, looking at an outcome-based approach with the observation of technical standards. I note that you refer to the proposal about Parliament's role. Are you really saying that you do not support that fundamental architecture? Given the complexity of the regulations and technical standards, do you think it is realistic for Parliament, in terms of capacity and expertise, to offer the sort of scrutiny that you think is lacking?

Fran Boait: Fundamentally, we want robust frameworks that allow for input and do not just allow legislation, such as the capital regulation requirements, to be changed without scrutiny, because they have really significant consequences for the whole UK economy. That is why I started by laying out how critical the direction of financial services is.

It is worth saying that we are not out of the repercussions of 10 years ago, so we do not want in any way to go back to the days of regulation being done behind closed doors. I understand that there is a capacity issue, but is about having those opportunities for both Parliament and the wider public—civil society—to feed in.

It is also worth thinking about the regulators themselves. For example, one of the things that the new chief executive of the FCA has said is that they will also be liable for legal attacks on what they are having to implement, so putting all the onus on them is an issue. At the same time, we know that there has been an issue with the revolving door between our regulatory bodies—the Treasury, the FCA, the PRA and the Bank of England—and the industry.

There is a grave concern about this transfer of power. If capacity is an issue, Parliament surely wants to be looking at how to resource things better, in terms of more Clerks or staff, plus thinking about how the EU funded civil society, rather than saying, "Actually, no, it's fine. We will just have reduced transparency and accountability."

Q196 John Glen: I just want to make the point that that is not what we are saying. There is a review looking at this holistically—for, I think, 12 weeks—to provide an opportunity to absorb those very relevant points, but I would be very happy now to hand over to Jesse to respond to the same questions.

Jesse Griffiths: Thank you. I think they are extremely important questions, and that is one reason why this Bill is so important as part of the other important consultations and discussions that you have mentioned—because we are now setting, if you like, the precedent for how we might deal with financial sector regulation in the new era, where the focus will be in London and not in Brussels. Actually, I worked for seven years in Brussels on related issues, so I have some experience from there to share.

I think I agree with the points that Fran has made about the fundamental importance of trying to find ways to support broader civil society engagement in these types of discussion. Perhaps it links to another important point on the Bill, which is that part of the issue will always be ensuring that the purpose of the regulations and the regulators includes social and environmental purpose, so that it is clear that that is an extremely relevant angle from which to discuss these things. One thing that definitely came out of my experience in Brussels was that the role of Parliament is very important, or can be very important, not just because it is important in itself, but because it does open a window for broader input and discussion.

I will explain one particular amendment or change we would welcome. As I understand it, the current Bill allows changes to capital requirements and other regulations under the affirmative procedure. That is obviously more welcome than the negative procedure, but it does not actually specify a role for specialised Committees, so finding a way in which specialised Committees in the House of Common or Lords, or both, could have input would be both a useful step and an entry point for a broader discussion for groups likes ours to help to support the new framework.

Could I say one other thing on a kind of related point? We recognise that it is important that different institutions have different regulatory frameworks and that this is not just about making every single type of institution abide by extremely stringent regulations. That sort of principle is involved in the Bill, and we would welcome that being extended to, for example, the nascent mutual banking movement. We know that the co-operative banking movement is struggling to get off the ground, because the regulations are not tailored to its particular circumstance. I would be willing to talk more about that. It is something that could perhaps also accompany this Bill as a commitment and that Government might like to think about.

John Glen: I am very supportive of your observations there, and I look forward to further engagement on that. I think that, in fairness to other Members, I should now pull back and hand over to Pat.

Q197 Mr McFadden: Thanks to both of you. We had a bit of a discussion earlier about a suggested reform for preventing economic crime. We were saying that when we get into it, we are probably going to be told to wait for the Law Commission. I have a feeling that, on accountability, we are going to be told to wait for the future regulatory framework review to conclude, but I do want to ask you about this area and about the duties on regulators, and I would like to start with the latter.

The Bill, in schedules 2 and 3, sets out new accountability frameworks for the regulators. They are to abide by relevant international standards and to have regard to the relative standing of the UK as a place for internationally active investment firms to be based, or to other matters specified by the Treasury. I would like to ask whether you think it is appropriate for broader goals to be considered in that regulatory framework, and I am thinking particularly of environmental, social and governance goals. The UK wants to be a leader in that area. The Chancellor of the Exchequer set out an ambitious environmental agenda for our financial services industries in his statement about 10 days ago. Do you think that the Bill is an opportunity to put regulatory weight behind the ESG agenda?

Fran Boait: That is a really great question. It is definitely something that stood out for me when I first read through the Bill. The Bill sets the direction, and it needs to integrate the needs of the wider economy, social responsibility, the environment and thinking about how we set a direction that is different from the one that led to the global financial crash in 2008.

As you mentioned, there is clearly cross-party agreement, and we have had announcements from the Government this week and last week on wanting to be a leader in green finance, especially ahead of COP26. There is also pretty much cross-party agreement on issues such as the banking sector severely under-serving small and medium-sized businesses. In his speech yesterday, Andy Haldane, the chief economist at the Bank of England, mentioned that the funding gap is £20 billion. We know there is cross-party agreement on wanting more of our productive and manufacturing sectors to grow, and we need to level up. Some Conservative MPs, such as Kevin Hollinrake and Danny Kruger, have done reports on that and on the need for a different banking system. We have to recognise that that will all require quite a significant shift in the direction of financial regulation, yet there is not anything in the Bill that suggests that such a shift in direction is something that the Treasury is interested in at the moment.

We would certainly support the hardwiring of ESG considerations into the regulation. I looked this morning at the proposed amendments, and we would be very supportive of amendments 20 and 24, which have regard to climate and net zero in terms of investment firms and CRR—that is on climate and environmental. There are some other amendments on social practice and corporate governance that are really important, and there are potentially bigger amendments that we could be thinking about, which would embed sustainability in the regulatory framework of our regulators, such as the FCA and the PRA. That would involve further amending the Financial Services and Markets Act, which I know is being amended already in the Bill, but we could add an environmental sustainability objective, for example, to the FCA's or PRA's objectives.

It is worth noting that the UK's financial institutions are among the worst culprits in Europe for fossil fuel financing. HSBC and Barclays alone have funnelled about £158 billion into fossil fuels since the signing of the Paris agreement. If the UK really wants to be a leader in green finance in a serious way, we need our regulators to be on board with that mission. Obviously, that starts with this piece of legislation and others. We would fully support the amendments to the Bill that have been put forward already, and we would potentially suggest further ones.

Jesse Griffiths: I think that the absolutely fundamental issue with regards to the Bill is that it is an opportunity to put social and environmental purpose at the heart of both the regulation and the duties of the regulators. I do not think it would take a huge change, or huge amendments to the Bill, to set that precedent and really kick-start what I agree is a cross-party consensus that we need to deal with the climate crisis and the rising problems—inequalities caused by covid and so on—and that the financial system is central to that. How it is regulated determines a lot about how it will react to those points.

I can give some examples. Of course, it would be helpful if the Bill required the FCA to refer to the Climate Change Act when preparing secondary legislation. If you wanted to be more ambitious, it would obviously be helpful if capital requirements for investment firms introduced weightings on environmental, social and governance issues—for example, by penalising assets that have climate risks.

I know the Bill covers legislation on PRIIPs—packaged retail and insurance-based investment products—which is a huge, €10 trillion market in the EU. One specific example we have suggested is that, if we could improve the key information document that investors receive when they are looking at PRIIPs to include disclosure on environmental, social and governance issues, and ask the FCA to ensure that that happens, that would be an important signal.

I think that there are real opportunities here to change the nature of the discussion and set the UK as a leader in this area. We know that the direction of travel is towards much greater ESG integration across the financial sector. Investors are pushing for it. We do a lot of work with the big four banks in the UK, and many of them are pushing a purpose-driven agenda. It is the way that we are going, and I think about this as a real signal that the UK wants to be the leader in this field and takes it very seriously.

Q198 Mr McFadden: Thank you, both. The second thing that I want to ask you about is accountability. It is true that proper scrutiny of all this requires resources, but that is a question not just for Parliament but for the regulators, which are being given big additional tasks. You have indicated that you are in favour of a more active ongoing role for Parliament, and I would like to give you the chance to tell us a bit more about that. Obviously, the regulators have to have day-to-day freedom to apply regulation at the level of the individual firm, but you are absolutely right, Fran, that in the financial crisis capital was at the heart of this and how we regard that level of resilience for firms.

If we are giving the regulators these big new responsibilities, both at the prudential and the conduct level, how would a more active role for Parliament work? We have one Select Committee that is active in this area, which already has a really broad agenda of work—the Treasury Committee. We have members of it on this Bill Committee, and they all do a great job, but things are pretty thinly stretched. Could you tell us more about how you think Parliament could have a more active role after the onshoring of all this regulatory responsibility? Again, I will start with you, Fran.

Fran Boait: I think we agree that this is the critical part of the Bill. That is why I mentioned the suggestion that has been put forward of a new potential Joint Committee between the Commons and the Lords. That would be absolutely right. The direction of the financial services sector is fundamental to the direction of the UK. We are really at a crossroads. We have been a large financial sector in the world, and generally the Treasury would say that it has prioritised the international competitiveness of our financial sector in the global market. It has held that in greater reverence than domestic competition that serves the needs of the people—your constituents, your businesses and the productive UK economy.

I think it is in Parliament's interests to think about how we set up processes for greater scrutiny and about engaging civil society actors in that as well. I would have thought that quite a few people sitting within those regulatory bodies would welcome that. They are under immense stress from the last 10 years of post-crash change. As I mentioned, they are subject to legal challenge from the industry.

Although, ideally, there would be greater scrutiny in Parliament, and I think that a Joint Committee would be good, some of the amendments that have been tabled on specifics, such as an annual review of capital regulation requirements, are really great additions—I hope the amendment on that will go through.

I also think that we need to ensure that the regulators are given the right direction for financial services, which is why I would also welcome the amendment that was put to us about this Government's strategy for financial services. As I said, we are at a kind of crossroads, and understanding what direction the Government want to take it in is critical for the regulators. I support a lot of the amendments that have been put forward. Setting up a new Select Committee or some kind of Joint Committee is also a strong proposal.

Q199 Mr McFadden: Jesse, you have experience of this at EU level where they have the ECON Committee, which looks at things before they are implemented. We have also had a suggestion from the hon. Member for Hitchin and Harpenden (Bim Afolami) for some kind of specific financial services Committee in Parliament. Would you think of that suggestion?

Jesse Griffiths: I think it is extremely important that there should be some Committee, whether it is a financial services Committee or some other way of doing it, that gives Parliament that role. That could be operationalised in a number of different ways, but it should be done in a way that makes sure that consideration is given to the way the Bill and, I presume, future legislation delegate a lot of power to the Treasury and the regulators to change, through secondary legislation, regulations that were previously agreed jointly between the European Parliament and the European Council. Some kind of check that that has been done in the correct way, and that it has been done with regard to the fundamental purposes of that legislation, is the role that the Committee would fulfil.

Obviously it would need more resources, which is a key lesson from the European experience. You are right to say that it is not an easy thing to do, nor is it something that can be done in addition to what is already being done by the Treasury Committee, for example. Resources is a key point.

The second key point, of course, is that such a Committee, and potentially the Bill and some of the amendments that have been referenced, can allow the regulators to report and explain more clearly why they are making certain changes, so that is a useful transparency and information point. The third point is that, without such parliamentary oversight, it becomes extremely difficult for civil society organisations such as ours, which are trying to ensure that the voice of the environment and social issues are raised in financial sector regulation, to be heard as effectively as other voices that are trying to influence that regulation. So it helps to create a better balance of lobbying, if you like, or of advocacy in this area.

Mr McFadden: Okay. I will stop there and leave it to others.

Q200 Alison Thewliss: I would like to thank Finance Innovation Lab for the briefing, which was really quite interesting and a different approach. Pat has hoovered up some of the questions that I was going to ask, but is there anything else in particular that you would like to see in the Bill?

Jesse Griffiths: One of the main issues that we would have loved to have seen in the Bill—I recognise that it would be outside the scope to introduce it now—is a proportionate regulatory regime for mutual banks. One thing that is important, or one problem that is very evident in the UK financial sector, is its lack of diversity of institutions. Across Europe, co-operative banks have an average of more than 25% of assets, and in the UK they were not even legal until 2014. The mutual banking movement is now trying to establish that vital part of the system that would help to improve services for customers, improve competitiveness and bring important countercyclical and social and environmental benefits. That would have been nice, given that the Bill recognises that there is a need for a different regime for investment firms from banks, for example. There is a huge unmet need for a more proportionate regime for those institutions. That would be my wish list of what might have been in the Bill. Perhaps as part of the Bill discussions, we might get a commitment to consult on such a proportionate regime.

Of course, the other point to make here—to repeat some of the points we have made about social and environmental purpose and accountability—is that the main issues with the Bill are the things that are missing that could make it much more ambitious and set a much better precedent for financial sector regulation going forward.

Finally, one issue that is worrying to us is the danger of a return to framing the purpose of financial regulation as being about the competitiveness of the UK financial sector globally. That appears in a few places in the Government's explanatory notes to the Bill. The key point is to make a distinction between competition, which is good, and competitiveness, which can be dangerous when applied as a principle for regulation. Framing regulation within that competitiveness framework is widely recognised as one of the main contributors to the global financial crisis. It was easy to make the case for relaxing regulation to make any particular financial sector more competitive compared with others, when actually I think what we want to establish, through the Bill and other actions, is that the UK financial sector will seek to set high standards and to be the leader in that, not to introduce a competitiveness framing that raises the risk of standards being lowered.

Fran Boait: I can build on that. I agree with a lot of what Jesse has said. For us, the overarching areas are accountability and seeing more that it in the Bill, the environmental, social and governance aspects, and the purpose. On that last point, while we understand the Bill is onshoring and tidying up, as I have said before, it sets the direction, and that strategy for the financial services sector has not been laid out by the Government. I think that is key because, as Jesse has mentioned, it is concerning to see competition and competitiveness in there—in the run-up to the crash, that was shorthand for deregulation—at the same time as handing a lot of power to regulators. Again, it is worth noting that the FCA chief executive said himself that they would prefer high standards to the idea of competition, so there is support for that. Making the direction clear is critical.

On a few specifics that have been left out, over the last few years Positive Money has been working on things such as access to cash and the need to protect people's right of payment in different ways—I noted that there were a few questions on that—and thinking about financial inclusion. Thinking more about the financial services' role in the wider UK economy is absolutely critical at this time, and there is not too much in the Bill in terms of the direction of that.

Q201 Alison Thewliss: In terms of saving for people who are at the margins, have you any thoughts about the Help-to-Save scheme and the measures on that?

Fran Boait: I welcome the Help-to-Save scheme, but again, I point to the wider issue—it is the focus of what Positive Money does—of how the financial services sector contributed to the global crash, which has undermined a lot of our economy in terms of people being able to meet living standards, pay bills and so on. Critically, we have to understand that where the money goes from financial services really determines that shape of the UK economy. If most of the money goes into property and financial markets, which it does, and we have four big banks occupying pretty much the whole market in the UK, as Jesse mentioned, we have an economy that has an oversized finance sector and property bubbles, and we have less money going into creating jobs, supporting small and medium-sized businesses and getting into people's wages. We have a crisis of living standards in this country, as well as a household debt crisis. I am not a debt specialist, but I welcome some of the changes put forward for breathing space and debt repayments.

Again, we need not only to look at fixing some of the symptoms, but to think about the cause. I sound a bit like a broken record, but this is why, unless we get a grip on the direction of the financial services sector that we want—whether we want financial services to serve the UK domestic economy and not just international financial markets—I do not see us really stemming the problems with problem debt, limited savings and incredibly low savings across low-income households in the short, medium and long term.

Q202 Alison Thewliss: Lastly, Jesse, I think the phrase you coined, accountability deficit, is quite useful. Can I ask a wee bit more about the risks that moving everything over to the regulators might have?

Jesse Griffiths: Before I turn to the risks, I want to recognise that it is not the case that more regulation is better or that regulators should not have leeway to design proportionate regimes. That is absolutely not the case, and we need to recognise that. However, I think there are risks involved in turning over quite so much authority to regulators as the Bill proposes. As we mentioned, it will allow them to make changes to important regulations with limited parliamentary oversight. Secondary legislation will become one of the main ways in which regulations are changed.

The risks come from different angles. The obvious risk—we have seen this in the past in the run-up to the global financial crisis—is that there is a potential problem of regulatory capture, where the regulators become very close to the people they are regulating, who have regular discussions and meetings with them. The more those decisions take place behind closed doors, the greater that risk becomes.

From our perspective, another big risk is that you miss out on the opportunities to have a broader section of voices contribute to framing regulatory changes, from the kind of organisations that Fran mentioned, which represent the people who are the most badly affected by problems in the financial sector—those with problem debt or who are highly financially vulnerable—to those who think about the environmental impacts of the different regulations. The other risk is that we will not be able to reflect some of the most important impacts that changes in regulation will have.

I will make one final point. It is extremely important for Members to think about how they can actively encourage participation and engagement in those discussions by more of the groups that represent those affected by the financial system. This is in no way a criticism of the Treasury, which I know has a lot on its plate now, but there was an important consultation we noted over the summer that had a one-month consultation window during August, which basically made it impossible for groups that are not directly involved in that particular issue to think about the implications and whether they should contribute. Having requirements to consult in a certain way that allows more groups to participate would be useful.

The Chair: I have seen two other Members indicating. First, I will come to Abena Oppong-Asare.

Q203 Abena Oppong-Asare (Erith and Thamesmead) (Lab): I found your comments really insightful. I have several questions, but first I want to go back to your comment about how the Bill does not mention any environmental priorities. You have come with several recommendations, and you said that you have seen the amendments, particularly amendments 20 and 24, which you support.

I want to clarify something you mentioned, which is that there should be an element of penalising large organisations for not carrying out environmental risk assessments. As we know, there are large organisations and companies such as Barclays that do that. I wanted to hear from you about how those penalties would be carried out. Are they financial ones? The concern that I have is that big companies would be able to afford to pay financial penalties, so is that really a great incentive or way of holding them to account?

Fran Boait: This idea is really in the capital requirements regulation, the idea being that financial institutions and banks lending towards high-carbon sectors would have to hold much more capital against that loan. I agree with the concern that they would maybe go ahead and do it anyway, but I think this is an important mechanism for pricing in climate risk, which has taken off in the past couple of years. There is obviously a recognition from the Financial Policy Committee of the Bank of England that climate risk is a huge risk to financial stability—both transition risk and physical risk—so we need to think about that.

Implementing a penalising factor requiring them to hold higher capital should have an important effect. We have seen a similar thing already done in the housing system, which has not completely solved the problem because it is systemic, but it is an important step forward in regulation and really signals to the market that the regulators do want to keep control of the situation. It is not going to solve everything—it is not going to completely stop lending into the fossil fuel industry—but it is quite an important step forward.

The key here is that there should also be a mechanism for scrutinising the CRR that we are onshoring. At the moment, it seems to say, "We are not going to say what we are going to do. We are going to let the financial regulators decide what it is," which is very dangerous. As Pat McFadden pointed out, it was capital and the lack of banks needing to hold it that resulted in the crash, and it will be the lack of banks needing to hold capital against fossil fuel lending that will keep that carbon bubble, if you like, being pumped up. I am keen to continue the conversation about wider regulation and other things that need to be done alongside that in order to ensure a transition out of fossil fuels, and towards a green economy.

Abena Oppong-Asare: Jesse, do you have any further comments?

Jesse Griffiths: Yes. I think it is another extremely important question, and it is an extremely important way to think about the impact of regulation, as being about what kind of incentives it places on different actors to behave differently.

With regard to climate, there are three key points. One is about disclosure: that is why, for example, we made the recommendation on the PRIIPs point that the key information document should have better disclosure on environmental and social governance issues. That creates an incentive between the sellers of those products and the investors buying them, and we know there is strong demand in the investment industry to know much more about those issues and try to redirect their investment towards greener ends. That is important. Disclosure is obviously also important in terms of civil society and the public understanding what different institutions are doing, and also the Government.

The second point on incentives is the point that Fran has made, which I would fully support. Finding ways to disincentivise or penalise fossil fuel investments in particular is extremely important. The scientific research shows us that if we exploit only those oil and gas reserves that are already being exploited, we will still go above the dangerous 1.5° threshold, without even taking coal into account. There really is not any room for further investment in fossil fuels, so it would be an important signal to think about how we fundamentally disincentivise that by introducing penalties for that within the capital requirements of organisations.

The third point is that this is a newish area for regulators. Although we have been thinking about it for a long time and many regulators have been discussing it, it is not like all the answers are known. We had a report a couple of years ago called "The Regulatory Compass", which explored what it would look like if regulators put a social and environmental purpose at the heart of what they do. There is a lot to do, and a lot of thinking to do there. The first step is, through Bills such as this, giving regulators the responsibility to think about that. I think that is extremely important.

Those are the three main things. The fourth incentive point is that regulation does not solve everything, as Fran said. It is important not to try to solve all problems through this lens, but to think about all the other things that we should be doing—investing in the green future and so on—if we are to solve the climate crisis.

Q204 Abena Oppong-Asare: The Bill mentions a statutory debt repayment plan; I want to get your thoughts on that. Are there elements that you are concerned about? Do you think it goes far enough, and if not, can you make some recommendations? Can I go with Jesse first?

Jesse Griffiths: You can. I do not have anything in particular to say that goes beyond the evidence from StepChange and others on this point. I fully support what they said.

Fran Boait: Similarly, a point that StepChange brought up that it is critical to keep in mind when looking at this kind of regulation is how we look at debtors and the stress and strain that they are under. We need to ensure that their needs are prioritised above those of creditors.

Earlier I made a macroeconomic point about financial services: unless we get our financial services sector better aligned with the needs of the people, small businesses and different parts of the economy in this country, household debt will keep rising. Obviously, we also need good direction from the Government's fiscal spending plan. The direction of financial services and the direction of Government spending are critical in tackling household debt. If we do not look at some of those underlying systemic causes, we will keep kicking the can down the road, in terms of household debt being a problem. Although changes such as breathing space are welcome, they do not tackle the underlying causes and the need to get the number of people in problem debt down.

Q205 Stella Creasy: I want to follow up on a couple of things. First and foremost, Jesse, you were talking about the co-operative banking sector, what we could do, and what would be within the scope of the Bill, given that co-operative and mutual banking would be covered by the Prudential Regulation Authority. Obviously, there are a number of requirements on co-operative banking that we could consider superfluous now that we have this legislation. I am thinking in particular about section 67 of the Co-operative and Community Benefit Societies Act 2014, which has some unnecessary constraints, given the capital structure it requires. Do you agree that it would be helpful in creating a level playing field, and ensuring that co-op banks and mutuals could compete, to recognise that as the Bill provides prudential regulation that covers those banks, those earlier provisions are superfluous?

Jesse Griffiths: Yes, I think that is very sensible. The main point I would make is that those institutions are very different from other types of financial institution, and need a proportionate regulatory regime. The point that you raised is important. They frequently raise the idea of establishing a network of 18 regional banks on the model of the German Sparkasse system. For that to work, they would need to centralise IT and other services so they do not have to replicate those across the different institutions. As they have, embedded in the network idea, an agreement that they will not compete with each other, they can fall foul of competition regulations, so those would need to be considered.

Those are some of many examples that show you need a different regime for these types of institutions. On following a model like the Sparkasse system, in Germany those regional institutions are jointly responsible for each other, so that creates a very powerful incentive for them to be prudent and responsible lenders. If that internal incentive is already there, you should consider which other regulations are not so necessary for those institutions because, by their nature, they are highly prudent lenders.

Q206 Stella Creasy: I take your point that being concerned only with competitiveness is a very narrow view of what is good for the consumer. That piece of regulation does not prevent co-op banks from holding a banking licence, but it could be seen as preventing the competitiveness of co-op banks. If the Government are interested in co-operative banks and supporting their ability to compete, it would be a good thing to remove.

You and Fran talked powerfully about trying to ensure that this Bill has at its heart a positive approach to consumer regulation. Perhaps one of the things missing from it is consideration of its inevitable impact on consumers. Do you have a view about the benefits of reviewing how the Financial Conduct Authority has acted for consumers, and are there are areas where you think it could have gone further and been more proactive? The Bill gives the FCA new regulatory powers. I have an interest in high-cost credit. If we wanted the FCA to take a more proactive view in using these new regulatory powers for consumers, where would you want it to act?

Fran Boait: That is a great question. To build on what Jesse said about mutuals and your wider point about consumer regulation, the issue with our financial services regulation is that all regulation tends to favour the status quo—the incumbents. That is where Parliament's voice is so crucial, as is having more of a civil society voice than we had pre-crash. It might not be obvious how the FCA regulates a mutual bank. Without direction from Parliament that the regulator's purpose is to look at diversifying the UK banking or financial services sector to include different ownership models, the FCA is not really in a position to understand fully or quickly, or move fast on how it can support the emergence of new banks.

On banks and consumers, since the crash, we have seen all these challenger banks coming in, but they are operating very much the same model of a shareholder bank, with short-term profits, and without any kind of wider thought for environmental or social mission-driven aims, or regional considerations. We have not really diversified the sector, and it will be very challenging for us to do so unless the regulators think differently. I think that Jesse and I agree that one of their goals should be to diversify the sector's ownership models, in terms of mission, geographic location and so on. For consumers, and especially someone setting up a new local co-op or small business, that would be a lot better, particularly as we emerge from the pandemic wanting to build back better.

I definitely support a lot of your work on high-cost credit, but although there were some wins on payday loans and in other areas, that issue tended to be transferred to other areas, such as credit cards; some good proposals were put forward on how to regulate those. Obviously, we hope to see the FCA moving fast on trying to ensure that regulation is put forward as quickly as possible where there is a clear issue with extremely high interest rates on high-cost credit.

I repeat that we need to bring this back to the systemic problem of such a large sector of society being on low pay with high living costs. We need to think about the underlying macroeconomic issues, which are very relevant to the direction of financial services. If we are serious about taking things in a more positive direction as we emerge from the pandemic and Brexit, we need more voices for consumer rights in financial services, and for environmental and social considerations. That will be critical if we are to see a more positive direction from financial services, in terms of serving consumer needs.

Q207 Stella Creasy: Jesse, you may wish to answer this. Fran talked powerfully about mission. Our regulatory structure talks about consumer protection. In previous evidence sessions, we have talked about, and indeed the Bill contains provisions for, debt respite, which is very much about protecting consumers when things go wrong. Is there a case for being more proactive about the consumer experience, and perhaps charging our regulators with being more proactive on consumer detriment to try to prevent some of those problems? For example, we could look at what we could learn from capping high-cost credit, and extend that across the whole credit industry—or to sectors where there is no regulation, but we can see that consumer detriment is likely to occur from the model. We could move to a more proactive approach from the regulator, with horizon scanning for what might happen to consumers.

Jesse Griffiths: Absolutely; I agree. On consumers, to bring this back to high-cost credit—this links to the point about the purpose of regulation—regulators should always have at the front of their mind the impact on the most vulnerable people in society, and those who are in many ways excluded by the financial system. This is not just about consumers as a whole, although they are important; it should be about those consumers who will lose most if their needs are not taken into account.

One example that we have been discussing are the new regulations on open banking and open finance, which can lead to further exclusion of marginalised people, who might get their income, withdraw it as cash, and operate in the cash economy, or who often—this has been raised—get income from a lot of different sources, and in such small amounts that it is not recognised as income by the open banking system, as it is set up. Those are just small examples, but if the regulator is not thinking, "What is the impact on these people?", they get missed. Unfortunately, in that example, it feels a bit like that discussion has been, "Well, if it works for 95% of consumers, then it is good." If it does not work for 5%, that is probably the biggest impact that we should care about.

The Chair: I thank both witnesses for their evidence. Our final panellist is poised and ready to go, so thank you, Jesse and Fran.

Examination of Witness

Hon. Albert Isola MP gave evidence.

4.9 pm

The Chair: We have a treat now. Every other word seems to have been "Gibraltar" this afternoon. Our final witness is the hon. Albert Isola, Minister for Digital and Financial Services in Her Majesty's Government of Gibraltar. Minister, thank you for being with us. Will you introduce yourself for the record?

Albert Isola: I am Albert Isola. I am charged with responsibility for financial services in Her Majesty's Government of Gibraltar. I have with me the chief executive of Gibraltar Finance, who has driven much of the work on the matters under discussion today, and Mr Julian Sacarello, who is the head of policy at the Gibraltar Services Commission. You cannot see them, but they are in the room with me.

The Chair: Good value! Thank you. We will start with our Minister, John Glen.

Q208 John Glen: Minister, thank you very much for taking the time to join us as we start our scrutiny. It would be helpful for the Committee if you could set out the nature of the relationship between the UK and Gibraltar on financial services, whether you welcome the measures in this Bill, and what you see as the most significant elements of the legislation.

Albert Isola: I thank you and your team in the Treasury, as well as the regulators at the PRA and the FCA, who have engaged with us over a three-year process of looking at all the areas of market access, all the challenges and opportunities, and how, post Brexit, we can best replicate what we had under the European Union, as that ends and we begin something new. It has been an interesting and almost enjoyable journey. It has been extremely hard work, but the professionalism of your team has been exemplary, and I am extremely grateful to all of them for the conversations that we have had. Sometimes they were difficult, but they were always positive and proactive in looking for solutions, for which I am extremely grateful.

On the relationship between Gibraltar and the United Kingdom on financial services, it is important to remember that when the United Kingdom joined the European Union in 1973, because the United Kingdom was responsible for Gibraltar's external relations, we joined with you. As a consequence of that, for many years, up until 2001, we were striving to enjoy the benefits of that membership. With that came the responsibilities of adhering to the many directives and complying with regulations that were passed from Brussels.

We talk about 28 or 27 member states, but there was another competent authority, the Gibraltar Financial Services Commission, in financial services; it was able to issue a banking licence, an insurance licence or any other financial services licence in exactly the same way as all the other competent authorities within the remainder of the European Union. I ask the Committee to think through the fact that Gibraltar has complied with all European Union directives and legislation in all areas, including financial services. That includes all the anti-money laundering perspectives, which you may wish to discuss later.

For all intents and purposes, Gibraltar and the UK, from a financial services perspective, are aligned. We have the same rules. As we discussed with your teams over the past few years, this is about outcomes—where we get to, and how we get there. We have been through a very long assessment with an independent contractor that was jointly engaged by Her Majesty's Government and the Government of Gibraltar to deep-dive into insurance, which is the largest area of interest between the United Kingdom and Gibraltar, to analyse in enormous detail, and to conduct a sort of gap analysis of whether we were getting to the same outcomes. Where we felt that we were not, we have dealt with that.

Parallel to that process, we also had what you call the legislative reform programme, which was a three-year piece of work, which started before Brexit, to completely redo our financial services legislation. Before, we had 87 pieces of legislation; we now have one Financial Services Bill, which encompasses everything, and is far more aligned to the Financial Services and Markets Act 2000 than we were previously.

This legislation came into play in January this year. Section 20(2) refers to the Gibraltar regulatory regime aligning its standards and supervisory practices with that of the United Kingdom. We had that before, and we again have it in 2020. We are drawing closer together under the new regime that we are discussing; that relationship should continue and prosper, so that consumers in the United Kingdom can have more choice and competition. At the same time, we can know that our aligned standards of law and practice match those of the United Kingdom. I apologise if I have gone on a bit long, but I thought it was important to put today's discussions in context.

John Glen: Thank you very much. It was extremely helpful of you to set the context for the Committee. I have no further questions. I will invite my colleagues to probe a bit further into what you have experienced in the past few years, and how you see the future.

The Chair: We have until 5 pm for this session, so there is a good length of time.

Q209 Mr McFadden: Minister, thank you for giving us your time this afternoon. There is a long-standing and warm relationship between the UK and Gibraltar that informs the measures in the Bill. The Government are trying to create a sort of mini-single market in financial services between the UK and Gibraltar to ensure your continued market access to the UK in future. I am sorry we cannot do much about your market access to the other 27 states to which you currently have market access, but sadly that is beyond the powers of the Committee. Can I ask you, in simple terms, are you happy with the Gibraltar provisions in the Bill as they stand?

Albert Isola: The fundamental question for us is, do we continue to have market access? The answer to that, of course, as you know, is yes. As you have rightly pointed out, we lose single market access to the remainder of the European Union with the United Kingdom on 1 January, and this is where we will look for our future. If I can put it a slightly different way, some 90% of our financial services business before Brexit was with the United Kingdom, so that puts in focus how important this legislation is for all of us here. In each of the different areas in which we have worked, we have developed a niche—an area of specialisation and expertise—that has served those who work here with us well. We very much hope that that will continue into the future.

Q210 Mr McFadden: We have heard quite a lot of references today to the proportion of motor insurance policies in the UK that are sourced out of Gibraltar. I think it is roughly 20%. Looking at the market access regime established by the Bill, is it Gibraltar's ambition to grow the proportion of UK-purchased financial products from Gibraltar—for example, in other areas of insurance, other savings products, or other parts of financial services? Is it a platform on which you want to grow?

Albert Isola: As the Minister with responsibility for financial services, I would love to see our businesses grow—of course I would—but responsibly and in a manner that matches the standards that we have with the United Kingdom in terms of the regulatory approach. The reason that we have been successful in motor insurance is because we have developed expertise and specialisations in the firms that have come here. It is not that we switched on one morning and had 20% of the United Kingdom motor market; that has grown over a 15-year period. As they have grown, so have we, in terms of the business we do with the UK. There are a number of other businesses that have tried in other areas of insurance, and they do well, but with nothing like the success that the motor insurers have enjoyed in working with the UK.

Q211 Mr McFadden: My final question is one that I touched on with the Association of British Insurers in its evidence earlier this afternoon. Given the platform that is being created by the Bill, do you see any potential for attracting businesses currently in the UK to relocate to Gibraltar? Would there be any corporation tax advantage for them in doing so, for example?

Albert Isola: My experience, put quite simply, is that of all the firms that have come and set up here in the last seven years while I have been in this job, not one of them has ever said they are coming for tax purposes. There is a tax differential—I think the rate of the UK's corporate tax, or profit tax, is 19%; in Gibraltar, it is 10%—but that has never been cited as one of the reasons for setting up in Gibraltar.

It is far more about our agility as a jurisdiction and the accessibility of the regulator. I can arrange to meet every single insurance company in Gibraltar in two weeks if there is something that I would like them to do or be more conscious of. That is just not possible in the United Kingdom. The accessibility of our regulator for all our insurance firms is the No. 1 point that they measure as to why Gibraltar has been so good to them. They have that access and they have that contact. Then you have the expertise we have developed: the lawyers, the accountants, the insurance managers, who are able to provide the services that they need. These are far more important to the firms than the corporate tax. I have to say, if I may—allow me this plug—the quality of life is obviously important too. The sun shines here for a little longer than it does in the City of London, and I think that is important too.

Mr McFadden: I am sure it is; your weather is certainly better. I have no further questions. Thank you very much, Minister.

Q212 Alison Thewliss: I just have a couple of questions. You mentioned that insurance is the largest area; are there any other aspects of financial services that require any further legislative action, or are you content with the way in which the legislation is set out?

Albert Isola: Forgive me, I did not hear the question particularly well. Would you mind repeating it?

Alison Thewliss: Apologies; you are quite far away, I suppose. You mentioned that insurance is the largest area in which you have dealings. Are there any other aspects of financial services that are not covered in this Bill that require any further legislative action, or does the Bill cover everything that you require it to?

Albert Isola: This legislation is like the enabling legislation, if I can call it that. If I can just say what it does for us, this requires alignment of normal practice, and it also requires, as a secondary condition—if I can call it that—co-operation between regulators and between Governments. In terms of the aspect that you are referring to, what will actually happen post 1 January 2020, I expect, when we begin the serious work, is that we and the Treasury will work through each of the different activities that we wish to have to access to, to the United Kingdom. The Treasury will then satisfy themselves, or not, that we meet the standards required to be able to have those passed through a statutory instruments in 2022, as one of the subsets of the activities that we can do. Insurance will be one; banking will be another; funds will be another. All of these are different subsets of controlled activities regulated in the United Kingdom, which we will work on with the Treasury in the coming 12 months to satisfy it of our ability to meet and match the standards that we have discussed here today.

Q213 Alison Thewliss: Thank you. Presuming that all these standards are met at the current time, do you have any worries about meeting those standards or any implications that not meeting those standards would have?

Albert Isola: No, not at all, but again, simply because today we can passport our services under the European Union or Gibraltar order, mirroring the European Union provisions. We both have the same rules today: that is obviously true in insurance, in banking, and in the funds sector. We all have the same rules and regulations today, so I have every confidence that we will meet the standards that the Treasury will ask us to meet in the next 12 months in each of those different areas, because we are at one already today.

Q214 Alison Thewliss: Do you think that the rules give adequate protection for UK as they are set out in the legislation?

Albert Isola: Yes, because we need to be aligned in terms of authorisations, supervision, capital finance and enforcement, so the whole array of measures that a UK consumer can expect to receive in the United Kingdom, they can fully expect to receive from us also.

Q215 Alison Thewliss: You do not foresee any diminution of that protection that UK consumers have?

Albert Isola: No, no, absolutely not. On the contrary, as the UK moves in whichever direction it moves post 1 January 2021, whether there is divergence or not, we will obviously, in respect of the areas that we seek market access, follow those through.

Alison Thewliss: Thank you very much.

The Chair: Stephen Flynn, could you make your way to the mic and speak right into it? That one will work, although it has Duncan Hames's name by it.

Q216 Stephen Flynn (Aberdeen South) (SNP): I am sure that Duncan would be overjoyed to be associated with me.

Thank you, Minister Isola, for presenting yourself before us today and for the information that you have provided. I would like to follow on from the shadow Minister's questions about the competitive advantage that Gibraltar may or may not have. As I see it, the Bill seeks to create a level playing field, but it could be inferred that Gibraltar has a competitive advantage over our constituent parts of the United Kingdom—indeed, the home nations—given that it has abilities in relation to corporation tax and other forms of taxation that the home nations do not. How would you assess that? I appreciate that you sought to answer Mr McFadden in that regard, but do you feel that we could see a situation in which businesses will seek to take advantage of what is clearly a level playing field with a competitive advantage for yourselves?

Albert Isola: The simple answer is no, and I will tell you why. If you think about it, we have been setting our own tax rates for the past 20 years, during which we have had access to the United Kingdom market through the European Union single passporting system. I do not think that I have ever heard any discussion in the financial services environment about different tax rates in different member states of the European Union, let alone Gibraltar, having an impact. It is not as if an advantage were being created by the Bill that would endure to 1 January next year and beyond. Where we are today is where we have been for the past 10 or 15 years with different tax systems.

I do not think that you will find a company that—with the level of investment that it requires in terms of capitalisation, particularly with respect to insurance—will make a judgment call on a difference of 9% in corporate tax, assuming that it can make a profit. As I said to the shadow Minister, the information that I have from the firms that have come here is that that is very low on their list of priorities, if it is there at all. I do not see it having the impact that you suggest; if there were such an impact, it would already have happened a long time ago. As I mentioned, the firms that are in Gibraltar today have been here for a very long time, and as they have grown, so have we. Our market share has been 20% for the past year or two; it was a lot less before those businesses grew and became more successful.

The Chair: As there are no further questions, I thank you, Minister, for joining us remotely from Gibraltar as our final witness of the day. This is the end of our fourth and last evidence session.

The Committee will meet again, not here but in Committee Room 14, on Tuesday at 9.25 am—bright-eyed and bushy-tailed for our first sitting of line-by-line scrutiny.

Ordered, That further consideration be now adjourned.—*(David Rutley.)*

4.28 pm

Adjourned till Tuesday 24 November at twenty-five minutes past Nine o'clock.

Written evidence reported to the House

FSB 02 Building Societies Association (BSA)

FSB 03 Finance Innovation Lab

FSB 04 Revolut

FSB 05 Association of British Insurers (ABI)

FSB 06 Spotlight on Corruption

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

Fifth Sitting

Tuesday 24 November 2020

(Morning)

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PBC (Bill 200) 2019 - 2021

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Saturday 28 November 2020

The Committee consisted of the following Members:

Chairs: † Philip Davies, Dr Rupa Huq

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
† Eagle, Ms Angela *(Wallasey)* (Lab)
Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison; Nicholas Taylor, *Committee Clerks*

† attended the Committee

Public Bill Committee

Tuesday 24 November 2020

(Morning)

[Philip Davies *in the Chair*]

Financial Services Bill

9.25 am

The Chair: Before we begin, I have a few preliminary points to make, some of which you will have heard before. Please switch electronic devices to silent; tea and coffee are not allowed during sittings and, again, I remind everyone about the importance of social distancing and thank you all for complying with that. The *Hansard* reporters would be grateful if Members could email any electronic copies of their speaking notes to hansardnotes@parliament.uk.

Today, we begin line-by-line consideration of the Bill. The selection list for today's sitting is available in the room and shows how the selected amendments have been grouped together for debate. Amendments grouped together are generally taken on the same or a similar issue, and decisions on amendments do not take place in the order they are debated, but in the order they appear on the amendment paper. The selection and grouping list shows the order of debates; decisions on each amendment are taken when we come to the clause that the amendment affects.

If a Member wishes to press to a Division an amendment that is not the lead amendment in a group, it would be helpful to indicate that in advance. I will use my discretion to decide whether to allow a separate stand part debate on individual clauses and schedules, following the debates on the relevant amendments. We start with clause 1 and amendment 19.

Clause 1

Exclusion of certain investment firms from the Capital Requirements Regulation

Mr Pat McFadden (Wolverhampton South East) (Lab): I beg to move amendment 19, in clause 1, page 2, line 21, at end insert—

"(7A) The Secretary of State must, within three years of this Act being passed, prepare, publish and lay before Parliament a report on the impact of the amendments to the Capital Requirements Regulation made by this section and Schedule 1 to this Act.

(7B) The report must assess the impact on—

(a) financial stability;

(b) competitiveness; and

(c) consumer risk."

This amendment would ensure that, where departures from current capital requirements take place, the Government carries out a review of the impact on competitiveness and consumer risk.

Thank you for your chairmanship today, Mr Davies. With your indulgence, I would like to explain to the Minister broadly the approach we are going to take with these amendments. A number will be about reviewing, producing reports, parliamentary accountability and so on. Another number get into the accountability framework for the regulators and that "have regard to" list, and we will want to explore that quite deeply. Then there will be another set around the later parts of the Bill, relating to the savings provisions, the debt scheme and so on. That might help the Minister and the Committee to understand broadly where we are coming from when we move these amendments.

This first amendment, amendment 19 to clause 1, is in the first of those groups. Clause 1 exempts certain categories of investment firms from the requirements of the capital requirements regulation. This amendment explores what the effect of that might be and not only our right to know that effect, but our obligation to understand it. The reason we tabled this amendment is that capital, or the lack of it, was at the heart of the financial crisis. The banks that keeled over were over-leveraged and behaved as though a rainy day would never come. In fact, it is estimated that when the financial crisis hit, Royal Bank of Scotland, which was one of the biggest banks in the world at the time, was leveraged to a degree of about 50:1, so they had very little cushion of resilience for when more troubled times came.

The Basel II rules, which were in place at the time, failed to stop either the collapse or the public's having to step in—through taxpayers and Governments around the world—to bail out the sector. Last week, when we were taking oral evidence on the Bill, I quoted Paul Volcker, the former Chairman of the Federal Reserve, who gave evidence in this House about a senior banker who had told him that his bank did not need any capital at all, that money could always be borrowed on the wholesale markets and that the banks could operate without capital. The crash proved that not to be true. The banks need capital. They need a cushion. That is not just their insurance policy, it is ours—it is the public's insurance policy too.

Following the crash, the world's regulators, whether in the United States, the UK or the European Union, set out to solve the problem of "too big to fail", which has been characterised as privatising the profits and nationalising the risks, and developed a new set of capital requirements for banks and financial institutions. It was designed to make them more resistant to downturns. Those rules, on a global level, are set out in the Basel III process, now revised to the Basel 3.1 process, in the CRR and in the actions of national regulators. That is important, because the Basel rules should not be regarded as a maximum when it comes to the safety of our financial institutions. They should be regarded as a floor.

Most banks and regulators will say that today they hold significantly more capital against their loan books and that they are better equipped to handle a downturn or economic shock than they were 12 years ago. That is broadly true. Banks are better capitalised now than they were. However, they do not all like that situation, in truth. They will also say—I am sure that some banks tell the Minister and the regulators—that if only they did not have to hold so much capital they could lend more. They may well be saying that more loudly during the covid situation, when, as we see light at the end of the tunnel, we want to get the economy moving again. The smaller banks and new entrants will complain about being held to the same capital rules as larger and more established institutions. They will argue that that is a barrier to market entry and that it acts to reinforce the oligopoly in the UK where there are four or five major high street institutions, which it is difficult for new entrants to compete against. Other institutions will complain of being held to the same rules as deposit-taking institutions, which is part of the exemptions in clause 1, arguing that the character of their business is different.

Clause 1, as I have said, equips the regulator to respond to some of those points. We are not only onshoring, as it were, the capital requirements regulation, we are making provision, through the clause and other subsequent clauses, for the regulators to depart from it. Of course, departure from a common rulebook is a consequence of Brexit. Indeed, some might argue that it is the whole point. The clause allows it, and it is important that the Committee understands that the amendment would not prevent it. Neither does it seek to relitigate the referendum or to prevent the common rulebook to which we have subscribed for many years from ever being changed. That is not what the Opposition are saying. We are saying that, Brexit or not, and inside the EU or not, capital requirements still matter and they are there for a reason.

I would argue that for the UK the need for financial resilience is even greater than it is for most economies. We are a medium-sized economy with a huge financial sector. The consequences of that sector getting into deep trouble are potentially all the greater for our economy than for some others. Having a big financial sector is in many ways a great strength, of course. It brings employment, tax revenue and investment to the country, but it is a risk when it gets into trouble, as we found out in our recent history.

The other thing that we learned during the crash was how interconnected the system was. With so many institutions lending to and trading with one another, when one falls over the consequences for the whole system can be catastrophic. That old saying "The thigh bone's connected to the knee bone" was certainly true during the financial crash, as it is of our interlocked and interdependent financial system. We therefore have a duty, at the very least, to be vigilant about capital requirements. They are, as I said, the public's insurance policy against having to bear the costs of another crash or steep financial crisis. The changes that have been made since 2007 and 2008 through the CRR, the Basel rules and other steps are, as yet, untested. Yes, the regulators do conduct stress tests and scenarios about what would happen if employment rose to this level or GDP fell to that level, but these are inevitably not quite real-world exercises. They are as real as war games compared to the real thing.

All the amendment does is ask for a report from the Treasury after three years of the new regime. That report should cover the impact of any departure from the current capital requirements in three areas: financial stability, that is to say the overall health of the system, because we learned how interconnected it all was; competitiveness, which is built into the regulator's aims in the Bill and is bound to be the argument for any changes to the capital requirement rules; and, importantly, consumer risk. If we are only thinking about the competitiveness of our financial institutions and not considering consumer risk, we have not learned from the financial crisis. That is the other side of the scales. We can make the system ultra-competitive by asking institutions to hold hardly any capital but that exposes the consumers and public to greater economic risk. That last point is crucial.

To recap, the amendment does not attempt to freeze the situation forever as it is now. It does not stop clause 1 doing what the Government want it to do. It does ask for a report on the consequences and broader issue of divergence from capital rules, should the regulator allow greater divergence in the future. We should not allow this regime to be set up and then opened up to all the banking and industry lobbying that is likely to take place without making sure we have a means of understanding the consequences of that. Given the importance of this sector for the UK economy, we should be careful of these consequences. By enshrining these in a report from the Treasury, we can ensure that Parliament and the public see the consequences of divergence. That is the purpose of amendment 19.

Alison Thewliss (Glasgow Central) (SNP): It is a pleasure to see you in the Chair, Mr Davies. I rise to support the amendment. I think it is perfectly sensible that we make assessments and ensure that the changes the Government are putting in place are worth while and valid and that we keep a close eye on them, because of the very risks that the Labour Front-Bench spokesman set out. We cannot predict the future, but we can assess how things are going and make sure that neither consumers nor businesses are at risk. I support that very much and do not have much to add to his comprehensive speech.

Ms Angela Eagle (Wallasey) (Lab): I repeat that is a pleasure to see you in the Chair today, Mr Davies—there will be a bit more of that as we make our way through the Bill. I support my right hon. Friend's amendment, and want to tease out some of the Government's intentions in this very technical Bill. We may not have known before 2008, but certainly know now, that highly technical things can be crashingly important if we do not keep a close eye on them. Given that we are now onshoring all these directives, and that the Government have decided, before the transition period is even over, in anticipation of changes to the capital requirements regimes, to diverge from what was put into UK law as part of the withdrawal agreement, I think the Minister owes us—I am sure he will be prepared to do this—a detailed explanation of what the Government perceive to be the advantages of diverging from rules that we had such a crucial part in writing when we were in the European Union.

It was certainly the case when I was a Minister, and I am sure it still is, that because of the relative size and importance of the financial services industry in the UK, our technocrats, if I can call them that, were always very involved in drawing up and agreeing the financial service directives that were in effect in the whole of the European Union. We used to have quite vigorous arguments with the European Union about the nature of some of that, given the slightly different culture that we have in the Anglo-Saxon world, if I can put it that way—the Minister knows what I mean—compared with some things that more routinely happen in the EU, and also because, frankly, our financial services sector is far larger than most financial services sectors within the EU and differs in its make-up. There were always these cultural issues.

However, in the aftermath of the financial crisis, there was widespread recognition and agreement—not only in the Basel III and 3.1 regulatory negotiations and how those agreements were put into EU law, which we are talking about now—about what had gone wrong;

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about needing to identify systemically important companies and make sure they were regulated appropriately, given the risk that under-capitalisation posed to the economies of countries in which those organisations were based; and about having rigorous and intrusive regulation to avoid some of the mistakes and traps that were fallen into in the run-up to 2008.

I am particularly interested in—I hope the Minister will explain it—how this will work, given that the Bill gives our regulators the power to change what has just been onshored to create a completely different system for investment firms, and then to take that forward in future regulation. We know that we have to be eternally vigilant to the way that companies evolve to respond to regulatory systems. If we end up fighting the previous battle, we will probably miss the next bubble. I would therefore appreciate it if the Minister—in commenting on the amendment, which is probing, in that sense—will explain how he believes that the regime that the Bill introduces will be able to respond to the challenges of the evolution of threats. Once the nature of what had been going on during the financial crisis was laid bare—a lot of it had been going on under the radar—one of the surprises was the connection between investment companies and banks, particularly the investment arms of banks. We discovered their trading of derivatives and the leverage they got out of those derivatives to make more money for themselves, more commission and more remuneration. Actually, a lot of what was in those derivatives was not sighted, and the regulation had essentially involved taking on trust the rating agencies' assessments of what those derivatives were worth, without looking inside the packages.

9.45 am

There are many slightly different ways in which a similar problem could occur with investment companies. When the Minister replies to the debate, could he set out how he believes the Financial Conduct Authority and the regulatory authorities will keep an eye on that, if we are going to make it easier, as I believe the Bill does, for investment companies to pull away from the regulations that the CRR and the directive have imposed on banks?

I accept the argument that investment companies are not deposit-taking institutions and so we will not see a run on them, but there are equivalent runs on those companies when their credit freezes. We saw that happen in more than one example during the financial crisis, and we also saw many banks dragged to the edge, and potentially over it into insolvency, by the activities of their investment arms. I want some reassurance about how such interconnections, often not fully visible, can be properly tracked if we are loosening the regulatory requirements on investment bodies.

I remember talking to the Governor of the Bank of England about how deep and liquid the credit market was shortly before the whole thing froze. There is a lot going on below the surface that is not always obvious, including connections between institutions in terms of some of the assets they hold. Everyone missed that during the crisis, but there will be other new things that the Minister and I have probably not thought of that those institutions will be doing even as I speak. I hope that the regulators will know about that; otherwise we are in for some even more exciting times than we have had this year. I want reassurance that the proposed loosening, change and divergence that this Bill allows for does not prove less effective than the regime that we helped to design, and which we are now leaving behind.

Can the Minister share with the Committee some of the benefits that that divergence will deliver for the country? We know from 2008 what the risks can be, and that is why the amendment is so important, because it asks for an impact assessment to be made public of the effect of the changes that this Bill, were it put on the statute book, would introduce. It is only worth introducing change and diverging from what is generally judged to be state-of-the-art, good, high-standard regulation if we get some benefit from that. Perhaps the Minister could outline what he believes that benefit to be.

In common with my right hon. Friend the Member for Wolverhampton South East, who speaks from the Opposition Front Bench, I worry about just using competitiveness as the reason for fewer regulations. We have been there and seen the damage that can be done if competitiveness runs away with itself. Can the Minister say a bit more about competitiveness, and how he thinks that the proposed regime will benefit those who seek to ply their investment trade in this jurisdiction, as opposed to that of the EU or others around the world? Risks may have to be balanced, and I would like an understanding of them.

In line with what my right hon. Friend said, we must not forget the consumer interest. It is not often mentioned in the fog and the forest of regulation, but if money is being taken out of the system by middlemen and remuneration systems that incentivise the wrong behaviour, the people who suffer—first and foremost and always—are the consumers and customers of these institutions. If it is systemic and goes badly wrong, we all suffer as a result. I would like some information from the Minister about the benefits and the potential risks that we are running in introducing this regime.

There is a final area I would like to ask the Minister about. The three pillars, I think, of investment company will be regulated differently. I am sorry; I meant classes, not pillars. I am all over the place at the moment with Test and Trace and all sorts, so I often get my pillars and classes mixed up. Class 1 investment companies are the systemically important ones: if they go belly up, we have a big problem. Class 2 is slightly lower, and class 3 is much smaller. Clearly, if regulations are proportionate, it makes a lot of sense not to regulate the class 3 ones as if they were systemic.

I am interested in a couple of points. First, has the Minister thought about the dynamics of how the class system might change? How does a firm get from class 2 to class 1? Is the Minister introducing incentives to make it harder for firms to grow because they become systemic? Should we be worried about potential cliff edges? Secondly, if something below a systemic element is not systemic—which by definition has much lower levels of oversight and regulation—there is an incentive for companies to remain in class 2 rather than go up to class 3. Has the Minister thought about that? How will the FCA deal with that if there are situations with companies that might be on the edge in a dynamic situation?

Those are just a few observations about our amendment. I would like some insight from the Minister over and above the rather dry descriptions in the notes about how they foresee the system working.

The Economic Secretary to the Treasury (John Glen): I would like to take this opportunity, at the beginning of the Committee scrutiny stage, to say what a pleasure it is to serve under your chairmanship, Mr Davies, and to consider this important legislation with all Committee members. I welcome the opening comments of the right hon. Member for Wolverhampton South East, who described how the Opposition will approach the eight sittings over the next two weeks. I also broadly acknowledge and agree with virtually all of the comments that he and the hon. Member for Wallasey made in respect of the history of financial services regulation, and I look forward to responding to the points made and to a wide-ranging and constructive discussion over the next two weeks.

As I set out on Second Reading, this Bill forms an important part of the Government's wider strategy for financial services at this critical moment, as we approach the end of the transition period. I just want to say at the outset that financial services, as some of us know—I look particularly to the hon. Member for Glasgow Central who has been in multiple Committees with me over the last three years—is necessarily a complex topic with a sometimes impenetrable vocabulary of its own. I will do my utmost to ensure that, in speaking to the Bill and any Government amendments, my comments are as clear, accessible and accurate as possible. Please feel free to challenge me on this and if at any point Committee members feel that I have fallen short of that ambition, I look forward to trying to correct that.

Let me move to amendment 19. The Government are fully committed to ensuring that any delegation of responsibility to the regulators is accompanied by robust accountability and scrutiny mechanisms. Members referred to divergence and regard to consumer interests. The differentiation between different categories of firms depends on an assessment of eight systemically important firms that will continue to be the responsibility of the Prudential Regulation Authority. Amendment 19 seeks to add a requirement for the Secretary of State to publish a report within three years of this Act, including an assessment of the impact of amendments to the capital requirements regulation on financial stability, competitiveness and consumer risk.

The amendments to the capital requirements regulation tell only a small part of the story. The Bill amends the capital requirements regulation to remove Financial Conduct Authority investment firms from the scope of the banking regime. The more important story will be told by the FCA's rules that implement the investment firms prudential regime. I want to be absolutely clear on the point about divergence. Obviously, as we get towards the end of the transition period, we will get to a point where we have left the EU and the provisions of alignment within the transition period. Therefore these measures reflect the reality of where we will be on 1 January. As the hon. Member for Wallasey said, the UK's regulators, Ministers and officials played an instrumental role, given the size of the UK financial services industry, in shaping those regulations on an EU-wide basis. But it is surely only appropriate that, when we have left the alignment provisions of the transition period—and rightly so—we should look to actually govern and set the regulatory environment that suits the particular needs of our industry. The configuration of that industry, as was understood in the speeches that have been made, is different.

When the FCA does implement the IFPR, the Bill requires the FCA to demonstrate how it has regard to several considerations, which I shall set out now. First it must have regard to relevant international standards: Basel 3.1. That goes to the point about the relative standing of the UK. The right hon. Member for Wolverhampton South East made a point about the risk around individual firms lobbying for differentiated treatment. It is right that the regulators are responsive to the needs of the UK industry, but they are also accountable to those international standards—the relative standing of the UK—in addition to the current statutory objectives under the Financial Services and Markets Act 2000 to protect consumers and the integrity of the UK financial system.

This approach aligns with the March 2020 House of Lords EU Financial Affairs Sub-Committee recommendation to delegate more power to the regulators, underpinned by more and strengthened parliamentary scrutiny. We are delegating this to regulators because they have the technical expertise, not the Government. The Bill's reporting provisions should provide the information that Parliament is seeking. This amendment would create a duplication of efforts by the regulator and the relevant Departments on undertaking such an assessment.

10 am

I recognise that some points were made about, and the hon. Member for Wallasey in particular asked me to respond on, the relationship in terms of moving between different categories of firms. I think it absolutely necessary that we essentially, through this provision, right-size the regulation for the different configurations of firms. I also think this right in an environment where, in general in the UK, we have had standardised models of capital requirements. One of the key arguments with respect to banks, for example, is that there has not been meaningful competition because those capital requirements are too rigid. I will draw attention to the Committee's experience last week with Gurpreet Manku from the British Private Equity and Venture Capital Association, who, when asked about the levels of capital required, said that in some cases higher levels of capital would need to be held. I think that that recognises that what we are doing here is actually seeking to empower the regulators to right-size the regulation, having regard to international standards but also fixing it appropriately for the UK regime.

I do not see that this amendment delivers over and above the accountability and scrutiny mechanisms already in the Bill, which already find the right balance in relation to parliamentary scrutiny and regulator accountability. Therefore, I ask that the amendment be withdrawn.

Ms Eagle: I want to come back on that and press the Minister on a couple of questions that, with all due respect, I do not think he answered in his response. Clearly, our amendment is a hook on which to hang a debate about transparency, so that we know what the regulators are doing, and about accountability, because, as I said earlier, if these organisations begin to respond

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to particular inducements, such as their own remuneration, they can cause risk to happen in a way that can be severely detrimental to consumers and entire economies, as we have seen in recent history. I think that, in the light of that, we are perhaps owed a little more of an explanation from the Minister—I am putting this gently—about what the approach of the regulators will be. The Minister can stand there and say, "The regulators are going to right-size regulation." That sounds like a fantastic thing because of the very phrase that the Minister has used—"right-size"—but how are they deciding?

We clearly got the wrong size because of evolutionary behaviour to avoid regulation and increasingly risky behaviour in the global financial system in the run-up to the global financial crisis in 2008, which was caused by or began in the subprime mortgage market in America but which brought most of the—if I can put it this way—western-style banking systems close to ruin in the rest of the very interconnected economy because of what had been happening with derivatives. Therefore I wonder whether the Minister might be able to say a little more about the benefits of having the regime that he called right-sized regulation; why we might wish to move away from the current position so quickly after the transition period is over; and what he sees as the benefits of doing this. Refusing our amendment means that there will be no transparent analysis of the effect on the public domain, so we will not be able to discuss it.

I for one think it is important to get these very technical, dry regulations out into the open and to translate them, with the seriousness they deserve, into the potential implications that they present for all our constituents. Our amendment seeks to do that by at least having a transparent publication of these kinds of analyses. The Minister wants to keep it in the regulators' ambit, in which there is not so much light, to be honest. It is highly technical, and it is hard for those on the outside to have a look inside to see what the implications are. I have hardly had any correspondence from outsiders on the Bill to help me through the long hours and sittings to come. That rather illustrates my point: that a light needs to be shone on this area, because of the risks if we get it wrong.

The Minister rightly wants to get it right, but surely it is relevant to hear from him and to have a bit of transparency, and to put something on the record now about how he sees the advantages playing out, as opposed to the risks. Will he have another go?

John Glen: I am very happy to have another go. The hon. Lady is at risk of suggesting that there is somehow a clumsy, rushed delegation to regulators and a risk that—in that delegation—the industry will influence regulators to right-size in a way that damages consumers. I draw her attention to the fact that the legislation gives the FCA responsibility to have regard to the impact on consumers, on the market and on firms—that is, the impact on themselves—of not having the appropriate capital requirements.

The right-sizing comment refers to the fact that the firms are currently bound by rules that align them to other institutions that are clearly functionally different. Nobody really believes that it would be right for there to be a prescriptive mandate from primary legislation on exactly how those technical rules and those capital requirements on a firm-by-firm basis should exist. The FCA has the right to reclassify firms and monitor that reclassification as firms evolve. The PRA will retain oversight of systemically important firms.

I contend that the Bill contains sufficient mechanisms to ensure public and parliamentary scrutiny of both the FCA and the Treasury through the draft affirmative procedure and the FCA reporting requirements. That combination of the FCA's existing statutory duties and the "have regards" set out in the Bill cover the areas that amendment 19 seeks to address.

I make one further important point that goes to the heart of the wider regulatory framework. The future regulatory framework consultation that we launched on 19 October sets out over a 12-week period to look holistically at what should be the constitutional relationship between the FCA, the PRA, the Treasury and Parliament to embed an enduring accountability framework on a much broader basis. There will be another consultation subsequent to that. I anticipate that the response to the consultation might be, "Why haven't you done this before?". The bottom line is that the measures are required to meet international standards within an internationally determined timeframe of expectations. I declared on Second Reading that this is the first in a series of pieces of legislation, and I have always said so. This first piece of legislation sets the accountability framework for the initial measures.

Stella Creasy (Walthamstow) (Lab/Co-op): I do not think any of us doubt the Minister's intention to get this right and to recognise that these decisions have a consumer impact. The challenge, which I think we all see, is that it is one thing for the FCA to conduct a public consultation on high-cost credit firms, for example—he knows my specialist subject—but on something like LIBOR or the Basel regulations, which is less tangible but no less impactful, the argument he is making seems rather to strengthen the point the amendment makes about including consumer risk as one of the things to be reported on, because it does not immediately grasp people's imagination until a catastrophe such as the last financial crisis happens. He says he envisages the FCA's performing this role, so will he set out how he sees it performing that role if we do not say, "Actually, could we in a couple of years' time get some information on how consumer risk has been identified and addressed in this process?". That is harder to quantify, but no less important.

John Glen: I am very happy to respond to that point and I thank the hon. Lady for her comments. I recognise her expertise, particularly on high-cost credit, and I look forward to—I imagine—further amendments on that, perhaps next week.

The FCA will be required to publish an explanation of how having regard to the additional considerations that I have set out has affected the proposed rules that it comes up with. When the FCA makes those final rules, it will publish an explanation complying with them, as well as a summary of those new rules, aligned to the FSMA publication requirements.

The challenge here is a bit of a mismatch between the concerns that we have collectively in Parliament to maintain standards that will not allow a repeat of what the right hon. Member for Wolverhampton South East eloquently set out as the problem leading up to 2008 and to have regard to the enduring and ever-transforming consumer risks, which derive from rules and technical standards that we in this place are not well placed to deliver, given their design. What we must do subsequently with the future regulatory framework review—it is not some short, rushed exercise, but a deliberately open exercise of consultation to try to examine best practices—is to come up with something that gets that balance right between the direction that Parliament sets in primary legislation and the accountability to this place that will exist for our regulators, through the Treasury Committee and through potentially significantly enhanced accountability mechanisms.

However, setting out the enduring final framework of that relationship between the regulators and Parliament is the point of that consultation exercise. With respect to this measure, I believe that the accountability mechanisms set within it and the procedures set out will achieve the accountability that is necessary and appropriate at this stage.

The Chair: Before I call the shadow Minister, I say that one of his many qualities is that he is very softly spoken, which is not conducive to Committee Room 14 with social distancing in place, so I encourage him to speak up; I am sure that would be appreciated by all.

Mr McFadden: I am a softly spoken and moderate man; it has not always done me good, but I am on track here at the moment.

I want to respond to the Minister's reasons for advising us not to press the amendment. I talked at the beginning about three pots of amendments, and it strikes me that there are really two or three pots of reasons why Ministers say no to amendments. The first is that the amendment is wrong or not competently written in some way. Pot two is that it has completely misunderstood the Bill and therefore is not just incompetently written, but actually wrong in its intent. Pot three is to say that it is covered anyway. Usually, if somebody is not going to say yes to an amendment, it falls into one of those categories. The Minister has gone for pot three today. He has not really argued that the amendment is wrong in its content or that there is anything wrong with the way it is written; he has argued that this kind of thing is covered anyway. There is a problem for us in accepting that.

Ms Eagle: Does my right hon. Friend agree that there is a fourth one, which is to say, “This should not be on the face of the Bill; we are going to do it, but we are going to put it in secondary legislation,” which of course is unamendable and usually rammed through this House in a way that makes scrutiny even harder?

Mr McFadden: My hon. Friend is absolutely right. Perhaps there is even a fifth one, which is, “Wait for the consultation on something else.” The problem with going for pot three and saying the amendment is covered anyway is that that concedes that it would be completely harmless and there would be nothing wrong if it were accepted. The Government are, in effect, agreeing with its intent and saying they will do it.

10.15 am

The Minister, probably not for the last time, referred to the future regulatory framework consultation that was published a month ago and said, “We will cover a lot of this in there.” I have had the pleasure of going through that document—I was looking longingly as I did so at Tim Bouverie's excellent book on appeasement on my bedside table and resisting the urge to pick it up—but we do not know its conclusions. He might turn out to be right and we might have something similar, but we might not.

More seriously, the reason why we need such a report and why we need to be careful about what is in the clause—we may come to this in the stand part debate—is that although investment firms, which do not take deposits, may be characterised in some ways as different from deposit-taking banks, we learned during the financial crash about the degree of interconnectedness. Frankly, if the system falls over, no one will care about that—it will not matter at all. When the system is so connected, it will not matter that one company, metaphorically speaking, put its hand up and said, “We wanted to be treated differently because we did not take deposits.”

That brings us back to the consumer, who has to know that the system as a whole is safe—or as safe as can be expected. I find myself unconvinced by the reasons not to accept the amendment, so I am minded to press it.

Question put, That the amendment be made.

The Committee divided: Ayes 6, Noes 10.

Division No. 1]

AYES

Creasy, Stella
Eagle, Ms Angela
McFadden, rh Mr Pat
Oppong-Asare, Abena
Smith, Jeff
Thewliss, Alison

NOES

Baldwin, Harriett
Cates, Miriam
Davies, Gareth
Glen, John
Jones, Andrew
Marson, Julie
Millar, Robin
Richardson, Angela
Rutley, David
Williams, Craig

Question accordingly negatived.

Question proposed, That the clause stand part of the Bill.

John Glen: As ever, the UK remains committed to the highest level of regulatory standards. The UK is also committed to better regulation—regulation that is fit for purpose and appropriate to the risks, size and activities inherent to UK firms. At present, investment firms are supervised by either the FCA or—for those that are systemically important—the PRA. However, both currently operate under the same prudential regulatory regime as banks, which is not appropriate for non-systemically important investment firms. Such investment firms do not typically grant loans or accept deposits, so the risks they face and pose are different from those of banks.

A new, bespoke regime is required for investment firms, and the first step in that process is to remove non-systemically important FCA investment firms from the relevant regulations for banks. That is precisely what clause 1 does: it sets out the necessary amendments to remove FCA investment firms from the scope of the capital requirements regulation. Only credit institutions and PRA-designated investment firms will remain under

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the CRR. That is appropriate, as systemic investment firms pose similar risks to financial stability as the largest banks.

Clause 1 also introduces a definition of "designated investment firm" that recognises that only investment firms that conduct bank-like investment activities may be designated by the PRA as systemic institutions. As such, commodity dealers, collective investment undertakings and insurance undertakings that are not bank-like are excluded from the definition. That reflects the EU's approach. The remaining investment firms—all FCA investment firms—will be regulated under the new investment firms prudential regime, which I will turn to when we debate clause 2 and schedule 2.

Clause 1 also amends the Capital Requirements (Country-by-Country Reporting) Regulations 2013. The amendments are necessary to ensure that FCA investment firms adhere to tax reporting requirements that are consistent with the new investment firms prudential regime, and not with the current banking regime. For example, the smallest FCA investment firms will be exempt from the reporting requirements, which is in line with the IFPR's more proportionate application of regulatory requirements on the smallest firms.

Clause 1 is merely a first step in the introduction of the investment firms prudential regime, but it is a crucial step. I therefore recommend that the clause stand part of the Bill.

Mr McFadden: I just have a couple of questions for the Minister. He described the rationale behind the clause, but can he tell us how many firms we are talking about? How many of the non-deposit-taking investment firms are likely to be exempt from the capital requirements regulations under the terms of the clause?

What is the Minister's response to the point that my hon. Friend the Member for Wallasey and I have been trying to make about interconnectedness? He has advanced a reason as to why such investment firms should be treated differently, but how will the regulators cope with the interconnectedness of the system if companies are treated differently in that way?

Alison Thewliss: My concerns very much lie around the interconnectedness, because the system will be only as strong as the weakest part within it. If the weakest parts start to pull down everything else and make everything else unravel, we have a real problem on our hands.

My questions are about the monitoring of risk within the system that is being established. How can the Minister be certain that the risks are being closely monitored by the regulators, that the regulators understand the business that smaller firms are doing in their part of the market, and that the activities that those smaller firms are engaged in does not pose a risk to everything else? There is definitely cause for them to be monitored in order to have an eye kept on them, and to ensure that their activities do not cause wider risk. If attention is not being given to them, how can we ensure that their activities are above board and are not causing further risks anywhere else within the system?

How will the monitoring be scrutinised more widely by Parliament and others? The Treasury Committee gets the opportunity to question the regulators, but getting down to such a level of detail is not necessarily something that we would do. How does the Minister envisage Parliament having a role in that scrutiny in order to ensure that, should something happen or go wrong, we find out about it timeously rather than when it is too late to have any impact and when the whole thing has tumbled down?

Ms Eagle: Like the hon. Member for Glasgow Central, I am on the Treasury Committee. We have a very full programme. The hon. Member for Hertford and Stortford also shares the pleasures of being on the Treasury Committee. However, it would be very difficult for us to question the FCA with this level of granularity. Therefore, given the onshoring and the importance of this regime as it evolves, how does the Minister expect the transparency, oversight and accountability to be put in place going forward? Does he expect that to also include consumer authorities and the consumer interest, and will explain what he expects these companies to be able to do under this regime that they cannot do now?

John Glen: I am grateful for those questions, and I shall seek to bring some clarity. The right hon. Member for Wolverhampton South East asked me two questions about the numbers. I cannot give a specific number here, because it is fluid and would be something for the FCA to determine. I am sure the FCA would be very happy to give him an indication on that.

To the other point around interconnectedness, made by the hon. Member for Glasgow, Central as well, the classification will be based on the evolving nature of the activities, and this is something the FCA makes judgments on all the time. The PRA is responsible for eight systemically important institutions, covering Goldman Sachs and J. P. Morgan, among others, which are of a size and scale such that their interconnectedness means they are of systemic significance.

There are a lot of complex relationships between financial institutions. Therefore, as acknowledged by the hon. Member for Wallasey, as people who are technically capable of evaluating those interconnected elements, it is appropriate and in their interest to make those judgments, and that sort of decision making does go on currently.

The scrutiny process links back—I will not keep repeating it—to the point that the right hon. Gentleman made about the "Future Regulatory Framework Review", which will look at the appropriateness in a situation where that scrutiny has previously happened at an EU level, through combined conversations, the Council of Ministers, work that is then is auto-uploaded to the regulators. What is the new mechanism to hold regulators accountable in a situation where they are given the task from this place? That would be the purpose of the extended regulatory review and future legislation. It may involve an enhanced role for the Treasury Committee, with additional resources to augment the expertise that already exists, but that is a matter for that consultation.

In answer to the question from the hon. Member for Wallasey about what I expect the companies will be able to do that they currently cannot, this comes back to some of the evidence we heard last week from the British Private Equity and Venture Capital Association, which says there is a wide family of firms with different activities. The question is: are the regulations as they apply at the moment—as fitted for 28 countries, where obviously some compromises were made—appropriate for the configuration of firms as they exist?

What I would expect to see is consideration given for capital requirements that match the actual profile of activities, notwithstanding the very legitimate points made around the interconnectedness and the risks associated with their broadest activities. I have stressed throughout the passage of this Bill so far, and I reiterate now, that the essential purpose of the Government's approach is to ensure that we have the highest regulatory standards. Our reputation as a centre for financial services is based not on finding quick fixes that shortcut regulatory standards, but on finding something that fits the nature of our industry, aligned to international standards, that gives us the best opportunity to grow and prosper in a way that is safe and secure for consumers.

Question put and agreed to.

Clause 1 accordingly ordered to stand part of the Bill.

Schedule 1

Exclusion of certain investment firms from the Capital Requirements Regulation: consequential amendments

Question proposed, That the schedule be the First schedule to the Bill.

10.30 am

John Glen: Schedule 1 complements clause 1, in so far as it makes consequential amendments to the Capital Requirements Regulation 2013 and the Capital Requirements (Country-by-Country Reporting) Regulations 2013. For example, many of these consequential amendments remove references to the Financial Conduct Authority as the competent authority under the CRR in recognition of the fact that henceforth only the Prudential Regulation Authority will be responsible for regulating credit institutions and PRA-designated investment firms under the CRR. Taken together, these technical amendments achieve the aim of removing FCA investment firms from banking rules while keeping the most systemically important investment firms under the regulation and supervision of the PRA. I therefore recommend that the schedule be accepted.

Mr McFadden: I have just one question. The Minister mentioned country-by-country reporting, which we may come to at other points in the debate. Could he help the Committee by telling us what is covered in the country-by-country reporting? There is an ongoing and very live debate about what we expect multinationals to cover in country-by-country reporting in order to avoid tax arbitrage or transfers between countries that do not stand up to scrutiny. What are the things covered by country-by-country reporting in schedule 1?

Alison Thewliss: I just want to ask the Minister about the additional responsibilities in the schedule. When we took evidence last week, Sheldon Mills said:

"We can always do with more resources".—[*Official Report, Financial Services Public Bill Committee,* 17 November 2020; c. 9, Q12.]

What further discussions has the Minister had about ensuring that the PRA and FCA are adequately resourced for these additional responsibilities? It is an awful lot of extra work. We are moving an awful lot of work over to them while they have covid and Brexit to look at too. I just wondered whether there had been any further detail about what additional resources might be available or required in the months and years ahead.

John Glen: I will come first, if I may, to the hon. Lady's point about the resourcing of the FCA. It is resourced by a levy, which it determines. It is under review, but it is approved and set by the FCA. The hon. Lady has asked that question a number of times over the past 18 months. She is right to draw attention to the enormous pressure that the FCA is under, in terms of giving guidance about the forbearance measures for consumers and banks. That will be a matter for the FCA. I have six-weekly conversations with its chief executive officer. That is not a matter that he has raised with me, but it will be under review. I support it in what it needs to do to secure those resources.

The right hon. Member for Wolverhampton South East asked about the Capital Requirements (Country-by-Country Reporting) Regulations. They were designed to ensure that appropriate tax reporting regulations are imposed on firms regulated under the banking framework. They require firms to report relevant information on tax and revenue in each country that it has operations. An objective of the IFPR is to make regulations for FCA investment firms more proportionate to the risk, size and activities of those firms. That will be reflected in the country-by-country reporting. That will enable certain investment firms, such as the smallest FCA investment firms, to have reporting requirements consistent with their size and activities, and ensures that such firms are competitive. Furthermore, the smallest investment firms do not typically have overseas operations, making these requirement irrelevant for them. I cannot say any more about that at this point, but I am happy to follow up further if the right hon. Gentleman wishes to have information.

Question put and agreed to.

Schedule 1 accordingly agreed to.

Clause 2

Prudential regulation of certain investment firms by FCA rules

Question proposed, That the clause stand part of the Bill.

John Glen: This short clause gives effect to schedule 2, which inserts provisions that will enable the introduction of an investment firm's prudential regime into the Financial Services and Markets Act 2000. I therefore recommend that it stand part of the Bill.

Mr McFadden: I do not really have substantial questions at this stage, because schedule 2 sets out the detail, and I think we will probably have an extensive debate on it.

Ms Eagle: The clause inserts a new part 9C into the Financial Services and Markets Act 2000, which forms the legal basis for the new regime that the Bill introduces for investment companies. We have been talking about the minimum amount of capital required. We have covered some of that, although we will get further into it when we come to the Basel 3.1 bits.

[Ms Angela Eagle]

Will the Minister say a bit about remuneration policies? That is another issue that will be regulated. We know from what happened in the financial crash and the build-up to that bubble that remuneration policies formed a key part of the bad incentives that created the behaviour that caused the crash. How will the Government be dealing with the regulators about remuneration? What will the principles be? Getting the right incentives for remuneration is a key driver for behaviour, and behaviour is a key driver for activities in that area, as we know only too well. If we did not know that from 2008, we would know it from the Wall Street crash in 1929. It is part of a set pattern. How will the Government ask the regulators to deal with that issue?

John Glen: I am happy to respond to that. The risk that the hon. Lady sets out—that, broadly, this country will go down a route where we deviate significantly from the new established norms of the regulation of remuneration and the rules around rewards and bonuses and so on—is a matter for which the regulator has responsibility. It will be incumbent on the Government to look at evolving best practice and the appropriate way to bring continuity to such regulations in line with those highest standards.

It is not our wish to create deviation for the sake of it. We will continue to look at the market situation. The point has been made already that we have to be alert to evolving new practices. In the same way, I think the hon. Lady would acknowledge that, in the light of the last crisis, there was an evolution in business models with respect to high-cost credit. There is always a risk in the sort of environment that we are in now that there will be new developments. I cannot prescribe precisely how we will look forward, but we will look to adhere to global high standards, because the integrity of our reputation relies on it.

Ms Eagle: I thank the Minister for his indulgence. Clause 2 is also partly about enforcing regulations; there are references to fraud and criminal offences, which again we will come to in more detail later. Will he let us know whether fraud enforcement will be beefed up? We can have a great regulatory regime and redefine fraudulent behaviour, but if enforcement is not up to scratch, that will not really deter. This is area where, if enforcement is too weak, the rewards are very high and the risk of being caught and prosecuted or fined is very low. Can he give some reassurance on that point at this stage?

John Glen: I am happy to. The hon. Lady makes a fair and reasonable point. We have to maintain the highest standards of regulation. The FCA and the PRA are extremely well respected globally, but that does not lead me as the Minister to be complacent. We must continually be vigilant about whether those standards of compliance and intervention into non-compliance are sufficient and adequate. We will always seek to maintain that.

To return to the principle, these capital requirements for firms are extremely detailed and technical. The regulators have the right expertise to update them. They will have increased responsibility, but they will need to consider the principles set out in the Bill. We are following the advice of the House of Lords Financial Affairs Sub-Committee, which said that these delegations would be appropriate. The broader conversation about the direction of travel around what sort of framework we wish to have in the UK is not fully addressed at this moment, but there will be more to say in the context of the response to the future regulatory framework two-stage review and the legislation we bring forward subsequently.

Question put and agreed to.

Clause 2 accordingly ordered to stand part of the Bill.

Schedule 2

Prudential regulation of FCA investment firms

Mr McFadden: I beg to move amendment 20, in schedule 2, page 63, line, at end insert—

> "(ba) the target for net UK emissions of greenhouse gases in 2050 as set out in the Climate Change Act 2008 as amended by the Climate Change Act (2050 Target Amendment) Order 2019, and".

This amendment would require that, when making Part 9C rules, the FCA must have regard to the UK's net zero 2050 goal and the legislation that has been passed in pursuit of this goal.

The Chair: With this it will be convenient to discuss the following:

Amendment 39, in schedule 2, page 63, line 5, at end insert—

> "(ba) the likely effect of the rules on the UK meeting its international and domestic commitments on tackling climate change, and".

This amendment would ensure the likely effect of the rules on the UK meeting its international and domestic commitments on tackling climate change are considered before Part 9C rules are taken.

Amendment 24, in schedule 3, page 79, line 29, at end insert—

> "(ca) the target for UK emissions of greenhouse gases in 2050 as set out in the Climate Change Act 2008 as amended by the Climate Change Act (2050) Target Amendment Order 2019, and".

This amendment would require that, when making CRR rules, the FCA must have regard to the UK's 2050 net zero goals and the legislation underpinning those goals.

Amendment 42, in schedule 3, page 79, line 29, at end insert—

> "(ca) the likely effect of the rules on the UK meeting its international and domestic commitments on tackling climate change, and".

This amendment would ensure the likely effect of the rules on the UK meeting its international and domestic commitments on tackling climate change are considered before CRR rules are taken.

Mr McFadden: Amendment 20 focuses on the new accountability framework for the FCA set out in schedule 2. If anyone wants to follow the detail, I am referring to the list at the top of page 63 of the current edition of the Bill. Returning to my opening remarks this morning, we tabled a similar—possibly identical—amendment to the accountability framework set out for the PRA in schedule 3, but we will come to that in due course.

As the Bill stands, the accountability framework in schedule 2 asks the FCA to have regard to three things: international standards, which I do not think anyone would argue with; the relative standing of the UK as a place to do financial business, which can be interpreted in a number of ways, but could be summed up as a competitiveness criterion; and other matters, which may be specified by the Treasury. I ask the Minister, why were those three picked out of all the things that we wanted the FCA to have to regard to in this brave new world, where we are onshoring all this, and not others?

We take the view that this list is incomplete and could be usefully added to. The regulators have an expanded new task, between schedule 2 and schedule 3, of regulating this huge, globally significant financial services industry with a lot of new powers, so what should they have regard to when they do this? There could be a number of things added to this "have regard to" list. Perhaps the most obvious is the UK's climate change goals, specifically the commitment to reach net zero emissions of all greenhouse gases by 2050.

Why do we want to add that in particular? There are several reasons. First, this is completely bipartisan. The Government are committed to it and the Opposition support it. It does not divide the parties in this House; it has multi-party support. Secondly, we are not asking for something that has not already been legislated for. It was legislated for on two important occasions in this House. We are not tacking on a new, previously undiscussed climate change commitment to the Bill. The legislative history of this, as hon. Members will know, is that the original goal of an 80% reduction in greenhouse gases by 2050 was legislated for in the Climate Change Act 2008 under the last Labour Government, which the Conservative Government changed to a commitment to net zero by 2050 through the 2019 order referred to in the amendment, so this has already been legislated for twice, once at 80% and now at net zero.

10.45 am

Thirdly, the commitment goes beyond international standards. The accountability framework references adhering to international standards, which is absolutely right. However, as I said when we were discussing the capital requirements previously, that does not mean that that is always what the UK should do. We have chosen as a country to commit to net zero by 2050, which goes beyond what we have to do under international standards. It is a specific UK goal, in line with our commitment under the Paris agreement of using the "highest possible ambition". Through that agreement, we will end our contribution to global warming.

Fourthly, the Chancellor has already signalled that he sees the financial services sector as playing a crucial role in achieving this target. In fact, he signalled that just two weeks ago when making a statement to the House on the future of financial services, saying that the UK will issue its first green gilt and that he wants to put

"the full weight of…capital behind the critical global effort to tackle climate change"—[*Official Report*, 9 November 2020; Vol. 683, c. 621.]

This is very much in line with what the Chancellor says he wants to do.

Stella Creasy: Is it not also important to recognise that some of the strongest drivers for reaching some of those emissions targets will come from the financial sector itself? For example, the move towards decarbonising pension funds has been hugely beneficial in promoting renewable energy. It makes sense to join the dots when it comes to our country's financial objectives and our wider social and climate objectives.

Mr McFadden: My hon. Friend is absolutely right. Joining the dots is exactly what we should do. Of course, she is right that individual investment firms will make their own decisions on these things, perhaps sometimes pressed by pension fund members, consumer groups or trustees in some ways. We applaud firms that do that, but how much more powerful would it be if that was a goal of the regulators, set out in our own financial services legislation? It would be more powerful, because the UK has this huge financial sector, which has around it this cluster of expertise, which we refer to a lot—legal and accountancy firms and all the rest—and because our own domestic commitments can bend the power of that sector towards the net zero goals.

The amendment goes with the grain of what more and more firms and people in this sector are talking about. By including this change, we can take all the fine-sounding commitments on corporate websites and put them at the heart of our regulatory mission. It can mark out the UK financial services regulation as having a new post-Brexit mission. If asked what we want the UK financial services sector to do in this post-Brexit world—we debated divergence and capital rules and all the rest earlier—what would be a better answer than making sure that the power of this is bent towards us achieving net zero, and in so doing encouraging financial sectors elsewhere in the world to go down the same path?

Finance will play a huge role in whether or not we meet the target. I do not propose, Mr Davies, to go through what the Committee on Climate Change has said that we need to do to reach the target in great detail, because we would be here all day, but I want to give the Committee an idea of a few headings that will require enormous investment.

If we are going to achieve the target, we will need a quadrupling of the supply of low carbon electricity. We have done well on low carbon electricity in the UK, in the last 20 years or so. We have vastly expanded the provision of renewables that go into the grid, but even after doing well we need to quadruple that if we are going to meet the target.

We will need a complete automotive transition, from internal combustion engines to electric or other zero emission vehicles. Just a few days ago, the Prime Minister himself announced a new, more advanced target for the phasing out of internal combustion engines.

There will need to be a huge programme of investment in buildings and heating. Whether that is through heat pumps or hydrogen boilers, there will need to be a huge programme of retrofitting equipment to millions of houses throughout the UK.

There will need to be a large programme of afforestation, because remember this is net zero. It will not be that we never have emissions, but we will have net zero. One of the main vehicles, if you like, in absorbing the emissions that we are still responsible for is afforestation, so we will need a huge programme.

We will need changes in farming and food production. We have the return of our old friend, carbon capture and storage. That takes me back, because a decade ago, when I was sitting where the Minister is now, we were

[Mr McFadden]

announcing carbon capture and storage. It was announced again last week. There might be Members here who are quite new to Parliament, such as my hon. Friend the Member for Erith and Thamesmead, the hon. Member for Hertford and Stortford and maybe others who were elected in 2019. I look forward to them coming back in 10 years' time and debating a Bill where new carbon capture and storage has been announced. Maybe we will even have achieved it by then, who knows?

Alison Thewliss: Members may indeed remember carbon capture and storage well, because we were promised a huge project in Peterhead, ahead of the indy ref, which has not yet emerged.

Mr McFadden: The hon. Lady is quite young, so she might be here in 10 years' time—

Alison Thewliss: I hope not!

Mr McFadden: Perhaps it is not her ambition to be here in 10 years' time. Carbon capture and storage is back. There are more things that we will have to do, but all of those headings will need finance, capital and investment. That will not all come from the state. It has got to be a combination of public and private investment, if the country is serious about this goal.

This is not an ordinary piece of legislation or A. N. Other Bill that we want to tack on to the regulatory framework. It is an overarching piece of legislation that will inform investment patterns and work production in a whole range of areas. It is one of the most significant pieces of legislation in this country since the end of the war. Perhaps we do not always realise that, but it really is, if one thinks about the list that I have gone through.

All of those things will take finance. It seems to me not odd to add this to the regulatory framework, but very odd that it has not been added already, particularly because the Government have made so much of the country being an international leader in the area, including asking the former Governor of the Bank of England, Mark Carney, to play a leading role. We absolutely welcome that.

Gareth Davies (Grantham and Stamford) (Con): The right hon. Gentleman sets out very well the problem that our generation faces. I say that as someone who has worked in financial services and has a family member who also works in the sector. The right hon. Gentleman is totally right that the key to unlocking progress towards 2050 is through private capital, but will he not concede that the Government have already made significant announcements such as those on the green gilts, the long-term asset fund and the green homes grant? Many announcements that have been made will help to mobilise capital towards the goals that he seeks.

Mr McFadden: The hon. Gentleman is right and he goes for pot 3 in terms of my reasons. I repeat: the problem about pot 3 is that the reason not to accept an amendment is that it concedes that it is absolutely heartless to do so. He is absolutely right. The Government have said that they want the UK to be a leading player and they appointed Mark Carney, who is a champion of green gilts, I believe. I was pleased to hear the Chancellor's announcement, because green gilts have been issued by other countries in the past year or two. They have often been oversubscribed, which shows an investor appetite for products geared to that end.

Let me put the point back to the hon. Gentleman. If there are new financial innovations, such as green gilts, that Governments can issue to finance the list of things I mentioned from the Climate Change Committee and if there is investor appetite, as there seems to be, for the limited number of green gilts that have already been issued, why on earth would we not put at the heart of the regulator's mission that they should have regard to these goals and use them as a guiding principle, particularly as we are going into a post-Brexit world where we will be asked on many fronts what we are for now given that we have left an existing framework? It is particularly appropriate to add this proposal to the Bill. This will require investment and it cannot all be done by the state. It will require innovation in finance. We have mentioned green gilts but other kinds of saving products, investment products, bonds, loans and all sorts of instruments will all have to be geared to the necessary changes to meet the net zero target.

The final reason for the proposal is to stress the ambition of the target. Any one of the things that I read out would require a lot of ambition and a lot of investment. It is pretty hard to see how this can all be achieved if it is not an explicit goal of financial regulation.

To recap, the amendment seeks to make these changes in the least possible contentious way. We have not added a syllable or comma to anything that the Government have not already legislated for. All we are asking for is that the Government signal that they are taking their own legislation seriously by adding the net zero commitment, which the House has already legislated for, to the mission of the financial regulators. That seems to be a most uncontroversial and reasonable thing we can do in the post-Brexit financial regulatory framework.

Alison Thewliss: I support Labour amendments 22 and 24 and wish to speak to amendments 39 and 42 in my name and those of my hon. Friends.

I agree very much with the right hon. Member for Wolverhampton South East. Our amendments are trying to help the Government out. That is unusual but, in the spirit of cross-party consensus and doing things together to save the environment, that is perhaps how we should proceed. On 9 November, the Chancellor said that he wanted to lead the world in the use of technology and green finance. Unfortunately, the Bill somehow missed the boat. It is unfortunate that the Chancellor's statement came just before the Minister made his Second Reading speech because the Bill would be the place to start with this ambition.

11 am

Our amendments very much align with the Chancellor's stated aims on green finance and we want to help the Government meet their aims. Amendment 39 would ensure that

"the likely effect of the rules on the UK meeting its international and domestic commitments on tackling climate change"

was considered before part 9C rules are made. Amendment 42 would do the same for the CRR rules. This is very important to me, not least because the COP is scheduled to happen in my constituency next year. I am sorry that it did not happen this year, but that is the way that things are with covid.

We know that it is important for all parts of Government and the financial services sector to assess how their activities impact climate change, because if we do not take this seriously right across the board, change will not happen. The radical change that we need will not happen quickly enough. I was heartened when the Governor of the Bank of England said at the Treasury Committee yesterday that he was very keen on his rules being changed to help meet these green objectives. The Bank of England is in discussions with the Treasury about changing its mandate to reflect green ambitions. It is important that we reflect that across all the regulators as well.

Our amendment would ensure that climate change remains high on the FCA's agenda and part of its core activities. New section 143G(1)(c) in part 1 of schedule 2 refers to

"any other matter specified by the Treasury by regulations",

so it may well be that this will be done anyway, but it would have been nice, in the spirit of cross-party consensus, if the Government had taken this on rather than waiting for some point further down the road. We have the opportunity here today to say that we think that this is important enough to put in the Bill itself. It may well be something—the Minister will tell us—that they are going to do later or eventually, but why not take the opportunity today?

While we welcome and recognise movements within the financial services sector to progress environmental, social and corporate governance and other moves supporting the environment, it is vital that the regulations keep pace with the pressing need to ensure that the private sector contributes as much as possible to our environmental goals. The covid-19 pandemic has been an unprecedented global crisis that has fundamentally changed every aspect of our lives and it will continue to do so for some time to come. While the immediate focus of the Government continues to be on protecting lives and livelihoods, the climate emergency has not gone away and must be central to our recovery from this difficult time. The amendment would be timely in doing this now to ensure that the recovery and the actions of the financial services sector reflect that.

In anticipation of the new normal, we have the chance to reimagine the world around us and begin building a greener, cleaner and more equal society and economy. Our starting point has changed but our ambitions have certainly not changed. The SNP remains deeply committed to its ambition to end Scotland's contribution to climate change by 2045. I am equally clear that the year's delay to the COP should not and must not mean a delay in collective global action to tackle climate change.

The UK really does have the opportunity to be a leader here. If Scotland were independent, we would hopefully be leading that charge, but we leave reserved matters to the UK Government and ask them to take on those obligations. We hope that the FCA can go further in tackling the climate crisis. Westminster still lacks the ambition that we have in Scotland. I should set out that our climate change targets are for a 75% reduction in emissions by 2035, net zero carbon emissions no later than 2040 and net zero for all emissions by 2045, which is five years ahead of the UK. Energy policy is largely reserved to the UK, so we need to take this opportunity to follow the money, to look at where investment is going and to ensure that we can meet our obligations. We welcome the pledges on green finance and think that the amendment would help to enhance the UK Government's commitments.

Since the right hon. Member for Wolverhampton South East mentioned carbon capture and storage, I want to set out briefly where we see this. We see very much that the north-east of Scotland has been left behind again. My hon. Friend the Member for Aberdeen South is still travelling down here. When we discussed the scheduling of the Committee, I mentioned that the way the Committee meets during the covid pandemic makes it difficult for Members from further afield to get here, and this afternoon is very much the soonest that he can make it here this week, because of the difficulties we have with transportation, the limitations of this Committee and the fact that we cannot do things virtually. He would want to highlight that the north-east of Scotland has not had the commitments that we were promised on carbon capture and storage or on the oil sector transition deal.

In 2015, the UK Government axed the £1 billion grant that established the carbon capture scheme in Peterhead, which would have created 600 jobs and made Scotland a global leader in clean energy technology. Despite the promises made pre-indyref and in the 2015 manifesto, the money did not appear. The £200 million is a far smaller amount. It was earmarked for two clusters by the mid-2020s, with another two for the 2030s. One must be in Scotland and the north-east as well as at Grangemouth, which needs to make that transition.

We very much feel that the UK Government have not met the promise in their rhetoric on climate change. We know that there is much more that could be done. Although the purse strings are held and the decisions made in Westminster, we will continue to put pressure on the Government to be more ambitious and to do more. Our amendments would push them and the regulators a wee bit further, to try to move a good deal faster because of the pressure of the climate emergency that we face. We cannot wait until some point down the road to make the changes. We need to start today.

Abena Oppong-Asare (Erith and Thamesmead) (Lab): I am delighted to speak in favour of amendment 24. In just 12 months, the UK will host and hold the presidency of the 26th UN climate change conference of the parties in Glasgow, where the world will be watching. The amendment shows that the UK means business on climate change and that the Government are putting in place their promise to join forces with civil society, companies and people on the frontline of climate action ahead of COP26. It has the support of all political parties, so this is in no way party political or controversial.

Last week the Committee heard evidence from the likes of the Finance Innovation Lab and Positive Money, which support the amendment. The witnesses mentioned that it would be helpful if the FCA could refer to the Climate Change Act when preparing secondary legislation. Will the Minister therefore consider putting in capital requirements for investment firms, introducing weighting on environmental, social and governance issues such as penalising assets that have climate risks? As we know,

[Abena Oppong-Asare]

the Bill covers legislation on packaged retail and insurance-based investment products, which will bring the £10 billion market to the EU.

We also heard last week that the Bill could be improved further, with a key information document that investors receive when looking at PRIIPS to include disclosure on environmental and social governance issues, and to ask the FCA to ensure that happens. I am sure the Minister will agree that that would help the Prime Minister achieve his ambitious 10-point plan—it is certainly ambitious—for the green industrial revolution.

It is important to know that there is a drive towards greater ESG integration across the financial sector, which investors are pushing for as well. This is an opportunity for the Bill to be shaped more robustly, and it sends a really strong message that the UK takes climate change seriously.

As we sit here today, hundreds of young people are meeting virtually at the mock COP, ensuring that net zero goals are deliverable. I am therefore surprised that elements of the amendment are not already in the Bill, given the Prime Minister's ambitious 10-point plan for a green industrial revolution, which will not be deliverable if we do not reinforce our commitment to environmental sustainability in the Bill.

The amendment, which I believe is rather reasonable, would lay the foundations for sustainable environmental infrastructure with substance. As mentioned by a number of colleagues, this is not controversial but something that we really need right now. Particularly as we are dealing with covid, we need to be thinking seriously about the environment. The only way we can ensure that this is delivered is by putting something in the Bill that requires firms and the regulator to step up on this issue.

We do not have time for delay. This is an opportunity for us to put our heart into the Bill and deliver what we have promised, and it falls in line with what all political parties have been asking for.

Stella Creasy: The shadow Minister is making a powerful speech. I take the point made by the Government side, but I always wonder: what about the counterfactual? What problem will there be if we do not put these things into legislation? What message would that send about what might be jettisoned if, God forbid, we had another crisis on a similar scale to this year's? Action on climate change is something that we simply cannot afford to go slow on. The counterfactual on this is an important issue, because it gives us an opportunity to say that if we do not put it into legislation, we are sending a message that this might be an optional extra, rather than an integral part of our future as a country.

Abena Oppong-Asare: My hon. Friend makes a good point. The UK Government constantly say on their website that they plan to go further and faster to tackle climate change. As my hon Friend has mentioned, this is a perfect opportunity to ensure that this is implemented in the Bill. I am surprised, frankly, that it is not in there. All that we are asking for is a reasonable amendment that already falls in line with the Government's objectives. It is not going to create any extra work. We need to think about the future, particularly if we do not take action to address climate change, because we are heading for difficult times and I am really worried about the future for younger generations.

John Glen: Let me say at the outset that the Government are fully committed to reaching our climate change aims both domestically and internationally. We have set our commitment to net zero in legislation. When I was listening to the right hon. Member for Wolverhampton South East discuss the range of interventions and announcements that the Government have made in recent weeks and pivot back to the good work done previously, this underscores the fact that looking at this through a bipartisan lens is probably the most effective way. The aims that we share should be supported by sectors across the economy, not least financial services, as the Chancellor set out in his recent statement to the House.

Amendment 20 would insert the net zero target into the FCA's accountability framework for the implementation of the investment firms prudential regime. Amendment 39 is similar, as it would insert an additional consideration into the FCA's accountability framework, requiring the FCA to have regard to the likely effect on the UK's domestic and international commitments on climate change.

I fully support the intention behind these amendments, of course, but the aim of this measure is to enable the implementation of a specific prudential regime to apply to a specific type of firm. The current "have regards to" provisions in the Bill are those that the Treasury found to be immediately and specifically relevant and that reflect issues raised by industry. I think about our relative standing and the importance of considering and aligning with international standards. Those are the ones that also relate to the equivalence decision and are directly tied to the implementation of the IFPR.

As the Chancellor set out in his statement outlining the new chapter for the financial service in the UK, if we are to achieve the net zero target it will mean putting the full weight of private sector innovation, expertise and capital behind the critical global effort to tackle climate change and protect the environment. The Treasury and the regulators are already making ambitious strides to that effect, and Members have referred to the role of the former Governor, Mark Carney. I draw attention to the green finance strategy, which the Government published just 15 months ago, and to the work across a number of activities in the City on which I have been seeking to lead over the past three years. The green finance strategy is something that the regulators have actively supported.

11.15 am

There is the joint PRA/FCA climate financial risk forum and the Chancellor's recent announcement that this country will become the first in the world to make disclosures that are aligned with the recommendations from the taskforce on climate-related financial disclosures. We are making those disclosures fully mandatory across the economy by 2025.

I think the hon. Member for Erith and Thamesmead mentioned the remit letters. I reconfirmed at the Treasury Committee hearing last week that we plan to use remit letters for the regulators, which the Treasury is required to issue at least once per Parliament, to set ambitious recommendations relating to climate change. We have already done that for the Financial Policy Committee, and we will issue the remaining remit letters at the next opportunity, to allow the Government to reiterate their expectations for the regulators ahead of the UK hosting COP26 in November 2021, which has also been mentioned this morning.

I acknowledge, of course, that a net zero "have regard" to the implementation of the IFPR would not be contradictory to the wider picture. However, the "have regards" currently in the accountability framework reflect the considerations that are tailored to each prudential regime. Furthermore, there is a lot of ongoing work on how to capture climate change risks in prudential regulation—for example, a Basel Committee taskforce seeks to understand how climate risk is transmitted, assessed and measured. Careful consideration of such work, and consultation of the regulators and other sources, is needed to understand how a prudential green "have regard" might best be added.

The Bill grants the Treasury a power to specify further matters in the accountability framework at a later date, which could be used to add a requirement to explicitly have regard to green issues in the prudential framework, if appropriate. In the light of that power, I can assure the Committee that the Treasury will carefully consider a green "have regard" in the future, once the Government have had consultations on their exact framing of the prudential regimes and on the considerable body of international work that is going on.

Stella Creasy: Apologies; I did not realise the Minister was going to move on. He has made an incredibly powerful case for the importance of including such a commitment, and he has essentially said that the Treasury might look to include it. He said that it had looked only at the immediate and specific regulatory requirements. Of course, many of us believe that we are facing an immediate and specific crisis, so can he tell us why the Treasury has not already taken on the issue of climate change, given that he has made a case that it should be part of it? He has gone for pop No. 3 in the shadow Minister's list. There might be a sixth option here, which is: "If we did not come up with it, we are not going to support it." That would be rather short-termist, surely.

John Glen: I hope I would never be accused of taking such an approach. The reality is that I want the Bill to work most effectively. As I just said, the regulators are already taking into account climate change as a risk to the economy. The FCA/PRA climate financial risk forum and the Bank of England's climate change stress test are alive and working, and I am confident that they will continue to consider climate change risk when making rules for the prudential regimes. In that context, we will look carefully at the need to add that specific additional reason. I have also stressed the work that is going on internationally. We should ensure that what we put in primary legislation is actually best practice and in line with the evolving consensus on how to deal with such matters.

I turn now to amendments 24 and 42, which make a similar set of changes to the Prudential Regulation Authority's accountability framework for the implementation of the remaining Basel standards. As I have already said, the Government are already considering how best to ensure that the regulators and the financial sector can meet the commitments, and the Bill grants the Treasury a power to specify further matters in both accountability frameworks at a later data, which could potentially be used to add such a "have regard" in future, if appropriate. Therefore, after serious consideration, I respectfully ask the right hon. Member to withdraw the amendment.

Mr McFadden: The Minister is effectively saying that this is not the right time or place, but it is something that the Government will carefully consider. Given the things that have happened in politics in recent years, prediction is a dangerous game, but I expect that this is something that the Government will eventually decide to do, and I think they will make a virtue of doing it at that time. Indeed, I can see the Chancellor making the statement to the House of Commons right now, saying, "This new requirement for the Bank of England, for regulators, for the whole of Government, puts the UK at the heart of this shift to green finance and the achievement of tackling climate change."

I agree with my hon. Friend the Member for Walthamstow that the more the Minister said he agrees with this, the more it begged the question of why he does not do it now; we have to start somewhere, and putting it in here would only encourage it being put in broader financial regulatory systems. We also have this consultation in the future regulatory framework; it might even be part of the conclusion to that. For that reason, I am minded to press the amendment today.

Question put, That the amendment be made.

The Committee divided: Ayes 6, Noes 10.

Division No. 2]

AYES

Creasy, Stella
Eagle, Ms Angela
McFadden, rh Mr Pat
Oppong-Asare, Abena
Smith, Jeff
Thewliss, Alison

NOES

Baldwin, Harriett
Cates, Miriam
Davies, Gareth
Glen, John
Jones, Andrew
Marson, Julie
Millar, Robin
Richardson, Angela
Rutley, David
Williams, Craig

Question accordingly negatived.

Ordered, That further consideration be now adjourned. —*(David Rutley.)*

11.23 am

Adjourned till this day at Two o'clock.

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

Sixth Sitting

Tuesday 24 November 2020

(Afternoon)

CONTENTS

PBC (Bill 200) 2019 - 2021

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Saturday 28 November 2020

The Committee consisted of the following Members:

Chairs: PHILIP DAVIES, † DR RUPA HUQ

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
† Eagle, Ms Angela *(Wallasey)* (Lab)
Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison; Nicholas Taylor, *Committee Clerks*

† attended the Committee

Public Bill Committee

Tuesday 24 November 2020

(Afternoon)

[Dr Rupa Huq *in the Chair*]

Financial Services Bill

2 pm

The Chair: We now continue the line-by-line consideration of the Bill. I think everyone is okay with all the normal announcements about social distancing, *Hansard* and tea and coffee. The Clerks have told me that you have to ask my permission to remove your jackets, so I can unilaterally grant everyone permission to strip off—to remove their jackets if they so wish. As you know, we may debate amendments together when that is logical, but the votes on them will not necessarily be in the same sequence.

Schedule 2

Prudential regulation of FCA investment firms

Mr Pat McFadden (Wolverhampton South East) (Lab): I beg to move amendment 21, page 63, line 5, in schedule 2, at end insert—

"( ) high standards in social practice and corporate governance including pay, adherence to equalities legislation, transparency and corporate responsibility, and"

This amendment would require that, when making Part 9C rules, the FCA must have regard to high standards in social practice and corporate governance including pay, adherence to equalities legislation, transparency and corporate responsibility.

The Chair: With this it will be convenient to discuss amendment 25, page 79, line 29, in schedule 3, at end insert—

"( ) high standards in social practice and corporate governance including pay, adherence to equalities legislation, transparency and corporate responsibility."

This amendment would require that, when making CRR rules, the FCA must have regard to high standards in social practice and corporate governance including pay, adherence to equalities legislation, transparency and corporate responsibility.

Mr McFadden: Thank you for your chairmanship, Dr Huq. Your initial instructions threaten to make the proceedings a lot more interesting than this morning's. We will not take them too literally when it comes to how much clothing we remove.

Like amendment 20, on which we concluded debate this morning, amendment 21 relates to schedule 2 on page 63 of the printed Bill. It is designed to ensure that the regulators have regard not only to environmental regulations, which we tried to press this morning, but to social and governance considerations.

Committee members who have anything to do with the sector or industry will know that the letters ESG—environmental, social and governance—come up a lot. I am sure that, like me, the Minister does lots of roundtables, meetings and so on, and he will be struck by the enthusiasm with which City voices are speaking about ESG. We dealt with "E" this morning when discussing amendment 20; amendment 21 is about the "S" and the "G".

The agenda of prioritising those things goes with the grain of what investors and fund managers say, at least, they are doing of their own accord. However, we believe that adding it to the Bill and the regulatory framework would put regulatory force behind these trends, which already exist with varying degrees of enthusiasm in the investor world.

The Chair: Order. I think you were told this morning that if you crank the volume up a bit, it is better for the recording.

Mr McFadden: I apologise, Dr Huq; I shall try to speak up.

There are many fine-sounding statements about ESG principles on corporate websites. Some of the toughest money management companies in the world are now telling us that it is no longer just about quarterly or annual returns, but about long-term sustainability. We are told that investors do not want to be making money on the back of poor governance or shoddy or illegal working practices; they want their investments to be in companies and projects that are sustainable for the long term and are run in the right way.

With your indulgence, Dr Huq, I will illustrate that with an example that has been in the news recently. I want to consider what these corporate statements were worth in the case of the clothing firm boohoo. When *The Sunday Times* exposed the shocking conditions in boohoo's supply chain back in July, including paying workers in the supply chain well below the minimum wage and serious fire risks in the factories in which the clothes were made, the company commissioned an independent review of the supply chain. That was chaired by Alison Levitt QC; she reported in September. She found that the allegations about the supply chain were

"not merely well-founded but substantially true".

On the corporate governance side of things, her findings were damning. Her report says:

"No member of the Board I interviewed mentioned that the responsibility for what is happening in the supply chain derived from the duty of the company's officers to act in the best interests of all the shareholders."

In other words, the board did not understand that it was not in the interest of their own shareholders to allow a supply chain in which these illegal practices were taking place. Ms Levitt was effectively concluding that the board did not know it was their duty—or that if they did know, they did nothing about it.

Ms Angela Eagle (Wallasey) (Lab): Does my right hon. Friend agree that the lack of effective enforcement is also an important factor in boards' thinking that the risk may be worth taking? Lack of effective enforcement has been a feature of the last 10 years, as enforcement authorities have been starved of funding and retreated further and further from the frontline, where these practices are going on.

Mr McFadden: My hon. Friend is absolutely right. The point I am making in moving the amendment is that, although there are arguments to be made about enforcement and minimum wage inspectorates and so on, there is another side to the issue: the considerations for investors in these companies and the role of regulators. That is what the amendment is about.

Following Ms Levitt's report, my hon. Friend the Member for Leicester West (Liz Kendall) wrote to all of boohoo's main shareholders—the list reads like a "Who's Who" of blue-chip City firms: it includes Jupiter, Fidelity, Invesco, BlackRock and Standard Life Aberdeen. None of those firms—with one notable exception, which I will come to—has taken meaningful action. They talk about engaging and following the situation closely, but only one has actually followed through. All the firms have on their websites very fine-sounding statements about ESG, corporate governance, social considerations, sustainability and so on—indeed, some have set themselves up as champions of those causes.

Let me come to the exception to the rule on that list: Standard Life Aberdeen. It has sold all its shares in boohoo and is clear about why. In a letter to my hon. Friend the Member for Leicester West, the Standard Life Aberdeen chairman Sir Douglas Flint says that the firm had been concerned about the supply chain for some time and that

"Our patience with the company's responses on the issue had been diminishing during the last year. That patience evaporated this summer with the company's response to the media allegations and that is why we took the decision to sell our remaining shareholding."

Standard Life Aberdeen is run by serious people. It is a very reputable, important financial management firm and it has decided to act in accordance with its ESG principles and wants to uphold them. What the story shows is that too many companies do not and that often it is just words.

Our amendment seeks to put some regulatory force behind the upholding of these principles. Firms say that they want to uphold them, but, as the story shows, too often that is not the case—action is wished away with talk of engagement and monitoring the situation and all the rest of it. The amendment would make the regulator have to have regard to the exploitation of workers and make upholding high social and governance standards a hallmark of the UK financial services industry. In that way, we would not just depend on good people such as Sir Douglas Flint and on companies that are the exception to the rule; we would send a clear signal to the whole investment industry about the kind of response that we want to see. Otherwise, the fear must be that, although there will be plenty more warm words and mission statements, they will be of little comfort to someone working in an overheated factory and earning £3 or £4 an hour—about half the minimum wage—and that, when the story is exposed and the exploitation is no longer hidden, the investors in the company that is ultimately responsible will not do anything about it.

I ask the Minister to imagine the signal that such a regulatory duty could send. Not only would there be a minimum wage law, as there is now, but the UK's supercharged, empowered regulators would have social and governance considerations at the heart of what they do.

We have had many debates about standards and what would happen in the UK after Brexit on this issue. Time and again, the Prime Minister has said that he does not want a race to the bottom: he wants the UK to uphold high international standards and there is absolutely no reason to think that our departure from the EU should be any threat to rights of work or any considerations like that. This amendment is a chance to prove that and put it at the heart of financial regulation.

The truth is that companies are much more likely to take such considerations seriously if their investors are tapping them on the shoulder and saying, "Why aren't you doing that?" It is clear that Standard Life Aberdeen tried to do the right thing for a time with boohoo and eventually got so exasperated that it divested itself of its shares in the company. That is what we want to see more of from major investors and shareholders. It is not happening enough at the moment. The fine words on corporate websites are not matched enough by that kind of action.

Adding what is in the amendment to the regulators' "have regard to" list and the accountability framework in the Bill would send a powerful signal about the character of post-Brexit financial services. That is why we have tabled it today.

Alison Thewliss (Glasgow Central) (SNP): It is a pleasure to see you in the Chair, Dr Huq. I rise to support the amendments tabled by the Labour Front Bench. It is really important to hold financial services firms to account; the example of boohoo given by the right hon. Member for Wolverhampton South East is a perfect example. Standard Life Aberdeen really should not be the exception rather than the rule. All financial firms should take their duty seriously, look all the way through their supply chains and act responsibly. It is clear that if the carrot of "doing the right thing" is not working, we need further means to hold companies to account.

The amendment is one of those that make me ask myself, "Why wouldn't the Government want to do this? Why wouldn't the Government want to support these things? Whose interests do they serve if they do not want to put this in the Bill?" The Scottish National party feels strongly that, although ESG is not the end of the movement towards a fairer, more sustainable future, it is certainly a vital part. We support the growing trend in the private sector towards greater corporate responsibility. By taking a greater stake in the communities where they operate, firms can become partners for social progress.

I was struck by the evidence given by Fran Boait in the session last week. She said:

"The Bill sets the direction, and it needs to integrate the needs of the wider economy, social responsibility, the environment and thinking about how we set a direction that is different from the one that led to the global financial crash".—[*Official Report, Financial Services Public Bill Committee,* 19 November 2020; c. 112.]

The amendments set a good example of that change in direction and responsibility, and of the strong message that the Government need to send out.

To an extent, we have been able to do that in Scotland. We have promoted social responsibility in corporate culture, not least through actions such as the Scottish business pledge. We welcome a wider framework, which would encompass the financial sector and encourage them to do their bit. The partnership between the Scottish Government and business is based on boosting productivity and competitiveness through fairness, equality, environmental action and sustainable employment. It is a commitment to fairness, with businesses signing up to mandatory elements of the Scottish business pledge

[Alison Thewliss]

such as paying the real living wage—not the pretend-y living wage that the Government like to promote: the real living wage, as set by the Living Wage Foundation—and closing the gender pay gap, which has slipped during covid and may well fall back.

2.15 pm

Stella Creasy (Walthamstow) (Lab/Co-op): We should put on the record that the gender pay gap has not slipped but has been abandoned as a commitment by the Government. I hope the Government will rethink that quickly, given the importance of the case that the hon. Lady makes. It has not slipped—it has gone.

Alison Thewliss: I meant more that the actions of businesses had slipped, but the hon. Lady is correct to point out that the Government have abandoned that commitment as well. I was going to go there with that point. If companies are not held to account, that slippage will become irreversible. Companies have worked so hard to try to bridge that gap, and going backwards really is unacceptable.

By bringing those elements together, companies across Scotland have shown that they can improve productivity and competitiveness and build sustainable growth in a way that achieves fairness, equality, opportunity and innovation. We have the UK's highest proportion of living wage employers in Scotland because the Scottish Government made that commitment. That is what we can do with the limited powers that we have. If we were to put into legislation here far more responsibility and accountability, it would certainly move that agenda forward.

In addition, we believe that moves such as increasing worker representation on company boards, which is commonplace among our more productive, investment-rich European competitors, would promote much greater social responsibility among companies that had that representation, as would increasing the representation of women and minority communities on public and private sector boards.

Scotland is on track to ensure that all public sector boards have a 50/50 gender balance due to the statutory targets that we put in place. We would support similar UK legislation for the private sector, because if these things are not in place, it will take a very long time before we see any meaningful change. The evidence shows that it is good for companies and organisations to do that, because they do better when they better represent society.

It is important that we make sure that companies are held to account in this way. The amendments tabled by the official Opposition are good and sound. I am interested to hear why the Minister thinks that they are not good ideas worthy of pursuit.

The Economic Secretary to the Treasury (John Glen): It is great to be under your chairmanship again, Dr Huq. I thank the right hon. Member for Wolverhampton South East and the hon. Member for Glasgow Central for their comments.

The right hon. Gentleman opened with a depiction of the appalling situation with Boohoo, the Levitt review and the challenge of securing widespread adherence to higher standards of corporate governance. He mentioned the actions of Sir Douglas Flint from Standard Life Aberdeen, with whom I have worked closely during the last three years.

Many of the particular aspects of that case are beyond the scope of the Bill, but the right hon. Gentleman uses it to illustrate the reasons why he tabled the amendments, which would introduce a new "have regard" in the accountability regime to which the Prudential Regulation Authority and Financial Conduct Authority would be subject when implementing the Basel standards and the investment firms prudential regime respectively. The amendments would require the PRA and FCA to consider higher standards in social practice and corporate governance when making new rules under the Bill.

It is unclear from the wording of the amendments whether regulators would need to look at their own best practices or those of the firms they regulate. Regardless, I fully support the intention behind the amendments. Indeed, I have chaired the asset management taskforce over the past three years: we have had 10 meetings with industry representatives, including Catherine Howarth, whose responsible investment charity ShareAction has done some significant work on stewardship and how we can get better transparency across the whole of the ESG agenda. Indeed, I believe that our report on that will be produced imminently.

There is no doubt that the regulators are committed to the highest levels of equality, transparency and corporate responsibility. For example, the UK has some of the toughest requirements on bonus clawback and deference in the whole world. The Government, working with the regulators, were also world-leading in the design of an accountability regime for senior managers in the industry; sequentially, over the past three years, that has extended to more and more parts of the financial services industry.

FCA solo-regulated firms are expected to have undertaken a first assessment of the fitness and propriety of their certified persons by 31 March 2021. The senior manager and conduct regime, implemented for all banks, building societies, credit unions and Prudential Regulation Authority-designated investment firms in 2016, was extended to cover insurance firms in December 2018 and most other FCA-regulated firms by December last year.

However, the track record of our regulators should not make us shy away from making them legally accountable for upholding the highest standards going forward. The fact is that the regulators, as public authorities, are already subject to the requirements under the Equalities Act 2010, as are businesses across the UK, including firms within the scope of the PRA and FCA remits. They already have existing powers and duties under the Financial Services and Markets Act 2000, which is being amended by this Bill, in respect of pay, transparency and principles of good governance. In fact, they are already responsible for making rules on remuneration under these two prudential regimes.

I recognise that when I think about the City, there are significant elements that need more work. For the past while, I have been responsible for the women in finance charter. I am currently conducting a series of challenges to the CEOs of banks, looking at what they are doing to address, beyond the targets, a pipeline of talent, so that there are better opportunities for more women to reach the executive level. I will speak more about that later this year.

Sound governance is necessary to support the regulator's primary objectives of safety and soundness, market integrity and prevention of harm; a new legal obligation in this space would only be duplicative and redundant. It would likely conflict with existing obligations on the regulators in exercising their duties to ensure the sound governance of regulated bodies, creating confusion over whether these vaguer concepts conflict with the regulator's general objectives.

I do not believe that this Bill is the right place for such changes, but there might be other routes to reassert how important we think these matters are. The Government are currently considering the policy framework in which the regulators operate through the future regulatory framework review, which I mentioned this morning and on Second Reading. I would welcome right hon. and hon. Members' engagement on this important question—I really would. The matters that the regulators need to have regard to as part of this Bill reflect considerations immediately pertinent to these specific prudential regimes and, I believe, provide the right balance.

Abena Oppong-Asare (Erith and Thamesmead) (Lab): I am really happy to put forward amendment 25, because it will require that, when making capital requirements regulation rules, the FCA must have a high regard to standards in social practice and corporate governance, including pay, adherence to equalities legislation, transparency and corporate responsibility.

We know that best practice corporate governance results in social and economic gains, and that is something the Government are particularly passionate about. Companies that persist in treating climate change solely as a corporate responsibility issue, rather than a business problem, are running a risky business and stand to lose out.

We have seen businesses turn the need to tackle climate change into successful business opportunities. For example, BrewDog, the world's largest craft brewer, will remove twice as much carbon from the air as it emits every year, becoming the first carbon-neutral brewery. If companies can already shoulder this social responsibility and incorporate it into a successful business model, there is no reason not to hold all businesses to the high standards our country needs to tackle imminent social and political issues.

Climate change affects every facet of everyone's lives. The effects of climate on companies' operations are now so tangible and certain that the issue demands a strategy and leadership from the Government. Government intervention has worked before, and it will work again, particularly through amendment 25. Take the Equal Pay Act 1970, for example, which was mentioned previously. Business and civil society converged, and companies with over 250 employees were made to publish data on pay gender discrepancies, resulting in a win-win scenario. Excellent work is now being done to tackle this further and understand racial, gender and environmental concerns, which are intricately linked. We have to follow civil society's work on equal pay and extend the reporting to data collections on the grounds of racial equality and environmental equity, because our actions will be futile if our evidence is not fertile.

There is no one-size-fits-all approach to climate change: each company's approach will depend on the particular business and strategy. What we are calling for in this amendment is for the Government to support and enable employers to publish an action plan to tackle climate change and social inequalities, including initiatives to mitigate climate-related costs and risks in client value chains. Jesse Griffiths, the CEO of the Finance Lab, had some important advice for the Committee last week. He said:

"I think that the absolutely fundamental issue with regards to the Bill is that it is an opportunity to put social and environmental purpose at the heart of both the regulation and the duties of the regulators."—[*Official Report, Financial Services Public Bill Committee,* 19 November 2020; c. 113.]

Environmental engagement is economic effectiveness, and this amendment will improve the economic health of our businesses and the environmental health of our country.

The amendment would also ensure that regulators can act in accordance with social needs, and ensure that businesses maintain corporate responsibility while still thriving in a competitive marketplace. When the Government asked Ruby McGregor-Smith to review the diversity pay gap, I welcomed that initiative. Campaigners have moved mountains in terms of identifying the profitability, both social and economic, of deepening our commitment to diversity and opportunity of wealth and health creation for all. In McGregor-Smith's review, "The Time for Talking is Over, Now is the Time to Act", she highlights how for decades, successive Governments and employers have professed their commitment to racial equality, yet we see that vast inequalities still exist. We must ensure this does not happen with our commitment to environmental stability, and the amendment will help ensure that.

Racial equality, gender equality and environmental stability can never be achieved unless we understand the ways in which they are intricately linked. As Ruby says, the time for talking is over, and I am sure that all the young people participating in the mock COP as we speak agree. I know that I mentioned this earlier about young people, but they are important: they are our future, and we really need to take them into consideration. With 14% of the working-age population coming from a black or minority ethnic background, we know that employers have to take control and start making the most of our talent, whatever their background.

The point stands out when looking at the pay gap for disabled people in the UK. In 2018, the median pay for non-disabled employees was £12.21 an hour, while for disabled employees, it was £10.63. The Minister mentioned earlier that he sat on the asset management taskforce—

John Glen: Chaired.

Abena Oppong-Asare: Chaired—apologies; I have bad hearing. He gave examples of shared actions and how to get better transparency, and mentioned that regulators are already committed to higher transparency. I am sure he agrees with me that businesses need to be held to account. The amendment will also help to create an environment that nourishes talent equality and protects our natural habitable environment.

The amendment basically brings huge financial, environmental and social rewards. Companies must realise they cannot ignore those issues anymore. However, we know that most companies will act only when they see a reason to do so. What we need is less talk and more action.

2.30 pm

Ruby McGregor-Smith highlights how BME representation in some organisations is clustered in the lowest-paid positions. She calls for employers with more than 50 people to set aspirational targets to increase diversity and inclusion throughout the organisation, not just at the bottom. Such reporting and data knowledge must be applied in other aspects of social and environmental regulations—I repeat, daylight is the best disinfectant.

The amendment will allow employers to push their aspirational targets, be transparent about their progress and be accountable for delivering them. The Government must legislate to make larger businesses publish their ethnicity data by salary to show progress. This is not about naming and shaming; no large business has a truly diverse and inclusive workforce from top to bottom at the moment, but with thorough publishing of data, the best employers will be able to show their successes and encourage others.

The same must be said for environmental targets. We must understand that our people's health and our wealth is our environment, particularly in this climate where we are dealing with the impact of the coronavirus. Let us not reinvent the wheel and double up on best practice, research and proposals that are already being provided by the Government; we have the opportunity today to vote to give regulators the power to ensure that businesses are held to account in areas of corporate social responsibility. It is important that the amendment sets a precedent that UK businesses adhere to the changing needs of our societies.

As I mentioned earlier, businesses such as Boohoo—I would also like to include Barclays in this—have shown how, without appropriate regulation, lives have been put at risk. As mentioned by my right hon. Friend the shadow Economic Secretary to the Treasury, Boohoo has been in the news for hiring supply chain workers for less than the minimum wage. That is unacceptable and shows that we need to regulate to ensure transparency in the supply chain.

Barclays was also under fire this year after increasing its support for fossil fuel companies. Despite announcing in March that it would target net-zero carbon emissions by 2050, the UK lender provided £24.58 billion of underwriting and lending to large fossil fuel companies in the first nine months of the year—a £200 million increase over the same period in 2019, according to the Rainforest Action Network.

It has been recommended that the capital requirements for investment firms introduce weightings for environmental, social and governance issues. The amendment would enable that to happen and position the UK as a leader in corporate social governance. I am sure we all agree that that is what we want the UK to be.

John Glen: I have listened carefully to the points made by the hon. Lady, who touches on a wide range of subjects, some of which I responded to in my response to the shadow Minister. I would just say that a number of initiatives are under way and intensifying. Just a few hours ago, I launched a piece of work with the Corporation of London on social diversity, a taskforce to bring people together to look at what we can do to improve access to financial services. That follows the work that we have been doing and that former Minister Mark Hoban is doing with the Financial Services Skills Commission. I mentioned the work of Women in Finance, but there are a lot of other pieces of work that my colleague the Exchequer Secretary is also looking at in her dual role as Equalities Minister.

I made clear in my response a few moments ago that I believe the provisions we have already give the regulators significant licence to operate in this area and, although I do not rule out any changes subsequently, I believe at this time that the amendments should be resisted.

Stella Creasy: The challenge that the Minister has with these instruments is exactly the issue around the gender pay gap. We were told that that did not need to be written into the legislation, because there would be a commitment. As we have seen this year, that commitment has not been absolute. It has been abandoned by the Government.

The Minister has said that he agrees with those commitments and the issues that the shadow Minister has raised, and that they might be put into legislation. Does he recognise that, for those of us who are committed to those high standards, the point of such amendments is to put it beyond doubt that they will actually happen? As we have seen, if we do not put them beyond doubt, it is tempting for future Administrations and future regulators to remove or weaken the protections.

John Glen: I thank the hon. Lady for those points. As public bodies, it is clear that the regulators are answerable and accountable to Parliament, and I have explained how that will be enhanced, but they are also subject to legal duties to publicly consult on the new rules and to how Parliament wishes to scrutinise them. I recognise the point that she is making, but I believe that putting that obligation into legislation in that way would not immediately lead to the outcome that she supports. Across those areas of completely legitimate aspiration, many of which I share in an identical form, this is something that we would need to look at in the round following the regulatory framework review.

Alison Thewliss: I appreciate the work that the Minister and other Ministers are doing in this area, but does he accept that he if puts it into the legislation, he might actually have less work to do, because everybody will then be obligated to do it, rather than him having to ask nicely?

John Glen: Unfortunately, I do not share that view. Given the arguments that I have made about the complications that it would bring, because of the overlap with existing provisions, I do not think that would be the right way to go. I am very sympathetic, however, to many elements of the speeches made concerning the aspirations that we should have to improve the overall quality of corporate governance and behaviour across the City.

Mr McFadden: I am sure that the Minister is completely genuine when he says that he supports this agenda and the aims behind the amendment, but anyone who has followed the issue over the years will realise that we have had taskforces galore on it in the City. We have had taskforces on women on boards and on diversity; now we have a new one on social mobility. I wish that well but, after all those taskforces, do those in the top jobs in this sector—the real pool of decision makers—reflect the country as it is today?

John Glen: Yes.

Mr McFadden: Of course they don't. We cannot conclude that, for all the taskforces and all the well-meaning, great people who have been involved in them, they have made enough progress.

This is not just a British agenda by the way. I read in the news the other day that the upper echelons of German industry are having exactly the same debate about whether to mandate quotas on boards for so many women and about the broader equalities agenda that my hon. Friend the Member for Erith and Thamesmead referred to.

Stella Creasy: If we are recognising that, it is worth noting that other nations that we compete with have already put gender quotas into legislation and beyond doubt, so we are behind our economic competitors. Ultimately, as we all know, the point about such regulation is that it would also make us more competitive. Blasting through the discrimination that has stopped us doing it would help our economy as well as our society.

Mr McFadden: My hon. Friend is absolutely right. For those reasons, we made specific mention of equalities legislation in the amendment.

It comes down to one's view of the difference between encouragement, taskforces and all that, and legislation. This amendment is not particularly prescriptive. It calls for high standards of social and corporate governance. Hon. Members might say, "How do you define 'high'?" and so on, but it is no less defined that talking about the relative standing of the United Kingdom as a place for internationally active investment firms to do business.

Once we have been through two or three of these debates, we begin to see a pattern in the way that the Committee works. I find myself a bit unconvinced that voluntary action will do this. There is not just an opportunity but a duty on us to start to define the post-Brexit financial services sector and what its characteristics will be. I want to put a few teeth behind all the fine words we have heard about the commitment to high standards, having no race to the bottom and all the rest of it. I always remember the plea of the former Chancellor, George Osborne: anybody in politics should be able to count. I look around the room and I can count, but I still want to press the amendment to a vote.

The Chair: We move to a vote—how exciting.

Question put, That the amendment be made.

The Committee divided: Ayes 5, Noes 10.

Division No. 3]

AYES

Creasy, Stella
McFadden, rh Mr Pat
Oppong-Asare, Abena
Smith, Jeff
Thewliss, Alison

NOES

Baldwin, Harriett
Cates, Miriam
Davies, Gareth
Glen, John
Jones, Andrew
Marson, Julie
Millar, Robin
Richardson, Angela
Rutley, David
Williams, Craig

Question accordingly negatived.

Alison Thewliss: I beg to move amendment 38, page 63, line 5, in schedule 2, at end insert—

"(ba) the likely effect of the rules on trade frictions between the UK and EU, and".

This amendment would ensure the likely effect of the rules on trade frictions between the UK and EU are considered before Part 9C rules are taken.

The Chair: With this it will be convenient to discuss amendment 41, page 79, line 29, in schedule 3, at end insert—

"(ca) the likely effect of the rules on trade frictions between the UK and EU, and".

This amendment would ensure the likely effect of the rules on trade frictions between the UK and EU are considered before CRR rules are taken.

Alison Thewliss: One of the things that concerns us most about where we are going with Brexit is the risk of trade disputes. We need only look at how one dispute can overspill into another, such as the overspill from Airbus/Boeing into Scotch whisky and cashmere—it is not very wise to spill Scotch whisky on cashmere. Our amendments are therefore sensible. They strengthen what is already in the Bill.

Proposed new section 143G(2) to the 2000 Act states that

"the FCA must consider the United Kingdom's standing in relation to the other countries and territories in which, in its opinion, internationally active investment firms are most likely to choose to be based or carry on activities."

Proposed new section 143G(3) states that

"the FCA must consider, and consult the Treasury about, the likely effect of the rules on relevant equivalence decisions."

That adds further consideration to the impact on trade frictions.

2.45 pm

There is still not clarity about what things will look like at the end of the year. Given that financial services are such a huge part of not just the UK economy but the Scottish economy, we feel that it is important that trade and the impact of overspill is looked at within the amendments. It is of significant concern that we do not know what the deals will look like in many ways. Despite the Chancellor's statement on his equivalence declarations, the EU has not sent yet out someone to respond. I appreciate that the Minister will say that that is up to the EU and the EU needs to move on this. It is true that there are two parties to this, but in order to prevent things from getting out of hand, it is important that that becomes part of the consideration and that in passing rules we look at the wider implications of what it means for financial services.

John Berrigan, the European Commissioner's top financial services official, is quoted in the *Financial Times* describing the end of the transition period as an "unavoidably fragmenting event". That type of fragmenting event could go in many different directions. There could be overspills from one thing to another, where the disputes from one area come into another. That is why it is important for financial services, which has been a seriously overlooked part of the Government's Brexit negotiations, that we take the small amendments that we have before us into a wider consideration and that we are very careful about the decisions that are made and the impact they could have.

I feel that that fits neatly within the change that we propose to schedule 2. I just want to add this bit in to make sure we do absolutely everything we can to prevent any trade disputes or frictions and anything that makes it more difficult for the financial services sector to trade, to make deals and to keep people employed in this country, rather than taking the easy option of shipping it over to mainland Europe. We need to take all of these things into account to make sure that we protect the jobs and economy that we have here and prevent anything spiralling out of control. We see from other trade disputes just how easily that can happen. The regulators should be mindful. If they are being mindful of other things, they should be mindful of this as well.

Mr McFadden: I will speak briefly in support of the amendment. I think it adds an interesting new angle to our considerations on the schedule. There is quite a lot in the schedule about the UK's standing as a place to do business. Proposed new section 143G(1)(b) to the 2000 Act talks about the

"relative standing of the United Kingdom as a place for internationally active investment firms".

Proposed new section 143G(2) says that

"the FCA must consider the United Kingdom's standing in relation to the other countries and territories in which, in its opinion, internationally active investment firms are most likely to choose to be based or carry on activities."

None of us has argued that those are not completely legitimate considerations. Of course we want to consider our standing in relation to other countries, but that is different from the trading aspect.

The amendment points out that decisions can be taken that are facilitated by the Bill, for example on divergence, which we have discussed and will discuss further, and those decisions can have one impact on competitiveness but a very different one on the ability to trade. That is particularly important when this equivalence decision is still on the table. I think these amendments on considering our trading position usefully add to the job description of the regulators, which should be about not just competitiveness, but market barriers, market access and our ability to trade into other countries. Considering both of these proposals would be a good addition to the "have regard to" list set out in schedule 2.

John Glen: It is a pleasure to respond to the hon. Member for Glasgow Central and the right hon. Member for Wolverhampton South East. The hon. Members for Glasgow Central and for Aberdeen South propose to introduce a new "have regard" for the FCA and PRA when making rules for the new investment firms prudential regime and implementing the Basel standards respectively. That would require the regulators to consider the likely effect of their rules on trade frictions between the UK and the EU, as the hon. Lady set out.

Again, I understand and share the ambitions for frictionless trade between the UK and one of our biggest trading partners, the EU, but, as I am sure the Committee will understand, I am not able to discuss the details of our ongoing negotiations. We want a free trade agreement outcome with the EU that supports our global ambitions for financial services, and we have engaged with the EU on the basis that the future relationship should recognise and be tailored to the deep interconnectedness of those relationships across financial markets. The EU has made it clear that it does not support such an approach. We remain open to future co-operation with the EU that reflects our wide, long-standing, positive financial services relationship, and we will continue to engage in a constructive manner.

The regulators do not have oversight beyond their financial services remit. It would therefore be highly disproportionate to require them to assess the impact of their rules on all trade matters, covering goods and services. Furthermore, trading partnerships with overseas jurisdictions are the Government's responsibility, not the regulators'. We consider that regulators should not be asked to go beyond the scope of their capabilities and duties. We have already discussed the capacity of the regulators; the amendment would really go beyond that.

We agree that financial services firms care about the UK's relationship with overseas jurisdictions, which has a real impact on them. That is why the accountability framework that the Bill will introduce already requires regulators to consider the likely effect of their rules on financial services equivalence granted by and for the UK. Financial services equivalence will be the main mechanism underpinning financial services relationships between the UK and overseas jurisdictions. I believe therefore that the accountability framework, as proposed, meets the aim of the hon. Member for Glasgow Central.

In addition, the amendments focus solely on the relationship between the UK and the EU. That is obviously a matter of enormous concern, but we need to make legislation that accounts for the future. Equivalence or trade in financial services considerations must relate to all jurisdictions. It is crucial that we recognise that in the context of financial services firms, which often have a global footprint and global operations. That also reflects the UK's present and future ambitions.

The accountability framework recognises the importance to UK firms of our relationship with overseas jurisdictions in financial services matters, while upholding broader international obligations. The Bill already supports the intentions behind the amendment, and for that reason I ask the hon. Lady to withdraw it.

Alison Thewliss: I would prefer to press the amendment to a vote because it fits well with the other parts of the Bill. Asking the FCA to consider the UK's international standing with other countries aligns with other areas in which it is taking on wider roles, and the amendment reflects that. Regulators should have regard to the wider impact of their decisions and to problems that their rules might cause to trade between the UK and the EU, which could be quite significant. It seems wise to put that in the Bill so that the regulators are mindful of it in the decisions that they make.

Question put, That the amendment be made.

The Committee divided: Ayes 5, Noes 10.

Division No. 4]

AYES

Creasy, Stella
McFadden, rh Mr Pat
Oppong-Asare, Abena
Smith, Jeff
Thewliss, Alison

NOES

Baldwin, Harriett	Marson, Julie
Cates, Miriam	Millar, Robin
Davies, Gareth	Richardson, Angela
Glen, John	Rutley, David
Jones, Andrew	Williams, Craig

Question accordingly negatived.

Mr McFadden: I beg to move amendment 22, in schedule 2, page 63, line 10, at end insert—

'(2A) The FCA must not make Part 9C rules unless—

(a) a draft of those rules has been submitted for scrutiny by a select committee of either House of Parliament which has a remit which includes responsibility for scrutiny of such rules, and

(b) any such committee has expressed a view on the draft of those rules.'.

This amendment is designed to enhance the accountability framework for the FCA by requiring it, prior to making Part 9C rules, to submit a draft of those rules for scrutiny by a relevant Parliamentary select committee before making any regulatory changes.

The Chair: With this it will be convenient to discuss amendment 26, in schedule 3, page 79, line 35, at end insert—

'(2A) The PRA must not make CRR rules unless—

(a) a draft of those rules has been submitted for scrutiny by a select committee of either House of Parliament which has a remit which includes responsibility for scrutiny of such rules; and

(b) any such committee has expressed a view on the draft of those rules.'.

This amendment would enhance the accountability framework for the FCA by requiring it, prior to making CRR rules, to submit a draft of those rules for scrutiny by a relevant Parliamentary select committee before making any regulatory changes.

Mr McFadden: We slightly change tack with this amendment. We have had some discussion of the "have regard to" list in the schedule, but the amendment covers a different aspect, dealing with the relationship between the enhanced role that regulators are to be given under the Bill and the role of Parliament. There are two important aspects to the role. First, in which way should Parliament be involved? Secondly, when should Parliament be involved? By that I mean, at what point in the regulatory process is it appropriate to have parliamentary involvement?

On Second Reading and several times today, the Minister has encouraged us not to look at the Bill in isolation but to see it as part of a process of reform, possibly involving other such Bills in the future. This may be only the starter and, if hon. Members are really lucky, they could be invited back here next year for the main course—who knows? In particular, he has asked us to look at the Bill alongside the consultation document on the future regulatory framework review, which was published a month ago. That document, which is I think 30 to 40 pages long, has a whole chapter devoted to accountability, including parliamentary accountability.

To anticipate the Minister's response to the amendments, of course the document does not yet reach conclusions because it is a consultation inviting responses. In the part about parliamentary accountability, the document sings the praises of the Select Committee system and the Treasury Committee in particular. My hon. Friend the Member for Wallasey had to pop out, but we have at least another three members of the Treasury Committee in the room, and I am a former member of it. There is no doubt that it is an esteemed Select Committee, which we all accept does a great job in this House, but the work of that Committee is very stretched. It has to cover a huge amount of business: not only banking and financial services more generally, but taxation, fiscal policy and everything else that the Treasury does.

I do not want to be unfair, but when I read that part on parliamentary accountability, I found it hard to escape the conclusion that it was written to give the impression that not a lot should change—the system we have at the moment is just tickety-boo; it is just fine. The underlying assumption seems to be that we can take this huge exercise in onshoring—this large-scale set of regulations, directives and all the rest of it—expand in a very significant way the role and remit of our regulators, and just tack that on to the present framework. I hope the Minister does not think I am being unfair, but that is the impression that I got when I read the future regulatory framework review.

3 pm

Just to help the Minister out, I will quote a bit from the review. Paragraph 3.18 says:

> "The government thinks that the long-established scrutiny mechanisms referred to above will continue to be effective in holding Ministers to account for the work of HM Treasury and the financial services regulators."

There we are. We have a great system that is anchored around the Treasury Committee, and the Government are saying they think that will be adequate. The review encourages us by saying:

> "There are two key reasons why Parliament may wish to focus on the select committee system when considering its future approach to Parliamentary scrutiny of financial services policy."

It lays those reasons out in paragraphs 3.20 and 3.21, but I am not sure that simply saying that we have a great system at the moment, and that it can continue, is really appropriate to the task.

The idea has been floated outside the Committee—I think it was either on Second Reading or perhaps during the Chancellor's statement on financial services a couple of weeks ago—that there be a specific Select Committee on financial services. There is precedent for that in Parliament, in the European Scrutiny Committee. Its members have spent many happy hours scrutinising the detail of various EU directives—in fact, some of them have spent many happy years doing so. Here, however, we run into the issue of the scope of the Bill, because it is my understanding that a Government Bill such as this, even it were to be amended by the Opposition on its way through the House, cannot tell Parliament which Select Committees to have.

The idea of a specific Select Committee on financial services may well have merits, and it might even be something that the Government come to favour, but my understanding is that the establishment of such a Committee would be a decision for Parliament—it would not be something that we can mandate by legislation. I am not entirely sure about that, but that is my understanding of the boundaries between a Government Bill and what Parliament will decide. Amendment 26, which I tabled, deliberately does not specify which Select Committees should be involved. That is a debate that will continue. It might be something that the Government eventually recommend or say they favour, but it would be for Parliament to decide which Select Committees to establish.

I want to make it clear to the Committee that although we might think there is merit in the idea of a Select Committee on financial services, the amendment before us does not mandate the creation of a new Select Committee. It is deliberately silent on the issue of which Committee should be involved in such work. Instead, it is focused on what should be considered by a relevant Select Committee, and on when in the process that consideration should take place.

The "what" is the part 9C rules, which are made under schedule 2 of the Bill—the rules governing investment firms that are regulated in this way by the FCA. Those are the rules to which the new accountability framework that we have been debating applies. That is made clear in proposed new clause 143G of the Bill, which states:

"When making Part 9C rules, the FCA must, among other things, have regard to—

(a) any relevant standards set by an international standard-setting body,

(b) the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active investment firms to be based or to carry on activities, and

(c) any other matter specified by the Treasury by regulations."

Proposed new clause 143F makes it clear that:

"The FCA must publish a list of all Part 9C rules in force".

That is the "what" that we are talking about here. It is set out on page 62 of the Bill, in the early part of schedule 2.

I come now to the "when". When should a Select Committee be involved? When should a parliamentary role kick in? This is actually at the heart of the amendment. It is true, of course, that the chief executives of the PRA and the FCA, plus the Governor of the Bank of England, appear periodically before the Treasury Committee. However, the regulators probably do so at most once or twice a year, and there is no onus on them to appear before a particular regulatory decision is taken or a particular set of regulatory rules come into force.

The amendment seeks—without being prescriptive about the Select Committee involved—to give the Select Committee system a role before final decisions are taken. I tread carefully here, given the debates that we have had in this House in the past few years, but there is an example of this: the ECON Committee, the European Parliament's Committee on Economic and Monetary Affairs, has played this role for a number of years, and it is regulations approved through that process that we are onshoring through the Bill. Its role is therefore somewhat different from that of the Treasury Committee, or any other Select Committee, in that it considers regulations in draft before they are finalised. That is important, because it allows public interests to be represented and considered before a decision is taken. The important part of the amendment is not so much what Select Committee, but when in the process Parliament should be involved.

If we do not have a process that pushes for parliamentary involvement before a decision is made, we will end up in the paradoxical situation that, after onshoring all this regulation in the name of taking back control, we end up with less scrutiny of these kinds of regulations than we have had up until now, or at least up until January this year, when we at least had British MEPs on the ECON Committee, as well as MEPs from many other countries. There was a role for elected representatives in that powerful parliamentary Committee as it considered and commented on these regulations in draft. Replacing that with a system in which successor regulations can be produced by UK regulators without any prior parliamentary involvement would mean that the onshoring process lost an important part of the parliamentary process. That would be a paradoxical outcome in an exercise that is supposed to be driven by taking back control.

Wherever we stood on that issue, taking back control was understood to mean taking control back to the UK Parliament, not replacing European parliamentary input with UK regulator control, with their perhaps making one or two appearances before Parliament after the decisions had been taken. That is why we believe that it is important to empower Parliament in this new system, rather than onshoring these regulations in a way that results in the public, consumer organisations and, indeed, elected parliamentarians actually having less of a voice over these things while they are in the development stage than was the case in the past. It is to avoid that paradoxical outcome that we tabled these amendments, to try to ensure a strong Select Committee role while regulations are being developed, allowing representations to be made during that development rather than simply after the fact.

Stella Creasy: As this is my first speech, let me say how fantastic it is to serve under your chairmanship, Dr Huq—none of us ever says anything other.

I rise partly to presage what I am sure the Minister knows is coming, given our previous correspondence on my concerns about existing financial regulation in this country and where the voice of the consumer is heard in that. I am sure he has looked avidly at some of the new clauses that I have tabled, which seek to get at that and which I note will come much later, in the shape of new clauses 15, 18, 21 and 23.

The shadow Minister has set out clearly how amendment 22 reflects those concerns. Again, where in the new financial regulatory regime being brought in by the Bill will the voices of our constituents be heard? The shadow Minister has focused on the consequences of leaving the European Union and the lacuna that will be created in terms of financial regulation by the Bill if we do not have that clear commitment with the Treasury or any other financial body to look at Select Committees and the role they might play. I want to focus on the other end of that telescope and what it has been like to seek to give consumers voices within the existing regulatory framework, what lessons that might offer us in the future regulatory framework and why involving Select Committees might be a way forward.

I am sure the Minister would say that working out how we make sure our constituents are heard is a work in progress. We talked this morning very strongly about the impact of financial regulation on people's everyday lives, the financial crisis and what could be learned from that. Many of us will have seen among our constituents people whose lives were decimated when financial institutions were found wanting and how that has driven the concerns about consumer protection in the wider work of the FCA. My concern as a Member of Parliament who has long had an interest in personal debt in this country has been about how that conversation is part of those bigger questions.

As I mentioned this morning, often we look for specific issues when it comes to consumer voice and financial regulation. On the wider impact, it is almost a given that somehow regulators will think about consumers. The reality is that over the past six or seven years of having the Financial Conduct Authority that has not always been the case. The Bill gives those regulatory bodies more powers. As the shadow Minister has pointed out, it removes one of the mechanisms for consumer voice through the democratic process within the European Union. Therefore, it is right that we ask how we replace that and whether there are gaps in what has happened to date that mean it is even more important, when asking whether the financial regulators are living up to the issues we might want them to have regard to, that that consumer voice is being heard in that process.

Amendment 22 is an eminently sensible idea to say, "Hang on a minute, where there had been previous scrutiny and challenge from democratic institutions, we need to replicate that within the UK Parliament." It comes from that perspective of saying that it is in everyone's interest to have that check and balance because it has been of benefit under the previous regime and, under that regime, there has been too narrow a consumer voice. I am not going to prosecute that argument in full today, because I am going to save it for the Minister for the new clauses that I have put down and how I think he can do that. I can see his disappointment already. However, I argue that it is worth looking at where the Select Committee process can add value to financial regulation in this country because, so clearly, it is our constituents who have paid the price when financial regulation has not looked at consumer risk and has not been able to ask questions before a crisis happened.

Many of the issues that our Treasury Committee, for example, as one body that may be involved in this, has looked at have come from our constituents raising concerns and a recognition that something might be on its way. Many of us would argue, and I suspect the Minister would agree, that sometimes regulators have been slow to react because they have been trying to balance the needs of the industry with questions about whether interference might cause more harm. The amendment is a way of getting that right, of having a place where those conversations could take place around financial regulation with a regulator that now has much more extensive powers than previously. It is a way of making sure that, as a democracy, we have a space where we can raise those concerns before problems happen.

When we get to the new clauses I have tabled, one of the concerns I will raise is where we see other regulators—in particular, I think of the financial ombudsman having to intervene where our financial regulators have not been able to do their job around supporting and protecting consumers, and so the ombudsman has picked up the pieces. Under the model we have coming forward in this Bill, it is not clear to me, without the involvement of Select Committees, where those conversations could take place, apart from with the financial ombudsman. Again, we are waiting until institutions potentially fail and organisations can pick up the pieces for that consumer voice to be heard.

3.15 pm

I would argue that the amendment is a very regulator and industry-friendly way of doing things, because having those conversations is good for doing good business. One of the principles I am sure the Minister will agree with is that good regulation is in everybody's interests. Active regulation that makes sure we have a fair, competitive and protected environment—the higher standards we are all talking about—does require explicit scrutiny. It requires not presuming that everybody knows what each other is doing.

It also requires asking whether there is information that can be gained from our constituents. We can all think of the banking crisis, and the kind of information we were getting in our surgeries could be brought to Select Committees and form part of understanding whether the Financial Conduct Authority is applying its role in due course.

I think of the debates we had when I was first elected over a decade ago about the then Office of Fair Trading—*[Interruption.]* Indeed, it has been that long; I am almost edging into grandee territory, but not quite. At the time we looked at the Office of Fair Trading, there was a recognition that information was coming through in Select Committee debates that was not being picked up by the Office of Fair Trading. That was a function of the fact that the Office of Fair Trading was not the appropriate regulatory body for some of these financial procedures.

If the Minister will not accept this amendment, how will he address the point raised by my right hon. Friend the Member for Wolverhampton South East on the Front Bench about the lacuna created by leaving the European Union and the democratic scrutiny that came from the Committees there? There are also the lessons that we have to learn from the last six or seven years about whether those early-warning systems that involve consumers, and those early-warning debates that can happen in this place, can be part of that new regulatory regime?

Otherwise, the Minister is almost setting up the FCA to fail, because he is asking it to be judge and jury of its own ability to deliver on competing objectives. They are sometimes competing objectives, and that is right—there can be a concern for competition and a concern for consumer protection that overlap, and there can be a concern for competition and a concern for consumer protection that stand against each other. However, without some sort of forum where the consequences can be teased out, information can be brought and democratic scrutiny can be part of the conversation, that gap is not filled. It will fall to the Minister or his successors or to the FCA to be judge and jury of their own homework. As we have seen in the past—I have no doubt we will see this again—that can be a very dangerous position to be in. We can have the groupthink that people talk about, where everyone agrees that everyone is probably doing the right thing, without really recognising that the wrong thing is coming up very quickly.

The financial scandals that our constituents have had to pay the price of tell us that we have to get this right. I look forward to hearing from the Minister that he has ideas about how that democratic scrutiny and engagement can be part of a competitive, high-standard environment in the UK and about the role that Select Committees could play in that.

Alison Thewliss: I very much agree with the proposals brought forward by the official Opposition. I congratulate them on their drafting and having found a way to put these amendments forward. Our attempt at this comes in new clause 32, and I will discuss that a bit further when we eventually get to it.

I agree that it is vital that there is scrutiny of these institutions and these powers. It is surely unacceptable that the Government have made so much play of taking back control from the EU only to hive it off to regulators because it is far too terribly complicated for us parliamentarians to worry our sweet heads about. That is not acceptable. That is not the way that it works in the European Union, and it certainly should not be the way Westminster operates. We should trust ourselves and our colleagues slightly more to do that scrutiny. If European parliamentarians, some of whom are now in this place, can do it, we can certainly look at a way that this can be done and that accountability can be taken for these powers.

I agree with those who have said that the Treasury Committee is stretched in its business. Having had a brief discussion yesterday in our pre-meeting about the sessions to come in the weeks and months ahead, I can tell the Committee that those sessions are already very full, running at two sessions in most weeks. We are certainly being kept very busy with all the important things our constituents bring to us, the responsibility the Committee has to scrutinise the Government and all the other things the Committee wants to do. The logic of setting up a new Select Committee to examine these things is certainly very compelling to me, because it will need that specialist knowledge in addition to the heavy burden of work it might have.

I noted that the hon. Member for Hitchin and Harpenden (Bim Afolami) made a very good plug for this on Second Reading. I think his feeling is that it helps out the Government to have this additional scrutiny. It helps everybody see what is coming, prepares the ground and tries to make decision making better, which should be in the Government's interest—trying to get to the right thing for all our constituents and for the financial services sector as a whole.

So that is important, and we should have no less of a role in all this than MPs currently have. I draw the Minister's attention to the evidence given to the House of Lords EU Financial Affairs Sub-Committee, whose reports I am sure he is an avid reader of, for International Regulatory Strategy Group, which also recommends enhanced parliamentary accountability and scrutiny. Its suggestion is a new system of Committee oversight in not just the Commons but the Lords, as we suggest in new clause 32.

The group has a series of principles it thinks such oversight should stand to, such as it being cross-party and apolitical—those are the principles of Select Committees, but it is important that we look at this. It mentions the ethos of the Public Accounts Committee in the way it goes about its business in scrutinising regulatory authorities. It also believes that oversight needs to be authoritative and expert, building up expertise within Committees, that it needs to be risk-based and mainly ex-post, and that it should be open to stakeholder input, which is incredibly important. We all know Select Committees do that; they take evidence and they have good records of bringing in expertise and evidence from people, but they need to be able to use that evidence in a practical way to inform the best strategy and best way forward as we take these powers back.

I very much recommend to the Minister the evidence given by the IRSG. What is he doing to meet this challenge of the "accountability deficit", as the Finance Innovation Lab put it? We cannot have a situation where more powers are coming back, yet we give them away. That is certainly not what was promised on the side of any Brexit bus, and it should not be the way we go forward. As the honourable grandee, the hon. Member for Walthamstow, said, it stores up a risk that we do not see something coming, that we have not identified a problem on the horizon and that we all end up in a bit of a crisis because we did not have the opportunity to scrutinise properly, to look at the regulations as they come forward and to ensure we do what is best for our constituents and the wider economy. There is logic in having some form of Committee to look at this, in whichever format the House wants to bring that forward. It is essential that that scrutiny exists and that it is at least as good as what was done in the European Parliament.

John Glen: I am very pleased to address the points raised by the right hon. Member for Wolverhampton South East, the hon. Member for Walthamstow and the hon. Member for Glasgow Central. I have listened carefully to what they had to say, and their remarks go to the heart of the distinction between the provisions of the Bill that we are scrutinising in Committee and the broader questions around the future scrutiny mechanism, and the necessity to ensure that we do not undermine the legitimate and appropriate scrutiny by Parliament of our regulators.

It is critical that we ensure sufficient accountability around the new rules of the UK's financial sector. Capital requirements for firms are extremely detailed and technical. It is right that we seek to utilise the expertise of the regulators to update them in line with international standards.

In return for delegating responsibility to the Financial Conduct Authority, this Bill requires it, under proposed new clause 143G of the Financial Services and Markets Act 2000, to publish an explanation of the purpose of its draft rules and of how the matters to which it is obliged to have regard have influenced the drafting of the rules. The Bill introduces a similar requirement for the Prudential Regulation Authority, under proposed new clause 144D of the Financial Services and Markets Act.

These matters concern public policy priorities that we consider to be of particular interest to Parliament. I have looked carefully at the amendments proposed by the right hon. Gentleman, and the amendments envisage Select Committees reviewing all investment firms prudential regime and capital requirements regulation regulator rules before they can be made. Under that model, Parliament would need to routinely scrutinise a whole swathe of detailed new rules on an ongoing basis. That is very different from the model that this Parliament previously put in place for the regulators under the Financial Services and Markets Act, where it judged it appropriate for the regulators to take these detailed technical decisions—where they hold expertise—within a broader framework set by Parliament.

It should not go unnoticed that, if Parliament were to scrutinise each proposed rule, the amendment does not specify a definite time period in which any Committee must express its view on them. That could bring a great deal of uncertainty to firms on what the rules would look like and when they would be introduced. That makes it more difficult for these firms to prepare appropriately for these changes. Ultimately, there is currently nothing preventing a Select Committee, from either House, from reviewing the FCA's rules at consultation, taking evidence on them and reporting with recommendations. That is a decision for the Committee.

My officials have discussed this amendment with the regulators, and they have agreed that they will send their consultation draft rules to the relevant Committee as soon as they are published. The FCA and the PRA both have statutory minimum time periods for consultation and will take time to factor in responses to consultation—so this is not a meaningless process—providing a more than reasonable window within which the Committee can engage the regulators on the substance of the rules, should it desire to.

The Government agree that Parliament should play an important strategic role in interrogating, debating and testing the overall direction of policy for financial services, while allowing the regulators to set the detailed rules for which they hold expertise.

Before I conclude, I would like to address the point the right hon. Gentleman made concerning the document that was published a month ago on the future regulatory framework, and to address the supposition he very courteously made that, somehow, the Government believed that everything was fine and little needed to change.

The purpose of this extensive consultation is to do what it says: to consult broadly to ensure that, through that process, the views of industry, regulators and all interested parties and consumer groups are fully involved, such that, when we then move to the next stage of that process—I would envisage making some more definitive proposals—it would meet expectations on a broader and enduring basis. This Bill is about some specific measures that, as I explained earlier this morning, we need to take with an accountability framework in place, but I do not rule out any outcome.

The right hon. Gentleman made some observations about the prerogative of Government over mandating Parliament and Select Committee creation. I think we are some way away from that. We want to do these things collaboratively and end up with something that is fit for purpose, and I recognise the comments he made about the resourcing of such Committees with respect to the role they would play.

I do believe that this scrutiny process, as set out in the Bill, is extensive, and, for the reasons I have given, I again regret that I must ask the right hon. Gentleman to withdraw this amendment.

Mr McFadden: I cannot resist the irony of pointing out that the Government are resisting what could be termed the "take back control" amendment and do not want to add it to the Bill. There are many illustrious Members of this House we could name this amendment after; they have been arguing to take back control for many years.

The Minister said that the amendment would cause a lot of uncertainty; that it might be too much work; that it might require a Committee—whichever Committee it was—to look in too much detail at rules, when it would probably be more concerned with the broad direction. He also pleaded with us to allow the consultation to play out.

There is a serious point at the heart of this about the sovereignty agenda. There will be some kind of consequence at some point, possibly a backlash, that will draw attention to how this is done and the new powers that the regulators have. At that point, people will ask, "What was Parliament doing? What role was Parliament playing?"

3.30 pm

On this occasion, I am not sure that the amendment is perfectly drafted or that it does things in the best way, so I will not press it and I will allow the consultation that the Minister has referred to to play out. The issue of Parliament's role in this new world will come back at some stage, perhaps on Report or when the Bill goes to the other place, but, for today, I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

John Glen: I beg to move amendment 1, in schedule 2, page 76, line 31, leave out "143O(4), (6) or (8)" and insert "143O(3), (6) or (8)(b)"

This amendment corrects a cross-reference to new provisions inserted by Part 1 of Schedule 2.

This is a technical amendment that corrects a cross-reference from section 395 of the Financial Services and Markets Act 2000 to new section 143O, as proposed in schedule 2.

Amendment 1 agreed to.

Question proposed, That the schedule, as amended, be the Second schedule to the Bill.

John Glen: Investment firms have a significant role to play in enabling investors to access financial markets, but the current prudential framework that applies to FCA investment firms was made for banks, which is why we need a new bespoke investment firms prudential regime. Schedule 2 contains relevant provisions that enable the FCA to implement a tailor-made prudential regime for non-systemic investment firms.

The new regime will set out new capital and liquidity requirements that will ensure that firms can wind down in an orderly way without causing harm. The right hon. Member for Wolverhampton South East and the hon. Member for Walthamstow are rightly concerned about consumer harm, so I draw their attention to the fact that the FCA will have to set those requirements in relation to the risks that firms pose to consumers, as well as the integrity of the financial system.

The FCA will also be required to make rules for parent undertakings of investment firm groups, because appropriate regulation and supervision are as important at the group level as at the individual firm level. Parents, as heads of the group, should be held responsible for the prudent management of the group.

[John Glen]

It is right that specific rule-making responsibilities should be delegated to the FCA as an independent expert regulator, but those responsibilities must come with enhanced accountability. Schedule 2 requires the FCA to have regard to a list of important public policy considerations when making its rules in relation to the new investment firms regime, including any relevant international standards and the relative standing of the UK as a place for internationally active investment firms to carry on activities. To support scrutiny, the FCA will need to report publicly on how its consideration of those matters has affected its decisions on the rules in relation to the IFPR.

The FCA will also have to consider the impact on financial services equivalence, both by and for the UK, and consult the Treasury on that. Consulting the Treasury ensures that the FCA has appropriate accountability for technical choices that might have an impact on firms, while recognising that the Government retain responsibility for international relations and therefore equivalence. These three considerations are those that we have deemed to be immediately pertinent to the new investment firms prudential regime today.

However, as I have mentioned previously, the accountability framework is meant to reflect the changing context. That is why the Treasury will have power to add additional considerations, which would be done following discussions with the regulators and industry, and following parliamentary scrutiny. That is the overall framework that will allow greater scrutiny and transparency, and provide the direction the FCA will take in implementing the new regime in the UK, while rightfully leaving the detail to the experts.

In the longer term, any wider deregulation will need greater debate and the proper scrutiny of Parliament. The Government intend to address that part through the future regulatory framework, as I have discussed, which is now out for consultation. I therefore recommend that that this schedule stand part of the Bill.

Question put and agreed to.

Schedule 2, as amended, accordingly agreed to.

Clause 3

Transfer of certain prudential regulation matters into PRA rules

Mr McFadden: I beg to move amendment 23, in clause 3, page 4, line 31, at end insert—

"(9A) The Treasury must, within six months of making any regulations under this section, prepare, publish and lay before Parliament a report setting out—

(a) the reasons for the revocation of the provisions of the Capital Requirements Regulations being made under the regulations;

(b) the Treasury's assessment of the impact of the revocation on—

(i) consumers;

(ii) competitiveness;

(iii) the economy."

This amendment is intended to ensure the Treasury reports to Parliament on the impact of divergence from CRR rules.

In debating this amendment and this clause, I am hoping the Minister will be able to explain the relationship between this clause and clause 1. Clause 1 specifies the certain type of investment firms to which CRR rules need not apply, and he was at pains to say that that was a specific, targeted approach, but clause 3 looks to range very widely on the Treasury's powers to revoke aspects of the capital requirements regulation.

The list in clause 3(2), on page 2 of the Bill, has many different headings, including business lends such as mortgages, retail investments, equity exposures and so on. Without getting into the detail of the technicalities of the Basel rules, not all capital is treated as equal. A pound is not just a pound. It depends against which line of business it is weighted. For example, financial institutions will argue that mortgages pose a particular category of risk, probably quite low risk, compared with another line of business where they may be lending against business loans, commercial property or some other activity. The Basel rules do not judge all these activities equally and they apply what are known as risk weights to them.

The clause allows the Government pretty sweeping powers, as far as I can see, to depart from and to revoke aspects of the capital requirements regulation, against all these different types of business. I would be very interested for the Minister to set that out and clarify it.

Through this process, the capital ratios are allocated. Again, I draw the Committee's attention to the important paragraph (m) at the bottom of page 3 of the Bill, the leverage ratio. That is described in the notes on clauses as the "backstop." I hope that that term does not cause too much excitement in the Committee. Like all backstops, it is there in case the list from paragraph (a) to paragraph (l) does not prove sufficient.

This particular backstop of the leverage ratio casts aside all this stuff about risk ratings. It takes the whole lending book and the whole lending business, and says that a certain proportion of capital must be held against the whole thing. It is a bit of an insurance policy in case the risk ratings do not do the job. It is true that the risk ratings are where this is open to all kinds of lobbying, as people will say that one line of business is less risky than another.

At the core of this is a debate between regulators who must consider the safety and resilience of the system as a whole, and individuals who will argue that if only they did not have to hold all this capital, they could lend more, stimulate more economic activity, and so on. That is the debate that takes place. Without wanting to go over all the ground that we covered this morning, the amendment asks for a report on the degree to which the divergence—the leeway powers, as we might call them—will be used, and the Treasury's assessment of the impact on the economy. As I said this morning, we believe it is important that such a report should consider the impact on consumers, because they do not want to be on the hook for decisions that allow capital levels to fall too much, thereby weakening the resilience of the financial institutions in question.

This is a "lessons learned" amendment. It is important that the debate about capital ratios does not take place altogether in the dark—that it is exposed to what my hon. Friend the Member for Erith and Thamesmead called the daylight of scrutiny—and that we do not hear just from financial trade bodies. If they all genuinely have no intention of lobbying for a less safe system, have no desire for a race to the bottom and want the highest possible global standards on regulation, they have absolutely nothing to fear from this amendment. It does no more than ensure that we have reports from the Treasury on what happens when these powers are passed to UK regulators, and what happens if the divergence that is facilitated in clause 3—in this long list on pages 2 and 3 of the Bill—takes place.

Alison Thewliss: I agree very much with what the right hon. Gentleman has said. It is important that we are kept up to date, in the absence of other scrutiny mechanisms. At the very least, within six months of Royal Assent, we should find out the impact of any revocations. The point was well made about consumers, because in many ways they are very far away from where this Bill is, and they may not see any issues that are coming up. It is important that we, as parliamentarians, are sighted on what those issues might be and have some degree of scrutiny over what happens with the regulations.

Stella Creasy: We are talking in quite abstract terms, but it is worth remembering that when Fannie Mae and Freddie Mac fell apart in America, consumers were the first to feel the repercussions that were felt around the world. This financial regulation comes in in the aftermath of that, because it is still going on. There are still people and families who are paying the price for what happened in the financial crisis. This is not about reheating and repeating the arguments about who caused the financial crisis. It is about recognising that consumers in all our constituencies paid the price, first and foremost.

As others have said, when we think about financial regulations, it can feel quite technical, distant and obscure because of the language we use, but let us remember back to those days. Many years ago, when I first came into Parliament, we were dealing in 2010 with the aftermath of the financial crisis, and it was a very painful crisis for many. Everybody asked why we did not see what was happening. Why did we not see it coming? How could we not have seen that banks were over-leveraged? How could we not have seen that mortgages were being resold in the subprime market? The truth was that it was a closed shop, so everybody was marking each other's homework and saying, "I am sure this will be fine." This seems to me the mildest of amendments, simply asking whether we have the information to ensure that such an occurrence could never happen again, when we are talking about something as simple as the capital requirements that banks and financial institutions should have. After all, that is exactly what happened in 2008: everybody leveraged each other, so the capital was gone, and when the roundabout stopped, it was our constituents who paid the price. I know by now, on the first day, that Ministers will think we are a broken record, but to ask the Treasury simply to provide that information and to look at it from a consumer perspective does not seem an unfair thing to do, given the history and the legacy of this that we have seen for so many in our constituencies.

3.45 pm

I would like to push back a little on the Minister, because in the debate on the previous amendments he said, "Well, these are the technical reasons why these proposals for scrutiny would not work," but he has still not set out an adequate alternative. If he does not want to provide reports or have that modicum of accountability on how any divergence might affect our constituents, it would be very helpful if he set out on the record what he sees as the alternative accountability metrics for our constituents. Then we can go back to those who might still be in rented accommodation because they lost their properties, because their jobs went, because entire industries ultimately went, because of the financial consequences for us as a country in paying back those debts, and say, "It's okay. With this new Financial Services Bill, we have put in protections to ensure that we can never be in a position again where, after the fact, everybody turns round and says, 'Well, of course we should have seen that coming. Of course we should have seen the problems that were coming with the subprime market,' and yet nobody did because there was not that adequate financial regulation, there was not that scrutiny and, frankly, there was not that consumer element." The industry was deciding what risk our constituents could take, rather than our constituents' having somebody speak up solely for their interests.

If the Minister does not want to accept this amendment, which is simply about producing a report and checking that the homework is accurate, can he set out what he is going to do to ensure that none of our constituents ever goes through one of those experiences ever again?

John Glen: In addressing this amendment, I want to start by saying that the Government are fully committed to ensuring that this greater delegation of responsibility to the regulators is accompanied by robust accountability and scrutiny mechanisms. To pick up on the point made by right hon. Gentleman about clauses 1 and 3, they amend the existing banking framework for different reasons. Clause 1 only removes FCA investment firms from the CRR. Clause 3 enables the implementation of Basel standards for the remaining firms, credit institutions and PRA investment firms by enabling the Treasury to revoke parts of the CRR that relate to Basel. That is so that the PRA can fill the space with its rules.

Amendment 23 seeks to add a requirement for the Treasury to assess and report on the impact of its revocations of the capital requirements regulation on consumers, competitiveness and the economy. However, I would argue that the emphasis is in the wrong place. The Treasury will only make revocations to enable the introduction of the PRA's rules. A stand-alone assessment of the provisions being deleted would not provide meaningful information for Parliament—it is unnecessary. Those revocations are to be subject to the draft affirmative procedure, so they will be explained to Parliament and Parliament will be able to debate their appropriateness before they are made.

I agree with the principle of scrutiny, but the emphasis should be placed on the PRA's rule making, and that is what this Bill does. The Bill includes provisions requiring the PRA to publicly report on how it has had regard to upholding international standards and relative standing in the UK, as well as facilitating sustainable lending. Those are in addition to the PRA's existing statutory objectives on safety and soundness of financial institutions and its secondary competition objective, so they overlap with the areas that the amendment attempts to address.

[John Glen]

The provisions in this Bill sit alongside existing provisions in the Financial Services and Markets Act 2000, which require the PRA to publish a cost-benefit analysis alongside its consultation on rules. That will provide Parliament and the public with the information required to scrutinise the PRA's actions. Therefore, the current provisions in the Bill, combined with those existing provisions in the Financial Services and Markets Act, already ensure that the information that Parliament is seeking will be in the public domain. The hon. Member for Walthamstow asked me to set out a vision, almost, for the conduct regulator with respect to the future operating environment. To some extent, that is deferred to the future regulatory review, but I will give her my view because this goes to the core of the future of financial services. We need an environment in which the regulator is accessible to consumer concerns. I recognise the work that she has done and the shortcomings that she perceives with the regulator's current dynamic. We need Parliament to be at the heart of scrutinising its activities. The legislation would give it an obligation to report, but then we need meaningful scrutiny from Parliament.

The challenge is based on the work that the hon. Lady did after 2010—we came into Parliament at the same time—after which there was a rapid evolution in business models and new types of things. That is why I am delighted that Chris Woolard is doing a high-cost credit review and looking at some of the areas that she is engaged in, such as buy now, pay later. He is looking at that urgently so that we do not make the mistakes of the past and do not face some of the emerging challenges, in terms of behaviours—*[Interruption.]* She smiles. I suspect that she is not completely convinced by what I am saying about the provisions. We are resisting the amendment because in the narrow confines of what we need to achieve, with respect to the translation of these directives appropriately at the end of the transition period, that is distinct and different from an enduring solution. I look forward to her contribution to the regulatory framework review, because that will drive a meaningful discussion about how we achieve the sort of accountability that she and I want and think should be enhanced.

Stella Creasy: I am sure the Minister will have some delightful conversations about the regulatory framework that will keep many people wide awake for hours to come, but the two are not mutually exclusive. This amendment and this debate are about capital holdings.

Does the Minister recognise that what I said about what happened in 2008-09 is directly linked to this? We need to keep a tight eye on this, especially because of the global context in which it is happening. We cannot protect our economy and our constituents without some form of scrutiny and control. The Minister said that it is important to have parliamentary involvement, but he has just refused an amendment that would have brought the Select Committees into the process.

I am struggling to understand why in this instance, with this amendment and this requirement of the Bill, given the role of the FCA in overseeing capital requirements, the Minister feels that it would not be important to have the data, so that we are not in a position in which that subprime lending happens again in a different guise. If we have learned anything—this is not just about the high-cost industry—it is that these models evolve. It is like water: exploitation in the system will find a way through unless we have robust procedures. It is possible to have both this report and a regulatory framework; the two are not mutually exclusive. If there is not a reporting provision, the Minister leaves a gap until one is in place.

John Glen: This legislation provides the regulators with the responsibility and the reporting obligation to Parliament. What the hon. Lady has done is make an explicit relationship between conduct failure and capital requirement decisions. Decisions about the overall framework for accountability for the regulators are embedded within this Bill. The point of disagreement between us is whether there are sufficient obligations, in terms of reporting and scrutiny, for these narrow measures. We obviously disagree. I am trying to signal that, more broadly, on the wider issues of the future dynamic among Parliament, the Treasury and regulators, there is scope for significant review, and appropriately so given the changing nature of where these regulations are coming from. I do not have anything else to say.

The Chair: You both look too young to have been here all your adult life.

Mr McFadden: The Minister said that he does not want to accept the amendment because he thinks it is in the wrong place. I would find that a little bit more convincing if I really thought he would accept it if he thought it were in the right place, but so far today, Members on the Government Benches have steadfastly voted against this kind of reporting back and reviewing of things to do with the capital rules, as well as the other amendments tabled. I am sure that the Minister has read the whole amendment paper, and will have seen that I have tried to come at the same issue from a number of different angles and different timetables. This morning, we pressed to a Division an amendment asking for a report after three years, which was defeated. I will not press this one, Dr Huq, but we will be coming to other, similar amendments very soon. I therefore ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Question proposed, That the clause stand part of the Bill.

John Glen: The 2008-09 financial crisis led to significant economic hardship. Since then, post-crisis regulatory reforms set by the Basel Committee on Banking Supervision have supported financial stability, which underpins our economic prosperity. We in the UK intend to uphold our international commitment to the full, timely and consistent implementation of these reforms, alongside other major jurisdictions, and clause 3 creates the space in legislation for the financial regulator—the Prudential Regulatory Authority—to implement the remaining Basel standards. Like our approach to investment firms, our intention is to delegate the responsibility of implementing these to the PRA with enhanced accountability, as I have described. This is the right thing to do: the PRA has the technical expertise and competence to implement these post-crisis reforms as they should be implemented.

However, in delegating this responsibility, this Bill ensures that checks and balances are in place. First, clause 3 ensures that we transfer only some elements of the capital requirements regulation, or CRR, to the PRA, and that the extent of the Treasury's powers to delete will be constrained to those areas of the CRR that are necessary to implement the Basel standards and ensure the UK upholds its international commitments. Secondly, this clause ensures that the deletions the Treasury makes take place when it is clear that adequate provision has been made by the PRA to fill the space. Those deletions will also be subject to the draft affirmative procedure, providing the opportunity for Parliament to scrutinise the Treasury's actions. The clause also allows the Treasury to make consequential, supplementary and incidental deletions to parts of the CRR. This is to ensure a coherent regime across the CRR and other PRA rules, amounting to a clear prudential rulebook that industry can follow.

Further, clause 3 enables the Treasury to make transitional and savings provisions to protect cliff edges from the deletion of certain provisions on the operations of a firm. This will allow the Treasury to save permissions already granted by the PRA, to modify capital requirements and avoid the need for firms to reapply for those permissions under new PRA rules where they are being replicated in the rulebook as a result of the Bill. This clause is essential to the delivery of our international commitments, and I therefore commend it to the Committee.

Mr McFadden: I do not want to force the Minister to go over the same ground again and again, but I am just trying to fully understand this. He used a phrase something like "the clause allows for departure from the CRR in order to implement Basel", if I have understood him correctly. I am not trying to be obtuse, but I want him to explain fully to the Committee what that means. Why do we have to "depart" from the capital requirements regulation in order to implement the Basel rules? On the face of it, the list contained in clause 3 is a very wide list of things from the CRR that the Treasury is taking powers to revoke, and I am therefore trying to fully understand what the effect of this clause is. Is it just to implement Basel, or does it give a wider, ongoing power to the regulator to change capital ratios against these lines of business that are set out in the amendment? I genuinely want to understand that.

My second question is about the potential impact on risk weightings and how capital ratios can look. There is a potentially perverse effect here—almost a mathematical one. Because these things have risk weightings attached to them, if the regulator makes a decision to reduce that weighting—from 50% to 40%, for example, or whatever it is—but the bank still holds the same amount of capital against that stream of business, it has the effect of making the bank look more safe and secure, even though it does not have any more capital—even though nothing has changed.

4 pm

It is possible for the amount of overall capital held to fall and, if the risk weighting also fell, that could still make the bank look more secure, even though it had less capital than it had at the start of the process. How will the Government guard against the process of divergence against that line of business set out in the long list in clause 3(2) from resulting in that perverse effect of reducing the risk weightings and making the banks and the institutions look more secure, when actually the amount of capital that they have is the same as they had in the beginning?

John Glen: I thank the right hon. Gentleman for his points. On the first point about why we are deleting what we are deleting, we are deleting elements of the capital requirements regulation to the PRA so that it can implement the provisions of capital requirements II, which the EU is commencing, in the appropriate way for our firms—that is basically it. The EU is on a journey of implementing CRR II, and we need to do what is appropriate for our firms, as I have discussed.

Mr McFadden: And the future?

John Glen: The future in terms of the evolving rulebook of the EU and other jurisdictions and how we seek to do that here will be subject to the future regulatory framework. We cannot anticipate the future evolving regulatory direction of new directives that have not yet been written elsewhere. What we have to do is to build the right framework for origination of rules in the Treasury and from the regulators, with the right accountability framework in place.

The problem we have conceptually in this discussion is that we are coming out of an embedded relationship in which we have auto-uploaded stuff that we have discussed, crudely, elsewhere. We have a legacy set of issues over which we have not had complete control this year that we are obliged to implement, but as we approach the end of the transition period, we have to make provision for things that actually make sense and we want to do anyway, in an appropriate way.

The driver of the right hon. Gentleman's remarks— I understand why—is this desire to scrutinise the appetite for a sort of ad hoc, and I do not mean to be pejorative, but almost opportunistic, divergence, when what we are trying to do is to enable the regulator to do what is appropriate for a set of entities that will not naturally conform to the enduring direction of travel of the CRR II within the EU, because of the different nature of our firms and, as we have discussed, the different treatment of capital that is appropriate, given what they are actually doing vis-à-vis banks.

Secondly, he asked some detailed questions about risk weight.

Mr McFadden: Before the Minister moves on to the potentially perverse effects, does clause 3 simply give the regulators the powers to implement Basel 3.1, or does it give the regulator broader powers to change risk weightings against those lines of business in ways other than under Basel 3.1?

John Glen: My understanding is that the licence to operate given to the PRA is to make it consistent with Basel 3.1, in the context of the evolving rules that are being implemented elsewhere, but the notion that there is a single downloadable format of the Basel 3.1 rules in every single jurisdiction is a false proposition. Every regulator in different jurisdictions will do that in different ways. It is important, therefore, that whatever decisions they come to around the specific decisions on different entities will be published and scrutinised, such that it

[John Glen]

could be justified against the international standing and the other factors that we have put in place as a meaningful accountability framework.

I am probably close to the limit of my capacity to answer further on this point, but I am happy to reflect further and to write to the right hon. Gentleman and make it available for the Committee, to clarify anything that would be helpful to the Committee.

Question put and agreed to.

Clause 3 accordingly ordered to stand part of the Bill.

Clause 4 ordered to stand part of the Bill.

Clause 5

Prudential regulation of credit institutions etc by PRA rules

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss the following:

New clause 1—*Annual review of the CRR rules*—

"(1) The Secretary of State must, once each financial year, prepare, publish and lay before Parliament a review of the changes to CRR rules made by the PRA in the relevant financial year.

(2) The review must include an assessment of the impact of any changes to CRR

rules on—

(a) consumers;

(b) competitiveness; and

(c) the wider economy."

This new clause would require regular reviews of any departures from the current regime of capital requirements.

Mr McFadden: This is my third attempt to get the Government to commit to reporting on the impact of these measures. Clause 5 and the accompanying provisions in schedule 3 insert new part 9D into the Financial Services and Markets Act 2000. This new part 9D will empower the PRA to make changes to capital requirements regulation rules. Schedule 3 also sets out the accountability framework, which we have discussed quite a lot throughout the day.

New clause 1 is an attempt to understand and explain the effect of changing these rules. It calls for an annual review to be published of changes to the CRR rules and their impact on consumers, competitiveness and the wider economy. As with similar amendments, all of this is an attempt to ensure that we do not simply pass all these powers from the EU to UK regulators without having processes in place, making clear what the changes we are making do and giving Parliament a proper voice in debate over these matters.

As I have said in relation to other amendments that, as things stand, unless we strengthen the parliamentary side of this, we could end up having less input to these issues in the future than we do at present. All these capital rules are there for a reason. We have thrashed it out today. It is important that we have proper transparency and a full understanding of the consequences if we depart from these rules in a significant way in the future.

My hon. Friend the Member for Walthamstow described these amendments as mild. I think they are mild. None of them say even that we should not have any of these departures. They simply ask for some process to understand the effect of them, which is open to Parliament. That is what new clause 1 would do.

John Glen: I really respect the right hon. Gentleman's approach to this. It is very constructive. I accept his frustration with what I am saying, but I do respect his patience with me through this process. Each time, I will try to justify what we are doing.

This Bill enables the implementation, as the right hon. Gentleman understands, of the Basel standards. That will be done by deletion of parts of the capital requirements regulation that need to be updated, so that the PRA can make those Basel updates in their rules. As a result, we will see a split in this prudential regime, perhaps temporarily, depending on the end result of the future regulatory framework across legislation and regulatory rules.

The regime is already split in this way to an extent, with some rules for firms set directly by regulators and others contained in retained EU law or law that has originated in this Parliament, and it will continue to work in this way. However, we will seek to ensure that this is done as effectively as possible through clause 5. Clause 5 ensures that cross-references between legislation and PRA rules work properly on an ongoing basis. It also requires the PRA to publish an explanatory document outlining how it all fits together. Finally, the clause introduces schedule 3, which contains further detail to ensure that the regime works. As the elements contained in the clause help to ensure a workable framework for the UK to remain Basel-compliant, I recommend that the clause stand part of the Bill.

New clause 1 seeks to add an annual reporting requirement, as the right hon. Member for Wolverhampton South East said, for the Government to carry out and publish a review of PRA rules that implement the Basel standards, including an assessment of the impact of changes to the rules on consumers, competitiveness and the wider economy. The Bill will require the PRA to demonstrate how it has regard to several considerations: the international standards that it seeks to implement, the relative standing of the UK and the ability to finance businesses and consumers sustainably.

However, I regret that the amendment has the potential to duplicate the PRA's reporting duties. I respectfully contend that this additional annual reporting requirement is not necessary, because through the Bill the PRA will also be required to publish a summary of the purpose of the rules it makes when implementing the Basel standards and an explanation of how it has complied with its reporting duties. Furthermore, the Financial Services and Markets Act 2000 already requires the PRA to make an annual report to the Chancellor on its activities, including on the extent to which its objectives have been advanced and how it considered existing regulatory principles in discharging its functions. The Chancellor must lay that report before Parliament.

I therefore question whether the proposed review would really provide much more insight than what the current reporting arrangements already achieve. I have myself checked whether there are no reporting requirements and we are entering some sort of wild west environment, but I do not think that that is the case. The amendment duplicates efforts that are already in place. Ultimately, to require the Treasury to undertake such an assessment would undermine this delegation and the regulator's independence. I therefore ask the right hon. Gentleman not to move the amendment.

Mr McFadden: The Minister has given a pot 3 defence. I apologise for using that in-joke from this morning's session; I am happy to explain it to you later, Dr Huq. A pot 3 defence means that it is already covered. It is my pleasure not to move the amendment.

Question put and agreed to.

Clause 5 accordingly ordered to stand part of the Bill.

Schedule 3

Prudential regulation of credit institutions etc

Alison Thewliss: I beg to move amendment 40, in schedule 3, page 79, line 25, after "activities" insert

"in the UK and internationally".

This amendment would ensure the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active credit institutions and investment firms to be based or to carry on activities are considered both in terms of their UK and international activities before Part CRR rules are taken.

This is quite a modest amendment. The Bill is supposed to ensure that Scotland, the City and the rest of the UK remain internationally competitive but robustly regulated, as the sector and everyone beyond a few marketeer ideologues are looking for. The amendment seeks simply to ensure that the FCA has regard to the standing of the UK as a base for financial firms that operate internationally. It is a kind of reflection amendment. It is common sense. It is really a drafting amendment. There is not terribly much more to it.

John Glen: As I have said, the UK is committed to maintaining its high standards. We heard during evidence sessions last week that these high standards will not hinder the UK's ambition to remain an attractive place to carry out business. None the less, the Government want to ensure that our regulators have specific regard to these ambitions, particularly for international businesses, which bring jobs and innovation and, I believe, improve our economic prospects and prosperity.

The amendment aims to ensure that that is the case, and I welcome the intention, but I reassure the Committee that the Bill as drafted will deliver that. I highlight in particular to the hon. Member for Glasgow Central that subsections (1)(b) and (2) of proposed new section 144C to the 2000 Act requires the PRA to

"consider the United Kingdom's standing in relation to the other countries and territories"

that could affect where international firms

"are most likely to choose to be based or carry on activities."

I believe that that is adequate to address the concerns that have been raised.

4.15 pm

It is not entirely clear what the addition of the words in the amendment would deliver. We must be careful not to create ambiguity. The provisions as drafted are important instruction for the PRA to clearly understand the responsibility bestowed upon it. It is important that Parliament also has that clarity so that it can hold regulators to account. I am afraid that I must therefore ask the hon. Lady to withdraw her amendment.

Alison Thewliss: I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Mr McFadden: I beg to move amendment 27, in schedule 3, page 80, line 8, at end insert—

"(7) The PRA must, at least once every five years, review the provisions of this section.

(8) The Treasury must lay before Parliament a report setting out—

(a) the outcomes of this review; and

(b) any changes the Treasury proposes to make as a result of this review.

(9) The Treasury may by regulations make any changes identified in subsection (8)(b).

(10) Regulations under subsection (9) may not be made unless a draft has been laid before and approved by a resolution of each House of Parliament."

This amendment would ensure there is a review of the accountability framework for regulators once in each Parliament and give it a role in approving subsequent changes to the accountability framework.

This will be my last attempt. I have tried to get reviews after six months, one year and three years; this is the attempt at once in every Parliament. Of all the mild amendments, this has to be the mildest. Once in every Parliament, we are asking for the PRA to review the provisions of proposed new section 144C in schedule 3, and for the Treasury to lay before Parliament a report setting out the outcomes of that review and any changes that it proposes to make as a result. I really think it reasonable to expect that as a minimum, given the sensitivity and potential combustibility of the provisions, which is why we have tabled the amendment.

John Glen: On a human level, I have found this process quite challenging, because my instincts are to try to accommodate the right hon. Gentleman when he sounds so reasonable and plausible. The amendment seeks to introduce a requirement to review the PRA's accountability framework for Basel implementation and, as he said, it would require the PRA to conduct a review every five years, which is the least demanding of his requests today.

It is right to ensure that the accountability framework is fit for purpose and up to date. Indeed, that is one of the aims that we want to achieve through the Bill: flexible and agile regulation. The Bill's purpose is to enable the implementation of the Basel standards, and the international deadline for Basel 3.1 reforms is 1 January 2023. By 1 January 2023, the bulk of Basel-related rules made as a result of the Bill should therefore already be published. The accountability framework that the Bill introduces for the PRA to make rules to meet Basel requirements relates only to the implementation of the specific so-called Basel 3.1 rules and does not

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relate to the ongoing prudential regulation of financial service firms that is being considered by the future regulatory framework review. The review is consulting on the important split of responsibilities between Parliament, Government and the regulators now that the UK has left the EU.

Reflecting the wisdom of the right hon. Gentleman with respect to the value of reviews, in that context a five-year review would clearly be appropriate. However, in the current context, it would be inappropriate to ask the PRA to report on an Act of Parliament given that the Bill already includes a more appropriate reporting requirement for the PRA, as set out in proposed new section 144D, that is adapted for the CRR rules. That requirement is to publish an explanation of how the matters in the accountability framework have impacted on the PRA's rules whenever it consults on and publishes final rules to implement Basel. That will directly attend to the logic and rationale for what it has done.

The amendment would also add a new power for the Treasury in relation to the accountability framework. The Treasury already has a similar power in the Bill to add additional matters for the PRA to consider. The power proposed in the amendment goes further, allowing the Treasury to amend the list, including removing matters from it. It is not clear to me why the Treasury should ever remove, for example, the requirement for the PRA to have regard to the Basel standards. Such matters are immediately pertinent to the prudential regime and would have been agreed by Parliament through the Bill process. Therefore, the existing provisions in the accountability framework already appear to achieve the aims intended in the amendment in the best way possible and, as such, do not need to change. For those reasons, I regret to ask the right hon. Gentleman to withdraw the amendment.

Mr McFadden: Is the Minister saying that if there were a Basel 3.2 or a Basel IV process—that is quite likely, because at some point there will be a revision to the capital rules because things change and the system has to evolve—somehow the part 9D provisions cannot be used? Are they only for Basel 3.1? That is the implication of his response. I would have thought that giving the regulator powers over all those areas would be applicable to future Basel revisions and not just this one. In other words, we are not making a regulatory snapshot; we are creating a movie. This is a genuine question: the part 9D rules must be applicable to any future revisions of the Basel process, too. If so, there is a strong case for a once-in-a-Parliament review of how that is going.

John Glen: Those rules will have regard to future Basels. The reporting mechanism we have and the accountability to Parliament when those rules are published is more immediate and comprehensive. My contention is that a five-year provision would be out of date because we would have done it by then. That is why I am apprehensive about the right hon. Gentleman's suggestion.

However, within the context of the future regulatory review—I cannot be bound on the outcome of that, because it is genuinely consultative—and what would be the appropriate reporting, there is a difference between short-term reporting on a particular measure or decision and a more fundamental review of the strategic dynamics of the relationship between the regulators, which we have seen evolve over decades. On the principle, there may be the need to have something like that. I am straining to be positive and constructive in my engagement with the right hon. Gentleman.

Mr McFadden: The truth is that there is no science about what is exactly the best timetable for reviewing these things. I am not pretending that one of the various timescales that we have mooted is perfect, and there is probably a legitimate debate to be had about that. However, as the Minister has just confirmed that we have given the regulator the power to make rule changes regarding future Basel changes on an ongoing basis—I am sure he is right about that—having a review and a report on this once every five years is a reasonable timescale to say what the impact of these things has been. I therefore wish to push the amendment to a Division.

Question put, That the amendment be made.

The Committee divided: Ayes 5, Noes 10.

Division No. 5]

AYES

Creasy, Stella
McFadden, rh Mr Pat
Oppong-Asare, Abena
Smith, Jeff
Thewliss, Alison

NOES

Baldwin, Harriett
Cates, Miriam
Davies, Gareth
Glen, John
Jones, Andrew
Marson, Julie
Millar, Robin
Richardson, Angela
Rutley, David
Williams, Craig

Question accordingly negatived.

John Glen: I beg to move amendment 2, in schedule 3, page 84, line 19, leave out paragraph (b) and insert—

"(b) section 144D (explanation to accompany consultation on rules);

(c) section 144E(1) and (4) to (7) (exceptions from sections 144C and 144D)."

This amendment corrects the explanatory words in a list of provisions that apply to section 192XA rules that are not CRR rules.

This technical amendment corrects a reference to words contained in parentheses to make it clear that those words apply only to proposed new section 144D to the 2000 Act, and it adds the correct words in parentheses to the references in proposed new section 144E. The words in parentheses explain the scope of the clause.

Amendment 2 agreed to.

Schedule 3, as amended, agreed to.

Clause 6

Power to amend the Credit Rating Agencies Regulation

Question proposed, That the clause stand part of the Bill.

John Glen: The Basel standards include rules relating to credit assessments—also called external ratings—which some firms use to assign risk ratings. Risk ratings are used to determine the minimum amount of capital that must be maintained by a firm, and the right hon. Member for Wolverhampton South East has already drawn attention to this matter.

In the UK, credit ratings agencies, or CRAs, that issue credit assessments are regulated by the credit ratings agencies regulation, and the changes needed to the CRA regulation to implement Basel are minor. Consistent with the 1 January 2023 international deadline, however, the PRA has yet to issue its rules implementing the Basel 3.1 reforms, and it makes sense to consider changes to the CRA regulation as part of the wider 3.1 package of changes. Therefore, the clause gives the Treasury a power to amend the CRA regulation while requiring it to consider the Basel standards when that power is exercised. That confirms our intention to use the power only to implement changes stemming from Basel. The changes to the CRA regulation will help to ensure that the UK is fully Basel-compliant.

4.30 pm

Mr McFadden: I have a couple of questions, because credit rating agencies did not cover themselves in glory in the financial crisis, so I want to be clear about what clause 6 does and does not do with regard to them. How does the credit rating agencies regulation regulate them at the moment, and how will that be altered by the provisions in clause 6? For example, does clause 6 deal with the situation where a credit rating agency charges a fee to those who are asking for a rating and with the potential conflicts of interest involved in that process? That played out in the financial crisis, as anyone who has watched the movie "The Big Short" will have seen. The clause does talk about the regulation of the credit rating agencies, so I wonder if the Minister could explain a bit more how they are regulated and how that would be altered by the clause.

John Glen: I am happy to do my best. In terms of the changes and why they are not set out in the Bill, the changes that need to be made to the CRA regulations stem from "Basel III: Finalising post-crisis reforms"—the Basel document—which is part of the most recent Basel 3.1 package of reforms. Most of those have not been legislated for in the UK or the EU, and it makes sense to consider changes to the regulation as part of the wider implementation of the 3.1 package, which will be done through the future rules. They will be consulted on prior to the deadline.

The power to amend the regulation will be used solely to implement Basel 3.1. There are a number of minor amendments contained in that "Basel III: Finalising post-crisis reforms" document of December 2017. The two eligibility criteria that credit rating agencies need to satisfy are added. The power in clause 6 safeguards that intent as it requires the Treasury to have regard to the standards rather than making other amendments for unrelated reasons.

In terms of the other limited changes made in schedule 4 as part of the implementation of the UK regime equivalent to the EU's second capital requirements regulation, they again relate to earlier Basel III standards. I do not think I can answer with enough specificity to do justice to the right hon. Gentleman, so I think I will need to write to him on this matter.

In what I have said, I hope that I have explained the confines and drivers of the reform; the powers that we are giving to the regulator; and the consistency with which they will be exercised to the Basel 3.1 proposal. I have previously spoken about accountability for that. I need to write to the right hon. Gentleman to give more clarity, and I am happy to address the issue at further stages in the Bill's passage.

Question put and agreed to.

Clause 6 accordingly ordered to stand part of the Bill.

Clause 7 ordered to stand part of the Bill.

Schedule 4

Amendments of the Capital Requirements Regulation

John Glen: I beg to move amendment 32, in schedule 4, page 89, line 11, at end insert—

"11A (1) Article 500d (temporary calculation of exposure value of regular-way purchases and sales awaiting settlement in view of COVID-19 pandemic) is amended as follows.

(2) In the heading, omit 'Temporary'.

(3) In paragraph 1, omit 'until 27 June 2021,'."

This amendment removes the time limit on the availability of the derogation under Article 500d of the Capital Requirements Regulation.

This is a minor amendment. In 2017, as I mentioned, the Basel Committee on Banking Supervision introduced favourable treatment for firms in how they calculate the leverage ratio. The EU was due to introduce that treatment through its second capital requirements regulation on 28 June 2021. Given that the revised calculation will reflect the leverage of a transaction more appropriately, and at the same time increase the capacity of an institution to lend and to absorb losses amid the covid-19 pandemic, the EU brought this provision forward through a derogation to the first capital requirements regulation that is currently in effect. The UK supported that approach. This derogation is time-limited in the EU to 28 June 2021, as that is when the relevant EU CRR II comes into force, which will put in place the new permanent provisions on leverage ratio.

As the Committee will be aware, the European Union (Withdrawal) Act 2018 provides that EU law, as it is in effect at the end of the transition, will continue to apply in the UK. This means that the first capital requirements regulation as it exists on 31 December will remain in place in the UK until it is amended by this Bill. That means that the derogation would also cease to have effect in the UK on 28 June 2021, because we will have adopted it on the terms that it is now live in the EU. The UK has not legislated a date by which to update its prudential regime in this Bill, because it is most important that our regulators get the rules right and have enough time to consult and finalise them, and also to minimise disruption.

The UK is targeting 1 January 2022 for firms to have implemented the PRA CRR rules. This decision was made after introduction of the Bill, in response to industry concerns about the general volume of regulatory reform in 2021. I referred earlier to the future regulatory

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framework review. The first stage of that was a piece of work that the Treasury did with industry and the regulators following Chancellor Hammond's work 18 months ago, which sought to rationalise and understand the range of regulatory interventions that were ongoing.

UK financial services providers would have to revert to the previous rules from June for a period of approximately six months, which would be costly for industry and inconsistent with the EU regime during that period. This amendment therefore removes the time limit on the derogation, so it will remain in place until the new permanent provisions are in place in the UK, giving clarity and certainty, and not seeking to cause disruption. That is why I ask hon. Members to accept this amendment.

Mr McFadden: Can I ask a question about this? The Minister said that the leverage ratio had been changed so that institutions could lend more. I assume that means it is being reduced as a temporary measure during the covid crisis. He then said that, while at EU level that was to be for six months, the UK had not decided when such a change should end. The implication is that we are allowing a reduction in the leverage ratio without an end date. That is potentially very significant in terms of the discussions that we have had about capital today.

I appreciate that it is late in the afternoon and all the rest, but having listened to the Minister, and given how sensitive this issue of leverage ratio is—how can I best put this?—I would be grateful if he could undertake to write to the Committee with more detail on how this will operate. A permanent or long-term reduction in the leverage ratio would be a very big regulatory decision and would be precisely the kind of thing that we have been talking about all day, and precisely the kind of thing that we have been saying should have proper reports back, which those on the Government Benches have been resisting all day. I would like to find out more about what exactly this means and how long it will last for.

John Glen: To the right hon. Gentleman's point, the UK has not legislated a date by which to update the prudential regime in this Bill, because it is most important that our regulators get the rules right. On the amendment made for the covid crisis that we have aligned to, which essentially ends next year, he is asking about the potential for us not to end it and therefore to be at odds with the prevailing new situation in the EU after 28 June.

Mr McFadden: It is not an EU point.

John Glen: Well, whatever the enduring reversion environment is in the EU following the end of this special measure. I will be happy to write to the right hon. Gentleman on that, but the key point is this: it would not be appropriate for the UK to determine where we would be beyond 28 June in advance of the regulator's looking at those matters, when at the same time the EU's definitive position at the end of June is not yet known. I will write to him, because I recognise that he is saying that he is apprehensive about the fact that we will have an apparent 18-month period from next June until January 2022 where we are at odds with the prevailing norms, and that is a risk. If I have understood him correctly, I am happy to address that point.

Mr McFadden: I am grateful to the Minister, but it is not an EU alignment point that I am making. He is right that, yes, this has arisen because of a disalignment with the EU, but my point is not that we have to always look at this through the lens of being aligned with the EU on capital requirements. I am talking about a public safety point; I am talking about a UK regulator taking a view on the leverage ratio, not necessarily in the light of what the EU is doing after June, but precisely because of all the points we have been making about the importance of capital after the financial crisis.

John Glen: I am happy to restate what I said. We have inherited an environment and indeed we have been obliged—quite reasonably—to absorb into law where the EU has got to at the end of the transition period. My point is that, in order to get the right enduring solution for our capital requirements for the UK, as it is in the UK, we have to allow a regulator to do that work.

The point the right hon. Gentleman is making is about the potential deviation of that enduring solution, and the gap between its implementation and the capital requirements that are normative globally, next June. I will undertake to clarify how we consider, in essence, the trade-off between that potential deviation and the disruption to firms. However, what I have tried to convey throughout today's proceedings is that our desire is not to deregulate or to deviate from international norms, but to set out a UK framework that is necessary and appropriate for the institutions that exist in the UK.

The Chair: So the letter will be on its way to the whole Committee?

John Glen: Yes. I am very happy to confirm that that communication will be made available to the whole Committee.

Amendment 32 agreed to.

Schedule 4, as amended, agreed to.

Ordered, That further consideration be now adjourned.—*(David Rutley.)*

4.43 pm

Adjourned till Thursday 26 November at half-past Eleven o'clock.

Written evidence reported to the House

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