

HOUSE OF LORDS  
HOUSE OF COMMONS  
ORAL EVIDENCE  
TAKEN BEFORE THE  
JOINT COMMITTEE ON THE DRAFT FINANCIAL SERVICES BILL

THURSDAY 20 OCTOBER 2011

MR RUSSELL COLLINS, MR GUY MATTHEWS, MR ADAM PHILLIPS and SIR  
ANTHONY HOLLAND

MR MARK LYONETTE, MR MARTIN SHAW, MR JEREMY PALMER, MR STEVE  
GAY and MR NICK CANN

ANDRÉ VILLENEUVE

Evidence heard in Private

Questions 438 – 557

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## Oral Evidence

Taken before the Joint Committee on the Draft Financial Services Bill

on Thursday 20 October 2011

Members present:

Mr Peter Lilley (Chair)  
Mr Nicholas Brown  
Mr David Laws  
Lord Maples  
Lord Newby  
Mr David Ruffley  
Lord Skidelsky  
Baroness Wheatcroft

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**Examination of Witnesses**

*Witnesses:* **Mr Russell Collins**, Chairman, Financial Services Practitioner Panel, **Mr Guy Matthews**, Chairman, FSA Smaller Businesses Practitioner Panel, **Mr Adam Phillips**, Chairman, Financial Services Consumer Panel, and **Sir Anthony Holland**, Complaints Commissioner, examined.

**Q438 Chairman:** Good morning, gentlemen. Welcome to the meeting of the Joint Committee of both Houses scrutinising the draft Financial Services Bill. I particularly welcome our witnesses this morning. We are very grateful to you all for attending. Would you be kind enough to introduce yourselves, starting from my left?

**Mr Collins:** My name is Russell Collins. I am the current Chairman of the Financial Services Practitioner Panel.

**Mr Matthews:** I am Guy Matthews. I am the Chairman of the Smaller Businesses Practitioner Panel.

**Mr Phillips:** I am Adam Phillips. I chair the Financial Services Consumer Panel.

**Sir Anthony Holland:** Tony Holland. I am the Complaints Commissioner.

**Q439 Lord Skidelsky:** Concerns have been expressed about the financial stability objective of the FPC and alternatives have been suggested. Barclays has suggested that the objective should be to maintain a sustainable supply of credit and HSBC has suggested a stable and sustainable supply of finance to the economy, as possible more specific alternatives. Do you think it would be helpful to have a more specific statement of objectives for the FPC? What are your views on the suggestions provided by Barclays and HSBC?

Two things follow from that. First of all, leaving aside the question of how you define an adequate and sustainable supply of credit, can one do that in any way that makes sense? Secondly and particularly to Guy Matthews, do you think there is already an adequate supply of credit to small businesses? Do you think the objectives of the FPC would improve that situation? This has been one of the perennial complaints: that small businesses are starved of credit.

**Mr Matthews:** You make an extremely good point. As you stated, the credit supply to smaller businesses has been a problem with the economic backdrop. The overall requirement

of the FPC to focus on financial stability is an understood concept but very difficult to measure. One of the aspects of that is proportionate regulation. The view to have an overriding aspect on financial stability needs to be proportionate in how it is overlaid and the impacts on smaller businesses and consumers. It is a much wider remit that is required. Going back, financial stability is a difficult concept to measure. It is an understood concept, but if you start to bring in having regard to diversity or competitiveness and other aspects, that would be something we would consider.

**Q440 Lord Skidelsky:** Would it be helpful or not?

*Mr Matthews:* It is a difficult basis. If financial stability is the focus, if you have other regards to competitiveness and other aspects then those things would help the overall Bill.

**Q441 Lord Skidelsky:** In general, what would the witnesses think about making the objective a bit more specific, which is to include an adequate supply of credit as one of the remits?

*Mr Phillips:* One of the existing difficulties is that the FSA only regulates deposit taking. Unsecured lending to companies and consumers is regulated through the Office of Fair Trading. If credit regulation comes to the FCA, it would be a very good idea to have a somewhat broader objective, but at the moment it would not be something that they could necessarily do very much about.

The reason I make this point is because we have about £1 trillion of unsecured lending to consumers, which is a very important aspect in driving the economy—the way that consumers spend their money. In my view that should be under regulation. That is best done through conduct, through the FCA, rather than by prudential measures. In unsecured lending the interest rates are already very high. It is the ability of firms to extend credit to their customers and the length of the repayment terms which affects the affordability of the credit.

*Mr Collins:* From the Practitioner Panel point of view, when we discussed this we preferred one overriding objective of financial stability, which resonates well with the people on our panel. We do a survey every two years of the regulated firms. In the last survey, which was published earlier this year, 84% of the firms supported strong regulation for the benefit of the industry as a whole. The financial stability objective brings that together. We also think that the reference to not doing things that would adversely affect the growth of the economy probably does capture these issues.

Having said that, we are concerned that work does need to be done to define “financial stability” as far as we can; otherwise we will find ourselves arguing about that definition. If measures such as the supply of credit or others can be introduced as indicators, yes, we would support that but we think it is broadly covered by the overall terms at the moment.

*Mr Phillips:* I would, however, like to add to what Russell has said. From our perspective we think that the focus on the capacity of the financial sector to contribute to the growth of the UK economy is too narrow a focus. This is such a powerful group that they should look at the impact of their actions on the growth of the UK economy, not just the financial sector. We feel they should have to take that into account.

**Q442 Baroness Wheatcroft:** I am interested in the make-up of the FPC, which is going to have huge input into the new system. Are you confident that the balance is right between executive and non-executive on the FPC? Do you have views on that?

*Mr Collins:* No, we are not confident at the moment. We have quite strong views that the balance should be shifted more towards independent members. We would like to see as wide a variety as possible of relevant expertise from parts of industry in that group. We are moving into somewhat uncertain territory with macro-prudential and new tools. We want to

see the experience and expertise of people who can work out how that is likely to pan out in the industry, available to the FPC. We would strongly support that.

**Q443 Baroness Wheatcroft:** Mr Matthews and other members, do you agree with that?

*Mr Matthews:* Certainly, again, our panel has endorsed the basis that the current power, with the Bank of England's overall position within this regulatory system, is overpowering. There should be checks and balances and a wider and more informed membership taking account of all aspects, consumers and smaller businesses. That is certainly something that we would support.

**Q444 Baroness Wheatcroft:** That would be, presumably, a majority of non-executive members?

*Mr Matthews:* Correct.

*Mr Phillips:* We would have the same view, which is a majority of non-Bank members of the FPC. We question whether there need be quite so many people from the Bank on the FPC as currently proposed.

**Q445 Baroness Wheatcroft:** Because they have input anyhow.

*Mr Phillips:* Yes, absolutely. We also think that there needs to be diversity on this group, because if it is simply cast as a group of economists working on the stability of the economy there is a possibility for its decisions to bear very heavily on small sectors of the population. This really is an issue where people with a wider perspective need to be engaged in the discussions. We have no doubt that at a time of crisis they would vote together, but most of the time we hope it will be a benign environment where their decisions could have a major impact on the future development of the UK.

**Q446 Baroness Wheatcroft:** That is interesting; thank you. Sir Anthony, this is probably not something that concerns you?

*Sir Anthony Holland:* No. I don't think I can help on this particular issue. I am concerned more with complaints.

**Q447 Baroness Wheatcroft:** But you are perhaps on the next question, which really leads on. I am interested in the PRA, which is going to have a duty to engage with the outside world but not with the Practitioner Panel. I would like to hear your views on that. Some of your submissions have made clear that you are not entirely happy about that.

*Mr Collins:* If I could start, we believe that there should be a requirement for a statutory panel for the PRA. We would envisage that would have common membership with the FCA Panel. There are a number of advantages to that. There is the straightforward one that it provides a regular means for engagement. The members of all the panels, but particularly the Practitioner Panel, come from the senior ranks of all parts of industry. We don't look at one sector: we look across the whole industry. We have also historically looked at conduct and prudential regulation. There are some significant benefits to improve the co-ordination between the FCA and the PRA that could be gained by having a group of practitioners who look at this.

By way of an example, we all have concerns about the way the regulator is willing to face with Europe and internationally. One of the jobs of a panel like this is to remind the regulators early in the process, early in the development of initiatives, what the impact would be as it applies to other international regulations. We are quite strongly in favour of this.

We are not suggesting at the moment that this is in any way a panel to whom the PRA would be accountable. We see it as an engagement, a consultation. In other words, it is broadly a continuation of the current role of the panel.

**Q448 Baroness Wheatcroft:** I confess I didn't really understand the Bank's reasoning for not continuing it.

**Mr Collins:** They made two points. They said it is a form of accountability with which they don't agree. Currently we are an advisory body. We send our thoughts to the board of the FSA and they consider them. If we felt that they were really not taking us seriously and not listening, we would put it in our annual report and we would make a public statement to that effect. That is broadly what this equivalent Committee designed when the Financial Services and Markets Act influenced the input of the current panel. We see that as an advisory body. They make a reference to previous self-regulatory organisations. I think that is ancient history. The panel we are talking about here came into being when the Financial Services and Markets Act came in. I am afraid I don't fully understand their arguments either.

**Mr Matthews:** There is not much more to add to Russell's comments. Certainly our view is that the smaller businesses on the PRA will still represent the majority of the firms—the smaller credit unions, mutuals and small deposit takers. This co-ordination and the cost of burden are across the twin peaks. We question the basis of twin peaks and the weaknesses that are created. As to the complexity that we are now talking about—the underlaps and overlaps of the regulatory system—the panel would help in this co-ordination across the two panels and see how it works in practice.

**Mr Phillips:** If I could add to that, there is a perception—at least that is the way it appears to come from the Bank—that the consumer interest is really only represented at the FCA and it is not relevant to the PRA. In our current single regulatory structure we have been having serious discussions with the FSA about the mortgage market review and the balance between conduct and prudential regulation in order to deliver the best market. In their recent guidance which they put out on forbearance, we had a long discussion with the prudential side—the shadow PRA in effect—about what they were proposing to do and how we could make that work in the best possible way, both for them and for consumers. The inability of us to make those representations to the PRA would be a significant weakening of the quality of the input into their decisions.

**Q449 Baroness Wheatcroft:** There is nothing to say that they would not listen to representations, or indeed seek them. This just does away with the formal structure, is that right?

**Mr Phillips:** In the current structure, the panels get access to the agendas of the board and the major executive committees, so we can be aware of the issues that are being discussed and make our input at an appropriate time, before the decision is taken. We would not necessarily have that access if we were waiting for the PRA to contact us.

**Q450 Baroness Wheatcroft:** That seems a step in the wrong direction, with respect. Sir Anthony, do you think these proposals would actually lead to more potential complaints?

**Sir Anthony Holland:** I am sure they will. The present arrangements as proposed will be rather difficult to implement in practice. It reminds me very much, having had some experience of the railway industry in consideration to complaints, of the situation that arises between Railtrack as was—now it is Network Rail—and the train operating companies. There are complaints, and people know what has happened. The end result is that the consumer suffers. What is going to happen here is that, first of all, there is this enormous overlap by a number of bodies, each doing different things. If you have a complaint, for example, against

the FCA, they may use as a partial explanation the policy of the PRA, who would have a different Complaints Commissioner, not truly independent. As you may remember, the last Joint Committee in this very room 13 years ago insisted that there should be an independent complaints system. You will not have that in the context of the PRA. You will have it in the context of the FCA, but if the FCA use, as part of their cover for what they did or did not do, a policy of the PRA, who in turn may blame the FPC, I can see there being problems.

In addition you have the implications of what is called section 348, and the issue of confidentiality. As it happens at the moment, the FSA can say to a complainant, “Well, we can’t tell you what we did when you made a complaint about a particular activity.” However, I can actually see what they did. I can examine in great detail what they did. I can then report to the complainant, in not such great detail, but having said that I have seen it, exactly what happened. However, in the current arrangements as proposed the PRA could use as against the FCA the section 348 principle. The FCA might be quite happy to tell me what happened and I could see that, but the PRA may use a curtain and say, “We are not prepared to tell the Complaints Commissioner via the FCA what happened because of the section 348 implications.”

This confidentiality issue is quite important if you want a truly independent complaints system. That brings me back to my particular point, which I said in my evidence to this Committee. The separation of a complaints system between the PRA and the FCA will lead to less transparency, not more. It will create more problems for the FCA and it will also mean that you cannot truly say that the system is a stand-alone independent one, which you can say it is at the moment.

**Q451 Baroness Wheatcroft:** Can you see any advantages in it?

**Sir Anthony Holland:** In what is proposed?

**Baroness Wheatcroft:** Yes.

**Sir Anthony Holland:** No, I can’t actually. I can see from the Bank of England’s perspective that it is much better of course to have this curtain and this protection, but from the consumer’s point of view and indeed from the industry’s point of view—and remember this original idea of a Complaints Commissioner stemmed from the industry’s need to feel that if these vast powers are being given there needs to be some protection for the industry—they will not feel particularly protected either. I do not think the current arrangements as proposed in the draft Bill represent a fair deal either for the consumer or indeed for the industry.

**Q452 Baroness Wheatcroft:** And potentially it represents more cost?

**Sir Anthony Holland:** It is bound to involve more cost, because you have my system which runs fairly modestly and has been at the same level in budgetary terms of about half a million for the last 10 years, or since I have been there, for the last seven years, whereas you are going to have another system for the PRA. Indeed, the interrelationship between the PRA and the FCA in dealing with a particular complaint that covers both areas or both activities will in turn lead to greater costs, both in terms of the bodies themselves and in the fact that you have to duplicate what I am doing.

**Baroness Wheatcroft:** Thank you; that is very helpful.

**Q453 Mr Brown:** We have touched on some of these issues. My questions are directed at Sir Anthony. You were kind enough to send us a written submission in response to our original call for evidence. You sent us this diagram, which makes your point very well. What is the remedy?

**Sir Anthony Holland:** People say, “He would say that, wouldn’t he?” but that doesn’t apply because I finish my particular role in about 18 months time so it won’t impact upon me. My own view is that you ought to have it combined in one operation. I cannot see any advantage in separating it except, of course, that the Bank of England would much prefer not to have someone like me digging around in their activities, because they operate in a particular way. I cannot see anything but a simple benefit of having one body to do it.

**Q454 Mr Brown:** It is probably important to all the other citizens involved in this. Could you say something to us about transparency versus commercial confidentiality?

**Sir Anthony Holland:** Yes. To be perfectly honest, I always find the FSA very helpful in telling me what I want. When I first went there, whatever had gone before had not been entirely successful, if I can put it like that. I said to the FSA that as far as I could see any complaint system has to operate on the basis that the person doing the investigation is there to help the person complained about improve their performance. That is the object of the exercise, both in terms of its response to the industry and indeed consumer. That has worked very well. I have always gone to the board. I have told them where I think things were going wrong or going right. Certainly in my view there has been a rapid improvement over, initially the first three years and since then over the last four years. I have been there seven years.

If you have a system whereby both parties appreciate that what you are trying to do is to improve the performance of both the body of the FCA and the PRA, it will work very well. But if you have a defensive attitude, which can creep in very easily—“We have got it our way and we don’t want to change that”—that is a problem for the consumer. This is where section 348 comes in on this question of transparency. If you are going to give to the FCA a consumer-championship role, although that is not the word used in the proposed legislation, you have to be able to show them that in fact with transparency they are performing their role in that context. The only way you can do that is to have one independent Commissioner, in my view, who is able to get at everything that went on but then you have to rely upon him to use his discretion in what he discloses to the complainant.

**Q455 Mr Brown:** As you know, this is a pre-legislative scrutiny exercise and we can make recommendations. Should we be seeking to recommend amending the Bill to reflect the points that you are making to us?

**Sir Anthony Holland:** In a word, yes.

**Q456 Mr Brown:** What do you think about consumer protection more generally in the current structure?

**Sir Anthony Holland:** You have of course the FOS which deals with the issue of consumer protection.

**Q457 Mr Brown:** Is it strong enough? Will it work?

**Sir Anthony Holland:** It is strong, in the sense that it covers up to £150K, or will do, and it does not operate a system which is what the law provides. It is on a “fair and reasonable” basis when it comes to a decision now. There is more to consumer protection than just providing a remedy for a particular mis-selling operation. You have to have regard to the products themselves. The issue is, do you start to regulate the products before they are sold, as happens on the continent? That is quite a tricky area, because you are inhibiting freedom of choice and so on. There is a balance to be struck, but what is currently proposed does need improvement.

**Q458 Mr Brown:** We have heard different views on that point. Do any of the other people giving evidence want to say anything to us on that?

**Mr Phillips:** From the Consumer Panel's perspective, I have already made the point that there are areas that the PRA will be dealing with—specifically mortgages and insurance—where an input of the consumer interest, shall we say, will be helpful to the quality of the decisions. Certainly the FSA have found it useful. It is not clear in the current structure that there will be any need to take account of that. It will depend very much on the people who are involved asking for advice.

One of the advantages of all three panels is that we get quite closely involved in the early stages of the development of regulation. We have the ability, because we are reasonably expert in our areas, to bring alternative perspectives to the same problem. Very much like this Committee is doing, there is a pre-discussion about whether the approach is a good approach and whether other approaches might be tried. It would be a pity if that is not written across into the new structure so that there is the possibility for this external input to operate.

One of the PRA's objectives should be to take account of the impact of its actions on consumers. There will be issues particularly relating to activities regarding mortgages but also to life assurance, that are really important.

**Q459 Chairman:** Do other witnesses have views on that issue of whether the PRA should have regard to the impact of policies on consumers?

**Mr Collins:** From the Practitioner Panel we have our own request, which is that it should have regard to the international competitiveness of the UK financial services industry. That just reflects our perspective. On one specific issue we can see that the PRA will be involved in consumer protection, which is around the insurance and policyholder area. We think that would be an area where they need to have regard to that.

**Mr Matthews:** The fact is that certainly the widening of that objective is helpful: looking at competitiveness and looking at the consumer. If you have a slightly wider objective, that would be helpful.

**Q460 Chairman:** Though quite often it has been put to us that an emphasis on consumer protection has an adverse effect on competitiveness of the industry. Would that be a view you share?

**Mr Phillips:** If you couch it in the terms of consumer protection that is not an unreasonable view. It implies a level of regulatory intervention which is not what we are looking for. What we are looking for is a positive impact, as Sir Anthony was talking about, for both the industry and the consumer. It is the case that if you are involved in prudential regulation, to make a strong and stable industry you may not have to take as much account of what that does to the consumer in times of stress as we are seeing now as might be seen to be appropriate if you take a wider perspective. It is the ability to pay regard to the impact of your actions which is important, as we have seen with the FSA and the industry with forbearance in the mortgage market at the present time where repossessions are much, much lower than they were 15 years ago.

**Sir Anthony Holland:** Can I just add one further relevant point? Don't forget that the bodies concerned, both the FCA and the PRA, will have legal immunity for anything to do with negligence, mistakes, lack of care, etcetera. Having been given that, in my view the sine qua non following on from that is that you must have a really independent system. It is this lack of transparency that worries me. Indeed the Burns Committee, sitting here in the same room 13 years ago, said that you have to have that. With legal immunity you must also have some independent complaints system which stands, is transparent and is seen to be consumer friendly.

**Mr Collins:** From the Practitioner Panel's point of view, we would support the idea of one complaints system across the PRA and the FPC. We do like the idea of a straightforward financial stability objective for the PRA, but we also support the idea that they should have regard to the wider considerations.

**Q461 Lord Newby:** This is a question initially to Sir Anthony about complaints and compensation. At the moment when complaints are upheld there is no right to compensation; it is done on an ex gratia basis by the FSA. What are your views about the way that system works? Do you think that the Bill should contain any provisions around that issue?

**Sir Anthony Holland:** It is a Pandora's box that I really don't want to open up, as you probably saw in the evidence I submitted last time when this debate was had in the House of Commons. The difficulty is that if you allow the bodies concerned to be exposed to claims for liability and damages, in the normal way that the civil law operates, that is being funded by the industry, and therefore indirectly and in turn by the consumer. You can get substantial amounts of damages awarded. What has happened has been a fudge really over the past 13 or 14 years. The Law Commission under Paper 187 looked at this in great detail and published a vast tome about what you do about damages against administrative bodies when the citizen needs to have redress against those bodies. They came down in the end to a similar kind of fudge—that if you have direct and clear liability then there are serious issues about the volume of damages that can be awarded as well as a ghastly thing called causation. What actually caused the loss? Was it the initial act of negligence or did something happen in between when the person suffered the final loss which actually prevents the body being held responsible for that loss?

Once you go down that road it is a lawyer's paradise. I am no longer practising, so I can say this. The lawyers love it. It is a real opportunity to pile in there and make things really complicated. I don't think you can have that. You have to have something like we've got now, which is compensatory awards—and the word “compensatory” has never been defined by the courts—which are ex gratia. First of all, the definition of how you calculate the damage is not in accordance with the common law calculation. Secondly, it may depend upon the interpretation placed upon it by Strasbourg under the Human Rights Act. Then it is ex gratia, because it depends upon whether the body concerned—the FSA now, but it will be the FCA—wants to pay up. All the awards I have made have always been honoured by the FSA. There are times I could have made quite substantial awards. I don't take evidence on oath, so it seemed to me there was a break in the chain of causation which prevented me from coming to a final decision about making a large award. The current fudge is about as good as you are going to get.

**Q462 Lord Newby:** Have there been many complaints about the current system? When you have not made an award, for example, have there been many cases where people have felt really aggrieved and that there should have been greater redress?

**Sir Anthony Holland:** Yes, they do feel sometimes that I am not being very generous but by and large their main complaint, which we come back to time and time again, is that it is not transparent enough. The FSA has used section 348. I have seen everything. I tell them I have seen everything. I try to get them to rely upon my goodwill and integrity that I have seen everything and I have come to the view that the FSA did do the right thing. They usually complain that I would say that, wouldn't I? But the complaint about the level of damages is not as frequent as it might have been. It may be because I explain fairly early on in the negotiations and the correspondence that my powers are limited. That seems to be understood by them. They may not agree with it, of course, and certainly the debate that took place in the

House of Commons last time round was a bit disingenuous as to what was going to happen because it never did actually happen as was portrayed.

**Mr Phillips:** Since Sir Anthony has raised the section 348 constraints that are imposed on the FSA, they bear very hard in terms of forcing the regulator to be non-transparent. I have received several complaints in my term from consumers. Although we don't take complaints from individual consumers they do still complain to us about their assurance from the Complaints Commissioner that the FSA has done a reasonable job, but no evidence about what the follow-up has been by the FSA. For example, if they believe there has been mis-selling and the FSA will not tell them what action they have taken other than for them personally. The Complaints Commissioner cannot tell them either. All he can do is say, "I think the action of the FSA was appropriate." We believe that section 348 should be modified to allow the FSA, in pursuit of its regulatory purpose, to release information which would help that purpose. This is a particular area where that easement would be very useful.

**Q463 Chairman:** Could you give us your views on whether the Bill should create a presumption in favour of the early publication of disciplinary action? For instance, in the case where the FCA or PRA have issued a warning notice in relation to a proposed disciplinary action should there be a presumption that this will be publicised?

**Mr Phillips:** Perhaps I should go first, because I am sure the practitioners will have a slightly different view from my own. The term "warning notice" is slightly misleading. What in fact happens is that if the FSA decides that a company has, in their view, broken the rules and they report this to the Regulatory Decisions Committee and the that committee decides that this breach is likely to be contested, which is many of them, then they institute an independent investigation to report on whether the independent investigators think that there has been a breach of the rules. That report goes to the Regulatory Decisions Committee, and if they decide that it seems to be fairly conclusive that there is likely to have been a breach they issue a warning notice. At this point the company, the organisation or individual is able to make its own representations to the committee.

From that point it can typically take nine to 18 months before a decision notice is issued. At that stage the outcome will become public. During this period of time, which can be a year-and-a-half, no one knows what is happening. We think, given there is an independent investigation that decides that there is a case to answer, the publication of a warning notice is very similar to a committal in a criminal activity. It is also not dissimilar to what happens with the Securities and Exchange Commission in the United States. It should be published except in exceptional circumstances and where there may be good reason not to do so.

**Mr Collins:** From the practitioners' point of view we do have some reservations about this, as I think you would expect. The fact of the matter is that, if there were publication of early warning notices with the name of the firm involved, then there would be publicity and concerns around the firm's reputation before the firm had had a full chance to defend itself and any guilt had been proved. We would draw attention to the fact that quite a significant proportion of the final notices are different from the original notices, so in quite a number of cases firms would have suffered reputational damage and then subsequently found to have been acting correctly. In some cases consumers might take action on the basis of the early warning notice that a product was not appropriate and then subsequently find that it was safe.

I am personally not a lawyer and I do not know if it is practical, but our suggestion in this regard is to not publish the name of the firm. The FSA and the new regulators should find a way to make public their concerns in a way that would not damage the reputation of an individual firm. We can see that as a perfectly valid regulatory tool. As Adam says, there is sometimes a long period to wait for the final outcome.

**Mr Phillips:** If I might come back on that, this happened with four mortgage advisers a couple of years ago. It was announced that four advisers had been mis-selling mortgages. It then took nearly nine months before anybody knew who they were. It cast a blight on the industry, because clearly there was some problem, but nobody knew who the people were. Perhaps it might give the industry some comfort if there was the ability to have an independent review before the warning notice was issued, so that the process could be examined to make sure that it was reasonable.

**Q464 Lord Skidelsky:** Is there any way of speeding up the process and therefore reducing the period of uncertainty? Why does it take up to 18 months?

**Mr Phillips:** Lawyers.

**Sir Anthony Holland:** I can perhaps help on this. It will take that sort of time if there is a lot of money involved, a lot of possible mis-selling, if PI insurance is involved and so on. That is what takes the time. I can give you my view about this question of publicity. It is a really tricky area. It is a very fine line, and there is a very fine judgment to be made. This is a civil matter, not a criminal matter, for a start. That means that you cannot precisely compare it to a committal proceeding. Secondly, it is a regulatory matter which determines people's livelihoods and people's jobs and so on. Publishing it before you have reached finality in relation to what actually happened does run the risk—and everyone has to accept that—that in the interests of consumer protection (a) there may be no guilt and (b) that people's jobs and/or security may be affected. It is a very fine line to draw. It is not very helpful to tell you that, but from a legal perspective it is, probably on balance, a decision that most lawyers would say "Don't publish until you have reached some kind of finality." That is purely a personal opinion.

**Q465 Lord Maples:** Following up this point, we had some witnesses about two weeks ago who were consumer representatives of one sort or another. They made two points to us. One was that the FSA allowed the payment protection insurance mis-selling, or whatever one wants to call it, to run for months without either banning it or publicising what was going on, and in that process lots of people were mis-sold this insurance. Secondly, one of them said that another FSA—the Food Standards Agency—regularly bans products and publicises what it has banned. It does not ruin people's reputations; they are taken off the shelves and stopped. But the FSA does not seem to want to do that. You all seem slightly reluctant to let it do so. Might there not be cases where it would be appropriate for the FSA, or its successor body, to say, "We are not going to allow people to sell that"?

**Mr Phillips:** Absolutely. We would very much like to see them being able to do that. The industry fights tooth and claw where the FSA tries to do that. We have seen with payment protection insurance that they went to judicial review over whether the concept of treating their customers fairly was being reasonably defined by the FSA, even though the FSA had consulted on the fact and had published the results of its consultation. That caused part of this delay.

As Sir Anthony has pointed out, the Financial Services and Markets Act constrains the FSA in ways that the Food Standards Agency is not constrained. When the payment protection super-complaint came from the Citizens Advice Bureau in 2005 it goes to the OFT; it does not go to the FSA. The OFT starts off by asking the FSA to answer the complaint. There was then a discussion about who had the power to do a competitive investigation because this looked like a market failure, and that is the OFT and the Competition Commission which introduced further delays. We believed at the time that the FSA should have stepped in, using the principle of treating customers fairly which in fact resolved a lot of this towards the end, and it would have sorted things out two or three years earlier.

What would help in the new Bill is to make it very clear about the competitive responsibilities of the FCA. We would like them to have concurrent powers similar to other regulators, which would give them the lead on competitive activity in such a situation where a super-complaint comes in. Of course the Competition Commission would be there, but in the financial services market they can be quite competitive without necessarily delivering good value to the customer, as the Vickers Independent Commission on Banking pointed out. The ability to use the tools which the FCA will have in order to encourage effective competition means that we think they should be given concurrent powers and they should be the lead regulator in this area.

**Sir Anthony Holland:** Can I try and cut through an issue here which may be confusing everybody? You have the product and then you have how it is sold. If one is talking about forewarning difficulties about the product—whether it is PPI, pensions or whatever—that is one issue. As much advance warning as you can give there from the consumer's point of view, the better. How that product is sold is an individual responsibility of the particular person engaged in selling that product. That is a separate issue. I suspect all of us probably agree that when you have a product that looks as though it is going to be causing consumer loss and damage, then it is very important that there should be a rapid response. But how it is being sold, which in turn may make it a dangerous product when it would normally be a safe product, is where you have this very fine line to draw. I don't know if that helps or not.

**Q466 Lord Maples:** Isn't the issue likely to be that the product of itself—it isn't like the Food Standards Agency, I agree with you, where it might poison you—may be very suitable for some people and totally unsuitable for others? The two issues do necessarily become entangled, it seems to me.

**Sir Anthony Holland:** They can become entangled. PPI is a beautiful example. I could think of very few occasions, speaking personally, when I can envisage PPI being a good deal for anybody, because of the way the conditions were imposed. If you changed the conditions, of course, then suddenly it might become a reasonable product. It is entangled. You have the product; the conditions you impose with it; how far they relate to the person to whom it is being sold; and then, was the sale suitable for that particular individual? Those four aspects can cause enormous confusion.

**Q467 Chairman:** We have a different view from this end of the table.

**Mr Matthews:** The question was really the presumption of an early warning notice. As you can see, it is finely balanced as to whether you actually announce this. There are a lot of aspects. In relation to the appropriate decision and when to use it, of course early warning notices have their appropriate time and place to be used. It depends sometimes on the complexity of the issue. There is also the undermining of the confidence of the financial system and consumer behaviour. Making an announcement which for a consumer may be ill-informed may result in detriment to consumers. There are all these aspects. We talk on product intervention. That is one of the powers that is being proposed for the new regulator, so there are those aspects. Certainly for the smaller businesses, there must be enough checks and balances that are used in the most appropriate circumstances and there is not this presumption that it will be used.

**Mr Phillips:** I would just like to say again though that one of the issues here is confidence in the regulatory system. The fact that the police are taking action to arrest criminals, that they are discouraging people from speeding too fast on the roads and are seen to do that is important in building confidence that if you break the rules you will be caught. If you look at the Food Standards Agency, we had a real problem and a crisis of confidence in

the quality of British food at the time of BSE. The Food Standards Agency stepped in and they have restored that confidence.

We have a crisis of confidence in financial services regulation and we have to think about whether being more transparent would help that process.

**Mr Collins:** From the Practitioner Panel point of view, we completely agree that it is the interaction of product intervention—how the product is sold and indeed to which consumers—that matters. You cannot look at any one axis, so I completely agree with the interaction.

We also completely agree that if there is wrongdoing in the industry then early identification and enforcement of that is for the benefit of the industry as a whole. On the specific point we are talking about here, the concern we have is that there are sufficient safeguards for the firm to know that due process has been gone through and they have had enough ability to make an appeal against the initial contact from the FSA so that there can be as much assurance as we can get that that firm won't suffer unnecessary reputational damage. From our point of view, the safeguards in the process are really important. Our preference would be that, wherever possible, the name of the firm is not published until the final notice is issued. Statistics indicate that approximately 30% of the final notices do not bear a great deal of resemblance to the initial notice. That is the balance we have to take here.

**Q468 Mr Ruffley:** On that point, I have a question for Sir Anthony, just so I am clear. Would you recommend that before early warning notices were sent out there was an independent panel that a firm could go to, to say, "Look, on the face of it this early warning notice is ridiculous and there are no grounds for it," in the light of Russell's statistics, which do seem a bit worrying, showing that final decisions would throw into doubt the need for an early warning notice in the first place in a high proportion of cases?

**Sir Anthony Holland:** Probably on balance they would. It is this eternal triangle of the consumer, the industry and fair play. On balance that would provide some modicum of comfort if you are going to publish these things at an early stage. After all, it is an important industry. There has to be protection for the industry in the way they operate on a daily basis. On the other hand, the consumer is also entitled to be protected. That would provide some safeguard if you are going to publish early.

**Q469 Mr Ruffley:** Why has not such a system been in place already? The logic of the position, which is where I am coming from, is that there should be some independent panel before these early warning notices are issued. That is not just a good idea because this Bill has been put before us. It seems to me a good idea in principle. Why do you think this has not happened before?

**Mr Collins:** My personal view, and it is the Panel's view, is that the firms have always placed a lot of reliance on the system that Adam outlined right at the outset of this discussion, where there is a process internally at the FSA for an independent review of the case. When that was introduced it gave the firms the critical assurance that was needed that the evidence base would be looked at coldly by the FSA. While I am generally in favour of independence, it would create quite a cumbersome process to have to have a fully independent review from scratch of all the facts related to a case. It is a balance. I can see the benefit of that, but we have placed reliance so far on the internal process within the regulatory body.

**Q470 Mr Ruffley:** Finally, Sir Anthony, how might such a process be set up at the early warning stage, where there can be an appeal or a challenge? Do you think it is desirable to put it in the Bill?

**Sir Anthony Holland:** It would be cumbersome. The Regulatory Decisions Committee was meant to be that kind of safeguard initially, but of course it has developed its own jurisprudence in the way it has processed itself. You can now get hearings and lawyers present and so on. Originally it was intended to be the kind of safeguard we are talking about. What you would be building on is a safeguard on a safeguard. That is what would make it cumbersome. It could be done. You could have an individual or two who are experienced in this particular work who could look at the preliminary papers and say, “This is something that could be published without prejudice to anybody” or “This is frankly a very dubious way forward or one where there are arguments on both sides so I don’t think there should be publication.”

**Q471 Mr Ruffley:** How do you think the Bill should be amended?

**Sir Anthony Holland:** I did not come prepared to have a view about this. My own view is that I would amend it so as to provide that when you have the process involving the RDC there is the opportunity before publication, if the person concerned who is to be the victim of the publication wants to refer it to a third party, for them to have it done at their option. It does slow things down; one has to accept that. You could build in a time limit of, say, six weeks so there is a very limited space of time. It would not be popular with what I call the people who are operating the system, but it would provide a safeguard if you want to have publication. Does that help?

**Mr Ruffley:** It does, yes.

**Q472 Baroness Wheatcroft:** What you are saying is really interesting. I wonder whether there is a risk that there will be a willingness to publish early warning notices and to name names only of smaller practitioners. I cannot see the point in the suggestion that Mr Collins came up with of saying “four anonymous firms are subject to potential disciplinary action”. Naming big names—for instance, that a big bank has been guilty of potentially mis-selling mortgages—would place the financial stability objective at risk. Is that potentially a problem?

**Mr Phillips:** We have always accepted that there will be situations where certain kinds of warnings could not be published. That would be part of the review process. There are almost no cases that have come for enforcement which really have a systemic impact, as far as I am aware.

**Q473 Baroness Wheatcroft:** It is quite clear that there should be.

**Mr Phillips:** It is always possible that that could happen, but essentially the cases that go through enforcement tend to be about rule breaches and by their very nature they can be quite significant. The most significant one we have come across of course is PPI, which does have a huge cost implication. It has been broken down through enforcement into a number of different individual cases, but the real issue has been dealt with at the regulatory level, and I would anticipate that that would happen in the future.

**Sir Anthony Holland:** That is a very real problem. When I get complaints from small firms or consumers, that is one thing; but when I get a complaint about a major body, of course then I get what are called the “magic circle” firms involved. I will have long 100-page submissions as to why I should or should not be doing something. While that may test my mental acumen about dealing with it—and that is something I accept—they bring a different dimension to the whole thing. They are in there because it is big money and a lot is involved.

There was one particular area where I was involved fairly early on with one of the magic circle firms, where they really did want to stop something happening. I do have the power to do a preliminary investigation even though the FSA are continuing their

investigations. I can do that if there are exceptional circumstances. You will then get a submission of perhaps 30 pages on what are exceptional circumstances as to why I should intervene. It doesn't sabotage it, but effectively it makes it very difficult for the FSA to continue to investigate. So far, in all those cases I have declined to find that there have been exceptional circumstances, but no doubt the day will arrive when someone, and if not me then my successor, will decide that in fact they can intervene. That is when the problems would start.

**Q474 Baroness Wheatcroft:** When you refer to the "magic circle", you mean the big banks or the big financial institutions that are using the big law firms?

**Sir Anthony Holland:** It will be one of the big banks, yes. The big organisations will use a magic circle firm, who will then throw teams of lawyers at it. Ultimately it is only myself and an investigator who have to field the issues.

**Q475 Baroness Wheatcroft:** Clearly the smaller firms just don't have that firepower?

**Mr Matthews:** First, they don't have the firepower, but also, picking up Russell's point on the number of times an early warning notice occurs, that could be the death of the company. If later on it comes out that it was not appropriate, you will have firms going out of business based on that.

**Mr Collins:** We do have one example which is a larger firm, which was Gartmore. I know we were operating a different system but that firm's reputation was affected by something that was done in an earlier process. Subsequently, of course, things developed commercially for them.

**Baroness Wheatcroft:** That is very interesting; thank you.

**Q476 Mr Laws:** Following on a bit from those questions and looking at the issue of the FCA's objectives, including strategic objectives, there have been quite a few bodies, including the ICB but also consumer organisations, that have been critical about the way in which those objectives have been framed, not least the objective to protect and enhance confidence. Do any of you share those concerns and would any of you like to suggest any restatement of the objectives?

**Mr Collins:** I can be quite brief. The Practitioner Panel is quite comfortable with the FCA's overall objective. I will repeat my comment that we would prefer to see international competitiveness there as a consideration. What we are more concerned about is that they have to operate that objective on a definition of "consumers" which is so broad, from the smallest retail consumer to the largest wholesale and professional consumer, that it would mean that they are trying to apply a single objective to such a wide range of situations where, frankly, a different approach is needed. It has been one of the strengths of our system here that the regulators have taken into account the fact that even if a professional and a very large wholesale firm is a consumer they come at it with a different set of information and knowledge. Our main concern would be around potentially narrowing the definition and making it clear which consumers they are really talking about. That would be our preference. The Bill does provide for a different approach by the FCA on the different types of consumer. It does allow it, but it is not really as strong as we would like to see. We think they could easily drift into treating all consumers as small retail consumers. On the objective we are broadly comfortable.

**Mr Phillips:** We think the overall objective, which is confidence, is not a particularly helpful objective. In our original submission this time last year to the Treasury we suggested that fair and transparent markets should be the objective. Now we would say, having thought

about it for another 12 months, that fair, efficient and transparent markets would be a clearer description of what we think the FCA should be trying to deliver.

**Q477 Mr Laws:** Do you think this is about issues of real substance in terms of the way the FCA does its job, or is it just about getting the technical definition right?

**Mr Phillips:** First of all, the overall objective sets the tone for the discussion. To say that markets should be fair, efficient and transparent are good things to guide the discussion. When it comes on to the subsidiary objectives which are more specific we don't think that either access to markets or competition have really been effectively dealt with. There is an objective which says that the FCA should have the objective of delivering efficiency and choice. We would like to add "efficiency, access, choice and competition". We think access is important because competition does not necessarily lead to access to financial services. It depends on the cost of provision, and yet many financial services are essential to operating in a modern economy. As with Sir John Vickers, we would like to see the word "competition" in there. This idea of effective competition is really quite important to deliver value to the consumer.

Could I come back on Russell's point about the definition of "consumer"? I mentioned this earlier on. Currently FSMA does have quite a broad definition of consumer. We have had a number of representations from SME organisations about their concerns about provision of credit to small businesses. At the moment we have no levers to pull because FSMA does not influence that market, but we would be very interested in getting engaged should credit come to the FCA. Also, consumers have an interest in how their pensions and savings are handled in the wholesale markets. There is no doubt that there are problems in the wholesale market relating to the size and power of the consumer. We would support the broad definition.

**Q478 Mr Laws:** Do any of the other witnesses want to add anything to those comments?

**Sir Anthony Holland:** There is an impossible tension between "consumer champion", to use a terminology that has been used by other people, and regulating a financial services industry. You have to accept that that tension exists. Whenever I do a response to a complaint, which I do quite frequently, I always try and explain that there is this problem. You are trying to ride two bicycles at the same time, which can produce a very uncomfortable result for the body doing it and make it almost incomprehensible to the person complaining about the manner in which it is being done. Either way, you have a problem, but this is how the system works. You have to have responsibility for consumer protection inbuilt into what you are doing, at the same time regulating the industry, giving it fair access and making it competitive. Those are all very conflicting objectives and you just have to get the wording right and make it workable from the point of view of a Complaints Commissioner.

**Q479 Mr Laws:** In relation to the FCA's consumer protection powers, there seem to be some very different views between some of the consumer groups that think that what is in the Bill on consumer protection is really pretty feeble, and some of the other bodies, including financial services companies like Barclays, that have said the pre-approval regime could have a potentially chilling effect on product innovation. What are your views on that issue of whether this is an improvement in consumer protection? A question for you, Sir Anthony: is this likely to lead to additional complaints compared with the existing system?

**Chairman:** Brief answers would be appreciated.

**Sir Anthony Holland:** Yes, there will inevitably be additional complaints. That is my answer.

**Q480 Mr Laws:** Because?

*Sir Anthony Holland:* Because the consumer will be led to believe as a result of these changes that in fact consumerism has a greater part to play in the way this legislation operates. Indeed, it will have a greater part to play, as we all concede by the consultation paper we have been reading. There is inevitably going to be an increase in complaints, plus the fact that you have this overlap which in turn will make the thing very complex to operate and will make it less transparent to the consumer.

*Mr Phillips:* Written into the Financial Services and Markets Act and carried across into this draft Bill is the concept that consumers should take responsibility for their actions. Looking from the consumer perspective, and I can understand some of the points that were made in the earlier hearing, there is an issue about whether the industry actually delivers a reasonable product to consumers in a way that they can effectively engage with. We would like to see written into the new Bill a duty of care for customers being imposed on the industry as a principle.

The FSA has tried to go as far as it can with the principle of treating customers fairly and has found it very difficult to make it stick. We think that an expectation that the actors in the industry should treat their customers in a way which is fair and reasonable—a duty of care—would be a good expectation. If we copied the proposals in the Dodd-Frank Act in the United States, which gives the SEC rule-making powers to deliver that duty of care, that would make it quite clear that the principle would be delivered through rules which would be subject to the normal controls of cost-effectiveness and proportionality but would move the debate in a direction where the industry would be trying to provide to the customer something which the customer can engage with.

If I could just take a little bit more time to give two examples. We currently have products which are called absolute return funds where you can lose significant amounts of your capital, which is not what the name implies. The ABI has done work which suggests that what they define as a cautiously managed product most people would regard as quite a safe investment. When told it contains a 70% equity content, two-thirds of them say that they think that is a risky product. If a duty of care was imposed on the industry, the way that products are named, for example, would become an issue for discussion, because this is clearly something which a consumer may be misled by. I would just like to put forward this idea.

*Mr Collins:* The naming of products is an issue. It can be dealt with under the current legislation and, if that is carried across, that can be dealt with by the regulators. On the question of a duty of care, we the practitioners want to retain this consumer responsibility comment in the Bill. We think it is important to the way business is done in this country that people have that responsibility. There are lots of duties of care in the Act that firms have to follow. If we are going to extend it in any way, clearly it requires consideration of quite complex legal duties. If you already have a number of duties of care which are imposed through the Act, and then another one is introduced, you have to—

**Q481 Mr Laws:** It sounds quite mild, Mr Collins.

*Mr Collins:* I have heard it expressed as a fiduciary duty. I have to say that that does bring in quite a lot of ramifications for firms and what they have to know about the person and the responsibility they take when ultimately, and we have to be clear, they are selling a product to the person. They are not just providing trust services; they are actually selling a product. When you are selling a product, it depends how far Adam intends that to go. It is a legal question but exactly what duty of care are we imposing when we already have lots of responsibilities on firms in the Act? It is not something we want to rule out of court now because we have not really had time to consider it.

**Mr Matthews:** With the regulations as they are currently drafted, if we go to the naming of products, many of the products require pre-approval currently from the FSA so that naming can easily be brought into the process and is part of the process. If it needs improving that should be easy. In terms of fiduciary responsibility, again it is a question of balance. Firms have a duty of care to a number of relevant parties. That balance between consumer and its own financial well-being and viability is potentially a conflict.

**Chairman:** Thank you very much indeed, Sir Anthony, Mr Phillips, Mr Matthews and Mr Collins. We are very grateful to you for your evidence today. It will be very helpful to the Committee in its deliberations.

### Examination of Witnesses

*Witnesses:* **Mr Mark Lyonette**, Chief Executive, Association of British Credit Unions Limited, **Mr Martin Shaw**, Chief Executive, Association of Financial Mutuals, **Mr Jeremy Palmer**, Head of Financial Policy, Building Societies Association, **Mr Steve Gay**, Director General, Association of Independent Financial Advisers, and **Mr Nick Cann**, Chief Executive, Institute of Financial Planning, examined.

**Q482 Chairman:** Gentlemen, welcome. We are very grateful to you for appearing before the Committee. We are conscious that there are a lot of you. Please don't feel obliged, all of you, to answer every question but only if it is either specifically to you or you have something different to say from what others have said. It would be helpful to the Committee if you would begin by introducing yourselves, starting on my left.

**Mr Gay:** I am Steve Gay. I am the Director General of the Association of Independent Financial Advisers.

**Mr Cann:** Nick Cann, Chief Executive of the Institute of Financial Planning.

**Mr Palmer:** Jeremy Palmer, Head of Financial Policy at the Building Societies Association, standing in for our Director General who is abroad.

**Mr Shaw:** Martin Shaw, Chief Executive of the Association of Financial Mutuals.

**Mr Lyonette:** Mark Lyonette, Chief Executive of ABCUL, the Association of British Credit Unions.

**Q483 Chairman:** Thank you very much. Could I ask you in particular whether you think that the draft Bill makes sufficient allowance for the particular nature of your businesses, many of them smaller and certainly different from the banks and the large institutions on which attention has focused? Do you think the Bill will be okay, and will the proportionality principle enshrined in it be sufficient, or do you think something different is needed?

**Mr Gay:** Constant regulatory change places a heavy burden on small firms. It deters investment in the sector. In some cases it can threaten the existence of small firms as we have seen with the Retail Distribution Review. We are concerned about the overall burden of cost on small firms, the layers of cost for different regulatory entities, whether it be the FCA, the Financial Ombudsman Service, the Compensation Scheme—now the Money Advice Service—and whether or not that aggregate burden is being looked at in the whole in terms of whether or not it reduces access to services and therefore creates detriment to the consumer. We would like the FCA to be required to quantify how incremental cost damages consumer access. As far as the proportionality principle is concerned, it really only works if it works visibly.

**Mr Cann:** We would share the subject of cost being a real issue. As yet there is no sign of how any regulatory dividend might be shown through in terms of this change. It is still more of the same rather than more of an improvement. On the other part, I am concerned about consumer engagement which seems to have been missed. There is talk about competition and protection but no real engagement, which we see is a big issue as an outcome of the current regulatory regime.

**Mr Palmer:** We see the proportionality principle as very helpful and broadly sufficient. The wording we saw in the Bill we thought was quite careful. In the end, it will also be a matter of culture and not just legislation as to how it works out in practice. We found helpful indications of a proportionate approach in the PRA's launch document, where they talked about concentrating on systemic risks, but as the other witnesses have mentioned we also remain very concerned about the overall cost burden.

**Mr Shaw:** We are very pleased that the latest Bill takes account of the Coalition agreement's commitment to a more diverse marketplace for financial services. We believe that was very critical for the new regulators to have that sewn into the way that they operate given that, over the last 20 years or so, the environment for the mutual sector in particular has been incredibly hostile. There is a lot of coverage of the demutualisation of building societies, but with mutual insurance as well the same has applied since around the mid-1990s when the mutual insurance sector represented over 50% of the whole insurance sector. We now have a position where it has fallen to 5%. That in itself is a reflection of legislation and regulation which has made it increasingly difficult for mutuals to prosper.

We therefore see that the Bill takes account of the need for the new regulators to take account of diversity. That is incredibly welcome but in itself it will not be enough to stop a new trend to demutualisation and in mutual insurance in particular given some of the policies that we see in place within the FSA at the moment. We remain very concerned that while the Bill goes to some extent to help to address some of the issues around diversity, it does not go the whole way.

In addition, in relation to proportionality we also see there that the Bill assumes that proportionality will be inherent in the way that the regulators operate. Interestingly, most of the dialogue there relates to the proportionality in the functions of the regulator; in other words, that it spends its money cost effectively and focuses on large organisations. It does not really consider proportionality in relation to the impact on the industry itself. There we remain concerned that small firms face an increasingly hostile and expensive environment in which to operate.

**Mr Lyonette:** Along with my colleagues here we have three main concerns, as you will see in our response overall: proportionality, diversity within the industry, not just in terms of the Government's model and I know there is a commitment in terms of looking at it from mutuals but diversity in terms of customer base, membership base, who the industry is managing to serve and cost. Of course for our sector, which is a small sector but there would still be 1.4 million people using credit unions by April when Northern Ireland credit unions are under the new regime, we have no ability to pass on that cost to the consumer. If regulatory costs rise and we have a maximum interest rate on our lending, which we are the only folks in the UK that do, then we have very limited ways in which we can manage that growing regulatory cost. Cost is absolutely key to us. It will not just be in the law but of course in the implementation of the regulation. The devil is in the detail.

**Q484 Mr Brown:** My questions are aimed primarily at those of you whose members are going to be subject to dual regulation, i.e. by both the PRA and the FCA. What are your views on the arrangements for dual regulation as they are set out in the proposals in front of

us? Could they be improved? Are they too burdensome? What would you want to say to us about them on the subject?

**Mr Shaw:** There are lots of examples of countries across the world where dual-regulation does work. There are by necessity some complications around the edges in terms of what represents prudential regulation and what is conduct regulation. Certainly in some jurisdictions it is sometimes quite difficult to see that the conduct regulator has sufficient powers to be able to discharge its responsibilities fully. I don't think that is the case with the PRA and the FCA. The concern we have is to the degree of overlap between the two regulators where both of them are trying to do the same job in different ways, and therefore where the cost burden on firms increases as a result.

**Q485 Mr Brown:** Is that the view of all of you?

**Mr Palmer:** We would certainly broadly share that view. We saw some useful improvements in the White Paper and in the Bill itself. We welcome the statutory duty to co-ordinate, which seems very sensible, and we welcome a common authorisation gateway. Beyond that we can see again whether it works is down to culture as well as legislation. We think it is very important that the successor bodies should co-operate and not empire-build or fight turf wars.

There is promised a draft of a memorandum of understanding between the two bodies, which we understand was to be published before the Bill is introduced but we are not aware that it has appeared yet. It is difficult to have a concluded view until we have seen that.

**Q486 Mr Brown:** What are your views of the PRA's veto over the FCA?

**Mr Palmer:** We are content with that.

**Mr Shaw:** Likewise, particularly in the most recent version of the Bill, the veto is built around issues of "with profits" in particular. That is one of those product areas which matters a great deal to mutual insurers and where there have been historic difficulties in terms of the regulation of those products. The veto itself provides a much greater opportunity for stability within the whole financial system.

**Q487 Mr Brown:** Do you have views on a single point of contact proposal?

**Mr Lyonette:** Perhaps for ourselves. Remember that for many credit unions you are talking about one or two people who are dealing with these two organisations. We are still a healthily growing sector but you are talking about just doubling the institutions and having potentially two different people to talk about and work out whose responsibility it is. Martin was talking about the overlap. It is really burdensome. We are not necessarily convinced by the Government's arguments that this should not be something that is captured in legislation and it should just be left to operation because it seems elsewhere that quite a bit of detail has been captured in the legislation. It does not seem to me unduly burdensome to suggest that you don't want to put out of business all the small deposit takers.

**Q488 Mr Brown:** Is that a universal view? Do any of you have dissenting views?

**Mr Palmer:** I would agree with Mark. We think things could go further in making clear that there should be single points, particularly to help smaller firms.

**Mr Cann:** A single point is preferable, to come with the same objective rather than having cumbersome duplication meetings with slightly different agendas.

**Q489 Mr Brown:** You think it would have a better chance of working if we were clearer about it in the legislation?

**Mr Cann:** I think so, and also the fact that you have this ombudsman and compensation scheme coming in the same remit. It makes sense to have a co-ordinated conversation rather than negotiation and discussions with three completely independent regimes.

**Q490 Chairman:** Would the same apply to the idea of a single rule book for dual-regulated firms?

**Mr Palmer:** Yes. In our evidence and in what we said to the Government, we have advocated as far as possible—and we understand there will be difficulties—keeping a single regulatory handbook because firms have got used to it and it is another upheaval which, if it can be avoided, would be good.

**Q491 Mr Laws:** Do any of you believe that the definition of consumer in the Bill needs to be qualified in some way?

**Mr Palmer:** We think it is possibly too wide. We looked at it and it is quite difficult to understand. It has four sub-clauses and it took five or 10 minutes to work out what it was actually saying. This point was touched on by witnesses from your previous panel. It appears that it does cover users up to the largest firm. Our view is that consumers are individuals and small businesses but not large businesses. Maybe that is too simple but that is what we think.

**Q492 Mr Laws:** So you want some sort of refinement that would make clear which bits of the Bill should deal with different classes of consumer, if you like?

**Mr Palmer:** It is confusing to use the term “consumer” if it is capable of meaning large businesses as well.

**Q493 Mr Laws:** Can I ask Steve a question? I think that your organisation supports the concept of having some sort of longstop in the Bill that would restrict people’s ability to go back and make claims after a certain period of time. What is the argument for that from your perspective, and how would you convince the consumer groups that this is not going to be something of a conspiracy against legitimate complaints?

**Mr Gay:** Yes; I understand the concern around that. We are very keen that there should be a longstop available for financial advisers. We think it is in the consumer interest that there should be so, because we want to see a vibrant and well-capitalised advisory community. At the moment it is very difficult for them to attract investment if they cannot quantify the risk to any potential investor. At the moment we have a sector that is populated to a large extent by small firms that are unable to attract that capital because they have an unlimited risk into the future.

**Q494 Mr Laws:** What type of time cut-off are you suggesting?

**Mr Gay:** I think 15 years would be appropriate.

**Q495 Mr Laws:** What type of complaints are you getting at the moment to your members that typically go beyond 15 years?

**Mr Gay:** The complaints tend to be for longer-term products, as you might expect.

**Q496 Mr Laws:** But are they more mortgages or pensions?

**Mr Gay:** Primarily they tend to be pensions, but of the number of complaints that are received by the Financial Ombudsman Service, the proportion of them that come from independent financial advisers is remarkably low. It is less than 2%. Of course, with

consumer redress schemes now they are already subject to legal requirements and therefore have that longstop in place. It does not seem to us that it is too much of an extension.

**Q497 Mr Laws:** Do you have any idea of the number of complaints that this would impact? Are we talking about quite a trivial number of complaints that frankly get nowhere anyway, or is there really much evidence of a significant number that go anyway?

**Mr Gay:** I don't have the numbers but I could revert to you with details.

**Q498 Mr Laws:** I can ask through the Chairman. That would be very useful, because it would be helpful to understand a bit more about the numbers, and also what types of complaint and whether this is really a side issue or not.

**Mr Gay:** We are not talking about very large amounts.

**Mr Cann:** Looking at that, we would be supportive of a longstop. The retail advisory sector is going through a huge change of cost and having to improve and demonstrate having met new standards and adhering to that. A lot of the problems historically through all of the various mis-selling or issues that have risen to the top have been around short-term selling as against the ability to be able to provide ongoing service and advice. You get to a stage where after 15 years very few things would still exist that would be any systemic issues that have not already been picked up or developed. It would only be the odd type of occasion where people are unhappy, having not looked at something for some while, and it being brought to the attention of any new adviser. There needs to be some recognition built in of the changes that small, medium and some large firms are changing to adhere to the new standards and, having proved that they are adhering to those new standards, that that can then be improved on an ongoing basis. That term might be reduced then over a period against maintaining the status quo or improving it still further because that does start to give confidence to the sector. There is some proof and evidence that firms have made changes to what might have historically happened.

**Q499 Mr Laws:** Thank you. Any information you have on that we would very much appreciate. I don't know whether any of you heard the last evidence session. We had some discussion about the product intervention powers in the Bill. Many people might feel that these are quite sensible powers that will prevent some fairly dangerous products getting out there in the future, or perhaps being sold to people whose level of financial literacy is quite low and who don't really understand entirely the risk that they are taking. Are any of you sympathetic to that or is your general view that this is going to stifle innovation?

**Mr Cann:** Product innovation worries me on two levels. On the one hand it sounds very attractive. On the other hand we have seen people looking to short-circuit opportunities to create sales opportunities for businesses. It has to be looked at very carefully. If you look at the environment where we are, as a result of the Retail Distribution Review there is going to be far less access for people to be able to take advice. Therefore, they are currently going to be far more reliant upon the internet and friend recommendations, and not being able to either afford or engage an adviser to be able to take sensible decisions. Therefore, the risk of innovation and other ways of presenting products will stack up some problems for the future.

**Mr Lyonette:** We are broadly very happy with it. Credit unions tend to offer simple, straightforward products. We don't employ departments to add complex and difficult to understand features. Provided it works well in practice for the industry as a whole, we are broadly happy with that.

**Q500 Mr Laws:** Are there any products that spring to mind that would not have gone out into the marketplace or have been significantly amended if this power had been there for the last decade?

*Mr Shaw:* It is quite difficult, of course, because the benefit of hindsight is great in terms of identifying products that have gone wrong. I full well remember 20-odd years ago the regulators endorsing the concept of mortgage endowments, only at a later point to understand that they were not by any means suitable for all consumers. That is part of the challenge of getting product intervention right. You need people within the regulators who have the relevant skills and experience to be able to understand what products are designed to do, but also to understand some of the problems that can emerge at a point in the future where circumstances unknown today might emerge.

**Q501 Mr Laws:** With something like the shared appreciation mortgages, because the point you make is obviously a very good one, do you think, if this type of product intervention had existed when they were originated, that would have led to any different approach or failure to validate or approve them?

*Mr Shaw:* I would certainly like to think that an earlier engagement from the regulators in the design of products which have features which are uncommon or unlikely to be understood fully by consumers would have prevented those products either from being developed or else would have put some kind of structures around the way that they were marketed and distributed.

**Q502 Mr Laws:** But do you think in that particular case, which is a good example, because it has gone wrong for lots of consumers, but arguably you could say it might have gone right for them, and some of them might have understood the risk they were taking very well, it would have led to much of a difference with that product?

*Mr Palmer:* On the specific point, Mr Laws, it is possible that this is a good example of something that could have application for some consumers but may be unsuitable for many, but that does not lead you to ban the entire product. It comes back to the point that was touched on in the earlier panel session. You have products and the selling, and is it the product itself or is it how and to whom it was sold?

**Q503 Mr Laws:** Could there have been any useful intervention in that particular product, as a general example, at the beginning that would have allowed the people that were qualified to take a punt on it to do so while protecting others?

*Mr Palmer:* Possibly.

**Q504 Mr Laws:** How?

*Mr Palmer:* Maybe if you have product intervention rather than banning you have some way of being clear which products are not suitable for less sophisticated or vulnerable consumers in the most general sense. Otherwise you just rely entirely on the selling process to make the decision.

**Q505 Mr Laws:** It's a tough call, though, to decide that you are financially literate and the person next door to you isn't.

*Mr Palmer:* Exactly.

**Q506 Mr Laws:** You might not be very charmed when you speak to the company and are told that you are graded as a financial moron, basically.

*Mr Palmer:* But it might be worse to ban the product entirely.

**Mr Cann:** A lot of products are designed with today's market in mind without any real thought for the next few years. There is talk today about 30-year fixed mortgages. That sounds great at today's interest rates, but who knows what is going to happen over the next 30 years for that to be a decision that people might or might not want to take either from the person who has got to supply that, maybe the bank, or the consumer in terms of what might happen to interest rates. Endowment mortgages were the same at the time. In terms of the economic conditions they were an excellent product, but nobody reviewed that over the first five or 10 years as the economic conditions changed completely and product innovation started to take those products in different areas for the sales function to continue far better.

There can be more co-ordination at the start potentially of a product, but there has to be something in to review some of these that are designed for a longer term on changing market conditions. We need to come from a situation of selling rather than provision of long-term advice, and as that is changing we need to change with it.

**Mr Gay:** I do think there is a more general point behind this that should be made as well. It is not entirely clear how these powers in reality would be exercised. If a product is going to be banned on a temporary basis, it would appear that it could be done without there being a cost-benefit analysis or without there being thorough consultation. We think there needs to be greater clarity about how it would work in practice. We have talked here about the difficulty in making some of these decisions. We would need to be confident that the FCA would have the right skills and experience to be able to do that.

**Q507 Baroness Wheatcroft:** We have been talking about fairly nitty-gritty issues. I would like, if I may, to take you back to something rather larger, the Financial Policy Committee, which is at the centre of this new legislation. Do you feel that the FPC has the right objectives as currently constructed, or would you like to see them taking them rather wider to take in more of an objective on the competition front? Perhaps we could start with you, Mr Shaw.

**Mr Shaw:** We would like to see the FPC have much better regard to competitive forces within the financial services industry. We would like to see it take account of diversity in particular, both in terms of the size of organisations and the business models which they explore. We believe that the FPC will be ideally placed to be able to measure diversity over time and that that in effect would both act as a signal to the regulators and also help support the Government's commitment to diversity.

**Q508 Baroness Wheatcroft:** Thank you. Mr Lyonette?

**Mr Lyonette:** We have not made any particular comments on the FPC at all.

**Q509 Baroness Wheatcroft:** So as far as you are concerned financial stability is available?

**Mr Lyonette:** Yes; it really fits into the general tenor of our remarks. So long as it does not have a detrimental impact and we don't see fewer and fewer firms paid more and more for their regulation, which is what we have seen for 10 years. We have said that proportionality, cost and diversity are key.

**Q510 Baroness Wheatcroft:** I have that. Mr Palmer?

**Mr Palmer:** We have said that we support the formulation in the Bill which qualifies the financial stability remit by reference to UK economic growth and the contribution of the financial sector. I would agree with what Martin said about diversity as well.

**Q511 Baroness Wheatcroft:** There was also a suggestion that perhaps one of its objectives should be to ensure a ready supply of credit. It has not always been the case, and particularly for small firms that is not the case. It is not necessarily from building societies, but do you think that there should be an obligation on the FPC to ensure that there is a ready supply of credit?

*Mr Palmer:* We are content with the present formulation. We have not advocated the sort of credit supply objective.

*Mr Cann:* I say much the same. My broader concern is more about consumer engagement generally rather than competition and other restrictions.

*Mr Gay:* Likewise, I would endorse what has been said there. The broader requirement to ensure that consumers are represented in the discussion is very important.

**Q512 Baroness Wheatcroft:** Your concerns really lay elsewhere in this Bill?

*Mr Gay:* Yes.

*Mr Shaw:* In terms of financial stability, for a long time the received wisdom was that financial stability was best achieved by encouraging the growth of “big is beautiful” organisations and “banks are best”. The last few years have proven that that is not the case and financial stability is more likely to be achieved where there is a diverse marketplace for financial services.

**Q513 Baroness Wheatcroft:** Of course, the Government are really embracing the concept of mutuality now with new enthusiasm.

*Mr Shaw:* Absolutely; and that in itself is very much part of the way in which a diverse marketplace will help to ensure that the marketplace is stable but also that consumers have access to good products no matter what their financial circumstances.

**Q514 Lord Skidelsky:** I would just take up that last point that in your view financial stability can be achieved by increased or greater diversity. There has not been financial stability for the last three years, ever since 2007-08. Do you think anything in this Bill would have made it more likely that financial stability would have been achieved over that period?

*Mr Shaw:* Yes, because the formulation of the new regulators should ensure that there is much better early warning of adverse trends; that organisations are more accountable for the way in which they operate and therefore that the regulators have both the knowledge and the power to intervene earlier if they see those adverse trends emerging.

**Q515 Lord Skidelsky:** But that has nothing to do with diversity or competition, has it?

*Mr Shaw:* It does in as far as if you take the premise that the shareholder model itself inflicts greater risk and less likelihood that organisations will wholly focus on the best interests of their consumers, then at a micro level it forces you to consider that stability is supported by a diverse range of product providers.

**Q516 Lord Skidelsky:** So you would have no interest in laying on the duty of the regulator to ensure an adequate supply of credit or take into account the interest of economic growth, for example?

*Mr Shaw:* Within individual regulatory bodies you have to focus them on the issues which they can reasonably take responsibility for. With the system itself the Bank of England and the FPC are clearly looking at those macro issues in a much greater level of detail than you would necessarily want the day-to-day supervisory teams to be focused on.

**Q517 Lord Skidelsky:** But at your level you think that is a level above that which is of concern to your organisation?

*Mr Shaw:* Yes.

**Q518 Lord Skidelsky:** And therefore you have nothing really to say on those macro issues?

*Mr Cann:* The proof will be in the outcome. If you look at the troubles when they occurred, part of the reason was there was not enough challenge of those large institutions and what they were doing strategically. There was a belief that what they were doing was okay. Under this new regulation the proof will be in how that new organisation challenges those regimes in the future. Having set that aside, the reality will be what happens in practice.

**Q519 Chairman:** I have one final question. The Government are emphasising the move towards more judgment-led regulation rather than box-ticking. Will this affect you and your organisations? Do you favour it or do you think it will make life more unpredictable for you than having clearer rules and less judgment?

*Mr Palmer:* Perhaps I can go first on that one. There will still be in the new regulatory regime a very large number of rules, many of them deriving from European legislation. In Europe the culture tends to be more rules based. Within that framework we would support a judgment-driven rather than a box-ticking approach. We are aware that won't always be comfortable for all firms but we think it is the right way to go.

**Q520 Chairman:** Does anyone else wish to comment?

*Mr Gay:* I would agree with that. In broad terms movement towards a judgment-based approach would be welcome although, again, there would need to be appropriate skills and experience within the FCA to make that work effectively otherwise we could get some unintended consequences. There would also need to be an appropriate mechanism of appeal that is suitable for small firms and cost effective for them.

*Mr Lyonette:* That would broadly support our points. We have only been in the regulated sector for 10 years. We found the move in the FSA towards principles-based regulation and away from rules-based was quite challenging for small firms. Even to start from a principle of treating customers fairly, while intrinsically it is part of our ethos, in a firm with a few employees and work out what it means is quite burdensome: more so than treating customers fairly. For small-scale firms rules are quite helpful. Bearing in mind what Jeremy said there about there still being the existence of rule books and we would hope within it our own rule book survives, then judgment per se does not appear to be a problem. It is all about the resources firms will have to operate in that way, as much as the issue of complying itself. It is more about the resources needed to show that you are complying.

*Mr Shaw:* Jeremy made a very good point about the impact of European regulators. Of course one of the things that we will all have to come to terms with is the fact that most rules will be developed in Europe in the future rather than within the regulators here. That inevitably means that you don't want regulators repeating the rules that are made elsewhere, and therefore judgment-based regulation is a very natural place to get to.

**Q521 Chairman:** Do you think it will be compatible with Europe? Mr Palmer was saying that was a much more rule-based and box-ticking approach. Will it be possible to combine a judgment basis with rules emanating from Europe?

*Mr Shaw:* A lot of that, of course, is based on how well the judgments are maintained and how well they are consistent with the rules which we would be expecting both the regulators and regulated firms to understand and to work with. Given that the rule books will

be at least as dense as they are now from a European perspective, then those judgments must be seen in the light of how those rules emerge over time.

**Chairman:** Thank you all very much for your evidence today. It has been very helpful and will be valuable to the Committee as it prepares its report. I am very grateful to you.

### Examination of Witnesses

*Witnesses:* **André Villeneuve**, Chairman, International Regulatory Strategy Group (City of London), examined.

**Q522 Chairman:** Mr Villeneuve, welcome. Thank you very much indeed for agreeing to appear before the Joint Committee. We are grateful to you and for your submission. Could you begin by giving us your views on the consistency of regulation across the EU and internationally, whether you have any concerns about Basel III and how it is implemented within and outside the EU?

**André Villeneuve:** “Consistency” is not a word I would use at the moment. We are moving towards a lot of inconsistency. Would you mind if I just explained for one minute the constituency I represent because it is quite important you understand this?

**Chairman:** Yes, of course.

**André Villeneuve:** My body, which is the International Regulatory Strategy Group, is not a specific trade association. It looks across the whole spectrum of things that are happening in financial services, particularly in the wholesale area, and tries to draw out macro issues of concern right across the sector from banks to insurance companies to fund managers, etcetera. We also have legal and accounting firms on it and we work very closely with the Treasury. We have the FSA on it. If you want technical input on Basel III, I am not the person to give it to you. I will try in my comments just to focus on the macro issues that come out in the group. We undertook quite a detailed study ahead of this meeting to make sure that we properly captured the views of the group, although there is no such word as a “unanimous” view when you are talking about the City of London.

Coming back to the question you asked, it is quite clear that different countries are on different railroad lines. You have the US with Dodd-Frank, which is absolutely focused on the US, with the added twist that the US is very generous about exporting its rules to the rest of the world where it can. You have the EU which is focused on a single rule book, and you have us who have signed up to a single rule book but, as we heard from the previous panels and no doubt in lots of previous sessions, we have introduced an element of judgment in how the supervision is done. There is an inherent potential contradiction between having a single rule book and exercising a lot of judgment at a national level as to how you apply it. That contradiction is quite apparent to the EU authorities that we talk to, who are quite concerned about it.

**Q523 Chairman:** So the EU itself is concerned?

**André Villeneuve:** Yes.

**Q524 Mr Brown:** One of the rules in this place is that you should never ask a question to which you do not know the answer. I genuinely do not know the answer to this question, so I hope that you can help us. We understand that the European Union regime will set out a minimum set of regulatory requirements to which everybody will be required to adhere within the European Union. Is there also a maximum level? To give an example, if the

**André Villeneuve:** There is a cultural difference between the two. The European authorities are looking to have a single rule book which applies everywhere. For instance, on the Basel III issue which you raise regarding capital requirements, they would basically like a maximum.

**Q525 Mr Brown:** As well as a minimum?

**André Villeneuve:** Yes.

**Q526 Mr Brown:** So it would be the same for each country?

**André Villeneuve:** Yes; so everybody has the same rule. If you operate in a single market, in theory that is desirable. If you are the biggest wholesale centre in financial services in the single market one might think that you would want to have a single rule book because that would facilitate your ability to operate.

The UK has asked, because of the special nature of financial services in this country, its size in proportion to GDP and all the other issues as you know, to be able to make its own judgment on what the maximum should be and increase it. They have effectively allowed in their discussions for wiggle room in order to introduce Vickers and other issues surrounding that. This is causing a lot of tension. The tension is exacerbated by the fact that the UK seems to be leading the charge on being the first with everything. They will take a rule and then they will apply super-equivalents. This causes problems not only with the EU, who are trying to create a single rule book with the same rules for everybody, but it potentially causes problems internationally. Bear in mind that most of the constituency on my committee are international banks, fund managers and all the rest of it. They are very concerned about international consistency and they don't like it that Dodd-Frank is going in one direction and the EU is going in another direction on certain issues. Certainly having the UK on top of that going in its own direction complicates it.

**Q527 Mr Brown:** I am still not quite clear what the actual answer to the question is, though. Is it possible for the European Union to say, "Our minimum requirement is also our maximum requirement; you may not move below it"—that, of course, I understand—"but you may not move above it either"?

**André Villeneuve:** Just a minute. You have Basel III, where you can effectively put on whatever criteria you want over and above the minimum. Then you have CRD IV, which is the European implementation of Basel III. CRD IV is single rule book. Basel III gives you more flexibility. The answer to your question is actually not clear at the moment, which is probably why you were asking it. I am not able to answer this question.

**Q528 Mr Brown:** At least you understand why I don't know the answer.

**André Villeneuve:** But I do not think anybody can answer it because this remains to be tested. In theory CRD IV is a qualified majority voting issue. If you have qualified majority voting for maximum capital as part of CRD IV, then the UK has an issue. Is it going to apply Basel III; is it going to apply CRD IV; how is it going to deal with the QMV problem?

**Q529 Mr Brown:** We would be obliged to, wouldn't we?

*André Villeneuve:* It remains to be seen. Yes, I think we would be. I am sorry that I cannot be clearer than that, but that is where we are at the moment.

**Q530 Chairman:** It seems obvious that you have a minimum to prevent people getting unfair advantage by having less than the minimum level of capital which is thought to be required for stability, but it is not obvious to me why countries should not, as they have been up to now, be entitled to impose their own minimum above the minimum set by Basel III or by the European Union. What is the advantage to anybody preventing any individual country making its banks even safer still?

*André Villeneuve:* I have two answers to that. First of all, if you just take a single thing like capital requirement then maybe you can say, “Well, given the special position of the UK we should take into account the fact that they need to do this”. But of course it is not just capital requirement where the UK is taking the lead; it is on liquidity ratios and all sorts of other issues where, if you aggregate them all, it would take us quite far away from the principle of a single rule book

The second part is, of course, if you are an international bank and you have to meet international requirements in lots of different countries, having different standards in every country in which you operate complicates the issue.

**Q531 Chairman:** Yes, I can see it might be a disadvantage to British industry if Britain imposed more onerous obligations, but I cannot see why anyone else in Europe should be worried about that.

*André Villeneuve:* As I say, international banks are just worried about different standards. Your point about British industry is quite interesting. I saw it manifested last week when I was in the US. What we are seeing now in the US are French banks—and I just cite them because it is a clear example—reducing their dollar assets and therefore not participating in the sort of credit deals that French banks would normally have participated in. I mean plain vanilla stuff like bridging loans for big mergers. They are just pulling out. The implication of them just pulling out is that it has to be worked through. If individual countries are going to see their banks looking at their domestic agenda much more than any international agenda, this has implications also for large firms in the UK and their ability to raise credit. We have not worked through the implications of that yet but certainly this is a trend which is beginning to develop. I don't think it will only be French banks that will be doing this as a result of the Euro zone crisis.

**Q532 Lord Skidelsky:** If that trend continues will it lead to a less international banking system and a banking system which pays more attention to their domestic requirements than expanding their international business?

*André Villeneuve:* In theory one would say that it might well do that. It does then raise the issue of what benefit the financial wholesale market is for the UK. We are about to do some work on that, just so that you know, because we need to nail down now what the benefits are of having a wholesale financial centre in terms of credit raising for UK companies. We are not sure what the answer is. We think it is positive, but we need to demonstrate that.

**Q533 Lord Newby:** Coming on to the way in which we interact with the European supervisory bodies, we have a twin peaks system and they have a triple peaks system. How much of a problem do you think that difference in structure is?

*André Villeneuve:* There are lots of twin peaks in Europe. One of the previous speakers was talking about that. I am less concerned about having an exactly matching

regulatory structure than I am about how we interact with it. First of all, an absolutely critical element of this is that we are well represented on three European bodies even if they don't exactly match our whole layout; that we have worked out carefully between the three bodies that we have an integrated approach to each issue that comes up at a European supervisory body. The mechanisms need to be in place to make sure that that happens.

Secondly, we need competent and authoritative people who contribute to these debates. Thirdly, a point raised earlier by the Chairman is that if you are too keen to go down the super-equivalents route on supervision you then tend to make your negotiating position more difficult with the other members of the European supervisory authorities, who on the whole would not want this to happen.

**Q534 Lord Newby:** Do you think there is more scope for putting in the Bill provisions to ensure that we do exercise our influence as effectively as possible, or do you think that is just a basic organisational thing that will drop out?

*André Villeneuve:* I would welcome it. If you hardwire something fairly solid into the Bill it really does reinforce the need to have an integrated UK approach. The reason my group was created, by the way, was because the industry did not have a sufficiently integrated approach on key issues.

**Q535 Lord Newby:** Given that you have the bodies here, do you think it would be sensible to have a European secretariat in the Bank of England or located in one of the three bodies that drew together both the expertise and the approach that we were adopting to make sure there was a controlling mind and that things did not slip between the gaps?

*André Villeneuve:* That would be a very interesting contribution to the issue. One of the things exacerbating the UK's position at the moment is the huge turnover at the FSA as a result of these moves. I am not saying that the moves are wrong, but it is just a practical fact that we have a huge turnover. We are losing people who have got placed on the European supervisory authorities. We have a further problem as a country that we are under-represented on the European supervisory authority secretariats. That is not for any nefarious reason on the part of their secretariats but just because we did not have the people in place. It seems to me and my members that we do not have an adequate plan to make sure that the UK is well represented at the right levels of all these groups.

**Q536 Lord Newby:** Isn't the problem there, though, that the financial services firms themselves are very resistant to seeing any of their staff who are any good going off either to the FSA or to the European supervisory bodies? There is a brake almost on getting the best people. A number of our witnesses have discussed this. If that is the case, do you think that there might be scope for some kind of almost mandatory system under which significant firms are expected to second good people, both domestically and internationally?

*André Villeneuve:* I would imagine that at the senior levels of these firms they can certainly see the logic of what you are suggesting. Whether it needs to be mandated or not, I don't know. I am not a banker but if I were a Chairman or a CEO of a British bank and I was concerned about UK engagement with the European supervisory authorities, I would also expect myself to be able to contribute something to resolving this. A really serious discussion at very high level between the appropriate Minister and the CEOs or Chairmen of the banks would probably produce the right result. You see a lot of this transfer in the US and it is encouraged. People who come out of public service back into the private sector often benefit from a career perspective.

**Lord Skidelsky:** It is called "the revolving door" sometimes.

**Q537 Lord Newby:** I have talked about the EU bodies, and there are issues about how we exercise our influence there. Do you think there are any problems or challenges about exercising influence on other bodies; on the Basel procedure or on G20?

**André Villeneuve:** As far as I know, we are as influential as we should be at the Basel procedure. There are issues internationally, particularly with the US, but that is not necessarily of our making. The US is very focused on their domestic agendas. There are some regulatory authorities in the US who are trying hard to get some sort of international co-ordination on some of these issues, but they have their own political battles to fight back home which are not helping them, frankly. It is an issue.

Our position vis-à-vis the US would be better if we were seen to be more part of the EU than just some offshore place that sits uncomfortably between the US and the EU. That is a personal view.

**Q538 Lord Maples:** Following up on this, I would like your views on where this input should come from within the British Government. It is being suggested that the Bank of England needs to beef up its capacity to lobby and make representations within Europe. On the other hand, the Treasury has for years had representatives in Brussels well plugged in. They have had a huge amount of input into resolutions, directives, regulations and one thing and another. Where do you think this is best to come from? Should the Treasury retain overall responsibility for it—the Financial Conduct Authority and people will have issues that they may well want to raise direct or through a forum—or should we in future see this coming through the Bank of England? As you said, they are well plugged into the whole Basel procedures but I am not sure they are well plugged into the Commission's activities on regulation, whereas the Treasury is perhaps the other way round.

**André Villeneuve:** At a technical level the regulators need to speak to each other. At a macro level, which is what I think you are talking about if I may use that term loosely, the Treasury has to play a key role. I would be more attuned to seeing a key Treasury role because they tend to listen to the industry more than the Bank of England does. The Bank of England is concerned about stability. It is perfectly reasonable that a regulator should be concerned about stability given everything that is happened, but they are not particularly concerned about balancing stability and facilitating growth. They are not like the Fed. They do not have that, as far as I know, as part of their remit. Therefore they are not necessarily sympathetic to listening to the consequences of the judgments they are making on European rules, for instance.

The Treasury, in our experience, is at least more open although the processes could be substantially improved. Probably the major macro concern about this new set-up is how we get a balance between delivering financial services stability and facilitating growth, particularly as we have moved away from looking at the economic impact of what is being proposed to making judgments. The danger with judgments is that first of all they are very heavily dependent on who is making the judgments and the quality of the people who are making those judgments. Bear in mind what I said earlier about staff turnover at the FSA. Secondly, it is less transparent. Rule making tends to be more transparent, so we tend to have more input into the rule-making bodies in Brussels than we do in how the rules are interpreted and applied here.

That was a very long-winded answer, but we would be more comfortable working with the Treasury and the Treasury taking a lead on this; and the Treasury having to balance not just regulation but also economic growth, credit flow and all that sort of thing than just relying on the Bank of England, particularly in its current philosophical mode.

**Q539 Lord Skidelsky:** On the financial stability requirement a couple of banks, Barclays and HSBC, have suggested that the objective should be to maintain a sustainable supply of credit and have regard to economic growth, and that that should be the FPC's mandate rather than financial stability. Your remarks seem to support that.

**André Villeneuve:** Both those banks are members of my Committee and they would be part of the critical mass. The answer is yes, and I will add one thing to that. It is an illusion to think that it is only medium and small-sized companies who are affected by credit flow. That may be the case now. Large companies have much better access to capital markets than they did in the past, but if you go and talk to some of the continental European CEOs they are very concerned at the trickle effect of limited credit at medium and small-sized companies trickling up to have an impact on large companies as well.

By the way, the story I was telling you about a French bank applied to a very large company, a Dow 30 company. No French bank credit and nothing to do with their balance sheet.

**Q540 Lord Skidelsky:** Do you think the Treasury is more committed to economic growth than the Bank of England?

**André Villeneuve:** I would like to think so.

**Lord Maples:** I hope so.

**Q541 Baroness Wheatcroft:** I would like to ask you about the twin peaks structure, Mr Villeneuve. You said that in the context of the international negotiations it did not worry you terribly much, but are you concerned about those organisations that are going to be regulated by two separate regulators: the FCA and the PRA?

**André Villeneuve:** Yes. If I used the words "did not worry me too much", that does not entirely reflect what I should say. I don't think there is much we can do. We've got what we've got so we have to work with it. The answer to your question is yes. There have been a lot of suggestions as to having a co-ordination committee. I do not know how that is coming along. I sit on the board of an insurance company, by the way, in this country. We have heard very clearly from the FCA that they were going to do all their interviewing and investigations completely separately from the PRA, which means effectively that you have two lots of people coming in. It may not always be for the same things but often there is an overlap in these products.

**Q542 Baroness Wheatcroft:** That is time-consuming and expensive.

**André Villeneuve:** Exactly, and probably not very efficient as a regulatory tool.

**Q543 Baroness Wheatcroft:** It is interesting that they are telling you that at this stage because there is supposed to be a memorandum of understanding being written.

**André Villeneuve:** I think they are moving towards trying to get a more rational view, but this was expressed to us very recently.

**Q544 Baroness Wheatcroft:** If you were to be offering thoughts as to how this dual structure should work, could you be more specific? You would want single interviewing, for instance?

**André Villeneuve:** You would want single interviewing. It is already clear that PRA takes precedence over FCA if it concerns financial stability, although again how do you interpret what affects financial stability?

**Q545 Baroness Wheatcroft:** A single rule book?

**André Villeneuve:** Yes. I have run an electronic brokerage company in a country where we had two completely different regulators at war with each other, which is the US. It is very uncomfortable for the people in the middle. I am sure that that won't happen because you have the Bank of England over and above that, and they would bang heads together, but you can understand why some people might be sensitive if they have lived through having two different regulators trying to do the same thing.

**Q546 Baroness Wheatcroft:** You can. Do you think a single rule book may be the answer?

**André Villeneuve:** A single rule book helps. Assuming that we are not going to change the structure now, the real answer has to be to go along the lines you were proposing which is to make sure they work very closely together; that one person is in charge of individual firms; and then that person will make the call. It reminds me that the City of London at the moment is a complete bomb site in terms of navigating through it. The reason is that there are 27 different utility companies who have 27 opportunities to drill up the roads when they more or less feel like it. The analogy with what we are proposing—although it is not 27; it is two or arguably three—is a good one.

**Q547 Baroness Wheatcroft:** With the potential for things to fall down the holes they are all digging?

**André Villeneuve:** Yes. There is also the question of falling through the gaps. The potential for things falling between the gaps was exactly what happened in the US, as we heard, between the CFDC and the SEC. I hope that enough lessons have been learnt from that that this is not likely to happen in quite that form under the structure that is being proposed now because that has been quite well studied. But the fact is that, if we have two people pulling in different directions, that is not good so you need very tight co-ordination and you need one person to be clearly in charge.

**Q548 Baroness Wheatcroft:** Is there evidence of who is being consulted as this crucial MoU is being drafted?

**André Villeneuve:** Quite a lot of individual financial services companies and trade association have been consulted. That is my sense.

**Q549 Mr Brown:** I want to ask about the accountability and the contestability of the arrangements that we have under consideration and what your view is on that. As I understand it, we are putting an enormous amount of power and responsibility into the hands of the Bank of the England and I suppose ultimately the Governor. Yet the structure for accountability to Parliament is still as it is now, through Ministers. There is the Chancellor of the Exchequer and Treasury Minister at Question Time in the normal way and to the Treasury Select Committee. If there are any new responsibilities and accountabilities under these arrangements they are lodged in the Court of the Bank of England. Do you think that is the correct structure? If people wish to contest these arrangements there is not really a forum for debating it or sounding warning notes. Should there be such a thing and should it be located in Parliament or somewhere else?

**André Villeneuve:** I think you are right to be concerned about it. I was roundly condemned yesterday for calling it “the Court”; apparently it is “Court”. I stand corrected. I am sorry that Lord McFall is not here, because I appeared in front of his Committee a few months ago, and even then it was quite clear that the Bank of England Governor was going to be a uniquely powerful individual. The issue came up, which you have no doubt heard from others, that if you have a governor of a central bank, independent under Maastricht rules, who

is also responsible for supervision, are you quite sure that you can hold him ultimately accountable for failure in supervision without damaging his role as an independent central banker? This came up about three years ago during a financial crisis in the Netherlands. They had a similar issue where there was a supervisory problem and the Governor of the Dutch Central Bank refused to be fired, on the grounds that he was an independent central banker.

If you have that structure, then the governance and accountability thing becomes doubly important and you need to make sure that it is structured in a way that if there is a failure in supervision and you want ultimately to get rid of the Governor of the Bank of England—I am sure no such situation would happen—you could do it without damaging sterling, the UK's standing with an independent central bank, and all the rest of it. The way we have structured it, we have given unique powers, so it is very important not only that his actions have proper oversight but also that you can separate his role as independent central banker looking after the interests of sterling and everything else from his role as head of supervision.

**Q550 Mr Brown:** I understand the point you are making. We have not done that in the proposals that we currently have under consideration. I don't want to put words into your mouth, but I take from what you are saying that we should at least consider the point.

**André Villeneuve:** I think you need to consider what would happen if a failure of supervision—unlikely, but you need to consider it—would ultimately lead to you wanting to get rid of the Governor of the Bank of England, and how you would be able to separate his two roles.

**Q551 Mr Brown:** I was thinking of a situation a long way back from that, where there might be a tension between the Chancellor and the Governor. If they had, for perfectly valid reasons, different emphases on a matter of public policy, it is not clear to me how that gets resolved. On a different point, if the public representatives at large want to sound a warning note, where is the forum for doing that?

**André Villeneuve:** The answer is, I don't know. It needs to be clarified much more. This is a very important point that you raise. The objectives of the Treasury, particularly if there is a major downturn in the economy here, could be very different from the objectives of somebody who is concerned primarily with financial stability.

**Q552 Mr Brown:** It is not clear to me how that gets resolved.

**André Villeneuve:** No, it is not clear to me either. You are very wise to raise it.

**Q553 Lord Maples:** We are starting to get into these areas of governance. There is one area which particularly interests people which is the Court of the Bank of England, which has been largely decorative in our lifetime and probably longer than that. It seems to me it is going to need to be strengthened into more like a board of directors, perhaps even with a chairman who is not the Governor. I know it has a senior governor at the moment but somebody who plays that role of senior non-executive director. I would like your thoughts on that, given that under these new arrangements the Governor is such a powerful figure.

Secondly, this problem that the Governor might have if there is a failure in regulation feeding over into doubts about monetary policy, would it be better if the Governor were not the Chairman of the Prudential Regulatory Authority, as he is designated to be. He could be Chair of the FPC and the Monetary Policy Committee but let his deputies or maybe even independent members of the Court chair the other two Committees?

**André Villeneuve:** On the latter point, I would say yes, because it would distance himself a bit and therefore you could preserve the thing, but ultimately he is responsible. We

cannot get away from that from this structure. To your earlier question, it would be good if he were not the Chairman, but if he is the Chairman there has to be a very strong lead director.

**Q554 Lord Maples:** Chairman of the Court?

*André Villeneuve:* Of the Court, yes.

**Q555 Lord Maples:** Or of the Bank?

*André Villeneuve:* Sorry, yes. A very strong lead director with a very strong remit, to be able to overrule, basically if there is an issue. The third element is the degree of participation of non-executives in all this. That is very important. I was talking earlier about the voice of industry, and by “industry” I don’t just mean financial services but industry in general. The availability of credit needs to have a very strong voice at that governance level. It needs to be done in a way that they cannot be trampled over by an overly-opinionated central bank governor. I am not of course referring to the current one, but were ever such a thing to happen.

**Lord Maples:** We have known them in the past.

**Q556 Chairman:** Thank you very much indeed. You mentioned that you were doing a report on the wholesale market in London.

*André Villeneuve:* Yes.

**Chairman:** That itself might be of interest to the Committee, but it also raises a question which perhaps you could answer as a last one. Concern has been expressed to us that there is regulatory creep moving from the protection of consumers to involvement in the wholesale markets where the participants are probably not in need of protection other than through the courts. Is that a concern of yours? Do you see it? Do you think the Bill will aggravate it or alleviate this regulatory creep?

*André Villeneuve:* I don’t think it will affect it one way or the other. There is creep. We spend a lot of time with the European supervisory authorities when they are designing rules, trying to explain the difference between wholesale markets and consumer markets. A lot of time MiFID is brought up and all sorts of issues regarding that.

On your first point, we would be delighted to share the work. This work, by the way, is designed to be helpful to the Treasury. We have just decided this week so we have not had a proper discussion with the Treasury yet. It is designed to help the Treasury define what it is they want as a wholesale market in the UK. There is a lot of confusion amongst our members. They hear on the one hand certain regulators saying, “We want the financial services industry cut down to size; 4% of GDP” and all the rest of it. On the other hand, “We are open for business; please come in, please open branches”.

We are trying to do this debate in a helpful way, to say, “Look, the sort of wholesale industry you really need here probably looks like this.” If that were broadly accepted we would then seek to work with the Treasury to find a way of creating a framework in which it can thrive. That is what we are intending to do.

**Q557 Chairman:** That sounds very interesting. If it is produced in the timeframe of the operation of this Committee we would very much like to see it.

*André Villeneuve:* I am happy to share it with you.

**Chairman:** Thank you very much indeed for your evidence today. It has been very useful.