PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCIAL SERVICES BILL

First Sitting

Tuesday 17 November 2020

(Morning)

CONTENTS

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not later than

Saturday 21 November 2020

The Committee consisted of the following Members:

Chairs: †Philip Davies, Dr Rupa Huq

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

Kevin Maddison, Nicholas Taylor, *Committee Clerks*

† attended the Committee

Witnesses

Victoria Saporta, Director of Prudential Policy, Prudential Regulation Authority

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

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

Simon Hills, Director, Prudential Regulation, UK Finance

Daniel Chichocki, Director, LIBOR transition, UK Finance

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

Public Bill Committee

Tuesday 17 November 2020

[Philip Davies *in the Chair*]

Financial Services Bill

9.25 am

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

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

Ordered,

That—

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

(a) at 2.00 pm on Tuesday 17 November;

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

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

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

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

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

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

Table

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

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

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

Resolved,

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

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

Resolved,

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

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

9.26 am

The Committee deliberated in private.

Examination of Witnesses

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

9.31 am

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

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

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

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

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

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

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

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

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

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

John Glen: Thank you. That is all.

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

The Chair: Yes, absolutely. Fire away.

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

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

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

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

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

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

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

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

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

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

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

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

Mr McFadden: Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Ms Eagle: Thank you, Chair.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Examination of Witnesses

Simon Hills and Daniel Cichocki gave evidence.

10.25 am

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Alison Thewliss: Thank you very much.

The Chair: Do any other Members have any questions?

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

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

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

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

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

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

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

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

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

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

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

Ms Eagle: Thank you very much.

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

Examination of Witness

Paul Richards gave evidence.

10.48 am

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Q53 Alison Thewliss: And the potential cost of litigation?

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

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

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

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

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

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

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

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

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

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

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

11.13 am

Adjourned till this day at Two o'clock.