

ABSTRACT OF THE LONDON DISCUSSION

## Autumn Lecture 2019 presented by Dr Kay Swinburne

[Institute and Faculty of Actuaries, London, 2 December 2019]

**The Chairman (Mr J. Taylor, F.F.A.):** The IFoA hosts an autumn and a spring lecture every year to discuss topical policy areas, not only important to actuaries but to policymakers and to the public. We host these lectures twice a year to showcase how the work of actuaries relates to the wider world and to our commitment to leading debates that are in the public interest. This is an important part of fulfilling the obligations under our Royal Charter.

I would firstly like to thank Kay (Swinburne) for taking time out of her busy schedule to be here tonight. Kay's political career began as a local councillor in Wales. She then went on to be elected to the European Parliament. During her career as a Member of the European Parliament (MEP), she served as vice-chair of the European Parliament's influential economic and monetary affairs committee, playing at a pivotal role in shaping European Union (EU) and global financial services legislation.

Before becoming an MEP, Kay worked in the investment banking industry and she now works at KPMG as their vice-chair of financial services. So, it should come as no surprise that her main topic this evening will look at financial regulation in post-Brexit Britain.

Regulation is at the heart of what the IFoA does. We undertake our regulatory role first and foremost in the public interest.

Fundamentally, regulation is about protecting the public, but it extends also to assuring public confidence, maintaining the quality of actuarial work and the professionalism of the actuaries who deliver it. Regulation also extends to financial markets and the industries in which many of us work.

In 2018, the financial services sector contributed £132 billion to the UK economy – that is nearly 7% of total economic output. Pretty important in its own right, but then when you consider the role the sector has in providing liquidity and investment and insurance to every industry sector, it is even more important.

The financial services sector plays a critical role in the lives of everyone in the UK because if the market works well – competitively and fairly – those markets benefit consumers, staff and shareholders, and they maintain confidence in the UK as a major global financial centre.

The vote to leave the EU presents a question for the sector and also for regulators. Brexit involves a process of disentanglement of the UK financial services industry from the EU, both in terms of access to markets and in terms of future regulatory arrangements.

For some, the prospect of life outside the single market has led to focus on aligning our regulatory systems – in short, a quest for equivalence. For others, the UK's new trading environment presents an opportunity to remove regulatory barriers, to pick and choose what we like and what we do not like. Whatever the path set by the new government, that of equivalence or divergence – neither is straightforward nor clear cut – it is essential to get it right.

On that note, it is my pleasure to hand over to Kay (Swinburne).

**Dr J. K. Swinburne:** Good evening, everybody. Thank you ever so much, John (Taylor), for the invitation, and to the IFoA, for asking me here this evening. I know that I am not a true

management consultant yet because I do not have slides for you. You will have to listen to the speech this evening. I can assure you that the Q&A can be as interactive and as loud and boisterous as you want. I will try my best to answer every question posed to me, even if my former colleagues never, ever do.

I will say that, given Brexit is where it is, so much hangs on what goes on in the next couple of weeks and the outcome. I suspect my crystal ball is not much different from anybody else's crystal ball.

I am going to try to put where we are in terms of a crossroads in a global context and in terms of some of the big themes that are coming out; some of the big regulatory issues that you are going to have to deal with. And the theme this evening is that I do not think, ever again, it will always be about the numbers. From now on, it is about purpose; it is about principles; it is about doing the right thing for the right reasons; and not just having numbers to justify what you are doing.

When we actually move to that new paradigm globally, the world may well be a better place.

I have spent most of my working life working in financial regulations, not only in producing them, as I have done for the past 10 years – there have been over 100 pieces of financial regulation that I, in some way, have had to work on over the past decade – but also, as an investment banker and former hedge fund manager, in implementing much of that regulation.

So, I have some sympathy for being caught in the cross-fire of much of the regulatory tsunami that has come at you, particularly since the financial crisis.

But during all of that time I cannot remember a time such as we have now. I think that we are in a moment in time where UK financial services, in particular, are sitting right in the middle of a criss-cross of political, social, and regulatory shifts. I am going to try to elaborate on some of that.

In the long term, the role our sector plays in society is coming under a huge spotlight. In the medium term, there is obviously uncertainty over our relationship with our closest trading partners, and how we extricate ourselves from the EU will matter because it will set the future framework in motion.

In the short term, we have two potential candidates – some would say more – to lead our country. But they have widely differing visions for big business come December 13.

Incidentally, although I have spent a long time in politics, I am not going to try to predict the outcome in a couple of weeks' time. I am genuinely going to give you a breather on elections for the next 20 or 40 minutes or so. I am not promising you billions in spending, either. I am not going to be inciting any social media spats because of what I say. I have kept my comments very moderate.

The reality is I am here and it is my words, as opposed to anything else, that are, I hope, going to resonate a little. I am hoping to give you a snapshot of where we are with regard to the regulatory landscape, in a way that you might be able to use going forward, thinking about things, not just those that you are going to have to do tomorrow but things you are going to have to do over the next few years.

There are a couple of areas on which I am going to focus. Some of the developments are obvious. Before I talk about those, I want to talk about where we have come from. It really does shape how policymakers think.

Most economic theory suggests that economic growth demands that the financial system evolves over time. Just as a construction company has to change its business models by developing better building materials, having more effective tools and having an eye in its supply chain, the financial services sector is just the same.

Computer hardware companies have to evolve, too. They have to harness the power of new technology, new chips, new production lines, new everything. They have to evolve. Our sector, too, has to do that.

The form in which banking is being provided to customers is changing all the time. The form which money is taking is changing, too, even though the Bank of England does not want to admit to that. The areas of the financial system in which profits can be found are forever, and always have been, changing. I believe the task of regulators is therefore to support the positive evolution of

that financial system while fundamentally protecting customers from harm and safeguarding the integrity of the system as a whole.

That job for the past decade has been particularly complex and particularly global in its outlook. Regulation has undergone drastic change since the financial crisis, and in particular since 2008. The global nature of that financial crisis created a more global regulatory model in its image. Therefore, there has been more cooperation and more communication. It is as if the system came so close to plummeting off that cliff edge that all the regulators decided that they had to erect crash barriers at the top to prevent that happening again.

So, standards are tougher and more complex in virtually every area of financial activity, whether it is leverage, liquidity, governance, culture, systemic risk, or indeed resolution planning. All of these areas have been touched by the new regulatory framework. Although the banks were on the frontline of the crisis 10 years ago, and therefore the tougher regulatory tone was for them loud and clear, other parts of the sector such as insurance, asset management, investment firms, and the financial market infrastructure are all facing tighter rules, some of which were designed up to 5 years ago and are still waiting to be implemented.

So, all our standards are ratcheted up. I am going to give you a few examples, many of which you will be very familiar with. The Basel Committee, which sets global standards for banking supervision, has now finalised a further revised set of standards. They have put standards in place for prudential requirements, for how much capital people have to hold, and also they have looked at operational risk. They have looked at operational resilience. They have looked at all sorts of factors, all of which provide data that give them a much better idea of what risk is out there and how it will be managed.

It means that there are tighter restrictions on the actions of individual banks and, in particular, in the way that they calculate the risks that they hold on their balance sheets and the way in which they might have chosen, historically, to reduce their own capital requirement provision.

Banks that have been systemically important at the global level are obviously going to have to ratchet up the amount of capital that they hold in order to have greater capacity to absorb shocks. At the same time, we are seeing that the insurance industry is now facing exactly the same thing as Basel has done for the banking sector with the new rules that are going to be reformed and reviewed under Solvency II.

We are really seeing a ratcheting up of capital requirements. In fact, there is a ratcheting up across the board. For business conduct, anti-money laundering, the prevention of funding terrorism, and, of course, across all financial sectors, the direction of travel is the same.

To set it out like that suggests that regulation has been moving steadily and progressing in an evolutionary manner to a fixed destination. The reality, I am afraid, is that it has not been a single track where they have had one single agenda. It has been a busy three lane motorway in effect.

The earliest of the post crisis reforms are now being reviewed. Many of you will have been involved in the MiFID II ongoing saga. MiFID III has already been written in Brussels as we speak. They are calling it MiFID 2.1 as they think you won't notice.

The reality is that we have already had a review of the Central Counterparty (CCP) legislation within the European Market Infrastructure Regulation (EMIR) and EMIR 2.2. And, of course, under Basel, the iterations are now Capital Requirements Directives (CRD) 5 and 6 in European legislation. We are seeing that that early reform is now already itself being reviewed and reformed.

Meanwhile, there are other slower pieces of regulation that are only going to be completed and implemented right now. My favourites, because I love financial regulation – one of those few people that do – are CSDR (Central Securities Deposit Regulation) and SFTR (Securities Financing Transaction Regulation). Alphabet soups, but one deals with the settlement discipline within financial markets and the other is about securities lending in the repo market and its reporting.

I worked on those two pieces of legislation in my first mandate, so before 2014, but the date for implementation is not until next year (2020) and therefore already the markets have evolved and things have changed by the time we are actually implementing some of that legislation.

Then of course you have a fast lane – or, at least, what the regulators like to think of as the fast lane; I suggest it is probably already the slow lane. That regulation is going to deal with new technologies, with the fintech sector, with crypto assets, and with all of those new innovations that have happened because consumers are demanding them and because technology is now available to move at that faster pace.

But regulation is not the only variable that is going to affect the fortunes of the financial services firms in the short term. There is a different macro environment out there. There are changing customer needs, and the new millennials really do think of financial services in a very different way to their forebears.

Innovation also needs to be looked at differently. But it is a more influential variable than it has ever been in terms of how do you harness innovation? How do you promote it? But how do you also make sure that it is regulated so people doing the same activity are regulated in a fair and equitable way?

It is becoming more and more complicated. In my experience, where regulations are being formalised, certainly in Europe and now here in the UK going forward, there is an extraordinary clarity of purpose on regulations. In Brussels, they still feel that long shadow of the financial crisis and therefore they still feel they are in post-crisis mode. It is not over yet. So, where are we now? The after-shocks of 2008 are still registering on the seismograph – certainly in Brussels and elsewhere. The regulatory ground is still occasionally rumbling beneath our feet.

But in the past decade, and especially in the past 5 years, there has been a different kind of disruption brewing. Less of the earthquake, more of a change in the air. Geopolitical volatility and the macro-economic risks around that are growing and are more influential than ever on that regulatory agenda.

To understand properly the potential change, we need to appreciate fully the various factors at play individually and what they add up to collectively.

First, we have that rise in popular sentiment across the entire world. Nationalist politicians have come to power in a number of European countries over the past few years and the nationalist vote share has increased in virtually every European country.

We can argue as to whether this shift has its roots in the financial crisis of 2008, as many make the case, or whether it predates that and we go back to 1986 or, indeed, before that. But there is no doubt that the speed at which it is taking root is actively changing.

The nationalist world view is much more inward looking rather than outward looking. Global institutions, which set the tone and policed those global rules in the past: the United Nations (UN), the North Atlantic Treaty Organization (NATO), the World Trade Organisation (WTO) or whatever global body you want to look at, are now starting to be bypassed and are, in some circumstances, being brazenly ignored.

So, we are witnessing an escalating trade conflict around the globe. There are global contracts being awarded and used as proxy weapons, and punitive tariffs are now increasingly becoming the norm. The trade conflict between the US and China shows no signs of abating. The fact is that the EU was also mixed up within that trade war, both with China and the US.

The United States is now being forced, for the first time in history in my opinion, to look at a rival nation whose economic potential perhaps exceeds its own.

Trust in institutions by individuals is suffering too. They do not trust governments any more. They do not trust the media any more. Even non-governmental organisations (NGOs) are really suffering from that lack of trust. Individuals certainly do not trust business.

Trust has been plummeting across all of these institutions for the last decade. But the banner of hope was the social media businesses. They were the exception. People trusted them – but no

more. In the last 2 years, the trust that they had in that peer-to-peer relationship also seems to have fallen out of favour.

All these varied factors seem to tend to fall in the same direction – inwards – towards protectionism and towards protection economics that then follow. And certainly here in the UK, we have to be really careful, post-Brexit, that we do not fall into that same trap as a small nation trying to plough our own furrow.

As you can see, the impact on the global bottom line is already being felt. Global growth forecasts for both this year and next have already been revised downwards at least once. This knock-on effect on investment is going to hold back profitability for all of those companies operating within this space.

It may seem a really downbeat litany: lots of things that are happening; and lots of negative things that are taking place. But it is important to paint a picture so that we can then look at where things are moving and where we might want to position ourselves going forward.

The fact is that the financial institutions were built for an outward looking, ever more global, world; but the world that we are in today is starting to look slightly different. There is a lot of potential for divergence and a lot of potential for regulation to diverge too. The big challenge is going to be how do we get international standards right? How do we make sure that they stay relevant and secure global consistency in how the principles for those rules are being developed and applied in the financial sector?

The growing inwardness and mistrust only exacerbates the difficulty financial regulators around the globe are having.

I dropped my iPhone a week and a half ago. Have any of you done that? Where it falls down the tiniest little space, but it falls in such a way that you can pick it up and see the pattern of cracks all around it. That really gave me the impetus for a thought: it does not take much to cause major damage. I think that fragmentation of my screen almost gets me to where I am with financial regulation. It is going to be so easy to get something wrong that triggers a big change in the place that global cooperation has actually moved towards in the last decade.

Sometimes, with markets behaving in such a way, the wrong combination of forces at the wrong time can cause a serious splintering. I am genuinely hoping that governments around the world do not allow that to happen. I am really hoping that supervisory practice will make sure that that does not happen in the world of financial services.

You can put up blocks; you can prevent market players from doing certain things; and you can prevent cross-border business. But, in effect, two territories that are working together cross-border suddenly putting up some form of a barrier really does mean that they become out of sync very quickly. Actually, in implementing international standards at different times or in different ways, we are going to see a fragmentation really quickly.

So, you can get fragmentation as a by-product of what would be a sensible piece of regulation, if you are a government trying to protect its people. Ring-fencing in the UK could be seen as one of those examples where you decide to do something in the interests of your consumers because you believe that it is a risk to them. But, if you get it wrong, you end up not just promoting local stability but also causing instability elsewhere. You may be cutting down the opportunity for diversification, cutting down the opportunity to share risk cross-border – and indeed we are certainly seeing that within the European system for CCPs, where there is now legislation in place which will allow them to fragment the market if they believe that it is in the EU's interests to do so.

I do believe that you are now increasingly seeing, whether it is in market infrastructure, whether it is in the banking sector, or in the insurance asset management space, that close alignment is starting to fragment in what was a market taken for granted.

But you are seeing some bright spots. You are seeing increasing cooperation between the European and the Asian regulators. The US is becoming a little more silent as the US regulators step back from many of those global fora and they are not participating quite in the way that they were even just a couple of years ago. But the Eurasian alliance is still a little shaky. There

are divisive forces here between consumer and investor protection in particular, and European standards in this area might not ultimately be suitable for the Asian markets to adopt. Certainly, the Asian regulators may decide to go their own way in protecting their consumers as they see fit.

So, in banking, the consensus that emerged was that the financial crisis was fraying at its edges and you needed to come together. That may prove increasingly unsustainable. The issue of frustration with Asia and the frustration in Asia is that Asia sees most of rules in financial services as being conceived, made, delivered, and implemented in the West for the West. Some Asian countries are now feeling that they have a comparatively raw deal in the global financial regulatory environment.

There is a suspicion that regulators are less inclined to rap the knuckles of Western players for fear of losing out on their tax revenues, for example, in the US or, indeed, across Europe.

As this part of the world increases its footprint in both lending and in our capital markets, it is probably only fair that they also take on a much stronger role in that global regulatory framework. Certainly, I would expect them to step up, having more influence in designing the rules that we expect everybody to play by.

But I think that there is going to be a steady change in the way that those Asian markets interact with the rest of the world. I do think that that regulatory alignment is going to be very, very important going forward.

There are a couple of key areas that I want to look at which, even though it is not obvious to financial services how they interplay, will be critical to the future relationship that the UK has as a global financial centre and the way in which we have a role to play going forward.

We have looked at how we have reached this point and we have looked at where we are now and the potential paths ahead of us. As I have said, I am not making predictions. Given you are a room full of actuaries, you are probably much better than I am at doing that. But I do believe that there are some broad trends that we need to take into account and that regulatory change will follow those broad trends.

The first is that data are becoming increasingly political. The second is that capitalism, as we know it, is somewhat in retreat with social purpose being a new requisite for our businesses to adopt.

Let us first look at data. The first signs are there that Europe's approach to data is about to change drastically. To put it in perspective, you have to look at China and then look at why the EU might be changing its way of dealing with data. The Chinese artificial intelligence (AI) pioneer, Kai-Fu Lee, has written: in deep learning, there are no data like more data. Essentially in AI-driven technology, the more data you can feed a new product, the faster the new product will then develop.

Kai has written a lot about the battle for digital supremacy between the US and China. He believes that they are the only two superpowers. He believes that they are actually in a race to dominate technology going forward.

The data is political – it already is political – and the politics of data is worth keeping a close eye on because when people like Kai talk about there being only two horses in that race, Europe gets really upset because they would like to be the third horse in that race.

The Chinese government has made no secret of its ambitions in its interventionist “Made in China” 2025 policy. It clearly sets out the goal: that they want China to be the global leader in all tech heavy sectors like AI and robotics. It is happy to clear any obstacles out of the way of its companies operating in that space.

In Europe, and to a lesser extent here, and to an even lesser extent in the US, privacy regulations and competition law have been a harness on the activities and the growth of those businesses. They have had a fairly tough regulatory environment with which to deal. In China, regulations have simply not been applied in the same way. There is a much longer, looser, approach to



capturing the vital raw material of tomorrow's economy. This is what Kai calls China's alternate digital universe – oceans of data about the real world.

In fact, China has already surpassed the US in terms of being number one in the world for collecting raw data in terms of sheer volume. At the same time as China is championing being a data localiser, it has long-established controls on data. It does not allow any data to leave China if it believes it is important. Therefore, they have actually created their silos of data.

They believe that they can do this on the grounds of economic or national security risk. The result is data about Chinese citizens, Chinese companies, or their technologies have to be hosted on servers in China today. It is why giants in the technology world, global players like Apple and LinkedIn, are having, reluctantly, to use Chinese servers and localise their data, too, although it runs against everything that they want to do with our global data source. They have had to comply.

Europe is starting to move in exactly the same way. It would like to have its own EU Cloud to keep all its EU data within the EU going forward. Are we now going to start seeing data protectionism in practice? The kind of data localisation, or you could call it just data protectionism, reduces global collectiveness and adds complexity for businesses which are trying to operate a global model. Financial services businesses, I would suggest, are actually some of the most vulnerable of all.

We have seen a similar logistics sector example. Scania Trucks collects black box data in every truck that they drive across the world. For anybody who has the trucks, their data go back in real time into Sweden, to the headquarters of Scania Trucks. Except in China. All that data are kept in China so they no longer have access to that data to improve the way in which they provide their services, including how they service their vehicles, and how they develop those trucks going forward, and indeed how they make them optimal in terms of their green footprint as they take goods from one place to another.

They already have to deal with localisation. China is probably the best localiser of data. Europe has decided also to follow suit. The think tank, the European Centre for International Political Economy – a bit of a mouthful – calculates that in the decade to 2016, the number of significant data localisation measures in the world has nearly tripled from 31 to 84. That includes some of the European measures but also includes countries like India.

You have all heard the sound bite, I am sure, that data are the new oil. It has caught on because it expresses the idea that data now underpin the economic activity of entire sectors. I think that metaphor continues to hold up. Like oil in the 1970s, data are now a really powerful raw material. Data are a geopolitical lever. Data barriers put up by one group in one country have a major impact on many, many others.

Europe now has a really new bullish tone on data. If you have been listening to the new Commission President, Ursula von der Leyen, you will know that she has completely changed the direction on data.

So, what does that have to do with the UK and EU businesses post-Brexit? The policymakers have been looking at China. They have been looking at how they can have their version of this. While we in the UK have spent the past 3 years basically looking at all our institutions, looking at how we are going to leave, we have been very focused on the how, the why, and what we are going to do when we leave the EU. In fact, how we are going to do it. Not about what happens afterwards.

The EU itself has spent the last 3 years looking at what it wants to achieve in the UK's absence. The UK was the greatest fan of global data. It was the greatest fan of the global market and of that interconnectedness. In the absence of the UK at the table in the last few years, the EU has definitely been changing the way that they are looking at control for that data.

The tail end of our Brexit withdrawal agreement has coincided with the start of a new 5-year leadership in the commission. There was a new parliament elected; the new commission came into force yesterday. The new commission sets the political priorities for the next 5 years.

That new commission has new members, new portfolios, and actually one of the biggest things talked about is the fact that it would like to have some form of technological sovereignty.

The reality now is that the European data landscape that protects EU citizens and promotes EU companies is going to be a fundamental new priority for the EU, in a way that it pivots to protectionism much like Beijing has done over the past few years, and much like India has been doing of late.

Actually, we have become caught up in Brexit discussions in the UK, but the EU has been talking about how they want to position themselves and have spent a lot of time thinking about the future in a way that I wish we had.

The incoming replacement, Ursula von der Leyen, has genuinely just said: "It is not too late for Europe to achieve technological sovereignty in critical technology areas. We will jointly define standards for this new generation of technologies that will become the global norm."

She went on to say: "We will balance movement of data and protectionism of privacy because we have to find the new European way". It represents a new tone for the commission. It signals future policy changes. I suggest we need also to look at the other people at the top table of the European Union for the next 5 years. You have the vice-president for digital, who also is the vice-president for competition, Margarethe Vestager, who has been known in the US as "that Google finer-in-chief". She has made a reputation for herself globally already. She is now at the top table doing this new strategy for the digital world and for data protectionism.

She has made it a professional mission to rein in what she sees as being the anti-competitive impulses of Silicon Valley. You add to that the other important person who has the single market portfolio and also a lot of other digital topics, the French ex-finance minister, Thierry Breton. He is in line for a very influential job in this area, and he is on record as being a strong backer for data localisation.

It all comes about just as the EU's new data policy comes into play, and at its core is going to be the ability and the inclination to build new walls.

In terms of privacy and protectionism, the Europeans have always seen the debate as a question of protecting their citizens. For the past 30 years, especially in Germany and other German-speaking countries, they have been incredibly suspicious about anything that could be seen as data surveillance.

It means that when the user volunteers to become the product, a model and its critics now describe as surveillance capitalism, many in Europe are instinctively suspicious.

Europe now appreciates that its instinct on privacy has not helped the EU to become a big contender in the data fuelled technology world. They are trying to balance this out. The way in which they are looking to do this is to have more leadership in Europe, where they can help European champions in the tech space. They can promote, through various protectionist measures and through various selective means in trade, to help the national champions thrive. They will have a European Cloud and they will try to get the data within that Cloud and nowhere else. Certainly, as they put it, not within US or Chinese companies' jurisdiction.

So, I am assuming that there will be a Brexit deal of some kind in the near-term and that we will have a transition period. What does this mean for us here in the UK and for financial services firms? I do believe that once the transition period ends, there will be an abrupt change. There will be a big difference in the way that data, in particular for UK companies, are going to be handled. The UK will no doubt trust its European colleagues and allies to do the right thing with data, and they will trust them to look after and manage UK citizens' data in the appropriate way.

I do not think that holds the other way round. I genuinely do not think that the EU will trust UK companies that they see as being too liberal with market data, to do the same thing. I think that we are going to have some major issues that will mimic what has happened elsewhere in the world.

This concept of technological sovereignty is real and urgent. We need to keep a really close eye on it. Data-driven technology is increasingly seen as a national security asset.



I am going to turn to the final part about capitalism being in retreat. I have been a Conservative party member and a Conservative all my adult life. I do believe that capitalism as we know it, and as it has been historically defined, is changing. I am going to read some headlines.

The first one is that confidence in capitalism has eroded. Probably, none of us would argue with that.

Capitalism must be much more responsible. We, probably, could agree with most of that.

They call for a rethink of capitalism, and capitalism needs new standards.

All of this suggests that we need to think about the way in which business operates and the way business could interact with the rest of society in a different way. Up until a few years ago, you would not have seen headlines like that, particularly in the British press. You would have seen them, possibly, from the far Left, or think tanks, but you would not have seen them in the Financial Times (FT).

All of those headlines are from last month's FT. Capitalism is having a crisis, a crisis of purpose, and that crisis has the potential to trigger significant regulatory change in and of itself.

Climate change and rising inequality have thrust environmental, social, and governance (ESG) issues into the mainstream. They are firmly up there as the number one CEO concern this year. The whole of the financial eco-system is now waking up to ESG measurements and the need to do things differently.

To illustrate how much this has all changed, I am going to paint you a picture. When I was a member of the European Parliament, I was invited to speak at a conference for hedge funds in the US in 2010, so post-financial crisis but not far beyond it. The hedge fund world always thought that they were beyond reproach for the financial crisis; that they were nothing to do with it and they were all fine.

But I had a real issue. I was giving a speech but I had gone to listen to the conference proceedings beforehand. A very senior hedge fund manager – one of the largest hedge funds in the world – was giving an investor presentation. He was talking about how they could make money in a risk-free way in 2010. He was painting a picture. He was talking about a large green field somewhere in England being covered with solar panels. He talked about those solar panels being modified from a standard production line and that they were on stilts raised enough off the ground to allow sheep to graze underneath them. Because, in 2010, they realised that there were two subsidies that they were allowed to claim under the EU rules. One for the solar panels and one for the Common Agricultural Policy land use underneath the panels.

They did not think that this was wrong. They did not think that they might actually be doing the wrong thing. But just because they found a loophole, they were prepared to tell everybody that this was risk-free money and that they were finding a way to making a return for their investors that involved absolutely no risk.

I am glad to say that the loopholes were closed fairly quickly afterwards. Compare that way of doing business in 2010 with an image of a Swedish teenager. You can think what you like about a 16-year-old lecturing the world leaders, but I do not think I will ever forget the imagery on the Six O'Clock News of 16-year-old Greta Thunberg arriving in a sailing boat in New York before the UN conference on climate change. That was an image that I think my children will never forget either. Young people can make a difference.

Whatever those two images tell you, I feel that there needs to be a stark change in the way we do business. "Business as usual" has gone: we now have to rethink it. I genuinely believe that one of the images is very firmly in the past, or should be, and the other is looking at how we need to consider things going forward.

The public sentiment on climate change has accelerated. Some people have been working on this for years. Not everybody has been listening. They thought it was niche. It is no longer niche. Some of the flimsy lip service sustainability responses that certain firms have made are now consigned, or should be consigned, to the past. It has been catalysed by that urgency of a new generation.

New customers, younger customers, are demanding change; but also regulators are realising that they have to have a grown up, joined up, policy across all areas of regulation.

In my firm, we have been tracking the evolution of Climate Change attitudes, and the annual survey this year found that for the first time ever, climate change was the number one risk to growth of over 1300 CEOs globally. Seventy six per cent of them said that their growth would depend on how they navigate the shift to a different type of economy. That is ground breaking. That is a major change in the way global leaders are starting to think of their businesses. There are several existential risks to businesses that are now sinking in to boardrooms across the world.

There is the physical risk. Changes in the climate will affect the nuts and bolts of business operations in most sectors. There is also the financial risk. Changes in investor behaviour, driven by climate consciousness, will affect where capital goes in the future. There is also a family of risks associated with society's changing expectations of how businesses should behave, how they treat their workers, how they pay their suppliers, and how they give back to the communities that they sit within.

Even the CEO of Blackrock can say that he was the canary in the mines. At Davos, a couple of years ago, he called on companies globally to consider their purpose. He insisted that to be viable in the years to come, companies must benefit all of their stakeholders, not just their shareholders. We saw the movement this summer with the alliance of companies in the US changing their principles of business away from solely shareholders to all of their stakeholders.

We have seen asset managers follow suit. We have seen the likes of the CEO of Allianz Global Investors say that we need more sophisticated measures than GDP per capita to ensure that capitalism is not borrowing from the future while destroying our environment. These are all strong words.

Anne Richards, the CEO of Fidelity International, has called for a pivot away from shareholder primacy for the very same reason.

Over the summer I think that we saw a major change with the US business round table, where they re-wrote their guiding principles. We also saw, a couple of weeks ago, the Confederation of British Industry (CBI), at their annual conference, spending half a day looking at purpose. What is the social purpose of business within the CBI membership? These are all big changes. Big companies are starting to realise that they have to engage with this new programme.

ESG is now mainstream. It is the new lens through which the world will assess the value of a company. It is not just about sustainability; it is the E, the S, and the G in equal measures. If you get the G right, it means that you have the E and the S right too.

It is more than just about what a company is doing to mitigate climate change. The ESG criteria bring into focus data on how a company treats its workers, its supply chain, and the wider community.

For some time, the asset management industry has been under some pressure to integrate this ESG consideration at a fund level or at a firm level. It has been driven, so far, by demand. It is their customers who have been asking for these new products. At the last count, funds that use ESG criteria represented over 30 trillion dollars in assets. That is going up by the day.

Calls are coming from many directions. It is not just the big institutional investors. Consumers are demanding this, too. And now policymakers are getting in on the act.

I know this because they have been reporting back. The KPMG network is global. We have reports from all over the world, even at state level in the US, that this is happening everywhere. These changes are happening today. You have probably have seen signs yourselves within the data that you look at and within the risk profiles that you are considering.

Also look at who is buying what. Schroders bought impact investment house BlueOrchard in July. Their CEO talked at the launch of the new Institute on Institutional Investment: Green Investments earlier last week, about this acquisition. He talked about it being one of its proudest moments.

There have been a lot of big bets made in credit rating agencies looking at what type of assets they need to buy in order to deliver a new ESG credit rating within their overall ratings. Everybody is now looking at investing in data for that ESG purpose.

Most firms are getting on board with this shift and are genuinely doing it quite rapidly. Tech advancement will help; climate policies will help; physical risks are coming together to trigger what I think is a fundamental reassessment; and the complexity is going to be huge. People who understand data, who understand risk, are going to have to try to navigate this journey.

A new regulatory environment is coming. Europe is already regulating. The UK is regulating. Indeed, many of the states that I have alluded to are also regulating. China is regulating. Australia is regulating. Many, many countries around the world now believe that there needs to be a big regulatory push.

Next year is the fifth anniversary of the Paris agreement on climate change. Even though COP 25 is happening, as we speak, in Madrid, the actual 5-year anniversary is important because the 5-year anniversary is where the climate change targets and objectives are ratcheted up.

Next year, COP 26 is being held in Glasgow. The UK is hosting that particular set of conferences. It is at that conference, I think, where the UK is going to be expected to showcase how the UK can lead in this field. I do believe that with Mark Carney's recent announcement of his stepping up as a UN envoy for climate change, he will take the COP 26 agenda as one that he really wanted to fulfil in line with the work that he has done at the Bank of England, driving this agenda forward. I do believe we have a huge opportunity here.

As a planet, we are probably nowhere near where we need to be. But the reality is that I do believe that the financial system is willing to step up to help.

It needs a nudge. The regulation is going to be there to help it. There is going to be a new taxonomy. Indeed, there is already an enhanced disclosure for financial services firms being proposed, and if it goes according to EU law as it is currently written, that enhanced disclosure for funds and market discipline comes on the statute book to be implemented in January 2021. That is not that far away. Anybody who has not heard of this needs to start looking at what this might mean for the customers that you serve.

The motors driving this policy shift are the climate change agenda and, in particular, the COP sustainable targets will be really important.

The net zero announcement that many governments are now in the process of making, where they are intending to get to net zero carbon by 2050, is one which many environmentalists will say is not early enough. But if that is the latest, and everybody tries to get there sooner, at least the direction of travel is maybe the right one. When we have started on this journey, we could potentially accelerate.

For all of you I suggest that the European Commission's ESG proposals, particularly with regard to taxonomy, which provides a definition, is an area to watch. It is currently in political dialogue and will come out in the next few weeks or potentially months, depending on how political it becomes. The impact of ESG is about to deepen. Whether it is from the European Commission, or whether it is from other global rules, you are going to have to find ways to implement those rules.

It is going to have a hefty impact on investment. I think that there is a huge difference here now. A critical part of the regulatory picture is that taxonomy is still being discussed. But what is really important, and what is really exciting, is European policymakers have already answered some of those questions. They have already defined two new low carbon benchmarks. They have also established a new green bond protocol, such that anybody trying to raise money in this way now has to meet certain criteria in order for them to brand something a green bond.

But where does it end? Are we going to see ESG factors as a mandatory part of the rating process for credit rating agencies? Yes. That is coming.

Are banks and assurers are going to have to embed the ESG factors in their stress testing? Yes, it is coming, by 2022 at the very latest for the EU – possibly even sooner in 2021 for the UK PRA regulated bodies, in my opinion.

Change really is afoot. I genuinely do think that the best thing that can happen here is that these are not EU rules, but that they become global rules, and that we start to have much more dialogue between the different global regulators as to how we actually define these things.

How do we define Key Performance Indicators (KPI) that are measurable? How do we define things that you in this room can then compare and contrast for risk purposes? How can my firm, which has a major assurance and audit practice, potentially provide audit services for ESG to be meaningful going forward so that shareholders and the community at large know that when somebody is claiming something that it is real? These are all big things with which we have to grapple.

I think that financial services have been deliberately put at the centre. Anybody who thinks that it is by accident, it is not. It has been well thought through. You are all working with regulated entities and therefore can be forced to do things. That is a deliberate plan by Europe and by the UK as a partner within that European system when it was designed.

We need to have a common language and a common definition. Anything that your work can do to start bringing that together on a global basis would be very, very useful, particularly in a cross-sector capacity.

So, from where else is regulatory change going to come? I do believe that the UK will continue to have a strong voice. They are credible. They do have a strong regulator and they genuinely have a reputation for good management of financial services. We know that the UK's regulatory reputation contributes to our attractiveness for global funds, and it also supports the UK's influence in the financial markets.

At our firm, we are keen to see the introduction of any new regulations having a bit of a hiatus. If we are about to do MiFID III before we have even embedded MiFID II, then I think that everybody in this room will be really uncomfortable.

I think that we need to look at how we have done regulation, what needs to stay the same, and what can be changed. There are going to be enough things changing with the ESG agenda and with the other data protection issues in the broader picture.

But where are the next issues coming from? Brexit is going to affect the dynamic of Brussels. We are genuinely going to see a massive change in the way they do their business. I think the UK is also at a crossroads. It can decide whether it is going to be outward-looking or whether it is going to remain, as it has been in the past couple of years, much more inward-looking.

We have learned in 2008 that the biggest regulatory shifts tend to come with the biggest crises. So what is the next crisis point? What is going to bring the global regulators together again? What is going to force governments to come back to the table and realise that we are living in an interconnected world and that no matter what short-term barriers you put up, you may need to go back to that global network and really see it as an asset?

If I had to predict, I would probably predict a cyber security event. Cyber is the one area where people cannot know it all – everything is interconnected. I suspect that something major happening in that cyber threat space is likely to cause our global regulators to share information in a more robust way going forward rather than having their silos.

I think that a cyber event does not just affect the company that it has happened within. It may affect an entire system. It may also impact a market infrastructure, or indeed it may even affect the second order, such as the insurance companies that have insured the cyber resilience of many of those firms that have been affected. We are going to learn from a crisis, but it will take a crisis for some of that come about.

I also think for as much as we would like to think we have fixed “too big to fail”, many of you in the room will probably agree with me that we have not. We have just put better regulation around those businesses and more transparency to the regulators for the activities that are

happening. I would say that any of those systemically important global institutions that are too big to fail are not too big to fail and therefore any one of them going down could be quite a spectacular event.

A major failure would almost certainly lead to more calls for further breakup. Whether it is a breakup of the big four on competition grounds or whether it is a breakup of the big banks for systemic reasons in terms of stability, there are all sorts of calls that could come to change the landscape.

I am going to summarise. Without rules, we know that the wheels of the economy would quickly spin out of control. If the rules are excessively restrictive or poorly constructed, then the wheels will also grind to a halt.

It is a particular privilege for me to have been working with regulators for the last 10 years. They continuously, in my opinion, do look for the balance between the two extremes.

The complex regulatory landscape has become even more complex since 2008. We have heard how the atmosphere is defined by that inward-looking model that is taking place and taking root elsewhere. Domestic politics is pulling back from that connected global world. I do not think it is going to be definitive; I think we will have an opportunity to revisit this. I do not anticipate that the trend is going to stay the way it is. I believe that the US will come back to the table and I believe the UK will play a major role in trying to facilitate global cooperation.

Voters are frustrated with globalisation, with inequality and with the apparent connection between the two. I genuinely have faith in the wisdom of regulators. I can tell you that the people making rules in Europe do it for the collective good. They are pragmatic, most of the time. They are shrewd, most of the time. They are committed, all of the time, to making sure that individuals are helped by the financial system and are not hurt by it.

At this curious moment in history, I do feel that the regulators have been put on the back foot. I believe that they are globally minded people and they are watching their governments collectively fail to come up with global answers as they go down a more protectionist path. These are nervous times for global cooperation.

Despite the gloomy picture, I genuinely believe that global cooperation will be in the ascendency once more. I firmly believe that the pragmatism and long-termism that regulators do show in good times and bad will mean we come through this, despite what the politicians may do.

We may be in for an increased period of fragmentation. We may all be part of that hairpin turn of history, but I do believe pressure on politicians to involve themselves in the business of regulation will lessen. Regulators will become less politicised as time goes on.

I therefore believe that we will reconnect – but only if business embraces a sense of purpose. If business genuinely changes the way it looks at what it does for society, if it genuinely meets all of the criteria on the environment and all the social considerations and governance, then maybe there is a new paradigm around the corner.

I am optimistic, despite all the negative stuff that may have been brought out in on data localisation, and everything else. I do genuinely believe that ultimately we will be in a better place.

**The Chairman:** That was a fascinating, broad-ranging talk discussing all the influences acting on the UK regulators and on other parties as they start to contemplate life post-Brexit.

I will now open the meeting to questions.

A member of the audience: Thank you very much, Dr Swinburne. You ended by commenting on the wisdom of regulators – and most of us are regulators – and that triggered a thought in the context of global regulatory alignment and trends.

I work in the insurance sector. For background, I led my firm's submission to the Treasury Select Committee on Solvency II and Brexit. We have seen lots of good things from Solvency II, but also some real challenges for some of the key stakeholders that regulation is supposed to help.

If you think about consumers, Solvency II was a huge burden of cost for the UK industry. It was another nail in the coffin for some of the very important products in the UK – annuities and with-profits.

If you think about capital providers, Solvency II disincentivised the long end of the market. When you think about government, it disincentivised insurers from investing in government bonds and promoted the then LIBOR swaps. We now see a trend towards SONIA swaps.

That is just one example where I think there can be very serious unintended consequences of either EU or global regulation. I do wonder, whether it is post-Brexit or whether it is a different philosophy, if there is a need to redirect some of the incentives for quantitative measures into something where we have a much more fit for purpose regulatory philosophy.

**Dr Swinburne:** Solvency II was a strange piece of regulation. It came out at the time that Solvency I itself was already on the statute book. Solvency II was done at the beginning of the crisis legislation and it was therefore part of that big agenda.

The striking thing about Solvency II was that it was influenced heavily by Germany. Germany, as a member state, does not take a very proactive stance on most regulations, but tends to step back and end up being the kingmaker at the last stages of a piece of regulation, particularly within the council.

On this particular piece of legislation, I think all but one of the negotiating team in the parliament was German, across all the political groups. Every single one, bar one, was a German. That was because there was no German in the other political group to be appointed.

Germany had lined up all their ducks in a row on this one. In council, Germany took a very strong line. In the commission almost all the staffs were German. They had been thinking about Solvency II for a long time. I am told they were thinking about it since they got it wrong in Solvency I because it did not support the German insurance sector. Therefore, they were determined that Solvency II was going to be made in their image. And it certainly was. It certainly helped many German insurance company models.

It does not help the British insurance sector. And, in particular, the annuity business is one that nobody else recognised. It is a product which the UK has, in particular, because it has a pre-funded pension scheme for many of our private pensioners. They do not have that in many of the countries across Europe. There are only four other countries in Europe in the same position.

If I ever wanted a pension fund exemption, I only have five countries, four others with me, to try to find that exemption. None of the others are large. Therefore, we probably would not get the exemption.

So, I do believe that when you come to doing the separation between the UK and the EU, that Solvency II is probably one that is at the top of the list, and it is at the top of the list because the UK market never fitted with most of the principles of Solvency II.

I believe that you would genuinely still be in line with Solvency II if you changed some of the rules for annuity products because if other countries had pre-funded pensions, they would need them too, but they have not and therefore did not put them in as exceptions.

We can, within the spirit of conforming, still make changes to this. There are some big things that I would want to change. We need to have infrastructure investments. There is a serious alignment between those who have a long-term requirement for capital returns and those who can provide it. Some other government infrastructure projects would be fantastic for some of those pension funds and other long-term asset holders to hold.

The reality is that Solvency II's capital requirements make it unachievable or prevent it.

Those are simple changes that I do not believe go against the spirit of the rules. If we were to come out, it would not affect equivalence because it would be for the domestic market and not for a global cross-border impact.

If I were to be in the regulator now, or indeed at HMT, I would be red penning certain pieces of legislation to make the minimum changes that you need to give you your market specificities. But



make sure it does not have a cross-border impact because then you would no longer receive as big a mutual recognition assessment.

But you can make changes, and, if you are careful about it, you can craft it such that you would not impact the long-term relationship between the EU 27 and the UK.

If it gets a huge fanfare and people talk about it being a bonfire of regulations, it will get nowhere. It needs to be done with a scalpel and not a sledgehammer. I think you can make some major inroads.

I do know that most of my chiefs of staff are now moving to the Financial Conduct Authority (FCA) to do a similar type of process behind the scenes. So, many people who used to work in Brussels and who did the original legislation are now looking at how it might need to be modified to make it more fit for purpose for a British-only audience.

**The Chairman:** Online, people are latching on to this tension you drew out between political nationalism and the need for global cooperation in certain areas.

To pick on climate change specifically, there are certain politicians who are pursuing short-term economic self-interest at the expense of the global environment. You are describing companies and indeed consumers and individuals expecting more action. How will that tension resolve itself?

**Dr Swinburne:** The big elephant in the room is the US.

China has a major programme for greening – and I suspect we could probably be here all night debating whether or not their green programme is a real green programme as we define it in the West. So, the biggest polluter is also the biggest investor in green technology. There is a serious issue on being on both sides of that coin.

The reality is that they have a green policy. They already have a taxonomy. It is not the one that we would recognise here in the UK. But it is a taxonomy. They do define whatever is involved for their market. They are not backward. They are actually at the forefront. It is just a slightly different set of criteria from the ones that we would use.

The US is the elephant in the room. The US is not sitting on many of the working groups right now in its official capacity, which is unfortunate when a working group has some 45 countries involved and the US is not at the table. Then you find out, on some of the Financial Stability Board (FSB) working groups, that San Francisco are sitting on them.

You end up finding the local state level is fully engaged. There are two or three states that have produced legislation in the last year which has ESG criteria embedded. I think at a state level, we are seeing major moves. We are not going to see it at federal level, I do not think, for some time. But then, it does not need to be at the federal level if you have companies embracing it, both at the state level and globally.

The movement that we have seen is reflected in the number of incoming phone calls I am getting from some of the large financial services providers with a global footprint saying “Can you come and explain to me what the EU taxonomy might mean?”; “Can you explain to me how that fits with the work that the World Economic Forum (WEF) is doing with regard to Key Performance Indicators (KPIs) and how we obtain global measurable standards?”. Those incoming phone calls suggest to me that US global players are keen to play their part and that they are not going to shirk their responsibilities.

It may be vested interest. It may be that they have seen the writing on the wall. Whatever it is, I do not think they are going to run away from it.

**The Chairman:** Thank you.

Another question from the online audience: you describe the EU as at risk of being left behind in AI development because of the regulatory constraints around data.

There are a few questions coming online on similar topics that privacy standards and anti-trust legislation could inhibit commercial innovation.

Do you think those privacy standards and anti-trust standards might, therefore, be challenged in the European Union too?

**Dr Swinburne:** The interesting thing is that the General Data Protection Regulation (GDPR) is one of those pieces of legislation that took nearly 8 years to get over the line. When they started talking about it to when it was delivered, there was a hugely different environment into which it was facing.

The shock to me was that GDPR has not just been implemented across Europe. It has the global reach intended by those who designed it. It has had an extra-territorial reach that very few pieces of EU legislation usually achieve. Usually, it is US legislation that has that major reach into other countries.

But, for me, when I look at the way that it has been adopted around the world, many of the Asian markets have decided that the model of GDPR is not a bad one. They have not adopted all of it: they have taken pieces of it and applied it for their market. GDPR, in one form or another, is now exported around the world, whether it is by companies or governments adopting it.

The reality for me is that GDPR was constructed because data were global and therefore we wanted to put in some privacy protection for EU consumers. The reality now is that if you say that that is not good enough, and you need to contain the data, and you need to keep it within your shores to keep it safe, then why do we bother with GDPR?

I suggest the rationale for having GDPR was the right one. It was in that global outward-facing world. It was a sledgehammer. It was seen to be very intrusive and very expansive in its mission. But it has done its job, and it is doing its job, so why now build the wall?

**The Chairman:** Please join me once again in thanking Kay this evening for a fascinating talk.

I should like to thank everyone who has participated this evening: to our audience, both physical and virtual, for giving up their time this evening. Our two new Honorary Fellows for joining us tonight and of course to Kay (Swinburne) for giving us such a fascinating lecture this evening. Thank you all.