HMT FINANCIAL SERVICES FUTURE REGULATORY FRAMEWORK REVIEW: PROPOSALS FOR REFORM CP 548

Submission by The Financial Inclusion Centre

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The Financial Inclusion Centre is an independent, not-for-profit policy and research group (www.inclusioncentre.org.uk). The Centre's mission is to promote a financial system and financial markets that work for society. The Centre works at two main levels:

Promoting system level change
Research and policy development to promote sustainable, resilient, economically and socially useful financial markets that: benefit the environment; encourage responsible corporate behaviours and create a positive social impact; and efficiently allocate long term financial resources to the real economy.

Ensuring households' core financial services needs are met
Promoting fair and inclusive, efficient and competitive, well-governed and accountable, properly regulated financial markets and services that meet households' core financial needs. We do this by undertaking research into the causes of market failure in the sector, formulating policies to address that market failure, developing alternative solutions where the market cannot deliver, and campaigning for market reform.

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INTRODUCTION

We are pleased to submit our response to this important consultation. As we explained in our response to the Phase II consultation, in the post 2008 financial crisis period the current UK regulatory model has functioned fairly well in certain areas.

For example, we have seen considerable improvements in *conduct of business* and *prudential* standards in UK financial markets and services driven by a more robust approach from the regulators.

But, the degree of financial 'innovation' and growth in fintech and digital/ data services means that new conduct risks and consumer detriments are emerging. We cannot assume that the approach to conduct of business regulation which has worked well post 2008 will be effective in dealing with technology and data related risks and detriments.

Moreover, while conduct of business standards have undoubtedly improved, financial markets and services are still failing to meet public policy objectives relating to economic and social utility,[1] financial access and inclusion, supporting climate goals, and meaningful standards of corporate social responsibility.[2] [3] The UK legislative and regulatory system is not set up to address these public policy failures.

Post Brexit is an ideal time to rethink and reform UK regulation. The effectiveness of regulation depends on: the legislative framework; the regulatory architecture; the objectives and powers given to regulators; regulatory governance and acountability; and the regulatory culture, philosophy, and approach.

We do have concerns about the regulatory culture and philosophy adopted by UK financial regulators. An interventionist, precuationary approach is needed to make financial markets and services work for the economy, society, and the environment rather than trying to create the conditions for markets to work.

However, this consultation relates more to the legislative framework and regulatory architecture than the culture, philosophy, and approach. There are four main structural flaws in the current model of UK financial regulation:

- the legislative framework which determines the relationship between lawmakers and regulators;
- the objectives and powers given to the regulators which limits their ability to respond to emerging risks and harms;
- regulatory governance and accountability, and public interest representation mechanisms; and
- the lack of transparency relating to the regulators' supervision of financial firms.

[1] For example, how well financial markets and services: support real economy activities; produce good value products that meet consumers' needs such as saving for retirement; and help build financial resilience.
[2] For an assessment of the economic and social utility of financial markets and services see our report An Economic and Social Audit of the City, [An Economic and Social Audit of the City | The Financial Inclusion Centre]
[3] For an assessment of how well financial sector activities are actually aligned with climate goals see our report [Time for Action – Greening the Financial System | The Financial Inclusion Centre]

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It is unfortunate that HMT seems to have dismissed many recommendations from civil society organisations in response to the previous Phase II consultation. The latest iteration of HMT's proposals contained in this consultation document would do little to address those structural flaws.

To be fair, there are some positive proposals. But, these do not represent the once-in-a-generation reform and reset of financial regulation needed to face the challenges ahead such as:

- establishing a more agile, responsive regulatory system that can deal effectively with the constantly emerging risks created by complexity in financial markets and services and innovation in financial and digital/ data services;
- creating a regulatory system that deals more effectively and efficiently with the root causes of market failure and consumer detriment in financial services, and pre-empts and prevents rather than reacts to market failure and consumer detriment;
- introducing real accountability and transparency in financial regulation;
- ensuring the financial sector better supports real economy activities;
- achieving the necessary alignment of financial market behaviours with climate goals;
- promoting access and inclusion and driving out discriminatory practices in financial services; and
- ensuring the UK becomes a leading financial centre for sustainable, responsible, and social impact (SRI) finance – in other words socially useful finance.

Indeed, in some ways, the proposals in this consultation would be a retrograde step from the current position as they threaten to compromise the independence and operational effectiveness of the UK financial regulators.

RESPONSES TO SPECIFIC QUESTIONS

1. Do you agree with the government's approach to add new growth and international competitiveness secondary objectives for the PRA and the FCA?

No. We appreciate that the government wants to ensure the financial sector is internationally competitive and supports growth. But, the proposed objectives (combined with the proposal to give the government the ability to require the FCA to revise its rules if government thinks it is in the public interest) would compromise the independence and operational effectiveness of the UK financial regulators, and could undermine consumer protection objectives.

From a prudential and financial stability perspective the competitiveness objective could lead to significant risks being reintroduced into the UK financial system. This would undermine the integrity of, and trust in, the UK financial system affecting the long term competitiveness of the UK financial system.

To begin with, these new objectives would seem to be superfluous. The UK has, once again, been ranked as the most competitive global finance sector.[4] The sector is not short of organisations whose job it is to promote financial services domestically and globally. It does not need another set of institutions, in the form of regulators, promoting its interests.

The implication of the arguments presented for introducing these new objectives is that the regulators do not properly consider growth and competitiveness. This is not the case. The regulators already consider the impact of policy interventions on the industry.

For example, when developing policy, the FCA will evaluate a range of alternative policy options to meet its primary objectives (eg. consumer protection, promoting competition, or protecting market integrity). If it puts forward, say, two options that it considers would be equally effective at meeting those primary objectives, it will select the option which has the least impact on the industry. In doing so, it automatically factors in the competitiveness of the sector and its ability to provide services to the economy (so supporting economic growth). So, imposing new objectives is not actually necessary.

It is worth elaborating on the risks. These objectives are likely to be used as 'Trojan Horses' by industry lobbies to push for deregulation using disingenuous arguments that regulatory 'red tape', or 'burdens' are holding back financing of infrastructure (and 'levelling up' initiatives) and environment projects, or the international 'competitiveness' of the financial sector.

We already see examples of industry lobbying for deregulation using these arguments. For example, charge caps have been a very effective consumer protection measure for pension savers. Yet, the pensions and investment industry is lobbying for charge caps to be raised on pensions claiming this would allow for investment in infrastructure.[5] The insurance industry lobby is arguing for reforms to Solvency II claiming this would unlock funding to 'revive the economy, boost infrastructure, and

[4] London leads global financial rankings for the second year running (cityoflondon.gov.uk)
[5] See the report of the Productive Finance Working Group | Bank of England

meet climate change pledges.[6] But, we believe the main driver for lobbying to reform Solvency II is to allow benefits for shareholders to be brought forward at the expense of policyholder interests.[7]

There is a wider issue about the benefits of using private finance such as private equity, insurance and pension funds to fund critical green and social infrastructure. These sources of funding are more expensive than state funding.[8] There is the argument that private sources will be willing to take on risks of financing green and social infrastructure. But, the industry is also pushing for the state to take on much of the risk. So, rather than wanting to support national public policy, economic, and environmental goals these arguments are actually being deployed to unlock higher benefits for shareholders and/ or higher fees for financial institutions. Providing the financial regulators with statutory growth and competitiveness objectives would give industry lobbies even more influence over regulatory decisions.

In terms of operational effectiveness of the regulators, the boards and the staff should be free to focus on their primary objectives. Making these objectives explicit would be a distraction and cause boards and staff to check themselves when developing policies to pursue those primary objectives.

We are concerned that growth and competitiveness objectives could reintroduce significant financial system risks.

HMT is not particularly clear on how it defines 'competitiveness' or on what terms it would want the financial sector to compete on. But, we presume that it refers to the ability of the UK finance sector to compete for business overseas and for the UK to remain an attractive location for globally active financial institutions.

As our report, ***An Economic and Social Audit of the City***[9] explains, the financial sector delivers significant economic benefits for the UK. The same report explains how significant economic and social harms have been caused by an overreliance on finance in the economy and a growth in high risk financial activities enabled by misguided financial regulation. So, any regulatory reforms should be assessed against whether they improve the economic and social utility of the financial sector.

There is a real choice to be made as to how the UK financial sector competes internationally, and the UK attracts globally active financial institutions. Ideally, the government would want the UK financial sector to compete on: the quality, trust and integrity of its markets and institutions; providing services which offer true added value to customers; and being a financial centre that contributes to global financial stability. Over the years, the UK has become one of the leading global centres for financial markets and services (wholesale, institutional, and retail). There is now a real opportunity to ensure the UK becomes the leading financial centre for socially useful fintech and sustainable, responsible, and social impact (SRI) finance.

[6] Phoenix urges solvency reforms to unleash £50bn for UK economy | Financial Times (ft.com)
[7] There is a wider issue about the benefits of using private finance such as private equity, insurance and pension funds to fund critical green and social infrastructure. These sources of funding are more expensive than state funding. There is the argument that private sources will be willing to take on risks of financing green and social infrastructure. But, the industry is also pushing for the state to take on much of the risk.
[8] Private sources will expect a premium on the returns generated above gilts (the cost of state funding)
[9] An Economic and Social Audit of the City | The Financial Inclusion Centre

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But, there will be pressure from certain industry lobbies to create a regulatory system that allows the UK to compete on the basis of: cost-cutting; offering more ‘accommodating’ regulatory standards; and willingness to accept riskier financial business.

We would prefer the government ensures the UK finance sector competes on the first approach. Creating a regulatory system which promotes the highest standards of quality and integrity, that engenders trust and confidence is the way to promote competitiveness that is sustainable in the long term.

The second approach might seem attractive in the short term, but will cost the UK in the long term. Moreover, we cannot ignore the importance of the UK finance sector in the global financial system. What the UK does, influences others. A competitiveness objective could place UK financial regulators in a very difficult position of having to compete with other global financial regulators, and risks regulatory arbitrage.

As the Finance Innovation Lab points out[10] just a decade ago, the UK Parliament acknowledged that a focus on competitiveness by regulators had contributed to the global financial crisis of 2007/08 which cost the world economy $10 trillion.[11] In the words of Andrew Bailey in 2019 (then the CEO of the FCA, and today the Governor of the Bank of England), the regulator ’was required to consider the UK’s competitiveness, and it didn’t end well, for anyone.’[12]

It is, of course, important that the operations of financial markets and services support the real economy. One of the primary roles of financial markets is to allocate resources to the real economy. Yet, no part of the regulatory system is required to assess and report on how well financial markets perform that role.

Therefore, if government wants the financial sector to support productive economic activity, this would be better achieved by giving the Bank of England, Prudential Regulation Authority, and FCA new statutory obligation to assess and report to Parliament on how efficiently financial markets are financing the real economy. This assessment and reporting should be overseen by a Regulatory Oversight Committee.

2. Do you agree that the regulatory principle for sustainable growth should be updated to reference climate change and a net zero economy?

We agree with the government’s assessment that the UK’s regulatory regime could be strengthened in relation to climate change. Unfortunately, HMT’s proposals for updating the relevant regulatory principle relating to sustainable growth still do not reflect the magnitude of climate crisis and the degree of behavioural change required in financial markets and services.

[10] Financial Inclusion Centre is a supporter of the Finance Innovation Lab’s campaign to prevent the FCA and PRA being given a competitiveness objective

[11] https://www.chathamhouse.org/2018/01/lasting-effects-financial-crisis-have-yet-be-felt

[12] The future of financial conduct regulation | FCA

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As the Finance Innovation Lab campaign points out, UK banks, asset managers, and other financial institutions are responsible for nearly double the UK's annual carbon emissions.[13] We support other civil society organisations in their view that regulators should have a statutory objective that ***positively*** requires them to take action to help achieve the UK's emissions reduction targets and Paris Agreement commitments of limiting global warming to 1.5 degrees. However, the government's proposal would require regulators only to 'have regard to' the principle that growth should be consistent with the UK's net-zero 2050 target.

Greening the economy and financial system is one of the great economic and public policy challenges of our time. Financial regulation needs to actively drive positive behaviours and deter negative behaviours in financial markets and services, which in turn must influence the required behaviours in the real economy. Relegating the role of financial regulation to a principle/ have regard does not do justice to that challenge.

As we highlight in our report Time for Action: Greening the Financial System[14] the claims made by the UK financial sector about its commitment to climate goals is not matched by the necessary level of activity or actual behavioural change.

In that report, we identified a range of systemic and structural barriers to greening the financial sector and the real economy. Significant policy interventions are needed, therefore, to overcome these barriers so that financial market behaviours are aligned with climate goals and financial resources are directed to real economy activities that support climate goals. This needs to be done efficiently and cost effectively, in a way that avoids greenwashing and the creation of green asset price bubbles.

Therefore, even at this late stage of the consultation process, we urge HMT to consider more fundamental reform of the financial regulatory system to reflect the scale of the climate crisis. We propose that the Bank of England should be given a new statutory objective to promote financial market behaviours that contribute to economic and environmental sustainability. The FCA and PRA should be given new obligations to support and have regard to the impact of their policies on the Bank of England's sustainability objective.

The FCA should be given responsibility for overseeing how financial institutions, listed companies and larger private companies disclose compliance with sustainable, responsible, and social impact (SRI) criteria and mandatory reporting on compliance.

Government and Bank of England should establish a Financial Sustainability Committee (FSC) along the lines of the Monetary Policy Committee (MPC). The FSC should take responsibility for the Bank's new statutory objective described above and coordinate the work of all the regulators involved in managing climate related risks – the Bank of England, PRA, FCA, and The Pensions Regulator (TPR).

[13] https://www.greenpeace.org.uk/news/uk-banks-and-investors-responsible-for-nearly-double-the-uks-annual-carbon-emissions-report-finds/
[14] Time for Action – Greening the Financial System | The Financial Inclusion Centre

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The FSC should publish an annual report on its activities plus a wider triennial review on progress against its objectives. The FCA, PRA, and TPR should also publish an assessment in their annual reports on how their activities have contributed to the objective of the FSC.

3. **Do you agree that the proposed power for HM Treasury to require the regulators to review their rules offers an appropriate mechanism to review rules when necessary?**

No. The combination of the proposed growth and competitiveness objectives and this proposed power threatens to compromise regulatory independence. We have explained elsewhere why the growth and competitiveness objectives are misguided.

HMT has not made the case that this proposed power is necessary to improve collaboration between government and regulators or regulatory accountability. Rather, this new power could have the effect of changing the relationship between government and regulators from one based on collaboration (with regulatory independence protected) to one where government would have the opportunity to compromise regulatory operational independence. This power would add little, but threaten much.

4. **Do you agree with the proposed approach to resolve the interaction between the regulators' responsibilities under FSMA and the government's overseas arrangements and agreements?**

It is reasonable for regulators to be expected to consider the interaction between their responsibilities under FSMA and government's overseas arrangements and agreements.

But, we do not agree with the proposal in para 4.33 which says: '*When making rules and when setting general approaches on supervision where appropriate and proportionate, the government proposes that the regulators would be required to **consult HM Treasury** [our emphasis] on the general anticipated impact on these areas*'.

If there is to be consultation, this should be public and transparent, with a wider set of stakeholders. Without public and transparent consultation, there is a risk (as with other proposals in this consultation document) that this proposal could result in government's economic and trade goals overriding the regulators' other statutory objectives and compromise regulatory independence.

5. **Do you agree that these measures require the regulators to provide the necessary information to Parliament on an appropriate statutory basis to conduct its scrutiny?**

We support the intention to improve the levels of transparency and accountability on the performance of regulators. It is hard to object to the proposals set out in Chapter 5 of the consultation document.

But, it is difficult to see these proposals making much difference unless the relevance and quality of market data and metrics made available to external stakeholders is significantly improved.

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External stakeholders (including Parliament) need to be able to measure how effectively regulators use their available powers, resources, and interventions to produce improvements in consumer outcomes, or prevent negative outcomes. That is why regulators exist – to make markets work for consumers, not to create conditions for market participants.

For stakeholders to monitor regulatory effectiveness requires meaningful, relevant performance data and metrics. Data and metrics can be grouped into three categories:

- input (eg. availability of financial resources, number of staff);
- output (eg. level of activity, numbers of decisions made, use of resources); and
- most importantly, outcome data and metrics (on whether interventions make markets work from the consumer perspective, not from the industry perspective).

There is quite an amount of input and output data available in publications such as business plans, annual reports, and on regulators' websites.

Data and information on the effectiveness of specific interventions can be made available, for example, through independent reviews. And there is some data and metrics on outcomes and market performance made available when the FCA conducts thematic reviews and market studies. But, these by definition are reactive, after-the-event studies and focus on a specific issue rather than overall market performance.

In some cases, the effectiveness of the regulators can be judged by *observation*. As we mentioned, the FCA has clearly been successful in improving corporate behaviour in retail financial services as can be observed in the reduction in widespread systemic misselling scandals.[15] We can observe the effectiveness of the PRA by the absence of regulated firms in default.

The FCA is now implementing a data strategy to improve the way it uses historical data and intelligence to better understand harm and manage it more swiftly.[16] This is positive.

But, none of the above allow for objective, *regular* monitoring and assessment of how well markets are delivering for consumers – and therefore how well the regulators' are using interventions to deliver on their statutory objectives.

If markets are working for consumers they should produce the right consumer outcomes.[17] But, it is not possible to judge how well markets and individual sectors[18] are delivering against the outcomes as the relevant data and information is not produced on a systematic, consistent basis by regulators. Therefore, it is difficult for Parliament and wider civil society to scrutinise the regulators.

[15] These still occur. The defined benefit transfer misselling scandal is a case in point. But, the number and scale of system wide misselling scandals have been reduced.
[16] Data | FCA
[17] access to products and services that meet consumer needs (economic and social utility of products and services); affordability and value for money; quality of products and services; fair treatment of consumers; security of products and services; access to appropriate information and advice; and rights to redress.
[18] banking, mortgages and consumer credit, savings, investments and pensions, insurance, and financial advice/ information provision

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Specifically, the lack of public information is holding back efforts to promote financial access and inclusion. In the previous consultation, we proposed that the FCA should be given a new statutory objective to promote ***fair access*** to financial services.

To support that objective, we also proposed a rethink in the type and relevance of data published on market access and inclusion. In the UK, financial services firms have few meaningful obligations in relation to financial inclusion. There is almost no transparency on how well financial services providers are performing in relation to financial inclusion or the extent to which financial practices can result in outright discrimination against vulnerable groups.

Even equality impact assessments provide few usable insights into how well markets meet the needs of, or the potential impact of policy interventions on, consumers with protected characteristics.

The approach in the UK is contrast to the obligations faced by US financial institutions under the Community Reinvestment Act (CRA)[19] and Home Mortgage Disclosure Act (HMDA).[20]

Similarly, the FCA is consulting on introducing a new Consumer Duty for regulated firms.[21] This could be a powerful intervention and drive behavioural change in financial services if supervised and enforced properly. But, the FCA is not specifying the metrics that firms must use to measure compliance with the Consumer Duty. Nor is the FCA requiring firms to report to it on compliance performance. This is very disappointing. It means that civil society organisations and, of course, Parliament will be very much hindered in its ability to hold the FCA to account.

Therefore, we would argue that to enable real accountability to Parliament and citizens:

- the FCA should be required to produce regular reports on how well markets are meeting the needs of consumers (based on consumer outcomes);
- the FCA should be required to produce regular financial inclusion audits assessing the performance of the industry (and sectors) against financial inclusion metrics with a special focus on households with protected characteristics);
- the FCA should be required to produce regular audits of how well the financial services industry is complying with the Consumer Duty;
- the FCA should be required to report to Parliament and government on the extent to which commercial financial services is able to meet the needs of vulnerable and excluded groups (especially those with protected characteristics);
- the FCA should be required to report to Parliament and government on the impact of policy decisions on financial inclusion – for example, changes to the Universal Credit system; and
- individual firms should be required to produce financial inclusion audits similar to the US CRA and HMDA.

As well as problems with sectoral performance data, there are issues relating to transparency on the conduct and behaviours of individual firms. The current overprotection given to commercial

[19] Community Reinvestment Act (CRA) | OCC
[20] The Home Mortgage Disclosure Act | Consumer Financial Protection Bureau (consumerfinance.gov)
[21] CP21/36: A new Consumer Duty: feedback to CP21/13 and further consultation | FCA

confidentiality and sensitivity protects the interests of firms at the expense of consumers and wider regulatory accountability.

The Financial Services Act 2012 made several changes to FSMA 2000 that introduced some improvements on transparency and disclosure. But there are still significant legal constraints on what information the FCA can, and is required to, disclose. The restrictions in section 348 of FSMA on the FSA's ability to disclose 'confidential information' continue to apply to the FCA. In short, the FCA cannot disclose information that relates to the business or affairs of any person, and information that it receives for the purposes of its functions under FSMA, unless:

- the information is already lawfully publicly available
- the FCA has the consent of the person who provided the information and, if different, the person to whom it relates
- the information is published in such a way that it is not attributable to a particular person (for example, if it is anonymised or aggregated)

This defaulting to the withholding of information is not tenable. The presumption should be for disclosure. It is only in limited cases where constraints on disclosure are justified – for example, to protect the interests of small traders who may suffer reputational damage by unreasonable disclosure, or if disclosure would jeopardise the solvency of a firm or stability of the financial system.

We have seen some improvements to transparency on FCA enforcement actions. However, the FCA's policy on keeping investigations private until the Warning Notice stage is reached is retained. There is some merit in this on the basis of natural justice – particularly for small traders and individuals.

But, the FCA should be required to publish an annual digest of supervisory investigations instigated and completed, decisions on whether or not to take supervisory actions, which form of supervisory action taken against larger firms including an explanation of why investigations have not resulted in public enforcement action.

Transparency on financial promotions which breach rules is a particular issue. The FCA can issue an authorised person with a direction to withdraw, or refrain from making, a financial promotion, where it considers that there has been, or is likely to be, a contravention of financial promotion rules in respect of the promotion. In terms of transparency, the FCA may require the authorised person to publish details of the direction, and the FCA itself may publish such information about the direction, as it considers appropriate.

This is not tenable. The FCA should be required to publish details of any direction.

The FCA justifies its current approach on the grounds that: '*clear confidentiality restrictions encourage the free flow of information' and that 'if there was uncertainty about information becoming public, our sources could be less willing to give it to us*.' It is not appropriate that a financial regulator should rely on the willingness of regulated entities to supply it with information.

Therefore, as well as requiring the FCA to publish better market data and metrics relating to consumer outcomes, FSMA should be amended to:

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- require firms and individuals to supply information to the FCA in a manner that supports the regulator's activities
- provide the FCA with the power to demand relevant information in support of its objectives and activities
- specify that there should be a presumption of disclosure and transparency with the exception of a limited number of specific circumstances

The FCA's compliance with these requirements should be evaluated by the Regulatory Oversight Committee described below.

The measures outlined above would provide Parliament with the necessary information tools to hold the FCA to account for its effectiveness in making markets work for consumers.

6. Do you agree with the proposals to strengthen the role of the panels in providing important and diverse stakeholder input into the development of policy and regulation?

We have no comments on placing the FCA's Listing Authority Advisory Panel (LAAP) and the PRA Practitioner Panel's insurance sub-committee on a statutory footing. We support the proposal for a statutory requirement for the regulators to publish information on their engagement with the panels and for a statutory requirement for the regulators to maintain a statement on appointment processes for the panels.

But, again, we do not think that these measures on their own represent significant enhancements in regulatory accountability or stakeholder representation. Therefore, these are unlikely to result in noticeable improvements in the policy making process.

The role of panels is, of course, important. The FS Consumer Panel has an effective role to play in helping the FCA develop its thinking.

However, panels are a limited substitute for meaningful public interest representation at board level. Over the years, public interest representation on the boards of financial regulators has improved. But, even now the financial services industry is over-represented at the highest level. The FCA has seven independent non-executive members (excluding a representative from the PRA). Four have industry backgrounds. Only one has a dedicated consumer background, one has a public interest/ civil society background, and one is competition academic. The majority of FCA's Regulatory Decisions Committee (RDC) members have industry backgrounds.

The majority of the external members of the Prudential Regulation Committee have financial services industry backgrounds. Three out of six Financial Reporting Council board members have financial services backgrounds – three have public interest backgrounds.

None of the members of the regulatory boards appear to have direct experience of environmental issues which, given the increasing importance of the environment in discussions about financial regulation, seems strange. Similarly, there appears to be no one on the regulatory boards (or board committees) with significant experience of financial access and inclusion issues.

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Therefore, we would suggest that government should amend legislation to ensure regulators have an appropriate and representative balance of interests on their boards and high level decision making bodies eg. for the FCA this would include the RDC.

There is a case for more fundamental reform of the governance of regulators. We propose that the assessment of the overall strategy, approach, and effectiveness of the regulators should be scrutinised by an independent body consisting of public interest representatives, separate to the non-executive boards of regulators and complementary to existing panels such as the Financial Services Consumer Panel. We call this the Regulatory Oversight Committee. This committee should report to a relevant Parliamentary committee.

There is also merit in considering alternatives such as having Supervisory Boards for the FCA and PRA which would oversee the overall strategy and approach of the regulators with separate operational boards to oversee the running of the organisations.

There are a number of other measures which could enhance the governance and accountability of the regulators including:

- **Public meetings.** The FCA and PRA should be required to hold part of their board meetings in public along the lines of the Food Standards Agency. This would ensure that board members are given proper exposure to external views from civil society and consumer advocates.
- **Public hearings.** On key matters, the FCA, PRA, and Bank of England should be required to hold formal public hearings (in addition to annual public meetings).
- **Transparency regarding industry lobbying.** The Chairs, CEO, and senior managers should be required to maintain a public register with details of meetings held with external parties.
- **Strengthening whistleblowing measures.** As part of systems and control measures, the FCA now requires firms to have a senior manager or non-executive director to act as a 'whistleblower's champion'. The intention is that whistleblowing is the responsibility of the board.[22] The FCA also has a dedicated team and process for handling whistleblowing complaints from employees in the financial services industry.[23] But, the process for handling external whistleblowing complaints is not overseen by the FCA board – although the adequacy, effectiveness and security of the FCA's internal whistleblowing arrangements is overseen by the FCA's Audit Committee. We propose therefore that the FCA/ PRA be required to ensure there is board level oversight of the external whistleblowing arrangements.

Some of these measures might be considered to be operational matters for the regulators. But, these would be given more weight if specified in legislation.

[22] SYSC 18.4 The whistleblowers' champion - FCA Handbook
[23] Whistleblowing: How to make a report | FCA

7. **Do you agree that the proposed requirement for regulators to publish and maintain frameworks for CBA provides improved transparency for stakeholders?**

Yes. This should be helpful in terms of providing more *transparency*. But, again it would not address the main flaw in the way CBAs and impact assessments are undertaken.

For example, there is an issue with the way the FCA conducts CBAs. At the risk of oversimplification, FCA's approach can be summarise as one where the regulator publishes an assessment of the potential impact of its preferred interventions against the impact of 'doing nothing'.

But, it is not required to publish, as a matter of course, an assessment of potentially more effective interventions it has rejected.

A good example relates to the use of direct interventions such as price caps. Price caps have been shown to be very effective at protecting consumers and driving corporate behavioural change - much more effective than relying on traditional competition interventions (such as enhancing information disclosure or promoting switching) to achieve the same outcomes.

Yet the FCA, by default, tends not to opt for price caps. It sees direct interventions as a last resort, preferring to wait to see whether its competition/ market based interventions work. This can result in detriment and harm continuing while the FCA waits to see if its market experiments work. FCA usually explains why it opts to reject price caps or other more direct interventions such as product regulation by saying that these would be disproportionate.

It would be an aid to good policymaking and regulatory accountability if the FCA was required to publish a comparative impact assessment of i. 'doing nothing', ii. its preferred intervention, and iii. direct interventions such as price caps or product regulation.

Moreover, when the FCA's considers issues relating to Equality and Diversity the impact assessment it undertakes is very cursory – particularly with regard to the impact on people with protected characteristics.

Therefore, if HMT wants to enhance the utility of CBAs and impact assessments, a new statutory requirement should set down what criteria the regulators should include in their assessments and require them to explain how they intend to assess the criteria.

8. **Should the role of the new CBA Panel be to provide pre-publication comment on CBA, or to provide review of CBA post-publication?**

It should be restricted to post-publication review of CBAs. The financial legislative and regulatory framework is already too reactive and slow (and in our view will remain so even with the limited proposals contained in this consultation). Allowing pre-publication would risk further delays.

More important will be the make-up of any CBA panel. The panel must have sufficient independent public interest representation to:

- ensure industry views do not dominate (the industry has hugely more resources at its disposal to influence thinking on CBAs to skew policymaking in its favour); and
- avoid group think on the benefits of different types of intervention.[24]

9. Do you agree that the proposed requirement for regulators to publish and maintain frameworks for how the regulators review their rules provides improved transparency to stakeholders?

Yes. This would, by definition, introduce further transparency. But, unless these reviews are built on meaningful performance metrics (see response to Q5) it is not clear how this proposal, in and of itself, would allow us to assess with any degree of certainty the impact of rules and interventions on market behaviour and efficiency. So, these proposals are unlikely to be that effective in enabling stakeholders to understand what works in regulation or assess the regulators' overall performance.

10. Do you agree with the government's proposal to establish a new Designated Activities Regime to regulate certain activities outside the RAO?

We agree with the high level intentions to: provide continuity and stability during the transition; maintain a proportionate approach;[25] and try to make the UK regulatory regime more agile and responsive to emerging market risks.

The proposed approach for repealing and concurrently replacing EU law should support continuity and stability. Obviously, the governance around the process of repealing and replacing will be important.

For example, as we have explained elsewhere, we are concerned about the proposal to give government the power to require the regulators to change their rules if the government determines it is in the public interest. This threatens to compromise regulatory independence especially when combined with the proposal to give the regulators objectives to promote growth and competitiveness objectives. Regulatory objectives and national economic policy should not be mixed.

Will the proposals make the regime more agile and responsive? Up to a degree. It will allow the regulators to respond to activities that would have fallen within the perimeter - either through being covered by UK generated regulations or EU law directly applying into the UK.

[24] The established approach to CBAs/ impact assessments relies too much on established competition-economics measures of market efficiency – eg. measures such as numbers of suppliers/ products in the market, likely market entry/ exit, and premises such as more choice, switching, and competition will drive down prices and so on. Furthermore, the established competition-economics community tends to not like direct regulatory interventions as a matter of principle. A new approach to understanding how markets actually work in practice as opposed to in theory is badly needed in financial regulation.

[25] Of course, what is proportionate is always open to interpretation

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But, the approach set out in the consultation document would not appear to deal with the delays caused by the need for Parliament to legislate for innovations and activities that are not currently within the perimeter.

If anything, regulators need to be given more discretionary powers to rapidly bring new providers, products, services, and activities within its remit so that these are subject to regulator's supervision. The question is: how do we square the circle of allowing regulators more flexibility to respond, and ensuring public accountability?

It is possible to square this circle with a system of *purpose-based* regulation, providing the regulators with more discretion to bring new providers, products, services, and activities within its remit, combined with more formal reviews of the use of those powers by Parliament, enhanced governance and accountability mechanisms for the regulator.

Purpose based regulation means defining financial activities in law according to broad general purposes. For example, this could include: provision of payment services; deposit taking/ savings; creation and provision of credit; insurance and risk management; primary and secondary market activities; and asset management.[26] This would then be underpinned by two supporting categories: provision of financial advice and information; and provision of data and analytical services.[27]

Any new financial activity could be presumed to fall within one of these purposes The FCA could be allowed to determine which purpose a new financial activity falls under using a fast track consultation process. Parliament should monitor and review the FCA's use of these powers.

Parliament should define these broad purposes, the supervision and enforcement powers available to the FCA, and provide the FCA with the necessary powers to ensure financial services fall within the perimeter. FCA should adopt a precautionary approach to financial innovation and be given tougher product regulation powers.

This purpose based approach to regulation would allow the FCA to deal with risks created by 'innovations' such as buy now, pay later (BNPL) credit or high risk investment products without having to wait for legislation to determine that activities are within its remit.

We think this purpose based approach would also be more efficient and flexible than the Designated Activities Regime (DAR) outlined in the consultation paper. It would allow the regulators to presume that any activity was within the perimeter, classified under one of the categories outlined above.

But, depending on the nature of the person (financial or real economy firm) carrying out the activity, regulatory principles, rules and guidance could be temporarily switched off and disapplied.

Of course, HMT might argue that the DAR achieves this distinction but comes at it from the other direction. This is true. However, the purpose based approach is more flexible as it would allow for the disapplied provisions to be switched back on more quickly if it became clear those activities were causing harm and needed to be subject to full regulation.

[26] For use by pension schemes, retail investors and so on
[27] For example, data provided by credit reference agencies, credit ratings agencies, emerging ESG ratings services, and behavioural data

This system would also be more effective at dealing with the confusion and harm that arises when regulated firms may be involved in promoting and distributing unregulated products.[28] With purpose based regulation, there would be no doubt that products fall within the regulatory perimeter.

11. **Do you agree with the government's proposal for HM Treasury to have the ability to apply "have regards" and to place obligations on the regulators to make rules in relation to specific areas of regulation?**

No. It is for Parliament to determine what have regards are applied. After all, have regards are part of the general legislative and public policy framework. It is for Parliament to determine that framework.

Nor is it appropriate for HMT to have powers to place obligations on regulators to make rules. As with the proposed power allowing government to require regulators to revise their rules (see Q3), this would compromise the regulators' independence. It is for Parliament, through government, to determine the legislative and public policy framework.

We appreciate HMT is trying to address a specific concern about how to regulate critical financial market infrastructures (FMIs). These FMIs are indeed critical to the wider financial system and economy. But, that is all the more reason for Parliament to ensure that FMIs are brought fully within the legislative framework and remits of the relevant regulators.

This marks the end of our submission.

[28] As highlighted by Dame Elizabeth Gloster's report into the FCA's regulation of London Capital Finance

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