Treasury Committee: Future of Financial Services Inquiry

Submission by The Financial Inclusion Centre

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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SUMMARY OF SUBMISSION

We are pleased to submit our response to this important inquiry. We take the view that in recent years the current regulatory model has functioned fairly well given the sheer scale and complexity of the UK's financial markets and services. We have seen considerable improvements in the conduct of business standards in UK financial markets in the post 2008 financial crisis period driven by a more robust approach by the regulators.

But there is considerable room and need for improvement. The effectiveness of regulation depends on: the regulatory architecture; the legislative framework; the objectives and powers given to regulators; regulatory governance and acountability; and the regulatory culture, philosophy, and approach.

We have concerns about the regulatory culture, philosophy, and approach adopted by UK financial regulators who follow a permissive approach to regulation rather the precautionary approach needed for complex, high risk, system critical markets like financial services. They sometimes show a reluctance to intervene to make markets work.

However, this consultation relates more to the regulatory model and structures than the culture, philosophy, and approach. Therefore, the main emphasis of our submission is on what we see as the four main structural flaws in the current model of UK financial regulation:

1. The legislative framework which determines the relationship between lawmakers and regulators is not fit for purpose. We support the view that it is for Parliament and Government, with appropriate public interest input, to determine the overall strategic direction of financial services policy. But, regulators need more flexibility and powers to respond more quickly and effectively to emerging threats and risks. We argue for the introduction of *purpose-based* regulation, with greater Parliamentary and public oversight, to address the lack of agility in UK regulation to respond to emerging threats and risks.
2. The objectives and powers given to the regulators are not fit for purpose for the economic, environmental, and social challenges facing the UK. We propose that the UK regulators be given three new statutory objectives in relation to:

- serving the interests of the real economy
- sustainable and responsible financial behaviours and practices
- access, financial exclusion, and discrimination

3. There have been improvements in consumer and public interest representation over the years. But, there are still serious imbalances. Industry lobbies continue to dominate policy making. We make a series of proposals to improve the governance, accountability, and public representation mechanisms relating to regulation and regulators.
4. We make a series of recommendations to deal with the lack of transparency relating to the regulators' supervision of financial firms which undermines effective regulation.

The post-Brexit environment could result in a more fragmented, complex regulatory system. We caution against any moves for deregulation or the introduction of a *competitiveness* objective (which would be a Trojan Horse for deregulation and compromise regulatory independence and integrity). This would simply transfer costs and risks to consumers and real economy firms and undermine trust and confidence in UK financial markets and services. The UK can maintain and build on its world leading status by becoming a beacon of good practice in **s**ustainable, **r**esponsible, and social **i**mpact (SRI) finance, and fintech and digital services.

RESPONSE TO SPECIFIC QUESTIONS

How can the UK financial services sector take advantage of the UK's new trading environment with the rest of the world?

The UK financial services industry is one of the most important UK industries. In 2019, the financial services sector contributed £132 billion to the UK economy. This is equivalent to 6.9% of total economic output. This is down from the @8.5% of the economy at its peak on the eve of the 2008 financial crisis. Nevertheless, it is still one of the most important economic sectors. There were 1.1 million financial services jobs in the UK in Q1 2020. But, the number of jobs dependent on the financial sector is much bigger when associated professional services are factored in.

Financial services has been an export success story for the UK – in 2019, the surplus in financial services trade was £41 billion (£60 billion exports, £18 imports).[1] The headline data alone does not convey the important position financial services holds for the wider economy and society in providing finance to the real economy (business and households).

For a fuller picture of the contribution the financial services makes to the economy and society, see Financial Inclusion Centre's Economic and Social Audit of the City.[2] However, the Economic and Social Audit also sets out the level of damage caused by the financial services industry in the form of misselling, value extraction and destruction, and misallocation of resources within the economy.

So, any reforms to the financial services industry post Brexit should try to build on the value created by the sector (both domestically and overseas) but also improve the sector so it becomes more economically and socially useful for the real economy.

In terms of taking advantage of the new trading environment, we argue that the UK financial sector has an opportunity to build on its positive aspects to become a global leader in economically and socially useful finance such as **s**ustainable, **r**esponsible, and social **i**mpact (SRI) finance and value added fintech and digital services.

To do this, policymakers should ensure that the financial sector thrives by becoming a beacon of good practice and high standards. Policymakers should avoid at all costs attempts to make the UK sector 'competitive' in global markets through deregulation. Deregulation is a false economy as it either just transfers risks and costs to the real economy (businesses and households) and/ or it risks undermining trust and confidence in UK financial markets and services.

The EU will (or it should) remain an important market for UK financial services. In that sense, the UK will remain bound to the EU if in a less obvious, legal relationship. If we want to avoid damaging the sector's access to EU markets, UK policymakers are going to have to accept a large degree of compliance with EU standards.

Brexit is now likely to result in greater regulatory fragmentation and complexity. We could see a 'trifurcation' of regulation with the development of:

- regulatory standards aimed at allowing the UK to compete on the global stage

[1] Financial services: contribution to the UK economy - House of Commons Library (parliament.uk)
[2] An Economic and Social Audit of the City | The Financial Inclusion Centre

- EU aligned regulation – whatever happens the EU will remain an important market for much of the UK financial services industry and protecting this access will require alignment with EU standards
- domestic focused regulation

If this is not managed properly this could result in greater costs and less clarity for industry and confusion for financial users.

What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?

As mentioned above, we will have to think of regulatory policy in terms of three separate but interacting layers – global facing, EU aligned, and domestically focused. While the UK might be politically independent of the EU, it will have to remain tied to the EU regulatory system if it wants UK financial services to retain valuable access to those markets. Moreover, with regards to global markets, the UK will have to comply with global standards – although it will have the opportunity to influence those global standards. It could, of course, deregulate in attempt to create an illusion of competitiveness. But, this would be a false economy as it would be likely to undermine trust and confidence in the UK sector.

We are particularly concerned about the domestic sphere. Again, there are risks as industry lobbies will use the need to promote economic recovery post Covid and finance the green transformation of the economy as opportunities to lobby for reductions in prudential regulatory and consumer protection standards. The argument being made is that regulation is a 'burden' and stifles innovation. This, of course, is misleading.

We would also urge policymakers to resist the idea of giving regulators a *competitiveness* objective. This would compromise the critical independence of regulators and is a Trojan Horse for deregulation.

We take the view that in recent years the current regulatory model has functioned fairly well given the sheer scale and complexity of the UK's financial markets and services. In the post 2008 financial crisis period, we have seen considerable improvements in the conduct of business standards in UK financial markets driven by a more robust approach by the regulators.

But, there is an opportunity to create a more tailored, more effective regulatory regime for the UK domestic market. There is considerable room, and need, for improvement. The effectiveness of regulation depends on: the regulatory architecture; the legislative framework; 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, philosophy, and approach adopted by UK financial regulators who follow a permissive approach to regulation rather the precautionary approach needed for complex, high risk, system critical markets like financial services, and who sometimes show a reluctance to intervene to ***make*** markets work.

However, this question relates more to the regulatory model and structures than the culture, philosophy, and approach. We see 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;
- governance, accountability, and public interest representation mechanisms; and
- the lack of transparency relating to the regulators' supervision of financial firms.

The legislative framework

Firstly, given the fast moving pace of 'innovation' in financial services, new risks and threats emerge frequently. Due to current legislative framework, these innovations can fall outside the regulator's remit – the perimeter issue. The regulators must wait until new products, services, and activities are brought within their remit by Parliament. This slows down the regulator's response.

Moreover, regulators will need to be able to respond to increasing digitisation and ***intersection*** of markets. Digitisation exists at the intersection between financial services and 'real economy' consumer goods and services. The internet/ social media/ big data analytics is increasingly used to create demand for and to distribute consumer goods and services. Financial services, also increasingly digitised, facilitates the satisfaction of those demands – through consumer credit or insurance. It could be argued that this has always been the case in the sense that advertising has always created demand for products and lenders have provided the means. But digitisation has given this a rocket boost. Digital technology and big data analytics are influencing consumer behaviours as never before. This intersection between markets is poorly regulated.

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. This would then be underpinned by two supporting categories: provision of financial advice and information; and provision of behavioural information and services.

Any new financial activity should be presumed to fall within one of these purposes The FCA should 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 primary legislation to determine activities are within its remit.

The need for new statutory objectives

The second major flaw in the current set up relates to the statutory objectives provided to the regulators by Parliament. These are not sufficient to deal with the extent and nature of market failure in financial services or recognise the role of the financial sector in supporting the real economy, impact on the environment, or financial inclusion.

We argue that the regulators be given new objectives in relation to:

- serving the interests of the real economy
- sustainable and responsible financial behaviours and practices
- access, financial exclusion, and discrimination

These are set out in more detail below.

Governance and accountability mechanisms

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.

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 suggest that the assessment of the overall strategy, approach, and effectiveness of the regulators should be scrutinised 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, reporting to a relevant Parliamentary committee. We call this the Regulatory Oversight Committee.

There is 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 and PRA 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.[3] The FCA also has a dedicated team and process for handling whistleblowing complaints from employees in the financial services industry.[4] 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.

Lack of transparency about the behaviour of individual firms

It is encouraging that Government intends to improve the levels of transparency and accountability on the performance of regulators. We fully support this overall intention.

But, there are serious flaws in the regulatory system with regards to transparency on the behaviour and practices of individual firms. The current overprotection given to commercial 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

[3] SYSC 18.4 The whistleblowers' champion - FCA Handbook

[4] Whistleblowing: How to make a report | FCA

- 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.

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 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 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 entities to supply it with information.

FSMA should be amended to:

- 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 above.

What should the Government's financial services priorities be when it negotiates trade agreements with third countries?

The UK has an opportunity to build on its strengths to be a global leader in economically and socially useful finance such as **s**ustainable, **r**esponsible, and social **i**mpact (SRI) finance and value added fintech and digital services.

To do this, policymakers should ensure that the financial sector thrives by becoming a beacon of good practice and high standards. Policymakers should avoid at all costs attempts to make the UK sector 'competitive' in global markets through deregulation. Deregulation is a false economy as it either just transfers risks and costs to the real economy (businesses and households) and/ or it risks undermining trust and confidence in UK financial markets and services.

Should the UK open its financial services markets to external competition from countries outside of Europe, or should the UK maintain the current regulatory barriers that apply to third countries?

The UK should maintain high regulatory and consumer protection standards. Reducing regulatory standards in an attempt to invite more competition is not advisable. The UK is well supplied with financial services. Indeed, it is probably oversupplied in key areas such as asset management. Too much choice is as bad as too little choice.

Relying on competition and choice has not been, and is unlikely to be, effective at driving up and maintaining standards and value. It is not clear, therefore, what is to be gained from lowering regulatory standards to introduce yet more choice and fragmentation.

What skills and immigration policy will the UK financial services sector need once the UK has left the European Union?

N/A

How can Government policy and the UK regulators facilitate the emergence of FinTech and new competition; develop new areas of growth for the financial services sector; and promote the UK as the best place to incubate new financial technologies and firms?

See above. The UK has an opportunity to become a global leader in economically and socially useful finance such as **s**ustainable, **r**esponsible, and social **i**mpact (SRI) finance and value added fintech and digital services.

Policymakers and regulators can support this goal by ensuring the UK is a beacon of good practice, transparency, and integrity.

Moreover, targeted government interventions such as the recent announcement on the establishment of green finance research hubs will be helpful. [5] This initiative should improve the data and analytics provided to financial institutions and services. It will aid understanding of risk and reward in financial decisions, and provide information on the impact of those decisions on the environment and climate change.

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[5] 5 Leeds and London set to become global centres of green finance - GOV.UK (www.gov.uk)

We would welcome a similar venture for fintech and digital services. Much has been written about the potential benefits of fintech. Less acknowledged and understood are the major risks and threats to consumers. These are set out in our paper 'Fintech: Beware of geeks bearing gifts?'.[6] A research hub similar to the one announced for green finance would allow policymakers, regulators, and civil society to identify and better manage the risks and threats associated with fintech and digitisation. This would support the development of appropriate regulatory standards which, in turn, would enhance the reputation of the UK as a centre of economically and socially useful financial innovation.

Through what legislative mechanism should new financial regulations be made?

As outlined above, a flaw in the current regulatory system is that operation of the 'perimeter' can hinder the ability of regulators to respond agilely to emerging threats and risks.

We argue that the FCA needs 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 more regulatory flexibility to respond, and ensuring public accountability?

As described above, it is possible to square this circle with a system of purpose-based regulation, providing the regulator with more discretion on its remit combined with more formal reviews of the use of those powers by parliament, and enhanced governance and accountability mechanisms for the regulator.

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 primary legislation to determine activities are within its remit.

What role does Parliament have to play in influencing new financial services regulations?

The post-EU regulatory landscape warrants an adaptation of accountability, scrutiny, and public engagement mechanisms. Decisions made by EU institutions did indeed shape much of regulatory policy in the UK.[7]

We now need clear arrangements in place for dealing with the distinction between higher level strategic or public policy decisions (which might have an impact on wider economic and social issues in the UK) and regulatory policy and operational decisions (which in theory are there to interpret and support wider public policy goals).

It is absolutely right that Parliament should determine the overall policy direction of regulators of one of the most important sectors of the UK economy. The effectiveness of regulatory policy in

[6] Fintech – beware of 'geeks' bearing gifts? | The Financial Inclusion Centre

[7] Although it is worth saying that the direct influence of EU institutions on UK public policy should not be overstated

making financial markets and services work for society is integral to the delivery of government's public policy objectives.

Important decisions on issues such as regulatory equivalence with EU regimes could have a significant influence on the future of the UK financial services industry.

It will also be important for Government and Parliament to take a holistic view on the future regulatory framework. There is a very clear risk that the UK's detachment from the EU regulatory system will result in even more fragmentation and complexity, not less.

With Parliament responsible for determining overall direction and strategy, this allows the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) to be responsible for designing and implementing the regulatory standards that apply to financial services firms and markets.

In our view, the real issue here is how to balance the demands for greater Parliamentary scrutiny and regulatory accountability, with demands for greater regulatory efficiency and responsiveness.

We cannot see how the regulators – particularly the FCA – can meet public expectations with regards to responding to emerging threats and risks (particularly in an age of digitisation) unless they are given ***more*** discretion on how and when to intervene in markets.

It is self-evident that giving Parliament more *ex-ante* or even concurrent opportunities to scrutinise the operations of the main regulators will inhibit the ability of regulators to respond to those emerging threats and risks.

However, it must be stressed that giving the regulators more discretion does not necessarily limit public accountability. The way to strike this balance is to give Parliament and public interest representatives more direct opportunities to ***review*** the way regulators perform and execute greater discretion and responsibilities, and hold the regulators to account.

There is a more general issue relating to the governance of the regulators which we set out elsewhere. As mentioned, allowing Parliament a greater *ex-ante* or concurrent role would be counterproductive. However, this does not prevent Government and Parliament hard wiring greater accountability and public interest oversight into the governance and operations of regulators.

How should new UK financial regulations be scrutinised?

As mentioned above, we think a key priority is to make UK regulation more responsive to emerging risks and threats, while retaining accountability and scrutiny.

The way to strike this balance is to give Parliament and public interest representatives more direct opportunities to ***review*** the way regulators perform and execute greater discretion and responsibilities, embed good governance into the system, and hold the regulators to account.

Government and Parliament should hard wire greater accountability and public interest oversight into the governance and operations of regulators. 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 degree of 'independent' representation at the decision making/ board level of regulators, this still falls well short of providing the necessary governance – se above.

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.

We have also proposed the creation of an independent Regulatory Oversight Committee which would report to Parliament.

There is 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.
- Public hearings on key matters;
- Transparency regarding industry lobbying; and
- Strengthening whistleblowing measures.

Details of these measures are set out above.

What progress has the Government and regulators made in facilitating key financial services equivalence agreements with third countries; and would an alternative mechanism serve the interests of the UK market better?

N/A

How should financial services regulators be funded?

We strongly believe that the current system of statutory funding of the FCA via levy should be retained. This protects the FCA's independence and can be a much more flexible way of allowing the regulator to align funding to priorities. That is, the FCA can adjust funding to reflect the risks associated with specific activities.

But, there is clearly room for improvement particularly on the funding of the FOS, FSCS, and debt advice.

We have a great deal of sympathy for market participants who operate to high standards of behaviour but have to subsidise the failings and malpractice of less well run, or unscrupulous, firms. We support the idea of a more overt 'polluter pays' principle. This involves both adjusting the ongoing levy to account for higher risk business models and imposing higher capital adequacy requirements on higher risk firms at the authorisation stage.

As a separate but associated point, it also involves dealing with unregulated products. As we explain elsewhere, purpose based regulation would allow for high risk products and activities to be more rapidly brought within the FCA's remit. But, until and unless we get purpose based regulation, we still need to provide a proportionate degree of protection to consumers who choose to purchase unregulated products. Clearer warnings on the absence of regulatory protection and FSCS coverage are needed. There is also the wider point, not covered in this Inquiry, about deterring misselling of unregulated products and activities through the greater use of criminal sanctions.

There is also a debate to be had about whether to fund more of the levy on an ex-ante rather than ex-post basis. Moving to a more explicit ex-ante, risk based mechanism would discipline market behaviour.

There is also scope for using market data better to adjust regulatory costs and introduce more accurate funding of the debt advice.[8] As it stands, Registry Trust[9] can publish the name of the claimant for Scotland and Northern Ireland judgments but not for England and Wales.[10]

Registering the claimant name could have a number of benefits. It could be a useful 'real time' supervisory tool for the Financial Conduct Authority (FCA) and other regulators. It would allow supervisors to identify quickly which firms within their remit are most aggressive in using enforcement action, and compare their stated treating customers fairly policies against their practices. This would allow the FCA to adjust a firm's individual levy to reflect the level of detriment caused.

It could also help government and the Money and Pensions Service (MaPS) determine a more appropriate method of funding debt advice. If the name of the claimant was included on the register, this would allow the relevant authorities to identify with more precision which types of debt and bills are causing consumers serious difficulties. The model for determining the level of funding needed, and the allocation of funding between credit and service providers, could then be adjusted accordingly.

Should the mandate and statutory objectives of the financial services regulators change to include wider public policy issues?

Yes. While regulatory interventions have led to significant improvements in conduct of business standards in financial markets and services, we argue that the overall regulatory structure - including the statutory objectives - is not fit for purpose and should be modernised to take account of the challenges facing the economy, environment, and society.

Activity-specific regulatory principles are unlikely to ensure that the activities, and priorities of the regulators are fully directed towards the great environmental, economic, and social challenges facing us today.

[8] Funding debt advice is now a responsibility of the Money and Pensions Service (MaPS). But, it remains an important part of the overall system of consumer protection

[9] The non-profit which operates the Register of judgments, orders, and fines on behalf of the Ministry of Justice

[10] The Ministry of Justice specifies which data Registry Trust can include on the Register.

We argue for three new statutory objectives relating to:

- Serving the interests of the real economy
- Sustainable and responsible financial activities
- Access, exclusion, and discrimination

Serving the interests of the real economy

The sheer scale of misselling and other consumer-related market failures in UK financial services has already been well documented and accepted. It is why regulators have statutory consumer protection objectives.

But, less well understood is the failure of the financial sector to undertake one of its primary roles of efficiently allocating resources to the real economy (this is taking on even greater significance given the recognition of the role of 'green finance' in greening the economy). This failure to allocate resources effectively is documented in our report An Economic and Social Audit of the City.[11]

Yet, no part of the regulatory system is required to objectively assess and report on how well financial markets serve the interests of the real economy.

Therefore, we propose that the Bank of England, Prudential Regulation Authority, and FCA be given a new statutory obligation to assess and report on how efficiently and effectively financial markets allocate resources to the real economy. This assessment and reporting should be overseen by the Regulatory Oversight Committee reporting to Parliament.

Sustainable and responsible financial activities

Similarly, no part of the regulatory system is required to assess how well financial markets support or detract from efforts to green the economy, or promote responsible corporate behaviours.[12]

As we highlight in our report, Time for Action, the fact that regulators do not have statutory objectives with regards to sustainable finance or markets are not provided with clear regulatory direction is a major barrier to greening the financial sector - and therefore greening the economy.[13]

Therefore, 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 Prudential Regulation Authority (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. Reporting on SRI compliance should be made a statutory requirement rather than voluntary, with appropriate sanctions for non-compliance with reporting standards.

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

[11] An Economic and Social Audit of the City | The Financial Inclusion Centre
[12] For example, responsible practices in corporate supply chains
[13] Time for Action – Greening the Financial System | The Financial Inclusion Centre

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).

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.

Access, exclusion, and discrimination
Moreover, there is a strong intersection between regulatory and social policy. For example, social policy decisions such as setting levels of universal credit can determine whether vulnerable households need to turn to borrowing to make ends meet. Similarly, the primary causes of financial exclusion are poverty and the use of risk based pricing by commercial financial services providers.

In the UK, financial services firms have few statutory 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.

This is contrast to the obligations faced by US financial institutions under the Community Reinvestment Act (CRA)[14] and Home Mortgage Disclosure Act (HMDA).[15]

Therefore, we propose that the FCA should be given a new statutory objective to promote ***fair access*** to financial services. The emphasis on ***fair*** is deliberate. It would be easy for the financial services industry to provide access to financial services if consumer protection measures were relaxed and it faced no restrictions on charging practices. But, that would not be appropriate. The question is: can commercial providers provide access to fair and affordable financial services? If it cannot, we should be objective and transparent about this. This may require government and regulators intervening through the use of universal service obligations (USOs) or government making available alternative provision of services for households the market cannot serve on acceptable terms.

These issues are set out in more detail in our paper Financial Vulnerability and Rights.[16]

As part of this objective:

- 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 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 the Government on the impact of policy decisions on financial inclusion – for example, changes to the Universal Credit system; and

[14] Community Reinvestment Act (CRA) | OCC
[15] The Home Mortgage Disclosure Act | Consumer Financial Protection Bureau (consumerfinance.gov)
[16] Financial vulnerability and rights | The Financial Inclusion Centre

- individual firms should be required to produce financial inclusion audits similar to the US CRA and HMDA.

How important is the independence of regulators and how might this best be protected?

Regulatory independence is a key strength of the UK system. As mentioned, it is very important that government and Parliament set the policy framework for delivering strategic or high level public policy objectives.

But, care must be taken not to compromise the independence of the regulators or to create a policy framework that favours one set of stakeholders over another. For example, the idea of giving financial regulators a *competitiveness* objective would be misguided. This would allow be a Trojan Horse to allow industry lobbies to put pressure on regulators to reduce consumer protection and wider regulatory standards in order to give UK financial firms a competitive advantage. Of course, any such advantage would be illusory and a false economy in the long term.

Also, the current funding mechanism through a statutory levy on the industry allows for operational independence.

Of course, independence does not just mean independence from political interference. It means independence from undue influence of vested interests. The financial services lobby is very well resourced and influential. This needs to be countered by robust governance, accountability, public interest representation, and transparency mechanisms. We have set out proposals for ensuring good governance and proper scrutiny of the regulators in our response to the question on how financial regulations should be scrutinised, above.

How can the balance between lighter touch regulation and prudential safeguards be best secured?

It has become common to refer regulation as a 'burden' or to argue for 'lighter touch' regulation. These phrases feed the myth that regulation hinders markets from working, that it is imposed unnecessarily.

Regulation, in fact, codifies the terms of the social contract between markets and citizens/ real economy. Another way to think of it is that regulation specifies the terms of the licence to operate for market operators. This applies in both prudential regulation and conduct of business regulation/ consumer protection. Conduct of business/ consumer protection and prudential regulation are closely connected as weak consumer protection/ conduct regulation enables imprudent business practices.

Deregulation or reducing consumer protection standards does not reduce costs in the system. It simply transfers risks and costs from industry to consumers/ real economy.

Of course, in theory, we could try to place more reliance on corporate governance/ self-regulation/ ethics or consumer pressure/ competition to police corporate behaviour.

But we know that consumer pressure/ competition has limited influence on corporate behaviours in financial services.

Internalising greater responsibility through enhanced corporate governance or self-regulation might make it look as if regulation has become 'lighter touch'. A reliance on rules could be replaced with greater threat of costly sanctions. But, if firms responded in the right way to a system of fewer rules/ tougher sanctions, then they would just internalise the costs currently incorporated into regulation and rules.

However, if not done properly, as mentioned, it just transfers costs to consumers/ real economy.

The question is: can high standards of good conduct and fair treatment be internalised without robust, detailed regulation? The evidence of history suggests not.

Over the years, the body of rules has accreted because the financial services industry has been shown not to be able to interpret that social contract or licence without the terms of that contract/ licence being set down in increasingly precise detail in the regulator's handbook. The industry has shown itself not to be able to work with *principles based* regulation. Indeed, industry itself has often demanded more detail.

So, it is not at all clear what 'lighter touch' regulation means in practice. When this is considered closely, the only way to actually reduce costs in the system overall would be to reduce the level of activity in the market.

Note that we are not in favour of regulation for the sake of it. We propose that Government and regulators set up an independent committee to review whether specific rules can be removed safely. This committee should be made up of independent public interest representatives advised by suitable experts. The basis of this review should be: does a specific regulation, rule, or standard

- require anything over and above that would be expected of a well-run business that operates with integrity and with the interests of customers embedded in the culture of the business; or
- duplicate the effect of an existing requirement?

How should consumer interests be taken into account when considering potential regulatory changes?

Government and Parliament should hard wire greater accountability and public interest oversight into the governance and operations of regulators. 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 degree of 'independent' representation at the decision making/ board level of regulators, this still falls well short of providing the necessary governance – see above.

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 suggest that the assessment of the overall strategy, approach, and effectiveness of the regulators should be scrutinised 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, reporting to a relevant Parliamentary committee. We have proposed the Regulatory Oversight Committee – see above.

There is also a case for enhancing consumer and public interest representation at the early stage of policy development to address the undue influence of industry lobbies. We have proposed that HMT should establish an independent expert group consisting of public interest representatives (consisting of civil society, representatives of business, and academics) to advise on early stage policy development. This could be similar to the system operated by the European Commission with the Financial Services User Group (FSUG).[17] See below for further detail.

These governance and representation measures could be further enhanced by improvements to the way the regulators consult on and develop more detailed policy.

For example, although it is fair to say that the FCA consults widely on issues, even the most cursory analysis of the responses to consultations shows that industry responses significantly outnumber those from civil society. This is not because civil society is not interested in those issues. The primary reasons are the limited number of civil society organisations with the necessary technical skills and the lack of resources to respond to consultations which can be time consuming and laborious.

This could be partially redressed by the independent Regulatory Oversight Committee we propose. The primary role of the Regulatory Oversight Committee would be to provide independent assessment of the effectiveness of the FCA's approach to regulation from the consumer and public interest perspective. But, as part of its remit, the Committee could have as it disposal FCA staff whose role would be to proactively engage with civil society representatives. So, instead of relying on civil society representatives to respond in writing to consultation papers, FCA staff should go out and interview civil society representatives.

Moreover, we also propose that the FCA should hold part of its board meetings in public along the lines of The Food Standards Agency. During the public sessions, the FCA should hold hearings to obtain views from civil society organisations on policy proposals in development and more generally on topics such as FCA's approach to regulation or financial inclusion. Those parts of the board meetings requiring decisions on sensitive or confidential issues could still be held in closed session.

We have also proposed that the FCA/ PRA should hold formal public hearings on key issues.

[17] Financial Services User Group (FSUG) | European Commission (europa.eu)

Similarly, it would improve the effectiveness of the Regulatory Decisions Committee (and ultimately the FCA) if the RDC was required to hold public hearings on key decisions so as to take into account the impact of market abuse and regulatory breaches on victims.

We must also take into account the interests of consumers in the different nations and regions of the UK. For example, the Bank of England makes use of regional agents to inform its policymaking. This is not a practice adopted by the FCA. This has particular implications for Northern Irish consumers. The Northern Irish financial services market is in several ways very different to the GB market. For example, in banking, the even the largest NI banks would not feature prominently in the FCA/ PRA risk registers because of their comparatively small size in national terms. Yet, they represent a significant risk for the NI economy and consumers.

It would be welcome if the FCA/ PRA were required to have regard to the interests of all consumers including at regional level when developing policy, and supervising markets.

Moreover, as we explain above, we argue the FCA should be given a new *access* objective. The supporting measures we advocate including public inclusion audits would require the FCA to consider more formally the interests of consumers with protected characteristics.

What are the strengths and weaknesses of the European Union model of scrutinising financial services legislation?

Should the UK seek to replicate the EU's model for drafting and scrutinising financial services regulation?

The essence of the EU model for scrutinising legislation and regulation is both its main strength and weakness. The EU model by its very nature is more inclusive and allows for a much greater deal of political scrutiny. Political scrutiny is very important. But, that scrutiny and the legislative process means progress on key initiatives can be painfully slow and protracted.

The main advantage of the EU model of financial regulation, is not in relation to the process. Rather it is the approach to markets and regulation. EU policymakers are more accustomed to mandating certain market behaviours in the public interest. For example, the fact that UK consumers have a legal right of access to a basic bank account is due to EU institutions. The same with gender neutrality in insurance pricing.

Criticism is sometimes levied at the role of the Commission in the EU model – that the Commission unduly determines the course and detail of legislation and has more influence than elected representatives. This is overstated. It is not that different in practice to the relationship between Government/ HMT and Parliament in the UK.

As mentioned above, one EU practice that could be introduced into the UK to aid scrutiny and better regulation would be to create a version of the European Commission's FSUG. The FSUG provides high level, early stage advice to relevant Commission departments on financial services policy and complements the work of panels and expert groups attached to the European Supervisory Authorities (ESAs).

A UK FSUG could play a similar role by advising Parliament and HMT (and where relevant DWP and BEIS) on financial services policy matters at the early/ development stage. This FSUG could complement the work of the Regulatory Oversight Committee we have proposed and the Financial Services Consumer Panel which operates at the regulatory level.

This marks the end of the Financial Inclusion Centre's submission

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