HM Treasury Financial Services Growth & Competitiveness Strategy

Call for Evidence

Submission by The Financial Inclusion Centre

About The Financial Inclusion Centre

The Financial Inclusion Centre (FIC) is an independent, not-for-profit policy and research group (www.inclusioncentre.org.uk). FIC's mission is to promote a financial system and financial markets that work for society. FIC 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. We focus on: households who are excluded from, face discrimination in, or are underserved by financial markets and services; and the intersection of finance, technology, and data.

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

Introduction

We are pleased to make a submission to this important consultation. Due to lack of resources and our specific remit, we are only able to provide a fairly high level response and are unable to answer all of the questions.

For further information, please contact:

Mick McAteer
Co-Director
Financial Inclusion Centre

mick.mcateer@inclusioncentre.org.uk

Summary of our position

- Our key message is that, while we fully recognise the need for the UK to have a successful financial sector, government should not prioritise financial sector growth for the sake of it. The financial sector should be judged on how well it serves the interests of the real economy, the environment, and society; and the sustainability of any growth including the terms on which it attracts overseas business. History shows us what happens when finance is allowed to become too dominant.
- There are competing visions on what success looks like and how to deliver success. One vision of success emphasises the size and revenue-generating potential of the City and wider financial sector. It involves a greater financialisation of the UK economy and society. With this vision, the way to deliver 'competitiveness and growth' is via: financial market deregulation and liberalisation; 'rediscovering' risk taking and allowing financial markets to have a greater 'risk appetite'; and the financialisation of social infrastructure and assets with private finance supported by corporate welfare and 'de-risking' (and rebranding that private finance as 'social impact finance' etc). This might create illusory short term success. But, it is also very risky (as we know where financial liberalisation and financialisation leads) particularly given that there is a serious risk of regulatory arbitrage now being used as an economic policy tool by nation states and trading blocs.
- The other vision defines success by how well the City meets the needs of the real economy, environment, and households/ society. It considers how sustainable that success is, the extent to which the City stops financing activities that damage the environment, and how much finance contributes to efforts to promote equality and inclusion, and regional economic success.
- Sustainable success is built on making the UK financial sector attractive as a leading global financial centre by being a beacon of trust and integrity, particularly important if the UK is to be the leading global centre of green finance. This vision is delivered by robust regulation that inspires trust and confidence, and policymakers and regulators not afraid to actively intervene to ensure that financial resources get from where they are, to where they are needed, in the most equitable and economically efficient way. We urge the government to support this vision.
- So, we would suggest that the strategy should be articulated as having a dual purpose of creating a financial sector which: serves the interests of the real economy, environment, and

society; and competes and attracts overseas business on the basis of trust, and confidence and a deserved reputation for market integrity. The emphasis should be on sustainable growth and economic, environmental, and social utility not growth per se.

- One of the key concerns we have about the government's strategy is the absence of a comprehensive performance framework to allow for an objective evaluation of how well the sector is serving our interests. Strategies are usually accompanied by such a performance framework. The financial regulators have been required to develop and produce a number of operating service metrics to demonstrate how well they are supporting the growth and competitiveness objective.[1] It is quite right that Parliament and government should expect regulators to demonstrate how efficiently they execute their roles. But, operating service metrics are input and output measures. They indicate how well regulators are serving the interests of the firms they regulate. They tell us little about how well regulated markets are serving our interests and, in turn, how effective financial regulators are at ensuring that those markets work. As the Financial Inclusion Centre said in its submission to the House of Lords Industry and Regulators Committee report on the accountability of UK regulators: "*regulators should be judged on how well they make the industries they regulate serve the interests of the real economy, environment and society, not on how well they serve the interests of regulated industries*".[2]
- There are numerous reports published by industry trade bodies and consultants extolling the benefits of the financial sector to the UK economy.[3] But, we are not aware of any regular reports which assess how well the 'City' serves the interests of the real economy, environment, and society (including households).
- Financial Inclusion Centre did produce An Economic and Social Audit of the City.[4] It was a comprehensive and more balanced assessment of the value that finance contributes to the economy and society, and also the harm caused by the sector's activities including crisis-related costs, misselling costs, value extraction through high fees, short termism, misallocation of resources and so on. But, even that was limited. For example, it wasn't able to cover in any real detail the climate harm caused by the City.[5] Moreover, it was a one off and hasn't yet been updated.
- In a forthcoming report, we are proposing a new performance framework to allow stakeholders to measure how well finance serves the interests of:
  - Consumers and households
  - The real economy, business with a focus on SMEs and microbusinesses, regional and local economies
  - Environmental and social goals
- Specifically, we have developed a set of performance outcomes to track and measure how well finance meets the needs of those interests. Each of the categories has its own performance outcomes. Details of this new framework can be found in Annex I, below.

[1] The FCA has produced 51 operating service metrics.
[2] See: committees.parliament.uk/publications/43211/documents/215050/default/
[3] See for example: State of the sector | annual review of UK financial services 2022 (theglobalcity.uk)
[4] An Economic and Social Audit of the City | The Financial Inclusion Centre
[5] We did address this in a later report called Time for Action: Greening the Financial System which examined how much the City continues to finance climate damaging activities. See: Time for Action – Greening the Financial System | The Financial Inclusion Centre

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

Response to specific questions

Stakeholder Information

Question 1: Which of the following statements best describes you as an individual or as an organisation:

h) Other – policy and research organisation/ think-tank

Question 2: Which of the following best describes your business: a) Established Player b) Mid-Tier Firm c) Scale-Up d) Start-Up e) Other – please specify

N/A

Question 3: Which of the following UK regions do you:

a) operate out of: ix) London.

b) have headquarters: ix) London.

Question 4: Which part of the financial services sector does your organisation operate in?

Other – please specify. Financial Inclusion Centre covers all parts of the financial sector and the intersection of finance/ technology.

Question 5: How many employees are in your organisation: a) in the UK? i. ii. iii. iv. Micro (0-9) Small (10-49) Medium (50-249) Large (250+) b) in an overseas branch, subsidiary or headquarters? i. ii. iii. iv. Micro (0-9) Small (10-49) Medium (50-249) Large (250+) 31

N/A

Question 6: Do you intend to take on additional staff in the next 12 months?

N/A

Question 7: Are you planning to: a. Invest more in your UK business in 2025 than in 2024? b. Invest roughly the same amount in your UK business in 2024 as in 2023? c. Invest less in your UK business in 2024 than in 2023? What are the reasons behind the answers you gave to the above questions? What opportunities/growth areas are you investing in?

N/A

Chapter 3 – Objectives and Approach Objectives and Approach:

Question 3.1: Do you agree with the proposed objectives set out in paragraph 3.6?

As we outlined in the Summary above, we recognise the benefits of the UK having a successful financial sector. But, it very much depends on how success is defined, and how that success is achieved. The financial sector should be judged according to how well it serves the interests of the real economy, the environment, and society including households. Linked to this, the Financial Inclusion Centre said in its submission to the House of Lords Industry and Regulators Committee report on the accountability of UK regulators that "*regulators should be judged on how well they make the industries they regulate serve the interests of the real economy, environment and society, not on how well they serve the interests of regulated industries*".[6]

We do not disagree with the objectives set out in para 3.6. But, these objectives seem very much articulated from the perspective of the finance sector. They are not a particularly helpful framework for assessing whether the UK finance sector is successful from the perspective of those interests it is meant to serve.

Moreover, growth in and of itself should not be the focus of government strategy. There is evidence to suggest that 'too much finance' can actually be detrimental to the interests of a country.[7]

It goes without saying that the financial sector is hugely important to the UK economy and society. The City of London is seen by politicians as the 'goose that lays the golden egg' or one of the remaining 'jewels in the crown' of the UK economy, which is why successive governments have been so keen to create such favourable conditions for the financial sector.

Yet, the data on its own does not properly convey the role finance plays in society. Like the tech sector, the finance sector is a contributor in its own right to GDP. But, it is also a critical service industry in that it is meant to serve the interests of the real economy, households/ consumers, and increasingly to support environmental goals.

The financial sector should be judged on how well it functions in the interests of the economy, environment, and society/ households/ consumers. In other words, on the economic, environmental, and social utility not just on headline economic numbers.

Financial sector representative bodies are quick to extol the contribution the sector makes to the UK economy. Indeed, a leading trade body, The City of London Corporation, produces the State of the Sector report which promotes the positive role of the City.[8] While it is true that the City of London makes a major contribution to the UK economy, less well acknowledged is the negative aspects of financial sector activities.

Financial Inclusion Centre published An Economic and Social Audit of the City some years ago. It is one of the most comprehensive assessments of the benefits and disbenefits of the UK financial sector we are aware of. It highlighted the various types of harm caused by the financial sector including: crisis related costs, misselling costs, value extraction through high fees, short termism, misallocation of resources and so on. But, even that was limited. For example, it wasn't able to cover in any real detail the climate harm caused by the City. The lesson from the analysis was that, while the financial sector created a great deal of benefits for the UK economy, its activities also created major economic, environmental, and social harm.

So, we would suggest that the strategy would be better articulated as having two strands:

[6] committees.parliament.uk/publications/43211/documents/215050/default/

[7] Too Much Finance?; by Jean-Louis Arcand, Enrico Berkes and Ugo Panizza; IMF Working Paper 12/161; June 1, 2012

[8] State of the sector | annual review of UK financial services 2022 (theglobalcity.uk) Previously HMT collaborated with the City of London Corporation to produce an earlier version of this report.

- **Domestic focus:** ensuring the financial sector serves the interests of the real economy, environment, and society or improving the economic, environmental, and social utility of finance; and
- **International focus:** helping UK finance compete and attract overseas business on the basis of trust, and confidence and a deserved reputation for market integrity.

The emphasis should be on sustainable growth and economic, environmental, and social utility not growth per se; and robust regulation which promotes market integrity and deserved high levels of trust and confidence.

The other vision of success emphasises size and profitability of the City. It involves a greater financialisation of the UK economy. With this vision, the way to deliver 'competitiveness and growth' is via: financial market deregulation and liberalisation; 'rediscovering' risk taking and allowing financial markets to have a greater 'risk appetite'; and creating a new PFI regime by substituting low cost public investment with high cost private finance (and rebranding that private finance as 'impact finance' etc).

This might create illusory short term success. It is also very risky (as we know where financial liberalisation and financialisation leads) particularly given that there is an increased risk of regulatory arbitrage being used as an economic policy tool by nation states and trading blocs.

Determining whether any new strategy is working will require a comprehensive, balanced performance framework and appropriate metrics. In a forthcoming report, we are proposing a new performance framework to allow stakeholders to evaluate the economic, environmental, and social utility of finance. In other words, how well finance serves the interests of:

- Consumers and households
- The real economy, business with a focus on SMEs and microbusinesses, regional and local economies
- Environmental and social goals

In turn, this would allow stakeholders to evaluate the effectiveness of financial regulators in making financial markets work. Specifically, we have developed a set of performance outcomes to track and measure how well finance meets the needs of those interests. Each of the categories has its own performance outcomes. Details of this new framework can be found in Annex I, below.

Question 3.2: [For Financial Services Organisations] For firms operating in more than one jurisdiction, what are the main drivers affecting your decisions on where to invest?

N/A

Question 3.3: What do you consider to be the most important trends or changes likely to affect the financial services industry over the next 10 years?

It is difficult to predict with any degree of certainty what the most important factors, trends, or changes likely to affect the financial services industry over the next 10 years and, more importantly, its customers. However, we would highlight the following political and policy, economic, and social factors. In no particular order these are:

- The risk of regulatory arbitrage being used as a national economic policy tool by nation states and trading blocs.
- The risk of financial deregulation in the UK being used to promote the interests of the UK financial sector, and the risk of the secondary growth and competitiveness objective becoming a de facto primary objective for regulators.[9]
- The impact of finance sector lobbying on government and regulatory policy.[10]
- The potential impact of new misselling cases and other major issues (eg. insurance company buy outs) affecting consumer trust and confidence.
- The impact of scams and fraud on trust and confidence.
- Whether competition produces the right outcomes for consumers, the environment, and the real economy.[11]
- Continued evolution of AI/ tech/ big data creating systemic and market risks, and exacerbating financial exclusion and discrimination.[12]
- Intergenerational, regional, and group asset and income inequality.
- Demographic trends including the ageing of the population.
- The individualisation and transfer of risk to individuals (for example, as defined benefit pension schemes are closed and the 'freedom and choice' reforms leave consumers more exposed to greater intertemporal risks).
- The financialisation of the UK economy and society, the risk of green and social impact washing.[13]
- Potential systemic issues such as a failure in the non-bank financial system, a collapse in asset values, and a failure of a major UK life insurer due to weak Solvency UK regulation.[14]

Chapter 4 – Policy Pillars Question

4.1: Do you agree with the list of policy pillars that the government intends to focus on? Are there other areas that should be included?

We note that there seems to be little emphasis on critical factors such as: promoting the right culture, trust and confidence in markets; driving much needed market efficiency to curtail value extraction; addressing market inefficiencies such as short termism and misallocation of resources; and making markets more inclusive as key pillars of the strategy.

[9] See for example our concerns about financial inclusion being used as a Trojan Horse for financial deregulation FCA Call for Input on streamlining rules following the introduction of the Consumer Duty | The Financial Inclusion Centre

[10] See: The Power of Big Finance

[11] Just because there are numerous products and providers, evidence of 'innovation' such as new products and business models coming to market, easy market entry and exit for providers, and evidence of activity such as switching (ie. the conventional indicators of competition) doesn't mean competition is actually effective from the perspective of consumers, the environment, and society. Indeed, it is often the case that the fiercer the competition, the greater the financial harm.

[12] For example, see our work with The Finance Innovation Lab AI-in-Financial-Services-November-2023_Final-1.pdf

[13] Time for Action – Greening the Financial System | The Financial Inclusion Centre The Devil is the policy detail – will financial regulation support a move to a net zero financial system? | The Financial Inclusion Centre ESG ratings – DRWG voluntary Code of Conduct consultation | The Financial Inclusion Centre

[14] Submission to HM Treasury Review of Solvency II consultation | The Financial Inclusion Centre

We have no comment on the particular pillars set out in the strategy other than to say that those appear to be primarily 'input' measures. That is, the presumption seems to be that if the government focuses on those pillars, the right *outcomes* will result.

It is difficult to say whether the overall strategy is likely to be effective until we see more detail on how the most important input included in the strategy as currently articulated, regulation, is to be deployed. Experience tells us that if we want finance to work, regulation has to actively shape markets not 'create the conditions' for markets.

As mentioned, we also want to see a successful UK finance sector. But, it all depends on how this is defined and to be achieved. As set out in the Summary above, there are two different competing visions of what success looks like for the City of London, and how to deliver success. We very much urge the government to support a vision built on sustainable growth, not growth per se.

4.2: Please rank the list of pillars in order of importance to your business or organisation for i) day-to-day operations and ii) longer term plans for investing in the UK: 1. Innovation & Technology 2. Regulatory Environment 3. Regional Growth 4. Skills & Access to Talent 5. International Partnerships & Trade Question

No comment.

4.3: How well is competition currently working in the financial services sector, and how can it be improved?

To understand whether competition is working effectively in finance, it is first necessary to understand the actual nature of competition in the sector. With regards to retail market competition, the conventional view is that firms compete for the custom of consumers who are able to shop around and exert a disciplining effect on those firms. This dynamic is meant to ensure that firms compete on value and treating customers fairly; the theory being that those firms who don't offer good value and treat customers fairly will lose market share to those who create value for consumers.

That is not how it works in the real world of financial markets and services. Firms do compete for the custom of a minority of active, empowered, commercially attractive (usually better off[15]) consumers. But, the competition dynamic is better described as one where:

- firms compete with each other to acquire market share and distribution;
- firms compete with consumers to see who can extract value from a relationship, with firms able to leverage their inherent advantages to exploit consumers' behavioural biases;

[15] Although it isn't always the better off. In some cases, it may be the most vulnerable, low income consumers who can be commercially attractive for firms operating in poorly regulated markets. Payday lending was a case in point. The payday lending model was built on consumer detriment.

- firms compete by ‘innovating’ new, often spurious products and services, creating ‘churn’, rather than focus on improving the value of the customer relationship; and
- consumers compete with each other to obtain value from a finite amount of value in a market.

Overall, while competition does work for some consumers in certain retail financial markets, we do not believe that it works very well for the mass market of consumers and in particular for excluded, underserved, and marginalised consumers.

As to making competition work better, this requires more robust regulatory interventions to shape markets, and a more precautionary approach to identify and mitigate risks. More detail on interventions can be found in this essay.[16] Remember, the interventions that have led to significant improvements in consumer welfare in financial services have come from direct interventions such as price capping payday loans, mandating access to basic bank accounts, and constraining charging structures on overdrafts. Creating the conditions for competition is just not effective. Markets need to be made to work.

With regards to the question of whether competition works well in institutional and wholesale markets, the answer is we do not know. Effective competition should not be measured using conventional indicators such as numbers of providers, ease of market entry and exit, levels of financial activity, or turnover and profits and so on. Competition should be judged on whether markets produce the right outcomes for the real economy, the environment, and society/ households.

But, as we explain above, we lack a proper performance framework to evaluate whether the financial sector is effective at undertaking its primary market functions. As mentioned above, we did produce a report called An Economic and Social Audit of the City which suggested very strongly that while competition dynamics may have created a deal of activity in markets, that same imperative was responsible for a huge amount of consumer detriment and wider economic harm. That analysis needs to be updated especially to incorporate the environmental harms caused by market competition in the financial sector.

Innovation & Technology

Question 4.4: What is your assessment of how effectively the UK supports innovation and the adoption of new technology? What could be improved in the financial services sector?

Question 4.5: Which technologies do you think have the most potential to transform financial services over the next 10 years? And in which financial services sectors or functions do you see these being applied most effectively?

We are not in a position to say how well the UK supports innovation and the adoption of new technologies from the perspective of the financial sector. Our focus is on the potentially damaging impact of technologies on consumers, especially vulnerable and marginalised consumers.

[16] This is explained more here: Essay – Rethinking consumer policy theory | The Financial Inclusion Centre

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

The important point is that technology does not change the fundamental operating principles of market based financial services. The greater use of technology and big data does not alter the tendency of market based systems to segment and profile consumers, which along with poverty and self-exclusion by consumers, is a primary cause of exclusion and discrimination in financial services. Indeed, advances in AI/ technology/ big data actually make it easier for firms to identify, segment, and exploit consumers even more effectively. [17] The intersection of finance and tech has been poorly regulated.[18]

As to which technologies have the potential to transform financial services, more important is the question of who uses the technology. Innovations such as a Central Bank Digital Currency (CBDC) could have the potential to be used to promote financial inclusion and more equitable and sustainable economic growth. But, for this to happen, it would require the government and Bank of England to determine the use cases for the CDBC, not create the conditions for the market to determine how a CBDC might be used as a platform for commercial, market based applications.

Regulatory Environment

Question 4.6: What is your assessment of the UK's current regulatory environment?

This very much depends on which aspect of UK financial markets and services is in question. It is our view that there has been significant improvements in the conduct of business standards and consumer protection regime in UK retail markets. Of course, misselling scandals still happen. The defined benefit pension scheme transfer misselling scandal is a case in point. Nevertheless, we do not think there is evidence of the type and scale of recurring systemic misselling scandals that blighted UK financial services in the past. Misselling and consumer detriment was not the exception then. It was intrinsic to the business models of much of the retail financial sector. There is always room for improvement, but the conduct of business standard in the market and attitudes towards consumers have undoubtedly improved.

We are very concerned at the concerted efforts by finance sector trade bodies to weaken the level of protection afforded in the current regulatory and redress system. The influence of the finance sector lobbies can be seen in current initiatives such as the Advice/ Guidance Boundary Review, review of the Financial Ombudsman Service, 'streamlining' the FCA's rule book, and the further weakening of the Solvency UK regime for insurers and pensions.

Although we do think we have seen significant improvements in conduct driven by the FCA, we remain of the view that the current legislative and regulatory system is too slow and unresponsive to emerging detriment. The approach embedded in the UK's legislative and regulatory system prioritises innovation and competition (even though as explained above the conventional meaning of these terms don't really apply in the real world) over actively making markets work and proactively preventing detriment.

[17] See: Fintech – beware of geeks bearing gifts? | The Financial Inclusion Centre AI in financial markets and services | The Financial Inclusion Centre

[18] See for example: HM Treasury Regulation of Buy-Now, Pay-Later | The Financial Inclusion Centre

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

There is a tendency for financial policymakers and regulators to intervene only when there is evidence of harm that cannot be ignored. There is also a presumption that ‘creating the conditions for competition’ will naturally lead to the right consumer outcomes. We would argue that a more precautionary approach by the regulators is appropriate for a sector as important (for good and bad reasons) as the financial sector.

One of the biggest barriers to regulatory effectiveness is the legislative approach. The regulators, particularly the FCA, often get blamed for not preventing harm arising from activities that fall outside their remit – the perimeter issue. It would be helpful for regulatory effectiveness if ‘innovation’ was dealt with more quickly within the regulatory perimeter. It would be more effective if innovations were presumed to fall within general purpose based categories eg. lending, described as the activity of advancing money or some such and therefore presumed to be within the FCA’s remit, subject to fast track consultation on the specifics of regulation. This approach would have dealt with the harms caused by payday lending and buy now, pay later (BNPL) much more quickly and effectively.

With regards to aligning financial market behaviours with climate goals, regulation is not very effective, see below. But, again that is more down to the legislative framework rather than regulation or regulators per se.

There seems to be agreement that financial stability and prudential regulation has been effective at ensuring that the mainstream UK banking and payments system is better protected against external economic and financial shocks. It is not clear that the same can be said of the non-bank financial system. We would recommend moving the systemic and prudential regulation of the pensions sector to the Bank of England/ Prudential Regulation Authority (PRA). We would also urge the government to expedite the regulation of pension and investment consultants, and ESG ratings providers and ratings.

We have serious concerns about the current Solvency UK regime. Solvency II was already weak due to the fact that allowed significant use of the Matching Adjustment (MA). The MA has allowed life insurers to create significant amounts of artificial capital. This makes some of the major UK life insurers look much stronger than they really are. Solvency UK further weakens the prudential regulation of life insurers by allowing further use of the MA conjuring trick.[19] This would be worrying enough on its own but the growth in pension scheme transfers to insurers (buy outs) heightens our concerns. This trend is further heightened by the competition aspects. The market for transfers is dominated by a very small number of life insurers.

It is not possible to comment on whether financial regulation is effective at ensuring financial markets are economically and socially useful because: i. financial regulators do not have explicit objectives with regards to those priorities; and ii. we lack a comprehensive, objective performance framework to evaluate the economic, environmental, and social utility of the UK financial sector.

[19] See: Submission to HM Treasury Review of Solvency II consultation | The Financial Inclusion Centre

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

Question 4.7: How can regulation support responsible and informed risk-taking?

It is not at all clear what is meant by this question. It is not the job of regulators to support risk taking in, and by, financial markets, institutions, and consumers. It is the job of regulators to be independent and ensure that risk and reward is properly understood by institutions and individuals, and that consumers are protected from misselling.

There is a narrative promoted by finance sector lobbies that we live in a 'risk averse' society. This is obviously not true. The closure of defined benefit schemes, the growth in defined contribution schemes, and the misguided pensions 'freedom and choice' reforms means that ordinary individuals are now exposed to significant market and intertemporal risks.

Regional Growth

Question 4.8: [For Financial Services Organisations] What are the three most important factors, ranked in order, that you consider when making an investment location decision within the UK?

N/A.

Question 4.9: How can we capitalise on synergies between different regional financial services hubs to support growth?

We are not quite sure what is meant by this question, or why it is a question of synergies. We would argue that a priority for government strategy is to ensure that finance serves the interests of the real economy, including regional economies.

This means using policy and regulatory tools to promote finance which supports the real economy at national and regional levels, and deters activities which just finances other financial activities. If finance starts to better support regional economies, this in turn should lead to regional real economy firms requiring financial services with regional and local knowledge and expertise, thereby creating a virtuous circle.

Without government and regulatory interventions to steer markets, the dominant City of London institutions will continue to prefer to finance other, often speculative, financial activities rather than more productive real economy activities. As with green finance below, interventions will be needed to change the relative commercial attractiveness of real economy activities and financial market activities.

Skills & Access to Talent

Question 4.10: What is your assessment of the UK's ability to attract global talent to the financial services sector?

We have no real comment on this other than to say that, as we pointed out in the Economic and Social Audit of the City report, promoting the financial sector can have a detrimental impact on more economically and socially useful private and public sectors of the economy by attracting away the most skilled and talented staff. This is yet another reason why prioritising the growth in finance is not a productive option.

Question 4.11: What is your assessment of the UK's ability to effectively upskill and reskill domestic workers for roles in the financial services sector?

No comment.

International Partnerships & Trade

Question 4.12: What barriers do international financial services firms face in either establishing and operating in the UK, or using UK markets?

No comment.

Question 4.13: What opportunities should the government seek to advance through its international financial services relationships?

This is outside the scope of our work. But, we would urge the government to harness the UK's undoubted influence in international financial markets and global regulatory and standards setting institutions to promote the highest global regulatory standards and to prevent regulatory arbitrage.

Chapter 5 – Priority Growth Opportunities

Question 5.1: Do you agree with the priority opportunities that have been identified?

The government strategy does appear to have identified the areas in which the UK has a significant comparative advantage in terms of the potential to generate financial market revenues.

The two areas we believe the UK has the best opportunity to promote economically and socially useful innovation at a global level are in green finance and AI/ tech/ big data. We support the government's aims to make the UK a, if not the, leading centre for green finance and tech/ finance.

However, we would urge the government to use its influence to promote the UK as an attractive place to do business on the basis of *deserved* integrity, trust, and confidence; and to advocate for robust global regulatory standards and the avoidance of regulatory arbitrage.

Question 5.2: Which of the following business areas and activities do you see:

a) **For financial services firms: As high growth opportunities for your firm? b) For other organisations/individuals: As high growth opportunities for the sector?**

N/A

Question 5.3: What do you see as the most important ingredients for a thriving UK fintech sector in coming 10 years?

Question 5.4: Which are the critical factors for success that are specific to the fintech sector to enable innovative businesses to succeed?

The issue for the Financial Inclusion Centre is not so much whether the UK fintech sector is thriving per se or there appears to be a high level of 'innovation'. More important is whether the fintech sector works for consumers, particularly financially vulnerable, marginalised, and underserved consumers.

As we explain above, a growth in fintech (or indeed a growth in services more generally at the intersection of finance and technology) does not necessarily result in better outcomes for consumers. Fintech does not change the fundamental nature of markets which are built on customer segmentation and profiling, and competition for a narrow group of consumers. The basic dynamics of markets results in financial exclusion, marginalisation, and discrimination. If anything, AI/ fintech, and big data exacerbates the negative dynamics of markets by making it even easier to segment and profile consumers.

If the fintech (and broader tech/ finance sector intersection) is going to work for consumers, robust policy and regulation will be needed to: i. address the potential exclusionary and discriminatory effects of technology based finance; and ii. set clear boundaries to prevent firms using AI/ tech/ big data to exploits consumers' behavioural biases in a way that creates major detriment.

We are very encouraged that the government is implementing a National Financial Inclusion Strategy, We hope the strategy will address these risks.

Sustainable Finance

Question 5.5: In the UK's sustainable finance framework, as set out in the Chancellor's Mansion House package, do you see barriers or gaps that would support the growth and competitiveness of the UK sustainable finance market? 34

Question 5.6: What do you think should be the UK's priority when engaging with the global sustainable finance agenda, both bilaterally and at a multilateral level?

As we set out above, the priority should not be growth per se. Much depends on how 'competitiveness' is defined. We urge the government to make the UK sustainable finance industry competitive on the basis of deserved market integrity, trust, and confidence.

Question 5.7: What are the opportunities and barriers for the financial services sector in developing the products and/or services necessary to facilitate investment into the net zero transition? For each opportunity, please provide an indication of the type of intervention required, for example developing guidance, or supporting the development of further capabilities.

Realigning financial markets with net zero comes down to the challenge of how to achieve the most efficient allocation of financial resources to the goal. That is, how to divert resources *away from* climate damaging activities *to* climate supporting economic activities, and deal with the stock of existing climate damaging financial assets and flow of new assets.

Of course, the financial services sector isn't the only source of financial resources. The state itself can play an active role in providing low cost investment and in steering private finance resources away from climate harming activities to climate supporting activities.

The UK financial sector continues to finance, at scale, economic activities that harm the environment. While the UK may have significantly reduced its own economy-generated emissions, it continues to be a significant exporter of climate damaging finance. To be fair, we have seen some growth in climate positive financial activities, products, and services. But, not to the degree needed to align finance with climate goals.

The biggest barrier to driving private sector investment into the net zero transition is the fact that it is still very profitable to finance climate damaging activities. Policymakers and regulators do not deploy the necessary policy tools to sufficiently realign financial market behaviours with climate goals.

As a point of principle, it is remarkable that, quite rightly, that firms are prevented by legislation and regulation from financing terrorism, money laundering, enabling sanctions evasion, insider dealing, and misselling; yet, the financial sector is not prevented from financing *the* existential threat that is climate change.[20]

As a point of practice, we are unlikely to see the necessary realignment with climate goals unless sanctions and deterrents are deployed to phase out climate harming finance, over an appropriate time frame.

When required to align with public and social policy goals, financial markets respond to deterrents and sanctions. They do not respond as well to incentives. Of course, they respond well to incentives if commercial goals are at stake but that's a different matter. The use of deterrents to discourage climate damaging activities by default would then provide a financial incentive for firms to finance climate positive economic activities.

As mentioned, the state is also a source of financial resources. We would urge the government to create a strategic framework, in consultation with civil society organisations, to determine how, where, and when to deploy efficient state financial resources to support green goals.

This should include the role of state agencies such as GB Energy and The National Wealth Fund. There is worrying lack of transparency, governance, and accountability in place regarding the operations of these state agencies, the design of which appear to have been influenced by task forces and working groups dominated by private finance interests.

Capital Markets (including retail investment)

Question 5.8: Are there any barriers to growth in capital markets that are not being targeted by existing government reforms? How can private and public markets be grown so that they best support UK growth?

No comment.

[20] For a more detailed analysis of the limitations of the policy and regulatory tools deployed to align markets with climate goals, and for FIC's policy recommendations see: Time for Action – Greening the Financial System | The Financial Inclusion Centre and The Devil is the policy detail – will financial regulation support a move to a net zero financial system? | The Financial Inclusion Centre

Question 5.9: Are there any barriers to retail participation in UK capital markets? What more can be done to encourage consumers to invest in capital markets to a longer-term time horizon?

We are more concerned here about the proposals to get consumers to invest more in capital markets, particularly the Advice/ Guidance Boundary Review.

We, of course, want consumers to be able to have choices and make decisions that enhance their long term financial wellbeing and security, particularly in retirement. However, we are concerned that the industry lobby sees the Review, not as a means to support underserved/ invested consumers, but as an opportunity to push through deregulation and a reduction in consumer protection. In particular, we believe the industry sees this as a means to upsell consumers holding deposits to investment products which generate higher long term fee income; and while doing so shifting the line of responsibility for the sale of unsuitable products to consumers by reducing rights to redress.

Encouraging the sale of high risk investment products in a weakened consumer protection regime is likely to ultimately undermine long term confidence and trust in capital markets. This is set out in more detail in our consultation response.[21]

Insurance & Reinsurance Markets

Question 5.10: What are the barriers to insurers and reinsurers to growing their businesses and share of international markets?

Question 5.11: What are the barriers to innovation in the UK's insurance markets?

No comment.

Asset Management & Wholesale Services

Question 5.12: What are the barriers to setting up and conducting business as a UK asset manager or conducting wholesale services in the UK?

Question 5.13: In what ways could the regulatory landscape for asset management or wholesale services adapt to the needs of organisations over the next 10 years?

No comment.

This marks the end of our submission.
December 2024

[21] HM Treasury/ Financial Conduct Authority DP23/5 Advice Guidance Boundary Review | The Financial Inclusion Centre

ANNEX I: FIC PROPOSED PERFORMANCE FRAMEWORK FOR EVALUATING THE SUCCESS OF THE UK FINANCIAL SECTOR

The tables below summarises the framework to enable an objective and more balanced assessment of how well finance serves the interests of the real economy, the environment, and society (including households). It contains a set of high level outcome (s) for each category, with a set of specific outcomes which interpret and articulate the high level outcome (s). The high level outcome (s) articulates the overarching test of whether finance is serving the interests of that group; the specific outcomes allow civil society to assess whether this overarching test has been met.

Where appropriate, we have expressed these outcomes as both positive and negative outcomes. That is, as well as 'markets, products, and services are accessible and inclusive', it could be 'evidence of high levels of financial exclusion and discrimination'.

At the end of each section, there should be an overall assessment of how well finance performs.

PERFORMANCE FRAMEWORK AND METRICS: CONSUMERS AND HOUSEHOLDS

High level outcome (s)

- The financial sector provides access to socially useful, genuinely innovative, affordable, value for money, trustworthy products and services that meet needs and enhance welfare of communities/ citizens/ consumers.
- The financial sector behaves with integrity and treats consumers fairly.
- The financial sector supports social goals such as financial and social inclusion, and building financial resilience.
- Finance-related tech/ data is used for social good.

Specific outcomes	**Possible metrics**
Products and services are accessible and inclusive/ evidence of high levels of financial exclusion and discrimination, difficulties accessing products and services	• % of consumers who currently hold financial products • Product ownership by income, gender, ethnicity etc • Digital inclusion/ exclusion rates • Rejection rates on different products • Consumers understand products and services, terminology isn't a barrier to inclusion as measured by surveys
Products and services help consumers meet their core financial needs, help build resilience, enhance overall wellbeing (social useful)/ fail to help meet needs and enhance overall wellbeing (socially useless)	• Savings ratios amongst different consumer groups • % with savings cushion • % of consumers who currently hold financial products • Product ownership by income, gender, ethnicity etc • Balance of debt-savings amongst different consumer groups • Pension adequacy amongst different groups • Levels of assets amongst different groups
Products and services are affordable/are costly, consumers priced out of the market	• Surveys tracking % of consumers who say products and services are affordable • Pricing trends • Evidence of the poverty premium in financial services

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

Products and services provide good value for money/are expensive for what they deliver	• % of consumers who say products and services offer good value for money • % of consumers complaining about financial services • Comparison of charges and fees of dominant providers • Trends in charges and costs • Value for money comparisons for investments and pensions (investment performance net of fees) • Investment fund performance against benchmarks • Claims performance on insurance products • Net margins on mortgage and consumer credit products, savings/ loans margins
Financial products and services are genuinely innovative and enhance consumer welfare/ spurious choice, welfare damaging products and services	• Evidence on usage of products such as buy now, pay day lending, sub prime lending • Evidence of new business models, flexible products which adapt to consumers' needs and lifestyles • Regular stakeholder expert surveys to gauge opinions on how well products are meeting needs of consumers
AI, data, tech used for social good/ exacerbates exclusion, discrimination, and behavioural manipulation	• Synthesis of research on practices and impacts of AI, tech, data on financial services and consumers • Regular stakeholder expert surveys to gauge opinions on how well products are meeting needs of consumers
Financial products and services are safe, consumers protected from fraud and scams/ victims of scams and fraud, exposed to risky products and contracts	• Surveys and research on numbers of consumers exposed to/ victims of scams and fraud • Industry data on business flows into high risk investment/ pension products
Consumers have justified trust and confidence in financial institutions, products, and services/ consumers lose trust and confidence	• % of consumers who have trust and confidence in financial services • Trends in complaints and misselling • Trends in fraud, scams, firm failure
Consumers are treated fairly, firms comply with Consumer Duty/ treated unfairly, Consumer Duty has limited impact	• % of consumers who have trust and confidence in financial services • Trends in complaints and misselling • Evidence on impact of the Consumer Duty
Financial institutions are trustworthy and operate with integrity/ are untrustworthy and behave unethically	• Research on levels of misselling • Impact of Consumer Duty Complaints to FOS • Data on scams and frauds
Financial products and services are understandable and easy to engage with/ are unnecessarily complex, poorly understood	• Data and research on levels of financial capability and literacy • Data and research on digital capability and literacy
Consumers have access to appropriate redress/ are denied access to redress	• Surveys on attitudes to FOS • Comparative analysis of evidence of misselling/ fraud with numbers getting redress
Financial system is stable and resilient, institutions are secure/ financial instability, systemic	• Data on number of firms failing • Calls on the FSCS

crises, high levels of financial institutions failing	
Financial services are well regulated/ poorly regulated	• Data on enforcement cases • Impact of Consumer Duty • Comparative analysis of evidence of market failure with enforcement
OVERALL ASSESSMENT OF UTILITY OF FINANCE FOR CONSUMERS	

PERFORMANCE FRAMEWORK AND METRICS: SUSTAINABILITY – ENVIRONMENT

High level outcome (s)

Financial market activities are aligned with net zero and wider environmental goals. The financial system is resilient to climate risks.

Specific outcomes – environmental	**Possible measures and metrics**
An increase in finance allocated to economic activities which support climate and wider environmental goals (includes biodiversity)/ insufficient levels of finance allocated to climate and environmentally positive activities	• Improvement in financial institution's 'greenness ratios'.[22] • Evidence of improvement in number of financial institutions with climate management plans. • Data on fossil fuel financing • Data on economic activities which harm nature • Number and value of investment funds signed up to FCA's sustainable investment label and complying with meaningful standards.
Economic activities which cause climate and wider environmental harms are de-funded/ harmful activities continue to be funded Overall, improvement in the ratio of climate positive-damaging finance/ no improvement or reversal in ratio	• Evidence of disinvestment from environmentally harming activities. • Trends in portfolio emissions data at loan book, investment fund, insurance company, pension fund level.
An increase in the most **cost effective** aligned finance allocated to green infrastructure to reduce the cost of net zero transition/ expensive short term private finance pushes up cost of funding net zero	• Evidence of growth in investment/ financing of sustainable energy generation • Analysis of the source, cost, and terms of finance committed
Quality of financial institutions' transition plans improve/ reduction in quality and accessibility of plans	• Trends in data on financial institution compliance with TCFD/ ISSB disclosure and reporting standards. • Qualitative assessment of transition plans.

[22] Eg. esma50-165-2329_trv_trv_article_-_eu_ecolabel_calibrating_green_criteria_for_retail_funds.pdf (europa.eu)

Greater transparency and meaningful reporting on financial institutions environmental impact and performance/ reversals in compliance with standards	• Trends in financial institution compliance with TCFD/ ISSB disclosure and reporting standards. • Qualitative assessment of transition plans.
Quality of corporate sector transition plans improve/ reduction in quality and accessibility of plans	• Trends in data on corporate compliance with TCFD/ ISSB disclosure and reporting standards. • Qualitative assessment of transition plans.
Greater transparency and meaningful reporting on corporate environmental impact and performance/ reversals in compliance with standards	• Trends in data on corporate compliance with TCFD/ ISSB disclosure and reporting standards. • Qualitative assessment of transition plans.
UK is a trustworthy global centre of green finance operating to the highest regulatory standards/ UK competes on lowering standards	• UK financial markets score well against international peers on green finance standards. • Improvement in regulatory standards via expert assessment.
UK behaves as a responsible global corporate citizen by promoting consistently high international regulatory standards/ UK encourages regulatory arbitrage	• Improvement in UK regulatory standards relating to climate finance. • UK regulatory standards meet expectations of civil society organisations. • UK promotes highest global regulatory standards in international standards setting fora.
UK attracts green finance that complies with meaningful environmental standards/ attracts finance that does not comply with high standards.	• Evidence of climate positive listings on UK markets. • Evidence of green financial products launched in UK.
UK reduces exports of climate damaging finance/ continues to finance climate harming activities	• Evidence of disinvestment from environmentally harming overseas activities. • Reduction in bank financing, re/ insurance of climate harming overseas activities.
Greenwashing is reduced/ enabled or increases	• FCA reporting reductions in greenwashing. • Reduction in misleading advertisements and promotions.
Social impact washing is reduced/ enabled or increases	• FCA reporting reductions in greenwashing. • Reduction in misleading advertisements and promotions.
Financial system is more resilient to climate risk/ continues to be exposed to climate risks	• Evidence of UK financial regulators enhancing climate related policies. • Stress testing analysis. • Monitoring of climate related losses.
OVERALL ASSESSMENT OF UTILITY OF FINANCE FOR THE ENVIRONMENT	

PERFORMANCE FRAMEWORK AND METRICS: SUSTAINABILITY – SOCIAL

High level outcome

Financial markets make a positive contribution to tackling social harms such as poverty, inequality, and exclusion, ill health and improving standards of corporate behaviours on social issues such as diversity and inclusion, human rights, fair wages, ethnicity and gender pay gaps.

Specific outcomes – social	Possible measures and metrics
An increase in finance aligned to social goals/ misaligned with social goals	• Evidence of increase in UK financial institutions aligned to the UN Sustainable Development Goals (SDGs) or equivalent.[23]
Financial institutions drive positive behavioural change with regards to social issues in the corporate sector/ negative behaviours	• Growth in corporations complying with high standards on labour market issues eg. ILO standards, paying the Real Living Wage. • Reduction in sales and marketing of harmful products and foodstuffs.
Increase in genuine social impact finance/ finance extracting value from social sector assets	• Increase in support provided by financial institutions to organisations engaged in tackling issues such as financial and social exclusion *on below market terms*. • Evidence that rent seeking activity diminishing.
Finance has a positive impact on regional, asset, and income inequality/ financialisation contributes to asset and income inequality, intra and intergenerational inequality.	• Evidence of financial institution commitment to the regions. • Comparison of incomes and assets across regions, between finance and other industry sectors.
Reduction in social impact washing/increase in social impact washing.	Assessment of reports, expert views.
Reduction in facilitation of tax avoidance and money laundering activities/ increase in tax avoidance and money laundering.	Assessment of reports, expert views.
OVERALL ASSESSMENT OF THE SOCIAL UTILITY OF FINANCE	

[23] See for example ESMA analysis of EU funds ESMA50-524821-3098_TRV_article_-_Impact_investing_-_Do_SDG_funds_fulfil_their_promises.pdf (europa.eu)

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

THE PERFORMANCE FRAMEWORK AND METRICS: BUSINESS AND THE REAL ECONOMY

High level outcome

Financial markets and services support the needs of the real economy and all types of business at national, regional, and local level. Financial market activities support sustainable, productive economic growth.

Specific outcomes – business and economy	**Possible measures and metrics**
The market for business finance is competitive, financial products and services aimed at the business community are competitively and fairly priced/ products and services are uncompetitive, exploitative, growth in rent seeking behaviours and value extraction by dominant providers. Financial products and services are structured and designed to meet the needs of business finance, provided in the appropriate form (debt/ equity)/ not aligned with business needs. Innovation in the financial sector meets the changing needs of business/ fails to meet changing needs, exposes businesses to risks.	• Business (particularly SME/ micro business) levels of satisfaction with finance. • Trends in prices and availability of financial services. • Amount and suitability of finance available to start ups. • Trends in structure of finance. • Evidence on loan terms and conditions aligned with the time horizons of businesses, lending facilities are flexible to accommodate changing business conditions or capital investment requirements • Evidence on market dominance.
The financial sector meets the needs of different sizes of business including new companies, SMEs, and micro businesses/ focuses on large corporates and other financial activities to the detriment of smaller business	• Trends in prices and availability of finance provided to SMEs and micro business. • Terms and conditions in financial products and services are supportive of SME and micro business needs.
Financial sector treats businesses especially SMEs and micro businesses fairly, honestly, and with integrity/ treats businesses unfairly and with lack of integrity Financial institutions treat businesses sympathetically when businesses are facing difficult conditions/ treat businesses unsympathetically. The financial regulators do enough to protect businesses from harmful financial practices.	• Use of personal guarantees in provision of finance. • Trends in loan rejection rates. • Trends in foreclosure and forbearance. • Trends in closing of small business accounts. • Evidence of fair treatment of SMEs and micro businesses in ESG policies. • Data on how financial firms handle complaints from SMEs and micro businesses.
The financial sector meets the diverse needs of different types of business model such as community based, for-profit, non-profit, hybrid models not	• Trends in financing different types of business.

just conventional business models/ fails to meet the needs of diverse business models	
The financial sector meets the needs of business at national, regional, and local level/ fails to meet the needs of regional and local businesses, overly focused on London, South East and other major centres	• Trends in national, regional, local level lending
The financial sector promotes diversity and inclusion within finance itself and supports diversity and inclusion in the real economy/ fails to comply internally with expectations on diversity and inclusion, and promote diversity and inclusion in corporate sector	• Data on diversity and inclusion. • Data on the 'S' part of ESG.
Finance supports real economy activities, and a well balanced economy/ finance crowds out real economy activities, creates economic imbalances, overreliance on finance, finances speculative activities, creates asset price bubbles	• Evidence of share of GVA accounted for by financial activities, share of finance and lending allocated to real economy activities and financial activities.
The financial sector makes a net positive contribution to the UK economy, evidence of financial value added/ makes net negative contribution	• Assessment of headline positive contribution and overall negative contributions.
Financial activities support R&D, innovation, and economic productivity/ financial short termism undermines business sector productivity and sustainable long term economic growth.	• Trends in investment time horizons, evidence of reduction in short termism. • Investment in R&D, growth in risk capital.
The financial sector contributes to economic regeneration and reduction in regional inequality/ exacerbates regional imbalances. The financial sector contributes to rising living standards, sustainable employment, quality of work/ exacerbates disparity in incomes.	• Evidence of financial institution commitment to the regions. • Comparison of incomes and assets across regions, between finance and other industry sectors.
A stable and resilient financial system supports wider economic stability and resilience/ financial activities and systemic failures cause harm to real economic growth and resilience, household living standards.	• Incidences of systemic failures
OVERALL ASSESSMENT OF THE ECONOMIC UTILITY OF FINANCE	

Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk