**Written evidence submitted by the Finance Innovation Lab (FSMB04)**

## Financial Services and Markets Bill
## Committee Stage - Written evidence

## Summary


1. Finance Innovation Lab has been closely involved in development of the new regulatory framework and remains concerned that proposals in the Bill are not calibrated to deliver an effective and accountable regulatory framework that will deliver for the needs of the people of the UK.

.

2. The independence of regulators risks being fatally compromised in two ways: 1) the "'competitiveness" objective; and 2) the newly-proposed "call-in" power. Compromising the independence of regulators can lead to instability, as we witnessed in 2007/08, reduce economic growth, and damage the UK's global reputation and international standing.

3. The proposals also risk ingraining a democratic deficit. While the Bill gives regulators and HMT significantly more power over financial policy and regulation, it fails to match this with measures to enable the public and Parliament to hold them accountable.


## Finance Innovation Lab

4. Finance Innovation Lab ("the Lab") is a UK-based charity working to bring about a financial system that works for people and planet. This submission builds on the Lab's previous relevant consultation responses[1] and it reflects dialogue the Lab has pursued with senior policy makers in relation to the Bill.

5. The Lab is also part of the Finance For Our Future coalition - an umbrella group of 39 civil society organisations and other public interest bodies that have called on the government to ensure its financial services reform package is adequate for the biggest challenges the UK faces now and into the future.[2] This submission focusses on key concerns about stability, accountability and standards, but also supports calls for climate and inclusion mandates for regulators, as the coalition has emphasised.

6. **Please contact Marloes Nicholls, Head of Policy and Advocacy at the Lab, to discuss this submission: marloes@financeinnovationlab.org.** We would gladly

---

[1] For example, the Lab submitted a response to HMT's Future Regulatory Framework Review in February 2022.

[2] *Finance for our Future (2022), Joint Statement.*

provide oral evidence to the Committee, as we did for the last Financial Services Bill (now Financial Services Act 2021), to assist with its work scrutinising the Bill.

## The Future Regulatory Framework

7. The landmark post-Brexit Financial Services and Markets Bill will bring about the biggest shake up of regulation for the sector since the 1980s. It will repeal retained EU law and deliver the Future Regulatory Framework (FRF). This will determine how financial services regulation is developed in the UK outside of the EU, and it opens up fundamental questions about what purpose the rules that shape this critical sector serve, and who holds power over them.

8. Former Economic Secretary to the Treasury John Glen MP correctly described the FRF as “a once-in-a-generation opportunity” to ensure that the rules that support financial services are fit for purpose.[3] However, we are very concerned about some important aspects of the proposals which mean that the Bill will fall short of achieving its goal for the financial services sector: “to act in the interest of all people and communities” across the country.[4]

9. **We are particularly concerned about the implications of the Bill for: i) regulatory independence; and ii) democratic accountability.** This is because the proposals include a major delegation of powers to HM Treasury (HMT) and regulators, specifically the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), without a sufficient increase in oversight and accountability by parliament and the public. In addition, the regulators will be mandated to pursue their expanded powers in accordance with a new statutory objective - to promote the ‘international competitiveness’ of the financial services industry in particular - that will undermine their ability to act independently in the public interest.

## i. Regulatory independence

10. Regulatory independence means that the regulators are empowered to pursue their statutory objectives without undue external interference or pressure. It is a critical prerequisite for well-designed regulation. Indeed, the Bank of England’s recent discussion paper examines an extensive literature that demonstrates that regulatory independence leads to greater financial stability.[5] The Bank’s evidence demonstrates that delegating regulation and supervision to independent agencies insulates these processes from the vagaries of the electoral cycle, and it avoids the risk of ‘moral hazard’ that might risk imprudent behaviour from bank executives.[6] The net effect is a

---

[3] *HM Treasury (2021), Financial Services Future Regulatory Framework Review: Proposals for Reform.*
[4] *HM Treasury (2022), Queen’s Speech 2022.*
[5] *Bank of England (2022), DP4/22 – The Prudential Regulation Authority’s future approach to policy.*
[6] ‘Moral hazard’ being the risk that bank executives are incentivised to act less prudently if they believe a regulator lacking independence is more likely to save a poorly run or failing bank due to the effect of their

reduction in economic volatility, greater bank efficiency, and better long-run economic performance.

11. Achieving financial stability has to be a priority for the government. The global financial crisis of 2007/08 saw millions lose their savings, homes, businesses and jobs, and cost the UK an estimated £1.8 trillion in lost UK GDP.[7] The Institute for Fiscal Studies estimates that the cataclysmic event cost each worker £800 per annum in lost income in the years that followed.[8] It is no wonder then that today, during a cost of living crisis, over 70% of the population are worried about the impact of another crash on their personal finances.[9]

12. Academic studies of financial crises consistently show significant and broad economic damage as a direct outcome. The long-term economic impact study by the Basel Committee on Banking Supervision reviewed the results from a plethora of studies, finding the median cumulative output loss across comparable studies represents 63% of pre-crisis output. The average output loss is higher still, exceeding 100%.[10] As the Bank of England found, across the substantial body of academic literature looking at the cost of crises, the costs in terms of forgone GDP is consistently substantial.[11]

13. On the other hand, the Organisation for Economic Co-operation and Development notes that political commitment to regulatory independence can lead to greater economic growth.[12]

14. The independence of financial regulators is also a factor in the UK's global reputation and international standing. The International Monetary Fund (IMF) noted earlier this year that enhanced accountability and transparency mechanisms in the UK should operate in a way that "preserves the independence of the regulators" and "should not reduce operational and regulatory effectiveness".[13] This is because independence has the effect of bolstering the stability of policy, thus reducing uncertainty and minimising political risk. International businesses will favour investment in jurisdictions where the regulatory decisions affecting them are made by regulators they can trust are acting in the interest of the stability and soundness of markets.

---

lobbying. An independent regulator is insulated from this lobbying, incentivising those running banks to avoid inappropriate risk-taking.

[7] *Baker, Epstein, and Montecino (2018), The UK's Finance Curse? Costs and Processes.*

[8] *BBC (2018), Workers are £800 a year poorer post-crisis. 12 September 2018.*

[9] *The Finance Innovation Lab (2022), Financial Services and Markets Bill: Polling reveals UK public oppose deregulation.*

[10] *Basel Committee on Banking Supervision (2010), An assessment of the long-term economic impact of stronger capital and liquidity requirements.*

[11] *Bank of England (2022), DP4/22 – The Prudential Regulation Authority's future approach to policy.*

[12] *Parker, D. and Kirkpatrick, C. (2012), Measuring Regulatory Performance. The Economic Impact Of Regulatory Policy: A Literature Review Of Quantitative Evidence. 3.5*

[13] *International Monetary Fund (2022), Country Report No. 22/57: United Kingdom: Financial Sector Assessment Program-Financial System Stability Assessment.*

15. **The Bill introduces two key measures that risk undermining the independence of regulators:**
    a. **the re-introduction of a focus on promoting the 'international competitiveness' of the financial services sector; and**
    b. **new powers for HMT to overrule (or "call-in") decisions made by regulators.**

**Competitiveness objectives**

16. The Bill introduces a new statutory objective for the FCA and PRA to pursue "competitiveness and growth….including in particular the financial services sector".[14]

17. Regulators are already required to promote *competition* between firms in order to drive better outcomes for consumers. "International competitiveness" is different; it asks regulators to promote the ability of UK firms to compete for business overseas.[15] Tasking regulators with this gives them a problematic double mandate: both cheerleaders for the industry as well as watchdogs over the industry.

18. This risk was noted by former FCA Chair, Charles Randell, to the Treasury Select Committee (TSC) in December 2021: "The risk [is] that whenever we propose to do something, we receive a large amount of lobbying input saying this rule doesn't exist in this country or that country or the other country, and therefore you shouldn't do it."[16]

19. We also know from recent history that the proposal risks putting UK regulators in a dangerous race to the bottom with other jurisdictions. In 2010, HMT identified that one of the reasons for regulatory failure leading up to the global financial crisis of 2007/08 was "excessive concern for competitiveness".[17] Parliament acknowledged this too, and they removed competitiveness from the mandate of the financial regulator.[18] In the words of the Bank of England's Andrew Bailey in 2019, when he was CEO of the FCA, the regulator "was required to consider the UK's competitiveness, and it didn't end well, for anyone".[19]

---

[14] UK Parliament (2022), Financial Services and Markets Bill. 24(1-4). For the FCA and PRA, this means:
"Facilitating, subject to aligning with relevant international standards—
(a) the international competitiveness of the economy of the United Kingdom (including in particular the financial services sector), and
(b) its growth in the medium to long term."

[15] *Kay, J. (2022), Why competitiveness should not become a goal for the FCA.*

[16] *House of Commons Treasury Committee (2021), Oral evidence: The work of the FCA, HC 146.*

[17] *HM Treasury (2010), A new approach to financial regulation: judgement, focus and stability.*

[18] It is critical to note that pre-crash the regulator merely had to 'have regard to' competitiveness, which is a far weaker requirement than pursuing a statutory objective.

[19] *Bailey, A. (2019), The future of financial conduct regulation.*

20. A wide range of stakeholders have expressed alarm. In May 2022, over 50 economists wrote to HMT warning of the dangers of any competitiveness objective for financial regulators.[20] The TSC has also expressed concern over competitiveness as a regulatory goal. In June 2022 it noted "sensitivity towards the idea of "competitiveness" as an explicit part of an objective, and fears that it might be interpreted as an invitation to overly loosen regulatory constraints".[21]

21. The IMF has warned of "tension" between the government's policies to enhance the competitiveness of the UK's financial system and financial stability. They reminded the government that "while maintaining a competitive financial sector is an important policy goal, financial stability should not be compromised for the objectives of competitiveness."[22]

22. These worries are shared by the UK public; a recent poll found that 91% think international competitiveness should not be a top priority for new financial services regulation.[23]

23. There are already many organisations whose job it is to promote financial services.[24] At the same time, the existing framework means regulators already take account of the impact of their decisions on industry competitiveness: there are a number of requirements and mechanisms which mean they consider the costs of their decisions on industry, including the regulatory principles,[25] the remit letter,[26] and cost benefit analysis. The UK's independent regulators have played an important part in securing London as a world-leading financial centre.[27]

**"Call-in" powers**

24. The government has stated its intention to amend the Bill at committee stage to bring forward an intervention, or "call-in", power that will enable the government to "direct a regulator to make, amend or revoke rules where there are matters of significant public interest".[28]

---

[20] *Balanced Economy Project (2022) Competitiveness in financial regulation: some good news.*
[21] *House of Commons Treasury Committee (2022), Future of financial services regulation. First Report of Session 2022–23. pp.25-26.*
[22] *International Monetary Fund (2022), Country Report No. 22/57: United Kingdom: Financial Sector Assessment Program-Financial System Stability Assessment. p.11.*
[23] *The Finance Innovation Lab (2022), Queen's Speech 2022: Poll Shows Widespread Concern Over Chancellor's Financial Reforms.*
[24] For example, the City of London's Lord Mayor, industry associations, and the firms themselves.
[25] *HM Treasury (2021), Financial Services Future Regulatory Framework Review: Proposals for Reform. 1.20.* The principle of proportionality in particular.
[26] *The Rt Hon Rishi Sunak MP, Chancellor of the Exchequer (2021), Recommendations For The Financial Conduct Authority. 7 April 2021.* The regulators must 'have regard to' competitiveness.
[27] Z/Yen's Global Financial Centres Index 31 (2022) ranks London second in the world.
[28] *Hansard (2022), Financial Services and Markets Bill Volume 719: debated on Wednesday 7 September 2022. Col. 283.*

25. Without strong, well-defined and mutually respected safeguards a call-in power risks compromising the quality of regulation because politicians' and regulators' incentives are not always aligned and their roles are different. Politicians - concerned about near-term public opinion, electoral expediency, and (sometimes) the requests of special interest groups - are subject to pressures to favour fixes that deliver benefits in the short term, potentially at the cost of longer-term best outcomes. This is why it is right that the overall legislative framework and objectives of regulators should be the focus of democratically elected governments, not the detailed implementation of those objectives. Conversely, regulators can and do take a more holistic and long-run view based on their statutory objectives and expertise. Ultimately, a longer-term perspective is important for strong long-term growth and for protecting the interests of consumers.

26. Even if the government were to choose to exercise a call-in power rarely, its existence - and the threat of its use - could precipitate a "chilling effect" within the regulators whereby they are less likely to act as they see fit for fear the government will disagree and therefore intervene via the power. Indeed, the powers' presence on the statute book could disincentivise the regulators from acting in ways that might be perceived as running contrary to powerful firms, given concern that well-connected interests might successfully lobby the government to use its call-in power.

27. It is notable that a wide range of stakeholders have expressed concern with such a call-in power. Mel Stride MP, chair of the TSC, has described the proposed new powers as a "significant shift" from what is currently in the Bill, and has warned that "this may be an overly overbearing power for HMT, which may impinge on the independence of the regulators themselves."[29] Investor Gina Miller said that the UK "would be seen as an outlier compared to the rest of the world", creating uncertainty for businesses which could deter investment.[30] Lawyer and former regulator Matthew Nunan added that: "Having the ability to overturn individual decisions at the micro level seems a recipe for disaster".[31]

28. We are also concerned that a motivation behind the call-in power is a desire to move quickly to erode financial sector regulation.[32] Polling has repeatedly shown that the UK public is in favour of more - not less - regulation of the financial services industry, and they are concerned about another financial crash. **Only 9% believe that the banks and**

---

[29] *Ibid.*
[30] *Bloomberg UK (2022), UK Weighs Strength of Treasury Power to Overrule Regulators. 13 September 2022.*
[31] *City A.M. (2022), Ministers meddling in regulation is 'recipe for disaster', says former FCA official. 12 September 2022.*
[32] *Financial Times, (2022), New UK chancellor Kwasi Kwarteng promises 'Big Bang 2.0' for City of London. 7 September 2022.*

**other financial institutions need less regulation.**[33] As the FT reported in September 2022, City executives share unease that the government is taking deregulation too far.[34]

29. **Recommendation 1:** Amend the Bill to stop the introduction of a statutory objective for regulators to promote the growth or international competitiveness of the finance industry. This could be achieved by cutting "(including in particular the financial services sector)" from the new objective currently proposed by the Bill.

30. **Recommendation 2:** Do not accept any government amendments to introduce the proposed new call-in power.

### ii. Democratic accountability

31. While the Bill gives regulators and HMT significantly more power over financial policy and regulation, it fails to match this with measures to enable the public and Parliament to hold them accountable. As a result, we could see powers repatriated from the EU without robust new mechanisms for scrutiny, which risks ingraining a democratic deficit.

32. In particular, more attention needs to be paid to the decisions of HMT and how these can be scrutinised. This is because in the FRF, as outlined by the Bill, HMT will set the policy framework through secondary legislation (via aptly named "Henry VIII powers"). The Economic Secretary has promised that all secondary legislation will be made via the affirmative procedure,[35] but there will still be limited scope for Parliament to offer proper scrutiny given the sheer volume of secondary legislation HMT expects to produce. It is extremely rare for Parliament to strike down secondary legislation[36] and Parliament will not be able to amend any of the secondary legislation laid before it.

33. HMT has a close relationship with the financial services sector, which is not counterbalanced by equal engagement with other stakeholders, including consumer groups, civil society organisations, and small businesses. Close to a third of all Treasury minister meetings in 2020 and 2021 were with the financial sector and its lobbyists, far more than any other sector.[37] At the same time, responses to consultations about financial services policy are dominated by industry interests. As a result, handing HMT

---

[33] *The Finance Innovation Lab (2022) Financial Services and Markets Bill: Polling reveals UK public oppose deregulation.*

[34] *Financial Times, (2022), New UK chancellor Kwasi Kwarteng promises 'Big Bang 2.0' for City of London. 7 September 2022.*

[35] *Hansard (2022), Financial Services and Markets Bill Volume 719: debated on Wednesday 7 September 2022. Col. 280.*

[36] Institute for Government (2020), Secondary legislation: how is it scrutinised? The last time the Commons failed to pass an affirmative instrument was in 1978, while the House of Lords last failed to approve an affirmative instrument in 2015.

[37] *Positive Money (2022), The Power of Big Finance: How to reclaim our democracy from the banking lobby.*

greater power over financial services policy risks exacerbating the undue influence finance sector lobbyists hold over rule-making.

34. Some have argued that a call-in power (see paragraph 24) is the ultimate accountability measure because it allows elected representatives (in this case, HMT Ministers) to overrule decisions made by unelected regulators. However, the gross imbalance in access the industry and its lobbyists have to HMT versus public interest groups explains why the proposal fails to offer democratic accountability.[38]

35. Robust parliamentary scrutiny is necessary for democratically accountable financial sector policymaking. Given the size and importance of the finance sector, and the extent of reform underway, to be effective such scrutiny will require the dedicated attention of a committee. For this reason, we welcome the recent creation of the sub-committee for the scrutiny of financial services regulation by the TSC as a positive first step.

36. Transparency is also central to creating a democratically accountable financial sector policy. It is a prerequisite for stakeholder engagement, to combat corruption, and ensure public trust. When a lack of transparency over lobbying leads to policy outcomes that benefit only well-funded or well-connected interest groups, millions or even billions of pounds-worth of taxpayers' money can be put at risk. In the case of the financial sector, the stability of the whole economy can be threatened. It is therefore critical that the UK government develops a policy that provides for transparency regarding lobbying activities in the finance sector (and beyond). Such policies would bolster the UK's international reputation for financial integrity and should not be seen as a hindrance. They would bring the UK up to the standard of countries like the US and Ireland, which already have more stringent lobbying regulations than the UK.[39]

37. Following withdrawal from the EU, the UK also has an opportunity to demonstrate leadership and address the gross imbalance in stakeholder engagement. The government has acknowledged the need, stating that "any policymaking process risks being deficient if it does not draw sufficiently on the views, experience and expertise of those who may be impacted by regulation".[40]

38. To achieve this, we recommend that the government mandate public interest representation of at least 50% on all groups and committees providing advice and making decisions about financial services policy and regulation. The regulators' statutory panels are one mechanism for stakeholders to input into regulation, but are currently dominated by industry.[41] The government should build on its proposals in the Bill to

---

[38] Public interest groups include consumer groups, civil society organisations, and groups representing SMEs.

[39] *Transparency International UK (2021), [Understanding Access And Potential Influence In Westminster.](#)*

[40] *HM Treasury (2021), Financial Services Future Regulatory Framework Review: Proposals for Reform.*

[41] Of the FCA's panels, just one is for consumers – the Financial Services Consumer Panel. The Prudential Regulation Authority, meanwhile, has no public interest panel at all.

increase the transparency of the panels by ensuring that the voices of consumers and citizens are given at least equal weight to the voice of industry.

39. **Recommendation 3:** Amend the Bill to require statutory registration of all financial services sector lobbyists, disclosure of those who previously have been public officials involved in developing finance policy, and require all to report monthly on their communications with the government, including written communications.

40. **Recommendation 4:** Amend the Bill to require that FCA and PRA statutory panels consist of a maximum of 50% industry representatives and at least 50% public interest representatives. As part of this, a duty should be placed on the PRA to consult the public, not just firms (amending FSMA s136), including via a new statutory panel. Resources should be provided to enable public interest groups to participate.

## Finance for Our Future

41. As part of the Finance For Our Future coalition (see above) we believe the Bill is a key opportunity to deliver on financial inclusion and that it contributes to the greening of the financial system. We support the following recommendations that other members of the coalitions are focussing on in their submissions:

42. **Recommendation 5:** Amend the Bill to introduce a new secondary statutory objective requiring the FCA and PRA to facilitate the alignment of the financial services sector with net zero, including wider considerations of nature. (Please refer to the committee evidence submitted separately by WWF for more information.)

43. **Recommendation 6:** Amend the bill to give the FCA has a cross-cutting "must have regard" to financial inclusion (in line with the recommendation made by the TSC, [42] and as promoted by Fair by Design).[43]

*22 September 2022*

[42] *House of Commons Treasury Committee (2022), Future of financial services regulation. First Report of Session 2022–23.*

[43] *Fair by Design (2022), Financial Conduct Authority must think Financial Inclusion.*