

## Lords Industry and Regulators Committee inquiry into UK Regulators

Dear Lord Hollick,

1. We welcome the opportunity to respond to the Committee's inquiry into UK Regulators. Our comments are based on our experience of the regulation of financial services.
2. Regulation of financial services is currently undergoing much reform. In large part this is being delivered through HM Treasury's Smarter Regulatory Framework, following the powers provided by the Financial Services and Markets Act (FSMA) 2023. At its heart, the new framework provides enhanced powers to the sector's main regulators – the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) – by moving regulatory rules from the UK statute book to the regulators' handbooks. We support this as it permits a more principles based and, where relevant, proportionate approach to be taken by regulators.
3. This submission addresses the themes raised in the inquiry's list of questions.

### **The clarity of UK regulators' roles**

4. The FCA and PRA have primary objectives set by statute to help ensure markets function effectively, consumers are protected and firms are resilient. They now also share a secondary objective to promote growth and international competitiveness. HM Treasury also issues remit letters to the FCA and PRA to emphasise areas of economic policy they would like the regulators to consider. They also occasionally legislate to update and refine the regulators' list of primary and secondary objectives to reflect the Government's priorities.
5. While we support principle-based regulation, we urge the regulators to stick to the guardrails set by government and Parliament and avoid straying into areas that are not explicitly within their statutory remit. The FCA's new Consumer Duty is an example of an expansive policy that, given its breadth, risks becoming overly interventionist. For example, the Fair Value requirements, as part of the Duty, means there is the potential for the FCA straying into price control territory.
6. The CMA's role in sectors such as financial services should also be considered in this context. For example, the remedies that the CMA imposes at the end of a market investigation can act as another form of regulation, with the associated costs on firms.

### **The balance between the responsibilities of regulators and the Government**

7. The new Smarter Regulatory Framework for financial services that was provided for through the Act (and which reverts financial services regulation to the so called 'FSMA model'), will enhance the powers of regulators. HM Treasury will nevertheless still have the power to challenge regulators' decisions if it believes they are not administering their duties in line with the objectives that have been set. Additionally, scrutiny of the regulators by Parliament through select committee appearances remains important.
8. This post-Brexit environment allows for significant change to domestic regulation through the adoption of the new framework. It's important that industry is consulted on the necessary statutory instruments (SIs), which are being used to move rules into the regulators' handbook, as once passed there is limited ability to challenge these new responsibilities.
9. We support a financial services regulatory framework in which our independent regulators can be adequately held to account by Parliament, and we consider that existing mechanisms are suitable for achieving this. We, however, note the potential new Financial Services Regulation

Committee in the House of Lords, as recommended by the Lords' Liaison Committee, and look forward to engaging with the Committee as it carries out its duties.

10. Independence is a crucial pillar of the UK's financial services regulatory framework. It is vital that this independence is preserved and respected through the adoption of the new framework; empowering the regulators to take decisions independently of government. This will help improve regulatory certainty and avoid short-termism.

### **Guidance from government**

11. Government issues remit letters to the principal financial services regulators (i.e., the FCA and the PRA) at least once in each Parliament, which we believe strikes the right balance in providing the regulators with enough guidance when making regulatory decisions.
12. There is a risk that greater frequency could start to erode stability and the regulators' independence as government becomes more actively involved in directing their short-term priorities. That said, in some markets, we acknowledge there is a need for greater government co-ordination on regulatory outcomes, such as across the two competing payment initiatives – New Payments Architecture and the Digital Pound – which will end up competing for payment volumes. The overarching recommendation in the Future of Payments Review report is a vision for the industry which will also encourage greater coordination between regulators.

### **Roles and remits of the regulators**

13. Overall, financial services regulators, such as the FCA and the PRA, have clear roles and remits, through their statutory objectives set by Parliament. However, there is some blurring of responsibilities between conduct and economic regulators. For example, the PSR is responsible for overseeing compliance under the Card Acquirer Market Review, despite the FCA's role as the principal conduct financial regulator. There is also some duplication of supervisory activity in areas of common interest to the FCA and PRA, such as governance, which can result in additional burdens to firms.
14. There is also the possibility of encroachment from elsewhere in the regulatory landscape. As mentioned above, the CMA already plays a considerable role in the regulation of financial services. In order to reduce duplication and increase efficiency and effectiveness, further consideration should be given to whether it would be more appropriate for any remedies imposed by the CMA in a market investigation in the financial services sector to be overseen by the FCA and/or Payment Systems Regulator (PSR).
15. In addition, the Digital Markets, Consumers and Competition (DMCC) Bill is set to widen the CMA's role, providing it with enhanced powers to fine financial services firms and individuals, as well as new powers to revisit and amend remedies. These new powers for a non-specialist financial services regulator will significantly increase regulatory uncertainty in the sector and possibly dent the overall attractiveness of the UK for investors. It remains unclear whether these powers are intended to apply to already existing remedies which would further increase uncertainty and would be a disproportionate step.
16. UK Finance has previously highlighted that the CMA's enhanced powers, as set out in the Bill, have the potential to be out of step with the Government's wider competitiveness and growth agenda. In its recently updated 'Strategic Steer' to the CMA, the Government set out the

expectation that the CMA should prioritise outcomes that promote competition, investment, innovation and boost economic growth<sup>1</sup>.

17. The Wider Implications Framework coordinates activity between the FCA, Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Service (FOS) on cross-cutting issues. Whilst we support the Framework's efforts to increase co-operation, we have previously raised some concerns over how it has the potential to enable bodies such as the FOS to provide novel or differing interpretation on areas of policy that would normally fall under the remit of the FCA. We believe it's important that the framework reflects the FCA's role as the principal financial conduct regulator for the sector.

### **Regulatory co-operation**

18. There are examples of good co-operation between regulators. The Regulatory Initiatives Grid (RIG), developed and managed by the FCA, provides a helpful overview of upcoming regulatory activity and keeps the sector abreast of key updates. However, we think more could be done with the RIG, including updating it more frequently, and using it to gauge the overall regulatory burden on firms. It should also reflect the anticipated tranche 3 measures of the Smarter Regulatory Framework that were still missing from the latest update. This lack of clarity increases uncertainty for firms who will likely be impacted by the reforms.
19. Elsewhere, established frameworks have been developed to co-ordinate and manage the relationship and remit between different regulators, such as the Concurrency Arrangements Framework, which supports the co-ordination of activity between regulators with competition powers (i.e., FCA, PSR and the CMA). However, there is also duplication between the roles of the CMA, FCA and PSR in relation to Open Banking, which has in part slowed the progress towards the future entity and expansion of the ecosystem.
20. We would like to see greater co-ordination between regulators when developing parallel policies on similar issues, such as the FCA's and PRA's approach to advancing their new secondary objective on growth and international competitiveness. This would also help to ensure harmonisation in rulebook wording in shared policy areas, for example, on the new UK securitisation regulation regime. A lack of appropriate sequencing of regulatory initiatives across different regulators can increase regulatory burden and uncertainty, potentially leading to missed opportunities from aligned regulatory improvements.

### **Regulatory skills and capabilities**

21. The FCA and PRA both have knowledgeable sector specific experts that are vital to its work as effective sector regulators. Where there are cases of overlapping remits for certain policy issues, such as the CMA and the FCA on matters of financial services competition policy, we suggest that the sector expertise of the FCA is recognised and that its powers to regulate the sector (given to it by FSMA 2000) are given primacy, as they allow for a more agile, effective and expert-led supervision of the industry.
22. As with all institutions dealing with complex issues, there are points when resourcing challenges can prove difficult. For example, we believe that resourcing issues have at times hampered the PRA's ability to approve internal models for the calculation of the amount of capital firms hold against their credit risk in a timely fashion. Adopting a more nuanced, less legalistic approach could help improve and expedite model approval, potentially increasing the ability of challenger banks to compete in the retail banking markets.

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<sup>1</sup> Department for Business and Trade: Policy paper: Strategic steer to the Competition and Markets Authority 2023 (23 November 2023)

23. On a separate issue, the FCA's and PRA's new secondary competitiveness objective will require the regulators to adopt new approaches. It will require a cultural change that will need to be underpinned by appropriate programmes of training and development, internal controls and board governance.

### **Regulatory accountability for delivering on objectives**

24. The regulators are held accountable for their performance against their objectives by HM Treasury and Parliament, which can legislate to direct the regulators to undertake new duties and/or provide them with new powers. Parliament also scrutinises the regulators through select committee inquiries, including through the upcoming creation of the aforementioned Lords Financial Services Regulation Committee. We look forward to engaging with the new committee, though we encourage parliamentarians to ensure that it does not duplicate the work of others (particularly the Treasury Sub-Committee on Financial Services Regulations).
25. Through its scrutiny work, the Government and Parliament should acknowledge that, although there must be a balance and that regulators should work first and foremost to deliver on their statutory objectives, it is however not possible to eliminate all risks in the sector.

### **Accountability mechanisms and metrics**

26. Where scrutiny and oversight are required, government should in the first instance try to guide rather than strongly intervene in the day-to-day activities of the regulators. Setting expectations early in the policy development process is a more effective way to operate. For example, we welcomed the role HM Treasury is playing in consulting on and developing the metrics that the FCA and PRA will use to measure their success in delivering on the new secondary competitiveness objective.
27. As HM Treasury consults, it will be important for any outcome to ensure regulators put in place appropriate and transparent reporting systems to ensure that they can gather enough information to effectively measure themselves against the agreed metrics and KPIs. For example, the BoE has an independent unit within its organisation – called the Independent Evaluation Office – that measures its performance.
28. It is also helpful that FSMA 2023 includes a measure requiring the FCA and PRA to publish two consecutive reports – within 12 and 24 months – on their work to embed the new secondary objective. This should act as a helpful example on best practice whenever a new objective is introduced.
29. Financial services regulators are already subjected to an appropriate amount of scrutiny by Parliament, through updates to, and scrutiny from, relevant select committees. Industry will now also have an enhanced role in assessing regulation, through representation on Cost Benefit (CBA) panels, an approach we support.
30. Despite this, there are some specific, limited changes that would enhance regulators' accountability further. We would like to see the FCA and PRA introduce a new mechanism to encourage stakeholder feedback of their rules as part of their new Rule Review Framework, as well as regularly review their rulebooks to remove duplicative or outdated requirements.
31. Given their enhanced powers as a result of the FSMA model, we would also like to see the FCA and PRA introduce a new formal mechanism to allow representative bodies (such as trade

associations and consumer groups) to make formal representations to the regulator when a rule or regulation should be reviewed.

32. Further, the secondary objective on growth and international competitiveness should also be applied to the PSR and we were disappointed this was not provided for in FSMA 2023.

### **International comparators**

33. Monetary Authority of Singapore (MAS) is a good example of a regulator that supports the wider competitiveness and growth agenda of the Singaporean Government, through being proactive in steps it can take to strengthen Singapore's position as a leading international financial centre. Its approach includes setting out its vision, strategies and targets.
34. The UK Government and financial services regulators could similarly work together to articulate their vision for growth in the UK, the strategies to achieve that vision, including the actions that the regulators can proactively take in this respect.
35. Thank you for taking the time to read this submission. If you have any questions relating to this response, please contact Matthew Young, Principal, Strategic Policy, at [matthew.young@ukfinance.org.uk](mailto:matthew.young@ukfinance.org.uk)