UK FINANCE

FINANCIAL-SERVICES FUTURE REGULATORY-FRAMEWORK REVIEW: PHASE-II CONSULTATION

UK Finance response
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Contents

INTRODUCTION AND SUMMARY

Introduction

1. UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers and facilitate innovation. We welcome the opportunity to respond to HM Treasury's (HMT) first consultation on phase II of its future regulatory-framework (FRF) review.[1]

2. The current regulatory framework was established more than 20 years ago by the Financial Services and Markets Act 2000 (FSMA).[2] The four main problems that it sought to address were set out in Gordon Brown's first statement to Parliament as Chancellor of the Exchequer:

   - the regulatory structure was not delivering the standard of supervision and investor protection that the industry and the public had a right to expect;
   - the split of responsibility between regulatory and self-regulatory organisations was inefficient and confusing for investors and lacked accountability and a clear allocation of responsibilities;
   - the distinctions between different types of financial institution were becoming increasingly blurred; and
   - in a world of integrated global financial markets, the financial-services industry needed a regulator that could deliver the most effective supervision in the world.[3]

3. FSMA has been heavily revised since, not least to give the Bank of England (BoE) a statutory role in the oversight of payment systems,[4] to replace the Financial Services Authority (FSA) with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA)[5] and to create the Payment Systems Regulator (PSR).[6] The statute book and regulatory rules have also increasingly reflected European Union (EU) legislation as its competence and willingness to act increased, particularly after the global financial crisis. Nonetheless, the underpinning structure of independent regulators acting within a legislative framework determined by the UK Parliament and elaborated by the UK Government has endured, even if multiple public-sector bodies now regulate financial-services firms in ways that frequently overlap.

4. However, as Phillip Hammond recognised in his June 2019 Mansion House dinner speech as Chancellor,[7] the context for financial-services regulation has changed—and will continue to change—profoundly. The UK has left the EU, and the subsequent transition period has now ended. Technological change is fundamentally transforming the nature, provision and consumption of financial services. And the need to address climate change has highlighted the pivotal role the sector has to play in supporting a just transition to a net-zero economy.

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/927316/141020_Final_Phase_II_Condoc_For_Publication_for_print.pdf.

2 https://www.legislation.gov.uk/ukpga/2000/8/contents.

3 https://publications.parliament.uk/pa/cm199798/cmhansrd/vo970520/debtext/70520-06.htm.

4 Part 5 of the Banking Act 2009. See https://www.legislation.gov.uk/ukpga/2009/1/contents.

5 Part 2 of the Financial Services Act 2012. See https://www.legislation.gov.uk/ukpga/2012/21/contents.

6 Part 5 of the Financial Services (Banking Reform) Act 2013. See https://www.legislation.gov.uk/ukpga/2013/33/contents.

7 https://www.gov.uk/government/speeches/mansion-house-dinner-speech-2019-philip-hammond.

5. Taken together, these drivers constitute a compelling rationale for a once-in-a-generation review of the UK's regulatory framework. As the financial-services sector in the UK evolves, the framework can and should:

   - continue to serve the needs and protect the interests of customers;
   - support the UK's wider economic and societal priorities;
   - promote competition between, and the competitiveness of, providers;
   - take advantage of the opportunity afforded by Brexit to establish approaches tailored to the UK's retail and wholesale landscape; and
   - differentiate the UK as the best place in the world in and from which to provide financial services.

6. We welcome the Government's recognition of these challenges. Over the past year, it has already started to improve coordination among regulators within the existing framework.[8] This is, however, rightly seen as only a first step.

7. The FRF consultation is fundamentally about regulators acting within a legislative framework set by Parliament, aligned with Government policy and accountable for their decisions. HMT believes this approach will have "the agility and flexibility needed to respond quickly and effectively to emerging challenges and to help UK firms seize new business opportunities in a rapidly changing global economy." We support the broad thrust of its proposals for regulators with enhanced powers, subject to effective scrutiny and accountability, to deliver and be held accountable against democratically determined objectives. However, on its own, even this enhanced framework will not be proof against the trials of the next 20 years. How its components compel and incentivise its participants to act will be equally critical to its success. They are neither nice-to-haves nor minor details.

8. Elaborating how all these elements of the future regulatory framework can work together to the benefit of consumers, firms, society and the UK as a whole is the purpose of this response to the FRF consultation. We look forward to working with the Government, Parliament, regulators and other stakeholders to make it a reality. It must, of course, also be seen in the context of other legislative and regulatory reforms, including the Financial Services Bill currently before Parliament,[9] the UK Listings Review,[10] the call for evidence on the overseas framework,[11] the Payments Landscape Review,[12] the Independent Fintech Strategic Review[13] and the ring-fencing and proprietary-trading independent review.[14]

9. If you have any questions relating to this response, please contact Matthew Conway, Director of Strategy & Policy, at **matthew.conway@ukfinance.org.uk**.

8 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871673/FRF_Phase_I_-_Response_Doc_FINAL.pdf.

9 https://services.parliament.uk/Bills/2019-21/financialservices.html.

10 https://www.gov.uk/government/publications/uk-listings-review.

11 https://www.gov.uk/government/publications/call-for-evidence-on-the-overseas-framework.

12 https://www.gov.uk/government/consultations/payments-landscape-review-call-for-evidence.

13 https://www.gov.uk/government/publications/independent-fintech-strategic-review-terms-of-reference.

14 https://www.gov.uk/government/news/chair-of-the-ring-fencing-and-proprietary-trading-independent-review-panel-announced.

Summary

10. The FRF review is a major opportunity to improve the effectiveness and efficiency of banking and finance regulation now that the UK can determine its regime according to its own priorities. In this response to HMT's first consultation on phase II of the review, we make detailed proposals for updating the framework under five main headings.

Ambition and strategy

11. Banking and payments are the financial infrastructure of the UK. From current accounts and lending to the most sophisticated tools of modern financial risk management, the sector supports the economic lives of almost every individual, household and business. It employs over half a million people (two thirds of whom work outside London) and accounts for 4.1 per cent of economic output. The banking sector alone contributed nearly £40 billion in revenue to the Exchequer in 2019/20.[15] The UK is also one of the handful of jurisdictions that can lay claim to being a key part of the global financial infrastructure, and financial services are a major export strength. All these factors make the UK's regulatory framework critically important. Therefore:

- the framework must support the UK's role as an internationally competitive financial centre and place to do business for UK-headquartered firms, according an appropriate role to global standards;
- the framework should promote domestic competition, encouraging continued innovation in products and services and supporting a plurality of providers and business models;
- the framework must support, and be supported by, an overarching vision for the future of UK financial services, both domestically and internationally; and
- HMT should establish a set of core standards for regulation that will enable firms to plan for the future with confidence and give them the space in which to innovate.

A single model for regulation

12. The enhanced FSMA model proposed by HMT is the right one and should apply consistently across the regulation of banking and finance, not just to the PRA and the FCA. Therefore:

- the FSMA model should be extended to cover the BoE's other regulatory functions and to the PSR; and
- almost six years after it became operational, and in the light of significant changes in the payments landscape and blurring of regulators' remits, it is timely to review the status of the PSR.

A more coherent approach to regulation

13. The banking and finance sector has evolved, and new entrants and new technologies have brought benefits for competition and consumers. As a consequence, inconsistencies have arisen in the application of regulation, reflecting an approach focused on firms. Therefore:

15 https://www.ukfinance.org.uk/system/files/2020-UKF-TTC-for-the-UK-banking-sector.pdf.

- the framework should subject the same activities and risks to the same regulation, with the same consumer protection, irrespective of the nature and legal status of the provider; and
- the framework should rely less on prescriptive rules and be more responsive, allowing it to adapt to changing demands, evolving business models and emerging risks.

Roles and principles

14. We support the clear allocation of roles between Parliament, HMT and regulators. Legislation will be needed to turn onshored EU requirements into regulatory rules, and while this will be a major exercise, it can simplify and streamline regulation to the benefit of the UK's competitiveness. Therefore:

- competitiveness and proportionality need to be keystones of the future framework. They should feature prominently in the general regulatory principles, be translated into activity-specific regulatory principles and condition the standards implemented by regulators;
- regulators should explain publicly, including to Parliament, how their proposals are compatible with the principles and demonstrate how they balance the tensions between them;
- HMT should prioritise consolidating legislation in areas with the greatest concerns about the existing rules and the greatest opportunities to promote competitiveness; and
- regulators should undertake cost/benefit analyses (CBAs) and post-implementation reviews (PIRs) of all forms of intervention, recognise the cumulative impact of their proposals and minimise supervisory burdens.

Scrutiny and accountability

15. As regulators take on more powers, they need to be subject to additional scrutiny and accountability. These will improve the quality of regulatory decision making and enhance the UK's attractiveness as a destination for banking and finance firms. Therefore:

- Parliament needs new structures, resources and expertise to scrutinise regulators;
- regulators' rule-making decisions should be subject to a new review mechanism that is independent, expert, accessible and timely; and
- complaints to the Financial Ombudsman Service (FOS) that have wider implications or would set precedents should be decided by an expert panel or a different decision-making body, following a more consultative and collaborative process with effective rights of appeal.

Question 1. How do you view the operation of the FSMA model over the last 20 years? Do you agree that the model works well and provides a reliable approach which can be adapted to the UK's position outside of the EU?

16. We agree that the FSMA model has been successful and provides the correct basis for the post-Brexit regulatory framework. However, greater coherence could be achieved through a more balanced activity-based approach that incorporates the principle of same activity, same risk, same regulation. The regulatory perimeter could be more sharply defined, especially with regard to the unregulated activities of firms providing regulated activities. And the framework should avoid importing risks from the interaction with other sectors or having banking and finance firms become the default compensation provider for harms that arise or are facilitated there.

Same activity, same risk, same regulation

17. The UK's regulatory framework has become fragmented, evolving in such a way that it is now structured around both firms and activities. The prevailing skew toward prescriptive rules drives inconsistent regulatory approaches and a growing number of instances where the principle of proportionality is not consistently applied. For example:

- firms can face the same cost of regulation despite posing different levels of risk (e.g. in the case of thresholds for minimum requirements for own funds and eligible liabilities, firms crossing thresholds face higher costs than systemically important banks to raise capital instruments);
- firms can undertake the same activity but face different levels of regulation (e.g. differences in requirements for protecting customer funds for banks vs. non-banks such as e-money institutions); and
- levels of supervision and enforcement can vary even though firms are technically subject to the same regulation (e.g. banks have faced more enforcement action than non-banks in the past).

18. These inconsistencies reflect a regulatory system built with a firm-based focus on prudential soundness, capital and liquidity, governance and reporting. At the same time, modularisation, the entrance of Big Tech and shifting consumer preferences and behaviour are changing the landscape that regulation was designed to cover.

- **Modularisation.** The combination of new market entrants, technologies and regulatory initiatives has led to the modularisation of the banking and finance industry in both demand and supply terms: "modular demand" because customers are opting for multiple providers for their financial products and "modular supply" because firms are increasingly using third parties to provide services. The consequence is that activities are now being performed by a wider range of entities.
- **Entrance of Big Tech.** Big Tech firms are gaining ground within banking and finance. Though their presence is still nascent in absolute terms and their focus has been mainly within the retail and SME segments, it is expected that their role within the industry will only increase in the next five to 10 years.

- **Shifting consumer preferences and behaviours.** Consumer preferences and behaviours are evolving rapidly, with high-quality user experience and digital service provision increasingly considered a must-have for any provider in any industry. In this way, firms are increasingly judged not only on the services they offer but also on the way they deliver them.

19. These changes present new challenges for the regulatory framework. New entrants, new technologies, major regulatory initiatives and evolving consumer demands have led to the "unbundling" and division of core services in the value chain for banking and finance. Activities that were performed by a relatively small number of large firms, sitting clearly within the framework, are now being undertaken by a wider range of players and new entrants. This is good for competition and consumers but creates potential regulatory gaps and makes it harder to judge proportionality.

    - **Potential regulatory gaps.** Some activities may fall outside the regulatory perimeter if performed by an unregulated firm.
    - **Challenges in judging proportionality.** It may be difficult to determine the magnitude of the risk generated by a new entrant or an existing participant when it is conducting a specific activity. Many firms and new entrants may not create the same risk as large, established firms, and so proportionality would imply they should not be subject to the same weight of regulation or supervisory engagement. However, firms can change quickly. The systemic risk a firm poses once it scales up its operations, for example, could be vastly different to the risk it posed as a small start-up. The systemic risk of an existing firm performing a new activity could be vastly different to the risk it posed operating its previously existing business. And there may be insufficient monitoring of small firms that individually do not pose risk but in aggregate can cause instability to the financial system. For example, the poor operational resilience of a single non-bank payment provider may be of little significance from a systemic perspective, but the impact of poor operational resilience of multiple non-bank payment providers could be.

20. Regulators operating with a heavily firm-based focus will struggle to address these challenges because they cannot readily account for new players and risks that are associated with value-chain unbundling. In cases where the same activity generates the same risk, regulatory asymmetry can reduce competition, consumer protection, market integrity and financial stability. In contrast, a greater focus on activity-based regulation can ensure greater consistency of regulatory approach regardless of the nature of the service provider.

21. Of course, proportionality in application would mean activities would not always be regulated in the same way. Because the same activity can generate different risks depending on who performs it (e.g. systemically important firms vs. smaller firms), regulatory asymmetry is to be expected.

22. It would be beneficial for the UK's regulatory framework to achieve a better balance between an activity-based approach and a firm-based one. If designed appropriately, activity- and firm-based regulation can be mutually reinforcing. This is particularly true for consumer protection as well as in enabling legislators and regulators to systematically respond to a continually shifting regulatory perimeter. Delivering this better balance requires change, including:

    - **a less rigidly rules-based approach**. Relying less on prescriptive rules in the regulatory framework would make it easier to adapt to changing demands and emerging risks. However, careful analysis will be required to examine the existing

stock of rules on a case-by-case basis and determine appropriate action. This could include greater use of principles- and outcomes-based regulation, which by its nature allows more flexibility in its application as the industry evolves. We provide further thoughts on the use of principles- and outcomes-based regulation in answer to question 4;

- **a more responsive regulatory framework**. The framework will be more robust if it can capture the same activities performed by new entrants and existing participants in the same way, allowing regulators to adopt a forward-looking mindset that enables them to understand new and complex risks quickly;
- **an approach that integrates both activities and firms**. As a principle, the same activity should be regulated in the same way, deviating only for reasons of proportionality or where there is a need for a firm-level overlay (e.g. because of systemic importance); and
- **enhanced collaboration between jurisdictions and sectors**. As a broader array of firms offers banking and finance services, it will be important for regulators to ensure coherent policies across borders and industries on key topics (e.g. data and cybersecurity).

23. We therefore recommend the FRF review deliver a more balanced, activity-based approach and incorporate the principle of same activity, same risk, same regulation.

24. Supporting this response is a more detailed paper on these issues produced in association with Oliver Wyman.

Regulators' locus in the unregulated activities of firms providing regulated activities

25. The scope of regulation under FSMA is defined by the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended)[16] and relevant EU legislation, with the latter having been onshored prior to the end of the Brexit transition period. The overall result is a complicated boundary between regulated and unregulated activities, and understanding its intricacies typically requires specialist expertise.

26. The FCA itself recognises that "successive parliaments and governments" have made a "clear choice expressed in legislation" about the activities that are regulated and those that are unregulated.[17] These choices reflect, among other things, where risks to the economy or consumers arise and a desire to avoid stifling the financial-services industry with too much regulation, leading to higher costs for firms and their customers. While the Government's commitment to an annual perimeter-review meeting is welcome, this should consider not only extending regulation to new areas but also where there may be scope to reduce the perimeter.

27. Many firms undertake unregulated as well as regulated activities, and regulated financial groups often include unauthorised as well as authorised firms. In both cases, there can be dependencies between regulated and unregulated activities and/or authorised and unauthorised firms. A common example is where unregulated products are marketed under financial-promotions regulation.[18]

16 https://www.legislation.gov.uk/uksi/2001/544.

17 https://www.fca.org.uk/publication/annual-reports/perimeter-report-2018-19.pdf.

18 Sections 137R and 137S, FSMA.

28. There is also a long history of Parliamentary and media criticism of the FSA and the FCA for not using the full extent of their legal powers where the core product being sold is unregulated but there is seen to be detriment to the regulator's statutory objectives. An early example was split-capital trusts. These listed entities were unregulated, but the FSA was severely criticised for not using its powers as the UK Listing Authority to prevent them being listed and ended up negotiating the creation of a compensation fund into which the firms contributed.[19]

29. Since then, there has been a growing case for regulators to take more interest in unregulated activities. Most recently, the collapse of London Capital & Finance in 2019 has been viewed as a regulatory failure, and an investigation of the FCA's supervision of the firm was commissioned by HMT. The resulting report, published in December, found that "the FCA did not sufficiently encourage staff to look outside the Perimeter when dealing with FCA-authorised firms such as LCF, which was an FCA-authorised firm whose business consisted of entirely (or almost entirely) unregulated business."[20] The FCA has accepted that it could have done more to consider an "authorised firm's unregulated activities."[21]

30. During the global financial crisis, there were also occasions when unregulated "shadow banking" vehicles undertook significant maturity transformation outside the perimeter.[22] This led to the FSA (and subsequently the PRA) being given a limited power to require information from an unregulated entity so it could assess whether the firm's activities represented a risk to financial stability.[23] Other regulation since the financial crisis, notably the Senior Manager & Certification Regime, has been written very broadly to cover all firms' activities and functions, whether regulated or not. This can result in pressure being applied on Senior Managers to effect changes to the way in which unregulated business is carried out, regardless of regulators' locus.

31. As a result, regulated firms may feel regulators take unwarranted interest in their unregulated activities, while regulators may worry they will be blamed for not knowing enough about firms' unregulated activities. Moreover, the complexity of the boundary between regulated and unregulated activities means it is common for consumers to assume all the products and services they receive are regulated. This places severe pressure on regulators and politicians to act when consumers suffer detriment from unregulated products and services. A more coherent framework, including the principle of same activity, same risk, same regulation discussed above, would lead to a perimeter better understood by consumers.

32. The biggest risk of this unsatisfactory situation, for firms, regulators and consumers alike, is that an unregulated activity causes material harm to a regulators' statutory objectives. Historically, this has led to significant criticism of both regulators and the industry, provoking calls for the perimeter to be extended. Such a move would potentially add unnecessary cost to firms and overstretch regulators' resources.

19 http://news.bbc.co.uk/1/hi/business/4465039.stm.

20 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf.

21 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945252/FCA_Response_DIGITAL_final.pdf.

22 See https://webarchive.nationalarchives.gov.uk/20120302195806/http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

23 Sections 165A-C, FSMA.

33. The FRF consultation provides an opportunity to address this risk while recognising there will always be some residual tension around the legitimate reach of regulators' oversight. Progress will involve finding a fair balance between regulatory awareness of unregulated activity and democratic accountability for action to address this. The aim would be to achieve:

    - a stable perimeter that is increasingly widely understood;
    - a high degree of confidence among firms that regulators cannot intervene in unregulated activities unpredictably and without good cause;
    - a clear understanding by regulators of their duties and powers in respect of unregulated activities, the limitations on them and the circumstances in which they should intervene; and
    - Parliamentary and public confidence in the circumstances in which regulators can, should and cannot intervene in respect of unregulated activities.

34. As a starting point, there should be a presumption against extending the perimeter unless there is a clear public interest. This should be a high hurdle given the natural tendency toward scope creep and the fact that, no matter how wide the perimeter may be, some risk will always sit outside it. The ability to extend the perimeter should remain the preserve of Parliament and/or the Government acting under delegated powers.

35. In return, all regulators to which the FSMA model has been extended should have the power, under specific conditions based on the current provisions in FSMA, to request information that would enable them to assess whether unregulated activities undertaken by a regulated firm or within a regulated group posed a material risk to their statutory objectives. As a result, this would not be confined to the PRA in respect of financial stability as at present.

36. Regulators should draw up a statement of how they would use this power. The statement could be amended to reflect the changing risk environment and should be approved by HMT annually. It should also form an element of Parliamentary scrutiny of the regulators' performance.

37. It would then be for Parliament and/or the Government to amend the perimeter, as described above, in the light of any recommendations from regulators.

38. In parallel with this approach, as onshored EU legislation is consolidated, the perimeter should be clarified, and where possible simplified, in line with our comments above on same activity, same risk, same regulation.

Underwriting failings in other sectors

39. Financial-services regulation rightly focuses on preventing market failures within the sector from affecting consumers or the wider economy. However, failures in other sectors can affect banking and finance in ways that are equally detrimental. Legislation and regulation should, at the very least, not encourage these situations. Ideally, they should seek to prevent these situations from arising and provide for an orderly and predictable system to manage failures. In such a system, consumers will know what rights they have or do not have when they make a purchase and can make informed choices, and firms that bear risks will know what they are and be able to manage them. Yet there are at least two ways in which regulation (or the lack of it) currently transfers risks from other sectors into banking and finance.

40. The first such "step-in" risk arises where banking and finance firms are expected to provide support or compensation to customers of, or otherwise underwrite the costs arising from, businesses in other sectors that find themselves in difficulty. There are, of course, statutory provisions that engage firms when other businesses fail to fulfil contracts with customers. For example, section 75 of the Consumer Credit Act 1974 makes a credit-card issuer jointly and severally liable with the merchant where the customer has paid on a credit card and the merchant has breached the contract or carried out a misrepresentation.[24] While we believe the coverage of the Act exceeds the original intentions and needs to be reviewed,[25] expectations of banking and finance firms now go well beyond any statutory requirements. Recent airline failures in the UK are a case in point.

41. In October 2017, Monarch Airlines was placed into administration, leaving over 100,000 passengers abroad without their intended flight home. A Government-coordinated repatriation effort was launched at an eventual cost of approximately £60 million.[26] In the lead-up to Monarch's failure, the Government approached the banking and finance industry to contribute to the repatriation fund. Firms agreed to do so to the tune of c. £3 million as a goodwill gesture, which they were assured by the Government would not set a precedent. It was specifically confirmed as a one-off measure at the time and acknowledged as such pending a full review of travel-industry insolvency risks and customer detriment.

42. The following month, at Autumn Budget 2017, the Chancellor announced a review into consumer protection in the event of an airline or travel company failure.

This will draw on lessons from the collapse of Monarch and will consider both repatriation and refund protection to identify the market reforms necessary to ensure passengers are protected. This will include full consideration of options to allow airlines to wind down in an orderly fashion so that they are able to conduct and finance repatriation operations without impact on the taxpayer.[27]

43. The final report of the Airline Insolvency Review was published in May 2019 and found that the airline industry should take responsibility for, and protect against, its own insolvencies.[28] The Secretary of State for Transport committed to "work swiftly to introduce the reforms that are needed to ensure a strong level of consumer protection and value for money for the taxpayer."[29] This has not happened. A year and a half on from the report, the Government could only say it was "keeping under review the scope and timing of any future reforms."[30] Indeed, when Thomas Cook was placed into insolvency in September 2019, leaving an estimated 150,000 British customers abroad, the Department for Transport again asked banking and finance firms to pay toward the cost of the repatriation scheme it was mounting, even as they made significant efforts to support affected passengers and employees of Thomas Cook and paid out significant sums through chargeback and section 75.

24 https://www.legislation.gov.uk/ukpga/1974/39/section/75.

25 Specifically, liability for consequential loss means that liability under s.75 can be greater than the value of the transaction, while the expanding use of the internet to purchase goods and the global nature of potential debtor/creditor/supplier relationships mean the liability of the card issuer is not restricted by jurisdiction.

26 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/700396/airline-insolvency-review-call-for-evidencence.pdf.

27 https://www.gov.uk/government/publications/autumn-budget-2017-documents/autumn-budget-2017.

28 https://www.gov.uk/government/publications/airline-insolvency-review-final-report.

29 https://questions-statements.parliament.uk/written-statements/detail/2019-05-09/HCWS1546.

30 https://questions-statements.parliament.uk/written-questions/detail/2020-10-08/HL8943.

44. Since the Thomas Cook failure, there have been multiple travel failures during the Covid-19 pandemic. Although the risk and cost of repatriation have been reduced because of the decrease in the number of customers abroad, the continued need for reform is evident in the financial exposure that firms continue to face. Consumers paid for travel having been told by their operator and protection providers that their money was safe and "bonded." However, on several occasions, the providers have reported "bonding insufficiency," as a result of which card providers are exposed to financial risks that should be borne by the travel industry. Similarly, customers who take out and pay for insurance cover have been denied repayment and referred to their card provider for redress. As a consequence, the FCA intervened and issued guidance on how card firms and travel-insurance firms should treat consumers.[31] It is evident from that process that the purchase of travel insurance is voluntary and travel insurers are free to set the terms of cover they wish to offer and to change it, whereas card providers are not free to alter the joint and several nature of their liability under section 75.

45. This expectation creates a moral hazard. Businesses in other sectors, often subject to less regulation or oversight, have little incentive to put in place proper protections for their customers as banking and finance firms can be called on to put things right. Furthermore, the costs will inevitably be passed on to firms' customers through increased borrowing and/or reduced savings rates.

46. In general, where the Government does not believe it is fair for consumers to face the risk of losses, we believe the cost of protection should fall on those offering the products or services giving rise to those risks. In this way, costs are ultimately borne by those consuming precisely the goods or services in question. This was also the conclusion of the Airline Insolvency Review.

47. As part of the FRF review, the Government should ensure that expectations on the banking and finance sector to provide protection or redress to customers of businesses in other sectors are clearly set out in legislation or regulatory rules. It is, of course, beyond the scope of the review to ensure regulation is appropriate in other sectors (e.g. by implementing the recommendations of the Airline Insolvency Review), but HMT should use the opportunity to clarify that it does not expect banking and finance firms to underwrite or subsidise failings in other sectors.

48. The second step-in risk occurs where firms are assumed to be the default compensation mechanism for customers even though the harm has arisen from failures in other sectors. This is perhaps best exemplified by the current situation with authorised-push-payment (APP) fraud, which occurs where a customer is tricked into authorising a payment to an account they believe belongs to a legitimate payee but is, in fact, controlled by a criminal. Consumers lost £208 million to APP scams in the first half of 2019.[32]

49. One significant driver of APP fraud is the theft of personal and financial data through breaches at third parties outside the banking and finance sector. Whether at a retailer, a utility company, a transport provider or elsewhere, the theft of personal and financial data can both directly lead to fraud losses and be used by criminals as part of their scams. The data can be used for months, even years, after a breach takes place.

31 https://www.fca.org.uk/publication/finalised-guidance/cancellations-refunds-helping-consumers-rights-routes-to-refunds.pdf.

32 https://www.ukfinance.org.uk/system/files/Half-year-fraud-update-2020-FINAL.pdf.

50. Fraud losses are also driven by the abuse of online platforms used by criminals to scam their victims. These include investment scams advertised on search engines and social media, romance scams committed via online dating platforms and purchase scams promoted through online auction websites. Financial fraud and scams identified on social-media platforms increased from 88,000 in the 12 months to May 2019 to 383,000 over the following year.[33] 84 per cent of fraud reported between April and September 2018 was estimated to be cyber-enabled.[34] In 2019, nine banks and building societies covering more than 85 per cent of the market worked with consumer groups to introduce and sign up to a voluntary code under which customers who lose money to APP scams through no fault of their own are entitled to a refund. Almost £90 million has been reimbursed to customers since the code was introduced.[35] However, we recognise not all victims are protected by these voluntary measures.

51. Here again, moral hazard is being created. Online platforms can profit from adverts that turn out to be scams, social-media platforms are used to facilitate scams, and companies holding personal data do not pay the full costs of lapses in their security, which instead are funded by the banking and finance sector. It was therefore disappointing that the Government decided not to include APP fraud and other forms of economic crime in the scope of the new regulatory framework for online harms.[36] We believe it is crucial that the Government come forward with new legislation that ensures tech companies do more to clamp down on the fraud being perpetrated on their platforms. It is also vital that financial-services regulators engage in wider economic-crime reform. We will only be able to tackle scams effectively if all parts of the public and private sectors work together effectively to a shared set of objectives and a clear plan.

52. Again, while the specifics of this issue go beyond the scope of the FRF review, HMT should take the opportunity to make clear to regulators that banking and finance firms should not be the default compensation provider for harms that arise from, or are facilitated by, other sectors.

Sustainability

53. The FSMA model has been extremely effective in supporting the Government's sustainability policies, particularly since Mark Carney gave his landmark Tragedy of the Horizon speech in 2015 as Governor of the BoE.[37] As reflected in the Ministerial foreword to the FRF consultation, the UK can reasonably claim global leadership in regulating financial services in a way consistent with domestic and global climate objectives, and this leadership reflects well on the whole regulatory ecosystem.

54. Sustainable finance is increasingly an outstanding example of regulators and industry working together effectively and playing to their respective strengths. This cooperation is embodied in the Climate Financial Risk Forum, co-chaired by the

33 https://www.zerofox.com/resources/financial-services-digital-threat-report-2019/ and https://www.zerofox.com/resources/phishing-fraud-financial-services-report/.

34 https://nationalcrimeagency.gov.uk/who-we-are/publications/296-national-strategic-assessment-of-serious-organised-crime-2019/file.

35 https://www.ukfinance.org.uk/system/files/Fraud-The-Facts-2020-FINAL-ONLINE-11-June.pdf and https://www.ukfinance.org.uk/system/files/Half-year-fraud-update-2020-FINAL.pdf.

36 https://www.gov.uk/government/consultations/online-harms-white-paper/outcome/online-harms-white-paper-full-government-response.

37 https://www.bankofengland.co.uk/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability.

FCA and PRA, which facilitates an open and constructive sector-wide dialogue on climate-related issues.[38] This leadership and exemplary cooperation with industry must progress over the coming years for the UK to retain its global pre-eminence in sustainable finance. Indeed, this kind of cooperation across Government departments and with the industry should serve as a model for other areas of significant importance. As sustainability regulation develops, it is important that obligations on banking and finance firms align to the work of the Climate Financial Risk Forum and neither overlap nor contradict each other.

55. International coordination is critical as sustainable finance is a prime example of an area where the right approach involves sitting firmly within a global framework, with strategic alignment to leading practices in other jurisdictions. The UK's backing for the IFRS Foundation's proposal to establish a Sustainability Standards Board was a positive move,[39] and we, among many others, have since followed this lead. Similarly, the Chancellor's announcement at the November 2020 Green Horizon Summit that the UK will develop a taxonomy taking the scientific metrics in the EU taxonomy as its basis was welcome,[40] and we urge deviations only where clear improvements can be made.

56. For regulation to support the public-policy objectives on sustainability, it is important that new initiatives be introduced in a considered, strategic manner and sequenced to ensure effectiveness. For example, the UK version of the EU Sustainable Finance Disclosure Regulation[41] and the Non-Financial Reporting Directive[42] should be consistent and aligned to the IFRS Foundation's plans to deliver global reporting standards for environmental, social and corporate governance. In this sense, UK authorities should learn from the experience at EU level, where the pace and sequence of "green" legislation has in some instances led to overlaps and incoherence.

38 https://www.fca.org.uk/transparency/climate-financial-risk-forum.

39 https://www.gov.uk/government/publications/joint-statement-of-support-for-ifrs-foundation-consultation-on-sustainability-reporting/initial-response-to-ifrs-foundation-trustees-consultation.

40 https://www.theglobalcity.uk/PositiveWebsite/media/Multimedia/Rishi-Sunak,-Chancellor-of-the-Exchequer-transcription.pdf.

41 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN.

42 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN.

Question 2. What is your view of the proposed post-EU framework blueprint for adapting the FSMA model?

57. We support the proposed blueprint for regulation. It needs to be matched by a vision for banking and finance, so the Chancellor's November statement was welcome. The sector is of major importance to the UK economy, and this calls for international competitiveness to be a principle to which the regulators must have regard across the board and not just in respect of specific activities.

58. The regulatory framework has important consequences for overseas firms looking to operate in or do business from the UK. It should accord an appropriate role to global standards and consider potential effects on cross-border market access, both by overseas firms to the UK and by UK-based firms to markets abroad.

59. To ensure a coherent and consistent regulatory framework for the whole sector, the FSMA model should extend beyond the FCA and PRA to other areas of financial-services regulation, including the BoE's other regulatory functions and the PSR. Almost six years on from the launch of the PSR, and due to the significant changes in the payments landscape and blurring of respective regulators' remits, HMT should review the status of the PSR.

60. We agree with Parliament's proposed role of setting overarching and activity-specific framework legislation and identifying public-policy matters to be taken into consideration in regulatory standards. These should be consulted on before they are introduced. Where they need to be updated from time to time, secondary legislation must be subject to proper scrutiny, which may include the use of the super-affirmative procedure.

61. Post-Brexit, new legislation will be needed to transfer prescriptive EU rules into powers for regulators. This will be a major exercise, and HMT will need to consider which areas of regulation to prioritise. HMT should give firms an indication of its proposed process and timelines without creating arbitrary deadlines. Done well, this process can simplify and streamline, to the benefit of the UK's competitiveness.

62. Phillip Hammond's Mansion House dinner speech as Chancellor in June 2019 announced and set the context for the FRF review.[43] It would deliver "a regulatory system that continues to enable, rather than stifle, innovation . . . that protects consumers . . . maintains the highest possible standards . . . is proportionate and policed by independent regulators . . . and that recognises that the EU will continue to be one of our major trading partners . . . even as it lays the groundwork for the more global nature of our future financial-services industry." In its July 2019 call for evidence on regulatory coordination, HMT identified four key challenges for the future regulatory framework: operating outside the EU; new relationships; technological change; and wider global challenges.[44]

63. While the FRF consultation sets out a blueprint for regulation to address these challenges, it needs to be matched by a long-term vision of the UK as a safe, well-regulated jurisdiction open to cross-border financial-services business that helps to strengthen its attractiveness to foreign investors. We therefore welcome Rishi Sunak's

43 https://www.gov.uk/government/speeches/mansion-house-dinner-speech-2019-philip-hammond.

44 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819025/Future_Regulatory_Framework_Review_Call_for_Evidence.pdf.

statement as Chancellor on 9 November 2020 updating the House of Commons on the Government's plans for the UK's financial-services industry.[45] This was an important first step, but a longer-term strategy would be valued by firms, give direction to regulators and support Parliamentary scrutiny of policy and regulation. Neither vision nor blueprint alone is sufficient to the task. Each needs to support the other.

64. To enable the vision to be translated into the blueprint, we see merit in establishing a set of core standards that, if delivered, would enable firms to plan for the future with confidence and give them the space in which to innovate. The rest of our response to the FRF consultation expands on these in more detail, but we believe they serve well as a high-level checklist against which subsequent proposals can tested. Those standards are as follows.

- Regulation should only be introduced to secure clear public-policy objectives: effective competition, consumer protection, market integrity and financial stability.
- Regulation should promote competitive markets with a plurality of providers able to invest in the products and services that consumers desire.
- The regulatory perimeter should be clear.
- The same activities should be subject to the same regulation when they present the same risks.
- Regulation should be proportionate.
- Statutory regulation should defer to co- and self-regulation where appropriate.
- Regulation should enable consumers to take responsibility for their decisions, supporting their transition to digital while protecting services that society deems essential.
- Regulation should follow international standards where appropriate and justify where it does not.
- Regulation should promote the UK as a global financial centre and an attractive location from which firms can trade internationally.
- There should be checks and balances to the powers of regulators, including effective rights of appeal.
- Regulators should enforce and leverage existing rules before making new rules.
- Regulators should coordinate their activities with other public bodies.
- Regulation should make the UK the most trusted place in the world to conduct business.

Extending the FSMA model to the other financial-services regulators

65. The FRF consultation notes that the model of regulation introduced by FSMA continues "to sit at the centre of the UK's regulatory framework" and the Government believes that this model "continues to be the most effective way of delivering a stable, fair and prosperous financial services sector." It also argues that "central to the FSMA model" has been the "delegation of regulatory responsibility to dedicated financial services regulators which operate independently from government."[46]

45 https://hansard.parliament.uk/commons/2020-11-09/debates/D5E911A9-1270-457F-9F6A-57AE5C272FBA/FutureOfFinancialServices.

46 Ibid., paragraph 2.8.

66. As we have said earlier in this response, we agree that this is the correct model for banking and finance regulation. However, FSMA only applies to two of the regulators: the PRA and the FCA. To ensure a coherent and consistent regulatory framework for the whole sector, which is essential as structural changes drive the unbundling of value chains, it is essential the FSMA model be extended to the other regulators, in particular the BoE when carrying out its other regulatory functions (i.e. in relation to bank resolution under Part 1 of the Banking Act 2009,[47] payment systems under Part 5 of the Banking Act 2009[48] and recognised clearing houses under part 2 of the Financial Services Act 2012[49]) and the PSR.

The status of the PSR

67. Since it became operational in April 2015, the PSR's focus has been on enhancing competition in UK payments markets, fostering innovation by service and infrastructure providers and ensuring end-users benefit. It has engaged on several important issues, including the development of the New Payments Architecture, access considerations and the implementation of Confirmation of Payee (CoP). While the PSR has been able to drive the industry toward better outcomes in these areas, there are others where its role has been less clear. For example, while PSR regulation of LINK has helped to ensure access to cash remains free and widely accessible for personal customers who continue to need it, the PSR's wider interest in the issue has introduced unnecessary overlap in what is already a complicated regulatory environment. At the same time, we and firms are engaging with the PSR on its future strategy, and we are encouraged by its collaborative and open-minded approach.

68. In the light of these experiences, responses to HMT's Payments Landscape Review call for evidence[50] and the implications of the FRF review for payments regulation as a whole, we think it is an opportune time for HMT to review the status of the PSR. In so doing, we recommend it consider the following issues:

- the extent to which financial-services regulators whose remit includes payments markets (i.e. the BoE/PRA, the FCA and the PSR) overlap—see the diagram below. While their interaction is the subject of a memorandum of understanding (MoU),[51] the review should consider whether there is scope to rationalise and clarify their respective roles;
- the relationship between the PSR and the FCA. The PSR was established as an economic regulator independent in its duties and powers from the FCA's role as a conduct regulator, but this distinction has been blurred by both the overlap of their responsibilities and the governance of the PSR itself.[52] Of course, where different regulators have shared interests, they *should* benefit from each other's expertise; and
- how the PSR engages with stakeholders to advance its objectives while supporting the Government's ambition to renew the UK's position as the world's preeminent financial centre.

47 https://www.legislation.gov.uk/ukpga/2009/1/part/1.

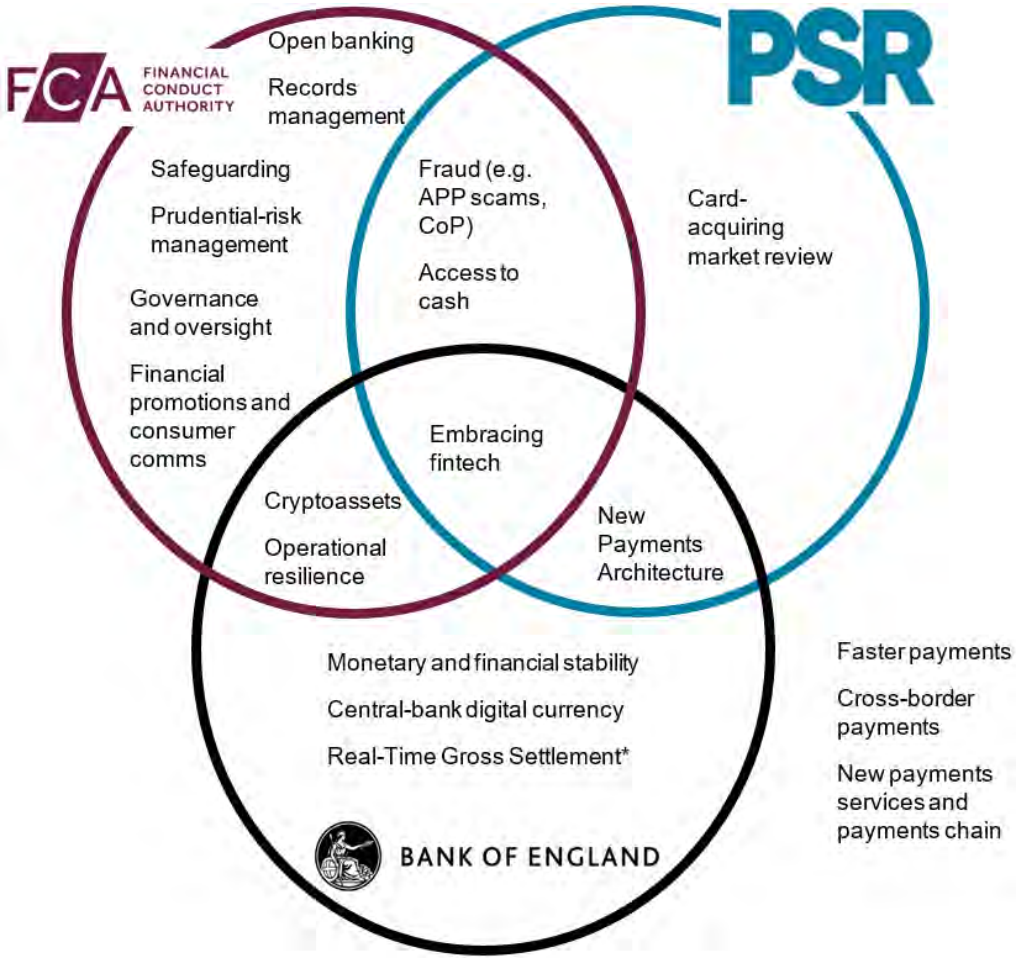
48 https://www.legislation.gov.uk/ukpga/2009/1/part/5.

49 https://www.legislation.gov.uk/ukpga/2012/21/part/2.

50 https://www.gov.uk/government/consultations/payments-landscape-review-call-for-evidence.

51 https://www.gov.uk/government/publications/memorandum-of-understanding-on-the-relationship-between-the-payment-systems-regulator-and-the-uks-other-financial-regulators.

52 The chair of the PSR is also the chair of the FCA, and one of its four non-executive directors is responsible for payments supervision at the FCA. See https://www.psr.org.uk/about-psr/psr-governance.



Dispute resolution

69. The FOS was established by part XVI and schedule 17 of FSMA so that "certain disputes may be resolved quickly and with minimum formality by an independent person."[53] The Government described its purpose as being to provide "easy access for individual retail consumers to a dispute resolution procedure that is speedy and informal."[54] Its jurisdiction has since been extended to cover many more SMEs.

70. It was intended to be an efficient, flexible and informal way to resolve "relatively minor complaints,"[55] determined on their individual merit. It has a valuable role in providing a fair and effective alternative-dispute-resolution (ADR) service, but Parliament never intended its remit to extend to writing the rules within which regulated firms operate.

71. The evolution of the FOS has not been limited to growth in its physical operations, caseload and jurisdiction. It now finds itself increasingly handling complaints that have wider implications for the banking and finance industry and the regulatory landscape within which it operates. This has arguably left a service far from that which Parliament intended, raising the very risks of stifling competition Parliament was keen to mitigate.

53 https://www.legislation.gov.uk/ukpga/2000/8/part/XVI.

54 https://hansard.parliament.uk/Commons/2000-01-19/debates/0fef08fc-703a-4995-94ba-e42012e61b6b/BankingSector

55 https://hansard.parliament.uk/Commons/2000-02-09/debates/25de6eea-1ba1-49d3-8ba8-a5b6d187a1d6/NewClause2.

72. There is a broad consensus that the current process works well for individual complaints. Where a complaint relates to a fact-specific operational or transactional failure, the informality of the FOS process is seen as appropriate. While there are some concerns about consistency, delay and costs, the FOS is generally regarded as fit for purpose in respect of its original remit. However, there have long been concerns that the FOS process is not appropriate for certain types of case.

73. First, there is the issue of precedent setting. The FCA Handbook requires regulated firms to ensure lessons learned as a result of FOS determinations are effectively applied in future complaint handling.[56] This means certain decisions are effectively precedent-setting, a power not usually attributed to a statutory ADR service. While a single decision may be valued at £355,000 or less, its economic impact can be significantly more in practice. In some instances, the value of that impact is unquantifiable, raising legitimate concerns about the basis, quality and proportionality of the FOS's decision-making process.

74. Second, although the FOS was established to decide individual complaints, there are cases where its decisions have a wider impact. There are many instances of the FOS determining a complaint based on its interpretation of the relevant regulatory requirements or industry guidance. In some cases, this will be limited to the specific facts of the case. In others, where there is a degree of ambiguity about the application of the relevant requirement, this can lead the FOS to make decisions that amount to retrospective rule-making or guidance on rules, something that Parliament specifically sought to avoid. For example, the FOS is often asked to determine complaints relating to affordability. The regulatory requirement for unsecured lending in the FCA Handbook is for firms to take reasonable steps to determine a customer's current income and non-discretionary expenditure.[57] As the FCA intended, this can lead to a variety of approaches to the issue. However, the FOS may decide that where a loan is of a specific term or size, the firm should have obtained bank statements to establish the customer's income and expenditure. Such a decision effectively seeks to define the application of the relevant regulatory requirements. It is an interpretation that applies not just in the specific case but in all similar cases and therefore affects not just the relevant firm but every lender that makes unsecured loans of a certain size or duration. This arguably places the FOS in the role of quasi-regulator, establishing rules without a requirement to consider their impact or consult on them as would be required of the FCA.

75. This position is exacerbated because the only avenue available to a firm to contest a FOS decision accepted by the complainant is judicial review, which is widely accepted to be an ineffective method of challenging the FOS. (We examine concerns regarding judicial review in more detail in our answer to question 6.)

76. A central pillar of the UK economy and its attractiveness for new businesses is the concept of legal certainty. Firms should be able to launch new products and services without the fear of retrospective redefinition of their legal rights and obligations. When considering the risks associated with a product or service, firms will undertake a detailed assessment and put in place mitigating measures. One factor that cannot be accurately assessed is the potential for the FOS to undermine the fundamental assumptions in the decisions a firm makes many years after the product or service is sold.

56 https://www.handbook.fca.org.uk/handbook/DISP/1/3.html.

57 https://www.handbook.fca.org.uk/handbook/CONC/5/2A.html.

77. FOS decisions that are not consistent with pre-existing law and regulatory standards create significant uncertainty and the risk of retrospective assessment. This uncertainty has a chilling effect on innovation and leads to reluctance to consider new products and services, to consumers' detriment. It can also have a chilling effect on the industry's desire to provide guidance. We therefore recommend HMT consider three areas for reform.

78. **First, there should be a more consultative and collaborative process for decisions with policy or precedent implications.** There will be some cases whose wider implications are not immediately apparent. However, the significance of many cases will be apparent to the FOS. For example, it is clear the FOS often identifies the need to make a policy determination in respect of certain cohorts of case, particularly where it sees a large number of particular complaints in respect of a new issue (e.g. affordability or APP fraud). It is equally evident there is some degree of internal debate within the FOS about the appropriate treatment of such cases. However, there is no visibility of engagement with external stakeholders such as the FCA, firms or consumer bodies. Rather, the FOS reaches an internal policy view on the issue entirely by itself, which may only be partially explained in the published decision.

79. The MoU between the FOS and the FCA could be amended at least to the extent that the FCA should be engaged in relevant issues. Its provisions already require the two bodies to "seek to achieve a complementary and consistent approach, so far as that is consistent with their independent roles" and "consult one another at an early stage on any issues that might have significant implications for the other organisation."[58]

80. While these cooperation provisions are helpful, they provide no detail on how they are implemented in practice and, more importantly, what discussions the FCA and the FOS have about decisions that interpret gaps in regulation. To ensure greater rigour and accountability in relation to such discussions, these should be made a matter of public record. Further, the MoU should establish clear guidelines to determine the types of case that will be a matter for discussion between the FCA and the FOS. The FOS should agree similar MoUs with the PSR and any other relevant regulators.

81. **Second, there should be a twin-track decision-making process.** As noted, the current statutory FOS process is appropriate for resolving individual, fact-specific complaints. However, it may be better if cases with wider implications are processed in a different way, either by an expert panel within the FOS or by a different administrative decision-making body. The important point is that the relevant cases would be subject to a more proportionate degree of analysis and consideration of applicable law and regulation. This process would represent a more formal encapsulation of the more collaborative and consultative decision-making process described above.

82. This twin-track process might alleviate some of the pressures on the FOS. A well-designed bespoke process for resolving cases with wider implications would allow it to focus its attention on dealing with routine individual cases. This, in turn, might allow for a more efficient allocation of resource and lead to faster resolution of complaints.

83. **Finally, there should be a new appeal process.** This would allow for sufficient scrutiny of decisions that have wider implications. Any appeal process would clearly need to be limited to certain types of case or risk defeating the purpose of the

58 https://www.fca.org.uk/publication/mou/mou-fos.pdf.

FOS. In addition to meeting certain threshold criteria, there would also need to be a funding mechanism and processes to ensure consumers were equally able to avail themselves of the right of appeal.

84. Such a right of appeal would only be available in a very small minority of cases but should be given to the FOS, firms and complainants. Any additional delay to the process would therefore only arise in a few cases and would be fully justified in the interests of ensuring a robust and proportionate process was applied to all cases.

85. Supporting this response is a more detailed paper on these issues produced in association with White & Case. Both are specific to the FOS as a statutory ADR service to whose jurisdiction regulated firms must compulsorily submit. Neither considers the recently established Business Banking Resolution Service (BBRS), which, by contrast, is a private ADR service voluntarily established by seven participating banks to resolve disputes between those banks and eligible larger SMEs. We make no comparisons between the FOS and the BBRS, and no readacross of our commentary and recommendations regarding the FOS should be made to the BBRS.

The respective roles of competition, collaboration and regulation

86. Competition drives better outcomes for customers. Where it can solve an issue without further intervention, that should be preferred. However, there will be occasions where competition alone is not sufficient.

87. Where there is a common agenda and an opportunity to improve the outcome for groups of customers (recognising that industry approaches work best where its incentives are aligned with those of the public, as set out below in answer to question 4), the industry should seek to identify opportunities to collaborate, including through trade bodies. This includes sharing knowledge and identifying risks, with the objective of developing common approaches to meeting the needs of customers. To enable this level of collaboration, firms must feel confident about the information they can share when working toward common objectives.

88. In addition, firms, trade bodies and regulators should collaborate to bring greater unity to sectoral regulation and guidance. Consistency should enable greater co- and self-regulation across the industry without the need for statutory regulation. (We consider the merits of co- and self-regulation in more detail in our answer to question 4.)

89. Where competition is found to be inadequate or a market failure arises and firms are unable to address an issue collaboratively, regulators have powers to investigate and, if necessary, make timely, measured interventions to fix the problem. These should be used only where a collaborative approach cannot be taken and intervention has been shown to be an effective and proportionate response.

90. Where competition and collaboration are not appropriate and the Government and/or regulators have decided it would be inappropriate to intervene, the public authorities concerned should explain their decision publicly. This would help remove the perception that someone is "to blame" for the outcome.

91. This discussion of the roles of competition, collaboration and regulation is particularly relevant to issues of vulnerability. More than 24 million people in the UK display one or more potential characteristics of vulnerability, which include physical and mental health issues, recent life events such as bereavement, capability and

financial resilience.[59] As Covid-19 affects people's health, mental well-being, families, employment and finances, the proportion of vulnerable customers will have increased from this previous estimate. Competition between firms to offer well-designed products and services to meet the needs of particular groups of vulnerable customer is a legitimate form of competition.

92. As described above, collaboration sometimes relies on data sharing, and this is particularly the case with issues of vulnerability. We strongly recommended the UK Regulators Network (UKRN) establish a workstream to consider future vulnerability data recording and application on a collaborative cross-sector basis that included includes regulators and the Information Commissioner's Office (ICO). With this in mind, the ICO should further help the industry determine what recording of individual vulnerability to protect a customer is acceptable.

International competitiveness

93. The FRF consultation rightly observes that the UK's importance as a financial centre and its role in the global financial system mean its regulatory approach can have important consequences for overseas firms looking to operate or do business in the UK. Any reform of the regulatory framework should therefore advance the broader public interest in a globally successful industry, particularly by promoting the UK as a financial centre both for overseas firms operating here and for domestic firms operating internationally.

94. Such considerations go beyond regulation to include the following:

- competitive and predictable taxation, a stable legal framework, flexible labour laws and credible deterrence against economic crime;
- an open migration regime, a deep local talent pool, a competitive cost of living and lifestyle incentives for cosmopolitan workers;
- international transport connectivity, robust physical and digital infrastructure and world-class professional and other support services (e.g. accounting, legal, consultancy, tech and media); and
- an open and supportive regime for overseas business, an open import regime for cross-border services (e.g. a liberal foreign-establishment regime) and open export frameworks for key partners.

95. They also need to address emerging issues that go to the heart of the UK's competitiveness:

- Covid-19—how the shift to home-working requires a rethinking of the operation of cluster effects and the model of imported talent at the same time as the recovery squeezes the resources available for infrastructure investment and other spending;
- digital change—as the growing use of remote supply opens new opportunities to both import and export banking and finance skills, digital infrastructure and its resilience become ever more central and regulation helps to realise the potential of data;
- Brexit—which reframes the challenge of insufficient flexibility *inside* the EU as a question of alignment/non-alignment *outside* it, removes the assumption of freedom of movement for UK and EU citizens, increases competition within firms

59 https://www.fca.org.uk/news/press-releases/new-guidance-help-firms-do-more-vulnerable-consumers.

for investment in the region, reframes the UK skills challenge and replaces the passporting framework for business in/with the EU (and supports such as free-flowing data) with a third-country trading model based on the EU/UK Trade and Cooperation Agreement and unilateral "gateways" for this business; and

- regulatory pressure—straining firms' capacities in the light of a decade of pressure on fiscal resources, rapid technological change and the management of both Brexit and Covid-19.

96. Many of these issues are beyond the scope of this response, but we will continue to contribute to relevant policy development, with a view to making the UK more competitive internationally (e.g. as a favoured location for banking and finance firms that serve markets beyond the UK). In particular, as a world-leading centre of technological excellence, we should maintain that advantage by undertaking an annual audit of our fintech competitiveness, benchmarked against countries like Germany, Portugal, Singapore, Sweden and the US. This could lead to specific recommendations, such as doing more to increase equity financing to help firms scale up and ensure our skills and immigration regimes enable us to nurture and attract the best talent.

97. More directly relevant are the international-competitiveness considerations in reforming the regulatory framework. First, the framework should accord an appropriate role to global standards. We recommend HMT review UK policy in this respect, addressing questions including:

- how the UK can best secure its interests in standard-setting fora (including the role of international coordination) in relation not only to banking and finance but also in areas such as data and sustainability;
- whether the UK should implement international standards as a matter of course (if necessary, superseding existing, inconsistent UK rules);
- how UK authorities should coordinate with non-UK regulators, including on international supervision and the timing, content and scope of regulatory intervention; and
- the extent to which gold-plating and super-equivalence should be removed as a matter of principle.[60]

98. We also recommend HMT consider the related issue of when and how to deploy deference, mutual recognition, substituted compliance, equivalence and similar tools. In doing so, it will need to balance potentially competing public-policy considerations such as the public interest in the UK being a successful international financial centre, having a competitive banking and finance sector and reducing barriers to cross-border financial flows on the one hand with the primary policy objectives of UK regulation (i.e. competition, consumer protection, market integrity and financial stability) on the other. We discuss competitiveness as a regulatory principle in response to question 3. Other considerations, like avoiding the UK being too much a "rule-taker" from any other jurisdiction, will also need to be reflected in the eventual policy choices.

99. In addition, reform of the regulatory framework, including the framing of regulators' duties, should consider the potential impact on cross-border market access, both by overseas firms to the UK and by UK-based firms to markets abroad. In particular, we would welcome closer industry working with the Government and regulators on its Global Britain and other trade and market-access initiatives to promote the use of UK-

60 See also https://www.irsg.co.uk/assets/Uploads/CD5719CityofLondonGlobal-Regulatory-CoherencefRonline2.pdf.

based firms' operations in their business abroad.[61]

100. We therefore welcome the Chancellor's announcement on 9 November 2020 of a call for evidence on the UK's "overseas regime."[62] Our response will cover the "gateways" for incoming banking and finance services, such as the overseas-persons exclusion and relevant onshored equivalence/third-country regimes (e.g. Title VIII of the Markets in Financial Instruments Regulation). These are key to improving the attractiveness of the UK to banking and finance firms operating overseas and should form part of the long-term vision for financial services for which we call in response to question 2.

101. Finally, while we support the general principle that regulators are funded by fees from the firms they regulate, we observe that the total annual funding requirements of the FCA, the PRA and the PSR have increased by 11.5 per cent over the four years since 2016/17 to nearly £900 million per year. These are sums not available to firms to invest in meeting the needs of their customers. Moreover, fees fall proportionately across the general population of firms (in the case of the FCA, for example, according to their annual income or number of mortgages) rather than more heavily on those whose conduct requires greater supervision or results in enforcement action. We therefore believe there is merit in reviewing the overall cost of regulation, in particular compared to that in other major financial centres, to ensure it does not act as a disincentive for firms to do business in and from the UK.

What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?

102. We agree with the proposed division of responsibilities between Parliament, HMT and regulators. This applies the Principles for Economic Regulation—published by the Department for Business, Innovation and Skills in 2011 and broadly applicable to financial-services regulation—inasmuch as "independent regulation needs to take place within a framework of duties and policies set by a democratically accountable Parliament and Government" and "roles and responsibilities between Government and economic regulators should be allocated in a way as to ensure that regulatory decisions are taken by the body that has the legitimacy, expertise and capability to arbitrate between the required trade-offs."[63]

Primary and secondary legislation and regulatory rules

103. We agree with Parliament's proposed role of setting overarching and activity-specific framework legislation and identifying public-policy matters to be taken into consideration in regulatory standards. We also agree that regulators are the right parties to be responsible for detailed rule making given their expertise and knowledge gained from supervising firms. Regulators can also respond quickly to market developments and update requirements.

104. Aspects of activity-specific framework legislation, such as regulatory principles, will need to be updated from time to time, and the FRF consultation envisages the Government will be able to do so using the affirmative secondary-legislation procedure. While we agree that secondary legislation is an appropriate vehicle, it must

61 See our soon-to-be-published report on international trade in financial services.

62 https://hansard.parliament.uk/commons/2020-11-09/debates/D5E911A9-1270-457F-9F6A-57AE5C272FBA/FutureOfFinancialServices.

63 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf.

be subject to proper scrutiny. Updating framework legislation could have significant consequences, from changing the way firms operate to affecting the competitiveness of the banking and finance sector as a whole.

105. We note that the scope of this proposed power is similar to that of legislative-reform orders under the Legislative and Regulatory Reform Act 2006.[64] Where appropriate, these are subject to the super-affirmative resolution procedure, under which an order is laid in draft before Parliament and the Government must have regard to any representations made and then secure the approval of both the House of Commons and the House of Lords before it can be made. As well as increasing transparency and scrutiny, this procedure makes it possible for the Government to make changes (minor or otherwise) to the draft order in response to representations made. We recommend HMT commit to thorough consultation and the use of the super-affirmative procedure for any amendments to activity-specific framework legislation.

106. Under the proposed framework, there will be a tension where the actions of one party affect the responsibilities of another. For example, the FRF consultation states that the Government and Parliament should be responsible for provisions that cover the UK's regulatory and trading relationship with other countries (e.g. equivalence and mutual-recognition agreements). It would also be possible for regulators to make rules, without reference to Parliament or Government, that could affect whether the regulatory framework was considered equivalent to another jurisdiction's. In respect of equivalence decisions, it is vital that firms be provided with stability and certainty. To the extent equivalence can be withdrawn for other than technical reasons, this will not be achieved.

107. However, we note three important safeguards mentioned in the consultation:

- the Financial Services Regulatory Initiatives Forum, created to help regulators plan ahead and improve coordination across the regulatory landscape for financial services;
- HMT's ability to "direct the PRA or FCA to take action, or refrain from taking action, necessary in order to ensure that the UK meets its international obligations." This ability should be extended to all regulators to which the FSMA model is extended; and
- the "arrangement whereby the regulators consult HM Treasury more systematically on proposed rule changes at an early stage."

108. We believe these should ensure HMT is able to fulfil its responsibility for the UK's cooperation and trading relationships with other countries.

109. Close coordination between HMT and regulators will also be required where the latter represent the UK at international standard-setting fora.

64 https://www.legislation.gov.uk/ukpga/2006/51/contents.

The respective roles of Government, regulators and firms in defining and delivering fair outcomes

110. Since FSMA, the role of defining and delivering fair outcomes has largely fallen to regulators, initially the FSA and now the PRA and FCA. In response, they have sought to frame their statutory objectives in outcome terms (e.g. the FCA's Mission)[65] and define outcomes for their major policy initiatives.

111. Measurement of regulatory outcomes will always be highly sensitive to changes in the industry and the macroeconomic environment. It is extremely difficult to describe a credible counterfactual in economic terms, and it is hard for the regulator to avoid the charge of "marking its own homework."

112. HMT's proposed solution involves the Government and Parliament taking a greater role, setting the policy framework in key areas. This would include defining the purpose of a given regime and deciding on the core elements of the regulatory approach and the regulatory principles to which regulators must have regard. Regulator would then be required to explain how their proposals satisfy these requirements. These inputs are intended to upgrade the FSMA model, which, while generally seen as strong, is acknowledged by HMT to be "under-developed and incoherent" in this area.

113. The FRF consultation is unclear whether this enhanced role covers defining outcomes, but the implication is that this responsibility will remain with regulators.

114. Accepting that the definition and delivery of outcomes will always be contentious, we suggest three practical steps.

- In line with the spirit of the FRF, the Government and Parliament should assume clear responsibility for defining regulatory outcomes, leaving regulators free to focus on delivery and measurement. By fixing the definition independently, Parliament will set the challenge, which will reduce (though not eliminate) the dangers of regulators self-marking.
- As part of their approach to each regime, regulators should set out how they plan to measure success. This should be costed as part of an overall evaluation budget that would become part of the regulators' annual business plan and fee consultation. We make further observations on the measurement of regulatory performance in response to question 9.
- Regulators and stakeholders agree that the regulatory framework should support the orderly failure of firms, but this has proved hard to define in principle and to defend in practice. Firms, consumer groups and regulators should seek to reach a consensus on this issue that, if achieved, should become part of the regulators' accountability to Parliament.

What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?

115. We broadly agree with HMT's proposed framework. Post-Brexit, a clear allocation of roles between the public authorities, with greater powers for regulators matched by greater accountability, is both desirable and inevitable.

65 https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf.

116. The FRF consultation proposes to go beyond the general regulatory principles set for the regulators in FSMA and to introduce activity-specific regulatory principles "to enable government and Parliament to direct the regulators to have regard to specific broader public policy issues that may be relevant to the particular financial services activity being regulated."

117. We support the allocation of roles between public bodies envisaged in the post-Brexit framework, and activity-specific regulatory principles are an appropriate consequence of this. As the regulators take on additional roles and responsibilities, it is right that the Government and Parliament specify policy priorities for how these responsibilities are exercised. HMT should commit to formally consulting on each new activity-specific framework.

118. Key to the success of this framework is a clear expectation that the regulators openly and transparently consider the public-policy issues set for them and explain how they have balanced competing priorities. Parliament could review how these frameworks have affected and been used by the regulators as part of its ongoing scrutiny of their activities.

119. In answer to question 1, we set out our views on the principle that the same activities, where they present the same risks, should be subject to the same regulation. We argue there that greater activity-based regulation would help prevent gaps emerging and ensure greater consistency. In this context, we believe activity-specific regulatory principles could help regulators to strike a better balance between activity- and firm-based regulation.

120. It is nonetheless important that cross-cutting objectives and principles remain part of the overarching legislative framework, as we argue in respect of competitiveness and proportionality in answer to question 3.

Managing onshored EU legislation

121. As the FRF consultation notes, while the onshoring of EU legislation was important for providing continuity as the UK left the EU, having detailed rules crystalised in primary legislation creates compliance and operational risk and is not suitable for the long term. Rectifying this will involve transferring requirements in onshored EU legislation, and also relevant aspects of legislation of an entirely domestic nature, to regulators' rulebooks. That will require a coordinated process in which the Government brings forward legislation to rationalise and consolidate the statute book at the same time as the regulators introduce replacement rules as necessary.

122. While detailed requirements will move into the regulators' rulebooks, some elements of legislation will need to remain the preserve of the Government and thus on the statute book. It is unlikely to be desirable in the long term for those resulting from onshored EU law to remain expressed in their current form. Rationalisation and consolidation will therefore also need to make appropriate new provisions for the roles and powers of Ministers.

123. This implies a major exercise for the Government and Parliament in converting decades of existing legislation into measures fit for the new regulatory framework—so much so that a single "big bang" approach is likely to be infeasible. We suggest instead considering it activity by activity. The proposal for policy-framework legislation for specific areas of regulated activity introduced in the FRF consultation would be well suited to this exercise. HMT would then need to identify which areas

of regulation to prioritise for new consolidating legislation. Recognising this is an opportunity at least in part to address issues with past EU legislation, we recommend that priority first be given to those areas where the greatest concerns about the existing rules and the greatest opportunities to promote UK competitiveness exist. For example, a review of the onshored Markets in Financial Instruments Directive (MiFID II), whose reporting and monitoring requirements of firms do not provide proportional protection for investors and customers, could enhance competitiveness. On the other hand, a more straightforward area such as mortgage regulation may be a lower priority. Noting that the EU is reviewing its approach in certain areas,[66] HMT may wish to study the outcomes as it considers which areas to prioritise.

124. As onshored legislation is reviewed, HMT and the regulators should consider the principles of competitiveness and proportionality in designing new domestic rules.

125. In some areas, onshored legislation will work acceptably well, at least in the medium term. It is more important that new legislation is carefully considered and subject to appropriate consultation and scrutiny than it is to complete this exercise within an arbitrary timeframe. HMT should publish its proposals for undertaking this exercise in due course and consult on which areas of regulation to prioritise. This would give firms an indication of process and timelines, without creating arbitrary deadlines.

126. When converting onshored legislation, HMT and regulators should give market participants clarity about where new rules are intended to have the same effect as the old and where there is a material change. This will enable firms to continue to comply with rules where no change is intended without the need to undertake costly reviews of their processes. They should also ensure new rules are available in one place and in similar (machine- and people-readable) formats across the different regulators.

Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?

127. Key to the success of activity-specific regulatory principles is a clear expectation that the regulators openly and transparently consider the public-policy issues set for them and explain how they have balanced competing priorities. Recognising that the principles to which the regulators must have regard may be in tension with one another is a subject to which we return in our answer to question 3.

128. Sections 138I and 138K of FSMA require the FCA and the PRA respectively, before making any rules, to publish a draft accompanied by an explanation of their reasons for believing that making them is compatible with the regulatory principles in section 3B of FSMA. We urge the Government to include a similar provision in any legislation for activity-specific regulatory principles. Explaining publicly why a regulator believes its proposals are compatible with the principles and how it has balanced any tensions between them will be vital for transparency and accountability. As described above, Parliamentary scrutiny of the regulators could include consideration of these explanations.

129. The Financial Services Bill currently before Parliament, where the first activity-specific regulatory principles are being proposed, will require the PRA and the FCA to explain the ways in which having regard to them has affected their proposed rules. This is

66 For example, the European Commission launched a targeted consultation in December 2020 on the review of the Central Securities Depositories Regulation. See https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en.

a good step toward transparency, but we ask HMT to go further and require the regulators to detail their thinking on how proposed rules are compatible with the activity-specific regulatory principles and how they have balanced any tensions between them. A robust CBA and thorough explanation of how proposed rules meet regulatory principles should be an integral part of the decisions to which they apply.

130. Openness and transparency in how regulators consider the regulatory principles are vital to effective scrutiny and accountability. HMT Ministers have an important role in the operation of this framework. We note the proposal in the FRF consultation for Ministers to "feed in views during the regulators' policy development stage." This should include Ministers giving views on the compatibility of proposed rules with the regulatory principles.

131. We also encourage Parliament to scrutinise regulators' approach to considering and balancing the regulatory principles on a regular basis.

132. Our answer to question 3 sets out our general view on the role and status of regulatory principles.

Question 3. Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?

133. Regulatory principles play an important role in a system that delegates significant responsibility to regulators. The general principles in FSMA were, rightly, deliberately created to be in tension, and regulators should explain transparently how they have balanced the principles in the decisions they make.

134. Proportionality should be at the heart of the regulatory framework, recognising that the international competitiveness of the UK's banking and finance sector and the UK's attractiveness as a place to do business would be enhanced by more proportionate regulation. The Government should reaffirm that regulators must afford due weight to the principle that consumers take responsibility for their decisions.

Regulatory principles

135. The role of regulatory principles was well described in the first consultation, in July 2010, on the creation of the Financial Policy Committee (FPC) within the BoE.[67] It was recognised that giving the BoE tools for macroprudential regulation would "create a powerful body with significantly increased influence over the UK's financial system and economy," and thus it would be important for the FPC to take into account factors such as "the levels of lending to businesses and families and the competitiveness and profitability of UK banks in relation to foreign competitors." The consultation recognised there would "be merit in providing a clear and transparent exposition of the factors it would be legally obliged to consider."

136. By the time the Government put legislation before Parliament, this thinking had been refined. As set out in the explanatory notes to the Financial Services Bill as introduced in the House of Commons on 26 January 2012:

> *New section 3B lists the regulatory principles to which the regulators must have regard when discharging their general functions; for example, the principle that a burden or restriction should be proportionate to the benefit that is expected to result from the imposition of that burden or restriction, and the principle that consumers should take responsibility for their decisions. These principles do not place burdens or requirements on consumers or firms. They also demarcate the role of the regulators - for example, the principle that consumers should take responsibility for their decisions, as well as to the responsibilities of firms' senior management in relation to compliance with the regulatory requirements (including those relating to consumers), make clear that the FCA and PRA should not aim for a zero-failure regime, which would effectively obviate consumers of their responsibility to look after their own interests and of firms to manage their own business.*[68]

137. As the FRF consultation considers "delegating a very substantial level of policy responsibility to the UK financial services regulators," it is right to consider again the regulatory principles enacted in 2012.

67 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/81389/consult_financial_regulation_condoc.pdf.

68 https://publications.parliament.uk/pa/bills/cbill/2010-2012/0278/en/2012278en.pdf.

138. We support the FSMA model of Parliament setting in legislation the principles and high-level public-policy objectives to which regulators should have regard in exercising their functions. We note these were sometimes created in tension with one another. It is right to set out these tensions transparently for regulators to consider and for regulators to explain transparently how they have balanced these principles in the decisions they make. We return to this issue in answer to question 4.

139. The regulatory principles in section 3B of FSMA apply only to the PRA and the FCA. Essentially the same principles apply to the PSR by virtue of section 53 of the Financial Services (Banking Reform) Act 2013 (FSBRA).[69] Consistent with our response to question 2 that the FSMA model should be extended to the BoE when carrying out its other regulatory functions, we believe the BoE should be subject to the same regulatory principles when doing so.

140. Lastly, we note the FRF consultation proposes to introduce activity-specific regulatory principles. While this is a positive innovation, the Government should monitor how these interact with the general regulatory principles. It can be healthy for regulatory principles to be in tension with each other, but activity-specific principles should not contradict general principles. The most important principles should continue to be recognised as general principles and not downgraded to activity-specific principles. The Government should consider reviewing this interaction at a suitable time after the first activity-specific regulatory principles come into effect.

Competitiveness as a regulatory principle

141. The FRF consultation notes the debate on whether regulators should have an objective to support the competitiveness of the UK's financial-services sector. HMT proposes that activity-specific regulatory principles could be the right place for competitiveness to be addressed.

142. The commitment in the Chancellor's November statement to ensuring the UK is "the most open, the most competitive and the most innovative place to do financial services anywhere in the world" was welcome. We believe this calls for global competitiveness to be recognised by regulators across the board and not just in respect of specific activities. A strategy and policy statement (see answer to question 8) would reinforce to regulators how they should have regard to this.

143. We note the European supervisory authorities have competitiveness as a general regulatory principle. Specifically, the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority are each required to take due account of the impact of their activities "on the Union's global competitiveness."[70]

144. Other countries have gone further and given regulators statutory objectives to promote economic growth. For example, the Australian Securities and Investments Commission "must strive to maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the

69 https://www.legislation.gov.uk/ukpga/2013/33/section/53.

70 Recital 13 at each of https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R1093&from=EN, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R1095&from=EN and https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R1094&from=EN.

economy."[71] Similar objectives can be found in the frameworks of Hong Kong, Singapore and the United States.

145. Post-Brexit, the competitiveness of the banking and finance sector is more vital than ever to the economic growth and prosperity of the UK. As onshored EU legislation is consolidated into regulatory rules, it is vital that regulators consider global competitiveness in their approach. This process should focus on simplification and rationalisation, not gold-plating. The principles set for regulators give important context and direction to their approach to this process.

146. We see merit in HMT's proposed approach of including competitiveness within relevant activity-specific regulatory principles. But this risks a piecemeal situation in which regulators are asked to consider competitiveness in respect of some activities but not others. The banking and finance sector as a whole is hugely valuable to the UK, as described above. Maintaining its contribution will require a continued focus on global competitiveness from the Government and regulators. We therefore recommend that HMT embed global competitiveness in the general regulatory principles set for the regulators to which the FSMA model applies and is extended. A requirement to have regard to the likely effect of rules on the relative standing of the UK as a place for internationally active firms to be based or to carry on activities, modelled on provisions in the Financial Services Bill currently before Parliament,[72] is a reasonable basis for consideration.

147. Competitiveness should also be included as a key test for the additional forms of accountability and scrutiny that the FRF consultation proposes for regulators.

Proportionality

148. The existing general regulatory principles in FSMA include proportionality: "the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction."[73] This follows from the identification of proportionality as one of the five principles that the Better Regulation Task Force devised in 1997.[74]

149. Delivering on the commitment made by the Chancellor in his November 2020 statement to ensure UK is "the most open, the most competitive and the most innovative place to do financial services anywhere in the world" requires proportionality to be at the heart of the regulatory framework. In particular, the framework should promote proportionality of regulation in line with systemic importance.

150. The current framework does not always achieve this aim. For example, mid-tier banks find themselves big enough to be included in new taxation, prudential and conduct initiatives but not big enough to be able to absorb them without an impact on their ability to innovate, compete and grow. Many such initiatives neither reduce systemic risk nor bring benefits to the customers of such banks.

71 https://www.legislation.gov.au/Details/C2018C00438.

72 New section 143G inserted into FSMA by paragraph 1 of Part 1 of Schedule 2 and new section 144C inserted into FSMA by paragraph 1 of Part 1 of Schedule 3. See https://publications.parliament.uk/pa/bills/cbill/58-01/0225/200225.pdf.

73 Section 3B(1)(b), FSMA.

74 https://webarchive.nationalarchives.gov.uk/20100407173247/http://archive.cabinetoffice.gov.uk/brc/upload/assets/www.brc.gov.uk/principlesleaflet.pdf.

151. Proportionality is an outcome to be desired in and of itself, but it is also vital for promoting competition. The international competitiveness of the UK's banking and finance sector would also be enhanced by more proportionate regulation and a greater recognition of its cumulative effect, with the impact on competition, innovation and customer service considered in the round. As well as seeking proportionality in rule-making, regulators should demonstrate it in supervision.

152. The FRF consultation recognises the need for a more proportionate regulatory approach to capital markets and the inclusion of provisions in the Financial Services Bill to introduce a new proportionate regime for non-systemic investment firms. HMT should take the opportunity to embed proportionality as a keystone of the new regulatory framework as a whole. As with competitiveness, we recommend it do so by ensuring proportionality features prominently among the general regulatory principles set for the regulators to which the FSMA model applies and is extended as well being translated into activity-specific regulatory principles. In respect of the former, we observe that the Office of Communications (Ofcom) must keep the carrying-out of its functions under review to ensure it does not impose or maintain unnecessary burdens. In reviewing its functions, Ofcom must consider the extent to which it would be appropriate to remove or reduce regulatory burdens it has imposed.[75] We see no reason why banking and finance regulators should not be subject to this stricter duty rather than that in FSMA (and shared by the PSR by virtue of section 53(b) of FSBRA). Similarly, we observe that Ofcom, the Office of Gas and Electricity Markets (Ofgem), the Water Services Regulation Authority (Ofwat) and the Civil Aviation Authority (CAA) are all subject to the principle that, "Regulatory activities should also be accountable, consistent and targeted only at cases in which action is needed,"[76] and Ofcom, Ofgem and Ofwat must have regard to (any other) principles of best regulatory practice.[77] We believe these, too, should be replicated for banking and finance regulators.

153. As for competitiveness, proportionality should be included as a key test for the additional forms of accountability and scrutiny that the FRF consultation proposes for regulators.

The general principle that consumers take responsibility for their decisions

154. Section 3B(1)(d) of FSMA requires the PRA and the FCA to have regard to "the general principle that consumers should take responsibility for their decisions" in discharging their general functions.

155. In advancing its consumer-protection objective of "securing an appropriate degree of protection for consumers" under section 1C of FSMA, the FCA must have regard to eight factors "in considering what degree of protection for consumers may be appropriate." These include "the differing degrees of experience and expertise that different consumers may have," "the general principle that consumers should take responsibility for their decisions" and "the general principle that those providing

75 Section 6(1) and (2), Communications Act 2003. See https://www.legislation.gov.uk/ukpga/2003/21/section/6.

76 Section 3(3)(a), Communications Act 2003 (https://www.legislation.gov.uk/ukpga/2003/21/section/3); section 4AA(5A)(a), Gas Act 1986 (https://www.legislation.gov.uk/ukpga/1986/44/section/4AA) and section 3A(5A)(a), Electricity Act 1989 (https://www.legislation.gov.uk/ukpga/1989/29/section/3A); section 2(4), Water Industry Act 1991 (https://www.legislation.gov.uk/ukpga/1991/56/section/2); and sections 1(4), Civil Aviation Act 2012 (https://www.legislation.gov.uk/ukpga/2012/19/section/1).

77 Section 3(3)(b), Communications Act 2003; section 4AA(5A)(b), Gas Act 1986 and section 3A(5A)(b), Electricity Act 1989; and section 2(4), Water Industry Act 1991.

regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question."[78]

156. The tension between and need to balance these considerations was recognised by Andrew Bailey in his first public speech as Chief Executive of the FCA:

How to balance the duty of care towards consumers, the duty of responsibility of consumers for their decisions, the role of firms and the role of the regulator, is an inherently difficult question to which there will be many potential answers. It lies at the heart of the FCA's mission. So far, I would say it has not been adequately answered.[79]

157. The FCA subsequently consulted in 2018 on whether its regulatory framework should go further and include a positive duty of care on financial-services firms when dealing with customers.[80] In 2019, it published a feedback statement in which it concluded there was not "a sufficient basis for making changes to primary legislation" to introduce such a duty but it would review how it applied the regulatory framework to "deliver a higher degree of consumer protection."[81] Its website says it aims "to consult on options for change in Q1 2021."[82] We have previously responded to the FCA arguing we do not believe there are significant gaps in the current regulatory regime; indeed, firms' existing duties are extremely extensive. We continue to believe the introduction of a duty of care is unnecessary and inappropriate and would have serious consequences, including for competitiveness.

158. Consumers themselves recognise this balance of responsibilities. Previous research commissioned by the FCA Practitioner Panel "found a surprising degree of willingness among consumer respondents to accept responsibility in principle for their actions. In other words not to 'blame and claim' if things went wrong with their decisions." It also found that, "Consumers accept that acting responsibly should mean trying to understand what you are buying (reading the product information and the T&Cs), researching the options available and seeking out help where needed."[83]

159. Regulators' FSMA duties reflect a balance in common law. In the consumer context, Lady Hale, then a Court of Appeal judge, confirmed in *Office of Fair Trading v Abbey National & Others* the principle of the customer making an informed choice:

As a very general proposition, consumer law in this country aims to give the consumer an informed choice rather than to protect the consumer from making an unwise choice. We buy all sorts of products which a sensible person might not buy and some of which are not good value for the money. We do so with our eyes open because we want the product in question more than we want the money.[84]

78 https://www.legislation.gov.uk/ukpga/2000/8/section/1C.

79 https://www.fca.org.uk/news/speeches/chief-executive-speaks-apm-about-recent-work-and-future-challenges.

80 https://www.fca.org.uk/publication/discussion/dp-18-05.pdf.

81 https://www.fca.org.uk/publication/feedback/fs19-02.pdf.

82 https://www.fca.org.uk/publications/feedback-statements/fs19-2-duty-care-and-potential-alternative-approaches.

83 https://www.fca-pp.org.uk/sites/default/files/fca_practitioner_panel_consumer_responsibility_report_september_2013.pdf.

84 http://www.bailii.org/uk/cases/UKSC/2009/6.html.

160. Rather than diminishing consumer responsibility for decision making, regulators should empower consumers to make well-informed decisions. The common-law duties provide a balanced set of rights and a means of delivering redress (which is free of charge to the consumer where provided by the FOS).

161. The FCA has previously recognised—correctly in our view—that "behavioural biases" may cause people to misjudge important facts and regulation may as a result be required.[85] This must be weighed against the negative effects of market interventions that reduce or disincentivise consumers from taking responsibility for their decisions. Markets work better when providers of products and services respond to consumer-driven pressures rather than regulatory intervention.

162. Parliament clearly intended regulators to have specific regard to the principle that consumers should take responsibility for their decisions. That is why is it is found in the objectives of the FCA and the general principles of both the FCA and the PRA. Therefore, we recommend HMT reinforce the vital importance of regulators affording due weight to this principle.

85 https://www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf.

Question 4. Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?

163. The FRF consultation is fundamentally about regulators acting within a legislative framework set by Parliament, aligned with Government policy and accountable for their decisions. We support the broad thrust of proposals for regulators with enhanced powers, subject to effective scrutiny and accountability, to deliver and be held accountable against democratically determined objectives in a transparent manner.

164. We believe the existing objectives of the PRA and the FCA are broadly right. There is concern that the BoE, acting as the UK's resolution authority, may excessively prioritise avoiding firm failure, and we recommend extending the BoE's existing secondary competition objective in its role as the PRA to its resolution activities to secure a better balance. HMT should also consider the case for regulators having a duty to consider the overall effect of their activities on the level of investment in relevant markets.

165. Competition is an objective of most regulators, and the regulatory framework should recognise the role that the Competition and Markets Authority (CMA), as the UK's primary competition authority, can play in making recommendations on regulatory, policy and legislative matters. In some instances where competition among providers alone is insufficient to deliver an outcome desired by society, co- or self-regulation may be a better approach than statutory regulation to securing the required outcome.

166. The regulatory framework should differentiate unambiguously between rules, requirements of firms introduced following due process and subject to recourse where this is lacking, and guidance intended to demonstrate a possible path to compliance with requirements but ultimately for firms to heed as they see fit.

A competition duty for the BoE in its role as the UK's resolution authority

167. Almost all the UK's sectoral regulators have a variant of the generic duty to promote competition among suppliers in the markets they regulate. This stems from the widely-held view that competition is conducive to better consumer outcomes with respect to the price, quality and value for money of goods and services.

168. This is equally true of regulators covering banking and finance:

- the BoE, in its role as the PRA, has a secondary objective to facilitate effective competition in the markets for services provided by persons whom it authorises in carrying on regulated activities;[86]
- the FCA has an operational objective to promote effective competition in the interests of consumers in the markets for regulated financial services or services provided by a recognised investment exchange in carrying on regulated activities;[87]

86 http://www.legislation.gov.uk/ukpga/2013/33/section/130.

87 http://www.legislation.gov.uk/ukpga/2000/8/section/1E.

- the PSR has an objective to promote effective competition in the market for payment systems and the markets for services provided by payment systems in the interests of those who use, or are likely to use, services provided by payment systems;[88] and
- the CMA must seek to promote competition, both within and outside the UK, for the benefit of consumers.[89]

169. The BoE has no such duty in its role as the UK's resolution authority. This is notable given the implications for effective competition in banking markets of measures the BoE can take in respect of this role.

170. Since Part 1 of the Banking Act 2009 introduced the UK's framework for resolution,[90] the regime has been used just twice,[91] most recently in June 2011 to place Southsea Mortgage and Investment—a firm with just 250 depositors—into modified insolvency.

171. It is, of course, highly desirable that if a bank or building society fails, it happens in an orderly way to minimise disruption to any of its vital services and protect financial stability. However, while the absence of use of the regime can be regarded as a measure of its success, a lack of firms failing can also be a negative indicator of competition in a market. It is notable that section 2G of FSMA explicitly states nothing in the PRA's objectives "is to be regarded as requiring the PRA to ensure that no PRA-authorised person fails."[92] Other regulated markets experience and tolerate much greater levels of firm failure. For example, based on Ofgem data, Citizens Advice estimated that 11 retail energy suppliers with 850,000 domestic customers between them failed between January 2018 and March 2019 and were successfully "resolved" under Ofgem's supplier-of-last-resort process.[93]

172. There is concern that the BoE, acting as the resolution authority, may prioritise the avoidance of firm failure to the extent that it inhibits competition in certain banking and finance markets, principally by requiring firms to hold excessive levels of resource that can be bailed in. This raises barriers to entry and expansion, which is not in the interests of consumers. We therefore recommend extending the BoE's existing secondary competition objective in its role as the PRA to its resolution activities in order to help secure a better balance.

A financeability duty

173. Most sectoral regulators in the UK have some form of financeability duty set out in legislation. This duty recognises the need for regulated companies to be able to raise finance for investment and to undertake their regulated activities. Examples include:

- **water**. Ofwat must "exercise and perform [its] powers and duties . . . in the manner which . . . it considers is best calculated . . . to secure that companies holding appointments . . . as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions";[94]

88 http://www.legislation.gov.uk/ukpga/2013/33/section/50.

89 http://www.legislation.gov.uk/ukpga/2013/24/section/25/enacted.

90 https://www.legislation.gov.uk/ukpga/2009/1/part/1.

91 https://www.bankofengland.co.uk/financial-stability/resolution#completed%20resolutions.

92 https://www.legislation.gov.uk/ukpga/2000/8/section/2G.

93 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/SoLR%20report%20FINAL_v2.pdf.

94 Section 2(2A), Water Industry Act 1991. See https://www.legislation.gov.uk/ukpga/1991/56/part/I/crossheading/general-duties.

- **postal services**. Ofcom "must carry out their functions in relation to postal services in a way that they consider will secure the provision of a universal postal service. . . . In performing [this] duty . . . OFCOM must have regard to the need for the provision of a universal postal service to be financially sustainable";[95]
- **gas**. Ofgem "is to protect the interests of existing and future consumers in relation to gas conveyed through pipes." In performing its duties, it "shall have regard to . . . the need to secure that licence holders are able to finance the activities which are the subject of [statutory] obligations";[96]
- **electricity**. Ofgem "is to protect the interests of existing and future consumers in relation to electricity conveyed by distribution systems or transmission systems." In performing its duties, it "shall have regard to . . . the need to secure that licence holders are able to finance the activities which are the subject of [statutory] obligations";[97]
- **airports**. The CAA must carry out its functions "in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services." In performing its duties, "the CAA must have regard to . . . the need to secure that each holder of a licence . . . is able to finance its provision of airport operation services in the area for which the licence is granted";[98]
- **air-traffic control**. The Secretary of State must exercise his functions "in the manner he thinks best calculated . . . to secure that licence holders will not find it unduly difficult to finance activities authorised by their licences";[99] and
- **rail**. "The Office of Rail and Road shall also be under a duty . . . to act in a manner which it considers will not render it unduly difficult for persons who are holders of network licences to finance any activities or proposed activities of theirs in relation to which the Office of Rail and Road has functions . . . (whether or not the activities in question are, or are to be, carried on by those persons in their capacity as holders of such licences) . . ."[100]

174. By contrast, the PRA and the FCA do not have a financeability duty. This is despite wide acceptance of the importance of banking and finance firms being able to invest in innovation, growth, customer service, security and resilience. Furthermore, regulatory change now accounts for increasing operational risk and a significant proportion of investment budgets. In light of these factors, and recognising the fundamentally competitive nature of banking and finance markets, we recommend HMT consider the case for the PRA and the FCA—and other regulators to which the FSMA model is extended—having a formal obligation to give appropriate consideration to the overall effect of their activities on the level of investment in relevant markets. This should include consideration by regulators of the benefits of having a plurality of business models.

95 Section 29, Postal Services Act 2011. See https://www.legislation.gov.uk/ukpga/2011/5/section/29.

96 Section 4AA, Gas Act 1986. See https://www.legislation.gov.uk/ukpga/1986/44/section/4AA.

97 Section 3A, Electricity Act 1989. https://www.legislation.gov.uk/ukpga/1989/29/section/3A.

98 Section 1, Civil Aviation Act 2012. https://www.legislation.gov.uk/ukpga/2012/19/section/1.

99 Section 1(2), Transport Act 2000. https://www.legislation.gov.uk/ukpga/2000/38/section/1.

100 Section 4(5), Railways Act 1993. See https://www.legislation.gov.uk/ukpga/1993/43/section/4.

Role of the CMA

175. While the financial-services regulators all have variations on a competition duty, the UK's primary competition authority is the CMA. The CMA itself has intervened in banking and finance markets in the form of long-standing remedies following market studies and investigations, and their fit with regulation interventions need to be considered in the light of the evolution of these markets.

176. Under section 7 of the Enterprise Act 2002, the CMA can advise the Government on how its own policies can facilitate the development of competition or where its policies risk constraining such development.[101] It has published guidelines to this effect.[102]

177. The Government's July 2019 updated non-binding strategic steer to the CMA explicitly called on it to "make recommendations on regulatory, policy or legislative matters, and their implications for competition and consumers at either national or local level."[103] This could apply in full to regulators of banking and finance firms.

178. It should be recalled that competition policy itself evolves:

- John Penrose MP is looking at how the UK's competition regime can evolve to meet the Government's policy aims of promoting a dynamic, innovation-driven economy that delivers for consumers and businesses across the UK, within the context of recovery from Covid-19 and the end of the Brexit transition period;[104]
- the former Chair of the CMA proposed reforms to safeguard the interests of consumers and maintain and improve public confidence in markets;[105] and
- the Conservative Party's 2019 general-election manifesto committed to giving the CMA enhanced powers to "tackle consumer rip-offs and bad business practices."[106]

Concurrent competition powers

179. Concurrent competition powers have existed in the UK since the first sectoral regulator, the Office of Telecommunications, was established in 1984.[107] They were formalised across a range of regulators by the Competition Act 1998[108] and the Enterprise Act.[109] FSBRA gave the FCA concurrent competition functions for the first time[110] and established the PSR with concurrent competition powers.[111]

101 http://www.legislation.gov.uk/ukpga/2002/40/section/7.

102 https://www.gov.uk/government/publications/competition-impact-assessment-guidelines-for-policymakers.

103 https://www.gov.uk/government/publications/governments-strategic-steer-to-the-competition-and-markets-authority-cma.

104 https://www.gov.uk/government/publications/terms-of-reference-for-john-penrose-mp-report-on-competition-policy/terms-of-reference-john-penrose-mp-report-on-competition-policy.

105 https://www.gov.uk/government/publications/letter-from-andrew-tyrie-to-the-secretary-of-state-for-business-energy-and-industrial-strategy.

106 https://assets-global.website-files.com/5da42e2cae7ebd3f8bde353c/5dda924905da587992a064ba_Conservative%202019%20Manifesto.pdf.

107 Section 50, Telecommunications Act 1984. See https://www.legislation.gov.uk/ukpga/1984/12/section/50.

108 https://www.legislation.gov.uk/ukpga/1998/41/section/54.

109 https://www.legislation.gov.uk/ukpga/2002/40/section/205.

110 Section 129 and Schedule 8. See https://www.legislation.gov.uk/ukpga/2013/33/contents.

111 Sections 59 and 61. See https://www.legislation.gov.uk/ukpga/2013/33/contents.

180. Section 2341 of FSMA requires that neither the CMA nor the FCA exercise their concurrent powers in a matter where the other has exercised its powers.[112] However, this kind of coordination has not always worked in practice as well as intended. For example, the CMA's retail-banking market investigation[113] introduced remedies on personal current-account overdrafts that were swiftly superseded by FCA interventions.[114] We expand on the importance of regulatory coordination in answer to question 8.

181. For market studies, the FCA can "decide on a case by case basis whether to pursue" a market study under its FSMA or Enterprise Act powers.[115] We note that in all eight market studies the FCA has begun since it received concurrent competition powers, it has chosen to proceed under its FSMA powers:

- MS15/1—investment and corporate banking;[116]
- MS15/2—asset management;[117]
- MS16/1—retirement outcomes;[118]
- MS16/2—mortgages;[119]
- MS17/1—investment platforms;[120]
- MS17/2—wholesale-insurance brokers;[121]
- MS18/1—general-insurance pricing practices;[122] and
- MS19/1—credit information.[123]

182. There are understandable reasons why regulators prefer to use sectoral powers. The procedural requirements and timetables for Enterprise Act market studies are more onerous than those in FSMA. Enterprise Act market studies can last no more than six months before the regulator must either propose a market-investigation reference or begin consulting on proposed remedies. Enterprise Act market studies, from beginning to end, can last no more than 12 months. By contrast, market studies undertaken under FSMA powers are not time limited. This has led to some market studies continuing over several years. For example, the FCA's market study on mortgages began in December 2016[124] and concluded in March 2019,[125] lasting 27 months in total.

112 https://www.legislation.gov.uk/ukpga/2000/8/section/2341.
113 https://www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk.
114 https://www.fca.org.uk/news/press-releases/fca-confirms-biggest-shake-up-overdraft-market.
115 https://www.fca.org.uk/publication/finalised-guidance/fg15-09.pdf.
116 https://www.fca.org.uk/publication/market-studies/ms15-1-1.pdf.
117 https://www.fca.org.uk/publication/market-studies/ms15-02-1.pdf.
118 https://www.fca.org.uk/publication/market-studies/retirement%20outcomes%20review%20tor.pdf.
119 https://www.fca.org.uk/publication/market-studies/ms16-02-1.pdf.
120 https://www.fca.org.uk/publication/market-studies/ms17-1-1.pdf.
121 https://www.fca.org.uk/publication/market-studies/ms17-2-1.pdf.
122 https://www.fca.org.uk/publication/market-studies/ms18-1-1.pdf.
123 https://www.fca.org.uk/publication/market-studies/ms19-1-1.pdf.
124 https://www.fca.org.uk/publication/market-studies/ms16-02-1.pdf.
125 https://www.fca.org.uk/publication/market-studies/ms16-2-3-final-report.pdf.

183. As part of the FRF review, HMT should consider the continuing appropriateness of the FCA's and the PSR's concurrent competition powers. While the time limits for Enterprise Act market studies may be too stringent, placing a considerable burden on firms, HMT should consider new procedural requirements for market studies under sectoral legislation.

184. A separate risk arises where regulators are tempted to tackle competition concerns through the use of their supervisory powers. Because the supervisory focus is on larger firms, this approach can lead to an unlevel playing field and a reduction in effective competition. While this is an operational issue rather than a feature of the regulatory framework itself, it is a concern that Parliament should consider in its scrutiny of the regulators.

The balance regulators should strike between principles and rules

185. In our response to HMT's call for evidence on regulatory coordination,[126] we urged the Government in subsequent phases of the FRF review to address "the appropriate balance between principles and rules, as recently rehearsed by the chief executives of the FCA[127] and the PRA.[128]" That this issue should attract so much senior regulatory attention indicates the importance of getting it right.[129]

186. We have considered factors that may help decide the appropriate balance regulators should strike between principles-, rules- and outcomes-based regulation. The last of these is important in light of the National Audit Office's (NAO) finding in 2019 that:

> ***Regulators have not been specific enough in defining the overall outcomes they want to achieve for consumers.*** *Clear success criteria such as outcomes-based targets are vital so that industry, consumers and consumer representatives are clear on regulators' expectations and priorities and how these address consumers' key areas of concern. Regulators set broad high-level aims, such as achieving high-quality and good-value services for consumers. However, apart from targets in some specific areas, they have not defined what these high-level aims mean in practical terms . . .*[130]

187. We conclude that principles, rules and outcomes are not mutually exclusive, and none should be exalted above the others. As activity-specific legislative frameworks are introduced and the statute book rationalised, regulators should aim for an appropriate and sensible balance.

188. Principles-based regulation generally describes how firms should act. Principles tend to be qualitative rather than quantitative. An example would be FCA Principle 5 (market conduct): "a firm must observe proper standards of market conduct."[131]

189. Outcomes-based regulation describes generally high-level, broadly stated objectives that regulators would like to achieve for the consumer or broader market. For

126 https://www.ukfinance.org.uk/system/files/HMT%20call%20for%20evidence%20on%20regulatory%20coordination%20-%20UK%20Finance%20response.pdf.

127 https://www.fca.org.uk/news/speeches/future-financial-conduct-regulation.

128 https://www.bankofengland.co.uk/speech/2019/sam-woods-ubs-20th-annual-financial-institutions-conference-lausanne.

129 Principles and rules in this context should not be confused with the principles (to be set by Parliament and the Government) and rules (to be set by regulators) about which the FRF consultation makes proposals.

130 https://www.nao.org.uk/wp-content/uploads/2019/03/Regulating-to-protect-consumers-in-utilities-communications-and-financial-service-markets.pdf.

131 https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html.

example, the FCA's business plan 2020/21 states that one of the key outcomes it wants to achieve in wholesale financial markets is clean markets that make it difficult to commit market abuse and financial crime.[132] We also discuss principles- and outcomes-based regulation in our response to question 1.

190. Rules-based regulation involves describing in detail what a firm should, can or must not do when undertaking a regulated activity. Following the example of market conduct, the FCA Handbook states that a firm must report to the FCA any significant breaches of the firm's rules, disorderly trading conditions, conduct that may involve market abuse and system disruptions in relation to a financial instrument.[133]

191. Regulators use principles, outcomes and rules to communicate what they expect from firms to help them achieve their objectives. There are advantages and disadvantages to each, recognising that objectives are often in tension (e.g. encouraging innovation and competition while preserving financial stability and ensuring investor protection) and zero failure should never be the aim of any regulator.

192. Principles and outcomes have the advantage of enabling firms to decide how to comply, allowing them to choose for themselves how best to manage risk and ensure consumers are well served. They discourage "tick box" compliance and place responsibility on firms to deliver the purpose of regulation. They also allow different approaches (e.g. to operational resilience) for differing business and operating models and sizes of firm and can enable better supervision, especially where a firm provides a complex product or service that a regulator cannot be expected to fully understand (e.g. algorithmic trading). Principles and outcomes can provide greater scope for a plurality of business models to evolve, something that policymakers have generally sought to encourage. Conversely, overly prescriptive rules may unjustifiably discriminate against certain business models or limit diversity in approaches to providing services.

193. If regulators develop detailed rules for nascent markets or where technology changes rapidly, they might stifle innovation or fail to address emerging risks. This could be mitigated by frequent rules updates but at a cost to both regulators and firms. Therefore, principles and outcomes tend to work better in these circumstances. As markets and areas of regulation mature, a movement toward rules may make more sense in some cases. For example, the climate-risk stress-testing framework is broadly outcomes-based now but may evolve into rules as the most efficient and effective approach becomes clearer.

194. Another advantage of principles and outcomes is that they can help facilitate cross-border activity and cooperation. Equivalence and deference decisions are more efficient when made against principles and outcomes than against a rulebook.

195. However, the flexibility and high-level nature of principles may have downsides. They can lead to confusion, inconsistent behaviour and different evaluation of compliance between regulator and firm. The lack of stringent and consistent prudential rules before the global financial crisis arguably meant banks were less financially resilient than they needed to be, whereas the more detailed and prescriptive rules introduced since 2008 have been effective at maintaining financial resilience during Covid-19.

132 https://www.fca.org.uk/publication/business-plans/business-plan-2020-21.pdf.

133 https://www.handbook.fca.org.uk/handbook/MAR/5/6.html.

196. Principles can be simple for regulators to define and generally easy for firms to understand, whereas detailed rules are less agile and cannot possibly cover every activity or service a firm may perform or provide. For example, in the foreign-exchange (FX) manipulation cases in 2014, the FCA fined firms for breaching Principle 3 (management and control)—"a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems"[134]—in the absence of detailed rules regulating the FX market.[135]

197. However, it can be difficult for both firms and regulators to gain assurance and evidence of compliance with a principle, leading to "grey areas" and firms being unaware they are non-compliant until they are so deemed by a regulator or the FOS.

198. Rules are therefore needed in banking and finance regulation. They are useful where there are quantifiable and standardised requirements (e.g. for capital and liquidity). They can also be used to prohibit certain behaviours that can cause harm (e.g. selling and marketing speculative mini-bonds). While they can give firms clarity about what they must do to meet regulators' expectations, they can result in major change projects and inefficient processes if they are not written well (e.g. some parts of MiFID II).

199. Outcomes can bridge the gap between principles and rules, with the regulator specifying what it is seeking to achieve (e.g. the harm it is seeking to prevent). This articulation can be useful in supervising firms, where compliance is determined by what actually happens rather than implementing a process or measuring inputs. Outcomes can also be set and measured at different levels. Nonetheless, outcomes can be difficult to define and measure: what are "clean markets"? Moreover, an outcome can be the result of many inputs as well as a firm's behaviour, and some of the factors may be beyond the control or responsibility of firms, a fact that should be recognised when assessing the success of the regulatory framework in achieving said outcome.

Recognising the merits of co- and self-regulation

200. Statutory regulation is not the only approach available to regulators. In some instances where competition among providers alone is insufficient to deliver an outcome desired by society, co- or self-regulation may be a better approach.

201. Section 3(4)(c) of the Communications Act requires Ofcom to have regard to "the desirability of promoting and facilitating the development and use of effective forms of self-regulation." In December 2008, it noted that the appropriate regulatory approach to deliver its duties ranged from no regulation at all, through industry self-regulation and co-regulation, to full statutory intervention.[136] It defined these approaches as follows.

134 https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html.

135 https://www.fca.org.uk/news/press-releases/fca-fines-five-banks-%C2%A311-billion-fx-failings-and-announces-industry-wide-remediation-programme.

136 https://www.ofcom.org.uk/__data/assets/pdf_file/0019/46144/statement.pdf.

Approach	Description
No regulation	Markets are able to deliver required outcomes. Citizens and consumers are empowered to take full advantage of the products and services and to avoid harm.
Self-regulation	Industry collectively administers a solution to address citizen or consumer issues, or other regulatory objectives, without formal oversight from government or regulator. There are no explicit ex ante legal backstops in relation to rules agreed by the scheme (although general obligations may still apply to providers in this area).
Co-regulation	Schemes that involve elements of self- and statutory regulation, with public authorities and industry collectively administering a solution to an identified issue. The split of responsibilities may vary, but typically government or regulators have legal backstop powers to secure desired objectives.
Statutory regulation	Objectives and rules of engagement are defined by legislation, government or regulator, including the processes and specific requirements on companies, with enforcement carried out by public authorities.

202. Ofcom went on to describe the high-level principles to which it would refer when determining appropriate regulatory solutions, recognise that industry approaches work best where the incentives of industry are aligned with those of the public and set out five steps to help assess industry's incentives to deliver effective co- or self-regulation:

- do the industry participants have a collective interest in solving the problem?
- would the likely industry solution correspond to the best interests of citizens and consumers?
- would individual companies have an incentive not to participate in any agreed scheme?
- are individual companies likely to "free-ride" on an industry solution? and
- can clear and straightforward objectives be established by industry?

203. These steps do not apply uniquely to the communications markets regulated by Ofcom but are equally valid and comprehensive in assessing the viability of co- or self-regulation in the banking and finance sector. Here, too, statutory regulation is most appropriate in circumstances in which firms lack an incentive, in the absence of compulsion, to deliver an outcome that society expects of them. In some circumstances, however, a significant majority of firms may have their own interest in that outcome being achieved and therefore a strong incentive to commit to a self-regulatory scheme of voluntary standards that would see the desired outcome delivered without the need for statutory regulation.

204. Ofcom rightly recognised the limits of self-regulation. Unlike statutory regulation, self-regulation bears the risk, under certain circumstances, of some providers opting not to participate in the industry solution, either because they do not share other firms' and society's interest in that outcome being achieved or because they calculate that they could enjoy the benefits produced by self-regulation without facing the costs involved in participating in it. This not only means that some customers would

not benefit from the measures but also jeopardises the sustainability of the industry-led solution.

205. The difficulties encountered in the industry-led effort to deliver a long-term, sustainable funding arrangement for victims of APP fraud, in the absence of regulatory intervention, are a good demonstration of suboptimal customer outcomes being produced due to self-regulation in unconducive circumstances.

206. There are nonetheless several current examples of successful co- and self-regulation in banking and finance, in which the principles identified by Ofcom do obtain.

- **Death Notification Service**. This is a free service that allows a number of banks and building societies to be notified of a person's death at the same time.[137] The participating firms share society's interest in there being an easy and painless way for this to take place. As such, statutory regulation has not been necessary to achieve this outcome.
- **Access to Banking Standard**. Supervised by the Lending Standards Board (LSB), and supported by the Government and the FCA, the Standard is a set of voluntary commitments to which the main 12 high-street banks are party, aimed at ensuring affected customers receive notification of potential branch closures, clear reasons for the closure and proactive help in seeking to access banking via other means in the run-up to the closure.[138] Here too, customers and providers have a shared interest, in branch closures being properly communicated to local communities. Self-regulation is therefore a viable solution.
- **Standards of Lending Practice.** Also overseen by the LSB, the Standards are voluntary and set the benchmark for good lending practice in the UK, outlining the way registered firms are expected to deal with their customers throughout the entire product life cycle. The Standards for both personal and business customers cover loans, credit cards, charge cards and overdrafts, with a separate set of Standards covering asset finance.[139] This self-regulatory solution has proven effective as both providers and customers share an interest in there being high standards, clear to all parties, for lending.

207. This consideration of co- and self-regulation could be and is being applied to the future model for open banking. As open finance would be built on standards already defined for open banking, there is a strong argument for co- and/or self-regulation here, too.

208. We recommend HMT recognise the merits of co- and self- regulation in the regulatory framework. This could be achieved by assigning the same duty to regulators as that enjoyed by Ofcom. Such a duty would oblige the regulators to show they have given due consideration to the suitability and merits of co- and self-regulatory solutions to an issue when weighing the various available approaches. While this might result in a greater reliance on self-regulation in some instances, it would also help to avoid self-regulatory solutions being prescribed for circumstances to which they are ill-suited.

137 https://www.deathnotificationservice.co.uk/portal.ofml.

138 https://www.lendingstandardsboard.org.uk/other-voluntary-standards/#access-to-banking-standard.

139 https://www.lendingstandardsboard.org.uk/the-standards-for-personal-customers/.

The role of regulatory guidance

209. Guidance is a valuable component of the regulatory framework. Used well, it enables a flexible approach to achieving desired outcomes and promotes discretion in the means by which firms comply with rules. Given its non-binding nature, and in the interests of regulatory nimbleness, the FCA is rightly subject to fewer procedural requirements when issuing statutory guidance than when making rules. Meanwhile, Dear CEO letters, speeches, case studies and the like provide firms with a useful steer about the intentions behind rules and regulators' priorities. Commensurate with its status, such non-statutory guidance is not subject to any procedural requirements. Rules, statutory guidance and non-statutory guidance are all important tools in an effective regulatory system. We believe their effectiveness would be further enhanced by a clearer distinction between their respective roles.

210. The FCA's ability to issue guidance is prescribed in section 139A of FSMA.[140] When it proposes to give guidance to firms, it must consult with the PRA, publish a draft with notice that representations about the proposals may be made within a specified time and have regard to those representations before proceeding to finalise the guidance (unless it considers the delay in complying with those provisions would be prejudicial to consumers' interests). The FCA is not required to undertake a CBA in order to issue guidance as it must when making rules.

211. The Reader's Guide to the FCA Handbook explains that guidance is mainly used to:

- *explain the implications of other provisions*
- *indicate possible means of compliance, or*
- *recommend a particular course of action or arrangement.*

Guidance is not binding and need not be followed to achieve compliance with the relevant rule or requirement. However, if a person acts in accordance with general guidance in circumstances contemplated by that guidance, we will treat that person as having complied with the rule or requirements to which that guidance relates.[141]

212. In 2015, the FCA published an explanation of the purpose of guidance, stating that, "We want firms to understand what we expect of them and our guidance material makes this clear."[142] Its Enforcement Guide states:

Guidance and supporting materials are, however, potentially relevant to an enforcement case and a decision maker may take them into account in considering the matter. Examples of the way in which the FCA may seek to use guidance and supporting materials in an enforcement context include:

(1) To help assess whether it could reasonably have been understood or predicted at the time that the conduct in question fell below the standards required by the Principles.

(2) To explain the regulatory context.

(3) To inform a view of the overall seriousness of the breaches e.g. the

140 https://www.legislation.gov.uk/ukpga/2000/8/section/139A.

141 https://www.handbook.fca.org.uk/handbook-readers-guide.

142 https://www.fca.org.uk/firms/guidance-firms.

decision maker could decide that the breach warranted a higher penalty in circumstances where the FCA had written to chief executives in the sector in question to reiterate the importance of ensuring a particular aspect of its business complied with relevant regulatory standards.

(4) To inform the consideration of a firm's defence that the FCA was judging the firm on the basis of retrospective standards.

(5) To be considered as part of expert or supervisory statements in relation to the relevant standards at the time.[143]

213. The increasing impact of guidance on the FCA's supervisory activity has been evident, including on remediation it instructs firms to carry out. For example, in a final notice relating to the handling of mortgages customers in payment difficulties or arrears,[144] the FCA considered its publication of guidance on arrears handling on several occasions in prior years, including examples of good and bad practice, as an aggravating factor.[145]

214. The FCA's willingness to issue guidance as part of its approach to new and emerging areas of regulation is welcome in helping firms to comply with often (necessarily) high-level rules as the optimal way to do so may not always be obvious. Of late, we have seen the publication of guidance relating to cryptoassets,[146] outsourcing and operational resilience[147] and climate change.[148] However, there are also examples of guidance being issued in more problematic circumstances.

- To respond to the impacts of Covid-19, the FCA issued a suite of temporary and permanent guidance notes on mortgages, payment deferrals and the treatment of vulnerable customers. While we acknowledge that the FCA sought to act quickly and decisively to protect consumers, some of this guidance was issued to tight timescales leaving insufficient time for meaningful consultation (including over a bank-holiday weekend), interacted in confusing and sometimes contradictory ways with pre-existing guidance (e.g. guidance on helping mortgage prisoners[149] sat uneasily with the payment-deferral guidance) and was challenging for firms to implement.
- The FCA issued guidance on branch and ATM closures or conversions in September 2020 while firms were continuing to manage the implications of Covid-19 and after a consultation period of just two weeks.[150] Yet the guidance recognised that, "In the 2020 Budget, the Government stated its intention to introduce legislation to protect access to cash for those who need it. This guidance is not intended to overlap with, or to pre-empt any decisions regarding that legislation. We will review this guidance within the next 12 months in the light of market developments and/or the timing of forthcoming legislation and will revise it if appropriate." As such,

143 https://www.handbook.fca.org.uk/handbook/document/EG_Full_20140401.pdf.

144 https://www.fca.org.uk/news/press-releases/fca-support-customers-struggling-mortgage-coronavirus.

145 https://www.fca.org.uk/publication/final-notices/lloyds-bank-plc-bank-of-scotland-plc-the-mortgage-business-plc-2020.pdf.

146 https://www.fca.org.uk/publications/policy-statements/ps19-22-guidance-cryptoassets.

147 https://www.fca.org.uk/firms/outsourcing-and-operational-resilience.

148 https://www.fca.org.uk/publications/feedback-statements/fs19-6-climate-change-and-green-finance.

149 https://www.fca.org.uk/publications/policy-statements/ps20-11-removing-barriers-intra-group-switching-helping-borrowers-maturing-interest-only-part-and-part-mortgages.

150 https://www.fca.org.uk/publications/finalised-guidance/fg20-3-branch-and-atm-closures-or-conversions.

it was unclear why the guidance needed to be published at that time and with minimal consultation.

215. All told, the FCA's statutory guidance does not always fit the non-binding description in the Reader's Guide to its Handbook. In 2012, during the passage of the Financial Services Act 2012 that amended FSMA in relation to guidance, the Financial Secretary to the Treasury stated that firms were "able to understand and see the distinction" between "guidance on a statutory basis" and "other guidance that is not on a statutory basis.[151] However, in practice, we observe that statutory guidance is both intended by the FCA and interpreted by firms as prescriptive statements of what must and must not be.

216. This is not just a theoretical distinction. The less stringent requirements that apply to the FCA when it is issuing statutory guidance rather than making rules mean important checks and balances—not least to undertake a CBA, explain the purpose of its proposals and explain its reasons for believing they are compatible with its general duties and regulatory principles—are not in play.

217. We therefore recommend the regulatory framework differentiate unambiguously between requirements of firms, introduced following due process and subject to recourse where this is lacking, and guidance to firms, intended to demonstrate a possible path to compliance with requirements but ultimately for firms to heed as they see fit. The latter should still be subject to the principles of good regulation, including clarity of purpose and sufficiency of consultation, but there should be no scope for confusion between the two classes of communication. In particular, failure to follow guidance should be considered as neither evidence nor an aggravating factor in enforcement cases or FOS complaints.

218. Guidance of this fashion is a valuable tool for regulators and firms alike. We therefore believe it should be recognised in statute for all regulators to which the FSMA model is extended, not just the FCA. It is of most value when it is comprehensible and easily accessible, so each regulator should consolidate its guidance in a single location, much as some FCA guidance is currently to be found in its Handbook. Revisions to guidance over time should also be visible to firms, and it would be helpful if regulators held all their guidance documents centrally in a navigable format.

219. Finally, while there can be good grounds for regulators to issue guidance quickly, with minimal or no consultation, we nonetheless believe it important that stakeholders can make suggestions for improvement. One way to achieve this would be for guidance to be subject to review six months after issue in the light of experience and comments.

Forbearance

220. Section 138A of FSMA gives the FCA and the PRA the power to grant waivers and modifications, in respect of specific rules, to firms that apply for or consent to them.[152] The regulators need to be satisfied that:

- compliance by the firm with the rules, or with the rules as unmodified, would be unduly burdensome or not achieve the purpose for which they were made; and
- the waiver would not adversely affect the advancement of the regulators' objectives.

151 https://publications.parliament.uk/pa/cm201212/cmpublic/financialservices/120308/pm/120308s01.htm.

152 https://www.legislation.gov.uk/ukpga/2000/8/section/138A.

221. Regulators' ability to forbear is a valuable aspect of the regulatory framework in that it allows for a pragmatic and flexible approach to firms' individual circumstances. We recommend it be extended to all regulators to which the FSMA model is applied, particularly the BoE in its oversight of payment systems and the PSR. Moreover, regulators should exercise these powers in respect of rules introduced to implement EU legislation now that the Brexit transition period has ended.

Question 5. Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?

222. We broadly agree with HMT's proposed framework.

223. Internationally a range of regulatory models exist, giving differing roles to legislatures, governments and regulators. In his 2019 Stylish Regulation speech, the PRA's Chief Executive, Sam Woods, set out a spectrum of models for regulation differentiated by the discretion granted to regulators. He contrasted the wide discretion given to operationally independent regulators under FSMA with the way rules are made in the EU, with a large body of technical rules set out in the equivalent of primary legislation.

224. Outside the EU, most major financial-services centres provide a greater degree of discretion for regulators than is found in onshored EU legislation. As Sam Woods noted in his speech, "the EU and Switzerland were the only two members of the Basel Committee on Banking Standards where Basel 3 was implemented through primary legislation."

225. We agree with the FRF consultation that the FSMA model maximises "the use of expertise in the design of regulatory standards and ensure[s] those standards can be flexed and efficiently updated to address changing conditions and emerging risks."

Question 6. Do you think the focus for review and adaptation of key accountability, scrutiny and public engagement mechanisms for the regulators, as set out in the consultation, is the right one? Are there other issues that should be reviewed?

226. We broadly support the proposals for enhanced scrutiny of regulators, and we expand on Parliament's role in that in answer to question 7. Accountability of regulators, in particular under the law, is hugely important but a failing of the current framework. A more effective review mechanism could support the Government's stated policy objectives and enhance the UK's attractiveness as a destination for banking and finance firms.

Regulatory review

227. The FRF consultation rightly notes that "accountability of the regulators will take on greater importance when their responsibilities expand as a consequence of leaving the EU and under the proposals set out in this consultation." Given the breadth and force of the powers delegated to the regulators, their accountability under the law is hugely important. That requires an effective mechanism for regulatory review.

228. An effective and appropriately used regulatory-review mechanism is clearly desirable, not only for firms but also for consumers, as poor regulation can ultimately hamper competition and stifle innovation. As noted when the Government consulted on options for reforming regulatory and competition appeals in June 2013, "The right of firms to appeal regulatory and competition decisions is central to ensuring robust decision-making and holding regulators to account in the interests of justice. Where firms are materially affected by regulatory decisions, they should have an effective right of challenge if they consider that the regulator has made a mistake or has not acted reasonably."[153]

229. As noted briefly in the FRF consultation, the principal way in which firms can currently challenge decisions by regulators is through a formal judicial review. However, there are a number of features of judicial review that mean it is regarded in practice as neither a viable nor desirable solution for firms to pursue. In particular:

- the focus of judicial review is generally on the process by which decisions are made rather than on the merits of those decisions. Of the available grounds of challenge, it is particularly difficult to argue regulators' decisions are *ultra vires* because the FCA's statutory objectives and powers are so wide;
- the risk of jeopardising the supervisory relationship with a regulator by challenging its decision is a key barrier, with a perception among firms that this would have negative repercussions. This appears to be a key concern in other jurisdictions where firms and regulators have a supervisory relationship, but such a disincentive does not appear to arise where the regulator does not interact as closely with individual firms (e.g. in the sectors overseen in the UK by economic regulators); and
- the reputational risk from a challenge also acts as a barrier to seeking judicial

153 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/229758/bis-13-876-regulatory-and-competition-appeals-revised.pdf.

review, even where the challenge is considered to be in the interests of consumers. This is exacerbated by the relative rarity of such challenges, which means they are inevitably high profile and attract a level of publicity that may be distracting and counter-productive.

230. As a result, judicial review of financial-services regulators is rare; we are not aware of any authorised firm having successfully challenged a decision of the FCA, the PRA or the PSR. We summarised these concerns in our October 2020 response to the call for evidence issued by the Independent Review of Administrative Law Panel.[154]

231. A more effective review mechanism, addressing these deficiencies, could be a useful tool for both firms and regulators. It could support the agility and the responsiveness of the UK's regulatory framework and encourage further rigour in regulators' rule-making processes. Indeed, as the Government considers the international competitiveness of the UK's banking and finance sector, we would argue an effective regulatory-review mechanism has the potential to be a differentiating factor, enhancing the UK's attractiveness as a destination for firms.

232. We have not yet considered the detailed form that an effective mechanism for regulatory review should take. However, we have identified a number of principles that we believe should inform HMT's consideration of such a mechanism.

- **Engendering confidence.** Consideration of an effective review process should take into account the degree to which it will engender confidence, not only in the process itself but also in the wider regulatory framework, to the wider benefit of the UK. As the Government noted in its June 2013 consultation on options for reforming regulatory and competition appeals:

  There is a balance to be struck between enabling interested parties to have appropriate rights of appeal and ensuring that the system as a whole functions efficiently and enables the regulator or authority to take decisions in an efficient and timely way, to achieve its duties. A well designed and proportionate appeals process can contribute to the quality, predictability and certainty of the regulatory framework, by exposing regulatory decisions to additional scrutiny and, if necessary, correction. Conversely a poorly designed process can lead to lengthy delays and regulatory uncertainty.[155]

- **Skills and experience.** Confidence will be enhanced through the review body having the requisite skills and experience to provide effective review of and challenge to regulatory decisions. The design of the body will also be informed by consideration of the extent to which it may be required to effectively overrule regulators. Such a body would need to be both confident and capable of engendering confidence.

- **Onward appeal.** Confidence in the mechanism may also be affected by the availability and extent of any onward appeal, and so consideration should be given to how any review body fits within the overall justice system.

- **Independence.** Consideration should be given to the need for any review body to be demonstrably free from any conflicts of interest, perceived or actual, so that

154 https://www.ukfinance.org.uk/policy-and-guidance/consultation-responses/uk-finance-response-independent-review-administrative-law-call-evidence.

155 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/229758/bis-13-876-regulatory-and-competition-appeals-revised.pdf

its decisions are not tainted by factors such as bias and firms have confidence in the process as well as the outcome the process delivers. A process allowing review of certain regulatory decisions by such an independent body could also help to address any potential tension that arises from the nature of the supervisory relationship between firms and regulators. While a process involving an "in-house" mechanism may score highly in terms of accessibility and timeliness (as discussed below), it may suffer from at least a perception of a lack of independence and increased risk of damage to the supervisory relationship.

- **Proportionate accessibility.** Consideration of an effective review process should take into account the degree to which it will be accessible to all regulated firms, not just firms falling within a particular category (e.g. those with the greatest resources). It should also have regard to minimising inappropriate barriers to access while recognising that some level of disincentive may be appropriate to avoid a disproportionate level of potentially unmeritorious challenge, which may lead to saturation, delay and increased cost and constitute a drain on regulatory resource to the detriment of the wider market. In meeting the principle of accessibility, it may be appropriate to consider including a mechanism for representative bodies to challenge particularly important issues for the industry. An example of this on the consumer side is the "super-complaints" regime under section 11 of the Enterprise Act,[156] which allows a designated consumer body to make a complaint to the CMA that certain features of a market are or appear to be significantly harming the interests of consumers.[157]
- **Timeliness.** Consideration of an effective review process should take into account the need to deliver a decision within a reasonable period of time. Long delays act as a disincentive to appeals, creating a high management time cost in addition to a high monetary cost. They also harm consumers and create regulatory uncertainty. Timeliness is an important principle in view of the potentially significant impact that regulatory rule changes can have on firms and their business models. Consideration should be given to measures that minimise the potentially adverse impact that rules or rule application may have while subject to review. In view of the recognised need for the regulatory framework to respond nimbly to the fast pace of change in the banking and finance, it is important that challenge mechanisms through which in-scope decisions of regulators are reviewed are equally equipped to deliver findings in a timely manner.
- **Transparency.** Any consideration of an effective review process should take into account the appropriate level of transparency required to meet objectives, including the extent to which detailed decisions should be published and whether any degree of anonymity should be permitted.

233. In conclusion, an effective and appropriately used regulatory-review mechanism would improve the quality of regulatory decision making and confidence in the regulatory framework and benefit the UK's international competitiveness. HMT should, as part of the FRF review, use the above principles to consider the form of such a mechanism.

234. Supporting this response is a more detailed paper on these issues produced in association with Norton Rose Fulbright.

156 https://www.legislation.gov.uk/ukpga/2002/40/section/11.

157 Super-complaint powers also apply to the FCA under FSMA and to the PSR under FSBRA.

Question 7. How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?

235. Following Brexit, Parliament has an important role in scrutinising financial-services policy making and the regulators to which it delegates substantial powers. Greater Parliamentary scrutiny will require new capability, capacity and resources but should enhance the UK's attractiveness as a destination for banking and finance firms.

236. Under HMT's proposals to delegate responsibility for the design and implementation of regulatory standards to regulators, the UK Parliament will not be required to replicate the highly technical role hitherto played by the European Parliament as a co-legislator of detailed banking and finance regulation. However, Parliament has a key role to play, both in setting the statutory and policy framework in which regulators will design and implement regulatory standards and in scrutinising their delivery of regulation within that framework.

Setting the policy and statutory framework

237. Parliament's primary role already includes considering policy issues, including those related to banking and finance. In practice, it could do more to help promote and align wider public and societal objectives, such as tackling climate change, with banking and finance policy. Parliament could also play a greater role in examining the appropriate responses to emerging debates and evolving trends in banking and finance policy, such as the growing role of Big Tech firms in providing services, and international developments with potentially significant ramifications for the UK, such as the planned adoption by some jurisdictions of digital currencies. Such issues are inherently political, often involving trade-offs that regulators—with narrower mandates centred on competition, customer protection, market integrity and financial stability—are ill placed to balance. Only democratic bodies can define and mediate these trade-offs, so Parliament has a critical role to play in setting the mandates that will steer how regulators should approach these important issues.

238. At the same time, it is not always necessary—or even desirable—for banking and finance policy to reflect every change in wider public-policy objectives. The latter can alter quickly to meet rapidly changing circumstances, but predictability and operational independence are cornerstones of an effective regulatory regime.

Scrutinising the work of regulators

239. Parliament already conducts a degree of scrutiny of regulatory activity through its periodic sessions with senior regulators, but, as the FRF consultation suggests, this should be intensified and reframed much more explicitly around regulators' execution of the mandates that Parliament sets and their navigation of the key trade-offs defined above. At present, the Treasury Committee hears from a number of regulators, including the BoE and the FCA, during the course of a Parliamentary session as part of its regular scrutiny of their work. A section of these evidence sessions, or separate, additional sessions, should be reserved for considering how the regulators have discharged their mandates, with a particular focus on how they have had regard to the public-policy issues set out by Parliament in activity-specific policy framework legislation. The Treasury Committee should also consider the work of the Regulatory Initiatives Forum.

240. We do not have strong views on the precise committee structure through which this greater Parliamentary scrutiny is to be achieved. An enhanced Treasury Committee, a new sub-committee for financial services or a joint House of Commons/House of Lords financial-services committee (perhaps modelled on the Joint Committee on Statutory Instruments) are all viable models. Whichever is chosen, the additional scrutiny that Parliament undertakes in the regulatory framework will require new capability and capacity. In particular, any new committee arrangements will need resources comparable to those in available in other legislatures with such roles. Staff providing additional expertise should be drawn from a wide range of sources, including the banking and finance sector. It may be prudent to divide these additional skills and expertise into different areas (e.g. regulatory, inquiries and legislative review). To achieve this, greater transparency will be required, and budgets and financing will need to be made available.

Question 8. What are your views on how the policy work of HM Treasury and the regulators should be coordinated, particularly in the early stages of policy making?

241. Coordination between HMT and regulators is important, but the context for policy making is also important. We make recommendations to improve both.

Policy-making

242. Our response to HMT's call for evidence on regulatory coordination included two recommendations that we continue to believe would improve the quality of policy making in the regulatory framework.

243. First, HMT should establish a strategy and policy statement providing context and guidance about priorities and desired outcomes over the medium term. Section 1JA of FSMA allows it to make recommendations to the FCA about aspects of the Government's economic policy to which the FCA should have regard.[158] Section 30B of the Bank of England Act 1998 makes similar provision in respect of the Prudential Regulation Committee when considering how to advance the objectives of the PRA.[159] This was last done by way of remit letters from the Chancellor to the Chief Executive of the FCA[160] and the Governor of the BoE[161] in November 2019, but the recommendations were, by necessity, broad, requiring the regulators to have regard to Government policy on competition, growth, competitiveness, innovation, trade and better consumer outcomes.[162] Additionally, HMT could establish a strategy and policy statement providing context and guidance about priorities and desired outcomes over the medium term specifically in the banking and finance sector for all the regulators to which the FSMA model has been extended, in line with the Principles for Economic Regulation. These have subsequently been implemented for water[163] and communications[164] and twice proposed for energy.[165]

244. Second, public bodies should not propose new or revised rules without reasonable grounds to believe there is a problem. As Philip Hampton recommended in 2005, "there should be no inspections without a reason."[166] Such an approach could prevent public bodies proposing new or revised rules in banking and finance without reasonable grounds to believe there is an existing problem. This approach could

158 http://www.legislation.gov.uk/ukpga/2000/8/section/1JA.

159 http://www.legislation.gov.uk/ukpga/1998/11/section/30B.

160 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844466/FCA_Remit_2019.pdf.

161 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844467/PRC_Remit_2019.pdf.

162 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/597668/Recommendations_Financial_Conduct_Authority_Spring_Budget_2017.pdf.pdf.

163 https://www.gov.uk/government/publications/strategic-policy-statement-to-ofwat-incorporating-social-and-environmental-guidance.

164 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/817921/SSP_-_post_consultation_version_FINAL.pdf.

165 https://www.gov.uk/government/consultations/strategy-and-policy-statement and https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/943807/201214_BEIS_EWP_Command_Paper_LR.pdf.

166 https://www.regulation.org.uk/library/2005_hampton_report.pdf.

be further refined to apply to intervention in particular markets (e.g. so perceived problems in retail banking are not automatically read across to firms operating in wholesale markets). To strengthen the link between strategy and supervision, supervisors could better justify to firms why they are concerned about certain markets, products and processes.

When to use which tool

245. The regulators have several tools to achieve their objectives and the correct behaviour from firms, including making new rules, enforcing existing rules and supervising individual firms. Rulemaking is probably the most resource-efficient tool for regulators but places more burdens on firms.

246. Supervision has the advantage of being reactive and better able to take account of different business and operating models, but it is extremely resource intensive and cannot possibly reach the whole population of regulated firms. Supervision has to be focused on those likely to cause the most harm. However, harm is a subjective term, and regulators have tended to equate this to larger firms, which have consequently received a greater degree of specialised attention. Related to this, firms are concerned about increasing instances of different supervisors interpreting their actions differently, particularly in relation to vulnerability and treating customers fairly.

247. Enforcement is also very resource intensive but has the advantage that it can be used to set an example to firms of the behaviours not tolerated by regulators. Unfortunately, enforcement cases can take a number of years to conclude.

248. The FCA has existing principles of good regulation that should help it decide when to use which tool: efficiency and economy; proportionality; sustainable growth; consumer responsibility; senior-management responsibility; recognising the differences in the businesses carried on by different regulated persons; openness and disclosure; and transparency.[167] In his Stylish Regulation speech, Sam Woods set out six principles that should "should form the basis of any regulatory regime which aims to deliver safety and soundness and financial stability in a UK context": robust prudential standards; responsible openness based on international collaboration and standards; proportionality and sensitivity to business models and promoting competition; dynamism and responsiveness; consistency; and accountability.[168] In 2019, the PRA argued that the Senior Manager and Certification Regime would be the best way to deliver these principles in future, and the FCA has equally extolled the virtues of individual accountability in improving customer outcomes.

249. We remain of the view in our response to HMT's call for evidence on regulatory coordination that regulators should not make new rules unless they can demonstrate supervision and enforcement of existing rules to be insufficient to addressing the relevant issue. As the Chair of the FCA, Charles Randell, observed in a speech at the Association for Financial Markets in Europe annual conference in October 2018:

Just as governments can tend to prioritise legislation over delivery, regulators can tend to prioritise rulemaking. So we need to make sure that we don't reach for the rulemaking tool when it isn't the best response.[169]

167 https://www.fca.org.uk/about/principles-good-regulation.

168 https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/stylish-regulation-speech-by-sam-woods.pdf.

169 https://www.fca.org.uk/news/speeches/rolling-rock-cycle-deregulation-crisis-and-regulation.

250. There is read-across here to the importance of giving due regard to co- and self-regulation, which we address in answer to question 4.

Coordination between HMT and financial-services regulators

251. The FRF consultation proposes a new "arrangement whereby the regulators consult HM Treasury more systematically on proposed rule changes at an early stage in the policy-making process and before proposals are published for public consultation." We understand that this frequently happens in an informal way under the current arrangements, and we see merit in formalising this process. However, it does create a risk of politicisation and a challenge to the independence of regulators. Independence has been central to the success of the FSMA model for many years, and the Principles for Economic Regulation recognised the importance of the Government ensuring it does not interfere with day-to-day regulatory decision-making.

252. On this occasion, we believe the risks can be mitigated through enhanced transparency arrangements. For example, when a regulator publishes a consultation, it should set out what it proposed to HMT, the comments it received in response and how it reacted. Regulators and HMT should ideally also publish correspondence in situations where a regulator decides not to pursue a rule change following consultation with HMT. There will, of course, be specific circumstances where full transparency is not suitable, but these should be the exception, and the expectation should be transparent publication.

Coordination between financial-services regulators

253. The development of the regulatory framework has resulted in multiple public-sector bodies regulating banking and finance firms in ways that frequently overlap. Consequently, the scale of firms' interactions with those bodies collectively is extensive. Effective coordination between them is vital to achieving the aims of ensuring financial stability and maximising benefits to consumers.

254. Coordination is also desirable insofar as it makes it more likely regulators will work closely together when addressing issues that require their joint involvement. The joint PRA/FCA discussion paper and coordinated consultation papers on operational resilience—an issue relevant to both of their remits—are excellent examples of good practice in this regard.

255. We welcomed the launch of the Financial Services Regulatory Initiatives Forum and publication of the first Regulatory Initiatives Grid in May 2020. These delivered on the recommendations in our response to HMT's call for evidence on regulatory coordination for a shared business plan and "air-traffic control." We believe the Forum can play an important role in identifying and reducing inefficiencies in, and promoting the coherence of, banking and finance regulation.

256. We continue to believe the Government should keep in mind the merits of enabling the Forum to impose binding decisions in circumstances where its members cannot (perhaps because of statutory restrictions) individually act in the collective good.

257. Distinct from air-traffic control, we also continue to believe the Forum could play a "town-planning" role, focusing on longer-term and strategic issues that affect the banking and finance sector as a whole (e.g. the identification and coordinated resolution of major regulatory problems that result in poor outcomes for consumers and disproportionate burdens for firms alike).

258. Greater standardisation of format, functionality and taxonomy between regulators' rulebooks would also help firms, especially smaller players and new entrants, to navigate and understand the rules themselves.

Coordination with other public bodies

259. As mentioned above, multiple public bodies are able to impose requirements on banking and finance firms in ways that frequently overlap or otherwise fail to align. While the focus of the FRF consultation is on financial-services regulators, it is important to recognise the impact of these other bodies, which include the ICO, the Financial Reporting Council and numerous Government departments (e.g. the Foreign, Commonwealth and Development Office, HM Revenue and Customs, the Home Office and the Ministry for Housing, Communities and Local Government). Although financial services and financial markets are reserved matters,[170] devolved institutions also exercise relevant powers (e.g. in respect of debt and housing policy).

260. The scale of firms' interactions with these bodies collectively is extensive. Given their very different remits, the means of ensuring coordination between them and banking and finance regulators may differ, but we believe there are some general observations to be made and recommendations for improved coordination to be considered.

261. There have been some attempts at coordination between sectoral regulators in the UK in recent years. The Joint Regulators Group originally brought together the principal economic regulators[171] before being succeeded in 2014 by UKRN.[172] In total, 13 regulators are now involved, including the FCA and the PSR, and UKRN has undertaken some good work, particularly regarding consumers in vulnerable circumstances. It enables members to share experience and best practice, to work together on common challenges (e.g. in response to the consumer-debt impacts of Covid-19) and to coordinate activity to enable a joined-up approach where appropriate.

262. A specific example of good practice in coordination between public bodies is the MoU between the FCA and the ICO. Signed in 2014[173] and updated in 2019,[174] this allows for data sharing and collaboration on policy. In practical terms, the FCA asks about data-protection issues when it speaks to firms rather than the ICO contacting them separately.

263. We are unaware of equivalent arrangements between banking and finance regulators and other public bodies. We therefore make three specific recommendations for improved coordination, building on the current remit of the Forum.

264. First, the Forum's membership should be expanded. We welcomed its expansion to include the ICO and the Pensions Regulator in September 2020.[175] Greater coordination yet would be promoted by the inclusion in the Grid of initiatives undertaken:

170 See paragraph 23 of Schedule 3 to the Northern Ireland Act 1998 (https://www.legislation.gov.uk/ukpga/1998/47/schedule/3), Head A of Part II of Schedule 5 to the Scotland Act 1998 (https://www.legislation.gov.uk/ukpga/1998/46/schedule/5) and Head A of Part 2 of Schedule 7A to the Government of Wales Act 2006 (https://www.legislation.gov.uk/ukpga/2006/32/schedule/7A).

171 https://www.ofgem.gov.uk/about-us/how-we-engage/engaging-other-regulators/joint-regulators-group.

172 https://www.ukrn.org.uk/.

173 https://www.fca.org.uk/publication/mou/mou-fca-ico.pdf.

174 https://ico.org.uk/about-the-ico/news-and-events/news-and-blogs/2019/02/the-ico-and-the-fca-sign-updated-memorandum-of-understanding/.

175 https://www.fca.org.uk/news/news-stories/financial-regulators-publish-updated-regulatory-initiatives-grid.

- by the Financial Services Compensation Scheme, the Money and Pensions Service and the Open Banking Implementation Entity;
- by the Gambling Commission where relevant (cf. its January 2020 decision to ban gambling on credit cards[176]); and
- in relation to data, digital and technology policy, particularly by the Department for Business, Energy and Industrial Strategy, the Department for Digital, Culture, Media and Sport, the Centre for Data Ethics and Innovation (CDEI) and the Equalities and Human Rights Commission (EHRC).

265. Second, the Forum and UKRN should work together to promote better coordination. UKRN is a non-statutory body whose priorities are set by its members. Its work has focused on issues relevant to multiple regulators and, as such, has reduced the burden on each to consider the same issue individually. The Forum and UKRN should focus efforts on how their collective membership could better reduce the burdens they place on the firms they regulate. As members of both the Forum and UKRN, the FCA and the PSR are well placed to expedite this.

266. Third, the Forum should forge links with other public bodies able to impose requirements on banking and finance firms. This could be undertaken on a voluntary basis, collectively on behalf of Forum members and within the scope of existing powers and duties, in a manner similar to the FCA/ICO MoU. It would help to ensure other public bodies best understand the implications for firms of initiatives they plan to undertake within their own competence and so minimise instances of their being contradictory, duplicative or unduly burdensome. Many such initiatives will require a CBA, and engagement with the Forum would assist in obtaining more accurate data to inform this.

Data-protection and privacy regulation

267. In some areas, customers' interests are better upheld through cross-sectoral consumer legislation or regulation rather than by regulation specific to banking and finance. This is the case where the risks to be mitigated by regulation, and the outcomes being sought, are broadly of the same type as in other sectors. Protecting customers' data is a good example of an area that is, rightly, left to cross-sectoral regulation. There is nothing intrinsically unique about the use of customer data in banking and finance, and it is therefore right that firms should adhere to the same data-protection standards as businesses in other sectors and their customers should benefit from the same protections as those in other markets.

268. While it is right that not all regulation affecting banking and finance customers should be sector-specific, HMT should recognise this architecture leaves the potential for the expectations on firms generated by general consumer legislation to be in tension with the expectations placed on firms by regulation specific to banking and finance.

269. To date, such instances primarily arise through the interplay between aspects of data-protection and privacy regulation, overseen by the ICO, and rules set by banking and finance regulators. In particular, there can be tensions between the interests of individuals as consumers and the equally important data-protection and privacy rights of those same individuals.

176 https://www.gamblingcommission.gov.uk/for-gambling-businesses/Compliance/consultation-responses-2020/Changes-to-licence-conditions-and-codes-of-practice-on-the-use-of-credit-cards-for-gambling.aspx.

270. In our response to HMT's consultation on regulatory coordination, we raised the following examples, which remain areas of concern.

- Firms highlight a conflict between the expectations of the PRA, the FCA and the FOS that firms retain customer data for subsequent redress and information requests and the requirement under the General Data Protection Regulation to delete data when they are no longer required.[177] Redress reviews can date back 20 years, and firms can be considered liable if they do not have the records to support their decisions.
- Similarly, there is a gap between ICO's regulation of direct marketing under the Privacy and Electronic Communications (EC Directive) Regulations 2003[178] and the FCA's desire that firms actively assist customers to move from lower-value to more advantageous products. Due to (draft) ICO guidance[179] in relation to unsolicited marketing, firms may derisk their practices and cease providing communications that are in customers' best interests in the absence of guidance from the regulators on activity that they agree does not breach data-protection requirements.[180]

271. We recommend that HMT examine these specific instances and give thought to how such clashes might be avoided more generally.

272. We note the lack of effective discussion with EU data-protection authorities led to challenging tensions in the revised Payment Services Directive that are still being resolved by the industry and public authorities. We are encouraged to see the establishment of the Smart Data Working Group, which should help avoid a repetition of such issues in this specific policy area of data portability.

273. Looking to the horizon, we see that the growing application of artificial intelligence and data sharing as tools to achieve not just business objectives but also public-policy goals will bring a growing crossover between sectoral regulation and data protection/privacy. In some instances, it is likely public authorities will have similar goals and priorities, but in others, there will likely be tensions, as in the example of unsolicited marketing highlighted above. In order to provide businesses with certainty and ensure a suitable balance of individuals' data-protection rights with their consumer-protection interests, there will need to be effective coordination between sectoral and cross-cutting authorities such as the ICO (in relation to data-protection and privacy law) and the EHRC (in relation to issues of discrimination and "algorithmic bias"[181]).

177 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R0679&qid=1569669984820&from=EN.

178 https://www.legislation.gov.uk/uksi/2003/2426/contents/made.

179 https://ico.org.uk/about-the-ico/news-and-events/news-and-blogs/2020/01/ico-launches-consultation-on-draft-direct-marketing-code-of-practice/.

180 https://www.ukfinance.org.uk/system/files/HMT%20call%20for%20evidence%20on%20regulatory%20coordination%20-%20UK%20Finance%20response.pdf.

181 See, for example, the recommendations in the CDEI's recent report at https://cdei.blog.gov.uk/2020/11/27/overview-of-our-review-into-bias-in-algorithmic-decision-making/.

Question 9. Do you think there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?

274. There should be an increased role for industry input into the policy-making process, particularly in the early stages. HMT and regulators should continue to closely interact with all market participants and seek input from subject-matter expects on the more granular aspects of proposed rules.

275. Effective use of CBAs is important in ensuring the appropriate and proportionate use of regulators' powers. CBAs should analyse a full spectrum of options, assess both the incremental and cumulative impact of regulatory change and bring in international experience and independent scrutiny.

276. Regulators could be more effective in measuring their performance. They could also be more aligned in the way they interpret their duties, define success and assess performance. Regular PIRs would provide insight for future policy-making.

Stakeholder involvement

277. As regulators take on more powers, there should be an increased role for industry input into the policy-making process, especially in the early stages. By the time regulators seek stakeholder views at the consultation stage, the range of possible policy options has often been narrowed down to one preferred approach and valuable stakeholder input on alternative approaches has been missed. Firms are close to their customers and have detailed market data and a wealth of expertise on implementing regulation, all of which could be used by regulators to improve their decision-making.

278. As part of this, HMT and regulators should continue to adhere to consistent consultation obligations and practices, including standard comment windows. Greater use should also be made of specialised practitioner panels early in the policy-making process. These should consist of individuals closer to the impact of regulatory activities and technical subject-matter experts able to engage in detail on the more granular aspects of proposed rules.

CBAs

279. Like other UK regulators, the PRA,[182] the FCA[183] and the PSR[184] all have legislative requirements to publish a CBA alongside proposed rules or requirements. CBAs are a vital part of the work of regulators. As the FCA has observed, "cost benefit analysis helps us to use our rule-making powers appropriately and proportionately . . . much of the value of CBA lies in the discipline and challenge it presents to decision making."[185]

280. However, there are issues where CBAs are not undertaken or the scope or extent of the analysis is insufficient. We make eight recommendations for improving regulators' policy-making processes by enhancing the CBAs they undertake.

182 https://www.legislation.gov.uk/ukpga/2000/8/section/138J.

183 https://www.legislation.gov.uk/ukpga/2000/8/section/138I.

184 https://www.legislation.gov.uk/ukpga/2013/33/section/104.

185 https://www.fca.org.uk/publication/corporate/how-analyse-costs-benefits-policies.pdf.

281. **First, extend the requirement to conduct CBAs.** Regulators can intervene through a range of measures, not limited solely to formal rulemaking. They frequently articulate their expectations through guidance, discussion papers and other publications, and regulated firms are often expected in practice to comply fully or otherwise have a compelling explanation of why they have not done so. To that extent, not mandating CBAs for all interventions that effectively impose regulatory change can lead to incomplete assessments of their impact.

282. Equally, permitting regulators not to conduct CBAs where costs or benefits cannot be reasonably estimated or it is not reasonably practicable to produce an estimate can create a perverse situation in which regulatory interventions with significant potential impacts (both benefits and costs) may not be fully assessed merely because it is difficult to undertake an assessment.

283. Therefore, regulators should be required to conduct CBAs for all interventions, whether or not in the nature of formal rulemaking. In addition, the scope of exceptions to this requirement should be limited to instances in which there are significant extenuating circumstances rather than merely some degree of impracticality. The reasons for availing of any such exceptions should be properly and publicly evidenced.

284. **Second, conduct cumulative-impact analysis.** Banking and finance markets are complex and operate within a multiagency regulatory landscape. They can be affected not only by changes promoted by one or more regulators but also by wider regulatory or legislative initiatives. The underlying complexities of these markets cannot be fully assessed through static or standalone CBAs that focus on the immediate impacts of single policy proposals by a single regulator.

285. Therefore, CBA requirements should include a clear expectation that regulators assess both the incremental and the cumulative impact of regulatory change. In addition, CBAs should consider not only first-order impacts but also potential second- and third-order impacts, as well as feedback loops, so they are robust and effective.

286. **Third, conduct a full options analysis.** CBAs should not be permitted to focus solely on one potential option or policy approach but instead should analyse a full spectrum of options, from "do nothing" through to formal rulemaking. Within this analysis, options to adopt non-regulatory solutions or improve supervision and better enforce current rules and guidance should be clearly considered. We believe the consideration of a wide set of options will bring analytical rigour to CBAs and improve the quality of regulatory interventions.

287. **Fourth, conduct sensitivity analysis.** In the same way all forward-looking assessments are based on assumptions, CBAs are subject to limitations and potentially significant variations against forecasts. Therefore, it is important to undertake an appropriate sensitivity analysis of options to assess the range of benefits and costs under varying assumptions. Such analysis should include consideration of how each option would affect different business models. This is critical to establishing, with a higher level of confidence, that the range of benefits of a regulatory intervention will exceed the range of the costs.

288. **Fifth, conduct market assessments.** Where proposed interventions would mandate or promote the provision of new products or services, CBAs could be improved by undertaking market assessments that demonstrate there is enough interest in supplying and consuming them. This could prevent regulators from considering policy options that, while guided by the right principles, are ineffective because of inadequate market acceptance.

289. **Sixth, conduct international comparative analysis.** As a global financial centre, the UK benefits from consistency in regulation and supervision with other important centres. Even after the end of the Brexit transition period, many UK firms have a significant interest in maximising consistency of approach between UK and EU regulatory authorities. While undertaking CBAs, regulators should consider whether rules with the same policy objectives exist in other centres (e.g. the EU and the US) and include an explanation for any proposed divergence from established international standards.

290. **Seventh, conduct independent scrutiny.** There are a range of potential approaches to independent scrutiny of CBAs, from an internal review by another department to external scrutiny by an independent body, whether specific to banking and finance or economy-wide, and with the possibility of either direct intervention or simply the ability to comment on the quality of the CBAs produced by regulators. We believe HMT should look at options to increase the independent scrutiny of CBAs, with a focus on the three-lines-of-defence concept.

291. **Eighth, additional considerations for retrospective application.** Firms have in the past been concerned that regulators have acted in a retrospective manner. The FCA explicitly considered these concerns in 2015.[186] Where a regulator proposes rules or statutory guidance with retrospective effect, CBAs need to take additional considerations into account. As set out by the Solicitor General in 2002:

The Government's policy before introducing a legislative provision having retrospective effect is to balance the conflicting public interests and to consider whether the general public interest in the law not being changed retrospectively may be outweighed by any competing public interest. In making this assessment the Government will have regard to relevant international standards including those of the European Convention for the Protection of Human Rights and Fundamental Freedoms which was incorporated into United Kingdom law by the Human Rights Act 1998.[187]

292. These recommendations do not operate in a vacuum. They interact with and reinforce each other. For example, cumulative-impact analysis by itself can be informed through sensitivity and options analysis. Moreover, as an overarching principle, CBAs should adopt a risk-based approach. This would improve their effectiveness by ensuring regulatory interventions are high quality, deliver desired outcomes and minimise the likelihood of regulatory failure.

293. We are mindful that robust CBAs are a means to the end of good regulatory decision-making. They should no more frustrate that outcome through ill-considered or disproportionate application than through their neglect. But we believe adopting these measures would enhance the CBA process and provide significant additional transparency to firms, and the market as a whole, about regulators' underlying decision-making processes.

294. Supporting this response is a more detailed paper on these recommendations produced in association with Avantage Reply.

186 https://www.fca.org.uk/news/news-stories/retrospective-application-rules-feedback-call-examples.

187 https://hansard.parliament.uk/commons/2002-03-06/debates/48085a3a-8954-46cf-b7c3-0b2c0f8eddf8/RetrospectiveLegislation.

Performance measurement and reporting

295. Given the importance of the role regulators play, it is vital they work—individually and collectively—as effectively and efficiently as possible. The NAO recognised this when it observed that, "Performance measurement is important in helping regulatory organisations to make sure that they are achieving their objectives and making the best possible use of their resources. It is also important for accountability, since regulators are accountable for their activities to Parliament, to government departments, and ultimately to the public who depend on them."[188] However, when it subsequently looked at the work of regulators including the FCA, it found that they "are not sufficiently specific and targeted in setting out what overall outcomes they want to achieve for consumers, and therefore what information they need to evaluate and report on their overall performance robustly."[189]

296. The PRA, the FCA and the PSR all have a number of tools they use to measure and report on performance against their statutory objectives. But there are challenges with the way in which these approaches operate in practice that can undermine their effectiveness. We make six recommendations on how the measurement and reporting of regulators' performance could be improved:

297. **First, regulators should coordinate more closely in the way they measure performance.** Regulators are generally striving to achieve common outcomes, but there are limited means of measuring the aggregate impact of their activities. Ensuring regulators report explicitly on their collective impact on overall outcomes using predefined success criteria would greatly improve accountability and result in their working more efficiently and effectively. The Forum provides an opportunity to improve the measurement and reporting of regulators' performance in the context of the overall regulatory landscape. Such coordinated measurement and reporting would also help Parliament scrutinise regulators and may realise efficiencies in the medium term.

298. **Second, regulators should align the way they interpret their roles and duties.** Each regulator can currently exemplify how it articulates its approach, the clearest example being the FCA's mission statement. Requiring regulators to document their approach would show the traceability from statutory objectives through to tangible outcomes, through to operational activities, through to measurement and reporting of success, through to taking on board lessons learned and external feedback. Common minimum standards for translating statutory objectives into operational activities could also improve firms' understanding. These could be designed through the Forum or agreed collaboratively between regulators. To be effective, minimum standards should be detailed enough to enable firms to understand key features that would benefit from commonality across regulators (e.g. accountability model, principles of good regulation, requirement for measurable outcomes) but not so prescriptive as to require regulators to apply common approaches where they would be counterproductive.

299. **Third, regulators should predefine indicators of success that map to predefined consumer outcomes**. The NAO recommended the regulators of the utilities, communications and financial services-markets, including the FCA, should, "Work together, for example through UK Regulators Network, to develop a consistent

188 https://www.nao.org.uk/wp-content/uploads/2016/11/Performance-measurement-by-regulators.pdf.

189 https://www.nao.org.uk/report/regulating-to-protect-consumers-utilities-communications-and-financial-services-markets/.

approach to modelling and measuring regulatory influence and impact, and providing links between regulatory activities, outputs and consumer outcomes." If it is right for regulators operating in different sectors to define, deliver and demonstrate intended consumer outcomes, we believe it must certainly be so for regulators operating in the same sector.

300. **Fourth, regulators should undertake regular formal self-assessments based on a centralised template.** The main tool regulators currently use to report on their performance is their annual reports. As these are designed for all types of stakeholder and cover a multitude of topics, their content does not facilitate reflective analysis of performance against statutory objectives. A centralised template could provide a more robust vehicle for reporting performance against statutory objectives. This should be formally submitted to the Treasury Committee for scrutiny on a regular basis.

301. **Fifth, formal PIRs of policy and supervisory change should be required.** Practices related to conducting PIRs vary between and within regulators. Requiring any change to policy and/or supervision to be followed up with a PIR would ensure there is consistent reporting of the aggregate effectiveness of regulatory changes. Such reviews should revisit pre-implementation consultation papers, feedback received and CBAs, highlighting how regulatory change has delivered against intended objectives and predefined success indicators. This may highlight the need for additional or remedial action and offer the opportunity to ensure lessons are learned for future policymaking. PIRs might be conducted for a specific change (e.g. a new policy) or a suite of changes (e.g. an annual review of minor regulatory initiatives).

302. **Sixth, regulators should have additional mechanisms to receive and respond to feedback.** A less process-oriented means for external parties to provide feedback on regulators' performance, perhaps anonymously and without fear of any conscious or unconscious impact on their supervisory relationship, could encourage engagement at key moments or on more thematic topics. Practitioner panels, for example, could play an important role in ensuring there is robust challenge from industry experts to how regulators define and prioritise their activities. However, we have found firms currently lack confidence in the effectiveness of these panels. A consultation on their role, composition, approaches and effectiveness might be initiated. A greater number of specialised panels, consisting of individuals closer to the impact of regulatory activities, could improve confidence. These might be bolstered with a small number of panels dedicated to considering cross-regulator issues.

303. Supporting this response is a more detailed paper on these recommendations produced in association with Baringa Partners.