Financial Services Bill – Report Stage Briefing for MPs

This briefing has been written by Commonwealth, the Financial Inclusion Centre, the Finance Innovation Lab, and Positive Money, and coordinated through the Transforming Finance network of civil society organisations working to improve financial sector policy for people and planet.

Summary

The Financial Services Bill[1] is important in its own right, but also because it is the key first step in defining how financial sector regulation will be conducted post-Brexit. This briefing makes three key points where MPs could consider amendments during the report stage:

1. **Parliamentary accountability** – to ensure that Parliament has a proper and significant role in scrutiny of regulators of important future changes to regulation.
2. **Social and environmental purpose** – in particular to recognise the urgency and scale of the climate crisis and ensure that regulators and financial sector policy makers take climate change and the UK's international commitments on this issue into account when setting regulations and making policy.
3. **Real economy focus, not 'competitiveness'** – to prevent the introduction of 'competitiveness' as an objective for regulation, which would divert finance from its main purposes of contributing to the real economy. Such proposals have been rejected before, in recognition of the fact that it could lead to 'light touch' regulation that increases the risks to the economy from the financial sector.

1. Parliamentary Accountability

This Bill is part of an expansion of powers for the executive and regulators that the government is proposing after Brexit. The Bill would give the Treasury considerable power to amend important regulations, requiring only nominal approval from Parliament using the Affirmative Procedure - such approval has not been withheld since 1978. HMT's second phase of its review of the Financial Services Future Regulatory Framework envisages a significant expansion of responsibilities for regulators.

This increased responsibility for regulators and executive power must be balanced by greater accountability, as the government's consultation on the Future Regulatory Framework recognises. One fundamentally important step will be to ensure that Parliament has a central role in scrutinising regulators and any important future changes to regulation. This vital role that Parliament should play in providing democratic scrutiny will help to improve regulations and the work of regulators in maintaining

[1] The Financial Services Bill passed its first reading on 21st October, its second reading on 9th November, and Committee Stage on 3rd December. The Bill covers a wide range of issues, covered in the corresponding explanatory notes. HMT has prepared an impact assessment, and the House of Commons Library has produced a briefing.

Parliamentary accountability will also create greater space for consultation of stakeholders, enhanced transparency, and will serve to promote democratic debate in this critical area of policymaking. It would guard against the risk that narrowly focused industry lobbyists, particularly larger players who have the resources to influence policy outside of the public eye, have a greater say than those with broader societal or environmental concerns, as well as smaller industry players.

Enhanced Parliamentary scrutiny does not imply that the regulators' flexibility and powers to act to ensure effective regulation should be curtailed, but rather that they must be accountable when exercising these powers.

We believe the following types of amendments should be supported:

- Amendments that require regulators to submit draft regulatory rules to a specialised Parliamentary committee for scrutiny, or that mandate that such a committee be established.
- Amendments that require periodic reviews by Parliament of the accountability framework for regulators, or that empower relevant Parliamentary Committees to require the FCA to undertake investigations when needed.

2. Social and environmental purpose

The policy objectives of financial stability, economic growth and competition that have been emphasised during the preparation of the bill, while important, should not be the ultimate purpose of financial sector policy. Broader social, environmental and economic objectives need to guide all legislation in this area.

Given the scale and urgency of the climate challenge, making sure that all legislation is compatible with the government's legally binding climate commitments will be essential. The 2015 Paris Agreement sets a target of 1.5 degrees of warming compared to pre-industrial levels. According to scientists, 2 degrees of warming will be devastating for large swathes of the globe with many low-lying areas becoming uninhabitable, extremes of weather multiplying, millions of people forced to leave their homes and billions of livelihoods affected. The Bank of England has suggested that the UK bond market is currently aligned with warming of more than 3.5 degrees, which would be catastrophic.

Despite an increasing number of commitments from banks and other financial sector actors to align their activities with the Paris Agreement, recent research found that lending to fossil fuels from 35 of the biggest global banks continues to rise: it was $736 billion in 2019, up from $700 billion the year before. UK banks are currently the worst in Europe for high-carbon lending, with Barclays and HSBC investing £205bn into companies active in fossil fuels in the four years since the Paris Agreement was signed in 2015.

Part of the reason that financial institutions are not moving fast enough is that regulators and policy making departments do not sufficiently consider climate issues. For example, the Treasury's impact assessment for the Bill does not list greenhouse gas impacts as applicable, even though significant changes to how investment firms behave – the centrepiece of the Bill – are bound to have such impacts.

As the Committee on Climate Change's recent Road to Net Zero Finance report points out, climate factors will need to be incorporated into the UK's risk-weighted capital adequacy rules that are affected by this Bill. The Committee adds:

> *"As most of our core financial regulations have not been designed with climate change in mind, it is to be expected that some provisions have an unintended consequence of making the financial transition harder. Examples that were presented to the Advisory Group include Solvency II and sustainable infrastructure; Basel III and long-term green finance; the Consumer Credit Act and electric vehicles; mortgage finance rules and retrofitting; regulations covering Defined Contribution Pension Plans and illiquid assets such as sustainable infrastructure. These and other key provisions need to reviewed and remedial steps identified where material unintended barriers are discovered."*

We believe the following types of amendments should be supported:

- Amendments that ensure that regulators and financial sector policymakers take climate change and the UK's international commitments into account when setting regulations and making policy.
- Amendments that improve environmental, social and governance requirements for financial institutions and products.
- Amendments that make the proposed new regulatory framework for investment firms respond to the climate crisis, by for example making the capital requirements that will be developed for these firms penalise assets that carry large climate risks.

3. Real economy focus, not 'competitiveness'

Ultimately, the purpose of the financial sector should be to serve the real economy to support positive social and environmental outcomes. However, there is a worrying push for an alternative objective to support the 'competitiveness' of the financial sector itself to be added to existing objectives. This introduces the dangerous idea that the growth of the financial sector should be seen as an end in itself, which would undermine the role it needs to play in contributing to the real economy and supporting the considerable investment required for a just green transition. Further, as the government's Financial Services Future Regulatory Framework Review consultation document says, it can be argued persuasively that "…one of the reasons for regulatory failure leading up to the financial crisis was an excessive concern for competitiveness leading to the acceptance of a 'light-touch' approach to regulation and supervision."

We agree with the head of the FCA who said that it would be far better for the UK to focus on maintaining high regulatory standards than to introduce a 'competitiveness' mandate.

We therefore believe that amendments that encourage the UK to focus on the international 'competitiveness' of our financial services sector should be opposed.