FINANCIAL SERVICES FUTURE REGULATORY FRAMEWORK REVIEW PHASE II CONSULTATION

SUBMISSION TO HMT BY THE FINANCE INNOVATION LAB FEBRUARY 2021

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Background and summary of recommendations

The Finance Innovation Lab[1] is a UK-based charity working to build a financial system that serves people and planet – one that's democratic, sustainable, just and resilient. We support the growth of purpose-driven financial institutions, including through Lab Fellowship,[2] the world's first incubator to support financial innovators putting social or environmental purpose at the heart of their work. We work with major UK banks, through strategic partnerships with them and their staff to support greater action on climate change. We also coordinate the Transforming Finance Network[3] of civil society organisations focussed on financial sector policy.

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[1] https://financeinnovationlab.org/about-us/why/
[2] https://financeinnovationlab.org/our-work/fellowship/
[3] https://financeinnovationlab.org/transforming-finance/

We welcome this consultation, and have structured our submission in two parts. The first covers the Post-EU Framework Proposal and the questions in Box 2A on the consultation document, while the second covers Accountability, Scrutiny and Public Engagement and covers the questions in Box 3A. There follows a summary of the key recommendations we suggest.

Key recommendations on the post-EU framework

In the context of this consultation, we believe that the following actions will allow the UK to be a true leader in financial sector regulation:

- *Updating the mandates of regulators to include social and environmental goals.* We set out some examples of what new objectives could look like in our *Regulatory Compass* report.[4] We recognise that such changes would require proper democratic consultation and deliberation over an appropriate time period.
- *Rejecting any suggestions that regulators should have an objective – even a secondary objective – relating to growth of the finance industry or its global 'competitiveness'.* Such proposals would introduce 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 social and environmental outcomes. We believe it was right that such a requirement was removed from regulators in 2012, recognising that it can undermine system stability – and also other social and environmental purposes – and will always provide grounds for actors that seek to weaken of regulatory frameworks.
- *Significantly strengthening the connection between the policy objectives for regulation to be set by parliament, and the regulators' requirements to abide by this.* 'Having regard' to these key objectives will not be enough, we believe: there need to be stronger mechanisms to ensure that regulation is anchored in the ultimate policy outcomes, including clear metrics for assessment, while allowing regulators flexibility to adapt to changing circumstances.

Key recommendations on accountability, scrutiny and public engagement

In the context of this consultation, we recommend the following actions:

- *Developing a best practice transparency policy for regulators* encompassing both procedural transparency, such as timely and proactive dissemination about key decision-making processes, and information transparency.
- *Improve methods of stakeholder participation and public engagement*, including greater use of deliberative approaches such as stakeholder groups and citizens panels and ensuring that at least fifty percent of the participants of stakeholder groups should not be financial services industry participants. We support the proposal in the consultation document for an external independent scrutiny function, which could be operationalised along the lines of the proposal for a Supervisory Board to monitor the functioning of the regulators, consisting of stakeholders with no direct links to the regulators themselves or the firms they regulate.
- *Strengthening integrity within the regulatory system,* including by redesigning whistleblower policies to emphasise their value to the integrity of the system and ensure

[4] The Finance Innovation Lab, 'The Regulatory Compass. Towards a Purpose-Driven Approach to Financial Regulation', 47.

their anonymity and safety, instituting an effective policy to prevent a 'revolving door' between regulators and the industries they regulate, and ensuring full registration of lobbyists and public records of their meetings with officials.

- *Supporting effective parliamentary scrutiny* including ensuring proper resources for Parliamentary Committees to hold regulators to account, conduct independent inquiries, and scrutinise proposed regulatory changes.

1. The Post-EU Framework proposal

We have carefully considered the five questions posed in the consultation document in Box 2A and have tailored our submission to answer them under key headings.

The objectives of regulators and the regulatory perimeter

We consider this issue first, because we believe that it is fundamentally important - and an opportunity for the UK be a true global leader - for the statutory objectives of the regulators to be updated to emphasise the social and environmental purpose of regulation.[5] As our major 2018 report, *The Regulatory Compass*,[6] sets out, the current system tends to focus on minimising the risk of bad individual outcomes, such as consumer detriment or bank failure, rather than on promoting good system-wide outcomes, such as adequate financial provision for aging populations, contributing to ending poverty or meeting key commitments such as the sustainable development goals or the Paris climate accord.

Regulation can, as a result, be too narrowly focussed and pay insufficient attention to many of the most important outcomes that the financial system should be geared towards. This is not surprising as the current regulatory focus on system stability, market functioning and competition, integrity and consumer protection is quite narrow. As the climate crisis proves, for example, this narrow focus does not guarantee good overall outcomes for the economy, society and environment. The Bank of England has made commendable progress in highlighting climate issues through creatively redefining its financial stability mandate. However, we believe it would show true leadership, and be far clearer and more effective, to accept that climate is a critical outcome that regulators should prioritise in its own regard, particularly given the scale and urgency of the crisis. A requirement for regulators to align regulation with net-zero emissions and the goals of the Paris Agreement would do this. Financial exclusion is another key area where a focus on outcomes is an opportunity to show real leadership. The market too often excludes those with 'consumer vulnerabilities' such as physical disabilities, or poor mental health, by increasing costs due to perceived increased risks, not making products that serve their needs or by simply excluding them altogether.[7] The same argument can be made for other key social priorities such as ending poverty or rebalancing the economy. Showing leadership by integrating good social, economic and environmental outcomes into regulators' objectives would also improve market functioning

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[5] We believe this is a prerequisite for achieving the objective set out in the consultation document of "making sure the regulators effectively internalise the full range of relevant public policy issues."

[6] The Finance Innovation Lab, 'The Regulatory Compass. Towards a Purpose-Driven Approach to Financial Regulation' (London, 2018), https://financeinnovationlab.org/wp-content/uploads/2018/06/Regulatory-Compass.pdf.

[7] See for example, https://www.tnlcommunityfund.org.uk/media/documents/research/Understanding-the-decision-making-of-people-experiencing-financial-exclusion.pdf?mtime=20190122144746

by giving consumers and market participants the information and tools to choose financial services that support rather than detract from objectives that matter to them.

We agree that the regulatory perimeter should be defined flexibly so that regulators can adapt and prevent problems caused by new activities or business models that fall outside existing perimeters, or 'fall between the cracks' of different regulatory remits. However, it is also vitally important to ensure that the overarching aim of holding the financial system to its overall social and environmental purposes does not fall between those cracks. The distinction between prudential regulation and consumer regulation currently leaves a grey area when it comes to the wider social and environmental outcomes of finance – such as support for the productive economy or compatibility with the UK's obligations under international climate agreements.

What would expanding the regulators' outcomes focus to be explicitly oriented towards social, economic and environmental outcomes mean in practice? It would mean having regulatory objectives that go beyond market efficiency or consumer detriment, as highlighted above. It would mean paying explicit attention to the mission, ownership, governance business model and culture of regulated entities – and treating the presence of a wider social purpose embedded in a financial institution as an asset to be nurtured. It would also mean extending the regulatory horizon – to focus on longer term outcomes,[8] which will be crucial as we face up to the challenge of climate change, the destruction of the natural world[9] and other global issues including pandemics.

The global financial crisis of 2007-8 resulted in one welcome shift in this direction by recognising the importance of overall financial stability as a key objective for regulation. As the consultation document says, this crisis "…revealed serious flaws in the UK's system of regulation" including that "no part of the [regulatory] framework had responsibility for monitoring the crucial link between the stability of individual firms and the stability of the financial system as a whole." The Bank of England is currently leading discussions about how regulators should respond to the fact that climate change is also a systemic issue, but one with far greater consequences than the global financial crisis. This consultation provides an opportunity to take the next logical steps to properly incorporate social and environmental purpose into the mandate of regulators to ensure they are guided by the outcomes the system is intended to produce, in the same way that they have responsibility for reducing systemic risk. While the climate crisis proves the urgency of re-orienting regulation towards public value outcomes and the need to be proactive in a world of 'radical uncertainty',[10] this is also true of the full range of environmental challenges set out in the Sustainable Development Goals, as well as issues of poverty, inequality and just transition.[11]

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[8] Mark Carney, 'Breaking the Tragedy of the Horizon – Climate Change and Financial Stability' (Lloyd's of London, 2015), https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability.pdf?la=en&hash=7C67E785651862457D99511147C7424FF5EA0C1A.
[9] Partha Dasgupta, Großbritannien, and HMT, *The Economics of Biodiversity: The Dasgupta Review.*, 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/957291/Dasgupta_Review_-_Full_Report.pdf.
[10] Hugues Chenet, josh ryan-collins, and Frank van Lerven, 'Climate-Related Financial Policy in a World of Radical Uncertainty: Towards a Precautionary Approach', *SSRN Electronic Journal*, 2019, https://doi.org/10.2139/ssrn.3520224.
[11] Simon Dikau, Nick Robins, and Matthias Täger, 'Building a Sustainable Financial System: The State of Practice and Future Priorities', *Banco de España Financial Stability Review*, no. 37 (2019): 99.

This shift to a system of regulation oriented to social and environmental purpose should be seen as an acceleration of existing trends and best practices. A recent study of the mandates of 135 central banks found that 12% already have explicit sustainability mandates, and an additional 40% have a mandate to support government policy priorities, including sustainability goals. [12] In the UK, the FCA's 2017 restatement of its mission to include the concept of 'public value' as part of its objective, shows a welcome willingness to move in this direction, as do moves to focus on good outcomes for consumers beyond just consumer protection.[13] Prudential regulators are also increasingly aware that the social and environmental impacts of finance cannot be assumed to be outside the scope of regulation, at least in as much as issues such as climate change impact on financial stability. As noted above, the Bank of England has taken a leading role in raising the responsibilities of regulators in relation to climate change.

These are welcome developments, and this Review represents a critical opportunity to go further, and allow the UK to become an admired global leader. UK regulators – and the policymakers who instruct them – have a golden chance to develop a more explicit, rounded and substantive concept of what social and environmental purpose (or 'public value') means in the context of financial services which can act as a compass which guides regulation at every level, including crucially being embedded in the objectives of regulators.

Division of responsibilities

The proposed division of responsibilities between Parliament, Treasury, and financial services regulators is logical, and we agree that the delegation of "a very substantial level of policy responsibility" to regulators requires significant strengthening of the mechanisms by which regulators are held to account for meeting the purposes of regulation. We support the need for legislation to set out the purpose, scope, and core elements of the regulatory approach, but for this legislation to have the necessary impact in guiding regulation, a firmer framework will be needed to tie the regulators to these policy purposes and principles. The proposal that the regulators should only explain how they 'have regard to' these purposes is, we believe, too weak, particularly given the incomplete scope of their current overall objectives highlighted above.

The Financial Services Bill, as the first legislative example of the new approach, suggests some weaknesses with regards to how such framework legislation treats social and environmental issues. For example, the main focus of the bill – a new prudential regime for investment firms – gives a very limited list of public policy issues that the FCA must 'have regard to' including the UK's global share of the market.[14] Social and environmental issues are not mentioned, nor are implications for the stability of the system as a whole, which we hope does not signal a regression from the direction of travel since the global financial crisis, noted above. This suggests that there is a need for these critical purposes of financial sector regulation to be set out in an overarching piece of legislation which would apply to all

[12] Simon Dikau and Ulrich Volz, 'Central Bank Mandates, Sustainability Objectives and the Promotion of Green Finance', *SOAS Department of Economics Working Paper*, no. No. 232 (January 2020): 1.
[13] FCA, 'FCA Mission: Approach to Consumers' (FCA, 2018), https://www.fca.org.uk/publication/corporate/approach-to-consumers.pdf.
[14] "the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active investment firms to be based or to carry on activities" - https://publications.parliament.uk/pa/bills/lbill/58-01/162/5801162.pdf

future legislation on sub-sectors of finance. This would complement the proposal above to include social and environmental issues in the statutory objectives of regulators.

Setting the system-level metrics by which regulators are judged and on which they should report regularly to Parliament as a central feature of the proposed framework legislation would also offer the UK the chance to play a real leadership role. Whole-system metrics can be set at a macro or sectoral level. For example, key measures of systemic risk can include leverage ratios, asset and risk concentration, system complexity, and diversity of ownership, funding and business models for financial sector firms.[15] To these can be added metrics that assess the social and environmental impact of the financial system as a whole, such as the extent to which it allocated funding to environmental and social 'bads' such as expanding fossil fuel production, or 'goods' such as boosting investment in underserved regions. Sectoral level metrics could include, for example, the proportion of money creation and lending allocated by the banking sector to the productive economy, or metrics assessing the adequacy of retirement incomes provided largely by the pensions system. Such metrics should also include indicators that underpin wellbeing factors such as the creation of decent jobs across all regions, or the degree of bias in financial sector outcomes against people of colour.

By ensuring that Parliament and HMT, in their interaction with regulators, focus on the ultimate purposes of regulation, this would 'cascade' down through every level of regulation, for instance being reflected in the information that regulators require firms to disclose. This will be necessary to gain a full and accurate picture of how well the system is serving its purpose. This means, of course, that the proposed enhanced collaboration between HMT and the regulators should be based upon the extent to which the regulators are aligning to overall policy goals, and should not be about micro-management of the regulators by the government.

However, we strongly believe that the government should resist pressure from some sources within the industry for any regular automatic review and updating of regulation for two reasons. Firstly, the flexibility that the Post-EU framework gives to regulators to interpret and adapt regulation to changing circumstances and threats should not be confused with flexibility to amend and alter the framework itself, which must be set through democratic means and with broad consultation. Secondly, regulatory frameworks should seek to be 'strong and simple,' but the two must go together – simplifying regulation should only be done if it also strengthens the impact of that regulation. In addition to shifting distribution of costs and having an impact on systemic risk, complexity of regulation can be a recipe for giving advantages to large players, and for increasing the influence of these players and their lobbyists over regulatory outcomes, and reducing the ability of non-industry interests to engage. The EU system that we are leaving had well documented problems in this regard,[16] and this consultation represents an opportunity for the UK to lead by raising standards. A push from certain actors in the industry to see Brexit as an opportunity to move to more 'light' touch regulation or to deregulate must be resisted.

[15] Christine Berry, Josh Ryan-Collins, and Tony Greenham, 'Financial System Resilience Index' (New Economics Foundation, 2015), https://neweconomics.org/uploads/files/70470851bfaddff2a2_xem6ix4qg.pdf.

[16] Jan Beyers and Sarah Arras, 'Who Feeds Information to Regulators? Stakeholder Diversity in European Union Regulatory Agency Consultations', *Journal of Public Policy* 40, no. 4 (December 2020): 573–98, https://doi.org/10.1017/S0143814X19000126.

As we know, regulation's ultimate purpose is not to enhance growth or profitability of the financial sector, but rather to ensure that the sector is able to innovate and develop in such a way as to maximise its contribution to the economy and society and its long term social and ecological sustainability. The strength, robustness and effectiveness of regulation must always be the top priority. The same is true for innovation, which may provide societal benefits when it allows, for example, greater opportunities to make sustainable investments, but can also create serious risks, as we saw with the greatly increased opacity and complexity of the system created by much 'innovation' in advance of the global financial crisis.

This is particularly important given the evidence that excessive growth of the financial sector is bad for the real economy.[17][18] There is a rich literature in this area, and a debate about what size of financial sector might be regarded as 'too large'. One estimate is that the financial sector reaches its optimal size when credit to the private sector is equivalent to around 90-100% of GDP,[19] significantly lower than the UK average. The reasons for this are varied, but include the drain of skilled workers into the financial sector which can harm research and development in particular,[20] one of the government's top priorities. A too-large financial sector is also likely to lead to a reduction in focus on the sector's main aim of providing finance to support the sustainable development of the real economy. One estimate, for example, is that bank lending to non-financial businesses is only 18% of total lending, and only 12% if the real estate sector is excluded.[21]

For this reason, we strongly believe the any suggestion that regulators should have an objective – even a secondary objective – relating to[22] growth of the finance industry or its global 'competitiveness' should be rejected. Such proposals would introduce 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 social and environmental outcomes. As the 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." Learning the lessons from the global financial crisis led to competitiveness being removed from the list of things that regulators should have regard to in 2012. We fully 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.

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[17] Stephen G Cecchetti and Enisse Kharroubi, 'Why Does Financial Sector Growth Crowd out Real Economic Growth?', n.d., 31.

[18] Jean-Louis Arcand, Enrico Berkes, and Ugo Panizza, 'Too Much Finance?' IMF Working Paper, no. WP 12/161 (2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12161.pdf.

[19] Arcand, Berkes, and Panizza.

[20] Cecchetti and Kharroubi, 'Why Does Financial Sector Growth Crowd out Real Economic Growth?'

[21] https://www.bankofengland.co.uk/-/media/boe/files/speech/2017/are-firms-underinvesting-and-if-so-why.pdf?la=en&hash=96588BB2D1AEEA1C13C0E2E159962B2B3E505DD4

[22] The Financial Markets and Services Act 2000 required the FSA to 'have regard to' "the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom." This duty was not passed on to the FSA's successors by the 2012 Financial Services Act.

Finally, we would like to stress that global standards are a minimum benchmark, and should not be seen as the end to which regulation should converge. It should be expected that UK regulation will go well beyond such standards in order to protect the integrity and reputation of the UK financial system, and deliver on social and environmental outcomes. When new international standards are agreed, UK regulation will of course need to be adjusted upwards if it does not meet these standards. Pressure to 'ratchet down' regulation to meet such minimum benchmarks should, of course, be resisted.

We believe a positive vision of the UK as the world's most trusted and respected financial centre, based on leadership on social and environmental outcomes, and unimpeachable integrity and transparency is the future. The alternative – a remit to enhance 'competitiveness' for its own sake would be a huge step backwards, leading the regulator to be torn in different directions as firms can always make the case that de-regulation is needed to become 'competitive.'

Regulating Purpose-driven institutions

We believe the government should consider alternative models for regulating truly purpose-driven institutions, to recognise that they will require a different regulatory framework to allow these institutions to thrive and the diversity, resilience and competition within the system to improve. Purpose-driven financial institutions are those which embed social and environmental purpose into their mission, supported through their ownership, governance, culture and leadership. Unlike many other leading economies, where such organisations are a bedrock of the financial system, the UK's ecosystem of purpose-driven financial institutions is currently small.[23] We submit that a key objective of any post-EU framework should be to significantly grow the ecosystem of purpose-driven financial institutions to deepen the diversity of the system, embed good outcomes into the DNA of institutions within the system, and strengthen the stability of the system.

This would recognise that the mission, incentives and culture that are built into such institutions are a very powerful way of ensuring that regulatory objectives are met – often more powerful than direct regulation itself. For example, the mission of the nascent network of Mutual Banks is to serve and create value in the different regions and localities of the UK in a sustainable way, based on the German Sparkasse model, where their stability and prudence are underpinned by mutual supervision and joint liability. Another example are credit unions, which work not for profit, but for the interests of their members. [24] We have set out in a recent report the current status of the purpose-driven banking sector in UK, examining the barriers to its growth, including regulatory barriers.[25]

We support the recent suggestion by the Chief Executive of the Prudential Regulation Authority[26] that there should be a new regime for smaller banks and building societies, and

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[23] Gemma Bone-Dodds, 'Barriers to Growing the Purpose-Driven Banking Sector in the UK' (Finance Innovation Lab, 2020), https://financeinnovationlab.org/wp-content/uploads/2020/12/Purpose-Driven-Finance-Finance-Innovation-Lab.pdf.

[24] C. V. J. Simpson, *The German Sparkassen (Savings Banks): A Commentary and a Case Study* (London: Civitas, 2013).

[25] Bone-Dodds, 'Barriers to Growing the Purpose-Driven Banking Sector in the UK'.

[26] https://www.bankofengland.co.uk/speech/2020/sam-woods-city-banquet

believe that this approach of tailoring regulation to institution type, and also thereby increasing diversity and competition within the sector, should be expanded to cover purpose-driven financial institutions. As a recent APPG report has noted, diversity is not just good for consumer choice but also enhances financial stability.[27] A review of competition policy to take account of institutional type and diversity of provision, would be a welcome complement to this, as genuine competition requires a diversity of providers with different business models for consumers to choose from.

2. Accountability, Scrutiny and Public Engagement

We have carefully considered the five questions posed in the consultation document in Box 3A and have tailored our submission to answer them under key headings.

Transparency

Central to all improvements to accountability, scrutiny and stakeholder participation will be improvements in transparency, and we trust that this will be included in the next stage of the Review given its centrality to all forms of public engagement and accountability. Previous FCA research has examined the benefits of regulators demanding transparency by regulated entities,[28] but in the context of this consultation, the focus should be on the transparency of the regulators themselves. The main transparency principle – which is the rationale for UK freedom of information legislation – is that people have a right to know about the activities of public authorities, unless there is a good reason for them not to. Transparency underpins meaningful participation, is an important tool in combating corruption and is of course, central to democratic accountability, and ensuring public trust.[29] In this context, transparency should be understood as the transparency of regulators to the general public both in terms of procedural transparency and transparency of information.

Procedural transparency means ensuring that the process by which key decisions are made – on the design of new regulatory standards for example – should be transparent to the public. This means disseminating information which facilitates informed participation by interested stakeholders in decision-making in a timely fashion, and in a manner that ensures that those affected and interested stakeholders can effectively access and understand it. This would include public access to key meetings and transparency in the process for selecting senior leaders.

The key to effective transparency of information is shifting to a presumption of disclosure. We agree with the Committee for Standards in Public Life that the regulators need to balance "the demands of their role and protecting sensitive information whilst also seeking to be as transparent as possible by not withholding information from the public."[30] A presumption of disclosure, which has been adopted as best practice by organisations

[27] https://www.cbbsappg.org.uk/diversity-in-banking-services-written-evidence/
[28] https://www.fca.org.uk/publication/research/oxera-transparency-report.pdf
[29] See, for example, Christine Kaufmann and Rolf H. Weber, 'The Role of Transparency in Financial Regulation', *Journal of International Economic Law* 13, no. 3 (1 September 2010): 779–97, https://doi.org/10.1093/jiel/jgq037.
[30] Great Britain and Committee on Standards in Public Life, *Striking the Balance: Upholding the Seven Principles of Public Life in Regulation Report.*, 2016, vii.

including the World Bank,[31] means that public institutions assume that they should publish information and documents about their activities, policies and practices and only withhold information under a limited regime of exceptions. In other words, regulators should work on the assumption that key documents should be published, but would be able to make a case for keeping any particular document secret, or for redacting parts of it. Transparency policies would provide a clear list of public and private interests that may override this right of access. In the case of financial sector regulation, where regulatory decisions can of course impact billions of pounds of investments, and sometimes more, we would expect that this list would allow for carefully considering the market impact of transparency. The point is not that all information should be publicly available, but rather that there should be no assumption that it should be kept secret. As the Committee on Standards in Public Life has recommended, regulators should ensure that "any pertinent information on regulated entitles is published once it is no longer sensitive."[32]

Regulators will also need to devote adequate resources and energy to ensuring effective dissemination of information, proper implementation of their transparency policies, and to building a culture of openness. This would of course, lead to a modest increase in costs but the evidence shows that improvements in transparency can also lead to greater efficiencies, in addition to improving the inputs received and broadening the range of stakeholders who can engage.[33]

We are unaware of any such transparency policies for any of the various regulators of the UK financial sector, so call for the development of such a policy as part of this process.

Stakeholder participation and public engagement

As the consultation document highlights, effective accountability and legitimacy depend on stakeholder participation and public engagement. This will be supported by accountability to Parliament, which we will cover later.

A recent thorough review of the evidence designed to provide a 'Field guide'[34] for regulators on these issues concluded that there were five key principles that regulators should follow to ensure effective engagement:

1. *Engage and inform the public early and often*, as "interactions between regulators and the public are much more meaningful if they occur early in the process, perhaps as early as the priority-setting, or agenda-setting, stage."
2. *Practice procedural fairness and neutrality in every public interaction*, as this is the key to ensuring greater public trust and support.

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[31] The World Bank, 'Towards Greater Transparency Through Access to Information. The World Bank's Disclosure Policy' (Washington D.C.: World Bank Group, 2009), http://documents1.worldbank.org/curated/en/241111468161347673/pdf/511890BR0REVIS101Official0Use0only1.pdf.
[32] Great Britain and Committee on Standards in Public Life, *Striking the Balance*, vii.
[33] See for example: Kaufmann and Weber, 'The Role of Transparency in Financial Regulation'; Jennifer Nash and Daniel E Walters, 'Public Engagement and Transparency in Regulation: A Field Guide to Regulatory Excellence', June 2015; Jens Forssbaeck and Lars Oxelheim, *The Oxford Handbook of Economic and Institutional Transparency* (Oxford University Press, 2014); Stephan Grimmelikhuijsen et al., 'Can Decision Transparency Increase Citizen Trust in Regulatory Agencies? Evidence from a Representative Survey Experiment', *Regulation & Governance* n/a, no. n/a (2019), https://doi.org/10.1111/rego.12278; OECD, 'Public Sector Transparency and the International Investor', 2003, https://www.oecd.org/investment/investment-policy/18546790.pdf.
[34] Nash and Walters, 'Public Engagement and Transparency in Regulation: A Field Guide to Regulatory Excellence'.

3. *Strive towards diversity of viewpoints and experience* as this is key for both learning and improving outcomes as well as supporting legitimacy. In particular, it is important for regulators to go well beyond the viewpoints of industry groups, to ensure engagement with civil society groups representing consumers, citizens, workers, and social and environmental concerns.
4. *Choose methods that fit the purpose.* For example, comment periods can be useful for gaining understanding of those most directly affected, particularly the industry, but to gain input and understanding of broader issues and affected citizens, deliberative approaches such as stakeholder groups, citizens panels and juries can be more effective.
5. *Embrace an ethic of experimentalism and evaluation*. Ensuring proper engagement, transparency and accountability can be difficult and it is easy for regulators to revert to ineffective 'tick box' efforts. As the OECD has noted, collecting data and evaluating impacts in terms of increased legitimacy and better policy outcomes, among other things, is also critically important.[35]

Improvements to stakeholder participation are crucial, in particular ensuring effective participation from a diversity of perspectives, especially those representing the broader public, and those with a social and environmental focus. It is critical here to consider carefully how marginalised and under-represented groups can be supported to participate. This is particularly important given the evidence of how the financial system discriminates against people of colour, for example.[36] This is an area where the UK could show real leadership, particularly given the well documented problems at EU level. One key study of several thousand EU agency consultations found that the large majority of submissions received in public consultations come from regulated industries, and in 85% of cases non-business interests represent less than 10% of submissions.[37]

Providing resources for civil society groups representing citizens and social and environmental concerns to engage will be important. Public interest groups face issues of capacity which can undermine their ability to participate. The technical complexity of much financial regulation can make it necessary to for regulators to invest in identifying and explaining the salience for social and environmental issues of regulatory changes.[38] To use a topical example, envisaging Open Finance in terms of a straightforward relationship between firms and consumers misses the secondary impacts on third parties, and on society more broadly. For example, digitisation in finance puts pressure on non-digital infrastructure - such as in-person branches or postal applications – which are most needed by poorer people, who face greater harm if that infrastructure disappears. We explore this issue further in our

[35] http://www.oecd.org/gov/digital-government/agenda-workshop-digital-government-indicators.pdf
[36] Omar Khan, 'The Colour of Money Report. How Racial Inequalities Obstruct a Fair and Resilient Economy' (Runnymede, 2020), https://www.runnymedetrust.org/uploads/publications/pdfs/2020%20reports/The%20Colour%20of%20Money%20Report.pdf.
[37] Beyers and Arras, 'Who Feeds Information to Regulators?'
[38] Stefano Pagliari and Kevin Young, 'The Interest Ecology of Financial Regulation: Interest Group Plurality in the Design of Financial Regulatory Policies', *Socio-Economic Review* 14, no. 2 (1 April 2016): 309–37, https://doi.org/10.1093/ser/mwv024.

recent report.[39] One good idea is for communities facing the highest risk of discrimination, vulnerability and exclusion to be represented by 'Citizen Ambassadors' –responsible for making sure the financial system develops in a way that supports equality and human rights.

Embedding social and environmental purpose into the regulators' objectives will be important for this, as it would help avoid the potential for such efforts to become tick box exercises. For example, we noted with concern that in HMT's impact assessment for the Financial Services Bill,[40] greenhouse gas impacts are listed as not applicable, even though significant changes to how investment firms behave – the centrepiece of the Bill - are bound to have such impacts.

We welcome that the consultation document focuses on the public rather than just the direct consumers of financial services as this ensures a framing that can capture the full economic, social and environmental impact of regulation. The new framework will need to include a stronger, clearer definition: currently, what is meant by the 'public' can be interpreted very narrowly, or can bias towards consulting industry representatives rather than representatives of the general public and their concerns. For example, the AI Public-Private Forum[41] includes only one civil society organisation, the Alan Turing Institute, and none that focus specifically on broader social and environmental issues or consumer representatives.

As noted above, deliberative approaches such as stakeholder groups, citizens panels and juries are important for gaining understanding of broader social and environmental impacts of regulation. Such groups also give different stakeholders the opportunity to learn, understand and develop views on the trade-offs inherent in policy making, allowing a more nuanced, better informed discussion. UK regulators are experimenting with these approaches, for example through the Bank of England's citizen's panels, and the FCA's Financial Services Consumer Panel. We welcome these moves and believe that they should be significantly expanded and improved. The composition of these groups should be expanded to include greater input from civil society groups with social and environmental mandates, and it will be important to make sure that the voice of consumers is given equal weight with that of industry, which is, of course, better resourced to lobby regulators. We note that the FCA's statutory panels are largely mechanisms for gaining input from industry, with only the Financial Services Consumer Panel (FSCP) for consumers, with limited powers. We note that the FSCP's public engagement ebbs and flows. Strengthening the resourcing and independence of the non-industry panels would be a true example of global leadership, as would requiring and resourcing them to report to the Treasury Select Committee annually on their views and concerns.

One sensible proposal is that participation mechanisms such as stakeholder groups should be a maximum of 50% industry representatives and at least 50% representatives of citizens and public interests including social and environmental groups. This protects against the

[39] Marloes Nichols, 'Lifting the Lid on Fintech. What Does New Technology Mean for a Financial System That Serves People and Planet' (Finance Innovation Lab, 2020), https://financeinnovationlab.org/wp-content/uploads/2020/11/Lifting-the-Lid-on-Fintech-Finance-Innovation-Lab.pdf.

[40] https://publications.parliament.uk/pa/bills/cbill/58-01/0200/FS%20Bill%20Impact%20Assessment%20-%20October%202020%20-%20201020.pdf

[41] https://www.bankofengland.co.uk/-/media/boe/files/minutes/2020/artificial-intelligence-public-private-forum.pdf?la=en&hash=516A86FA2353EFFBC518D9FD6F7EB707CD970221

very real issue that stakeholder groups can end up merely replicating the views of the industry lobby.[42] This approach is already being used elsewhere. For example, only 13 out of 30 representatives in the EU's Securities and Markets Stakeholder Group are financial market participants.[43]

The consultation document specifically highlights a potential external independent scrutiny function. We would support such a function which should be designed to fill the key current gap in input from a broader range of societal interests. One strong proposal, made by eminent expert Professor Prem Sikka is that this should be a Supervisory Board, to monitor the functioning of the regulators, consisting of stakeholders with no direct links to the regulators themselves or the firms they regulate.[44] The danger that it could end up being another mechanism for gaining input from the industries regulated must be avoided, such as by adopting Professor Sikka's approach, or the proposal above to ensure that the majority of such bodies are not from the financial services industry.

In the spirit of showing leadership, we would welcome a thorough review of consultation policies for regulators, to ensure that best practices are followed. Best practices include allocating enough time for the process, particularly for major changes, and recognising that quality normally trumps speed: regulators are aiming to make changes where impacts have been carefully considered and stakeholders properly consulted. Also centrally important will be addressing relevant policy objectives and economic, social and environmental implications of proposed changes. Early-stage consultations on purpose and principles, and setting out implications in simple terms are also important.[45] As a recent review of government consultations noted, there is "much work" to be done to ensure government consultations meet best practice, and HMT and the financial regulators are not exempt from this critique.[46]

The consultation document notes the need to conduct regulatory impact assessments, and we would welcome efforts to strengthen social and environmental impact assessments within these or, where appropriate, conducted in addition. It is often valuable, where large social and environmental impacts are anticipated, to ensure independence in this process, as regulators and officials may not have the necessary expertise and are likely to be under competing pressures which can affect the rigour of such assessments.

Ensuring Integrity

We are pleased that the consultation document confirms that the UK "remains committed to the highest standards of financial regulation", and hope that this means that strengthening of the integrity framework will be a central feature of the next stage of this review. For accountability to be effective in the post-EU framework, it will be critical that the regulators are seen to be impartial and to act purely in the public interest. This would include the following key areas:

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[42] Finance Watch, 'Finance Watch Blueprint on the European System of Financial Supervision', 2018, https://www.finance-watch.org/wp-content/uploads/2018/08/blueprint-esfs-feb2018.pdf.
[43] https://www.esma.europa.eu/about-esma/governance/smsg
[44] See Lord Sikka's proposed amendment (no 120) to the Financial Services Bill for details on the role and mandate of such a board: https://publications.parliament.uk/pa/bills/lbill/58-01/162/5801162-I.pdf
[45] Kaufmann and Weber, 'The Role of Transparency in Financial Regulation'.
[46] https://www.consultationinstitute.org/government-consultations-2019-retrospective/

Strengthening whistleblower protection policies and their implementation. A 2016 report found that, while 93% of financial sector whistleblowers raised concerns with their employer in the first instance, 70% "were either victimised, dismissed or felt resignation was the only option open to them" and 33% of concerns were ignored.[47] Recent evidence from the financial sector whistleblowing support organisation, Bank Confidential, suggests that the current system does not work in the way intended and actually puts whistleblowers at risk.[48] Issues raised include: banks and the FCA interpreting confidentiality in a way which does not protect the whistleblowers' anonymity, and hence puts them at risk or reprisals; a lack of support for whistleblowers from the FCA until very, very late in the process, and a consequent underestimation of the number of whistleblowers and the difficulties they face.

The post-EU framework offers a golden opportunity to conduct an updating of the whistleblower framework - and crucially its implementation - based on a recognition that whistleblowing is a key way to ensure the integrity of regulators and the system as a whole. This would mean closing the gap between best practice in institutional arrangements and the very poor experience of whistleblowers who use the system, by placing the anonymity and safety of whistleblowers as paramount. Designing a system that works to ensure their protection, starts obviously with requiring employers to assess and minimise the risks of harm coming to whistleblowers to proactively prevent victimisation. As the whistleblowers' charity, Protect, have argued, too many financial firms treat the whistleblowing rules as a 'tick-box' exercise so holding firms and senior managers to account where there is a credible case that whistleblowers have been victimised will be crucial.[49] One other proposal that is worth highlighting is that a whistleblowing organisation that is independent of the regulators be established, to prevent any conflicts of interest and signal the importance given to supporting whistleblowers.[50] Finally, providing proper resources including improved training for staff and the appointment of whistleblowing champions, among other things, will be important.

Instituting an effective policy to prevent risks arising from a 'revolving door' between regulators and the industries they regulate. The 'revolving door' is the practice of regulatory officials leaving their posts and being employed in the industries they regulate. This obviously increases the risk that the regulated industries can influence officials who may be expecting their next job to be in those industries. An academic study of the relationship between US regulators and the investment banks they regulate found that it "generates inequality of influence between financial firms and creates economic distortions" and particularly benefited Goldman Sachs.[51] As the Committee on Standards in Public Life has said, "if not properly managed with adequate safeguards, the revolving door can be a serious threat to the regulator's essential integrity and independence. This is not only true

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[47] Protect, 'Silence in the City 2', 2020, https://s3-eu-west-1.amazonaws.com/public-concern-at-work/wp-content/uploads/images/2020/06/19125704/Protect-SILENCE-IN-THE-CITY-2-2020.pdf.
[48] Bank Confidential, 'Whistleblowing Risks in Financial Services in the UK. Effectiveness of the Current Regime and the Role', 2020, https://bankconfidential.com/wp-content/uploads/2020/06/BC-WB-REPORT.pdf.
[49] Protect, 'Silence in the City 2'.
[50] Bank Confidential, 'Whistleblowing Risks in Financial Services in the UK. Effectiveness of the Current Regime and the Role'.
[51] Elise Brezis and Joël Cariolle, 'Financial Sector Regulation and the Revolving Door in US Commercial Banks', 2016, 53–76, https://doi.org/10.1007/978-3-319-44582-3_3.

for board members and senior executives, but also for operational staff at lower levels of the organisation."[52]

The Committee found that policies in this area have tended to be unclear or insufficient. Among their recommendations are the need for "explicit prohibitions on disclosing confidential information, [and] restrictions on contact with the regulator."[53] In addition, expanding the 'cooling off' period between leaving a regulator and joining a regulated industry to at least one year would be an important step, if accompanied by effective enforcement mechanisms. One proposal is to oblige financial sector regulators to protect rule making from the undue influence of the financial lobby, in the way that article 5.3 in the World Health Organisation's convention on tobacco control obliges officials to "act to protect these policies from commercial and other vested interests of the tobacco industry".[54]

Instituting proper lobbying policies to prevent improper influence and avoid 'regulatory capture.' Given the need to understand the industries they are regulating, it is, of course, important for regulators to meet with industry representatives, but there are real dangers inherent if regulators and regulated firms develop very close relationships. Ensuring that regulatory culture and practices, not just rules and procedures (such as those dealing with revolving doors and whistleblowers), emphasise the independence of regulators and their duty to act in the public interest is critically important. It will be important to make sure that regulators consistently meet a broader range of stakeholders, not just industry representatives. The civil society groups we work with report that it can be difficult to get a meeting with relevant staff in regulators on issues that are critically important to their causes.

Lobbying transparency policies are an important part of this agenda, ensuring that the public is aware of who is meeting and influencing regulators and that the content of such meetings is publicly available. Such policies ensure that necessary meetings with industry and external stakeholders are done transparently and remove any perception of impropriety, strengthening the credibility and standing of the regulators. The UK's lobbying register currently only includes consultant lobbyists, not in-house lobbyists, meaning that a mere fraction of the lobbying that takes place is captured. For example, research in 2015 from Transparency International UK found 96 professional lobbying firms on the register, representing 360 clients, but 2,735 lobbyists meeting with UK Ministers in one quarter alone.[55] No changes have been made to lobbying legislation since then. This is notably out of step with other major Western democracies, including the US, Canada, and Ireland, and with other nations in the UK, such as Scotland.[56] The EU has gone further by instituting a Transparency Register, to which any lobbyist has to register if they are to meet top officials or undertake other activities. If the UK wants to be a leader in financial probity and integrity, it needs to ensure that its lobbying regulations, register, and oversight mechanisms are fit

[52] Great Britain and Committee on Standards in Public Life, *Striking the Balance*, v.
[53] Great Britain and Committee on Standards in Public Life, vi.
[54] https://www.who.int/tobacco/wntd/2012/article_5_3_fctc/en/
[55] International Transparency, 'Accountable Influence. Bringing Lobbying out of the Shadows', 2015, https://www.transparency.org.uk/sites/default/files/pdf/publications/Accountable_Influence_Bringing_Lobbying_out_of_the_Shadows.pdf.
[56] See the US Lobbying Disclosure Act Section 3(7) 1995, Canadian Lobbying Act Section 7, Irish Regulation of Lobbying Act Section 5(2), and the Lobbying (Scotland) Act 2016 Section 1 for more information.

for purpose. For example, lobby registers should be legally-binding and cover lobbying of all public officials.

As the Committee of Standards in Public Life has recommended, "Regular, published information should include up-to-date registers of meetings, conflicts of interest and gifts and hospitality. These should be publicly accessible."[57] Written materials, including letters to regulators from outside parties should be published, with a limited regime of exceptions, as should minutes of meetings with external parties.

Parliamentary scrutiny

As the consultation document rightly highlights, the strengthening of parliamentary scrutiny over both the regulators and future changes in regulation will be important for the new system to work effectively. This vital role that Parliament should play in providing democratic scrutiny will help to improve regulations and the work of regulators in maintaining and enforcing rules. Parliamentary accountability will also create greater space for consultation of stakeholders, enhanced transparency, and will serve to promote democratic debate and improved outcomes 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, 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 note that the Affirmative Procedure, while giving Parliament nominal approval over changes does not in practice result in increased Parliamentary power as such approval has not been withheld since 1978.

We support the proposal that a specialised Parliamentary committee be truly empowered to provide in depth scrutiny over financial services regulation and regulators. This would involve requiring draft regulatory rule changes be submitted to this specialised Parliamentary committee for scrutiny. The committee should also conduct independent inquiries, scrutinise the selection of senior leaders, and be provided with regular reports from the regulators focussing on the overall economic, social and environmental impacts of regulation. It will be vitally important for Parliament to ensure that this committee is not itself dominated by representatives with ties to the industry. Whether this is done by the existing Treasury Select Committee or through a new committee is obviously a decision for Parliament, but the crucial point we would like to emphasise is that such work requires significant resources, which will need to be provided if Parliamentary scrutiny is to work effectively.

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[57] Great Britain and Committee on Standards in Public Life, *Striking the Balance*, iv.