Queen's Speech Briefing

Financial Services Bill 2022:

A once-in-a-generation opportunity to legislate for action on climate and nature

6 May 2022

The upcoming Financial Services Bill is an opportunity for the UK to deliver on its climate and nature commitments, future-proof financial services, and demonstrate global leadership.

We are calling on the government to introduce a new statutory objective, as part of the Future Regulatory Framework, that obliges regulators to align the UK's finance sector with the 1.5 degrees temperature goal of the Paris Agreement, and the UK's obligations on nature.

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Financial Services Bill 2022:

The government will announce a landmark Financial Services Bill in the Queen's Speech on 10 May. Crucially, we expect the Bill to deliver the government's Future Regulatory Framework (FRF). This will determine how financial services regulation is developed in the UK outside of the EU.

John Glen, Economic Secretary to the Treasury and City Minister, has described the FRF as a "once-in-a-generation" opportunity to make financial services regulation "right for the UK". The proposals include a major delegation of powers to regulators, specifically the Financial Conduct Authority and the Prudential Regulation Authority. The regulators will be mandated to pursue their new powers - making and amending rules, and overseeing their implementation - in accordance with updated statutory objectives.

The objectives parliament sets for the new regulatory architecture are absolutely critical. They will impact all future rules that structure and support UK financial services. Given the scale of reform underway (there are over 100 regulatory reviews in process, and several years of legislation anticipated), they will have far-reaching implications for the sector and the UK as a whole.

The problem:

The government has shown global leadership in committing to both reaching net zero by 2050 and making the UK the world's first net zero financial centre. Progress has been made towards this, for example on climate-related financial disclosure, but further action is required if the government is to fully realise its ambitions.

Despite an increasing number of finance sector actors committing to align their activities with the Paris Agreement, they continue to channel funding into fossil fuels. **Research has shown that financed emissions from UK banks and asset managers are responsible for nearly double the UK's annual carbon output.** Other research has also shown the strong link between financial institution investment activity and wildlife and nature destruction.

We have just **eight years to halve global emissions**: the latest IPCC report states that we will miss the crucial goal of limiting global warming to 1.5°C unless we dramatically scale up action to cut greenhouse gas emissions. At the same time, the risks of climate change and biodiversity loss to the financial system and broader economy are significant and varied, as documented by the Bank of England and the Network for Greening the Financial System.

The FRF proposals, as they stand, miss the opportunity to prioritise climate and nature in financial regulation, and threaten the government's ambition to become a world-leading sustainable finance sector.

The government has acknowledged that there is an opportunity to further strengthen financial regulation in relation to climate via the FRF. In order to achieve this, it proposes amending one of eight existing 'regulatory principles' that regulators must consider when discharging their duties. Specifically, it suggests updating a principle relating to the desirability of 'sustainable growth' by referencing climate change and a net zero economy. This is similar to a positive step made last year, when the Chancellor Rishi Sunak recommended that financial regulators, for the first time, 'have regard to' the government's net zero commitment.

However, **we are concerned that neither the Chancellor's recommendation, nor the proposed amended regulatory principle, will provide an appropriate legal basis from which regulators will be able to take the necessary action to align the finance sector with climate and nature goals**. This is because, as HMT itself points out in the FRF, "the regulators are not required to act to advance their regulatory principles; instead they must take them into account when pursuing their statutory objectives." There are currently a large number of factors (14) that regulators must 'have regard to', without clarity over how the regulators should prioritise these. The nature of this legal duty means that the regulators have considerable discretion and flex over the extent to which they consider these factors. Given the urgency and importance of taking action on climate and nature, this needs to be given clear priority and a legal duty requiring action.

The risk:

The government has also stated its intention to introduce a new statutory objective for the FCA and PRA to promote the "long-term growth and international competitiveness of the UK economy, including the finance sector". 'Competitiveness' is distinct from competition; regulators already have an objective to promote competition between firms in order to drive better outcomes for consumers. International competitiveness typically refers to the ability of UK firms to compete for business overseas, and for the UK to remain an attractive location for global businesses. However, the term is neither well-understood nor well-defined.

A duty to promote the competitiveness of industry risks putting UK regulators in a 'race to the bottom' with regulators globally to water-down standards. Just a decade ago, parliament removed competitiveness from the mandate of the financial regulator. In 2010, HMT identified that one of the reasons for regulatory failure leading up to the global financial crisis of 2007/08 was "excessive concern for competitiveness".

As Andrew Bailey said in 2019 (then CEO of the FCA, today Governor of the Bank of England), **the regulator "was required to consider the UK's competitiveness, and it didn't end well, for anyone."** The crash saw millions lose their savings, homes, businesses and jobs, and cost the UK an estimated £1.8 trillion in lost GDP.

By choosing to prioritise international competitiveness in the future of financial regulation, the government risks financial stability and climate action. The proposed international competitiveness secondary objective would trump the Chancellor's recommendation to 'have regard to' net zero and the proposed amended 'regulatory principle', both of which would sit further down in the hierarchy of regulators' duties. In this way, the proposal risks directly undermining climate action, just as it did for consumer protection and financial stability in 2007/08. For more information, please see this Finance Innovation Lab briefing.

The solution:

To achieve the government's vision of a net zero financial centre, climate and nature goals need to be embedded throughout the system, including within the legislative and regulatory architecture. The Financial Services Bill is a unique legislative moment for climate action and nature protection.

Statutory objectives are the most important component of a regulator's mandate. (For the FCA, for example, these currently relate to ensuring markets work well, as well as promoting consumer protection, integrity of the UK financial system, and effective competition.) They shape everything regulators do, including the allocation of their resources, the research they undertake, and the basis upon which they make their decisions and are held to account. Therefore, the government should use the rare opportunity of the FRF and upcoming FS Bill to upgrade regulators' objectives to reflect its net zero ambitions.

Recommendation: The government should introduce a new statutory objective, as part of the Future Regulatory Framework, that obliges regulators to align the UK's finance sector with the 1.5 degrees temperature goals of the Paris Agreement, and the UK's obligations on nature.

If regulators were given objectives to align finance with the UK's climate and nature goals, it would empower them to actively advance innovative climate policies and drive through new climate-related regulation without having to wait for legislation. This would complement and strengthen existing policy commitments, such as the green taxonomy, climate-related financial disclosure, and mandatory transition plans.

There is a global trend towards aligning financial regulation with sustainability goals. Following the UK's withdrawal from the EU, this is a crucial moment for the government to build on its commitment to creating the world's first net zero finance centre and pioneer leading-edge financial regulation that works for people and planet.

This briefing has been written by Finance Innovation Lab, ShareAction and WWF UK, and builds on a joint statement from 37 public interest groups published in February 2022.

Footnotes:

1 The UK has agreed, through the G7 Nature Compact, to committing to halt and reverse biodiversity loss by 2030. It also has national nature targets set in legislation, including the 25-Year Environment Plan, and in the new Environment Act, covering water quality, waste management, air pollution, biodiversity and supply chain deforestation. These commitments will require further development to cover all aspects of global financial activity.