

“Competitive” regulators - a threat to stability & consumer protection

Financial Services and Markets Bill

House of Lords Second Reading Briefing, January 2023

The Financial Services and Markets Bill (“FSM Bill”), due before the House of Lords for Second Reading on 10 January 2023, will fundamentally recalibrate the UK’s financial services rulemaking framework.

As currently drafted, it will give the finance industry regulators a dangerous new statutory objective to promote the “competitiveness” of the industry they are supposed to police. A diverse range of experts, including academics, business leaders, civil society organisations, MPs, and regulators have all warned that this risks:

- undermining regulatory independence;
- repeating the regulatory missteps witnessed in the leadup to the global financial crisis 2007/08; and
- allowing for the weakening of consumer protections.

We encourage you to raise these concerns at the bill’s second reading, and we are keen to work with peers on amendments to ensure the bill strengthens rather than weakens the UK’s regulatory framework for financial services. To discuss this briefing, please contact Tom Shields, Policy and Public Affairs Manager at the Finance Innovation Lab:

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The landmark post-Brexit FSM Bill will devolve enhanced powers to the Financial Conduct Authority (“FCA”) and Prudential Regulation Authority (“PRA”) to make and amend rules. As part of this initiative, the government intends to use the bill to give the regulators a new statutory objective (i.e., legal duty) to promote the “international competitiveness” and growth of the UK economy, “in particular the financial services sector”.¹

To be clear, the promotion of “international competitiveness” is a very different objective from the promotion of competition. Regulators are already required to promote competition between financial services firms in order to drive better outcomes for consumers. “International competitiveness” makes regulators responsible for boosting the ability of firms to compete for business and capital against companies in other jurisdictions. This is concerning as it gives the previously independent regulators a problematic double mandate: to be cheerleaders for the industry as well as watchdogs.

The proposed new objective is a significant addition to both regulators’ mandates. Finance industry regulators are set statutory objectives by Parliament, which dictate all the work they

¹ UK Parliament (2022), Financial Services and Markets Bill. Chapter 3, 24(1-4). (See [page 38 of the bill as sent to the Lords](#)).

undertake and how they allocate resources, and they are the basis for the metrics via which regulators' performance is judged (see Appendix for more information). The FSA, the predecessor to both the FCA and PRA, merely had a duty to “have regard to” the competitiveness of the UK financial services sector. In its [2010 post-mortem of the crisis](#), the Treasury recognised this as a driver of regulatory failure leading up to the global financial crisis. Accordingly, this duty was removed from the regulatory remit by the Treasury and parliament.

Just over a decade later, Ministers are now seeking to give the successors to the FSA a *stronger requirement* to make sure their regulatory activities promote the “international competitiveness” of the financial services sector. But as Andrew Bailey (then CEO of the FCA, now Governor of the Bank of England) [explained in 2019](#), the regulator “was required to consider the UK’s competitiveness, and it didn’t end well, for anyone”.

A threat to regulatory independence and financial stability

The competitiveness objective could damage regulatory independence by allowing industry and politicians to put undue pressure on the regulators to water-down standards in the name of “competitive” regulation. Financial stability ultimately requires robust rules made in the public interest, and the public interest does not always align with the immediate profit-seeking interests of financial institutions. In short, tasking oversight bodies with promoting the industry they police fundamentally compromises their work.

Over 50 economists and policy experts [wrote to](#) the then-Chancellor Rishi Sunak in May 2022 to warn him of this approach. Academics, such as [Sir John Kay](#), have continued to raise the alarm, cautioning that a regulatory focus on competitiveness opens the door to regulatory capture, thus subverting the model of regulatory autonomy that allows regulators to work toward long-term stability. Recognising the danger, [Howard Davies](#) - former head of the FSA and now Chairman of NatWest - recognised the proposed objective as the “thin end of a rather peculiar wedge”. Echoing Davies’ concerns, the Financial Times’ [Martin Wolf](#) warns the objective would “start the journey down a dangerously slippery slope”.

Finance industry regulators are already subject to [frequent and high-profile lobbying](#). If they are given an explicit remit to pursue the competitiveness of the industry, industry representatives then gain further leverage to petition against any initiative that might be construed as detracting from the industry’s competitiveness. As FCA Chair, Charles Randell, [explained to the Treasury Select Committee](#): “The risk [is] that whenever we propose to do something, we receive a large amount of lobbying input saying this rule doesn’t exist in this country or that country or the other country, and therefore you shouldn’t do it”.

The Committee itself also expressed concern over competitiveness as a regulatory goal, noting in [June 2022](#) “sensitivity towards the idea of ‘competitiveness’ as an explicit part of an objective, and fears that it might be interpreted as an invitation to overly loosen regulatory constraints”. And the government’s agenda has been noticed internationally. [The IMF warns](#) of “tension” between the competitiveness agenda and financial stability, arguing that “while maintaining a

competitive financial sector is an important policy goal, financial stability should not be compromised for the objectives of competitiveness.”

There are already many organisations whose job it is to promote the finance industry. Moreover, the existing regulatory framework guarantees regulators already consider the impact of their decisions on industry competitiveness. There are numerous mechanisms by which they consider the business burdens of their decisions, including via the regulatory principle of “proportionality”, and by cost-benefit analysis. The UK’s independent regulators have played an important part in securing London as a world-leading financial centre, and the OECD has shown that regulatory independence is [correlated with strong economic growth](#). The former Chair of the Independent Commission on Banking, [Sir John Vickers](#), concludes that “for the UK economy, it would be best to reject this addition to regulators’ objectives”.

Risking fraud & endangering consumer protection

Any compromising of financial stability could have clear and substantial impacts on the whole country - the [Institute for Fiscal Studies estimates](#) that the global financial crisis cost each worker £800 per annum in lost income in the years that followed. That cataclysmic event also cost the UK [an estimated £1.8 trillion](#) in lost GDP. However, even in the absence of a financial crash, ordinary people still stand to lose out if regulators are made to prioritise the competitiveness of the finance sector in their rulemaking.

Consumer protections in financial services are vital to ensure that citizens are able to confidently and fairly access vital financial products and services. However, the Financial Services Consumer Panel sees any competitiveness objective as existing in tension with consumer protection. According to the panel’s [submission to the FSM Bill committee](#), “[the panel remains] opposed to a competitiveness objective, even as a secondary objective [...] we do not believe the secondary nature of the objective is sufficient to mitigate the risk that consumer protection is traded off against competitiveness and therefore diluted”.

Put bluntly, one company’s “red tape” might well be a consumer’s important protection against, for instance, fraud or mis-selling. A competitiveness objective puts pressure on the regulator to consider the former position alongside the latter. The ability of financial services firms and their representatives to access decision makers makes this an uncomfortable development. In collaboration with Which?, the Finance Innovation Lab built on this argument in a [joint response to the PRA’s recent discussion paper](#) on its future approach to policy making.

The [International Compliance Association warns](#) that regulatory independence is vital to ensuring that decisions are made to protect consumers in the long-term from fraud and financial crime. As detailed above, the reforms in question jeopardise this independence principle and open the door to an erosion of the consumer protections currently built into the system. These changes are being pushed at a time when fraud and financial crime have reached unprecedented scale (fraud now represents [approximately 40% of all crime](#), a figure that

continues to grow). Customers are in need of stronger safeguards, not weaker standards, particularly as the cost of living crisis continues to damage financial resilience.

These developments must be seen in the context of the Chancellor's "[Edinburgh Reforms](#)" announced on 9 December 2022. That package - including the weakening of the "ringfencing" rules that protect customer deposits from banks' risky investment operations - shows the government's direction of travel. Alarm bells are sounding, [including for the Governor of the Bank of England](#). However, of all the elements of the reform programme, the proposed competitiveness objective for regulators will have the most far-reaching and insidious impact.



The **Finance Innovation Lab** is a UK-based charity working to bring about a financial system that works for people and planet. The Lab is part of the [Finance For Our Future](#) coalition - 39 civil society organisations and other public interest bodies that have called on the government to ensure its financial services reforms are adequate for the biggest challenges the UK faces.

Instead of repeating the mistakes of the past, the coalition calls on the government to use the FSM Bill to:

- **Act on climate change** - the FSM Bill does nothing to advance [bold promises](#) made at COP26 to make the UK the world's first net zero financial centre - despite the fact that the financed emissions of the UK financial services sector represent [1.8 times](#) the annual net emissions of the UK itself. To radically improve the bill, it could be used to give the regulators a new secondary statutory objective to facilitate the alignment of the financial sector with the UK's climate and nature commitments. These calls are echoed by a growing number of [private sector voices](#) and have been [championed by WWF UK](#) (briefing from WWF available upon request).
- **Promote financial inclusion** - the FCA currently has no requirement to combat, or even report on, financial exclusion. This is extremely concerning in the context of the cost of living crisis - currently [17.5 million people in the UK are financially vulnerable](#), and one-quarter of UK adults have [less than £100 in savings](#) (while one in six have none at all). The Finance for our Future coalition wants to see the bill amended to give the FCA a cross-cutting "must have regard" to financial inclusion in line with the recommendation made by the [TSC](#) and as promoted by [Fair by Design](#) (briefing from Fair by Design available upon request).

Appendix: The finance industry regulators' mandates

The mandates of the finance industry regulators are set by Treasury and Parliament. In order of importance, the FCA's *current* hierarchy of duties stands as follows:

1. Strategic objective:

In discharging its general functions, the FCA must (so far as reasonably possible) act in a way which ensures "that the relevant markets work well".

2. Operational objectives:

In discharging its general functions, the FCA must (so far as reasonably possible) act in a way which advances one or more of its operational objectives – (a) secure an appropriate degree of protection for consumers; (b) protect and enhance the integrity of the UK financial system; and (c) promote effective competition in the interests of consumers.

3. Regulatory principles:

In addition, in discharging its general functions, the FCA must have regard to eight regulatory principles set via legislation (one being, for instance, the need to use the resources efficiently).

4. Treasury recommendations:

The Treasury makes regular recommendations to the FCA via a "[remit letter](#)" about aspects of the government's economic policy, to which the FCA should have regard when considering how to meet the objectives and principles.

The PRA's hierarchy of duties has a similar structure to that of the FCA:

1. Primary objectives:

- (i) To promote the safety and soundness of PRA-authorized firms.*
- (ii) Specifically for insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders*

2. Secondary objective

To act, so far as is reasonably possible, in a way which facilitates effective competition in the markets for services provided by PRA firms.

3. Regulatory principles:

Like the FCA, in discharging its general functions, the PRA must have regard to eight regulatory principles set via legislation.

4. Treasury recommendations:

As with the FCA, the Treasury also makes regular recommendations to the PRA via a "[remit letter](#)" about aspects of the government's economic policy to which the PRA should have regard when considering how to meet the above objectives and principles.

Duties conferred by statutory objectives are backed by strong legal terms – they denote a requirement to act. However, the "have regard to" duty behind the regulatory principles and Treasury recommendations is weak; they must be taken into account by regulators, but they can be departed from. The proposed "competitiveness" objective is a powerful requirement that stands at odds with the existing objectives (and carries more weight than the former FSA's competitiveness duty referred to in this piece). It would be the FCA's only secondary objective.