ENSURING REGULATORS DELIVER CONSUMER PROTECTION & FINANCIAL STABILITY

Financial Services and Market Bill - House of Lords Report Stage Briefing

Finance Innovation Lab - June 2023

The Financial Services and Markets Bill (“FSM Bill”) will go to Report Stage in the House of Lords on 6 June 2023. The bill will fundamentally recalibrate the UK’s financial services rulemaking framework - it is a rare opportunity to rethink how rules that govern the finance sector are written.

As currently drafted, the bill will give the financial services industry regulators a 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, and former regulators - have warned that this is a dangerous path. It risks:

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

Peers have tabled two amendments (detailed at the end of this briefing) that might reduce these risks - we encourage you to support one of these amendments. To discuss this briefing, please contact Tom Shields at the Finance Innovation Lab: tom@financeinnovationlab.org

The landmark post-Brexit FSM Bill will grant enhanced powers to the Financial Conduct Authority (“FCA”) and Prudential Regulation Authority (“PRA”) to make and amend the rules that govern the financial services sector. As part of this transfer of powers, the government intends to use clause 24 of 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”.

To be clear, the promotion of “international competitiveness” is a very different objective to 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 gives the regulators a problematic double mandate as both cheerleaders for the industry as well as watchdogs.

The new objective is a significant addition to both regulators’ duties. The regulators are set statutory objectives by Parliament, and the objectives dictate the work the regulators do and the

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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).
allocation of their resources. Objectives are also the basis for the metrics via which regulators’ performance is judged.

The FSA, the predecessor to both the FCA and PRA, 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.

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. The danger here is clear. As Andrew Bailey (then CEO of the FCA, now Governor of the Bank of England) explained in 2019, the FSA “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 long-term public interest, and the public interest does not always align with the immediate interests of financial institutions. Tasking oversight bodies with promoting the industry they regulate 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’ Chief Economics Editor Martin Wolf warns the objective would “start the journey down a dangerously slippery slope”.

Financial services regulators are already subject to frequent, 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 then-FCA Chair Charles Randell explained to the Treasury Select Committee in 2021: “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”.

Baroness Minouche Shafik, President of the London School of Economics, has warned that the outcome of the competitiveness objective will be that the UK will have “a bigger financial sector that is taking more risks, and it’s the risks that I’m really worried about”.

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.”

These concerns are all the more pressing in the wake of the banking crisis that unfolded in March of this year. In the wake of that crisis, former Treasury Permanent Secretary Nick Macpherson warned that “the Treasury must be careful not to follow the US example and weaken regulation in the name 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 aspects of 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. Under their current mandates, 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 will have clear and substantial impacts on the whole country. 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 ensuring that citizens are able to confidently and fairly access vital financial products and services. However, the Financial Services Consumer Panel (an independent statutory body set up to represent consumer interests to the FCA) 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 part of a consumer’s important protection against 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 against financial crime. As detailed above, the reforms in question jeopardise this independence principle, and thus open the door to an erosion of the consumer protections currently built into the system. These changes are proposed while fraud (approximately 40% of all crime) has reached an unprecedented scale.

**Conclusion and amendments**

The FSM Bill represents a rare opportunity to futureproof the way UK financial services regulators make the rules that govern the UK’s large finance sector. The bill will give the regulators uprated powers, but it will also instruct them to dispense with these powers in a way that considers the “competitiveness” of the firms they regulate. This muddies the regulators’ mandates in a way that risks both undermining regulatory independence and facilitating the weakening of consumer protections. Ultimately, this initiative may set the UK on a course to repeating the regulatory missteps witnessed in the leadup to the global financial crisis 2007/08. To improve the bill, peers should support one of the below amendments.
Amendments to support

1. **Amendment to clause 24 tabled by Baroness Bowles of Berkhamsted:**
   
   Page 38, line 25, leave out “including in particular” and insert “through fair and efficient operation of”
   
   Member’s explanatory statement: “This amendment ensures that financial services operate to the benefit of the economy rather than financial services being an end in itself.”

2. **Amendment to clause 24 tabled by Baroness Bennett of Manor Castle:**
   
   Leave out Clause 24
   
   Member’s explanatory statement: “This amendment is to ensure that the regulators' core duty is to provide stability to the financial system and protect consumers, not growth or competitiveness.”

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