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Treasury Committee

Edinburgh Reforms One Year On: Has Anything Changed?: Further Government Response to the Committee's Second Report

Fourth Special Report of Session 2023–24

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The Treasury Committee

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Fourth Special Report

The Treasury Committee published its Second Report of Session 2023–24, *Edinburgh Reforms One Year On: Has Anything Changed?* (HC 221), on 8 December 2023. On 28 February the Economic Secretary to the Treasury committed to provide us with a more detailed response to the Report's recommendations.[1] The supplementary response is appended to this report.

Appendix: Government Response

Dame Harriett Baldwin MP
Chair of the Treasury Committee
House of Commons
London
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19 April 2024

Dear Dame Harriett,

TSC Report: "Edinburgh Reforms One Year On: Has Anything Changed?" (8 December 2023)

Thank you for inviting me to discuss SME Finance on 28 February. At that appearance, I agreed to provide you with a letter supplementing my letter of 8 February regarding the Sub-Committee's report on the Edinburgh Reforms. I have written a separate letter responding to the additional requests raised at the evidence session.

The Annex to this letter sets out the Treasury's response to each of the 18 conclusions in the report. I hope this serves as a comprehensive response to the committee's report.

As I set out in my letter of 8 February, I would like to reiterate my thanks for the report, and assure you that I remain focused on delivering the government's ambitious reform agenda. I look forward to continuing to work with you on this.

Kind regards,

BIM AFOLAMI MP

1 Oral evidence taken on 28 February 2024, HC 27. Q240–42

Annex: Economic Secretary to the Treasury - Response to TSC's Edinburgh Reforms Report Conclusions

No.	TSC Conclusion	Response
	The full Committee has previously concluded in its report on the Future of Financial Services Regulation that "there should be a secondary objective for both the Financial Conduct Authority and the Prudential Regulation Authority to promote long-term economic growth" but that "pursuing international competitiveness in the short term is unlikely to lead to economic growth or international competitiveness in the long term if it is achieved by weakening the UK's strong regulatory standards." The Sub-Committee's opinion is that completing all 31 strands of the Edinburgh Reforms is a vital step towards addressing examples of over-zealous regulation that disadvantage British companies.	I agree with the Sub-Committee's conclusion that the completion of the Edinburgh Reforms is a vital step towards a balanced and proportionate regulatory environment for UK Financial Services.
	The Sub-Committee agrees with the Treasury that the UK's regulators should consider economic growth when designing new regulations, and the best way to promote economic growth in the UK is through a strong, well respected, independently regulated, and financially resilient financial services sector.	I agree with the Sub-Committee's conclusion, and I look forward to the regulators' first reports on how they have advanced their new secondary growth and competitiveness objectives.

No.	TSC Conclusion	Response
	The Sub-Committee has raised concerns with the FCA about the risks to widening retail investment in Long-Term Asset Funds, since they are riskier non-liquid assets. These concerns are in part formed by our work looking into the failure of London Capital and Finance, and the role of promoters in potentially misusing exemptions for high net-worth individuals and so-called sophisticated investors, to garner greater sales. The Sub-Committee continues to have concerns in this area, and therefore about the protections the FCA is, in part, drawing upon for Long-term asset fund sales to a wider range of retail investors.	I disagree with the Sub-Committee's conclusion. The government is committed to supporting individuals to invest in a wider range of assets, suitable to their level of risk tolerance. Longer-term less liquid real assets can generate good returns for investors and help to grow the UK economy, for example by supporting investments in infrastructure. Long-Term Asset Funds (LTAFs) are required to meet high regulatory standards, designed to ensure that investors are able to access suitable investments that match their attitude to risk. The FCA has developed a robust regime for managing LTAFs, including requirements relating to diversification, disclosure, valuation and liquidity management. In broadening retail access to LTAFs, the FCA has implemented a range of safeguards including clear risk warnings and appropriateness tests for those who wish to invest. These measures are designed to reduce the chance of investors investing without a strong understanding of the risks.
4)	In our July 2023 report on venture capital funding we concluded that we were in favour of pension scheme consolidation where appropriate. Our view has not changed since. We therefore restate our conclusion on pension scheme consolidation in this report.	I note and agree with this conclusion. As the Committee will be aware, the government is pursuing an ambitious set of reforms to further consolidate the pension fund market.

No.	TSC Conclusion	Response
5)	Our evidence suggests that UK pension funds may be an untapped source for a deeper domestic capital market more inclined to risk investment in high-potential businesses. We welcome the Government's announcement of work on pension fund consolidation in the autumn. We will scrutinise the details of those proposals closely. Any change must pay due regard to the balance between risk and reward for pension investors. We encourage the Government to progress this work with urgency.	I welcome the Sub-Committee's conclusion, and look forward to further engagement as the government continues with its reforms. The government continues to work on consolidating the pension fund market, this includes setting a deadline for the Local Government Pension Scheme to consolidate assets into asset pools, as well as setting a direction towards fewer asset pools exceeding £50bn in size, and consulting on options for DB schemes that are unattractive to commercial providers to consolidate into the PPF. Most recently at Spring Budget 2024, the Chancellor announced plans that progress the Value for Money pension fund reforms to improve outcomes for savers and consolidate the DC pensions market. The proposals will ensure that pension managers are focused on securing good returns for savers, rather than focused on driving down management fees at the expense of long-term performance. Under the proposals, by 2027 pension funds across the DC market will be disclosing their costs and net investment returns, as well their level of investment in the UK. Pension schemes will be required to publicly compare their performance data against competitors, including at least two schemes managing at least £10 billion in assets. Schemes performing poorly for savers won't be allowed to take on new entrants, with TPR and FCA having a full range of intervention powers available.

No.	TSC Conclusion	Response
6)	The Sub-Committee remains sceptical that a government-approved monopoly for providing data to market participants through a consolidated tape is good for competition. Once a monopoly were granted, the incumbent would have little incentive to reduce costs or to innovate. Given the claimed benefits that a consolidated tape would provide to market participants, and the widespread consensus within the market that these benefits do exist, it is not unreasonable to expect the financial markets of the UK to be able to create their own conditions for such a tape to emerge without the regulator granting a monopoly. The Sub-Committee's preference would have been that market forces created a consolidated tape, therefore the Government and regulators should continue to monitor the impact on market forces of the new tape.	A consolidated tape will collate market data into one live, electronic, continuous stream, making UK markets more attractive by facilitating easier and cheaper informed investment decisions. Despite these clear benefits, it is clear that the market would not itself put a tape in place. Respondents to the government's Wholesale Markets Review thought this was because of the low margins yet high operational costs model that a tape would operate in. The majority of respondents argued a tape would not materialise in an open market competition. The government therefore legislated in the Financial Services and Markets Act 2023 to give the FCA powers to facilitate the development of a consolidated tape. The government also introduced a regulatory framework for a consolidated tape through the Data Reporting Services Regulation 2024. Taken together this replaces the previous EU-inherited framework. This framework allows the FCA to run a tender process to seek bids and then select one or more consolidated tape providers per asset class but only if the FCA deems this necessary, for example when doing so will improve the provision of the service. Respondents to the WMR suggested that a tender process would make it easier for UK authorities to ensure that the correct arrangements are in place, help mitigate conflicts of interest, and ensure that the costs for firms connecting to a tape and accessing data from a tape remain low. It is the government's view that such a tender process will help promote competition at the tender point while ensuring the emergence of a UK consolidated tape. The FCA has stated that they will be using the tender process to select a single tape per asset class, reflecting the feedback from the Wholesale Markets Review. The government and the FCA will continue to monitor the impact the consolidated tape has on market forces.

No.	TSC Conclusion	Response
7)	While the Treasury has delivered what it set out to do in these six strands of work, namely publishing documents, welcoming a regulatory consultation, and establishing reviews or taskforces, none of these are in of themselves reforms to the UK's financial services regulations. We do not consider reviews alone to be reforms. They are merely the preparatory work for future potential reforms. We believe the Treasury is incorrect in considering these strands of work as having delivered reforms. Only when the recommendations from these various reviews, taskforces and strategies have been implemented into regulatory rule changes can these be deemed to be financial services reforms that have been delivered.	As I set out in my letter of 8 February, delivering ambitious regulatory change is a multi-step process, and there are many milestones that it is appropriate to mark. The government made a number of specific commitments as part of the Edinburgh Reforms to consult on important issues, and we have confirmed where those commitments have been met. Reviews are a key part of the policy-making process, although of course I would agree that it is important that the findings of reviews are acted on. In many cases, the government has taken several steps in the past year to progress change in the areas where the consultation process demonstrates a case for reform. For example, in Edinburgh last year, the government committed to working with the FCA to examine the regulatory boundary between advice and guidance. The objective is to make changes to these regulatory structures in order to improve the support consumers receive with financial decision-making. In August, the FCA published an update on the review, providing firms with guidance to help firms move closer to the current boundary. In December 2023, we published a joint policy paper outlining initial proposals for reform. Feedback from industry and consumer groups on the proposals will determine the Review's next steps and we will progress work on the proposals accordingly. It would not have been appropriate to commit to more specific reforms at Edinburgh prior to this work being completed. Nevertheless, the commitment has been delivered, and the government is now progressing with the next steps.

No.	TSC Conclusion	Response
8)	Based on the evidence the Sub-Committee has heard, there is the potential for small changes to the ring-fencing framework to improve its interoperability with the PRA's resolution regime, but any longer-term plans to eventually remove the ring-fencing regime entirely should only be entertained once substantial evidence of what benefits this would bring is available.	The government has two related ring-fencing workstreams, delivering on the Chancellor's Edinburgh Reforms commitment to take forward the Skeoch review's recommendations. Firstly, the government is considering the long-term future of the regime. It is important to note that no other country copies our ringfencing rules, and they impose significant costs to the sector. I agree that any decision to remove or substantially amend the ring-fencing regime would need to have a robust evidence base. That is why, in March 2023, we launched a Call for Evidence on aligning the ring-fencing and resolution regimes. This produced a broad and mixed range of views on the ongoing benefits of the regime to financial stability and the options for aligning it with the resolution regime. Respondents also agreed that the Skeoch review's proposal to disapply ring-fencing where banks are deemed resolvable is likely to be difficult to operationalise. As such, the government continues to explore a range of options, including respondents' proposals for medium-to-long term reform. Secondly, the government is taking forward its package of smarter ring-fencing reforms in the near-term. These reforms take forward recommendations from the Skeoch review to introduce increased proportionality and flexibility to the ring-fencing regime while maintaining appropriate financial stability safeguards. The government will introduce secondary legislation in Parliament in the coming months, subject to parliamentary time, to implement these reforms.

No.	TSC Conclusion	Response
9)	The continued viability of building societies and mutuals is of high importance to the Committee. A diverse, competitive and vibrant financial services sector is strengthened by the presence of mutuals and building societies.	I agree with the Sub-Committee's conclusion. The government is a strong supporter of the mutuals sector and recognises the contribution mutuals make to the economy and the local communities they serve. More specifically, the government is supportive of the unique role played by building societies in providing vital diversity to the UK financial services sector. The government is progressing with the changes to the Building Societies Act 1986 announced as part of the Edinburgh Reforms. As part of this, the government is currently supporting Julie Elliott MP's bill, the Building Societies Act 1986 (Amendment) Bill, which would enact a number of the Edinburgh Reforms changes. HM Treasury is also working on other secondary legislation to enact the changes. these amendments will help to modernise the 1986 Act and help level the playing field between building societies and retail banks in relation to their funding and corporate governance requirements.
10)	Given that Parliament has expressed its will through the Mutual Deferred Shares Act 2015 that building societies should be able to raise finance through mutually deferred shares, the Committee expects the Government to address the lack of progress made on the secondary implementing legislation as part of its Edinburgh Reforms work in this area.	The Mutual Deferred Shares Act 2015 does not apply to building societies. As the Committee may be aware, the government previously worked up proposals on the design of mutual deferred shares (MDS) in detail, consulting on draft regulations in 2016. However, legislation to permit mutual deferred shares was not taken forward after it was found to be incompatible with mutual tax status. Mutual insurers have been clear that they would not issue MDS in any circumstances that would threaten their current tax status. Through recent engagement with the sector, officials did not find sufficient appetite from the sector for new share instruments, nor evidence of credible plans to develop them.

No.	TSC Conclusion	Response
11)	There is consensus among the Treasury, industry, and the Financial Conduct Authority that there are problems within the Packaged Retail and Insurance-based Investment Products (PRIIPS) regime in addition to a wider problem with cost disclosures. Such an example can be found with investment companies, where EU derived regulation, since removed by the EU and other international jurisdictions, disadvantages these British companies in the global marketplace. The Sub-Committee supports the efforts being made to correct these issues and has written to the Chancellor. We welcome the draft statutory instrument on PRIIPS and look forward to the forthcoming statutory instrument on the Markets in Financial Instruments Directive (MiFID).	The government has prioritised replacing the EU derived PRIIPs Regulation and has already made significant changes to the 'Key Information Document' in the Financial Services Act 2021. The government is now reforming the UK's retail disclosure regime, to replace PRIIPs with a new UK retail disclosure framework for Consumer Composite Investments which is tailored to UK markets and firms. The government will set out further detail on plans to deliver this reform in due course, and the Chancellor will provide further detail separately to respond to the questions you raised in the 13 March Committee on Spring Budget 2024.
12)	The Chancellor's Edinburgh Reforms speech made big promises. However, from what has been completed so far, the Sub-Committee is of the view that none of the achievements to date will make a substantial difference to the UK economy.	The Edinburgh Reforms set out a wide-ranging set of commitments that were welcomed by industry, and which will, as the Sub-Committee sets out, help address over-zealous regulation that disadvantages UK companies. As I set out in my letter of 8 February, since taking up my role as Economic Secretary, I have consistently heard the resounding message from industry that my key priority should be the delivery of these reforms, and I am confident that, collectively, the reforms will spur growth and competitiveness in this crucial sector. These steps alone will not fix all problems – but they are a critical part.

No.	TSC Conclusion	Response
13)	Many of the strands of work included in the Edinburgh Reforms are not reforms, but are more preparatory work for potential reforms in the future and should be treated as such. However, even among the reforms that we agree are genuine changes in regulatory rules, the categorisation of some as reforms to be championed by the Chancellor as significant and worthy of attention is unconvincing. For example, it is not obvious to the Sub-Committee how a small £25 million tax cut such as the reform to Real Estate Investment trusts, or a change to the Investment Manager Exemption to include cryptoassets, which is deemed to have no economic impact, sufficiently meet the Chancellor's description of the Edinburgh Reforms, which he described as "a bold collection of reforms taking forward the Government's vision for an open, sustainable, and technologically advanced financial services sector that is globally competitive and acts in the interests of communities and citizens. These reforms will create jobs, support businesses, and power growth across all four nations of the UK".	The Edinburgh Reforms package represented a collection of measures designed to strengthen and grow the UK's financial services sector. As set out above, delivering regulatory reform in complex areas is a multi-stage process, and it is true to say that work is still needed to deliver all of the promise of the Edinburgh Reforms. I am not of the view that highlighting smaller – though important – measures invalidates the assertion that, considered as a whole, the package will result in economic benefits for the UK through improving the competitiveness of our Capital Markets. I therefore disagree with this conclusion. The purpose has to be viewed as a whole.
14)	The Sub-Committee understands and supports the Treasury in carrying out reforms that follow the appropriate processes. Reforms to the financial services rules should be evidence-based, taking into consideration views from both industry and wider society. This engagement takes time and must be done correctly, giving stakeholders sufficient time to consider their responses. Nevertheless, the time taken between the Treasury announcing a policy objective and the implementation of changes to rules has been too long. Often Treasury consultations end, and the next stage of the process stalls at this point, with Treasury responses and next steps taking considerable time.	I am proud of the speed at which the Treasury has delivered a large number of wide-ranging financial services reforms over the past year, and it is my absolute priority to deliver the commitments – alongside the subsequent reforms announced at Mansion House - in their entirety and in a timely fashion. I do agree that it is important that we keep up the pace of these reforms, and continue to look for responsible ways to streamline processes and deliver results. I am working on this every day.

No.	TSC Conclusion	Response
15)	The Treasury's priorities in its financial services reform plan should be reforms that will make the most difference to the UK's economic growth, and reforms that prevent harm to consumers and businesses, making sure they are provided with well-designed, suitable financial products. We call on the Government to take this into account in pursuing plans to reform the financial services sector.	I agree with this recommendation, and share your view that reform should prioritise economic growth, prevent consumer harm and enable access to well designed and suitable financial products. I can assure you these are cornerstones of our work and are always considered when developing policy.
16)	The Treasury and the regulators have told us the process of moving the onshored rules into the regulators' rule books will take many years. The regulators and the Treasury must ensure that there is a sustained and focussed pace of change in order capture the benefits these changes can bring in a timely manner.	I agree with the Sub-Committee's conclusion and share your view on a focussed pace of change. The government recently published a note on the programme to deliver a smarter regulatory framework which sets out that we have already repealed 44% of assimilated law relating to financial services. With a significant amount of work left to do, I have decided to focus on the largest and most complex policy files which underpin the sector along with those with the biggest potential for UK economic growth. This note also sets out which areas of legislation that will be prioritised in the next phase.
17)	The Sub-Committee notes the proposed establishment of a Lord's Committee on Financial Service Regulation. While its remit is a matter for the House of Lords, duplication of work should be avoided. The Sub-Committee will continue to carry out its scrutiny of new regulatory consultations as and when they are published. The full Committee will naturally continue to consider the wider context of the regulators work, as it has always done. Consideration of the existing acquis could prove a rich seam of work for the Lord's Committee.	I note this conclusion, and look forward to engaging with the Committee's ongoing scrutiny, and with the Lord's Committee on Financial Services Regulation.

No.	TSC Conclusion	Response
18)	The Financial Services and Markets Act 2023 legislated for the creation of Cost Benefit (CBA) Panels dedicated to supporting the regulators in producing cost benefit analysis for each of their reforms. The Sub-Committee has consistently been of the view that the regulators' cost benefit analysis did not capture the full costs faced by firms, nor did they adequately explain and quantify the benefits of the reforms they were proposing. We will continue to scrutinise the cost benefit analysis of each proposal, and will pay close attention to the impact the CBA panels have, and whether they improve quality of the CBAs that are published in future.	FSMA 2023 required the regulators to establish new CBA Panels and to publish their framework for CBA. These measures were designed to increase the transparency of the regulators' approach to CBA, and to allow for industry input and engagement to ensure that they accurately capture the costs faced by firms. I look forward to engaging with the committee on this issue.