House of Commons

Treasury Committee

The Future Framework for Regulation of Financial Services: Responses to the Committee's Fifth Report

Fourth Special Report of Session 2021–22

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue and Customs and associated public bodies.

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Publication

Committee reports are published on the Committee's website at www.parliament.uk/treascom/ and in print by Order of the House.

Committee staff

The current staff of the Committee are Rachel Edwards (on secondment from the Bank of England), Kenneth Fox (Clerk), Dan Lee (Senior Economist), Adam McGee (Senior Media and Communications Officer), Aruni Muthumala (Senior Economist), Moyo Oyelade (on secondment from the Bank of England), Tony Verran (on secondment from HM Revenue & Customs), Adam Wales (Chief Policy Adviser), Maciej Wenerski (Committee Operations Manager), Jesse Williams (Committee Operations Officer), and Marcus Wilton (Senior Economist).

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1. The Committee published its Fifth Report of Session 2021-22, *The Future Framework for Regulation of Financial Services*, on 6 July 2021. In that Report, the Committee set out its view on how the future framework for the regulation of financial services should be designed, how it should be scrutinised, and where responsibility for regulation should sit.

2. The Committee received a letter from the Economic Secretary to the Treasury, John Glen MP, on 2 September 2021, constituting the Government response to its Fifth Report. That letter is appended to this Report.

3. The Committee received a letter from the Chief Executive of the Financial Conduct Authority, Nikhil Rathi, on 7 September 2021, constituting the FCA response to the Committee's report. That letter is appended to this Report.

4. The Committee received a letter from the Chief Executive Officer of the Prudential Regulation Authority, and Deputy Governor for Prudential Regulation, Sam Woods, on 10 September 2021, constituting the Bank of England's response to the Committee's report. That letter is appended to this Report.

Appendix 1: Response from HM Treasury

Letter from the Economic Secretary to the Treasury to the Chair of the Committee

Treasury Committee Report into the Future Framework for Regulation of Financial Services

I am writing in response to the Committee's report of 6 July 2021 on 'The Future Framework for Regulation of Financial Services'. I would like to thank the Committee for its report, and for inviting me to give evidence on 26 May on these important issues.

In his Mansion House speech in July 2021, the Chancellor set out the government's vision for an open, green, and technologically advanced financial services sector that is globally competitive and acts in the interests of communities and citizens by creating jobs, supporting businesses, and powering growth across all of the UK. To deliver this vision the government will maintain and build on the UK's attractive and internationally respected ecosystem for financial services across both regulation and tax. The Future Regulatory Framework (FRF) Review is an important part of this as it considers how the financial services regulatory framework should adapt to the UK's new position outside of the EU, and how to ensure the framework is fit for the future.

The government is considering the recommendations made by the Committee, alongside the responses to the Financial Services Future Regulatory Framework Review Consultation, which closed on 19 February 2021. The government will bring forward detailed proposals in a second consultation in the autumn. I therefore do not intend to respond in detail to each recommendation in this letter, as doing so would pre-judge that consultation. However, having noted your recommendations with interest, I would like to take this opportunity to reiterate some of the points I raised during my evidence session with the Committee.

First, the government agrees with the Committee that the independence of the regulators is vital to their role and vital to the UK's reputation as a global financial centre. As set out in the previous consultation, the government is committed to preserving the regulators' operational independence which, as observed by IMF studies, supports predictable and stable regulatory approaches over time.

Second, I note the Committee's view that 'the body of EU financial services law that was on-shored during the process of leaving the EU should be moved into the regulators' rulebooks.' As set out in the previous consultation, the government's proposed approach is that the independent regulators should have responsibility for setting the direct regulatory requirements that apply to firms, operating within an overall policy framework set by government and Parliament. The government considers that this continues to be the most effective way of delivering a stable, fair and prosperous financial services sector.

Third, I welcome the Committee's recommendation that a 'targeted approach' to scrutiny by Select Committees is the appropriate model for Parliamentary scrutiny of regulator activity, whereby the Committee should scrutinise the activities of the regulators in more detail where it considers there is a wider public interest in doing so. As I set out in my evidence session, this is more appropriate than the approach taken by the ECON

Committee, which reflects the EU approach to the regulation of financial services and the specific circumstances of the Single Market, where detailed and technical regulatory standards are set in legislation to ensure consistency across Member States.

Finally, while I note the Committee's conclusion that they do not see a clear need for the creation of a new committee or a new independent body, I would also like to reiterate that it is rightly a matter for Parliament to consider the appropriate structure for its scrutiny.

The Treasury is continuing to consider the 120 responses it received on the FRF Review consultation published last year, alongside reports from your Committee, and the All-Party Parliamentary Group for Financial Services and Markets, amongst others. I would welcome further discussion following the publication of the next consultation in the autumn.

John Glen MP

2 September 2021

Appendix 2: Response from Financial Conduct Authority

Letter from Chief Executive of the Financial Conduct Authority

FCA Response to TSC Report: Future of Financial Services

I'm writing to you following the Treasury Committee's report, 'The Future Framework for Regulation of Financial Services', published on 6 July 2021.

We welcomed the opportunity to provide evidence to the Committee's inquiry both in writing and in person, and read the resulting report with great interest.

Ex-Ante and ex-post scrutiny of FCA rule making

The findings set out in your report on the scrutiny of new rules demonstrate the fine balance needed between appropriately detailed scrutiny of our work, and the desire for us to be increasingly fleet of foot.

As Edwin Schooling Latter set out in evidence to you, the FCA is rarely accused of acting in an overly hasty manner. When considering an intervention, the FCA receives many, often competing, views and must decide upon a course of action without fear or favour, based upon the evidence. We therefore welcome the Committee's conclusions that any additional ex-ante scrutiny should not be built into the rule making process.

We would support any measures Parliament takes to ensure it has a sufficiently detailed understanding of how we are making decisions, within the bounds of what we can legally share under FSMA. Increased Parliamentary engagement with our consultation proposals would provide us with valuable insights, including into how proposals interact with other areas of public policy. We would support the Committee in exploring a route for prioritising detailed discussion on consultations it feels are most pressing.

Accountability to Parliament

It's clear from some of the evidence the Committee has received, and from debates which took place during the passage of the Financial Services Bill, that there is a sense that some democratic involvement has been lost from the formation of financial regulations, post-Brexit. While the FCA already had extensive powers to make firm facing rules, we are a public service organisation and we derive our powers from Parliament. Democratic oversight is vital for our ability to carry out our mission in an effective and transparent way.

With that in mind we welcome the suggestions in your report as to how Parliament and the Treasury Committee can continue to effectively scrutinise and engage with the work that we do. The scrutiny and challenge that the Treasury Committee and its members have provided to the FCA in pursuit of its objectives over the years since its formation has been invaluable.

Having several set ‘accountability’ hearings with the Treasury Committee as a baseline has helped to provide a continuity of focus on crucial issues as they develop over time. However Parliament chooses to arrange for the scrutiny of the regulators, we will of course continue to be available to answer to all of its committees.

Regulator relationships with the Treasury

The Committee raises concerns that the proposals put forward by the Government, allowing for earlier feedback from the Treasury during the policy formation process, will damage the perception of regulatory independence, even if they do not in practice.

We think that independent regulation is important to maintaining robust, fair standards and, where this is appropriate, maintaining a consistent approach for firms, markets and consumers. As the Committee highlights, the importance of regulatory independence is also recognised internationally. It is important to strike an appropriate balance between ensuring we work effectively with Treasury to secure a cohesive approach, ensuring we are accountable and protecting regulatory independence. We already have very regular engagement with the Treasury through the legal gateway, and we are committed to ensuring that engagement is as effective as possible.

The relationship of FOS decisions to the FCA’s regulatory framework

The Committee’s report outlined concerns that where the Financial Ombudsman is making decisions which go against regulatory principles there should be some right of challenge for those the decision goes against.

We and the Ombudsman Service are aware of the need to ensure that, where complaints potentially have wider implications, the Ombudsman is aware of our expectations of firms in the circumstances presented by the complaint, and we have given consideration to whether there are ways for consumers to obtain fair redress other than going through the complaints process. We and the Ombudsman are currently considering whether any changes to current arrangements are needed to ensure these outcomes are achieved.

I thank you again for the opportunity to comment on the Committee’s important report and look forward to continuing dialogue with you on these issues.

Nikhil Rathi

7 September 2021

Appendix 3: Response from Bank of England

Letter from Chief Executive Officer of the Prudential Regulation Authority

Treasury Select Committee's report on the future framework for the regulation of financial services

I am writing in response to the recent Treasury Select Committee report on the future framework for the regulation of financial services, published in July.

The Bank of England welcomes the Committee's report. As you know, we see our accountability to Parliament as the cornerstone of the future regulatory framework for financial services. We will of course operate in accordance with Parliament's wishes on the appropriate future accountability arrangements, and note the Committee's views on this issue.

The Committee's report supports Treasury's proposal to transfer relevant retained EU law provisions into regulators' rulebooks. As the Bank noted in its written evidence to the Committee, this would give the UK the opportunity to make rules more accessible while moving towards a more coherent prudential regime.[1] This would also enable the Bank to tailor the prudential regime to the UK market, for example by delivering a 'strong and simple' prudential framework for non-systemic UK-focused banks and building societies. Under this model we should also be able to act more dynamically in targeting responses to changes in the market.

This change in role represents a major undertaking for regulators and the Committee notes that regulators will need appropriate resources to deliver it efficiently. We agree. We are determined to maintain a strong focus on the efficiency of our operations, but taking on this larger role will inevitably require more staff – albeit we anticipate that this increase will be a relatively small portion of current total staffing levels. Some of this needs to happen now, subject to consultation with levy-payers, but the wider change to the nature of our rules, and our role in that, will not happen overnight – though we will prioritise areas of greater opportunity or need.

In its report, the Committee also makes a range of recommendations on the statutory framework, consultation requirements with HMT, and accountability arrangements for the regulators. These are a matter for Parliament to decide, and we look forward to Parliament's view on how such arrangements should be structured.

Coming to objectives, likewise these are for Parliament to define and us then to deliver. Our view is that regulation works best if regulators' objectives are focused, complementary and clearly delineate responsibilities and accountability. Focused objectives that complement, rather than compete with, each other make it more likely that we will be effective and should make it easier for us to be held to account by Parliament. We are also aware that a proliferation of objectives and 'have regards' could dilute the focus of the regulatory regime. However, there is a balance to be struck, and it seems reasonable to expect that regulators' mandates might evolve somewhat as regulators' roles change and we take

1 Written evidence submitted by the Bank of England (FFS0080)

on some functions previously exercised by the Government through its role in the EU legislative process. As the report notes, there are some advantages to the Government's use of remit letters to set 'have regards'.

In that spirit, we suggest that in order to ensure regulatory effectiveness the framework should be shaped by some key principles as follows:

- Maintaining high standards, which are crucial both to our existing objectives and to the UK's international standing as a place to do business;
- Dynamism to respond to new opportunities and risks;
- Efficiency so that the cost of regulation to the public and to firms remains proportionate;
- Transparency around regulatory decisions and the rationale for them, to support legitimacy; and
- Taking a UK-tailored approach to setting standards while meeting international norms, rather than becoming 'rule-takers' who mechanically apply other jurisdictions' approaches.

I hope this is helpful to the Committee and would be happy to discuss this further.

Sam Woods

10 September 2021