

Innovate Finance submission to House of Lords European Affairs Committee inquiry into the UK-EU relationship on financial services

Contents

About Innovate Finance	2
Post-Brexit opportunities for the UK financial services sector, including in relation to possible areas of future growth	3
Table 1: Principles for regulators to consider for their approach to FinTech	9
Annexe 1: Financial Services Future Regulatory Framework Review: Proposals for Reform Innovate Finance response to HM Treasury consultation	11

About Innovate Finance

Innovate Finance is the independent industry body that represents and advances the global FinTech community in the UK. Innovate Finance's mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators.

The UK FinTech sector encompasses businesses from seed-stage start-ups to global financial institutions, illustrating the change that is occurring across the financial services industry.

Since its inception in the era following the Global Financial Crisis of 2008, FinTech has been synonymous with delivering transparency, innovation and inclusivity to financial services. As well as creating new businesses and new jobs, it has fundamentally changed the way in which consumers and businesses access finance.

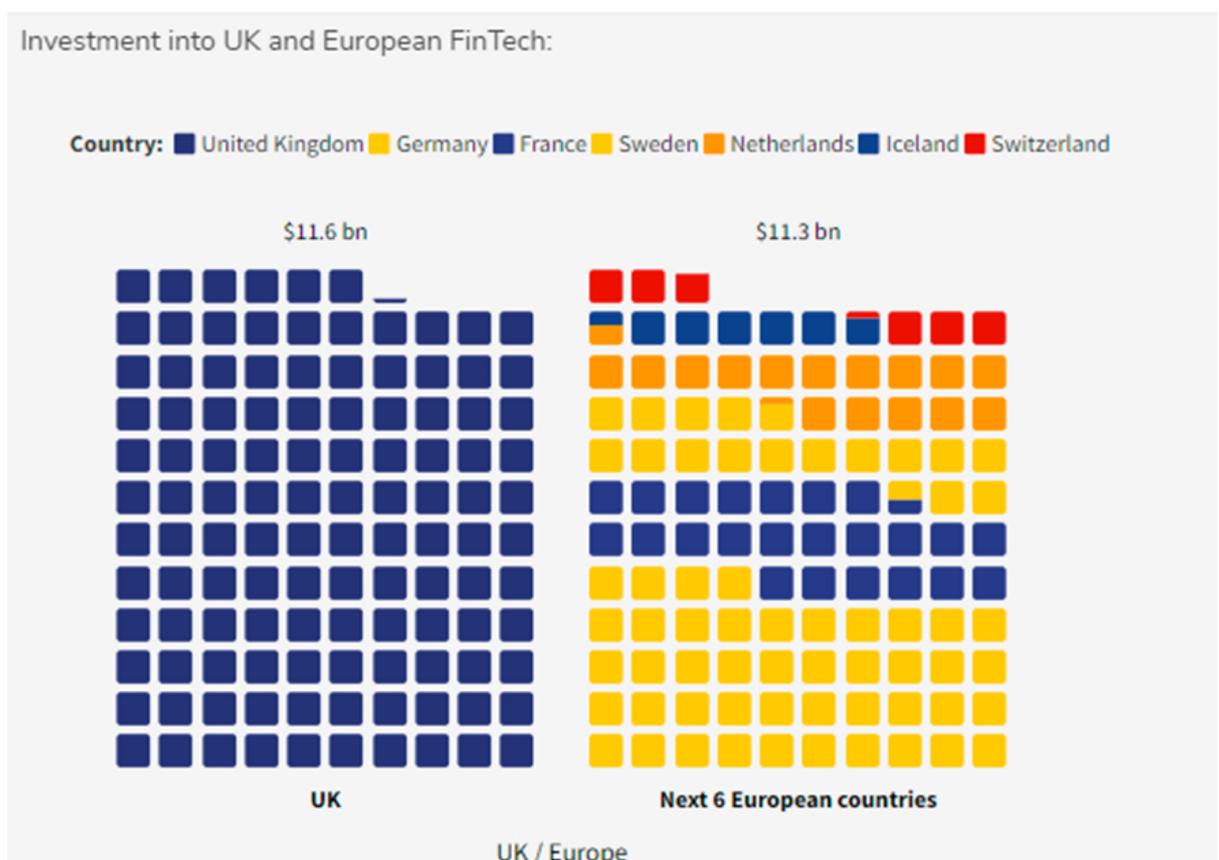
Post-Brexit opportunities for the UK financial services sector, including in relation to possible areas of future growth

Financial technology (FinTech) is a fast-growing element of the UK's financial services sector.

FinTech companies have emerged since the global financial crisis of 2008, bringing new technology to bear, putting consumers and small businesses at the forefront of their business models.

To provide a sense of the growth of FinTech in the last decade:

- In 2021, \$11.6bn was invested into UK FinTech companies - a record number¹. By way of comparison, in 2014 \$929m was invested into UK FinTech. Last year, only the United States attracted more capital into FinTech than the UK; on this measure Britain is well ahead of its European neighbours. This chart shows that in 2021 investment in the UK was equivalent to the next six countries in Europe's Top 10 combined.



¹ <https://www.innovatefinance.com/capital/a-record-breaking-year-in-fintech/>

- Data compiled by Innovate Finance in September 2021 shows that alternative FinTech lenders and banks increased their contribution of the total amount lent to all UK SMEs from 50% in 2014 to 65% in 2019 (from £69bn to £83bn). Despite initial obstacles and delays to obtaining accreditation for the Coronavirus Business Interruption Loan Scheme (CBILS), FinTech lenders and banks provided around 30% of all CBILS Loans to businesses in 2020.
- During the pandemic FinTechs have continued to support individuals and businesses, accelerating the adoption of FinTech products which are now being used by 8 out of 10 UK citizens.
- British FinTech firms are challenging and overtaking incumbent banks, with Revolut valued at \$33 billion last year. Other UK FinTech “unicorns” in the UK include: Checkout.com (valued at \$40bn in January 2022), OakNorth Bank (valued at \$5bn in 2021), Monzo (valued at \$4.5bn in December 2021), Starling Bank (valued at \$1.9bn in February 2021), and GoCardless (valued at \$1bn in March 2022)

The growth of new technologies such as cloud computing, blockchain and artificial intelligence, together with a greater consumer use of digital platforms for engaging with financial services and shopping (ecommerce) has powered the expansion of FinTech.

Another crucial element behind the UK FinTech success story is the UK’s unique and proactive approach to FinTech regulation.

Initiatives such as the rollout of Open Banking, the FCA’s regulatory “sandbox”, and an overall desire to take a proportionate approach to regulating new business models has led to the UK taking the position as global leader for FinTech regulation. The success of the regulatory “sandbox” was such that it has now been replicated by nearly 50 other jurisdictions around the world.

Brexit is an opportunity for an even more forward-thinking UK regulatory system, one that protects the consumer and enables innovation and competition in financial services to thrive. This is crucial, because it is innovation and competition that ultimately leads to benefits for end users - consumers, citizens and small businesses.

In its recent paper on the benefits of Brexit, the Government set out guiding

principles for regulation which include a desire to “lead from the front” to develop new technology and ‘proportionality’. However, many FinTech founders (including members of Innovate Finance) are concerned that these positive objectives are not always reflected in the actions of regulators like the FCA. FinTech firms fear regulators may take a more risk-averse approach.

Innovate Finance’s view is that the UK requires a new wave of regulatory innovation to unlock and nurture the next generation of FinTech innovation for the benefit of consumers and small businesses.

Principles for regulators to consider for their approach to FinTech

We would recommend that as regulators face new technology, their post-Brexit regulatory approach should be guided by three principles.

This is summarised in Table 1, below.

1. Fit-for-purpose regulation

- Out-of-date rules need to be removed or updated, and new products should be brought into the regulatory perimeter faster.
- The FCA is proposing a new ‘outcome-based’ consumer duty. This could support innovation, but only if it replaces existing tick-box regulation, some of which (like the Consumer Credit Act) is 50 years old and no longer serves to provide positive outcomes for consumers. Outcome-based rules will not promote innovation if they are superimposed on top of existing prescriptive rules. The FCA is proposing to remove two existing handbook principles, but aside from that there is no indication of other regulatory requirements being removed in favour of outcome-based requirements. In advance of the introduction of the new Consumer Duty, we recommend that there be a thorough, post-Brexit review of FCA retail consumer regulation to identify existing prescriptive rules which could be removed when the Consumer Duty is introduced².
- Some examples of rules and guidance that could be replaced by the Consumer Duty include (non-exhaustive list):

² Further details are set out in the Innovate Finance response to the FCA’s consultation on a New Consumer Duty: <https://www.innovatefinance.com/blogs/a-new-consumer-duty>

- Various sections of the Consumer Credit Act (1974) (“CCA”), including prescriptive rules on communication with customers, contract forms and communication of late payments. In many cases, better outcomes can be achieved for consumers by reliance on the Consumer Duty and scrapping ineffective, prescriptive ‘tick box’ rules. While we recognise that making amendments to the CCA is not within the FCA’s gift, we note that when Parliament repealed some CCA requirements they were then replaced by rules within the FCA Handbook.
- Related to the CCA rules on notices of sums in arrears (“NOSIAs”), for example, sections of the FCA’s consumer credit sourcebook (“CONC”) could be removed such as CONC 7.17. Where consumers have entered into a forbearance arrangement with their lenders, the application of NOSIA rules can cause confusion and distress. In this scenario, firms compliance with prescriptive NOSIA rules is ostensibly at odds with the consumer understanding and good customer outcomes promoted under the Consumer Duty regime.
- Financial promotion obligations where the consumer duty obligations apply.
- Outside of the EU, the UK now has the ability to move quickly. However, as has been seen in the example of Buy Now, Pay Later, new providers are ready and willing to be regulated but the process has been slow, creating unnecessary uncertainty.
- Reform capital requirements to remove the minimum requirement for own funds and eligible liabilities (MREL) burden on smaller new banks and revise SME capital ratios. This would level the playing field for FinTech or “challenger” banks and EMIs, remove disincentives for global investors into UK FinTech by improving the landscape and growth opportunity for FinTech companies, and unlock further lending to SMEs by allowing more capital to be made available for borrowing. EY estimates MREL rules will reduce SME lending by £42bn over 5 years (20% of lending)³. The Bank of England should raise the threshold for MREL and clarify some of the transition arrangements. MREL is a scheme designed to prevent the ‘too big to fail’ approach but applied to many banks that are not big and where any corporate failures would be absorbed by the wider market. The PRA should also make it easier for the Challenger banks to use IRB (the internal ratings-based approach to capital requirements for credit risk-large banks are allowed to use a ‘modelling approach’ which enables more efficient capital provisions) for their SME loan risk weightings, and

³ EY report: [MREL financial implications for mid-size and challenger banks](#)

where IRB isn't permitted/used, the PRA should reduce standard risk weightings for SME loans to reflect the underlying risk of the asset class. At present these increase capital requirements which challenger banks could otherwise put to productive use by lending to small firms.

2. Fit-for-the-future regulation.

- Introduce a consumer data right to create an economy-wide Open Data ecosystem. FinTech companies want to see the rollout of Open Finance to unlock new uses of Smart Data that go above and beyond Open Banking. This could see the emergence of far more holistic personal financial management platforms, where consumers can have a really clear, up-to-date and accurate picture of their financial life. The majority of contributors to the Kalifa Review of UK Fintech⁴, and many Innovate Finance members (which include Third Party Providers and Technical Service Providers), agree that Open Finance is worth pursuing within the context of wider Smart Data projects.
- Legislation for Digital ID. As highlighted in the Kalifa Review, being able to determine an individual's identity and that "you are who you say you are" is critical to accessing financial services. Government and regulators must work with the industry to achieve the outcome detailed in the Kalifa Review, namely to secure the "effective development of the future digital ID architecture and ecosystem [which] will provide more safe and secure financial transactions for all UK citizens."
- The UK needs a coherent, joined-up strategy for regulating digital money, to include cryptocurrencies, central bank digital currency (CBDC), decentralised finance and blockchain-enabled market infrastructure. Regulators must recognise that (aside from anti-money laundering rules) squeezing new products into old rules often does not work. The FCA's current proposals for extending financial promotion rules to crypto-assets would create a situation where there is no viable route for a crypto-asset firm to obtain approval for otherwise compliant financial promotions or marketing.⁵ The UK has the opportunity to be the leading G7 country for blockchain-enabled financial services, including payments systems, environmental, social and governance (ESG) assurance and capital markets infrastructure. To capitalise on this, we now need a strong vision from the UK government, a joined-up strategy and a regulatory system that can evolve in collaboration with industry and other nations.

⁴ <https://www.gov.uk/government/publications/the-kalifa-review-of-uk-fintech>

⁵ See Innovate Finance response to FCA consultation CP22/2 on "Strengthening our financial promotion rules for high risk investments, including crypto-assets": <https://www.innovatefinance.com/blogs/fca-consultation-paper-strengthening-our-financial-promotion-rules-for-high-risk-investments-including-crypto-assets-cp-22-2-innovate-finance-response/>

- Regulators need to continue to engage with and support the RegTech and Supervisory technology (“SupTech”) providers to design technology-based compliance that achieves better outcomes at lower cost.
- Regulators must develop better understanding of technology across regulatory functions and include a “RegTech test”, assessing whether and how the proposals enable RegTech solutions for compliance. This also means a shift to greater adoption of RegTech, including a timetable for implementing machine-readable regulatory rulebooks.

3. Reform of regulators

We need reform of regulators themselves. The government’s Future Regulatory Framework is a good start, with its proposal for regulators to have a statutory secondary objective to promote the competitiveness of UK financial services.

Innovate Finance’s full response to the Future Regulatory Framework Review can be seen in the annex to this document, but to summarise, Innovate Finance thinks that:

- The proposed framework should be expanded in scope to include all financial services regulators: including the Bank of England (“BoE”) and Payment Systems Regulator (“PSR”), as well as the Prudential Regulation Authority (“PRA”) and Financial Conduct Authority (“FCA”). While we recognise that there is a forthcoming consultation on the regulation of payments firms by the BoE and PSR, which aims to ensure alignment with the broad principles of the Future Regulatory Framework Review, we remain concerned that this may lead to a fragmented and sectoral approach taken by the regulators.
- Regulators must have specific consideration of the impact of regulation on start-up and scale-up entities. This should include statutory requirements for a more comprehensive approach to cost benefit analysis methodologies — and specifically all new regulations should include a start-up and scale-up test (assessing proportionality of the proposals).
- Reform of the Financial Ombudsman Service (“FOS”) must be included: given the FOS’ quasi-regulatory role and impact on industry, we recommend that an independent review take place to check whether it remains fit for purpose. We would recommend that the governance and accountability mechanisms are reviewed, and the Future Regulatory Framework measures on accountability and scrutiny should be applied to FOS, as well as our additional recommendations on culture change and capacity building. Further, we recommend that the independent review

should consider whether the introduction of 'have regards', which the FOS must take into account while exercising its functions, would be beneficial.

- Accompanying culture change and capability building must take place: the new objectives will only be successfully applied if accompanied by a culture (behaviours and incentives, at all levels of the organisation) that supports them, and culture change to achieve these; and the right capability, in terms of skills, knowledge and resources. Industry interchange should be encouraged and measured, technology skills and understanding should be rolled out across all supervisory and policy teams, and the resourcing of regulators should be assessed to identify whether they have sufficient capacity, as well as capability, to respond in an agile manner to new market developments. A regular independent benchmarking study should be used to provide additional accountability and organisational support for the international competitiveness and growth objectives. The benchmarking exercise should also monitor domestic competition in financial services to ensure the focus on international competitiveness does not inadvertently entrench incumbents' dominant position across key industry verticals.

Table 1: Principles for regulation to strengthen the UK’s leading position in financial innovation

1. Fit for purpose: updating existing rules	2. Fit for the future: Enabling innovation	3. Innovative, agile regulators
Bring new technology and services into the regulatory perimeter , with proportionate regulation that protects consumers and supports innovation including BNPL and crypto regulation.	Introduce Consumer Data right to create economy wide open data – unlocking new Fintech solutions including NetZero, financial inclusion and SME lending. Support this with legislation for Digital ID.	Reform regulators’ capability, capacity and culture to underpin proposed competitiveness objectives. Including statutory benchmarking reports, capability reviews and industry interchange.
Reform out of date legislation that provides poor consumer outcomes and/or fails to reflect technology: including Consumer Credit Act. And review regulation to remove barriers to Net Zero solutions.	Digital currencies: Introduce CBDC – possibly starting with wholesale currency and regulation for asset backed stablecoin – to establish the UK as the centre of the next phase of payment technology.	A consistent approach – across all regulators including FOS, Bank of England and PSR. New Future Regulatory Framework should be extended to these regulators and ‘quasi regulators’ and action taken to ensure FOS and FCA have the same interpretation of rules.
Reform capital requirements to remove MREL burden on smaller new banks and revise SME capital ratios - to level the playing field for challengers, remove disincentives for global investors, and unlock lending.	Enable RegTech solutions. Launch machine readable regulatory rule books. Enable machine readable ESG data. Introduce a RegTech test: requirement for all new regulations to consider how best to enable SupTech/ RegTech solutions	Support start-ups and scale ups: extend the FCA scalebox to the PRA; introduce start-up and “scale-up test” as part of Cost Benefit Analysis.

Concluding comments

Regulation can bring many positives. It can:

- create trust and confidence for consumers and investors, supporting adoption and growth of innovation and attracting innovative firms to the UK as a trusted jurisdiction;
- open up market opportunities for innovation and new services;
- enable technology-based compliance solutions, whether RegTech or SupTech;

However, regulation can also bring negatives and hinder innovation if it:

- applies analogue approaches to digital solutions;
- fails to understand current customer behaviours;
- fails to appreciate how digital customer journeys can be designed to achieve better outcomes;
- has built-in bias in favour of incumbents and larger firms; and / or fails to keep up with market and technology developments.

Maintaining and strengthening UK competitiveness means both supporting innovation and protecting consumers and financial stability; it is not an 'either, or' equation.

The UK is home to some of the largest global players in FinTech, is a world leader in FinTech investment, and is in many ways driving the international financial innovation agenda.

However, if we – government, regulators, and industry - rest on our laurels, the innovators who are making financial services more democratic, more effective, and more inclusive will go elsewhere, taking jobs and economic growth with them. Consumers will miss out on beneficial services and may even be left unprotected from unscrupulous players.

But if the government, regulators and industry come together to seize the clear opportunity that lies before us, in supporting a new wave of effective regulation, we can secure the UK's position as the trusted global centre for financial services.

We would be pleased to discuss our response in more detail with the members of the Committee, and facilitate discussions with our members and the wider FinTech ecosystem.

Annexe 1: Financial Services Future Regulatory Framework Review: Proposals for Reform Innovate Finance response to HM Treasury consultation

About Innovate Finance

Innovate Finance is the independent industry body that represents and advances the global FinTech community in the UK. Innovate Finance's mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators.

The UK FinTech sector encompasses businesses from seed-stage start-ups to global financial institutions, illustrating the change that is occurring across the financial services industry. Since its inception in the era following the Global Financial Crisis of 2008, FinTech has been synonymous with delivering transparency, innovation and inclusivity to financial services. As well as creating new businesses and new jobs, it has fundamentally changed the way in which consumers and businesses access finance.

Introduction

We welcome HM Treasury's consultation on proposals for reform of the regulatory framework for financial services. This is a unique opportunity to develop a regulatory regime that is fit for purpose and fit for the future. The onshoring of EU regulations and the increasing pace of regulatory change and extension of the UK's regulatory perimeter, means that ever increasing powers are given to the financial services regulators. This should enable regulators to act with greater speed and agility, but it also calls for an effective framework that guides and oversees this increased power.

We support the proposals set out by HM Treasury ("HMT"). In particular, we strongly support the introduction of secondary objectives for international competitiveness, economic growth and specific reference to Net Zero and climate change.

In order for HMT's proposals to succeed, the framework needs to be expanded and developed and a wider reform programme actioned alongside it. In this paper we provide our response to the specific questions and proposals set out in

the consultation document and also highlight other areas we believe are critical to success.

In particular we call for the following:

- **The proposed framework should be expanded in scope to include all financial services regulators:** including the Bank of England (“BoE”) and Payment Systems Regulator (“PSR”), as well as the Prudential Regulation Authority (“PRA”) and Financial Conduct Authority (“FCA”). While we recognise that there is a forthcoming consultation on the regulation of payments firms by the BoE and PSR, which aims to ensure alignment with the broad principles of the Future Regulatory Framework Review, we remain concerned that this may lead to a fragmented and sectoral approach taken by the regulators.
- **Reform of the Financial Ombudsman Service (“FOS”):** given the FOS’ quasi-regulatory role and impact on industry, we recommend that an independent review take place to check whether it remains fit for purpose. We would recommend that the governance and accountability mechanisms are reviewed, and the Future Regulatory Framework measures on accountability and scrutiny should be applied to FOS, as well as our additional recommendations on culture change and capacity building. Further, we recommend that the independent review should consider whether the introduction of ‘have regards’, which the FOS must take into account while exercising its functions, would be beneficial.
- **Accompanying culture change and capability building:** the new objectives will only be successfully applied if accompanied by a culture (behaviours and incentives, at all levels of the organisation) that supports them, and culture change to achieve these; and the right capability, in terms of skills, knowledge and resources. Industry interchange should be encouraged and measured, technology skills and understanding should be rolled out across all supervisory and policy teams, and the resourcing of regulators should be assessed to identify whether they have sufficient capacity, as well as capability, to respond in an agile manner to new market developments. A regular independent benchmarking study should be used to provide additional accountability and organisational support for the international competitiveness and growth objectives. The benchmarking exercise should also monitor domestic competition in

financial services to ensure the focus on international competitiveness does not inadvertently entrench incumbents' dominant position across key industry verticals.

- **Innovation and Regulatory Technology ("RegTech")**: to enable technology and ensure continued innovation can bring economic, social and environmental benefits to the UK (in UK and global markets), the framework needs to enable and accelerate RegTech and Supervisory technology ("SupTech") solutions, develop better understanding of technology across regulatory functions, and require specific consideration of the impact of regulation on start-up and scale-up entities. This should include statutory requirements for a more comprehensive approach to cost benefit analysis methodologies — and specifically all new regulations should include a start-up and scale-up test (assessing proportionality of the proposals) and a RegTech test, assessing whether and how the proposals enable RegTech solutions for compliance. This also means a shift to greater adoption of RegTech, including a timetable for implementing machine-readable regulatory rulebooks.

Regulation matters to the UK FinTech ecosystem. Regulation can:

- create trust and confidence for consumers and investors, supporting adoption and growth of innovation and attracting innovative firms to the UK as a trusted jurisdiction;
- open up market opportunities for innovation and new services;
- enable technology-based compliance solutions, whether RegTech or SupTech; and
- hinder innovation if it:
 - applies analogue approaches to digital solutions;
 - fails to understand current customer behaviours;
 - fails to appreciate how digital customer journeys can be designed to achieve better outcomes;
 - has built-in bias in favour of incumbents and larger firms; and / or
 - fails to keep up with market and technology developments.

Maintaining and strengthening UK competitiveness means both supporting innovation and protecting consumers and financial stability; it is not an 'either, or' equation.

We have set out our wider priorities and comments in more detail, followed by our responses to the specific questions raised in the consultation. We would be pleased to discuss our response in more detail with HM Treasury and / or facilitate discussions with our members and the wider FinTech ecosystem.

1. Scope: all Financial Services regulation and regulators

All financial services regulators

The consultation proposes that the framework (including the objectives, accountability and cost benefit analysis approach) would apply to the PRA and the FCA. This leaves a wide range of other financial regulators out of scope, **including the BoE and PSR**. We believe all the regulators should be bound by the framework. The BoE, for example in its approach to capital requirements for smaller banks, has the ability to significantly impact the competitiveness of the UK's challenger banks. On the question of reform of minimum requirements for own funds and eligible liabilities ("MREL"), where it has applied a more robust regime than the EU and US, the BoE has rejected the case for more proportionate regime for smaller banks despite evidence of limited financial stability impact and evidence that its approach is limiting lending to the real economy. An EY report⁶ examining the disproportionate impact of the BoE's MREL regime for mid-tier and challenger banks identified potential foregone lending of £42bn — which amounts to c.20% fall in the projected stock of lending to customers — for 11 mid-tier and challenger banks over a 5-year period, versus a non-MREL scenario. This reduced lending is significant as mid-tier and challenger banks tend to operate in segments of the market that may otherwise be poorly covered or not served at all (e.g. SME lending and specialist mortgages). EY also highlighted the significant impact of the MREL regime on profitability (37% reduction over 5 years), severely impacting the ability for mid-tier and challenger firms to grow, attract investment, and compete, while also weakening financial strength and stability. Additionally, there is uncertainty as to how the PRA will implement Basel 3.1: our members remain concerned that the SME discount factor may be removed (the European Banking Authority previously adopted it and PRA had to follow whilst the UK was in the European

⁶ ey-mrel-financial-implications-mid-size-challenger-banks.pdf

Union). If the SME discount factor were to be removed, it would not only negatively impact our mid-tier and challenger banks' competitiveness, but also the flow of capital to UK-based SMEs.

Further, as it currently stands, the BoE's proposed 'strong and simple' prudential framework for non-systemic banks and building societies offers no benefits to scaling digital banks. This issue is compounded by current capital requirements and the lack of level playing field between banks permitted to use standardised versus internal ratings-based models for credit risk (particularly given the Pillar 2B concentration risk add-on for UK focussed banks).

Moreover, the UK regulators' approach to Operational Resilience means that it applies equally and in full to small and larger firms. Operational Resilience requires firms to set impact tolerances and test them in relation to each important business service — in order to do this, as a first step, firms had to identify and document the necessary people, processes, technology, facilities and information required to deliver each of its important business services. This created significant resource needs for our start-up and scale-up members. The lack of a pragmatic, risk-based and proportionate approach to regulation by the BoE and other financial services regulators adds to the regulatory burden for start-up and scale-up firms and lessens the international attractiveness of the UK as a place to do business.

Regulation, such as that described above, needs to be more clearly linked to wider objectives, and demonstrate a proportionate cost benefit analysis. Alongside this, regulators need to be accountable and challengeable.

The PSR and FOS are increasingly significant players in the financial services regulatory regime. As the regulatory perimeter expands, more firms are coming within the ambit of FOS (for example buy now, pay later firms). While the FOS is not a regulator, our members consider that the FOS acts in a quasi-regulatory capacity, without the relevant checks and balances.

Our members increasingly express frustration at the lack of consistency between FCA and FOS interpretation of regulation, in the context of adjudication. This incoherent application of FCA rules sets unhelpful precedents and imposes new requirements for firms to manage, broader than those contained in the Handbook. The viewpoint from industry is that the 'golden sources' for firms' compliance, legal, and risk professionals should be the regulator's rulebook, and points raised during bilateral supervisory dialogue. The quasi-regulatory

requirements arising from FOS' findings translate to uncertainty and unpredictability from a compliance standpoint, which start-up and scale-up firms find costly to manage.

One example of this unpredictability leading to significant costs for firms is around the varying FOS viewpoints on what amounts to effective warnings (to alert consumers to potential Authorised Push Payment ("APP") fraud) in the payments journey. Start-ups and scale-up firms have spent significant sums to create bespoke, well-evidenced solutions with the understanding from FOS that they were 'effective', only to find that when challenged by a consumer, the FOS found in favour of the complainant. As the Financial Services and Markets Act makes FOS decisions final and binding on firms, but not on consumers (complainant's recourse to the courts is unaffected), firms had no appeal mechanism (save for judicial review⁷ on the grounds of some error of law or procedural impropriety relating to the manner in which the decision was reached). We would therefore recommend that a suitable appeal mechanism be introduced.

Further, the precedents set by the FOS' casework can have significant unintended consequences for the industry with regard to economic crime: in terms of online scams, our members' experience indicates that organised gangs are exploiting the FOS' approach to money mule cases and are actively targeting UK-based payment services providers as a result.

Moreover, the FOS' fee structure can cause significant damage to smaller providers and innovators (with a set £750 fee payable per case⁸ whether the case is successful or not), and when used by less scrupulous claims management companies this has the potential ability to kill off entire new services and sectors. Further, we have also heard of a backlog of 50,000 cases at FOS, which ties in with our recommendations on capacity building.

Reform is needed to make the ombudsman fit for purpose and fit for the future, aligned to the principles of the Future Regulatory Framework Review and to ensure consistency with the FCA. While the publication of FOS' action plan⁹ for internal transformation is a welcome step forward, we do not consider this is

⁷ Judicial review of FOS has been pursued very rarely. There are examples from 2020 where the Administrative Court allowed a judicial review claim quashing three FOS final decisions – for example, see *R (TF Global Markets (UK) Ltd (t/a Thinkmarkets)) v Financial Ombudsman Service Ltd* [2020] EWHC 3178 (Admin) (25 November 2020).

⁸ Which follows after the first 25 'free' cases.

⁹ <https://www.financial-ombudsman.org.uk/who-we-are/governance-funding/action-plan-2021>

enough to address the issues raised¹⁰. If Parliament itself is to play a role in setting the regulatory principles of the FCA, it needs to be satisfied that the principles which it has set the FCA are not being undermined by decisions by the FOS. Similar concerns have also been raised by the Treasury Committee¹¹. To that end, applying the regulatory framework (including the additional measures we propose) would be a good start and would ensure consistency across the regulators.

Similarly, the PSR is grappling with a greater set of issues and challenges, and new participants and technologies, than envisaged when it was set up. The recent PSR consultation on APP scams contained a flawed and inadequate cost benefit analysis, which reflected a failure to engage widely beyond the large, established market incumbents and failed to assess the impact on new entrants, scale-ups and start-ups. Further, the PSR's consultation on remedies following the market review into card acquiring services does not include a worked-up cost benefit analysis; instead, the PSR seeks comments on its proposed methodology (which does not appear to consider the impacts for the FinTech ecosystem). We would recommend that cost benefit analyses take place before proposed policy interventions are shared with industry for comments.

The *Kalifa Review of UK FinTech*¹², published in February 2021, for which Innovate Finance served as the co-secretariat, highlighted a number of issues within the current regulatory framework for payments. An overarching comment from the *Kalifa Review* was that the move towards principles-based regulation in payments services has been welcome, since it will enable the regulation to adapt to change. However, contributors to the *Kalifa Review* voiced concerns about existing rules. The Review noted that some rules may inhibit the effective operation and regulation of key aspects of payment services — such as the rules relating to Strong Customer Authentication, acquiring, and capital and liquidity. Contributors to the *Kalifa Review* said that these issues are impeding innovation and deterring new entrants, resulting in a less competitive environment, to the detriment of consumers.

¹⁰ The Treasury Committee has also requested more information from the FOS, following the publication of its action plan. This follows previous concerns raised by the Committee in January 2021 – see <https://committees.parliament.uk/committee/158/treasury-committee/news/159498/treasury-committee-requests-further-information-on-fos-action-plan/>

¹¹ <https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/147/147.pdf>

¹² <https://www.gov.uk/government/publications/the-kalifa-review-of-uk-fintech>

Again, application of the proposed Future Regulatory Framework Review reforms to PSR, together with our wider proposals set out here, would help to address some of these issues.

In addition to the FOS, PSR, and BoE, consideration should also be given to applying the principles of the Future Regulatory Framework Review to other regulators who have an increasing role in financial services — notably the Information Commissioner’s Office (“ICO”) and the Competition and Markets Authority (“CMA”).

With reference to the CMA, the view from the FinTech community is that the right balance between consumer protection, competition and growth is not being struck. There is a case for a more flexible approach to the assessment of mergers for nascent and fast-moving markets such as FinTech. This is because some consolidation will be critical in facilitating the scale that UK FinTechs need in order to become global champions.

Unless all financial regulators are brought into scope, we risk developing an even more inconsistent, disjointed and disproportionate regime, where the competitiveness objectives of FCA and PRA can be undone by other regulators.

Joined-up, strategic approach to regulation

The Government paper *A New chapter for Financial Services*¹³ (July 2021) provides a clear strategic direction, endorsed by the BoE and FCA and supported by the UK FinTech ecosystem. We believe that in the same way that this provides a high-level guiding star for UK financial services, there is an opportunity for further coordination and strategic cohesion between Government departments and the regulators in supporting a vision of UK financial services and within that UK FinTech. We would encourage this to be developed as part of the Future Regulatory Framework Review outcomes.

Our members regularly highlight the need for more cohesion across government — to ensure all regulators and departments are pointing in the same direction.

The *Kalifa Review* noted that “multiple departments and regulators have important FinTech competencies and functions” and recommended a strengthening of strategic coordination to ensure “delivery of the Government’s

¹³ <https://www.gov.uk/government/publications/a-new-chapter-for-financial-services>

stated objectives for FinTech through executing an impactful and coherent FinTech strategy and ensuring a joined-up policy approach on cross cutting issues related to digitalisation and digital finance”.

We would encourage HMT — as part of the Future Regulatory Framework — to make provisions for cross-regulator coordination, and the ability to set clear accountability for delivery of cross agency projects. Taking a specific example, there has been a lot of work in government departments and regulators on open finance and smart data. Efforts have been made to strengthen coordination, notably the smart data working group which brings together four Whitehall departments (Department for Business, Energy and Industrial Strategy (“BEIS”); Department for Digital, Culture, Media and Sport (“DCMS”); HMT; and Department for Work and Pensions (“DWP”)) and six regulators (Office of Gas and Electricity Markets (“Ofgem”), Office of Communications (“Ofcom”), the FCA, the CMA, and the ICO). Copious consultations and papers have been published on different aspects, and we still lack a single plan across the regulators and a firm timetable for implementation. A new model is needed for timely and effective development and delivery of projects that span multiple regulators.

While the publication of the *Wider Implications Framework*¹⁴ (January 2022) is a welcome step in the right direction, it does not address in full the issues raised above. The membership of the group does not extend across the regulatory family, and it does not include governmental departments. Further, the Terms of Reference for the group suggest that “consistent and complementary approaches may only be achieved where compatible with the members’ respective statutory roles and functions. The regulators’ respective statutory roles and functions should not serve as a stumbling block in the path towards greater cross-agency coordination — we would recommend that this issue be examined as part of the Future Regulatory Framework Review.

As noted above, there is increasing risk of divergence in interpretation between FCA and FOS, and mechanisms are needed to ensure a single, shared interpretation of regulations and a consistent approach to compliance. There are indications that in exercising its judgement as to what conduct on the part of firms is ‘fair and reasonable’, the FOS sometimes appears to be policing and enforcing FCA rules, including purporting to develop its own interpretations of these rules. We would welcome greater clarity in terms of how the FOS is expected to apply the ‘fair and reasonable’ standard for assessing customer

¹⁴<https://www.financial-ombudsman.org.uk/news-events/financial-regulatory-family-strengthen-wider-implications-framework>

complaints in a way that does not involve the FOS acting out of the scope of its statutory remit.

Bringing all regulation in scope

We are supportive of HMT's intention that the Future Regulatory Framework approach be applied to onshored EU legislation as well as pre-existing and new UK legislation and regulatory rules.

2. Culture, capability and capacity

The new objectives will only be successfully applied if accompanied by a culture (behaviours and incentives, at all levels of the organisations) that supports them, and culture change to achieve these; plus the right capability, in terms of skills, knowledge and resources.

In particular the new objectives, and a wider understanding of innovation and the markets being regulated, need to be embraced in individual supervisory teams, not just at leadership levels and in innovation or environmental, social and governance ("ESG") teams. A comprehensive programme of culture change and capability is needed.

The pace of change in technology and the market means it is difficult for 'vertical' supervisory and policy teams to keep up with change. Lack of capacity and capability to think about FinTech innovation in established sectors and to process new approvals can mean that the UK regime is less responsive and/or ill-designed for scale-ups.

To engender confidence with the FinTech community and wider financial services industry, it will be imperative that the regulators demonstrate upskilling of their teams, as they now can exercise significant new powers. As an example, in 2021, the FCA announced¹⁵ that it reformed its decision-making powers, so that it can take faster and more effective decisions for consumers, markets and firms. In practice, this means that senior managers can trigger criminal and civil actions against firms, without the need in many cases for escalating upwards to the Regulatory Decisions Committee ("RDC"). We remain concerned that without the requisite knowledge and training for FCA senior managers, and without the challenge of the RDC, it could result in an unfortunate "shoot first, ask questions

¹⁵ <https://www.fca.org.uk/news/press-releases/fca-reforms-decision-making-tackle-consumer-harm>

later” approach. If the regulator were to misfire in its approach, say when a FinTech was in the lead up to IPO, it could have serious ramifications.

Culture

Objectives need to be accompanied by a commitment to making them a reality, reinforced with ways of working and incentives within the regulators. We would like to see a requirement for each regulator to:

- set out a **culture change plan** to support the new framework and objectives, including measurable actions and targets;
- produce an **annual report on the new objectives**, including action taken to embed them and progress on culture change; and
- regularly (perhaps every three to five years) commission an **independent benchmarking review of its regime** against those in appropriate other international financial centres. The report should be published and laid before Parliament for scrutiny by the Treasury Select Committee. The regulators should be expected to have delivered improvements to the international competitiveness of their regime between successive iterations of this benchmarking exercise.

Skills and knowledge

We should aim for a mutual culture between regulators and FinTech of learning and improvement. In each regulator — or possibly across regulators — we would recommend a range of learning zones to strengthen interchange and exchange of ideas and understanding between FinTechs and the regulators. This might include:

- **A discussion forum:** for the people at the regulators and FinTech community to exchange ideas in a safe space, sharing insights and challenges, and exploring options and approaches in a Chatham House Rule environment.
- **Interchange:** a secondment programme, with people from the regulators and scale-ups spending time in each other’s organisations. From a ‘week in FinTech/FCA’ to a formal six-month or two-year secondment to a specific role. This should also include continuing, and expanding, the FCA’s

Tech Sprint programme. Safeguards will of course need to be put in place to protect against regulatory capture.

- **Learning and development:** regulators' employees should all have a learning objective or continuous professional development focused on developing understanding of technology. Where there is a 'scalebox', participating scale-ups could have matching development goals on supervisory and regulatory understanding. This could be supported by a joint training programme and events on topical or priority issues. A leadership development programme, with a cadre of future talent in the FCA and in scale-ups could undertake learning together.

Resources

In a number of areas recently we have seen significant backlogs. This includes a reported backlog of 50,000 cases at FOS; and in terms of the FCA's cryptocurrency anti-money laundering authorisation gateway approvals, some FinTechs have had eight different case officers.

As development and adoption of technology accelerates in financial services, regulators need to be able to quickly understand changes afoot and anticipate the impact of technology, to be able to develop new regulatory approaches (in line with the wider objectives and aims set out here), on-board new authorised bodies, and assess applications as the regulatory perimeter is extended and adapted. All of this needs to be done alongside maintaining existing supervisory and policy activity.

That creates significant resource needs and we would recommend the requiring regular reviews of each regulator to assess whether they have adequate resources, appropriately deployed. We would also recommend that a formalised requirement for strategic workforce planning be introduced across each of the regulators.

Furthermore, given the new powers afforded to the UK regulators, coupled with a very significant regulatory agenda with major deliverables over the short- to medium-term planning horizon, we would recommend that an independent review take place to ensure the funding mechanisms remain appropriate. As the regulators are funded by the firms they regulate, the independent review should assess and ensure that rising costs do not translate to barriers to entry or disproportionate burdens on start-ups and scale-ups.

Capability review

To strengthen accountability and scrutiny on these questions of culture, capability and resources, we would recommend regular independent capability reviews of each financial services regulator, perhaps every three years with additional reviews where significant remedial action is required.

3. Innovation and RegTech

FinTech, and technological innovation in financial services, can bring many societal benefits. This is something developed not only by start-ups and scale-ups but also established financial services entities.

FinTech has developed across many areas over the last ten years and is rapidly expanding. Developments include:

- Digital payment systems that provide cheaper, faster and more secure payments; increasing productivity in the economy and reducing costs and increasing convenience for consumers. Stablecoins are now starting to develop more low-cost payment systems and safety.
- Foreign exchange ("FX") services: massively reducing the costs and increasing the convenience for consumers to transfer funds and access money overseas.
- RegTech: including advanced solutions that have reduced criminal activity such as money laundering, increased online payment safety and supported the wider adoption of technology by providing cheaper, better compliance services.
- Financial inclusion: a variety of different services enable previously excluded citizens to access the financial services they need and avoid a 'poverty premium'.
- Financial wellbeing: tools to enable better financial planning and management, often utilising open banking data, as well as providing services that enable people to manage financial events, including salary advance schemes and affordable credit.

- **Wealth management:** online platforms have widened access to a greater range of investments and reduced the cost of brokerage.
- **Software as a service:** which has reduced costs for small businesses and widened access to finance and financial management tools.
- **Lending platforms and alternative lenders** have increased the availability of finance for small firms and diversified the availability, with products better suited to different small firms' needs.
- **ESG products:** across RegTech, business-to-consumer ("B2C") and business-to-business ("B2B"), FinTechs are providing ways of measuring carbon emissions and assessing transition to Net Zero, enabling consumers, businesses and financial institutions to take action to support climate targets.

To enable technology and ensure continued innovation can bring economic, social and environmental benefits to the UK (in UK and global markets), the framework needs to enable and accelerate RegTech and SupTech solutions, develop better understanding of technology across regulatory functions, and require specific consideration of the impact of regulation on start-up and scale-up entities.

Use of regulatory technology: RegTech and SupTech

RegTech can and should play an increasing part in regulatory solutions and deliver regulatory outcomes better, simpler and cheaper. Every regulator should be assessing what can be automated and how digital solutions can be deployed (e.g. artificial intelligence ("AI"), data, and blockchain). Where markets advance quickly and the regulator wants to focus on an area, auditing of outcomes and processes amongst scaling companies (e.g. those in the FCA scalebox) rather than detailed authorisation and approval may allow real-time lessons and risks to be appraised, without holding back innovation and market development.

Innovation teams within the BoE and FCA are strong champions of RegTech and SupTech solutions. They need to be given more tools and a stronger influence across their organisations, with specific requirements for every supervisory team to consider RegTech.

As part of this, we recommend:

- **a RegTech test** should be applied for every new regulatory proposal, to assess whether the proposals enable and allow for RegTech solutions within regulated firms; and support SupTech, including automated reporting.
- each **regulators' rules should be adapted to be machine readable**. The FCA piloted a machine-readable handbook in recent years, and whilst the entire handbook may not easily be machine readable, the majority can. Every regulator should be mandated to adopt a machine-readable rulebook or equivalent and be required to commit to all new regulatory requirements being machine readable.

RegTech access to regulator programmes

RegTechs may be unregulated entities but looking to play in the regulated space. Customers' first question tends to be 'what does the regulator think'. RegTechs should be eligible for the FCA Scalebox and other similar programmes, enabling the regulator to provide a view on new technology and its suitability, providing "permission to play."

Developing the scalebox approach

We welcome the FCA rapid adoption of a Scalebox, recommended in the *Kalifa Review* in February 2021. The FCA is piloting this as a way of increasing regulatory compliance by scale-up firms. We would welcome the establishment of this as an integral part of the future regulatory framework and:

- **extension of the Scalebox concept** to other regulators, including the PRA; and
- **building on the Scalebox concept to develop a deeper and wider approach to new technologies**. This should include:
 - **testing scale solutions**: scalebox participants should provide a basis, and a framework, for testing new solutions that have scale. Widespread use of AI, synthetic data, etc., will need to be tested on a larger scale than available in the Sandbox, with real-time monitoring of effects and outcomes and risk controls by a supervisory team.

- **testing systemic effects of technology:** linked to testing scale solutions, a Scalebox approach — possibly involving more than one scale-up — would enable testing of systemic effects of technology and developing new approaches to systemic risk and resilience.
- **Introduce a start-up and scale-up test:** a more comprehensive approach to cost benefit analysis methodologies should include specific requirements that all proposals for new regulations should include a start-up and scale-up test (assessing proportionality of the proposals), including assessment of impact on new entrants.

Consultation paper questions and responses

1. Do you agree with the government's approach to add new growth and international competitiveness secondary objectives for the PRA and the FCA?

Innovate Finance strongly supports the introduction of new growth and international competitiveness secondary objectives, which reflects recommendations we made in our response to the Future Regulatory Framework Review phase-II consultation. These secondary objectives will help ensure the UK's financial services sector is the most trusted and competitive place to do business.

While Innovate Finance is supportive of the government's approach to add new growth and international competitiveness secondary objectives for the PRA and the FCA, it is unclear why the BoE and the PSR are not within scope.

Our members' experience highlights regulation from the BoE and PSR which has had adverse, unintended outcomes for the FinTech community in the UK; negatively impacting start-ups and scale-ups' ability to grow and lessening the international competitiveness of the UK's financial services sector. Our introductory remarks cover the impacts of MREL and other policies, as examples with reference to the BoE. While the forthcoming consultation in H1 2022 on the regulation of payments firms by the BoE and PSR is welcome, our members remain concerned that this may lead to the regulators adopting a fragmented and sectoral approach.

Additionally, the impact of the Financial Ombudsman Service ("FOS") — established as a mechanism for alternative dispute resolution, but arguably operates in a quasi-regulatory capacity without the necessary checks and balances — raises wider questions around the efficacy and appropriateness of its governance and accountability mechanisms, and the need for reform.

We would therefore urge the government to extend the secondary objectives (and 'have regards') in a consistent way across the UK financial services regulators and — while recognising this falls outside the ambit of this consultation — we are calling for an independent review of the FOS to assess whether it remains fit for purpose. While the publication¹⁶ of the FOS action plan

for internal transformation is a welcome step forward; we consider that wider reform remains an important issue in the context of the Future Regulatory Framework Review, and would urge HMT to pursue reform by statutory means. If Parliament itself is to play a role in setting the regulatory principles of the FCA, it needs to be satisfied that the principles which it has set the FCA are not being undermined by decisions by the FOS — this sentiment is also shared by the Treasury Committee¹⁷.

Moreover, Innovate Finance recommends that the government sets out a timetable for a post-implementation review of the regulators' secondary objectives, and the interplay with primary objectives, to ensure the secondary objectives impactfully shape policy design considerations. The extent to which each statutory objective and/or 'have regards' have played into policy design should also be a feature of enhanced cost benefit analyses produced by the regulators (please see our response to question seven, for further detail).

Further, we recommend that HMT reviews the extent to which regulators take into consideration their existing competition objectives, as there is a perception amongst industry that it is not being used consistently.

As noted above in our opening remarks, the objectives will only be successful if accompanied by wider culture change including a statutory requirement to produce a regular international competitiveness benchmarking review and report on progress.

2. Do you agree that the regulatory principle for sustainable growth should be updated to reference climate change and a net zero economy?

Innovate Finance strongly agrees that the regulatory principle for sustainable growth should be updated to reference climate change and a Net Zero economy. The regulators have a key role to play in supporting the UK's transition to a Net Zero economy by 2050¹⁸, through policy-driven incentives. Given the importance of reaching this milestone, we would again call for the regulatory principle to be extended to the PSR and BoE. A regulatory approach can further drive the development of FinTech solutions that help achieve and accelerate transition to a zero carbon economy.¹⁹

¹⁶ <https://www.financial-ombudsman.org.uk/who-we-are/governance-funding/action-plan-2021>

¹⁷ <https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/147/147.pdf>

¹⁸ <https://www.gov.uk/government/publications/net-zero-strategy>

This principle should prompt review of existing regulations that may hinder Net Zero as well as consideration of new regulation needed to support Net Zero. As part of this approach, we would encourage a requirement for regulators to review the impact of their regulatory regime upon achievement of Net Zero climate change targets: specifically to identify any regulatory barriers to the economic, industrial and capital market transformation needed to achieve Net Zero, including those regulations that might slow progress and hinder the timely achievement of 2030 and 2050 targets; and to implement changes to remove such barriers.

Again, we would recommend that the government sets out a timetable for post-implementation review of this secondary objective, and the interplay with regulators' primary objectives, to ensure it impactfully shapes policy design considerations.

Additionally, the extent to which each statutory objective and/or 'have regards' have played into policy design should also be a feature of enhanced cost benefit analyses produced by the regulators.

3. Do you agree that the proposed power for HM Treasury to require the regulators to review their rules offers an appropriate mechanism to review rules when necessary?

Innovate Finance welcomes this proposed power for HMT as a welcome step forward; however, we would invite government to provide further detail on how HMT intends to use this power, and to clarify the 'trigger' threshold for when this power should be exercised.

We would reiterate our call that this review mechanism be extended across the financial services regulators and is not limited to the FCA and PRA.

4. Do you agree with the proposed approach to resolve the interaction between the regulators' responsibilities under FSMA and the government's overseas arrangements and agreements?

Innovate Finance is broadly supportive of the proposed approach. We consider it necessary that a consultative process exists between the regulators and HMT to

¹⁹<https://www.innovatefinance.com/wp-content/uploads/2021/10/The-Role-of-FinTech-in-Net-Zero151021.pdf>

ensure obligations and implications of actions taken are fully understood. There should be no mismatch between regulatory activity and government trade policy. Regulatory activity should be subordinate to overseas trade agreements.

Innovate Finance would welcome further detail on the way in which the regulators and government will share details of the decision making process in the interest of transparency and public scrutiny. It would be helpful to understand the extent to which the regulators' exercise of their powers is limited by conflicting cross-over with government's overseas arrangements and agreements.

5. Do you agree that these measures require the regulators to provide the necessary information to Parliament on an appropriate statutory basis to conduct its scrutiny?

Innovate Finance considers that the proposals do not go far enough, and further thought needs to be given to ensure that there is the necessary scrutiny by Parliament to balance the increased independence of the financial regulators. We reiterate our points made regarding scrutiny, in response to the phase-II consultation.

While we recognise this is a matter for Parliament, given the significant resource and expertise such scrutiny will require, we recommend such scrutiny should be performed by a new, independent committee set up for this purpose. It is essential that the committee must be sufficiently resourced, including with expertise in the financial services sector.

It will also be important to ensure rigorous scrutiny to pick up on any disconnect between Parliamentary direction setting and the actions of the regulators.

Among other things, the independent committee could be empowered to:

- initiate the review of any aspect of regulation;
- consider if regulatory action is consistent with the policy intent set out in the underlying legislation and assessing the actual outcomes of regulatory action against their stated outcome aims;
- scrutinise regulators' case for change and related cost benefit analyses prior to new rule-making;

- consider if proposed and existing rules are proportionate (or are being applied proportionately, where appropriate);
- require and scrutinise post-implementation reviews and the regulators' responses to the same;
- make recommendations to the regulators to which the regulators must respond on a "comply or explain" basis; and
- be a point of contact for stakeholders to feedback concerns about regulators' measures.

It would be inappropriate to directly replicate the EU's model and processes for regulatory policy design and scrutiny. However, it would be helpful to adapt some of the lessons of the EU model, including having a transparent regulatory work programme (annual and multi-annual), and clear and transparent processes for the development of new regulation, with guideline timetables for each stage of consultation and development. This should also clearly identify roles and responsibilities, including where and how technical issues are best scrutinised.

6. Do you agree with the proposals to strengthen the role of the panels in providing important and diverse stakeholder input into the development of policy and regulation?

While these proposals are a welcome step forward, they do not go far enough.

The FinTech and RegTech communities' perception of the practitioner panels is that it does not necessarily provide full representation for innovation and FinTech, and there is a lack of transparency in the way in which the panels operate and shape regulatory policy design. In light of this, we reiterate our suggestion that a consultation be initiated on the panels' role, composition and tenure, approaches (particularly with reference to diverging views as members will defend their respective competitive interests) and effectiveness.

We recommend that consideration be given to the creation of FinTech / RegTech focused panels. Alternatively, we would urge that representatives from the FinTech and RegTech sectors are represented on all practitioner panels. Given the pace of innovation and change in the financial services sector, it will be

critical that regulators draw on expertise from across the FinTech and RegTech ecosystems.

Further, there is a perception that the panels are more influential in shaping the design of regulatory policy when compared with the regulators' consultation process with industry and wider stakeholders — consultation outcomes can often be viewed as a 'foregone conclusion', with no scope for firms to achieve substantive revision of draft proposals. Innovate Finance would welcome further detail on the way in which the role of the panels sits alongside the consultation process.

Regarding stakeholder engagement more generally, Innovate Finance would recommend that regulators engage with industry at a much earlier stage in the policy design process — this could take the form of industry roundtables, calls for input, and discussion papers before launching consultation papers.

There is no silver bullet to better consultation and industry engagement. Regulators need to deploy a range of techniques and tools. Reliance on panels, formal consultation documents and the cost benefit analyses process is not in itself sufficient. In particular, smaller firms do not have the capacity or necessarily the capability to engage with these formal processes. We need to reach the point where the regulator better understands the nature of the businesses they supervise including the specific markets they operate in and what it means to be a small business; and the regulator is able to engage and seek views in different ways that ensure the voice of different regulated businesses is heard. This needs to include more outreach and interchange between the regulators and the firms they regulate.

Smaller firms without a supervision contact at the regulators find it more challenging to get specific information and engage with the regulators. This is something that the regulators need to address. Feedback meetings or stakeholder roundtables, perhaps held quarterly with the regulators, could give firms with little direct access to the regulators the opportunity to share with the regulators their views and sector developments.

Regarding consultation papers, Innovate Finance would ask that regulators take steps to review the consultation process to ensure it works for all. Taking the PSR as an example, a consultation was launched on APP scams in November, with only a two-month consultation window that fell over the festive period. There were a number of other regulators' consultations running concurrently

across this period. In our members' experience, small start-ups do not have the resources to work up well-evidenced responses to meaningfully inform the regulators' policy design considerations in such a short time frame — this issue is exacerbated if there are a number of relevant, overlapping consultations. It is essential that the impact of cumulative change on firms from multiple sources is considered.

Moreover, while the regulatory grid has been welcomed by industry, we would call on the regulators to publish this more frequently, and regularly engage with stakeholders regarding its efficacy in allowing firms to forward plan and manage workload associated with regulatory change.

Lastly, on transparency around regulator-to-regulator dialogue, we note that on 26 March 2021 a Memorandum of Understanding was agreed to establish a "Joint UK-EU Financial Regulatory Forum" to serve as a platform for dialogue on financial services issues. We would encourage the UK regulators to consult the industry ahead of future regulatory forum meetings, for example by meeting representatives for a discussion in the week before. We would also recommend that the UK meets the industry following forum meetings to provide a read-out and share progress. The US does both in the case of the EU - U.S. Joint Financial Regulatory Forum. As an example, it engages through the American Chamber of Commerce to the EU and the US Chamber of Commerce to share views and allow for the industry to comment and ask questions.

7. Do you agree that the proposed requirement for regulators to publish and maintain frameworks for CBA provides improved transparency for stakeholders?

Innovate Finance broadly welcomes requirements to improve transparency, but we maintain that additional requirements are needed.

We recommend that regulators' cost benefit analyses evidence the impact on start-ups, scale-ups and RegTech firms.

Moreover, it should be a requirement that the regulators evidence the impacts on all proposed measures — there are a number of examples where the cost benefit analyses in regulators' consultation papers only cover some, not all, of the proposals. Our introductory remarks provide examples of this with respect to the PSR.

To that end, we recommend that a formalised, cross-regulator approach to cost benefit analysis is developed and applied to ensure consistency. A similar approach to HMT's Green Book²⁰ could be adopted, for example.

Further, the extent to which each statutory objectives and/or 'have regards' have played into policy design should also be a feature of enhanced cost benefit analyses produced by the regulators.

8. Should the role of the new CBA Panel be to provide pre-publication comment on CBA, or to provide review of CBA post-publication?

Innovate Finance considers there is a need for ex-ante and ex-post review of the impacts of regulatory interventions. The findings should then shape regulators' policy making in future.

A holistic view of the impact of regulatory and legislative interventions should also be considered for each industry vertical — it is essential that the impact of cumulative change on firms from multiple agencies is considered.

There is also a case for the Regulatory Policy Committee ("RPC"), or a form of RPC for financial services, to be established to provide additional accountability for better regulation principles. In other areas of regulation, the RPC provides an independent view on better regulation and how to promote this across government, ensuring due consideration is given to limiting the unnecessary burden of regulation on businesses and civil society organisations; while supporting the development of appropriate, evidence-led regulation. This model would provide an additional form of accountability and culture shift for financial regulators.

9. Do you agree that the proposed requirement for regulators to publish and maintain frameworks for how the regulators review their rules provides improved transparency to stakeholders?

Innovate Finance is supportive of proposals to improve transparency for stakeholders. We would welcome additional detail on how this framework would work in practice, and how stakeholders can be assured that regulators' actions are aligned with the high-level framework set out by government.

²⁰https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/938046/The_Green_Book_2020.pdf

We recognise that robust review of rules will be resource intensive for regulators. In this regard, we reiterate the points made in our introductory section regarding regulators' resources and capabilities. Innovate Finance recommends that regular, independent reviews of each regulator be introduced, in order to assess whether they have adequate resources, appropriately deployed. Additionally, we recommend regular, independent capability reviews of each financial services regulator take place, with additional reviews where significant remedial action is required.

10. Do you agree with the government's proposal to establish a new Designated Activities Regime to regulate certain activities outside the RAO?

Innovate Finance is concerned to understand more about how the powers will work in practice, and whether this will translate to more regulatory complexity for new entrants to the UK market. Future development of activity-based rules (rather than regulated entities) could support innovation. More detail and discussion of this is needed, however, to ensure a clear understanding of how the proposals would be implemented, and to allow further consideration of consequences.

We understand that onshored legislation relating to retail consumers may not be swept up by the DAR, and it could be reserved for wholesale / B2B matters. We would welcome additional detail on this regime and the rationale for not amending the Financial Services and Markets Act (2000) and associated legislation to cover these activities.

With reference to our earlier remarks on the forthcoming consultation on the BoE and PSR's approach to payments firms, we remain concerned that growing regulatory incoherence with respect to electronic money institutions and payment institutions may develop if the DAR is applied to payments. Innovate Finance would be pleased to discuss in more detail with HMT the possible unintended consequences arising from the use of the DAR in the B2B space.

11. Do you agree with the government's proposal for HM Treasury to have the ability to apply "have regards" and to place obligations on the regulators to make rules in relation to specific areas of regulation?

Innovate Finance is supportive of these proposals, and we would reiterate the response to question one. A post implementation review needs to take place to ensure the secondary objectives and 'have regards' are impactful and not viewed as tokenistic by industry.

[ENDS]

10 May 2022