Financial Inclusion and Markets Centre – Written evidence (SCG0061)

Introduction

We are grateful to have the opportunity to make a submission to the inquiry.[1] We fully recognise the need for the UK to have a successful finance sector. In addition to the growth and competitiveness objective, the Government is developing a growth and competitiveness strategy for the sector.[2] We share the concerns of other civil society organisations about the emphasis on growth and competitiveness.[3] What's good for finance (and tech) isn't necessarily good for the real economy, environment, and society. The number of deregulatory measures[4] and the pressure now placed on financial regulators to promote growth and competitiveness[5] means that what was intended to be a secondary objective risks becoming a de facto primary objective. This could compromise regulatory independence and negatively affect the regulators' core primary objectives.

The success of the financial services strategy and regulatory objective should be judged on how well finance serves the interests of the real economy, the environment, and society and on the sustainability of growth including the terms on which the UK financial sector attracts overseas business. Yet, despite the central role finance is being given in the UK's economic future, we do not have a balanced performance framework to evaluate whether finance is serving the interests of the real economy, the environment, and society.[6] Financial regulators should be

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[1] The Financial Inclusion and Markets Centre has recently been established as a dedicated unit of the Financial Inclusion Centre which focuses on policy matters relating to financial services policy and regulation, and financial market reform. The Financial Inclusion Centre remains the name of the non-profit organisation and the main legal and operating entity. [About | The Financial Inclusion Centre]

[2] The Financial Inclusion Centre submission to that consultation can be found here: [HM Treasury Financial Services Growth & Competitiveness Strategy | The Financial Inclusion Centre]

[3] [Financial services growth and competitiveness joint response]

[4] There are a number of what we would classify as deregulatory measures already implemented, in train, or being considered linked to supporting growth and competitiveness. These include: further weakening of the Solvency II/ UK regime, weakening of the charge cap on workplace pensions, changes to the ring fencing regime and 'bankers bonuses', streamlining of the FCA rule book, the 'advice/ guidance boundary review, Consumer Credit Act review, review of the redress system, and reducing compensation in relation to authorised push payment (APP) fraud.

[5] Indeed, the Prime Minister has recently written to the main sectoral regulators, including financial regulators, setting out the need for the regulatory environment to become 'more pro-growth and pro-investment. [Starmer asks UK regulators for ideas to boost growth - BBC News]

judged on how well they ensure the firms they regulate serve our interests, not on how well they serve the interests of regulated firms. The absence of such a performance framework means we also cannot judge regulatory effectiveness.

Response to specific questions

1. **What opportunities or changes should be prioritised in order for the regulators to meet their secondary growth and competitiveness objectives effectively?**

This depends on the vision of growth and competitiveness adopted. One vision emphasises the size and revenue-generating potential of the finance sector enabled by deregulation[7] and greater financialisation of the UK's economic and social infrastructure supported by corporate welfare and 'de-risking'.[8] This might create illusory short term success but we do not think it is a strategy for sustainable success.

The other vision emphasises finance supporting sustainable national and regional economic growth, the green transition, and financial inclusion and resilience not growth per se. This vision prioritises robust policy and regulation to maintain market and consumer confidence in the finance sector. International success in this case is built on making the UK finance sector competitive by being a beacon of trust and integrity, particularly relevant if the UK is to be the leading global centre of green finance.

Specifically, financial regulators could focus on the difficulties small businesses and entrepreneurs face when trying to start up or expand a business such as opening a bank account, obtaining affordable loans, and getting business insurance.

2. **To what extent are the regulators focused on the objective to promote international competitiveness and growth? Are there areas where the ability of the regulators to fulfil their secondary objectives might be constrained by having to fulfil their primary objectives?**

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[6] Shedding light on finance and the financial regulators | The Financial Inclusion Centre
[7] The range of deregulation measures threatens to reverse the very real progress made post 2008 financial crisis and the litany of misselling scandals which left a legacy of mistrust in finance.
[8] Where private finance institutions expect third parties such as the state or non-profit sector agencies to underwrite risks allowing private finance to receive the financial rewards. This is known as socialising the risks, privatising the rewards.

Regulators are very focused and are supportive. The FCA has put much effort into supporting innovation in finance and fintech.[9] The real risk is that the secondary objective is becoming a de facto primary objective and will undermine the primary objectives.

3. **What are some of the barriers in the current regulatory framework (including the role and responsibilities of other regulators and bodies such as the Payment Systems Regulator, The Pensions Regulator and the Financial Ombudsman Service) that could hinder efforts to drive economic growth and international competitiveness in (a) the UK economy and (b) the financial services sector?**

We do not think the current framework hinders those efforts. Of course, we support efforts to restructure and streamline FCA rules as long as consumer protection standards are maintained.[10] But, this initiative is happening at the same time as the Advice/Guidance Boundary and Consumer Credit Act reviews. Finance lobby groups are using 'Trojan Horse' arguments that current standards stifle innovation and competition, hinder financial inclusion, and undermine competitiveness. There is no evidence that current consumer protection standards have these effects.

The FCA wants to move more towards high level rules giving firms more discretion on interpreting those rules. This has been tried before but firms could not be trusted, or could not trust themselves, to responsibly interpret high level principles and rules. Over the years, the FCA has had to tell firms in ever increasing detail what is expected of them. In our view, this is why the Handbook is so large and complex, it is not due to zealous bureaucrats.

The main costs of regulation come from firms operationalising regulatory expectations, setting up systems and processes, and employing risk and compliance professionals to avoid FCA sanctions and paying redress to consumers. So, streamlining the rules per se will not materially reduce industry costs, or change firms' 'risk appetites' – *if* consumer protection standards are maintained, which is a big *if*.

More generally, we see no evidence that current financial regulation hinders sustainable economic growth or economically and socially useful

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[9] How innovation and regulation in financial services can drive the UK's economic growth | FCA

[10] FCA Call for Input on streamlining rules following the introduction of the Consumer Duty | The Financial Inclusion Centre

innovation. Indeed, we would argue that robust regulation: supports sustainable growth; makes the UK attractive to global clients who seek to do business with trustworthy financial markets; promotes real competition and reduces prices for consumers; promotes financial inclusion and resilience which helps household participate in the economy and reduces financial anxiety that can affect workplace productivity; and promotes consumer confidence and trust in finance.

Certain activities are still to be brought within full regulation (namely buy now pay later, investment consultants and ESG ratings providers). UK regulation is not risk averse. The FCA does require reasonable authorisation standards but we think it generally adopts a too permissive approach to innovation where a precautionary approach and product regulation would be more appropriate. The system is slow in bringing harmful 'innovation' within the regulatory perimeter to apply conduct of business rules.[11] Too often, interventions occurred only when there was overwhelming evidence of detriment that could not be ignored.

4. Do the regulators have the right capability and capacity to fulfil their regulatory objectives on growth and competitiveness? To what extent might the culture of the FCA and PRA influence their ability to fulfil their growth and competitiveness objectives?

Contrary to claims otherwise, the UK regulatory approach is not risk averse and actively supports financial innovation. For example, the FCA has garnered widespread recognition for creating the regulatory sandbox to nurture innovation.

5. How effectively have the FCA and PRA consulted or engaged with industry in relation to the new secondary growth and competitiveness objective?

The industry clearly has preferential access to policymakers and regulators given the resources at its disposal.[12] The growth and competitiveness agenda is having an effect on regulatory policy with a range of deregulatory initiatives underway or in the pipeline.

6. In delivering their secondary objective on growth and competitiveness, what opportunities are there for the regulators to help to promote and support innovation in the financial

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[11] Buy now, pay later, payday lending, and regulation of cryptoassets are prime examples of this.
[12] Finance sector scores two-fifths of Treasury meetings

services sector? How effective has the FCA's regulatory sandbox been for supporting greater innovation in the financial services industry?

Regulators already adopt a supportive, arguably too permissive, approach to innovation. Much 'innovation' does not enhance consumer welfare and is just product development by firms wanting something new to sell but with little to differentiate from existing products. Product proliferation enables confusion marketing, and increases search and advice costs for consumers. For example, there are 4,700 investment funds,[13] 4,341 mortgage products,[14] and 2,117 savings products.[15] Moreover, much innovation has harmed the financial system, the economy, and consumers. So, we think the priorities for financial regulators should be to: promote economically, environmentally, and socially useful innovation; and proactively intervene to prevent harmful innovation and behaviours.

The FCA's sandbox does appear to have been successful for firms. Eight out of 10 firms who used the services said they found it useful.[16] Entry into the sandbox by fintech firms was followed by a significant increase in capital raised and improved operational outcomes. Moreover, sandbox firms are significantly more likely to still be in operation today and patent significantly more activities than comparable firms. The approach has been copied by over 50 countries.[17] Of course, it is too early to say to what degree those sandbox firms have actually created economically and socially useful innovation.

7. How should the regulators ensure that any measures introduced to meet the secondary growth and competitiveness objectives work for businesses of all sizes across the sector, including startups, scaleups, and incumbents?

From observing the FCA, the regulator already operates a proportionate approach. For example, most of the firms accepted into the sandbox have under 10 employees.[18]

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13 Funds List | The Investment Association
14 Mortgage products rebound: There are now more than 4,000 deals on the market | This is Money
15 Savings product choice reaches a record high | moneyfactsgroup.co.uk
16 10 year anniversary: FCA Innovation Services
17 Regulatory Sandboxes and Fintech Funding: Evidence from the UK – Review of Finance
18 10 year anniversary: FCA Innovation Services

8. Are there any additional metrics over and above those already agreed by the regulators that would better enable stakeholders to track progress and support scrutiny of their work against the secondary growth and competitiveness objective? How should a measure of growth be included in these metrics?

If the question relates to finance sector growth, then there are number of metrics such as new authorisations and listings, funds under management, and so on. But, we would reiterate that it is risky to place so much store on finance sector growth without assessing the potential consequences and ensuring there is a balanced performance framework in place to evaluate whether finance and financial regulators are working in our interests.

9. Does the requirement within the secondary growth and competitiveness objectives to align with international standards create any constraints to fulfilling those objectives?

This depends on what those international standards are and who interprets whether the UK aligns with the standards. Moreover, it also depends on how the UK: seeks to influence those international standards; and responds to the risk of international firms exploiting regulatory arbitrage opportunities created by nation states and trading blocs using deregulation as a means to promote growth and competitiveness.

10. Are the existing accountability measures around the secondary growth and competitiveness objective adequate?

No. The absence of a comprehensive, balanced performance framework to allow Parliament and civil society to hold finance and financial regulators to account is a major concern.

11. Are there examples of regulatory policies in other jurisdictions that should be considered by UK regulators to help facilitate the new secondary objective? What might the FCA and PRA be able to learn and apply from comparable supervisors in other markets in terms of applying secondary objectives on growth and competitiveness?

It is difficult enough to draw conclusions about the relationship between regulation and economic performance *within* a jurisdiction. It is even more difficult to undertake meaningful international comparisons given the significant differences between the UK and other financial systems and the relevant economic, political, and regulatory systems. Even a report produced for the key finance trade body TheCityUK concluded that other factors can influence decisions on where to locate or invest. [19]

27 January 2025

[19] Advancing international competitiveness and economic growth: April 2024 @thecityuk www.thecityuk.com how do financial regulators compare? Freshfields Advancing international competitiveness and economic growth: how do financial regulators compare? | TheCityUK