Written evidence submitted by Positive Money

Summary of Recommendations

Regulatory framework:

(1) Reject any 'competitiveness' objective that would seek to grow the financial sector regardless of the impacts on the government's wider economic objectives. The government must instead use regulation to create conditions for purpose-driven finance that serves the real economy.

Parliament:

(2) Make provisions to ensure that no changes to regulation can be made by regulators without adequate Parliamentary scrutiny, rather than regulations simply being 'rubber stamped' through the affirmative procedure, as per current plans in the Financial Service Bill.

(3) Institute robust processes for scrutiny of regulators by relevant Select Committees (including the Treasury Committee, and a new Joint Committee between the House of Commons and House of Lords).

Scrutiny:

(4) Improve stakeholder engagement with civil society groups, particularly those with expertise of how regulation impacts working on social and environmental issues - ensure that stakeholder groups include at least 50% citizens and public interest organisations.

(5) Avoid the risk of a 'revolving door' between financial regulators and the firms they regulate, initially through an increased 'cooling off' period of at least one year, especially for senior appointments.

Mandate and statutory objectives:

We recommend amendments to the FSMA to include environmental sustainability in the objectives and principles of prudential regulation. Specifically, we would propose:

(6) Add an amendment to FSMA part 3B, which defines the regulatory principles to be adopted by both regulators. This list of principles should include a provision on the desirability of each regulator exercising its functions in a way that recognises the need to tackle climate change and ecological degradation.

(7) Add an amendment to FSMA part 1B, which defines the Financial Conduct Authority's (FCA) general duties, including its operational objectives. In addition to the consumer protection objective, the integrity objective, and the competition objective, this should also include a new environmental sustainability objective, defined in a new section '1EA'.

(8) Add an amendment to FSMA part 2B, which defines the Prudential Regulation Authority's (PRA) general objective. Specifically, subsection 3c should include a provision that requires the PRA to discharge its functions in a way that seeks to ensure that the business of ring-fenced bodies is carried out in a manner that is compliant with the government's net zero target and international environmental obligations.

(9) Add environmental sustainability as a statutory objective to the Financial Policy Committee's mandate in the Bank of England act 1998.

Positive Money is a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

(1) What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?

1.1. The proposed transfer of powers from the EU to UK regulators will require significant strengthening of accountability mechanisms to ensure that regulators are meeting the defined purposes of regulation. These have not, in our view, been adequately laid out.

1.2. The Financial Services Bill, which lays the groundwork for post-Brexit financial services regulation, demonstrates the current democratic deficit of this new approach. The Bill transfers substantial authority over key financial regulation, including Basel III, to the Treasury and UK regulators. The Treasury will have the power to revoke or amend provisions and transfer powers for regulatory oversight to the FCA (for investment firms) and PRA (Banks and large systemically important investment firms). The bill also outlines changes to the FCA's prudential regime for investment firms, but specifies very limited policy objectives for this regime, mainly focused around expanding the UK's share of the global market.

1.3. In the absence of clear social and environmental objectives for financial regulation, these changes run the risk of transferring too much power to regulators to pursue growth and 'competitiveness', at the expense of finance's role in serving the real, productive economy. This is of particular importance given the considerable evidence that excessive growth of the financial sector harms the wider economy.[1][2][3] Any regulation that is 'purpose neutral' by default risks compounding such structural trends. We therefore recommend that the Treasury rejects any 'competitiveness' objective for regulators outright.

Recommendation:

(1) Reject any 'competitiveness' objective that would seek to grow the financial sector regardless of the impacts on the government's wider economic objectives. The government must instead use regulation to create conditions for purpose-driven finance that serves the real economy.

(2) What role does Parliament have to play in influencing new financial services regulations?

2.1. The guiding principles for the new framework must give Parliament a role in defining the public purpose of regulation and for overseeing and reviewing the regulators' performance against defined, measurable objectives at regular intervals. It is essential that regulators are not left to develop regulation behind closed doors. We recommend that there are provisions to ensure that no changes to regulation can be made unless they have been properly scrutinised by Parliament, rather than simply being 'rubber stamped' through the affirmative procedure, as currently outlined in the Financial Services Bill. There should also be processes in place for scrutiny by relevant Select Committees (including the Treasury Committee, and a new Joint Committee between the House of Commons and House of Lords).

Recommendations:

(3) Make provisions to ensure that no changes to regulation can be made by regulators without adequate Parliamentary scrutiny, rather than regulations simply being 'rubber stamped' through the affirmative procedure, as per current plans in the Financial Service Bill.

(4) Institute robust processes for scrutiny of regulators by relevant Select Committees (including the Treasury Committee, and a new Joint Committee between the House of Commons and House of

[1] Stephen G Cecchetti and Enisse Kharroubi, 'Why Does Financial Sector Growth Crowd out Real Economic Growth?', n.d., 31.

[2] Jean-Louis Arcand, Enrico Berkes, and Ugo Panizza, 'Too Much Finance?' IMF Working Paper, no. WP 12/161 (2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12161.pdf.

[3] Andrew Baker, Gerald Epstein and Juan Montecino, 'The UK's Finance Curse? Costs and Processes', Sheffield Political Economy Research Institute (2018), http://speri.dept.shef.ac.uk/wp-content/uploads/2019/01/SPERI-The-UKs-Finance-Curse-Costs-and-Processes.pdf

Lords).

(3) How should new UK financial regulations be scrutinised?

3.1. Improvements to stakeholder participation in the design and implementation of financial regulation are crucial. Consultations should include a diversity of perspectives, and organisations with expertise in social and environmental issues. Civil society groups often face issues of capacity, and the Treasury should design consultations with this in mind. Given evidence of how the financial system discriminates against people of colour and other marginalised groups, the Treasury should give particular consideration to how these groups can be empowered and enabled to contribute.[4]

3.2. To guard against corporate takeover of consultation processes, the make up of participation mechanisms such as stakeholder groups should be at least 50% representatives of citizens and public interests including social and environmental groups. This protects against the very real risk that stakeholder groups replicate the views of the industry lobby.[5]

3.3. There are increasing concerns of regulatory capture resulting from a 'revolving door' between financial firms and the institutions tasked with regulating them.[6] As a first step to guard against this, we would support an increased 'cooling off' period between employment by a UK regulator and a private financial institution under its regulatory watch, particularly for senior appointments.

Recommendations:

(5) Improve stakeholder engagement with civil society groups, particularly those with expertise of how regulation impacts working on social and environmental issues - ensure that stakeholder groups include at least 50% citizens and public interest organisations

(6) Avoid the risk of a 'revolving door' between financial regulators and the firms they regulate, initially through an increased 'cooling off' period of at least one year, especially for senior appointments

(4) Should the mandate and statutory objectives of the financial services regulators change to include wider public policy issues?

4.1. Regulation must be able to support rather than undermine the government's wider policy objectives. To fulfill this purpose, regulators need statutory objectives to incorporate social and environmental goals into their work. The current plans for a new regulatory framework, as well as the FInancial Services Bill currently passing through Parliament, run the risk of focussing excessively on a 'competitiveness' objective, which has historically been synonymous with deregulation and a harmful 'race to the bottom' on standards. The stated objective of the Bill is to align the role of regulators (PRA and FCA) with the government's aims "on growth, competition, and competitiveness".

4.2. There would be huge risks involved in deregulation and divergence from international standards, which the UK has played a globally important role in designing. The UK is still feeling the effects of a financial crisis that resulted from deep regulatory failures, and which the Bank of England chief economist Andy Haldane estimated cost the UK up to £7.4 trillion in lost output. As Sam Woods, the Bank's deputy governor for prudential

[4] Omar Khan, 'The Colour of Money Report. How Racial Inequalities Obstruct a Fair and Resilient Economy' (Runnymede, 2020), https://www.runnymedetrust.org/projects-and-publications/employment-3/the-colour-of-money.html

[5] Finance Watch, 'Finance Watch Blueprint on the European System of Financial Supervision', 2018, https://www.finance-watch.org/wp-content/uploads/2018/08/blueprint-esfs-feb2018.pdf.

[6] https://www.theguardian.com/commentisfree/2020/aug/20/politics-banking-unhealthy-whitehall-city

regulation, said in November, a race-to-the-bottom on standards "would be mad… only a decade or so on from a crisis in which the British taxpayer footed the bill for one of the biggest banking disasters in history."[7]

4.3. The financial services industry has been lobbying for regulators to have an international competitiveness objective, and there are risks that the industry may be seeking a 'regulatory dividend' after Brexit.[8] But as the new chief executive of the FCA said at his appointment hearing, maintaining high standards, not a competitiveness objective, is the best way of ensuring a 'strong, competitive' financial sector.[9]

4.4. The 'default' aim should not be to increase the size and competitiveness of the UK's financial sector. The government should not double down on a finance-led growth model, which has failed to deliver on sustainability, productivity and living standards. In addition, any weakening of regulation in service of this aim would rest on the false assumption that the financial sector is no longer vulnerable to the dynamics that led to the 2008 crisis. Instead, Brexit must be viewed as an opportunity to strengthen the statutory objectives of regulators to serve the real economy, as well as the government's wider social and environmental goals. Extending the regulatory horizon to include longer-term issues would help in this regard.

4.5. In addition, the blurred line between prudential regulation (under the remit of the FPC and PRA) and consumer regulation (under the remit of the FCA and CMA) leaves regulatory gaps in terms of the responsibility to ensure social and environmental outcomes - including the issue of aligning the financial sector with the government's own climate targets.

4.6. The Bank of England risks falling behind in this regard. A recent study of the mandates of 135 central banks found that 12% already have explicit sustainability mandates, and an additional 40% have a mandate to support government policy priorities, including sustainability goals.[10] Despite the Chancellor's ambition to position the UK at the forefront of green finance, the Financial Services Bill does not contain a single provision that supports this goal.

4.7. The Bank of England's mandate, defined in the Bank of England Act 1998, should therefore include a statutory objective which would greater emphasise the Bank's role in aligning the financial system with the government's wider social and environmental aims. While the remit of the FPC recommends that the Bank should have regard for key government priorities such as the Net Zero target and facilitating productive investment, much more could be achieved with a strong statutory objective that enables the Bank of England to use its substantial power to promote financial market behaviours that support these aims.

4.8. Given the severe risks of shocks to the financial system represented by climate change, this consultation represents an urgent opportunity to incorporate climate objectives into the mandate of all regulators. As we highlighted in a letter signed by 125 leading economics and finance experts, the Treasury and Bank of England's approach to managing these risks and greening the financial system is insufficient, as it relies excessively on market efficiency and the self-regulation of financial institutions.[11] The Bank of England needs to be given the powers to be more proactive in penalising and restricting lending towards fossil fuels, and catalysing sustainable investment.

4.9. Changing the objectives of the FPC, the PRA and the FCA would be more powerful than changing their regulatory principles, as it would embed environmental sustainability more fundamentally into every aspect of their decision-making.

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[7] https://www.thetimes.co.uk/article/bank-to-relax-regulation-after-brexit-s9kzs836x

[8] https://bibamanifesto.co.uk/regulation/international-competitiveness-objective/

[9] https://committees.parliament.uk/oralevidence/746/html/

[10] Simon Dikau and Ulrich Volz, 'Central Bank Mandates, Sustainability Objectives and the Promotion of Green Finance', *SOAS Department of Economics Working Paper*, no. No. 232 (January 2020): 1.

[11] https://positivemoney.org/wp-content/uploads/2020/11/PUB-Letter-to-Chancellor-on-green-finance.pdf

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