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Treasury Committee

The Future Framework for Regulation of Financial Services

Fifth Report of Session 2021–22

Report, together with formal minutes relating to the report

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Summary

We agree with the Treasury that the body of EU financial services rules that was on-shored during the process of leaving the EU should be moved into the regulators' rule books. Keeping rules in statute could require Parliament to amend or pass new legislation every time that the regulators wish to make changes to them. This would be resource-intensive and impractical. The regulators have a key role to play in designing and developing the rules with appropriate Parliamentary oversight.

We understand the need for Treasury Ministers to be well informed of the regulators' policy intentions as a matter of routine. However, we have not been provided with compelling evidence to justify changing the law to allow Ministers the absolute right to see financial services regulators' policy proposals before they are published for consultation, as opposed to the current arrangements whereby significant interaction between Ministers and regulators happens informally as a matter of routine. By doing so, the perception of regulatory independence from government could be damaged. The independence of regulators to be free from political interference is one of the key aspects of UK financial services regulation, and it is, arguably, one of the reasons why the UK is a world-leading financial centre. Regulators must continue to be free to choose what they share with the Treasury in this respect.

If done with a deft approach, there may be a role for activity-based principles or "have regards" to allow the Government to instruct the regulators, at a more micro level, how it wishes them to approach specific types of business sector. The Government can already instruct regulators more broadly on how to do this through remit letters. But the Government should be sparing in its approach: the strategic and operational objectives, combined with principles and "have regards" that are set out in their remit letters, are already numerous and expanding, to the point where regulators have to choose which to prioritise on a regular basis when drafting new policy proposals. The creation of too many activity-based principles would add a further layer of issues to which regulators must have regard.

We will only be able to conclude with more certainty on the merits or risks of activity-based regulation once the Government provides more details on their proposals in its next consultation.

We believe that effective scrutiny of regulatory proposals should be carried out through a targeted approach. Each new proposal made by the Financial Conduct Authority or by the Prudential Regulatory Authority under the future financial services regulatory framework would be put out for consultation. Industry stakeholders and civil society groups would have an opportunity to put forward views, as would Parliament, both through the select committee system and through the work of individual Members of either House. If any matter of public interest were to arise that we deemed sufficiently important to scrutinise in more detail, or indeed challenge, we would do so.

We do not see a clear need for the creation of a new committee or a new independent body to carry out this work. It would seem a more efficient use of Parliamentary resources to use the structures that are already available in both Houses. Although the scrutiny task will be substantial, it will be an extended one as new regulations are drafted, rather than a short-term surge of activity. There is already expertise in select committees in the Commons and the Lords, and both have the power to appoint specialist advisers and commission research.

Introduction and Scope

1. The UK left the EU on 31 January 2020 and entered into a transition period until 31 December 2020, during which the financial services industry remained subject to the same rules as those which had applied during the UK's membership of the EU.

2. The UK's financial services regulatory regime is set out in the Financial Services and Markets Act 2000. However, prior to leaving the EU, competence for much of the financial services regulatory regime sat with the EU. Now that the UK has left, the competence for the regulation and standards of financial services once again sits with the UK Government in Westminster.

3. In October 2020, the Treasury published a consultation on Phase II of its Financial Services Future Regulatory Framework Review, setting out proposals for redesigning the regulatory framework within which the financial services regulators operate.

4. We announced a wide-ranging inquiry into the Future of Financial Services in November 2020. The scope of that inquiry is split into two parts. The first part—covered by this report—primarily addresses the issues raised by the consultation that are relevant to the work of our Committee. These include:

- The Treasury's proposals for moving on-shored EU rules out of statute and into the financial services regulator's rulebooks;
- The role that the Treasury should play in influencing the policies of the regulators;
- The Treasury's proposal for activity-specific regulatory principles; and
- How Parliament should scrutinise the financial services sector and the regulatory framework within which it will operate.

5. This report also considers in passing whether the scope of the Treasury's own consultation was sufficiently broad, and whether other regulators not included in the consultation need to be considered as part of the proposed re-design of the UK's financial services regulatory landscape.

6. For this report, we took oral evidence from two former members of the Economic and Monetary Affairs Committee of the European Parliament, Baroness Sharon Bowles of Berkhamsted, and Dr Kay Swinburne; former EU Commissioner for Financial Services, Lord Hill of Oareford; representatives of the financial regulators: Vicky Saporta, Executive Director of Prudential Policy Directorate at the Bank of England, and Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA; and John Glen MP, Economic Secretary to the Treasury, together with Gwyneth Nurse, Director of Financial Services at HM Treasury. We are grateful to them for their time and input.

7. The second part of our inquiry will focus on a wide range of issues affecting the financial services industry, including what the Government's financial services priorities should be when it negotiates trade agreements with third countries and how consumer interests should be taken into account when considering potential regulatory changes, and how Government policy and the UK regulators can facilitate the emergence of FinTech and new competition, among others.

1 The Treasury's proposed future framework

Existing UK financial services legal framework

8. The Financial Services and Markets Act 2000 (FSMA) sets out the objectives of the Financial Conduct Authority (FCA). It sets the FCA a single strategic objective to ensure that the relevant markets function well, and in addition three operational objectives:

- to secure an appropriate degree of protection for consumers;
- to protect and enhance the integrity of the UK financial system; and
- to promote effective competition in the interests of consumers.

Below each of these objectives is a set of issues to which the FCA must have regard. These number eighteen in total.

9. The Act similarly sets out the objectives of the Prudential Regulatory Authority (PRA). It sets the PRA a single general objective of promoting the safety and soundness of the firms it regulates, through ensuring that firms' business is carried on in a way which avoids any adverse effect on the stability of the UK financial system, and minimising the risk they pose to financial stability.[1]

10. The PRA has an additional insurance objective of contributing to the securing of an appropriate degree of protection for those who are or who may become policyholders. The PRA has a secondary competition objective which requires it, when discharging its general functions in a way that advances its objectives, so far as is reasonably possible, to act in a way which facilitates effective competition in the markets for services provided by the firms it regulates.[2]

11. Section 3B of the FSMA states that both the FCA and the PRA must apply the following regulatory principles:

- the need to use the resources in the most efficient and economic way;
- a burden or restriction which is imposed should be proportionate to the benefits;
- the desirability of sustainable growth in the medium or long term;
- consumers should take responsibility for their decisions;
- the responsibilities of the senior management of persons subject to requirements imposed by or under this Act, including those affecting consumers, in relation to compliance with those requirements;
- a recognition of the differences in the nature of, and objectives of, businesses carried on;
- the desirability of publishing information relating to persons on whom

1 HM Treasury, PRC Remit Letter, 23 March 2021
2 HM Treasury, PRC Remit Letter, 23 March 2021

> requirements are imposed by or under this Act, or requiring such persons to publish information, as a means of contributing to the advancement by each regulator of its objectives;

- transparency.

12. Section 1JA of FSMA (for the FCA) and Section 30B of the Bank of England Act 1998 (for the PRA) allow the Treasury to make recommendations to the regulators about aspects of the Government's economic policy, to which the regulators should have regard. In the remit letters sent most recently by the Chancellor to the regulators, the aspects of the Government's economic policy to which they must have regard are:

- Competition
- Growth (including levelling up)
- Competitiveness
- Innovation
- Trade
- Better outcomes for consumers
- Climate Change[3]

Context of EU legal framework

13. During the years of the UK's membership of the EU, an increasing amount of financial services regulation was set at the EU level, in EU directives, often referred to as "files". The Treasury's Future Regulatory Framework Review consultation states that:

> The development of a single market in financial services, as well as interventions to address regulatory failures of the financial crisis, have resulted in EU legislation covering many key areas of regulation. This includes the prudential regulation of banking, insurance and investment firms as well as wide-ranging regulation covering financial markets activity and infrastructure.[4]

14. There are four tiers of EU regulation:

- Level 1 rules are the EU's overarching legal frameworks for specific financial sectors, such as Solvency II or MiFID II.[5] They are analogous to Acts of Parliament. These laws are based on an initial proposal by the European Commission (essentially a Bill), which the European Parliament and Council of Ministers (where EU Member State governments are represented) then scrutinise separately. Only when the European Parliament and Council have agreed on a legal text can it be formally adopted and take effect as EU law.

3 HM Treasury, PRC Remit Letter, and FCA Remit Letters, 23 March 2021

4 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.14

5 Solvency II regulates the capital requirements of insurance firms and MiFID II regulates financial markets.

- Level 2 rules are legally binding technical implementing and regulatory measures that flesh out Level 1 laws, similar to Statutory Instruments in the UK.
- Level 3 rules are non-binding policy documents relating to Level 1 and Level 2 rules produced by the three European supervisory authorities: the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), in their areas of responsibility. They include, for example, guidance to national financial regulators in EU Member States on how to interpret specific elements of the rulebook.
- Level 4 relates to supervision of the national implementation of Levels 1, 2 and 3 of the EU financial services rulebook carried out by the Commission and European supervisory authorities.

15. In order to avoid any regulatory gaps when the UK left the EU, the UK moved all of the EU-derived financial services rules into UK statute, a process known as "on-shoring". The Treasury's consultation paper (written prior to the end of the transition period) explained it as follows:

> The European Union (Withdrawal) Act 2018 saves all EU-derived domestic legislation (for example, legislation implementing EU Directives) and transfers directly applicable EU law (for example, Regulations) onto the UK statute book.[6]

The proposal

16. Having all of the EU-originating financial services regulations in statute following withdrawal from the EU was not the Treasury's desired long-term solution, due to the inflexibility and fragmentation of rules that this created, as well as the inability of regulators to change their rules as they saw fit. If the rules were to remain in statute it would require in some cases primary legislation to effect change, or in others Treasury Ministers to make change through secondary legislation.[7] The Treasury is therefore proposing to move these rules out of statute and into the regulators' rule books and to give the responsibility for setting future rules in these areas to the regulators. The proposal states that:

> The default approach would be for any retained EU law provision that is in scope of the regulators' FSMA rule-making powers to be taken off the statute book to become the responsibility of the appropriate regulator.[8]

Activity-based regulation

17. The Treasury's consultation also proposes that through primary legislation, Parliament would set "activity-specific" policy framework legislation for the regulators. This legislation would set the purpose of a regulatory regime, the core elements of the regulatory approach to that regime, the issues to which the regulators must have regard

6 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.17

7 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.19

8 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.25

to within the regime, and how the regulators would explain how they are meeting the requirements set for them by the legislation.[9] It would be for the regulators to decide for themselves the rules needed to fulfil the objectives set for them under this legislation.

18. The proposal for regulation to take place under activity-specific frameworks is a largely new one for UK financial services. Since FSMA was introduced, the UK approach to financial services regulation has been to set high-level broad statutory objectives and regulatory principles for the FCA and the PRA in primary legislation, supplemented by an ability for the Treasury to make recommendations to the regulators about aspects of the Government's economic policy to which the regulators should have regard. Prior to the Financial Services Act 2021 (described in more detail later), and with the exception of one specific insurance objective for the PRA of "contributing to the securing of an appropriate degree of protection for those who are or may become policyholders",[10] the regulators are largely not instructed in statute as to how they should regulate specific financial services sectors.

19. The Treasury consultation uses insurance as an example for how activity-specific principles would work:

> The legislation would include an explanation of specific policy priorities relevant to insurance prudential regulation, set out in regulatory principles, that the regulator should take into consideration when developing policy and designing regulatory requirements for that particular activity.[11]

20. While activity-based regulatory principles are proposed in the Treasury's consultation, the Treasury is already using them as a policy and legislative measure. This was confirmed when we asked John Glen MP, the Economic Secretary to the Treasury, for examples of where activity-based regulation might be helpful. The Economic Secretary's response was that the Treasury had already used it.[12] Gwyneth Nurse, Director of Financial Services, HM Treasury, explained the issues in more detail:

> The particular areas of focus that we were considering really came through the Financial Services Act 2021 in the sense of Basel and the investment firms prudential review, where you saw that the Government added the specific "have regard" there, particularly to "as a place for internationally active investment". That allowed us to build on the overarching principles and objectives, and to bring a spotlight to the areas in those files that Parliament wanted the regulators to consider. If you look at that approach and extrapolate it outwards, that is the kind of thing that we are driving at in the future regulatory framework.[13]

9 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.31 associated diagram.

10 https://www.legislation.gov.uk/ukpga/2012/21/part/2/crossheading/financial-conduct-authority-and-prudential-regulation-authority/enacted

11 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.28

12 Q131

13 Q131

Moving on-shored rules into statute

21. Transferring the regulations out of statute will be a significant enterprise. The FCA is responsible for 40 EU files[14] that have been on-shored, and the Bank of England is responsible for two. Vicky Saporta, Executive Director of Prudential Policy Directorate at the Bank of England, told us that the on-shoring process for the Bank alone involved "lawyers and specialist teams […] working through 10,000 pages of rules and another 6,000 of technical standards."[15] The Economic Secretary told the Committee that it was "realistic" that it would take several years for the on-shored rules to be moved into the regulators' rule books.[16]

22. When we asked the FCA in what order this work should be done, Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA, said:

> [it] could be done in one lump or in chunks, whichever best serves the objective of getting this rule set into a place where it can be kept up to date. […] If Parliament wanted to scrutinise each of the different files and we tried to do them all in one block, we might not get to number 40 until quite a long way down the track, and it would have been better to get numbers 1, 2, 3, 4 and 5, which might be the most important ones, done first.[17]

23. When we asked Mr Schooling Latter whether the FCA would want to make changes to rules as they were moved into its rulebook, he said that it would depend on the rule:

> The broad picture would be one of continuity. On the other hand, if we knew there was a case to change something, why not take the opportunity to do that while the exercise was being conducted?[18]

24. While there is agreement on the need to move the on-shored rules out of statute and into the regulators' rulebooks, we did receive written evidence from Aviva stating that it did not believe that all financial services regulation should be moved out of statute entirely. It told us that:

> The legislation that provides direction to regulators needs to be specific enough to: […] create enough specificity to empower genuine legal review. […] Sufficient reference in legislation allows the purpose and intent of these tools to be set by policymakers but still leaves significant latitude to the PRA in the design and operation of the rules, albeit within the clear parameters set in legislation.[19]

UK-derived rules

25. Not all financial services rules that sit within UK statute are there as a result of the UK's membership of the EU. The Treasury consultation gives the example of ring-fencing rules and states that the location of rules within legislation has been a problem for the regulators:

14 Q75
15 Q79
16 Q183
17 Q75–76
18 Q78
19 Aviva (FFS0049)

> In areas of financial services regulation not covered by EU legislation, regulators have usually had more policy discretion as originally intended by the FSMA model. But there have been exceptions to this. Domestic regulation to ring-fence banks is an example of setting requirements on firms through the use of more detailed legislation, in this instance constraining the PRA somewhat in designing and calibrating the requirements.[20]

26. We asked the Bank of England whether they felt "constrained", as the Treasury described it, by the ring-fencing rules being in statute. Vicky Saporta, Executive Director of the Prudential Policy Directorate at the Bank, told us that "the way that the ring-fencing regime was set up was fine. We have not felt particularly constrained. […] It is very early days. We might see constraints that we have not yet seen".[21] She also said that the Bank was not at all opposed to how ring-fencing was legislated for,[22] and the Bank was not pushing for it to be taken out of statute.[23]

27. **We agree with the Treasury that the body of EU financial services rules that was on-shored during the process of leaving the EU should be moved into the regulators' rule books. Keeping rules in statute could require Parliament to amend or pass new legislation every time that the regulators wish to make changes to them. This would be resource-intensive and impractical. The regulators have a key role to play in designing and developing the rules with appropriate Parliamentary oversight. We acknowledge that the process of moving rules out of statute will be time-consuming for the regulators and will be a heavy demand on their resources. It is important that the required resources are provided to ensure this process takes place efficiently.**

28. **The Treasury consultation alluded to certain UK-derived rules that are set out in UK statute, and it suggested that regulators might be constrained as a result. But we found that the regulators did not appear to feel constrained by the existence of any domestic rules being set out in statute. We therefore conclude that while periodic review of domestically-derived rules to see whether they would fit better in rule books rather than in statute may be necessary, they do not need to be included in the exercise that moves the EU on-shored rules out of statute and into the regulators' rule books.**

Ministerial oversight of regulator proposals

Is there a need for change?

29. Another element of the Treasury's proposal is that Ministers would be given sight of regulatory proposals at an earlier stage in the policy formulation process. The consultation states that:

> The Government proposes a general arrangement whereby the regulators consult HM Treasury more systematically on proposed rule changes at an early stage in the policy-making process and before proposals are published for public consultation.[24]

20 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.16
21 Q83
22 Q84
23 Q85
24 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 3.31

30. The Bank of England and the Financial Conduct Authority are operationally independent of the Government. The Treasury's own consultation sets this out clearly:

> The regulators operate independently from government and Parliament. As long as the regulators are acting within their FSMA statutory powers, and in accordance with other relevant financial services legislation, judgements on policy, rule-making and supervision are for the regulators to make.[25]

31. The consultation states that the reason to change the process is to give Ministers more time to consider policies. The proposals would:

> Give the Treasury sufficient time to consider any broader public policy implications that regulator proposals may have and to allow the opportunity to feedback views to the regulators if necessary. It is important to stress that this policy coordination arrangement would only allow the Treasury to feed in views as regulator policy is being developed. It would not give Ministers a veto over the regulators' rule-making functions or act as a constraint around the regulators' policy discretion when designing rules.[26]

32. We asked the Economic Secretary whether he wanted to change the law so that Ministers can change policy proposals, and he said "no",[27] and he also said that "I do not have any aspirations as a Minister to grab power for myself."[28] He explained the proposal by saying "what is sometimes helpful is for Ministers to be able to take account of the broader public policy landscape."[29] The Treasury consultation states that formalising the Treasury's sight of policy proposals before they reach the public consultation stage "could be achieved by requirements in legislation, arrangements set out in a Memorandum of Understanding (MOU) or a combination of the two." Gwyneth Nurse told the Committee that "The consultation leaves open the possibility of making a legal change, just by way of systematising what might happen in terms of a conversation".[30]

Regulator views

33. When we asked the regulators at what stage ministers were informed about policy proposals, Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA, told us that the FCA were "already more or less in a routine of discussing with our Treasury counterparts during the policy formulation process. […] It is better if the Treasury has the chance to comment on the ideas that we are working on […] rather than to find that our counterparts in the Treasury are surprised on the day of public announcements." The Economic Secretary told us that "Virtually every day, I have some sort of interaction with one of the deputy governors or somebody from the FCA, and they are embedded into a lot of our decision-making".[31]

25 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 3.24
26 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 3.31
27 Q150
28 Q154
29 Q149
30 Q152
31 Q137

34. Vicky Saporta agreed, saying that the Bank staff "co-ordinate with and speak to the Treasury regularly at the official level, not least because we need to co-ordinate certain policies, so that we do not come out with something that clashes with what Treasury wants to do, without having considered the appropriate timing for it or the issues involved".[32]

35. When asked, the FCA and the Bank also told us that they had never had policies stopped by the Treasury. Vicky Saporta did say, however, that there had been times where the Treasury had instructed them in the timings of making changes, in the context of negotiating the new arrangements with the EU, but she did qualify this by saying "delay is different to stopping".[33]

36. **We understand the need for Treasury Ministers to be well informed of the regulators' policy intentions as a matter of routine. However, we have not been provided with compelling evidence to justify changing the law to allow Ministers the absolute right to see financial services regulators' policy proposals before they are published for consultation as opposed to the current arrangements whereby significant interaction between Ministers and regulators happens informally as a matter of routine. By doing so, the perception of regulatory independence from government could be damaged. The independence of regulators to be free from political interference is one of the key aspects of UK financial services regulation, and it is, arguably, one of the reasons why the UK is a world-leading financial centre. Regulators must continue to be free to choose what they share with the Treasury in this respect.**

37. **The Treasury has in the past been able to delay policies in the interests of the wider negotiations that took place during the UK's departure from the EU. This suggests that there is already sufficient and appropriate Treasury oversight of the regulators' policy proposals without needing to put such a power in law.**

38. **If the Treasury does wish to give itself the formal power to see policy proposals before they are made public, comments or suggested changes to them using this power should be published alongside the public consultation.**

Activity-Based Approach views

Is there a need for change?

39. The Treasury itself still believes that the overall FSMA regulatory model is fit for purpose. In the Executive Summary of its Financial Services Future Regulatory Framework Consultation, it writes:

> The government believes that this model, which delegates the setting of regulatory standards to expert, independent regulators that work within an overall policy framework set by government and Parliament, continues to be the most effective way of delivering a stable, fair and prosperous financial services sector. […] It allows regulators to flex and update those standards efficiently in order to respond quickly to changing market conditions and emerging risks.[34]

32 Q107
33 Q108
34 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, Executive Summary

40. But the Treasury's consultation put forward a case for new regulatory principles, saying that these were needed because although the original FSMA "set high-level general objectives and principles, it did not provide for government and Parliament to set the policy approach for specific areas of financial services regulation".[35]

41. However, when we asked the Economic Secretary about whether the Treasury was moving towards a more activities-based approach he said "Not really, no", and went on to explain that "We will need to give ourselves some flexibility, but what is most effective is that we have regulators that can do what they need to do as the market evolves."[36]

Regulator views

42. In oral evidence the FCA told us that activity-based principles would add significant complexity to the FCA's work, and that the proposals could increase the risks of arbitrage that already exist around whether firms are within the regulatory perimeter or not. Edwin Schooling Latter told us:

> There would be quite a lot of additional complexity for us, if a slightly different set of objectives, have-regards or considerations applied to different firms. If those differences in objectives and rulesets were based on type of firm, for example, we would create a regulatory arbitrage where a firm that is not in that category might find it easier to do business than a firm that is, because one is subject to those constraints and the other is not.
>
> If it is done on the basis of activity rather than type of firm, we will probably have a slightly different problem, which is that firms may not be clear about whether the particular have-regard or objective is one that applies to them. […] It is simpler and more straightforward to have a single set of objectives and have-regards.[37]

Vicky Saporta agreed.[38]

Industry views

43. There were mixed opinions among the views we received from the financial services industry on this particular proposal. Those who had a view in general agreed that activity-specific principles would provide an opportunity for government and Parliament to set wider policy issues for regulators to have to consider. For example, UK Finance wrote that the proposal would:

> Allow government and Parliament to ensure financial regulators have specific regard to public policy issues of relevance to the wider economy and society […] clarifying those issues of pressing concern to society that the regulators should more comprehensively consider in their activity would be a very positive development.[39]

35 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.27
36 Q130
37 Q98
38 Q104
39 UK Sustainable Investment and Finance Association (UKSIF) (FFS0051)

44. However, there were notes of caution from some who were concerned about how the specific activities themselves would be defined. Legal & General told us that:

> It may be more difficult in other areas of financial services, such as asset management, where defining "activities" may be more complex. It will be important to calibrate the level of granularity of such principles.[40]

The International Regulatory Strategy Group (IRSG - an advisory body to the City of London Corporation) agreed, stating:

> There is an open question as to how broadly each "area of activity" will be set, the potential for overlap or insufficient delineation is significant. Whilst a number of "areas" such as insurance or particular types of market infrastructure have been quite clearly delineated, this has not been the case for, for example, asset management or other activities which have [for example] traditionally fallen within the very broad category of "investment business". The benefits of delineating between different areas could be compromised if firms performing particular business models were caught by multiple areas of regulation simultaneously or if the categories were drawn too broadly.[41]

45. Barclays were in favour of activity-specific principles, citing the example of e-money accounts, which they said consumers were using as current accounts. They argued therefore that e-money accounts were the same activity as current accounts, but that the regulators were regulating them differently to the way in which they were regulating current accounts provided by banks. For Barclays, the suggestion of an activity-specific principle offered the opportunity for reform:

> An activity-specific approach, based on the principle of 'same activity, same risks, same regulation', would ensure a more consistent regulatory approach with the same outcomes and standards for consumers.[42]

The European Union approach to regulation

46. Unlike the FSMA approach, which when introduced did not set specific rules for specific sectors of the industry, EU regulations for the financial services sector are set by specific types of activity, often referred to as "Files". The rationale for such an approach is that without detail set out in law, there would be a greater risk of divergence between the interpretation of principles by the various national regulators across EU Member States.

47. Some have argued that the UK has benefited from a historically more flexible approach. Barnabas Reynolds, partner at Shearman & Sterling LLP and Global Head of the Financial Services Industry Group, drew our attention to a paper in which he argued that the UK's more permissive approach to regulation, with less reliance on a set of rules that permit specific activities as seen within the EU regulations, is one of the reasons as to why the UK's financial services sector has been historically more developed than those seen within the EU.[43]

40 Legal & General Group (FFS0020)
41 International Regulatory Strategy Group (FFS0048)
42 Barclays (FFS0066)
43 Barnabas Reynolds, Restoring UK Law Freeing the UK's Global Financial Market, Politeia, 2021

48. However, the Treasury consultation stresses that:

> In contrast to EU legislation, this activity-specific policy framework legislation would be high-level, focusing on the overall purpose, approach and key policy considerations relevant to each particular regulatory regime. It would not set the requirements that would apply to regulated firms, which would be the responsibility of the relevant regulators.[44]

49. **It is not clear to what extent the Treasury wishes to implement activity-specific regulation. While the proposal is a key aspect of the Treasury's future framework consultation, when we asked the Economic Secretary whether the Treasury intended to move more towards regulating by activity, he said it did not. We note, however, that the Financial Services Act 2021 already sets regulatory principles for the FCA to follow at an activity-based level in regulating investment firms, and it gives the Treasury a power under secondary legislation to specify further matters to which the FCA must have regard when regulating in this field. We conclude that the Treasury intends to pursue this policy irrespective of the findings of this consultation.**

50. **If done with a deft approach, there may be a role for activity-based principles or "have regards" to allow the Government to instruct the regulators, at a more micro level, how it wishes them to approach specific types of business sector. The Government can already instruct regulators more broadly on how to do this through remit letters. But the Government should be sparing in its approach: the strategic and operational objectives, combined with principles and "have regards" that are set out in their remit letters, are already numerous and expanding, to the point where regulators have to choose which to prioritise on a regular basis when drafting new policy proposals. The creation of too many activity-based principles would add a further layer of issues to which regulators must have regard.**

51. **Regulating a company as a whole rather than by activity carried out should provide greater flexibility to regulators to respond to new activities as they develop, rather than needing new activity-specific principles or frameworks each time a new activity emerges.**

52. **We will only be able to conclude with more certainty on the merits or risks of activity-based regulation once the Government provides more details on their proposals in its next consultation.**

The Financial Ombudsman Service

53. The Treasury's consultation states that the "proposed blueprint for the Future Regulatory Framework involves adapting the FSMA model to address the challenges of managing the on-shored regime and to create a more coherent and democratically accountable framework for the development and application of future UK financial services regulation".[45] However the consultation makes no reference to the Financial Ombudsman Service (FOS).

44 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.29

45 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.20

54. We have received written submissions urging that the FOS should be included in the Treasury's framework review. The Finance and Leasing Association (FLA) explained how FOS decisions can set precedents that override FCA principles:

> The Financial Ombudsman Service is an important part of the FSMA framework in delivering consumer redress. […] FOS decisions sometimes set a precedent where the FCA has not previously considered an issue or where its principles-based regulation has not been prescriptive. As the FOS makes its decisions based on the individual merits of each case, this creates the risk that further 'regulation' is created without taking into account wider considerations.[46]

In addition to setting precedents, the FLA also explained that its members are concerned that FOS decisions were inconsistent and did not seem to align with FCA rules.

55. UK Finance also noted that "where cases before the FOS have wider implications or would set precedents, there should be a more consultative and collaborative decision-making process with effective rights of appeal."[47]

56. **Decisions by the Financial Ombudsman Service set precedents and form a critical part of the consumer conduct-focussed element of the regulatory environment for financial services in the UK. Given that the aim of the Treasury's consultation is to create a more coherent framework for how financial services are regulated, the Treasury should consider as part of this consultation how the decision-making processes of the Financial Ombudsman Service would interact with the future regulatory framework for the FCA.**

57. **If Parliament itself is to play a role in the 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 Financial Ombudsman Service.**

46 Finance & Leasing Association (FFS0002)
47 UK Finance (FFS0055)

2 Future scrutiny of financial services

58. The Treasury's consultation paper proposes a new framework for financial services. In this chapter we consider the legislative requirements of the new framework, and how scrutiny of the rules drawn up under the new framework might be conducted.

Proposed legal structure of framework

59. The Government's proposals can be separated into three phases. The first is to create a new, over-arching regulatory framework using primary legislation. The second is to move the EU-derived financial services rules which have been on-shored out of statute and into the regulators' rule books. The final and enduring phase would be where regulators make changes to rules as they feel appropriate over time and to discharge the duties given to them by Parliament in primary legislation. Any changes needed to the over-arching framework thereafter would be brought into effect through secondary legislation.[48]

60. When we asked the Economic Secretary how the on-shored rules would be moved out of statute, he said that it was his intention to use primary legislation to create the overall framework, and then to use secondary legislation to move the rules across:

> My preference would be for us to have framework legislation that would then allow for those transfers through secondary legislation. […] That cannot be done overnight. The complexity involved means that it is going to take some time to deliver, but I hope it will allow us to get it right and ensure that the responsibilities lie in the right place.[49]

Scrutiny response to new framework

61. Any primary legislation that is required to create a new regulatory framework, or activity-based frameworks, would be subject to the usual procedures in each House for scrutiny of primary legislation.

62. The Treasury suggests in its consultation that because the financial services regulators would gain substantial new rule-making powers, Parliament would want to consider its approach to scrutiny of the exercise by the regulators of those new powers:

> The government recognises that [the consultation proposals] will involve delegating a very substantial level of policy responsibility to the UK financial services regulators. […] It is therefore right to review the framework arrangements for accountability, scrutiny and public engagement in the policy-making process, particularly in relation to the regulators. […] Parliament will also wish to consider how its scrutiny of financial services regulation may need to adapt, particularly in relation to the financial services regulators.[50]

63. The consultation goes on to suggest that "Parliament may wish to focus on the select

48 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 2.31 diagram

49 Q182

50 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, page 6

committee system when considering its future approach to Parliamentary scrutiny of financial services policy",[51] adding that this is because the Government believes that "enhanced Parliamentary focus on the key public policy issues related to financial services would improve the overall operation of the UK's regulatory framework".[52]

64. The consultation does not propose any specific scrutiny approach, instead stating that "It is of course for Parliament to decide whether and how it will adapt its approach to scrutiny."[53]

65. Parliament has choices about how it will conduct scrutiny of rules made under the future framework. It might seek to replicate the level of scrutiny which the European Parliament conducts in relation to draft texts which are to apply across the EU; but there would be alternative approaches.

Previous EU Parliamentary scrutiny of financial services

66. Baroness Bowles, former Chair of the European Parliament's Committee on Economic and Monetary Affairs (ECON), told us how that Committee worked, and what work it did:

> There are 60 members. The work consists of both pre-legislative scrutiny and consultation, then actually doing the legislation itself and then also scrutinising what happens afterwards through oversight of the regulators. […] A committee of the whole House is the nearest thing that we have in our Parliament, where you are using your numbers and your expertise.[54]

The size of committees in the European Parliament reflects the need to be representative of 27 Member States as well as of multiple party groupings.

67. The European Parliament's standing committees broadly combine the functions of both select and public bill committees. As such, ECON plays a role both in drafting of Level 1 legal texts and in scrutiny of how they are subsequently implemented. ECON is where the Parliament's initial position on each Commission proposal for new financial services legislation is discussed and provisionally approved. This position then forms the basis for the "trilogue" talks with the Member States in the Council. It is also the Committee where any subsequent provisional agreement with the EU Member States in the Council on a Level 1 text is discussed and voted on.

68. ECON is also the main forum for European Parliament scrutiny of Level 2 legal texts. These technical measures set detailed rules supplementing the Level 1 legislation, in a similar way to the way in which the PRA and FCA rulebooks supplement FSMA. They are drafted and adopted by the European Commission and take the form of either Delegated or Implementing Acts. For all Delegated Acts, the European Parliament (EP) has a veto. Therefore, ECON conducts systematic scrutiny and produces a recommendation to the Parliament. This states in each case whether or not the EP should vote to block the draft

51 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 3.19

52 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 3.21

53 HM Treasury, Financial Services Future Regulatory Framework Review Phase II Consultation, October 2020, para 3.22

54 Q2

Level 2 rules, which is then subject to a vote in the Plenary. For Level 2 rules where the EP has no formal role (Implementing Acts), ECON can conduct ad hoc scrutiny on a case-by-case basis, if it has particular concerns over the policy being pursued.

69. The legislative workload of the ECON Committee is substantial. Dr Kay Swinburne, former member of the ECON Committee, explained the resources that the Committee would have at its disposal:

> There are 23 members of full-time staff in the secretariat alone. That is made up of 10 policy people, five admin people and then eight people in an economic unit that sits alongside the main secretariat. There are 23 in total who are there to support the committee. As well as the full-time members of staff, certainly in my time there were always at least three national seconded experts who came from the regulators. Usually there was one from Germany, one from France and one from the UK at any one time. They would typically be the technical experts—rather than the lawyers, who were the permanent members of staff—who would support individual pieces of legislation.[55]

70. Lord Hill, former European Commissioner for Financial Services, explained to us why comparisons between the European Parliament Committees and UK committees may not be very useful:

> The first and obvious point to make is that our system is fundamentally different from the EU system. […] What that illustrates is the fundamentally different natures of a consensus-building system, which is the European system, and ours, which operates for all of us on the basis of majority. That drives very different behaviour; it drives different attitudes to scrutiny. […] Parliament in Europe is not a bit of process that does a bit of scrutiny at the end, you have some votes and either you do it well or you do not, and it is either guillotined or it is not, and then it is shoved up to the House of Lords where they may do some more detailed stuff. The co-legislators construct, shape and drive the whole shape of the legislation and the policy. That leads to a completely different set of behaviours and, therefore, the different way that the Parliament thinks about the resources it needs and so on.[56]

71. The City of London pointed out that the EU model for scrutiny of legislative proposals is time-consuming due to its nature:

> The EU's model of legislative scrutiny is also designed to balance the interests of 27 Member States. This means that the system is necessarily built on compromise and can fall captive to wider political debates and tensions between groupings in the Parliament. It also means that decision making, or indeed changing legislation that has been passed, can be a time consuming and difficult process. There may be an advantage to the UK that it can now be nimbler in its regulatory approach.[57]

55 Q3
56 Q5
57 Office of the City Remembrancer, City of London Corporation (FFS0045)

72. Both Lloyds and the City of London proposed that Parliament should not replicate the European Parliament's model, which had been designed for specific circumstances. Lloyds wrote:

> We do not advocate establishing identical mechanisms and institutions in the UK, as Parliament will need to determine the best approach for the specific circumstances of the UK's future legislative and scrutiny framework.[58]

ISRG wrote that the UK should not "seek to wholesale replicate the EU's model for drafting and scrutinising financial services regulation. […] the UK's model is fundamentally different."[59]

Ex-ante scrutiny

73. We received written evidence from Positive Money, a not-for-profit research and campaigning organisation, stating that Parliament should scrutinise every change that regulators propose:

> 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.[60]

The Investment Association was also in favour of ex-ante scrutiny being carried out. It wrote:

> There is a need for an effective, informed and appropriately resourced body to scrutinise the activity of the FCA and hold it to account in the new regulatory environment. This would do two things: to contribute to "policy formulation" (i.e. ex-ante) and to look at the "real world effects" (i.e. the ex post assessment of whether or not the regulators actually delivered on the mandate they were given).

74. In contrast, the Financial Inclusion Centre, also a not-for-profit policy research group, was opposed to more ex-ante scrutiny, stating that it prevented regulators from carrying out their duties:

> It is self-evident that giving Parliament more ex-ante or even concurrent opportunities to scrutinise the operations of the main regulators will inhibit the ability of regulators to respond to those emerging threats and risks.[61]

75. In its written evidence, the Bank of England cautioned that "there is a risk that ex-ante scrutiny of every file weakens the independence and responsiveness of the regulators."[62] Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA, told us in oral evidence that ex-ante scrutiny could slow down the process of preparing new rules. He said:

58 Lloyd's (FFS0047)
59 International Regulatory Strategy Group (FFS0048)
60 Positive Money (FFS0044)
61 Financial Inclusion Centre (FFS0073)
62 Bank of England (FFS0080)

> If there are further mechanisms that mean it takes more time for us to change the rules, that would concern us in terms of being able to deliver against the objectives that you in Parliament have set for us. As I said earlier, we are rarely criticised for acting too quickly and are quite often criticised for being too slow to make sure that the framework is up to date. That is the heart of our concern. It is not a concern about scrutiny per se.[63]

76. When proposing new regulations, the regulators are already required to consult on them prior to implementation, thereby providing an opportunity for general scrutiny and for objections to be raised. The FCA told us that:

> Operationally, when discharging our general functions (including the making of rules), we are required by FSMA to act (ex-ante) in a way that is compatible with our strategic objectives and advances at least one of our operational objectives. We are required to:
>
> - consult publicly on making rules and guidance, with cost benefit analyses, before making rules,
>
> - publish our responses to consultation feedback,
>
> - consult, and consider representations from, a wide range of statutory panels (consumer and practitioner) on the extent to which our general policies and practices are consistent with our duties.
>
> In addition to FSMA cost benefit analyses, we are also subject to broader accountability and scrutiny under the Enterprise Act. We must in some cases publish impact assessments, which are scrutinised by the Regulatory Policy Committee.[64]

77. **We believe that a measure of "ex-ante" scrutiny by Parliament is necessary. But we do not believe that it would be proportionate for Parliament or its committees to carry out, as a necessary part of the rule-making process, the detailed and comprehensive textual scrutiny which the European Parliament's Economic and Monetary Affairs Committee conducts. The European Parliament's legislative processes, under which the existing acquis of EU financial services rules was created, were designed for a parliamentary system which is quite different from that of the UK Parliament.**

78. **We believe that effective scrutiny of regulatory proposals should be carried out through a targeted approach. Each new proposal made by the Financial Conduct Authority or by the Prudential Regulatory Authority under the future financial services regulatory framework would be put out for consultation. Industry stakeholders and civil society groups would have an opportunity to put forward views, as would Parliament, both through the select committee system and through the work of individual Members of either House. If any matter of public interest were to arise that we deemed sufficiently important to scrutinise in more detail, or indeed challenge, we would do so.**

63 Q64
64 Financial Conduct Authority (FFS0027)

Options for how Parliament should scrutinise financial services

A new financial services committee

79. We received several written submissions[65] either proposing a sub-committee or the alternative of a new separate select committee specifically for financial services. Innovate Finance, a body representing some of the FinTech community, wrote:

> With [the] increased role [for the regulators], we recommend that there is greater scrutiny of the regulators regarding the performance of their functions and rulemaking than is currently the case. This should be formalised under the Financial Services and Markets Act 2000 (FSMA). 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 the purpose. It is essential that the committee be sufficiently resourced, including sourcing appropriate expertise from the financial services sector.[66]

A Joint Committee

80. A different suggestion was made by Barclays, the Association of British Insurers, and the Investment Association, that a Joint Committee be created with Members from both the House of Commons and the House of Lords. Barclays wrote:

> A potential solution to increase the resource and expertise within Parliament would be to create a Joint House of Commons and House of Lords Committee. […] A Joint Committee would potentially increase expertise and experience of the membership and provide extra resource to enable the Committee to address a wide variety of policy matters. Its remit should also be differently and narrowly drawn to focus on regulatory scrutiny so as not to conflict with the work of other, established committees. This approach would closely mirror the committee system for financial services that is used in the US, with both Senate and House Banking Committees scrutinising financial regulation.[67]

Independent organisation to carry out scrutiny and report back to Parliament

81. A further suggestion is that an independent body be created to assess whether the regulators were fulfilling their statutory objectives in line with what Parliament had intended. That organisation might then report back to this Committee, or to Parliament more generally. The idea, which was endorsed by the City of London, was put forward by the International Regulatory Strategy Group (IRSG), a practitioner-led group comprising leaders from across the UK financial and related professional services industry:

> One option that could considered is to create a new, independent public body with the specific mandate to provide expert analysis of the regulatory

65 CBI, APPG for Financial Markets, City of London, PwC, The True and Fair Campaign
66 Innovate Finance (FFS0052)
67 Barclays (FFS0066)

> measures that the financial regulators introduce and of the regulatory landscape more broadly. Such a body could have a more or less formal relationship with Parliament but would be expected to have the resources and expertise that would enable it to produce robust analysis and recommendations. This would provide genuine scrutiny while preserving the regulators' operational independence.[68]

The status quo

82. While recommending changes to how financial services are scrutinised, TheCityUK, a representative group of the financial services industry, did make the case that scrutiny of the financial services system as a whole needed to be informed by the wider context within which the system was regulated. It wrote:

> […] Certain aspects of Parliament's existing scrutiny and oversight should, we believe, continue. Inquiries that the Treasury Committee undertake in the current framework already provide for the direct accountability of the financial regulators to Parliament. […]
>
> The Treasury Committee could also retain its existing role overseeing all of those aspects of policy (both macro and micro economic) that are the responsibility of the Treasury and its agencies. It is important that there is a forum within Parliament competent to shadow the Treasury's entire suite of departmental responsibilities and that can make connections between (and identify any inconsistencies or trade-offs between) the different components of government economic policy. Only the Treasury Committee is capable of forming a holistic view of how taxation, public spending, monetary policy, micro-economic reform, and financial market regulatory policy co-exist.[69]

Conclusion

83. It will be for Parliament to decide how to conduct scrutiny of rules drawn up by regulators under the future framework for regulation of financial services. Various suggestions have been put forward to this inquiry, and we have summarised them above.

84. It should be borne in mind that there are already scrutiny committees in Parliament within whose remit scrutiny of financial services regulation might fall. Besides our Committee, there is a very significant body of relevant expertise in both the House of Lords Economic Affairs Committee and the House of Lords Industry and Regulators Committee.

85. **We have set out above reasons why we do not believe that Parliament or its committees need necessarily carry out detailed and comprehensive textual scrutiny for every new draft regulation or rule, although it would always be open to a committee of either House to do so. We envisage that scrutiny would be both "ex-ante" and "ex post". "Ex-ante" scrutiny could be based upon expert analysis of draft texts, together with an exploration of representations made by industry stakeholders, consumer representatives and others, with robust challenge to the regulators when warranted.**

68 International Regulatory Strategy Group (FFS0048)
69 TheCityUK (FFS0068)

"Ex post" scrutiny might entail reviews of the impact of regulations and an assessment of the balance struck between protection for the consumer and effective operation for the industry.

86. **We do not see a clear need for the creation of a new committee or a new independent body to carry out this work. It would seem a more efficient use of Parliamentary resources to use the structures that are already available in both Houses. Although the scrutiny task will be substantial, it will be an extended one as new regulations are drafted, rather than a short-term surge of activity. There is already expertise in select committees in the Commons and the Lords, and both have the power to appoint specialist advisers and commission research.**

87. **The creation of a new independent body to assess whether regulators were fulfilling their statutory objectives would not remove the responsibility of this Committee to hold the regulators to account, and it would also add a further body to the financial services regulatory regime which we would need to scrutinise.**

88. The remit of our Committee is broad. It mirrors all the departmental responsibilities of the Treasury. It therefore incorporates public spending and taxation, financial services policy, other aspects of the Treasury's own departmental work,[70] and those of the bodies that are ultimately accountable to the Treasury. This includes almost all of the public bodies operating in financial services[71] and therefore entails scrutiny of the Bank of England, the Financial Conduct Authority, the Financial Ombudsman Service, and the Payment Systems Regulator. **Our Committee has been consistent in its regular monitoring of the work of the Financial Conduct Authority and of the Prudential Regulatory Authority, the extent to which they meet the objectives set for them by Parliament, and their responsiveness to consumer expectations. There is a strong logic in aligning the scrutiny of draft regulations and policy proposals with that of policy implementation and the day-to-day work of the regulators.**

A Treasury sub-committee

89. We received a number of written submissions, including those from PwC, the CBI and the Transparency Taskforce, which were in favour of a sub-committee of the Treasury Committee being created to specifically scrutinise financial services. The CBI wrote:

> The CBI believes fresh mechanisms, with active support from specialists, would have the headspace and authority to be a neutral critic for a changing sector. […] One approach is to set up a TSC financial services sub-committee, which could provide effective scrutiny over a financial services regulation and taxation culture that puts customers first. It would scrutinise new regulatory and tax policies, ensure that a meaningful and effective impact assessment has been conducted, as well ensure that new policies have been formulated in consultation with firms, regulators, HMRC/government and end users. This could take the form of a Financial Services Scrutiny Committee. Such mechanisms would also ensure effective post-evaluation of new legislation and regulation.[72]

70 The full responsibilities of the Treasury can be found on its website.

71 Financial reporting and accounting is regulated by the Financial Reporting Council accountable to the Department for Business Energy and Industrial Strategy. Some elements of pension regulation and policy are accountable to the Department for Work and Pensions.

72 Confederation of British Industry (FFS0025)

90. The most common reason given for the creation of a sub-committee was to free up time so that the sub-committee could concentrate its efforts on financial services without constraining the work programme of the full Committee. However, under the House's Standing Orders, the membership of a sub-committee would be drawn exclusively from the membership of the full Committee; so the capacity of the sub-committee to do that work would depend on the capacity of its members to participate in the work of both the full Committee and of the sub-committee. Furthermore, any report from the sub-committee would need to be agreed by the full Committee; so delegating work on financial services to a sub-committee would not necessarily relieve the full Committee significantly.

91. **The House could, if it thought it necessary to increase the capacity and broaden the expertise of the Treasury Committee in order to undertake scrutiny of financial services, expand the facility under Standing Order No. 137A(1)(e) for non-members of the Committee to take part in certain proceedings. This provision currently enables only members of other committees to participate, but it could be adapted so as to permit the Committee to invite any Member of the House to do so.**

92. **The House might also consider increasing the resources available to the Committee if it were, as we anticipate, to expand its existing responsibility for the scrutiny of financial services. Although the Committee already has the power to appoint specialist advisers, there may be merit in making provision for the Committee to have the assistance of the Counsel to the Speaker, in a manner similar to that provided to the BEIS Committee in its scrutiny of draft orders under Standing Order No. 141, on scrutiny of regulatory and legislative reform orders.**

93. **We will continue to maintain an open mind as to how best to scrutinise the significant flow of financial services proposals that will be made by the regulators, and we look forward to engaging constructively with the Government and with others in Parliament once more detailed proposals emerge from the Government's consultation response later this year.**

Conclusions and recommendations

The Treasury's proposed future framework

1. We agree with the Treasury that the body of EU financial services rules that was on-shored during the process of leaving the EU should be moved into the regulators' rule books. Keeping rules in statute could require Parliament to amend or pass new legislation every time that the regulators wish to make changes to them. This would be resource-intensive and impractical. The regulators have a key role to play in designing and developing the rules with appropriate Parliamentary oversight. We acknowledge that the process of moving rules out of statute will be time-consuming for the regulators and will be a heavy demand on their resources. It is important that the required resources are provided to ensure this process takes place efficiently. (Paragraph 27)

2. The Treasury consultation alluded to certain UK-derived rules that are set out in UK statute, and it suggested that regulators might be constrained as a result. But we found that the regulators did not appear to feel constrained by the existence of any domestic rules being set out in statute. We therefore conclude that while periodic review of domestically-derived rules to see whether they would fit better in rule books rather than in statute may be necessary, they do not need to be included in the exercise that moves the EU on-shored rules out of statute and into the regulators' rule books. (Paragraph 28)

3. We understand the need for Treasury Ministers to be well informed of the regulators' policy intentions as a matter of routine. However, we have not been provided with compelling evidence to justify changing the law to allow Ministers the absolute right to see financial services regulators' policy proposals before they are published for consultation as opposed to the current arrangements whereby significant interaction between Ministers and regulators happens informally as a matter of routine. By doing so, the perception of regulatory independence from government could be damaged. The independence of regulators to be free from political interference is one of the key aspects of UK financial services regulation, and it is, arguably, one of the reasons why the UK is a world-leading financial centre. Regulators must continue to be free to choose what they share with the Treasury in this respect. (Paragraph 36)

4. The Treasury has in the past been able to delay policies in the interests of the wider negotiations that took place during the UK's departure from the EU. This suggests that there is already sufficient and appropriate Treasury oversight of the regulators' policy proposals without needing to put such a power in law. (Paragraph 37)

5. If the Treasury does wish to give itself the formal power to see policy proposals before they are made public, comments or suggested changes to them using this power should be published alongside the public consultation. (Paragraph 38)

6. It is not clear to what extent the Treasury wishes to implement activity-specific regulation. While the proposal is a key aspect of the Treasury's future framework consultation, when we asked the Economic Secretary whether the Treasury

intended to move more towards regulating by activity, he said it did not. We note, however, that the Financial Services Act 2021 already sets regulatory principles for the FCA to follow at an activity-based level in regulating investment firms, and it gives the Treasury a power under secondary legislation to specify further matters to which the FCA must have regard when regulating in this field. We conclude that the Treasury intends to pursue this policy irrespective of the findings of this consultation. (Paragraph 49)

7. If done with a deft approach, there may be a role for activity-based principles or "have regards" to allow the Government to instruct the regulators, at a more micro level, how it wishes them to approach specific types of business sector. The Government can already instruct regulators more broadly on how to do this through remit letters. But the Government should be sparing in its approach: the strategic and operational objectives, combined with principles and 'have regards' that are set out in their remit letters, are already numerous and expanding, to the point where regulators have to choose which to prioritise on a regular basis when drafting new policy proposals. The creation of too many activity-based principles would add a further layer of issues to which regulators must have regard. (Paragraph 50)

8. Regulating a company as a whole rather than by activity carried out should provide greater flexibility to regulators to respond to new activities as they develop, rather than needing new activity-specific principles or frameworks each time a new activity emerges. (Paragraph 51)

9. We will only be able to conclude with more certainty on the merits or risks of activity-based regulation once the Government provides more details on their proposals in its next consultation. (Paragraph 52)

10. Decisions by the Financial Ombudsman Service set precedents and form a critical part of the consumer conduct-focussed element of the regulatory environment for financial services in the UK. Given that the aim of the Treasury's consultation is to create a more coherent framework for how financial services are regulated, the Treasury should consider as part of this consultation how the decision-making processes of the Financial Ombudsman Service would interact with the future regulatory framework for the FCA. (Paragraph 56)

11. If Parliament itself is to play a role in the 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 Financial Ombudsman Service. (Paragraph 57)

Future scrutiny of financial services

12. We believe that a measure of "ex-ante" scrutiny by Parliament is necessary. But we do not believe that it would be proportionate for Parliament or its committees to carry out, as a necessary part of the rule-making process, the detailed and comprehensive textual scrutiny which the European Parliament's Economic and Monetary Affairs Committee conducts. The European Parliament's legislative processes, under which the existing acquis of EU financial services rules was created, were designed for a parliamentary system which is quite different from that of the UK Parliament. (Paragraph 77)

13. We believe that effective scrutiny of regulatory proposals should be carried out through a targeted approach. Each new proposal made by the Financial Conduct Authority or by the Prudential Regulatory Authority under the future financial services regulatory framework would be put out for consultation. Industry stakeholders and civil society groups would have an opportunity to put forward views, as would Parliament, both through the select committee system and through the work of individual Members of either House. If any matter of public interest were to arise that we deemed sufficiently important to scrutinise in more detail, or indeed challenge, we would do so. (Paragraph 78)

14. We have set out above reasons why we do not believe that Parliament or its committees need necessarily carry out detailed and comprehensive textual scrutiny for every new draft regulation or rule, although it would always be open to a committee of either House to do so. We envisage that scrutiny would be both "ex-ante" and "ex post". "Ex-ante" scrutiny could be based upon expert analysis of draft texts, together with an exploration of representations made by industry stakeholders, consumer representatives and others, with robust challenge to the regulators when warranted. "Ex post" scrutiny might entail reviews of the impact of regulations and an assessment of the balance struck between protection for the consumer and effective operation for the industry. (Paragraph 85)

15. We do not see a clear need for the creation of a new committee or a new independent body to carry out this work. It would seem a more efficient use of Parliamentary resources to use the structures that are already available in both Houses. Although the scrutiny task will be substantial, it will be an extended one as new regulations are drafted, rather than a short-term surge of activity. There is already expertise in select committees in the Commons and the Lords, and both have the power to appoint specialist advisers and commission research. (Paragraph 86)

16. The creation of a new independent body to assess whether regulators were fulfilling their statutory objectives would not remove the responsibility of this Committee to hold the regulators to account, and it would also add a further body to the financial services regulatory regime which we would need to scrutinise. (Paragraph 87)

17. Our Committee has been consistent in its regular monitoring of the work of the Financial Conduct Authority and of the Prudential Regulatory Authority, the extent to which they meet the objectives set for them by Parliament, and their responsiveness to consumer expectations. There is a strong logic in aligning the scrutiny of draft regulations and policy proposals with that of policy implementation and the day-to-day work of the regulators. (Paragraph 88)

18. The House could, if it thought it necessary to increase the capacity and broaden the expertise of the Treasury Committee in order to undertake scrutiny of financial services, expand the facility under Standing Order No 137A(1)(e) for non-members of the Committee to take part in certain proceedings. This provision currently enables only members of other committees to participate, but it could be adapted so as to permit the Committee to invite any Member of the House to do so. (Paragraph 91)

19. The House might also consider increasing the resources available to the Committee if it were, as we anticipate, to expand its existing responsibility for the scrutiny

of financial services. Although the Committee already has the power to appoint specialist advisers, there may be merit in making provision for the Committee to have the assistance of the Counsel to the Speaker, in a manner similar to that provided to the BEIS Committee in its scrutiny of draft orders under Standing Order No. 141, on scrutiny of regulatory and legislative reform orders. (Paragraph 92)

20. We will continue to maintain an open mind as to how best to scrutinise the significant flow of financial services proposals that will be made by the regulators, and we look forward to engaging constructively with the Government and with others in Parliament once more detailed proposals emerge from the Government's consultation response later this year. (Paragraph 93)

Formal minutes

Wednesday 30 June 2021

Members present:

Mel Stride, in the Chair

Anthony Browne
Felicity Buchan
Emma Hardy
Julie Marson
Alison Thewliss

Draft Report (*The Future Framework for Regulation of Financial Services*) proposed by the Chair, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 93 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Monday 5 July at 3.00 pm.

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 27 January 2021

Lord Hill of Oareford, Former EU Commissioner for financial services, European Commission; **Baroness Bowles of Berkhamsted**, Former Chair of ECON Committee, European Parliament; **Dr Kay Swinburne**, Former Member of ECON Committee, European Parliament, Vice Chair of Financial Services, KPMG — Q1–55

Monday 26 April 2021

Edwin Schooling Latter, Director of Markets and Wholesale Policy & Supervision, Financial Conduct Authority; **Vicky Saporta**, Executive Director of the Prudential Policy Directorate, Prudential Regulation Authority — Q56–121

Wednesday 26 May 2021

John Glen MP, Economic Secretary to the Treasury, HM Treasury; **Gwyneth Nurse**, Director of Financial Services, HM Treasury — Q122–196

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

FFS numbers are generated by the evidence processing system and so may not be complete.

1 Anonymous (FFS0026)

2 Anonymous (FFS0070)

3 Anonymous (FFS0056)

4 Anonymous (FFS0001)

5 Aldermore Bank (FFS0007)

6 Amigo Loans (FFS0060)

7 Aon UK (FFS0035)

8 Association of British Insurers (FFS0062)

9 Association of Investment Companies (FFS0010)

10 Aviva (FFS0049)

11 Aviva (FFS0009)

12 BVCA (FFS0072)

13 Bank of England (FFS0080)

14 Barclays (FFS0066)

15 Bavoso, Dr Vincenzo (Senior Lecturer in Commercial Law, Law School, University of Manchester) (FFS0023)

16 ClientEarth (FFS0077)

17 Confederation of British Industry (FFS0025)

18 Consumer Credit Trade Association (CCTA) (FFS0029)

19 Envestnet Yodlee (FFS0011)

20 Euroclear UK & Ireland Limited (FFS0028)

21 FCA Practitioner Panel (FFS0037)

22 Federated Hermes Inc. (FFS0003)

23 Finance & Leasing Association (FFS0002)

24 Finance Innovation Lab (FFS0031)

25 Financial Conduct Authority (FFS0027)

26 Financial Inclusion Centre (FFS0073)

27 Financial Inclusion Commission (FFS0075)

28 Financial Services Skills Commission (FFS0034)

29 Finanical Services Consumer Panel (FFS0064)

30 Fintech Founders (FFS0041)

31 Funding Circle (FFS0059)

32 Hall, Professor Sarah (Professor of Economic Geography and Senior Fellow, University of Nottingham and UK in a Changing Europe); and Dr Martin Heneghan (Research Fellow, University of Nottingham) (FFS0032)

33 Hannaford Associates Ltd (FFS0019)

34 Innovate Finance (FFS0052)

35 Intercontinental Exchange (FFS0058)

36 International Regulatory Strategy Group (FFS0048)

37 Investment & Life Assurance Group (FFS0054)

38 Lane Clark and Peacock (FFS0012)

39 Legal & General Group (FFS0020)

40 Lloyd's (FFS0047)

41 Loan Market Association (FFS0021)

42 London and International Insurance Brokers' Association (LIIBA) (FFS0042)

43 Lyddon Consulting Services Limited (FFS0017)

44 Mid-Tier banks (FFS0083)

45 New City Initiative (FFS0014)

46 Office of the City Remembrancer, City of London Corporation (FFS0069)

47 Office of the City Remembrancer, City of London Corporation (FFS0045)

48 Pension Insurance Corporation plc; and New Financial LLP (FFS0036)

49 Positive Money (FFS0044)

50 PwC (FFS0050)

51 Quoted Companies Alliance (FFS0022)

52 Quoted Companies Alliance (FFS0015)

53 ShareAction (FFS0061)

54 Spotlight on Corruption (FFS0079)

55 Swiss Euro Clearing Bank (FFS0016)

56 The Consumer Council (FFS0030)

57 The Investment Association (FFS0081)

58 The Money Charity (FFS0038)

59 The True and Fair Campaign (FFS0074)

60 TheCityUK (FFS0068)

61 Third Generation Environmentalism (E3G) (FFS0063)

62 Turnbull, Dr Shann (Principal, International Institute for Self-governance) (FFS0043)

63 Tyfield, Sam (FFS0013)

64 UK Finance (FFS0055)

65 UK Sustainable Investment and Finance Association (UKSIF) (FFS0051)

66 United Kingdom Shareholders' Association (UKSA); and UK Individual Shareholders Society (ShareSoc) (FFS0067)

67 Vanguard Asset Management, Limited (FFS0024)

68 White, Martin (Director, United Kingdom Shareholders' Association (UKSA)) (FFS0082)

69 Zurich Insurance (FFS0078)

List of Reports from the Committee during the current Parliamentary session

All publications from the Committee are available on the publications page of the Committee's website.

Session 2021–22

Number	Title	Reference
1st	Tax after coronavirus: the Government's response	HC 144
2nd	The appointment of Tanya Castell to the Prudential Regulation Committee	HC 308
3rd	The appointment of Carolyn Wilkins to the Financial Policy Committee	HC 307
4th	The Financial Conduct Authority's Regulation of London Capital & Finance plc	HC 149