IRSG
INTERNATIONAL REGULATORY STRATEGY GROUP

IRSG Architecture for Regulating Finance workstream
Response to HM Treasury Financial Services Future Regulatory Framework Review
Phase II Consultation

Executive Summary

The regulation and supervision of the UK's financial services sector has a significant impact on the ability of firms to meet the needs of their customers, on the country's position as the leading global financial centre, and on the nation's broader economic and social wellbeing. With the end of the transition period the UK has a unique opportunity to review its regulatory framework and to consider reforms that will ensure that it remains appropriate to meet the social, economic and geopolitical challenges that are ahead.

In its consideration of these issues the IRSG seeks to make a constructive contribution to the policy debate and to offer a unique perspective, drawing on the breadth of our membership from across financial and professional services. Our first report on this topic 'The Architecture for regulating finance after Brexit[1]' began a debate and set out the principles of an effective regulatory framework. It made recommendations on how to strike the balance between competing regulatory objectives and ongoing consideration of broader public policy objectives. In our second report 'The Architecture for regulating finance after Brexit: Phase II[2]' we updated our findings as the process of onshoring had provided clarity on the transfers of powers post-Brexit and key stakeholders were beginning to engage in the conversation. In subsequent work we have responded to requests from policymakers for further detail on particular issues or topics.

All of this work has been informed by the need to develop a framework that recognises and responds to three critical features of the post-EU landscape:

- a significant amount of power now transfers back to the UK regulators from EU bodies;
- this additional power needs to be balanced by appropriate accountability and scrutiny mechanisms;
- but these mechanisms must operate in a way that preserves the day-to-day independence of the regulators and avoids undue politicisation of processes

In this latest contribution to the debate, we continue to identify possible options for improving the effectiveness and efficiency of the UK's regulatory framework, always striving for that appropriate point of balance between these three elements. The IRSG position on the key issues raised by the Treasury consultation are:

The model for regulation

The IRSG broadly support the enhanced FSMA model proposed by HM Treasury, while noting that:

- It has not always been applied consistently, with detailed rules sometimes being set out in legislation rather than in regulators' rulebooks.

[1] IRSG 'The Architecture for regulating finance after Brexit' December 2017, available at: https://www.irsg.co.uk/assets/The-Architecture-for-Regulating-Finance-after-Brexit.pdf

[2] IRSG 'The Architecture for regulating finance after Brexit: Phase II' Jan 2020, available at: https://www.irsg.co.uk/assets/Resources-and-commentary/The-architecture-for-regulating-finance-after-Brexit-Phase-II.pdf

- Expectations for financial services regulation have changed significantly over the past 20 years and are likely to change further. Consideration should be given to how issues such as technology and climate change may further shape the future direction of financial regulation.
- The UK's regulatory framework is unique and the context is unique and no other jurisdiction's model is necessarily an appropriate guide.
- Proportionality and simplification should be built into the system to prevent undue regulatory burden for small firms and innovators.

Accountability and Scrutiny

The IRSG believes that regulators must be accountable and subject to appropriate levels of scrutiny in order to effectively carry out their duties. As a result of the UK's departure from the EU there will be a reduction in scrutiny and accountability of the UK regulators. The IRSG therefore recommends:

- Parliamentary scrutiny, enhanced by maintaining the horizontal role of the Treasury Select Committee and establishing a new financial services (sub-) committee to provide a more focused venue for ongoing scrutiny of regulation; though Parliament will need significant additional resources to be able to perform this role;
- Independent oversight of financial market regulatory policy; a new Office for Responsible Financial Regulation (ORFR) could be an option to provide additional expert resource to scrutinise rule-making, without jeopardising the regulators' independence or impinging on Parliament's prerogatives
- Consideration of Judicial review; the courts play an important role in holding those exercising executive power to account but judicial review has proven to be inappropriate for financial services regulation due to the ongoing, close relationship between regulators and firms.

Roles and responsibilities

The IRSG supports the clear, coherent allocation of regulatory responsibilities as set out in the consultation. A clear division of responsibilities will enhance the UK's attractiveness and simplify regulation to the benefit of firms. The IRSG recommends:

- This model must include structured and consistent engagement between the government, Parliament and the regulators to allow for appropriate accountability and scrutiny.
- Careful thought must be given to how the different "levels" of the model (i.e. statutory objectives, general principles, activity specific principles and regulators' rulebooks) fit together to preserve clarity and avoid overlap.
- Amendments should be made to both the regulators' statutory objectives and the general regulatory principles in FSMA given the role of financial services regulators in influencing these broader policy goals.
- Activity-specific regulatory principles should be set at a relatively granular level in comparison to the general regulatory principles and statutory objectives.
- The allocation of resources should be aligned with the allocation of powers.

We hope this will be a useful contribution to the consultation which we believe should form one part of a wider blueprint for financial services. Setting out a national strategy for the sector would provide a guide for the overall direction of changes currently in train.

We would like to thank the members of the IRSG Architecture for regulating finance workstream for their input into the submission and in particular Linklaters LLP and M&G for their extensive work on these issues.

Question 1

How do you view the operation of the FSMA model over the last 20 years? Do you agree that the model works well and provides a reliable approach which can be adapted to the UK's position outside of the EU?

The IRSG agrees that the FSMA model of regulation has broadly operated effectively over the last 20 years in relation to the UK's domestic regulatory framework and can provide a reliable approach to be adapted to the UK's position outside of the EU. In addition, we note that the FRF Consultation highlights the need to consider the extension of the FSMA model and the proposed future framework to other financial services regulators, such as the PSR. The IRSG would welcome such an extension as it would help to ensure a consistency of approach across the whole suite of financial services regulation. This would be further enhanced if the same regulation, with the same consumer protection, applied to the same activities where they generated the same risks, irrespective of the nature and legal status of the service provider. Such an approach would address a prevailing concern that prescriptive rules that flows from a firm-based focus may no longer be appropriate given the challenge posed by the unbundling of the value chain in financial services.

However, the FSMA model has not always been applied consistently in the UK. Notably, in some instances rather than framework legislation being provided for, with the regulators then setting detailed rules, the legislation itself has contained detailed regulatory provisions. For example, bank "ring fencing", arguably the most significant UK banking reform in the last 20 years not derived from EU regulation, involves detailed legislative rules rather than the details being set out in the UK regulators' rulebooks. This has made certain aspects of implementation more problematic for the industry as the rules are not straightforward to amend when unforeseen problems have arisen. The IRSG believes that this is a further reason to more closely follow the FSMA model going forward, whilst making appropriate changes to reflect the new institutional context.

Even though the FSMA model remains the right fundamental basis for the future it will need to adapt. As noted in the FRF Consultation, the FSMA model has (for the large part) operated within a context where the EU has had significant competence for financial regulation. As a result, many key areas of financial regulation have in fact emerged from EU single market legislation, (albeit often with significant UK input) rather than through the FSMA model. Hence, the FSMA model has not in practice provided the architecture for a fully-independent and policy-making regulator in the UK.

As noted by the FRF Consultation and explained in our recent report, 'The architecture for regulating finance after Brexit: Phase II'[3] (the "Architecture Report"), "Level 1" EU legislation is proposed by the European Commission and adopted by the Council of the European Union (representing member state governments) and the European Parliament (which is directly elected). These "Level 1" rules (whilst often prescriptive in and of themselves), are then expanded upon in the "Level 2" rules, drafted by the European Commission and European Supervisory Authorities ("ESAs") within the relevant mandates set by the Level 1, and adopted by the European Commission as delegated acts. In many cases the co-legislators have the power to oversee the detailed rules adopted at Level 2, which helps to provide democratic accountability and legitimacy and to ensure that the detailed content of these rules are consistent with the political intent. "Level 3" guidance (both official "Level 3" texts

[3] IRSG 'The Architecture for regulating finance after Brexit: Phase II' January 2020 available at: https://www.thecityuk.com/assets/2020/Reports/87f3a48c7e/The-architecture-for-regulating-finance-after-Brexit-Phase-II.pdf

and less formal guidance from ESAs) further elaborates on the requirements to help coordinate the supervisory approach of National Competent Authorities.

As a result of this system, EU-wide single market rules are arrived at through a defined political process, which includes input from, and scrutiny by, parties with a democratic mandate, such as the European Parliament and national governments. Under this process, limited discretion is granted to National Competent Authorities, and legal accountability to single market rules limited the UK regulators freedom of action in setting their rules. Following the end of the transition period, this limitation on the UK regulators no longer applies. Similarly, ESAs no longer exercise the various scrutiny, peer-review and coordination roles that they once exercised in relation to the UK regulators.

Whilst certain aspects of the EU process are clearly inapplicable to the UK following the end of the transition period (e.g. the need for supervisory coordination by the ESAs disappears), it is clear that significant elements of scrutiny and accountability of the UK regulators (particularly by democratic institutions) will be lost and will need to be replaced. In particular, whilst the UK regulators are formally accountable to democratic institutions, in the current context they are not in practice subject to systematic scrutiny by Parliament, and certainly not in relation to the exercise of their detailed rulemaking and regulatory powers. This results in a lack of effective remedies ensuring the UK regulators act within the intended framework, and a lack of a structured approach to the evaluation of regulatory policy. Following the end of the transition period, the UK regulators are an outlier internationally in having a very high-level of independence and significant rule-making powers, but with relatively little systematic scrutiny of their role in delivering the broader policy outcomes set by government and Parliament. This is why the Architecture Report emphasised the need for additional scrutiny and accountability of the UK regulators (and HM Treasury) by Parliament.

There are however opportunities to the change in approach that is entailed by leaving the EU and its mechanisms. Notably, following the end of the transition period the UK regulatory system has the opportunity to be nimbler, more flexible more focussed on the technical effectiveness of rules and better able to ensure coherence on cross-cutting issues. Similarly, whilst the EU processes do involve more democratic input than the FSMA model, detailed technical rules can become politicised, something the UK should seek to avoid. Any financial regulatory mechanism needs to find a balance as effective scrutiny and accountability for regulatory policy need to be maintained, not least to ensure that the broader social and economic policy implications of financial regulation have been properly considered and the right trade-offs made. This should include avoiding the creation of unnecessary layers of bureaucracy that would inhibit the speed, adaptability and responsiveness of the UK regulatory system.

Similarly, we note that whilst the FSMA model has generally worked well, it is already under some strain as the tasks placed upon the UK regulators are significant, and not always matched by appropriate resourcing. Further, what financial regulation is expected to achieve has changed (and expanded) significantly over the past 20 years and is likely to change (and expand) further. This is why the Architecture Report noted that the allocation of resources should be aligned with the allocation of powers and responsibilities under any future regulatory model. It seems inevitable that the resources and capabilities required to in achieve appropriate accountability will need to be increased.

Question 2

What is your view of the proposed post-EU framework blueprint for adapting the FSMA model?

In the model that is envisaged by the FRF Consultation, it appears there are broadly four "levels" to the regulatory architecture to be considered:

1. the regulators' statutory objectives;
2. the general regulatory principles in FSMA;
3. the specific policy framework legislation that Parliament adopts for each area which sets the principles/policy goals for that area; and
4. the detailed regulation that the UK regulators adopt to deliver on the relevant mandate.

The IRSG is generally supportive of the approach in the FRF Consultation. However, all four levels must be considered together and each one carefully calibrated against the others to ensure that the requirements or expectations established at one level do not diverge from or undermine the others, and that overlap between them is minimised. In addition, the purpose of the obligations imposed at each level must be clearly articulated and understood.

For the third level, the scope of each "area of activity" should be carefully defined, and the industry should be engaged to ensure the boundaries of each area are set appropriately. There is an open question as to how broadly each "area of activity" will be set, and in any case the potential for overlap or insufficient delineation is significant. For example, 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 e.g., have 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.

In addition, even with the insertion of a new third level, if the first two levels (statutory objectives and FSMA principles) are not appropriately updated and reviewed for this new context, this may (1) lead to a confused approach to the overall financial regulatory system; and (2) give the regulators tasked with developing detailed rules the message that nothing has changed in their most general/fundamental operating principles and objectives.

If the regulators are expected to perform a changed role post-transition period (and it appears there is such an expectation) then an amendment to both their statutory objectives and the general regulatory principles in FSMA is an important signal. Hence, all four levels must be considered carefully and reviewed as we enter this new era, rather than just a new third level introduced. The IRSG therefore welcomes HMT's consideration of these levels as a whole.

The IRSG also feels it is important to highlight that these levels should be calibrated with a recognition of how the regulators and the financial market regulation that they promulgate sit within the broader context of public policy. i.e. the regulators should not be regarded simply as agents for the delivery of a narrow objective and a constrained set of technical rules, but equally there needs to be clarity as to where public policy issues, which are rightly the domain of elected representatives stop and regulatory policy starts. The level of detailed regulation (the fourth level mentioned above) cannot alone be expected to deliver a balanced approach that reflects and addresses both traditional financial regulatory objectives and other policy objectives that government and Parliament have set. Hence, the other three levels must also be deployed for this purpose.

These key issues are discussed in more detail in the rest of this response.

In particular:

a. **What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?**

The IRSG agrees with the principles of the division of responsibilities described in the FRF Consultation.

However, the IRSG notes (per our response to Question 1 above), that there will be an inevitable significant reduction in scrutiny and accountability of the UK regulators as a result of departure from the EU. The IRSG therefore welcomes the recognition in the FRF Consultation that the post-EU framework proposal should enhance policy input from the government and Parliament by ensuring they play a strategic role in financial services regulation to set out the key policy issues and outcomes which must be pursued in the formulation of regulatory requirements.

This role must be both *ex ante* (setting the regulators' specific mandate for a given sector or activity) and *ex post* (ensuring that mandate has been adhered to and delivered). Two elements need to be in place. First, the nature of the mandate set out in the policy framework legislation (the third level mentioned above) needs to be sufficiently clear and direct so that the regulators are clear about the outcomes that government and Parliament have set for them. And, second, the regulators' statutory objectives and FSMA regulatory principles (the first and second of the levels mentioned above) need to be adapted to take account of the broader social and economic policy outcomes that they are expected to deliver. If the policy framework legislation for a particular industry sector or activity only invites the regulators to "consider" or to "take into account" particular social or economic policy outcomes and if the statutory objectives to which the regulators work remain narrowly drawn then it becomes more difficult to see how government and Parliament will be able to ensure that financial regulation reflects the intent of the executive and the legislature.

As recommended in the Architecture Report, the IRSG also recommends that there should be a Parliamentary committee with a mandate specifically focussed on the regulators and with formal mechanisms to ensure regulators regularly report to it on the exercise of their functions. The IRSG believes that systematic engagement by Parliament in not just the formal accountability of regulators (i.e. through setting out key policy issues), but also in the scrutiny of them, is important to the design of an effective regulatory framework. This scrutiny and engagement by Parliament should be sufficiently resourced (for instance, with the relevant Parliamentarians being able to access expert input), as in our view, the current structures for Parliamentary scrutiny of the UK regulators do not have the appropriate level of resources for the role that is envisaged for, and required of, them.

The IRSG appreciate that it is for Parliament to explore how its select committee system will provide effective scrutiny in future, but we would like to emphasise the importance of systematic and focussed scrutiny by Parliament in this policy area. We would not support attempts to simply create a British version of the European Parliament's ECON Committee. This would not fit neatly with the nature of the UK Parliament's role in contrast to that of the European Parliament. A specifically British solution should be developed, recognising the circumstances within the UK, and taking the opportunity to tailor a specific solution best suited to this economy.

b. **What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?**

The IRSG broadly supports this approach. However, it will be important for the government and Parliament to carefully calibrate how specifically they set the principles and overall policy approach in key areas of regulation.

The IRSG notes that in the current EU framework, the background, underlying purpose and principles behind operative provisions are often set out in "recitals" to the relevant EU legislation. It appears from the FRF Consultation that the principles set out by the government and Parliament will be significantly more high level than we see in EU law from the interaction of operative provisions and recitals. Taking a different approach from EU legislation would be beneficial, as the recitals do not actually always clearly set out the intended policy approach of the legislation. There is clearly some benefit to a more high level approach as the regulators would have more ability to craft the detailed rules themselves than if the government and Parliament set out very granular policy principles, on the other hand, setting principles or the overall policy approach at too high a level risks there being too little accountability for the regulators when they formulate the detailed rules: the approach set by government and Parliament may be simply too high level to effectively judge the regulators against. It may also make it difficult for the regulators (and regulated firms) to glean the real policy intent behind the overall policy approach set out in legislation. Hence, at a minimum the principles should set out what each element of the relevant regime needs to achieve in order to secure the purpose of the legislation, and the key principles or aspects to which the government and Parliament wish to add more weight. As noted above in Question 2(a) of our response, if the framework legislation only requires the regulators to "consider" certain social or economic policy goals or to "take these into account" it becomes more difficult to see how the intentions expressed by elected politicians will be certain to be translated into regulatory action. Finally, different areas of regulation may require different levels of detail in the framework legislation, and this should be considered carefully as part of the overall approach.

Taking a practical example, in the proposed review of Solvency II, we think the activity specific principles should include a sufficient level of detail to provide clear direction and certainty in the following areas:

- Conditions governing business – role of the board, system of governance, duties of auditors
- Rules relating to the valuation of assets and liabilities, technical provisions, own funds, solvency capital requirement (for standard formula or internal model), minimum capital requirement and investment rules
- Rules for operation of internal models
- Rules for firms in difficulty
- Group supervision

We believe it is important to have sufficient certainty around these areas in the relevant legislative framework and not to leave them to the discretion of regulators (with the relevant considerations framed as issues they should have regard to), given the importance of such certainty for firms.

As a converse practical example, the previous primary legislation around ring-fencing has, in our view, proven to be too detailed and inflexible, and hence should be seen as an example of an area where too much detail was included in primary legislation.

The IRSG also notes that in certain aspects, the overall policy approach to given pieces of regulation, and the high-level principles the regulators operate under, will in fact be set by the general regulatory

principles in FSMA, and the objectives the regulators seek to obtain will be set out at a high level in their statutory objectives. Hence, it will clearly be necessary for the overall policy approach in key areas of regulation to be set out at a more granular level than in those general regulatory principles or statutory objectives if they are to be useful. A practical approach to this could be for the general regulatory principles and statutory objectives to be applied in more detail to specific areas by the policy approach in key areas of regulation. For example, the policy approach to a particular area of regulation may explain what the "recognition of business differences" means with regard to the firms that may operate within, say, consumer credit markets (where you may have FinTech business models operating alongside traditional banks).

If an element of a policy approach to a specific area of regulation should in fact be set out in the general regulatory principles in FSMA or a regulators' statutory objectives (due to its overarching importance), government and Parliament should ensure that this is the case to avoid accidental inconsistency between different areas of regulation. It may therefore be worth the government conducting periodic reviews of the general regulatory principles and regulators' statutory objectives, and area specific principles, to ensure they continue to be appropriate, do not unnecessarily overlap, and are not inadvertently inconsistent.

c. Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?

As highlighted in our responses above and in the Architecture Report, the IRSG believes it is important that Parliament engages with the regulators in a structured manner. As suggested in the Architecture Report, we believe it could be appropriate for the regulators to be required to report to a specific Parliamentary committee on a regular and structured basis. This could be used as an opportunity for regulators to explain their approach to implementing the specific regulatory principles.

It would also clearly be helpful for regulators to be required to explain their approach in their relevant consultation and policy documents. We note that the Financial Services Bill currently before Parliament, effectively proposes the first activity-specific regulatory principles. This will require the PRA and the FCA to explain the ways in which having regard to them has affected their proposed rules. This is a good step toward transparency, but we would suggest going further and requiring the regulators to detail their thinking on how proposed rules are compatible with the activity-specific regulatory principles and how they have balanced any tensions between them.

Were a new Office for Responsible Financial Regulation (ORFR) to be established to scrutinise regulators' rulemaking it could also scrutinise whether the regulators have indeed appropriately had regard to the relevant regulatory principles and could make recommendations as appropriate (see annex A and the answer to question 6 below for more detail on this). Such a body would need a clearly defined mandate and not impact on the agility of regulators. It would not impinge on the regulators' independence as they would retain the authority to adopt the regulations that they deem appropriate and compatible with all three of (i) their statutory objectives, (ii) the principles set out in FSMA, and (iii) the mandate set for them in activity-specific legislation. But a body like the ORFR would have the expertise, time and resources to be able to offer an independent assessment without acting as a regulator of regulators. An alternative option would be for the work of the ORFR to be done by a dedicated panel of experts supporting the dedicated Parliamentary committee set out above.

In addition, we note that from a practical perspective it would be helpful if the government and Parliament were given a clearer role in ensuring that the regulators have met the policy outcomes set out in the legislation. This would help the *ex post* scrutiny discussed in Question 2(a) above. Whilst the regulators' own explanations will be helpful, these explanations should then be properly scrutinised by the government and Parliament who have set out the activity-specific regulatory principles. An approach to achieve this might be a mechanism whereby HM Treasury makes a report to Parliament on its conclusions as to whether the relevant policy outcomes have been met. This could interact with the powers to make secondary legislation envisaged by the FRF Consultation – as HM Treasury could use its powers to amend or clarify the policy outcomes and prompt action by the regulators where the relevant policy objectives are not being achieved.

Question 3

Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?

The IRSG supports the current general regulatory principles in FSMA and believes they are fundamentally sound. However, as noted in Question 2 above, it is important to consider how the general regulatory principles in FSMA should operate in the new model proposed by the FRF Consultation. With this in mind, the IRSG is of the view that regardless of whether the existing general regulatory principles in FSMA are changed or updated, as part of the structured scrutiny of the UK regulators (discussed in Question 2 above), there should be greater scrutiny of whether the UK regulators have in fact had appropriate regard to the general regulatory principles. The principles are only effective to the extent the regulators are required to engage with them in a consistent and structured way and are held to account for doing so. Adherence to the principles and scrutiny of such adherence could be enhanced by the government prescribing how the regulators must have regard to the principles in more detail – e.g. setting expectations or performance indicators for certain principles.

Similarly, as discussed in Question 2 above, changes to the general regulatory principles could be used to appropriately set the tone for how the UK regulators are expected to act under the new post-transition period model.

On such specific changes, as noted, in the Architecture Report, we think the UK regulators should also be subject to a regulatory principle that requires them to take into account, where appropriate, international standards that have been developed by consensus when discharging their regulatory functions, and to actively promote their adoption. The intention of this would be that the regulators would be obliged when exercising their rulemaking powers to ensure costs that come from complying with a multiplicity of standards are not imposed on international market participants unnecessarily.

Similarly, we note that the FRF Consultation has mooted the idea of a regulatory principle to minimise compliance burdens on firms, for example by making rules machine readable. The IRSG supports this idea, and would suggest that the regulators should generally be required to consider the coherence and format of their regulatory rules to improve the comprehensibility of financial regulation and reduce unnecessary complexity.

We would also recommend that the "proportionality" principle is strengthened. Rather than just being required to consider whether the imposition of a burden or restriction is proportionate to the

benefits, this could arguably be strengthened so that it explicitly notes that burdens should not be imposed to the extent they are unnecessary, and the regulators should actively review their regulatory requirements to consider removing or reducing unnecessary or excessive burdens. For example, this could be phrased in a similar manner to Ofcom's duty to "keep the carrying-out of its functions under review with a view to securing that regulation by OFCOM does not involve - the imposition of burdens which are unnecessary; or the maintenance of burdens which have become unnecessary. In reviewing its functions under this section, it shall . . . consider to what extent it would be appropriate to remove or reduce regulatory burdens imposed by OFCOM." Consideration should also be given to whether the "proportionality" principle should acknowledge that even where regulatory changes may have merits, the sheer cost of changing the regulatory approach could outweigh the benefits.

Finally, whilst we recommend a change to the regulators' objectives to a similar effect (see Question 4), if this change were not made, we would propose that the principles should be changed to introduce a requirement to have regard to the international character of financial services and the desirability of competitiveness.

Question 4

Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?

As noted in Question 2 above, the regulators' objectives must be considered in the context of their significantly changed role under the model proposed by the FRF Consultation, and the evolution of their practical role over time. The regulators are increasingly expected – even if only informally - to further public policy objectives that do not sit neatly within their existing statutory objectives – for example contributing to climate policy or using supervisory and rulemaking powers in a manner that is consistent with trade negotiations and policy.

Under the model proposed by the FRF Consultation, the regulators also seem to be expected to be more directly responsible for the achievement of wider policy objectives. If it is the government's and Parliament's intention in future to ask the regulators to use their regulatory/rule-making powers in order to contribute to the delivery of such wider public policy objectives than those they have been pursuing for some years then their objectives should be explicit on this topic, so as not to be incongruous with the general or specific regulatory principles they are expected to implement. Notably, the primary objectives that an organisation has send an important signal to its people and to its stakeholders about what it ultimately values and how it will (and should) exercise its judgement. If in the new model we intend the regulators to enjoy a high level of independence and autonomy in relation to regulation but to exercise this in a way that will deliver on overarching social and economic policy priorities that government and Parliament have set then the regulators' statutory objectives should reflect this.

With this in mind, the IRSG supports changing the statutory objectives of the regulators to reflect consideration of the economic and social contribution of the UK financial services sector, and specifically so that the need to maintain and enhance the UK financial services ecosystem is reflected. There are different views as to how such an objective should be framed. It could take the form of an

objective that considers the relative international position of the UK financial services industry. For instance, we note that the Financial Services Bill proposes in its activity specific principles that regulators should have regard to "the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active investment firms to be based or to carry on activities", and we see no reason why this could not be adapted to be applied as a general statutory objective. Alternatively, it could take the form of an objective that considers the role of effective regulation in promoting sustainable economic growth in the UK economy. Both approaches have their own merits, but the IRSG believes at least one should be implemented.

We note the suggestion in the FRF Consultation, that these types of objectives or another objective that makes explicit the social and economic impacts of financial regulation, might suggest encouragement of a "race to the bottom". However, as noted in the Architecture Report, regulators in other countries (such as Hong Kong, Australia and Singapore) manage the consideration of wider policy goals such as competitiveness, or economic growth, without undermining their delivery of other policy objectives such as financial stability or consumer protection. There is no reason why the UK could not follow this approach. Similarly, high, well implemented and effective regulatory standards can clearly be good for competitiveness and economic growth, and so there is no necessary tension between an effective regulatory regime and this objective. Notably, the desire for harmonised and high regulatory standards as a method of promoting economic growth was part of the EU's rationale for the recent increase in the powers of the ESAs.

It is important to highlight that such an objective would not just be about ensuring the UK financial sector is "best in class" as compared to the rest of the world. It is also about ensuring that customers of that sector (including domestic consumers) are able to access the best financial services in the world and realise the full benefits of innovation.

However, probably the most important benefit of such a change is that the regulators would, if subject to such an objective (or others that recognise their broader economic and social responsibility), need to be more transparent as to how they have balanced such considerations against other existing objectives. The regulators undoubtedly have to consider and balance such trade-offs today, but without doing so under a formal framework. Hence, how they have settled upon their chosen approach is not always clear, and it is difficult for outsiders (including Parliament and the government) to appropriately scrutinise this process.

With regards to how changing objectives compares with the proposal for new activity-specific regulatory principles, as noted in our response to Question 2(b) above, we are of the view that any activity-specific regulatory principles should be set at a relatively granular level in comparison to the general regulatory principles and statutory objectives in order to provide useful and clear policy direction to the regulators.

Question 5

Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?

As noted in the rest of this consultation, the IRSG is generally supportive of the model proposed. Whilst we do not think there is a single alternative model that would be more appropriate for the UK to follow, we note that there are of course good regulatory practices in other jurisdictions that should be considered and learned from.

In particular, the IRSG would seek to highlight that no alternative regulatory model we are aware of in major jurisdictions gives financial regulators as much latitude for independent action as the UK's proposed model does without building in significant levels of scrutiny and accountability by democratically elected bodies.

Question 6

Do you think the focus for review and adaptation of key accountability, scrutiny and public engagement mechanisms for the regulators, as set out in the consultation, is the right one? Are there other issues that should be reviewed?

Chapter 3 of the consultation document recognises the scale and significance of the transfer of powers that is entailed by the UK's departure from the EU and acknowledges that this raises issues of real importance for all of those impacted.

Post-transition the UK regulators will attain a level of policy and regulatory responsibility that is unprecedented in the recent history of UK financial services and that in their current form these regulators have not previously possessed. The IRSG believes that the accountability, scrutiny and public engagement mechanisms that are put in place must be commensurate with this and that while there may be aspects of the existing approach that can be developed and made part of a new oversight model there is also a need to look at it critically and to be willing to consider significant changes.

Accountability involves regulators being subject to defined standards with mechanisms to ensure there are appropriate remedies if they do not adhere to them. *Scrutiny* involves the regulators being subject to observation and timely examination from outside bodies that have the resources and expertise to make this meaningful. *Public engagement* involves external stakeholders being given an early, meaningful opportunity to influence the agenda for regulatory activity (i.e. the selection of those issues on which the regulators will take action) and the shape of the action that is to be taken. It has to be more than being invited to comment on the detail of proposed interventions to which the regulators are already heavily committed and in which they have already invested.

Public Engagement

As the consultation paper notes, the regulators already have a number of statutory panels and these have performed a variety of functions within the existing financial regulatory framework for which they were established. We believe that the FCA panels are useful addition to provide extra scrutiny of the regulators but believe there is a case for reviewing their role and structure. In particular whether they work in an advisory role to the regulator or operate as a voice on behalf of a particular contingent or interest.

As currently operating the panels have a role that is much broader than contributing to the development of appropriate *regulatory* policy. There is clearly merit in providing the regulators with access to a group of stakeholders that can provide input on a broad range of issues, from market developments during a pandemic through to behaviour and values in financial services firms. Such forums should, the IRSG believes, remain in place. But given the scale of the transfer of *regulatory* authority back to the UK from the EU it is not clear to us that the statutory panels as currently conceived (predominately c-suite) will be able to provide the level of detailed analysis and

assessment (both ex ante and ex post) of regulatory initiatives that is required. There is a marked difference in resources available to the panels. The FCA Consumer panel have a dedicated secretariat based in the Financial Conduct Authority whereas the FCA Practitioner panel do not.

According to its website the FCA Market Practitioners Panel has not responded to a consultation for three years and while the Practitioners Panel has done so more recently (the last was in 2019) these responses tend to be high-level in nature and do not contain the sort of detailed analysis and assessment of impacts and trade-offs that needs to be undertaken to replace that which occurred within the EU regulatory framework.

The IRSG therefore propose that further consideration should be given to the purpose, operation and resource of the panels. If there is ambition for the panels to work in more of an advisory role for the regulator a possible option could be to revise the panels and form 'activity' specific expert groups which could ad-hoc advise on specialist issues. In the interest of ensuring that the regulators receive the technical advice they need for the operation of their responsibilities these could be drawn from a pool of individuals from different bodies who have a specialist interest or expertise in the proposed activity.

Accountability and Scrutiny

As the UK departs the EU's regulatory framework, where regulators had to comply with EU law (with the European Commission acting as guardian of this), and where there was peer review from other EU regulators and the ESAs, there is a need for new mechanisms in the UK system.

In practice accountability and scrutiny will often tend to go together as the framework's capacity to achieve the *former* will be heavily dependent on its ability to perform the *latter.* To be held to account in a meaningful way the regulatory policies the regulators pursue, their impacts, cost and benefits, need to be properly scrutinised, on both an ex ante and an ex post basis. Across the globe a variety of mechanisms are utilised, including

- parliamentary oversight and scrutiny
- power to issue binding directions to financial regulators
- independent bodies such as financial ombudsmen
- soft powers such as remit letters, reports etc.
- supervision by Finance Ministries, such as is in Japan
- court proceedings, such as judicial review

While it is not essential that the new UK framework includes all of these, they each have merit and are worthy of consideration. Some are mechanisms that seek to achieve similar outcomes, particularly items 2 (binding direction) and 6 (judicial review). These are both directed at the need for a backstop mechanism that ensures, in a timely, usable and effective manner, that the specific regulatory measures the regulators introduce are consistent with the particular legal mandate or legislative objectives under which they are introduced.

The consultation paper recalls (section 3.6) that "*Judicial Review can be used by individuals or organisations to challenge…a regulator if the law has not been followed"* but as the IRSG has noted – most recently in its contribution to Lord Faulk's review – this is not a route that many market participants are likely to feel is open to them. The IRSG proposed an alternative option could be

bespoke, specialist appeals similar to the Competition and Markets Authority. Another option could be to consider whether another institution – most likely the Treasury - could be given a limited power of direction over the regulators within tight parameters - for example, where the rules they have introduced are inconsistent with the high-level legislative framework or where there is a clear disregard of their regulatory principles and objectives.

In respect of the proper policymaking mechanisms the IRSG believes that these mechanisms could be utilised in order to achieve sufficient levels of oversight and engagement. As previously mentioned, any mechanisms should be balanced against the need for day-to-day independence of the regulators. In moving towards objectives-based supervision, it is important that this does not circumvent the correct processes and lead to policy making that is not adequately scrutinised.

Two further issues have also arisen during consideration of the new UK framework and are worthy of review; independent oversight of financial services regulatory policy; and accountability under the law.

Independent oversight of financial services regulatory policy

Key public policy decision-makers – whether those in central government itself or in an arms-length body - face external accountability and independent scrutiny. Given its significance, the IRSG believes that financial market regulatory policy should operate under a similar framework.

As the UK reviews its framework for financial services regulation the UK has an opportunity to establish a set of institutional arrangements that will set a new model for oversight of financial market regulation itself.

While existing bodies such as the RPC may have an ongoing role in setting horizontal standards for better regulation in the UK, the complexity of financial market regulation and the significance of its impact on the delivery of such a broad range of social and economic policy objectives justify consideration being given to the creation of a new and dedicated independent *Office for Responsible Financial Regulation* with a statutory duty: to examine the impact of financial market regulation and to make appropriate recommendations .

In its consultation paper (section 3.51) the Treasury, entirely appropriately, raises some practical questions about how such a body would operate. Annex A to this response explains in more detail how this body would work and addresses the "practical obstacles" set out in the consultation. But two of them are important to address here.

First, cost and value for money. Adequate oversight of financial market regulators by those with the knowledge and expertise of the markets, products and entities subject to the regulation *will* require resourcing. That is the case whether it is Parliament, the Treasury or a new independent Office. As regulated firms are required to re-prioritise and to take on new priorities so the IRSG believes that the resources needed for a potential ORFR (primarily staff costs; it could exist as a virtual entity with little or no need for any physical premises) could be found from within the existing resources available to the regulators.

Second, the regulators' independence. The IRSG does not believe that such a body should have *any* formal power to countermand or override the regulators. The regulators would retain the right (subject to any other constraints that might be introduced as part of this new framework) to adopt

the regulations that they deem appropriate. The ORFR itself would have no authority beyond the right to make public its analysis and recommendations. To the extent that this limits the regulators' independence it is a limit that is inherent to the concept of public scrutiny of bodies with regulatory power by those with the knowledge and expertise to perform a challenge function.

But if no such new body is established then the question still remains: how will systematic, learning-centred, evaluation of regulatory measures and of the trade-offs inherent in them be undertaken, and by whom?

None of the other options that present themselves are self-evidently preferable to an ORFR or at least not without significant changes to their current operations and, certainly, to their current resources:

- *the regulators:* while the regulators would want to undertake their own critical assessment of their regulatory policy and initiatives it is not clear that relying solely on such internal analysis would be sufficient or appropriate;
- *external stakeholders:* while they have a contribution to make (e.g. providing evidence or data) any particular group of stakeholders will be too partial to undertake a robust and credible analysis; and collectively stakeholders will be too uncoordinated to develop a comprehensive and rounded view of any regulatory initiative;
- *Treasury*: HMT could perform this role itself, but would need the resources to be able to do so properly; it is also questionable whether this would fit with the broader divisions of responsibilities that the consultation paper proposes;
- *Parliament*: clearly Parliament has a 'backstop' role and will want to understand the impact and implications of policy under all models. But it is not clear that as currently organised Parliamentary committees have the time, technical knowledge and resources to carry out the sort of detailed analysis that should be the aim.

Accountability under the law

As mentioned earlier in our response the IRSG believes that more consideration should be given to the accountability of regulators under the law. In the EU the Commission, Parliament and Council all have roles to play in ensuring that Level 2 measures are consistent with the co-legislators' intent, as set out in the Level 1 text. And the Commission plays an important guardianship role, checking that national implementation measures are consistent with the law and, where necessary, taking legal action if they believe that is not the case.

The IRSG questions who will perform such a role in the UK regulatory model. Judicial review plays an important role in holding those exercising executive power in the UK and it is suggested that it could fulfil this role in relation to financial regulation. – section 3.6 of the consultation paper notes the availability of this route, but as we outlined in the IRSG response to the Independent Review of Administrative Law in October 2020 in practice this mechanism is limited by the close and continuous model of supervision, which creates strong disincentives for any individual firm to use the courts in this way.

In addition, the grounds of review are narrow, focusing solely on the legality of decisions of the financial services regulators. This makes judicial review an unsatisfactory means of comprehensively scrutinising the full spectrum of financial regulatory activity.

If the current framework for applying scrutiny and accountability to the actions of the Financial Regulators is to be improved, an alternative option to power of direction from HM Treasury could be a bespoke, specialist appeals similar to the Competition and Markets Authority (in the same way that many decisions by economic regulators can be appealed). This could offer an alternative mechanism of challenge before specialists, prevent unfair or disproportionate decisions and prevent any challenge impacting the ongoing relationship between firms and those regulating and supervising them on a day-to-day basis.

Question 7

How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?

It is ultimately for Parliament to determine how it wishes to scrutinise the government and its agencies. Nonetheless the IRSG recognises the vital role that Parliament can play in ensuring the right checks and balances in the UK's regulatory system.

The IRSG believes that parliament's role in the new framework could fall into two spheres:

- overseeing the strategic direction and overall performance of the regulators (individually and as a group);
- providing an additional challenge function for and oversight of the regulations that they put in place.

The current mechanisms for scrutiny work well but, in our view, have limited capacity to offer the level of scrutiny that will be required in the future. The ongoing inquiries by the Treasury Select Committee (TSC) already provide for a direct accountability relationship between the regulators and Parliament but have historically focused mostly on supervisory failures rather than on the detail of regulatory policy proposals. This is partly due the political nature of its process, with Members of Parliament rightly responding to those issues that are receiving public attention and partly because of the structures that exist for political scrutiny across EU institutions.

The IRSG believes that the Treasury Select Committee (TSC) could retain its existing role, overseeing all 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 between) the different components of government economic policy. Only the Treasury Select Committee is capable of forming a holistic view of how taxation, public spending, monetary policy, micro-economic reform, and financial markets policy co-exist.

The IRSG believes that the Treasury Select Committee could also take a more proactive role in scrutinising regulatory policy while not second guessing the decisions made by an independent regulator. Within its overarching remit the TSC could in relation to financial services regulation place a particular emphasis on:

- Strategic orientation & objectives: overseeing both *ex ante* and *ex post* the government's and regulators' strategic priorities for the financial services sector and the operation of the overall framework for financial regulation;
- Monitoring delivery: assessing the regulators' delivery of their strategic plans;
- Organisational efficiency & effectiveness: ensuring the regulators are efficient, well-run and professional;
- International coherence: overseeing the general state of the relationship between UK policy and policymakers and those in other key jurisdictions and in international forums;

With the TSC performing this role a new financial services (sub-) committee could then be set up to provide a more focused venue for ongoing scrutiny of regulation, allowing the TSC to conduct thematic inquiries, as necessary. This sub-Committee should look to draw on the expertise of those with experience and/or an interest in financial services – perhaps comprised of members of both Houses, perhaps drawn (at least in part) from members of the TSC, the EU Services Sub-Committee and the now defunct EU Financial Affairs Sub-Committee – could look in detail at specific pieces of financial services regulation. It would place a particular emphasis on:

- Consistency: ensuring that regulatory action is consistent with the policy intent set out in the underlying legislation;
- Assessing outcomes: ensuring that the regulators are accountable for the 'real world' outcomes of the actions they have (or have not) taken, including where their actions have had impact on other public policy objectives;
- Interface with other public policy goals: providing a forum in which trade-offs between financial services regulatory policy and other public policy goals - including in relation to equivalence with international partners' regimes - can be considered and debated;
- Intervening in matters of immediate interest: on occasion such a new Committee may wish to intervene in a current issue on which regulators are developing new standards; such *ex ante* intervention would be comparatively rare, in accordance with the regulators' independence and need to be free to operate.

Such a Committee could operate primarily (though not exclusively) on an *ex post* basis, ensuring that regulators are accountable for the regulatory measures that they introduce but in a way that respects their operational independence, avoids politicisation of the process and that does not jeopardise their ability to act decisively.

Question 8

What are your views on how the policy work of HM Treasury and the regulators should be coordinated, particularly in the early stages of policy making?

The IRSG believes the proposal for more systematic consultation between the regulators and Treasury is a suitable mechanism for the consideration of wider public policy implications of future regulation. Coordination between HM Treasury and the regulators in the early stages of policy making will allow policymakers and regulators to fully consider their decisions in the wider economy and prevent adverse impacts. Financial services regulatory policy can often touch on issues such as pensions, housing, environment, foreign affairs etc. that are the responsibility of government departments

other than HM Treasury. Therefore we recommend consideration is given to early coordination and coordination with all necessary government departments.

The IRSG welcomed the creation of the Financial Services Regulatory Initiatives Forum and Regulatory Initiatives Grid which strengthen regulatory coordination and helps reduce the operational burden of regulatory initiatives on financial services firms. We believe the Forum and Grid are useful mechanisms to increase transparency and cooperation in financial regulation. The measures deliver on one of the International Regulatory Strategy Group (IRSG) recommendations in its report 'The Architecture for regulating finance after Brexit: Phase II'. The report highlighted the importance of establishing a permanent body of UK regulators to ensure regulatory coordination and coherence in regulation and supervisory approach and with public minutes. The range of accountability mechanisms between the regulators and HM Treasury are not utilised as much as they could be. HM Treasury have an obligation to inform the PRA and FCA of the government's economic policy once every Parliament. Given the regulators increasing powers to shape financial services policy and the impact this has on wider public policy initiatives the IRSG recommend that 'remit' letters could be made more frequent and more detailed in order to clarify the broader public policy considerations that the regulators need to pursue and to reflect in their regulatory initiatives. When combined with amendments to the regulators' objectives to make explicit their contribution to broader economic and social goals such remit letters would be a valuable additional tool.

It is noted in the consultation that the model proposed "should not prevent the regulators from introducing immediate rule changes as necessary to safeguard financial stability or protect consumers" and that the working relationship between the regulators and Treasury "will need to be developed [to ensure this]". Whilst we agree that it is necessary for the regulators to be able to act quickly when required, in our view it is important that this is not the norm and that systematic engagement with the Treasury (and with other stakeholders) is the usual basis or formulating policy.

Close coordination is very important, but the IRSG also believe it is essential to properly frame HMT's ex post role in rule making (i.e., the ability to change the core features) and the level of transparency around its conclusions as to whether the broader policy outcomes are being met. The consultation states that HMT will have secondary legislation powers to update the policy framework legislation. To achieve a clearer role for HMT, we believe a mechanism, such as an annual HMT report to Parliament on its conclusions as to why it is using, or not using, these powers is required. Similarly, and as we mentioned earlier in the response, as noted above it may be appropriate for a power of direction to be vested in HMT to enable it to act promptly if any of the ex post political accountability mechanisms highlight that changes to regulators rules are needed quickly (because they are not operating as intended by Parliament). These powers whether used or not, will provide clearer incentives for the Regulators to remain with the framework.

Finally, although perhaps outside the scope of this question, we would like to add a point on divergence. The unique international nature of UK businesses mean that it is vital that the regulatory environment is broadly in line with the global environment. Should a decision be taken to diverge from the areas of equivalence, it should be done so knowingly. Consideration should be given to the impact on the market, and in particular issues in relation to market access and also the competitiveness of the UK landscape This is especially important with regard to the EU due to the close ties that have built up over 40 years.

Therefore, as we recommended in 'The Architecture for regulating finance after Brexit: Phase II' [4], mechanisms should be put in place to track domestic and international regulatory developments which may jeopardise market access, as well as tracking measures that may have implications for equivalence with the EU. The impact of regulatory developments on trade negotiations should also be considered.

Question 9

Do you think there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?

The IRSG believes that stakeholder engagement is an important part of the regulator's policy-making processes and is vital to the development of fully considered regulation. The UK must not underestimate the importance of democratic oversight of the regulators as they take on additional powers. Wherever possible there should always be genuine consultation processes that make it possible for stakeholders to advocate for change. We would reiterate the need to ensure that the policy process is not undermined or second guessed by supervisory activities. The latter need to be exercised with a firm grounding in the rulebook. –

Ex ante involvement this requires much earlier and much more robust and meaningful engagement with stakeholders. This is more than just consultation on a policy whose contours are already set. It must involve genuine, open dialogue with stakeholders (and not just those from the industry) on how to achieve the multi-faceted objectives that legislation has set for the financial services sector or activity in question. One mechanism that has been suggested is more formal engagement at this stage with parliamentarians. As the regulators begin to develop their thinking at the early-stage of policy-making they could call on a panel of MPs, similar to the APPGs to test out proposals.

Dialogue is more inclusive and sees stakeholders as being involved in a common endeavour to produce regulation that will deliver the outcomes that have been set by Parliament. *Consultation*, by contrast, tends to be later and narrower, asking stakeholders to comment on policy once core decisions have already been taken and certain directions ruled in or out). This would allow the regulators to draw on a wide range of views early in the process of policy development and provide transparency on regulatory objectives and/or principles.

In the past for non-EU related consultations, we observed a formal consultation process for new regulations but, unlike in the Basel Committee on Banking Supervision (BCBS) and EU processes, it allowed one written response. Roundtables allowing industry to explain their positions and to provide more colour on technical issues, are less frequent than we have seen in other policy making bodies.

The IRSG therefore recommends that the UK regulators' formal consultation processes should start earlier in the policymaking process, allow more than one written response, and any roundtables that do take place should be genuinely two-way, giving interested parties an opportunity to feedback to the regulators with the assurance that their positions are fully taken into consideration.

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[4] IRSG 'The Architecture for regulating finance after Brexit: Phase II' January 2020 available at: https://www.thecityuk.com/assets/2020/Reports/87f3a48c7e/The-architecture-for-regulating-finance-after-Brexit-Phase-II.pdf

Ex post there needs to be an open culture of learning in which there is a collective ambition to find out whether the outcomes were achieved, and if not, why not. As other sectors like medicine or aviation have sought to develop a mindset in which everyone is encouraged to participate in such evaluation in order to learn (rather than to blame) so should such an approach be developed in financial regulation. This is one of the areas in which a body such as the ORFR could have a role to play – an independent, expert, third-party that has the time, expertise and resources to help the regulatory system work better.

These consultation processes should allow businesses and their compliance teams realistic timeframes for stakeholder consultation. It is important to understand that not every firm affected by regulation has the same resource to meet the standards set.

Another way to potentially improve the regulators policy-making processes would be to review the process for cost-benefit analysis (CBA). The IRSG believes that CBA is a useful tool to ensure regulators powers are used as intended however there are examples where CBA has missed the intentions of the proposed policy. For example, in 2017, UK regulators had proposed to gold-plate EU regulation and apply MiFID II telephone taping requirements to all aspects of corporate finance business. The regulators cost-benefit analysis was narrowly focused on the intentions of the proposed policy and missed the cost and impact it would have on the wider UK economy. In their response stakeholders stressed that extending the taping requirements would slow down corporate decisions, making the UK capital markets less attractive to raise finance. Without stakeholder input the decision to gold-plate the regime would have impacted on the competitiveness of the UK.

The IRSG recommend that thought should also be given to the direct impact supervision has on policy. If the regulators are to change an approach to policy the implications of the accompanying supervisory rules should also be fully understood as the two are intrinsically linked.

Finally, we note the additional burden on regulators from their increased powers and would recommend full consideration is given to their resources. Secondments from the private sector could be one solution to this issue, which would also strengthen industry/regulator cooperation and build practitioner expertise into the regulators. If the regulators do not have the capacity to fulfil their role then this will adversely impact on their ability to engage with government, parliament and wider stakeholders.

Annex A – ORFR

The response to question [6] summarises the challenges that an ORFR would address: the need for independent, expert scrutiny of the detail of the regulatory initiatives that the regulators introduce.

This annex sets out in greater detail how a new Office could function.

Core Functions of the ORFR

This could translate into four core functions:

- contribute to high quality financial market regulation in the UK by promoting continuous improvement in *how* financial market regulatory measures are developed;
- ensure that the full social and economic impacts of *proposed* financial market regulations are identified and considered before final decisions are taken;
- evaluate *existing* financial market regulatory measures in force in the UK with a view to identifying their full social and economic impacts;
- identify any *gaps* in the UK's regulatory framework and the social and economic impacts of these gaps.

Composition of the ORFR Board

Section 3.51 of the consultation document suggests that "*Securing appropriate membership of the committee, so that it provides impartial expertise without becoming a conduit for any particular stakeholder interest, would be challenging".*

But this challenge is one that the IRSG feels could be met, as it is for other such entities in public life. There is no reason to believe that this challenge would be any greater for the ORFR than it is for other public bodies and it could be held to the same standards as other such bodies. The Code of Conduct for Board Members of Public Bodies, for example, would apply to its work, thereby ensuring that the risk of it becoming a vehicle for a "particular stakeholder interest" would be limited.

The ORFR would be an advisory non-departmental public body appointed by and answerable to Treasury Ministers, which would provide further protection. Its board would be drawn from those in (or with experience of) the wider public sector; academia; the financial and professional services industry; the business community (e.g., representatives of the SME sector); and other civil society groups (e.g., the voluntary sector).

By setting criteria for individual members of the board (to ensure their expertise and independence) and by creating rules around the overall composition and diversity of the board collectively the risk of it becoming a "conduit for any particular interest" could be reduced to an acceptable degree.

Senior HM Treasury officials and those from other government departments could be invited to participate in the work of the ORFR but would *not* sit on its Board or be part of its day-to-day decision-making and governance. Engagement with senior officials from government departments would facilitate the ORFR's consideration of the implications of financial market regulation for the UK's overall public policy objectives. A framework document – similar to that existing between HMT and the Office for Budget Responsibility – would be negotiated to determine the specifics of the

interaction between the ORFR and government departments and to establish the details of the ORFR's own governance.

The Work of the ORFR

ORFR would be a *statutory consultee* for all new financial market regulations proposed by the UK regulators and its formal opinion would be required *before* any new regulatory proposal could be enacted. In practice ORFR would be selective in determining which regulatory proposals it would progress to a full assessment; not all would be 'called in' for such assessment and there would be a sifting process – conducted according to published criteria – that would allow certain proposals to proceed without a full ORFR assessment.

The ORFR would be subject to obligations regarding the timeliness of its contribution to ensure that the regulators, market participants and other stakeholders had certainty about timetables for regulatory developments. There would also need to be an 'emergency powers' clause, allowing the regulators in exceptional circumstances to proceed to enact new regulations without having received the input of the ORFR. Each use of this power by a regulator would need to be explained in full and the reasons made publicly available.

The ORFR and the regulators may in addition wish to agree specific working arrangements in order to facilitate their cooperation and collaboration, but that would rightly be left to the institutions themselves.

On the assumption that the regulators' objectives have been broadened as proposed above, the ORFR's powers would cover:

- the issuance of a formal opinion on whether the regulator had (i) adequately identified and considered the broader economic and social policy implications of its draft regulations; and (ii) whether appropriate mitigation of any negative impacts had been proposed;
- making recommendations for alternative approaches where it regards the regulator's proposals as incomplete or ineffective with regard to these broader economic and social policy implications;
- performing a 'quality assurance' role for the impact analyses and other evidence that the regulator produced to support a specific piece of regulation, indicating whether any specific piece of analysis accompanying a proposal was credible and comprehensive;
- issuing requests to regulators to provide or produce data or other supporting analysis or evidence that the ORFR needs in pursuit of its mission and objectives;
- identifying and reporting on horizontal trends in the impact of UK financial market regulation on particular social or economic objectives or on particular social cohorts or economic sectors.
- evaluating and reporting on the social and economic impacts of existing UK financial regulation. (Review clauses are not a standard feature of the UK's domestic regulatory framework but the power to review legislation is an important tool to understand the impacts of transposition, implementation and enforcement of initiatives. While the ORFR should be able to undertake its own review of existing regulation the regulators should also be encouraged to practice this discipline. Any proposals for further changes to policy

following a review should themselves be subject to Cost-Benefit Analysis/Impact assessment in the normal way: once compliance with the original requirement has been achieved the costs of further change have to be considered).

The ORFR would be able to establish sub-committees and technical working groups. These might be *standing sub-committees* (with expertise in a particular market or segment, such as insurance or banking, or in a particular aspect of social or economic policy, such as housing) or *ad hoc* expert groups convened to provide input on a particular regulatory proposal or instrument where the ORFR feels that additional input is required to supplement their own expertise.

This model would ensure that the regulators retain their independence and that they continue to have the final decision on the content of new regulations. But to ensure transparency – and consistent with the aim of securing continuous improvement in the performance of *all* parties - this should be on a 'comply or explain' basis, according to which the regulators would be expected to set out their reasons if they chose *not* to follow any recommendations from the ORFR.

It should be emphasised that the ORFR would have no role in enforcement policy or in the day-to-day supervision of firms or markets; its role would be *exclusively* on regulatory standards.

Avoiding Duplication with the Statutory Panels

In its consultation document the Treasury notes the need to avoid duplicating the work of the statutory panels that are already in place and this is clearly important, not least for reasons of cost. While there would be some overlap the IRSG believes that this would be limited in practice (and could be made to be so by drawing clear distinctions between the different bodies).

The ORFR would focus *exclusively* on regulatory initiatives and policy and would not consider any other aspects of financial market policy or any other dimensions to the work of the regulators. While the FCA Practitioner Panel is, for example, considering such important issues as the "principles-based supervisory approach" or "behaviour, values and diversity" in financial markets these would be outside the remit of the ORFR. Its sole and exclusive role would be in relation to regulatory policy and initiatives (as set out in the section above), and it would have the expertise and analytical capability necessary to produce authoritative, independent assessments of these.

The statutory panels would remain a valuable source of insight for regulators, as seen in the work of the Markets Practitioner Panel on market developments during the Covid-19 pandemic.

But their work does not extend to the provision of systematic analysis and assessment of regulatory proposals and the consideration of the implications of that regulation for the Government's broader social and economic policy objectives. The website of the Markets Practitioner Panel, for example, does not record any consultation responses since 2017 and those from the Practitioner Panel (the last is from October 2019) are usually high-level in nature and do not contain detailed assessment of effectiveness or impacts.

The IRSG therefore believes that in practice there will be little overlap between the role that the ORFR is intended to perform and the role that the statutory panels in practice are performing.

It is possible to conceive of a reconfiguration of the panels such that they could also perform the functions envisaged for the ORFR. But this would also require significant change and it is not evident to the IRSG that this is necessarily preferable to the creation of a new entity with a targeted mandate.

Staffing and Resources

To perform the roles that are envisaged the ORFR would require its own staff. This team would need to be of appropriate size to be able to:

- carry out an initial 'sifting' assessment of a broad range of draft regulations from the financial market regulators;
- undertake detailed analysis of draft regulations and their impact across multiple aspects of social and economic policy;
- evaluate and assess cost-benefit and other impact assessments and the methodologies and approaches that underpin them;
- evaluate *existing* financial market regulatory measures that are in force (and any gaps in the regulatory inventory); and
- coordinate and organise senior stakeholders e.g. providing a secretariat function to sub-committees and expert groups

ORFR staff would need experience of, and expertise across:

- a wide range of public policy spheres;
- financial markets and financial services and their interaction with the wider economy and society;
- cost-benefit analysis and impact assessment techniques and methodologies

The team would include a combination of permanent employees and secondees from the regulators themselves; industry; academia; and central government.

The ORFR would not be looking to second-guess the regulators or to duplicate their work – there would be a clear separation between *analysis* and *oversight* of regulation (which is for the ORFR) and regulatory *policymaking* and *enforcement* (which is for the regulators). But by providing an expert and informed challenge function the ORFR would be able to contribute to ensuring that UK financial services regulation continues to be of high quality, that it is developed in a way that ensures that broader social and economic policy goals are considered, and that it enjoys a high degree of legitimacy amongst all stakeholders.

Use and application of the ORFR's work

Consideration will need to be given to who formally takes receipt of ORFR analysis and recommendations and what (if any) obligations are placed on the regulators as a result. One might, as a minimum, expect the relevant Parliamentary committees that are providing scrutiny of the regulators to use the ORFR's outputs.

It is clearly important that the regulators retain their day-to-day independence and that they have the ultimate responsibility to adopt regulatory measures in line with the mandate they have been given. The ORFR would not become a parallel regulator.

But to the extent that the Treasury – or another body – is given a power of direction to be used where that mandate has been disregarded it would be legitimate for the work of the ORFR to be an input to that process.