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International Regulatory Strategy Group response to the HMT Future Regulatory Framework Review: Proposals for Reform consultation

The International Regulatory Strategy Group (IRSG) welcomes the proposals set out in the HM Treasury Future Regulatory Framework (FRF) Review: Proposals for Reform. 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 a leading global financial centre, and on the nation's broader economic and social wellbeing. The UK's departure from the EU offers the UK a unique opportunity to adapt its financial services regulatory framework so that it remains coherent and agile to appropriately meet the social, economic, climate and geopolitical challenges that are ahead.

Given its significance for, and impact on, a wide range of public policy objectives, the regulatory framework for financial services should have a transparent structure, whereby Parliament sets the high-level policy direction, and the regulators are tasked to set out, and are held accountable for, developing, and delivering the underlying rules and guidance in a way that achieves Parliament's policy objectives. The IRSG believes that effective, independent, and strong regulation is a competitive advantage for the UK, and this should be maintained. The framework, however, should also recognise the importance of innovation, proportionality, competitiveness, and the international character of financial services including by, where appropriate, supporting the regulators in driving convergence towards global standards.

Since the IRSG began its work on regulatory architecture for financial services, it has reiterated the need to develop a framework that reflects three main themes:

- that a significant amount of power has now been transferred back to the UK Parliament and regulators from EU bodies.
- these additional powers need to be balanced by appropriate accountability and scrutiny mechanisms.
- these mechanisms must operate in a way that preserves the day-to-day independence of the regulators.

The IRSG welcomes the proposals for new objectives for the regulators and mechanisms to improve accountability but believe that, as currently proposed, there may be too large a gap between the very high-level legislation that sets out the overall objectives of UK policy and the detailed rules applying to specific products or markets. If this gap is not filled by legislation the regulators may be left in a position of setting out *both* public policy goals which are properly the preserve of Parliament and / or government and the technical detail of how to achieve those goals[1].

In addition to responding to the specific consultation proposals the IRSG would also like to draw the government's attention to the following issues:

[1] An example where this has previously happened is when OFCOM implemented regulatory rules before the government had set out its policy design for Broadband which led to OFCOM taking an enhanced role in leading the policy direction.

Transparency and democratic oversight

- Given the nature and extent of the UK's departure from the regulatory regime of the EU single market, if these current proposals are adopted the UK regulators will have a high level of independence and significant rule-making powers.
- Regulators will be amending and producing a vast amount of regulation that will have wide-reaching impacts on the whole of society therefore technical democratic oversight will be critical to ensure the legitimacy of the decisions being made. This gap can only be filled by Parliament through a mechanism that has the time and resource to:
    - ensure consistency
    - assess outcomes
    - debate trade-offs between public policy goals
    - provide views on financial regulation as it develops
    - look in detail at specific pieces of financial services regulation
- The IRSG believes there are a variety of ways that Parliament could provide this oversight which could include the establishment of a specialist Parliamentary joint committee. However, it is ultimately a matter for Parliament to determine how best to oversee the framework.

Transferring retained EU law

- The IRSG appreciates the scale of the task in transferring retained EU law to the regulator. In 2017 in collaboration with Linklaters the IRSG published 'The Great Repeal Bill: Domesticating EU Law'. The report recommended that the approach to adopting and adapting EU and EU-derived law should comply with 5 overarching objectives, including continuity and certainty. These principles meant that retained EU law should be interpreted in the same way as EU law.
- The process for transferring onshored legislation to regulators' rulebooks needs to observe the same objectives of ensuring continuity and certainty unless there is an intention to change policy in which case the changes should be clear, consulted on, and subject to appropriate cost benefit analysis and impact assessment.
- The IRSG believe it is important that the system is not overburdened with change for the sake of change but rather priority should be given to areas where there is a pressing need to make amendments.
- The way EU law has been onshored means there are no consolidated versions of the rules available, which makes them very difficult for market participants to read. The IRSG therefore recommends that HM Treasury's proposals for changes to legislation should be carried out with sufficient consultation and time to allow industry participants to adapt accordingly. Changes to legislation should include (as an annex) full marked up text, in the way the FCA typically present clear mark-ups to their handbook text. This would improve accessibility, make reviews of proposed changes much more focused and efficient, enhance clarity and certainty around what is proposed, enable industry to better focus its energy, and could streamline the overall process.
- Finally, the IRSG recommends that HM Treasury consult the industry on the priority areas for change ahead of the transfer of retained EU law.

Resources and expertise

- The IRSG acknowledges that the proposals will generate significant additional tasks for the UK Parliament, the government and regulators. To operationalise the new model significant additional expertise and resources will be required, reflecting the scale of the transfer of responsibilities inherent in the UK having left the EU single market and its rulemaking framework.

- It is particularly important that in executing these significant new responsibilities for regulation the framework does not divert the regulators' resources away from conducting their day-to-day roles of authorisation and supervision (including enforcement) in an efficient, timely and effective way. It is crucial that rules are applied on the ground in a way that is consistent with the policy intent.
- Linking back to our summary point on transferring retained EU law, the IRSG would stress the need for sufficient resource for Parliament to provide scrutiny of the expected significant volume of changes to legislation.

Finally, whilst the IRSG welcomes the focus in the consultation on the processes and mechanisms in the framework the overall goal of the proposals should be to drive an appropriate regulatory culture for this new era. Effective policy making and oversight needs to be supported by effective day to day engagement with market participants and other stakeholders e.g., consumers and Parliamentarians. This requires regulators to have the confidence to listen, explain their thinking and consult with industry whilst also being willing to understand the environment that financial services providers and their customers are operating in. The IRSG is keen that any new mechanisms are not viewed as a substitute for, and do not inadvertently divert regulators' time and resources from, genuine engagement. Many new processes are proposed, but they cannot be a substitute for a highly competent, market-aware, respected regulator who enhances the UK's reputation as a world-leading financial centre.

The IRSG hope that this will be a useful contribution to the consultation and would like to thank the Chair and members of the IRSG Architecture for Regulating Finance workstream for their input into the submission and their extensive work on these issues.

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

The IRSG welcomes the government's approach to add new growth and international competitiveness secondary objectives for the regulators. Following the UK's exit from the EU, UK regulators have taken on a significantly changed role, with increased powers and additional independence. 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 policy and negotiations.

The purpose of objectives is to ensure that everyone, including the regulators themselves, are clear about the expectations of government and Parliament and to enable the regulators to exercise their powers transparently in service of those objectives whilst explaining how their actions support or impede the wider policy. It will be important that the regulators regularly set out how they have addressed potentially competing objectives and that this is subject to scrutiny from Parliament on a regular (we suggest annual) basis. The IRSG recommends that the government undertake systematic reviews of the regulator's actions on a regular basis – say every 5 years – to understand how successful they have been in achieving their various objectives.

The IRSG's final recommendation on this proposal is that the new international competitiveness and growth objectives should apply across the whole financial services ecosystem, including the Payments System Regulator (PSR), The Pensions Regulator (TPR) and the Bank of England's other, non-PRA regulatory functions (e.g., bank resolution, FMI supervision).

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

The IRSG believes climate change and net zero will be a critical part of future sustainable growth and therefore supports these being explicitly recognised in the regulatory principle for sustainable growth. Currently there are calls for the financial sector to play an even greater role in addressing climate change and environmental degradation and that focus for the sector is likely to grow following COP26.

The IRSG recommends that further discussion is had on whether it is expected that other ESG objectives might also be reflected in the regulatory framework in due course.

In updating the regulatory principles, the IRSG recommends that the government bear in mind the vital importance of the core role of the regulators and of regulatory policy. Even as the new Framework and any new principles grant the regulators a broader remit this core role must be delivered.

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

The IRSG supports the proposed power for HM Treasury to require the regulators to review their rules. The overall goal of the power should be to identify where there is a mismatch between the

policy direction (implemented through rules and supervisory action taken by the regulators) and the high-level framework set out by those institutions with direct democratic accountability to the electorate.

While recognising that the government may wish to retain a degree of flexibility, the IRSG requests further clarity and transparency on how this power might be used. The government might identify a non-exhaustive list of triggers for the mechanism to be invoked. These might include, for instance, significant concerns expressed by the CBA panel following an ex-post review of a particular CBA; a significant change in market activity/new market entry; or concern from stakeholders (for example consumer groups or industry bodies) that the rules are not meeting, or will not meet, their intended purpose.

The IRSG also recommends that there be formal and transparent processes under which market participants and consumers can request the government use the power.

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

The IRSG is keen that the UK continues to take a leading role in shaping international standards and ensuring that the UK regulators' responsibilities are aligned with the government's overseas arrangements and agreements will be a positive step in communicating the UK's commitment to them.

The proposals align with the consultation's overall goal of ensuring that the government is responsible for setting the high-level framework and policy intent with regulators responsible for the technical rules that deliver this. It is important that the actions of the regulators do not inadvertently cause a breach of overseas arrangements and agreements. The proposal will be particularly important regarding the UK deference arrangements, under which HM Treasury are ultimately responsible for recognising jurisdictions as equivalent and for determining how the UK will align with international regimes.

There will need to be an obligation on the government to engage with the regulators on those international commitments to make sure their implications are fully understood. It will also be important that there is transparency about how regulators consider overseas arrangements and agreements and where the regulators take a different decision than they would otherwise have done because of such arrangements and obligations.

The section in the consultation document headed "Overseas deference arrangements and trade agreements" (paragraphs 4.26-4.33) makes no reference to the prudential carve-out that forms part of most trade agreements. The prudential carve-out provides a wide freedom for regulators. As the Question does not refer to the aspect, the IRSG does not comment on it, while noting that it remains a relevant consideration.

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

The IRSG believes that the measures will be a positive step to ensure that regulators provide the necessary information to Parliament, however, at present, the proposals do not envisage any systematic or detailed consideration by Parliament of the wide range of regulatory initiatives that the regulators will be empowered to pursue. Given the potential significance of some of these initiatives this is an important omission.

When the UK left the EU several scrutiny mechanisms fell away. Whilst the IRSG believes that such mechanisms are not suitable for the UK framework, there remains a need for a democratic body which grasps the specificities and challenges of financial regulation and provides a mechanism to:

- **Drive consistency:** ensuring that regulatory guidance and regulations are consistent with the policy intent set out in the underlying legislation.
- **Assess 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 committee may wish to intervene in a given live 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.

There are several ways in which this oversight could be affected:

- Establish a new financial services joint committee made up of members from both the House of Commons and House of Lords with expertise and/or interest in financial services.
- Enhance the role of the House of Commons Treasury Select Committee (TSC)[2] or the House of Lords Economic Affairs Committee.
- Establish a new technical sub-committee of the TSC focused solely on financial services regulation.

Ultimately it will be for Parliament to determine how to oversee the framework, but the IRSG recommends that this critical gap in democratic oversight is given further thought along with the resources and expertise needed to support any mechanism.

Finally, on consultation responses it is not clear whether the requirement to respond in writing is intended to mean that the Treasury Select Committee (TSC) consultation response should be accorded a greater weight/status in the framework. If that is the intention, then the IRSG recommends it should be made clear. Where other committees in Parliament work on financial regulation then they might also need to be accorded this enhanced status.

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

In the IRSG's response to the last phase of this consultation, it outlined the need to review the panels to ensure consistency in their approach. As such the IRSG supports the intention to put the FCA's

[2] It is recognised that, as currently constituted, it is unlikely that the TSC would have sufficient resources or time to be able to oversee the vast amount of change in financial regulation and scrutinise the approach of the regulators in the way envisaged in the proposals.

Listing Authority Advisory Panel and the PRA Practitioner Panel's insurance sub-committee panels on a statutory footing, in line with the PRA's and FCA's other panels.

However, the IRSG proposes 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, we suggest the panels and regulators consider how they obtain more detailed technical expertise on 'specialist' issues on an ad-hoc basis. This technical advice could, for instance, be provided by subgroups drawn from a pool of individuals who have a specialist interest or expertise and could bring together consumer groups, different types of practitioners and other interested parties together around a particular issue.

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

The IRSG agrees that the proposed requirement for regulators to publish and maintain frameworks for CBA provides improved transparency for stakeholders. The IRSG would propose that for the requirement to be effective:

1. Government should set out minimum expectations in legislation as to what the frameworks should include e.g., how the rules compare with those in other international regimes.
2. The regulators should work together to develop consistent frameworks and explain the reasons for any differences.
3. External input into the framework will be important. Stakeholders and the CBA panel should be consulted on the framework as it is developed[3] and finalised and – in due course – reviewed.
4. The proposed CBA panel should have a role in inputting to the frameworks and carry out ongoing review of the frameworks and annual reporting.

Finally, HM Treasury may wish to consider whether the CBA panel could set the framework which would simplify the process to enable incremental changes to the framework.

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

The IRSG believes that it is important that the CBA Panel acts in a way which supports and reinforces good regulatory policy-making by the regulators and is not seen as a substitute for this. To achieve this, it will be critical that it has the right expertise, is able to respond in a timely manner and does not impact the agility of the policy-making process. The CBA panel should be transparent, and its output should be made public.

The IRSG recommends that the regulator and the CBA Panel work closely together on an ongoing and continuous basis. The IRSG also recommends that the CBA Panel operates both on a pre-publication and a post-publication basis. It will thereby be able to influence and improve, where required, Cost-Benefit Analysis before policy proposals are finalised to steer any policy away from disproportionate

[3] For example, to advise on guidelines for the framework to require CBAs to include requirements such as: an explanation of how the intervention is compatible with the regulators' objectives and principles, analysis of the full spectrum of options and range of implementation periods etc.

or unforeseen outcomes, ensure CBAs have been conducted according to best practice and ultimately save resource and cost. It will also ensure the continued effectiveness of the CBA framework by conducting post publication reviews which consider, over a range of policy proposals, how the framework has been applied and identifying areas of good practice and areas for improvement.

To ensure that the CBA Panel is used in situations where it can add most value and to avoid unduly delaying policy change, the IRSG proposes that not every proposal gets a pre-publication review. Instead, the CBA panel should set out transparently how they will apply reviews to select CBAs, based on pre-determined and public criteria. For instance, rule proposals which are broad in nature, expected to be high impact, extend rules to new products or market participants, or for which either the cost or benefit cannot accurately be assessed or are based on broad assumptions, should be subject to a pre-publication CBA panel review[4]. Rule proposals which are narrow in focus, or limited to minor technical matters, such as the correction of handbook references or the removal of redundant rules, should not require a pre-publication review, though regulators should have the option to seek one.

Whilst having responsibility for both aspects of the CBA scrutiny will extend the scope, the IRSG believes there will be significant efficiencies in the process since the panel's general findings from the pre-publication reviews (e.g., methodology issues) will feed into its high-level post-publication assessments to allow it to produce recommendations for the regulators on improving their approach.

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

The IRSG believes that improved transparency for stakeholders will result from this proposal. A structured approach to reviewing the rules will be key to ensuring they are having their desired effect and will provide transparency to stakeholders. Such a review mechanism should be used in a proportionate and targeted manner to address significant changes in circumstances, specific issues or unintended consequences that have arisen. It should not be used as a way of making minor tweaks to the rules which may not materially change outcomes but can cause cost and inconvenience to market participants.

Importantly it should also be recognized that review clauses are not a substitute for seeking to deliver the right outcomes in the first place through carefully considered policy making which listens to and takes into account the views of all stakeholders.

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

The IRSG sees potential for the DAR to be used in the future to move away from entity-based regulation towards activity-based regulation, based on the principle of same activity, same risk, same regulation. This would ensure a more consistent regulatory approach with the same outcomes and standards for consumers across the financial sector. An activity-based approach to regulation, rather

[4] An example would be the FCA Consumer Duty cost-benefit analysis where it was outlined 'it has not been possible to reasonably estimate the scale of benefits due to the broad and pre-emptive nature of our proposals'.

than the current entity-driven approach that is set out in FSMA, would allow policymakers to ensure consistent regulation of products and services, irrespective of the business model of the provider. This would be a significant shift and more detail of the intentions, both in the short term and long term, of the government in this respect would be welcome.

In the short term, the IRSG would welcome clarity on whether there is any expectation of supervision of activities under the DAR and if so, how the regulator will manage this. For example, how will regulators be made aware of individuals or entities carrying out designated activities without any sort of registration and what powers would they have available to oversee or challenge such activities?

The scope of any powers granted under DARs, and any limitations on those powers, should be clearly set out. This should include any territorial scope and whether regulators will have general powers to make any rules relating to designated activities, or only those contained in the DAR. There should be a clear process to establish how questions relating to interpretation of the scope of DARs should be addressed.

It is also important to be clear on how the operation of this regime will be funded.

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

The IRSG would welcome further detail on the "have regards" proposal. The IRSG welcomes the increased transparency and clarity of expectations of matters the regulators should consider. Given, however, that it appears that the 'have regards' will form part of the high-level framework within which the regulators are to operate the IRSG recommends that these should be set by Parliament and included in legislation rather than being set by the government.

For some sectors, wider global standards such as the Basel framework provide clarity on where the regulator should take wider standards into account when writing technical rules. Where there are no international standards setters (or where standards have yet to be set), the regulator could be left to make the strategic decisions about the scope of rules and the key policy trade-offs as well as writing the technical detail. The framework legislation needs of each sub-sector of financial services will be different depending on their context (i.e., existing international regulatory standards) and therefore the government should take on the role to fill this gap and could consider its approach to setting the regulatory perimeters in legislation on a case-by-case basis.

Finally, the IRSG recommends a formal review clause is adopted for the overall framework. If these proposals are adopted, it will result in significant changes to the framework, some of which will inevitably evolve during implementation. As a result the IRSG recommends a formal and comprehensive review takes place 5 years after the new framework comes into effect to assess whether the changes have led to the intended outcomes.