



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Lord Bridges, Baroness Bowles of Berkhamsted, and Baroness Noakes
House of Lords
London
SW1A 0PW

16 May 2023

Dear George, Sharon, and Sheila,

FINANCIAL SERVICES AND MARKETS BILL: INDEPENDENT SCRUTINY OF THE REGULATORS

Thank you for your contributions during the Grand Committee debate on the Financial Services and Markets Bill on 1 March. I committed to write to you on how the Future Regulatory Framework (FRF) Review consultations covered accountability and specifically the possibility of a new external body to scrutinise the regulators.

Baroness Bowles asked what questions were included in the consultations that provided an opportunity for respondents to discuss the issue of potential new bodies for independent scrutiny of the regulators, and Baroness Noakes asked whether the consultations specifically addressed the issue of independent scrutiny.

As I set out during the debate, the government consulted extensively as part of the FRF Review. The first consultation in October 2020 set out an overall blueprint for financial services regulation, focusing on the split of responsibilities between Parliament, the government, and the financial services regulators. It received over 100 responses. A number of questions asked about the overall framework and the division of

responsibilities between Parliament, government, and the regulators. The relevant questions are copied below.

Q1. 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?

Q2. What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:

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

Q5. Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?

Q6. 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?

Although there was not an explicit question in the consultation paper about establishing new bodies to support regulatory accountability, it invited comment on other models that should be considered and specifically on accountability and scrutiny asked whether other issues should be reviewed. The breadth of the questions meant that a number of respondents felt it was appropriate to raise the issue. However, this was a small minority of respondents and there was no consensus on what functions such a body should have.

The full consultation paper can be found here:

<https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-consultation>

In the second consultation in November 2021, the government responded to representations made to the initial consultation and, building on this feedback, set out specific proposals for reform to the UK's model of regulation, based on the Financial Services and Markets Act 2000. This consultation also received over 100 responses.

As part of this, the government set out that the structure of Parliamentary scrutiny is a matter for Parliament, and that Parliament already has the ability to draw on expertise to ensure it has the information it needs. The government therefore did not make recommendations to Parliament on these matters, but set out proposals that aim to ensure that Parliament has access to the information needed to best scrutinise the work of the financial services regulators and set expectations for how the regulators must respond to any representations from Parliamentary committees.

In the consultation, the government noted that some respondents had suggested establishing new scrutiny bodies, and outlined its reasons for not adopting such an approach. The relevant text, from paragraphs 6.38 and 6.39 on page 56, stated:

Some respondents recommended the creation of an external body to provide additional independent challenge to the regulators and scrutiny of final rules. Proposals differed on whether this would be a body explicitly supporting the relevant Parliamentary committee, or an entirely stand-alone body. In both cases it was suggested this body could enhance Parliamentary scrutiny of proposals by issuing independent reports (at public consultation stage) on whether the regulators' proposals are likely to advance their objectives. The practical obstacles to be overcome in making such a body operate effectively are substantial, and there would be significant cost and resource burdens. Such a body would also duplicate existing functions and potentially undermine the regulators' operational independence.

The government considers that the existing avenues for stakeholders to provide input, feedback, and challenge through public consultation, as well as the role of HM Treasury and Parliament in assessing whether the regulators are advancing their objectives, remain the appropriate accountability mechanisms. This position is supported by the Treasury Select Committee (TSC) report on The Future Framework for Regulation of Financial Services, which said 'the creation of a new independent body to assess whether regulators were fulfilling their statutory objectives would not remove the responsibility of [the TSC] to hold the regulators to account, and it would also add a further body to the financial services regulatory regime which [the TSC] would need to scrutinise.' Therefore, the government does not propose the creation of an external scrutiny body.

The full consultation paper can be found here:

<https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-proposals-for-reform>

In addition, Lord Bridges asked that I confirm whether the specific proposal in his amendments, to create an Office for Financial Regulatory Accountability, had been consulted on. As noted above and during the debate, the vast majority of respondents to the first consultation were focused on how the existing mechanisms for accountability to Parliament and government, and engagement with stakeholders, could be strengthened, rather than advocating for the creation of an entirely new body. As a result, the government's second consultation did not consult on any specific proposals for a new body similar to that proposed by Lord Bridges' amendments.

In response to the second consultation, some respondents felt that there should be further measures on accountability, though there was no consensus on exactly what these measures should be, or whether this accountability should be to stakeholders, Parliament, or the Treasury. Some respondents also noted the importance of the Treasury Select Committee (TSC) having access to appropriate resource and expertise to support their scrutiny. Parliament already has the ability to draw on expertise and use industry and

regulator secondments to further enhance technical expertise where required. As this is a matter for Parliament, the government has not brought forward proposals in this regard.

As I set out in the debate, the issue of a new body raises questions that would need to be considered, such as who such a body would be accountable to and the interactions with existing, and indeed enhanced, parliamentary accountability. This would take time, and it is not appropriate to introduce such a significant change during the late stages of this Bill. In enacting such a change to the framework, it would also be important to fully consult stakeholders. This was the case for the creation of the Office for Budget Responsibility (OBR), which Lord Bridges' amendments are based on. The OBR operated as a non-statutory body for almost a year before the relevant legislation was introduced in Parliament.

I look forward to further discussing these issues throughout the passage of the Bill. I am copying this letter to other Peers who spoke during the debate, and I am placing a copy of this letter in the Library of the House.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Baroness Penn', with a stylized, cursive script.

BARONESS PENN