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Dear Baroness Neville-Rolfe, Baroness Kramer,

FINANCIAL SERVICES AND MARKETS BILL: MATTERS RAISED AT COMMITTEE

Thank you for your contributions during the second committee debate on the Financial Services and Markets Bill on Wednesday 24 June. I committed to write, following the debate, to follow up on a number of specific questions and concerns which were raised, linked to the accountability of the financial services regulators and the role of the regulatory principles under the new framework.

The Government agrees that robust accountability of the financial services regulators is critical. Parliament has enshrined the principle of regulatory independence into primary legislation through the Financial Services and Markets Act 2000 (FSMA). This approach is known as the FSMA model. This model sets out clear roles and responsibilities for Parliament, Government and the regulators: Parliament sets the framework of statutory objectives, duties and powers that the regulators must operate within, and holds them to account for how they have discharged their functions within this framework. The regulators are operationally independent from Government and Parliament.

The Government remains firmly of the view that the FSMA model continues to be the best and most appropriate model for financial services regulation in the UK, and the most effective way of delivering a stable, fair and prosperous financial services sector.

This framework includes substantial provision to ensure that the regulators are fully accountable to Parliament and Government for how they discharge their responsibilities, while remaining independent. It also includes extensive reporting and transparency requirements to support Parliamentary scrutiny, and to ensure that those with an interest in how the regulators operate can understand their approach, and make appropriate representations regarding it.

The Financial Services and Markets Bill builds on this by introducing new requirements for the regulators to publish long-term strategies.

These new requirements – and particularly the requirement to publish long-term strategies – are designed to support effective scrutiny of the regulators, and in particular to make it easier to make an overall assessment of the regulators' approach and the impact of their work. Considering separate rules in isolation is not effective for assessing the cumulative effect of the regulators' actions – both the benefits in terms of advancing their objectives, and the costs to affected businesses.

The Government has often heard feedback from the sector calling for the regulatory system to have an overall long-term strategy with clear goals, where the regulators consider the cumulative impacts of their policies and the interaction between supervision and rule-making. Clause 16 is intended to address this feedback and improve transparency around the regulators' long-term direction and focus and, in turn, support more effective oversight and scrutiny of the regulators.

The amendments made to FSMA and the Bank of England Act 1998 by clause 16 specify that the regulators must take full account of their objectives in the design of the strategies, and must have regard to a number of matters, including the regulatory principles and the Treasury recommendations. They will also be required to review progress against their strategies within their existing annual reports. This will mean that Parliamentary committees will now be able to hold regulators to account against published, time-bound strategic commitments. That represents an enhancement of parliamentary oversight, not a reduction.

There appears to be broad agreement that, in some areas, regulatory requirements on firms have become overly prescriptive, in some cases duplicative, and that this results in high costs for firms, and means that they spend a large proportion of their time and resources focusing on regulatory requirements.

The Government considers that this is also true of the regulators in some areas. Over time, various requirements have been added to and extended. This places a resourcing burden on the regulators that is ultimately paid for by firms, and can reduce the regulators' capacity to act quickly and effectively.

That is why the Government considers it appropriate to change the way in which the regulatory principles in FSMA apply to the regulators: applying them to the new strategies, and removing the ability to consider them each time they exercise a general function, will ensure that these issues continue to be considered at the strategic level, and that Parliament can continue to scrutinise how the regulators comply with these regulatory principles holistically – while removing overly-burdensome requirements where there is limited evidence they impact outcomes.

Alongside this, the Government has proposed removing a very small subset of the existing reporting requirements on the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

The Bill also introduces a requirement on the regulators to report annually on their work to advance their international competitiveness and growth objectives, with the aim of providing greater clarity for Government, Parliament, the financial services sector and those who rely on it.

The attached note on the FSMA model and accountability framework sets out further details of the existing requirements and the changes being made through this Bill.

The Government is confident these changes will enhance regulator accountability and scrutiny by streamlining requirements to focus on where they have the highest value, enabling the regulators to be agile and responsive in advancing their objectives, without degrading the quality of scrutiny and accountability.

I will now address in full the specific questions which were raised during the second committee debate:

Baroness Kramer asked about the capacity for Parliament to make recommendations to the regulators, and oversight to make sure those recommendations are taken into account.

There is no provision currently within FSMA that provides Parliament with a general ability to make recommendations to the regulators, or makes provision about how any such recommendations should be dealt with. Central to the FSMA model is the operational independence of the regulators.

However, as the regulators' authority ultimately comes from Parliament, and given Parliament's constitutional position, the regulators must of course take the views of

Parliament seriously. Parliamentary committees can and do make recommendations, for example through reports, correspondence with regulators, and public hearings.

The Financial Services and Markets Act 2023 enhanced Parliament's role, by introducing specific provisions requiring the regulators to notify relevant committees of consultations, and to respond to any representations made by committees, explaining how they have been taken into account in the regulator's actions.

Baroness Bowles asked about a situation where particular rules might be seen to be inconsistent with the regulatory principles, and gave an example of rules leading to unfair outcomes for consumers.

The FCA is required, when discharging its general functions (such as rule-making) to act compatibly with its strategic objective and to advance one or more of its operational objectives which include securing an appropriate degree of protection for consumers. The regulatory principles are subordinate to the objectives, and both the FCA and PRA are required to have regard to them – not to advance them.

If Parliament considers that regulator rules are not achieving their intended outcome, or for example place a burden on firms that is disproportionate to the benefit they achieve, Parliament can use its existing accountability mechanisms to explore this further, and to set out its conclusions.

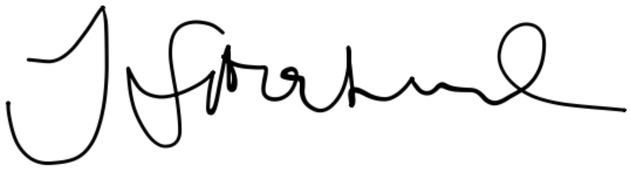
Baroness Noakes asked why the Bill does not include a requirement for the regulators to consult on their long-term strategies.

As I said in the debate, the Government expects the regulators to engage appropriately with relevant stakeholders when preparing or revising their long-term strategies. During the development of its 2025-2030 Strategy (which the FCA introduced on a voluntary basis), the FCA engaged widely, including with industry bodies and consumer groups, to ensure it responds to the needs to the markets it oversees and the consumers it serves.

However, the Government's view is that including a statutory public consultation requirement, of the kind that FSMA requires when the regulators propose making new rules, would be overly prescriptive and could lead to delays in developing the strategy. The Government's approach preserves flexibility in how the regulators develop their strategies, while still ensuring that they remain accountable for the quality, credibility and usefulness of the final published document.

I am copying this letter to all Peers who spoke in the debate and all members of the Lords Financial Services Regulation Committee, and a copy of this letter will be placed in the Library. I look forward to continuing to discuss these issues during the passage of the Bill.

With best wishes,



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