APPG Financial Markets: Consultation on the role of the UK parliament in the future regulatory framework for financial services

Building Societies Association

Introduction

Establishing the framework for the future regulation of financial services is important since financial services plays a key role in the UK economy. Clarifying the role of Parliament and of the regulators plays an important part in this framework.

All 43 UK building societies and 6 credit unions we represent agree that there is scope for a simpler, proportionate regulatory framework post-Brexit, and work is underway on this in the regulatory sphere.

The role of Parliament is to set the architecture of financial regulation set in primary legislation. There is then provision for further flexibility through powers to make secondary legislation, and the statutory regulators have the powers and responsibility (within suitable constraints) to develop regulatory policy and detailed regulation.

Response

1. Policy

What role, if any, should parliament play in the formulation of financial services policy?

There is already a distinction between financial services policy and financial services regulation. Parliament has an important role in:

- scrutinising the outcomes of existing policy,
- identifying problems,
- advocating solutions and new directions, and
- challenging Government proposals.

In terms of regulation, Parliament has already established a balanced approach under the Financial Services and Markets Act 2000 (FSMA). The main parameters are already set in primary legislation, and the detail is delegated to statutory independent specialist regulators, who are accountable to Parliament.

It is instructive to compare and contrast the divergent UK and EU approaches. The UK's approach, going back to FSMA, and much earlier in the building society sector, is to set the architecture of financial regulation set in primary legislation. There is then provision for further flexibility through powers to make secondary legislation, and the statutory regulators have the powers and responsibility (within suitable constraints) to develop regulatory policy and detailed regulation.

By contrast, the European approach, possibly reflecting the civil law tradition, involves far more of the detail of financial regulation being set out in legislation. The EU initially enacted most financial regulation as Directives, which Member States transposed within their own traditions. More recently, the updated content has been expressed as directly effective EU Regulations. The range of (and need for) both REFIT and COVID "quick-fix" initiatives at EU level illustrate the resulting loss of flexibility.

Post-Brexit, the immediate result of on shoring these EU regulations (e.g., CRR with over 500 pages) is that too much detail ends up in UK primary legislation. A Bill is needed to make amendments. As we have said since autumn 2016 this is not practical in the long term. Instead, the UK should adopt its previous position as outlined above. Detail should be left to the regulators after consultation and cost benefit disciplines.

How can parliament ensure that wider public policy goals are reflected in financial services regulation?

In the Treasury's consultation on the financial services future regulatory framework a list of design principles were included (https://www.gov.uk/government/consultations/financial-services-future-regulatory-framework-review). Parliament should ensure that these principles, along with parity of treatment across different corporate forms and proportionality in retail financial services, are reflected in the architecture of financial services regulation.

Encouraging competition and innovation will help promote diversity of corporate form, provided mutuals are accorded parity of esteem alongside the shareholder model. Mutuals have a different mission from the shareholder capitalism of the banks. Essentially, to make life better for their members. Both building societies and credit unions are driven by social purposes rather than profit, focus on the long term, and are democratically accountable to their customer-members. This diversity of ownership will also reduce systemic risks, as a range of flourishing business models mitigates the risk of a particular type of institution.

Both the FCA & the PRA have duties to support diversity of ownership of provider in their objectives. The benefits of encouraging this include greater systemic resilience and consumer choice. Scrutiny of both these regulators in Parliament, specifically on these objectives, will help keep these at the forefront of the regulators' minds.

The Treasury has already recognised the need for proportionate regulation, noting that regulatory standards need to be proportionate to the risks they address, and by seeking to avoid undue regulatory burdens on firms from the operation of the regime as a whole.

2. Legislation

Do you think that the role of parliament in scrutinising primary and secondary legislation on financial services needs to be changed post-Brexit? If so, in what way?

Could the role of the Treasury Committee encompass detailed scrutiny and review of financial services legislation? If so, would this be desirable?

Immediately post-Brexit, a great deal of the detail of regulation will be set in UK legislation. Whereas previously Parliament undertook some scrutiny of EU legislation during the proposal and co-decision stages, it had no role once an EU regulation such as CRR was made (because it is directly effective). Now however, Parliamentary time may be taken up with re-making the fine detail of regulation. One example is the forthcoming implementation of the Basel 4 agreement will require extensive amendment to the UK-on shored version of the CRR.

A better use of Parliamentary time would be to scrutinize the actions of the regulators, for which they are already formally accountable, and scan the horizon for upcoming issues. In short, the BSA favours re-establishing both Parliament's, and the statutory regulators' roles, as set out in FSMA. Once that is done, Parliament will not need to revise EU-derived rules and a period of stability and settling down will be needed. One example of an area for Parliamentarians to scrutinise the regulators are the FPC mortgage tools.

Should the House of Lords play a greater role in the scrutiny and review of financial services legislation?

Both Houses should play fully the roles envisaged and provided for in FSMA.

Would a joint Financial Services Scrutiny Committee help improve the quality of future financial services legislation?

Are there lessons to be learned from the experience and practices of other legislatures?

3. Regulators

How can parliament best scrutinise the work of regulators with expanded powers post-Brexit?

How can parliament effectively scrutinise coordination between multiple regulators—including those with broader responsibilities, such as the Competition and Markets Authority and the Information Commissioner's Office—on issues of common interest?

4. Market access arrangements

Future arrangements between the UK and third countries, including free-trade agreements and memoranda of understanding between regulators, will need to address cross-border financial services trade. How should parliament scrutinise such arrangements (and the negotiations over them) before ratification? Are there existing models that might address this issue?

5. Resources

What resources and expertise do parliamentary committees and individual parliamentarians need to effectively discharge their roles in the future regulatory framework for financial services?

Should there be a mechanism that allows further involvement from regulators and the sector in the law-making process?

6. Further comment

Are there any further comments that you would like to make as part of this consultation?

Post Brexit there is an opportunity to introduce proportionate regulation. This issue forms part of the conversation about Parliament's role in the future regulatory framework for financial services. An outline of the issue is below.

Regulation imposes costs on the firms being regulated. To some extent these costs are fixed, in that there is little difference for firms of different sizes when the requirements apply universally. The proportionate burden is therefore much greater for small banks and building societies than it is for large firms operating in financial services.

Basel standards are designed for large, internationally active banks. As part of the EU, the UK applied these standards to all banks and building societies, regardless of their size or complexity. There is now an opportunity to make regulation and supervision of small, simple firms more proportionate.

Making banking regulation more proportionate does not involve lower resilience on key measures, or weaker standards of customer-facing conduct. Instead, it requires regulation to be more appropriately tailored to the nature, scale and complexity of activities undertaken by a firm. Even the EU has belatedly introduced, through CRR 2, some modest simplifications for "small and non-complex banks" that will take effect in the EU27 in June 2021. This could be achieved in the UK by creating a simpler, parallel regulatory regime into which firms meeting certain criteria for size and simplicity could opt, and wider simplifications to regulatory reporting.

More proportionate regulation could result in:

- **Better regulation:** Scarce supervisory resources can be allocated to the greatest risks, and benefit from potentially more accurate regulatory reporting.
- **Improved resilience:** Resources including senior management time can be spent on managing risks rather than administering compliance and simplified reporting enables a clearer picture of a firm's position.
- **Increased competition:** Lower operating costs for small firms from the removal of inefficient compliance and reporting that was of little value in terms of stability enables them to compete more effectively against the big banks.

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We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £420 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.