

Spotlight on Corruption submission to the consultation on the Future Regulatory Framework for Financial Services

Organisation overview:

Spotlight on Corruption is an anti-corruption charity that works to end corruption within the UK and wherever the UK has influence. We undertake detailed, evidence-based and impactful research on the implementation and enforcement of the UK's anti-corruption laws, looking for ways in which they can be improved. Our vision is for a society where strong, transparent, and accountable institutions ensure that corruption is not tolerated.

We welcome this consultation on the UK's future regulatory framework and have responded with a particular focus on ensuring integrity, transparency and democratic accountability are embedded into the framework from the outset.

Key Recommendations

1. Promoting competitiveness should remain as the responsibility of the government with parliament's oversight while regulators' mandate should retain its focus on ensuring the integrity of markets and consumer protection.
2. Regulators' mandate should be extended to include a commitment to protect and promote the public interest.
3. An independent oversight body dedicated to monitoring the financial services regulators' activities should be established to enhance democratic accountability.
4. A specialist parliamentary select committee focused on financial services regulation should be established to provide an additional level of parliamentary scrutiny.
5. Responsibility for handling and protecting whistleblowers should be transferred to the new independent oversight body.
6. There should be much greater transparency and stakeholder participation in the development of policy by financial services regulators, including through the creation of citizen panels.

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?

Spotlight on Corruption recognises that the FSMA framework based on the model of independent regulators accountable to parliament remains the best available framework to regulate the financial services industry. Adapting the FSMA regime for the UK's position outside of the EU is an opportunity to both strengthen the democratic accountability aspects of the framework, but also to address gaps in regulatory performance, particularly with regard to supervision of financial crime and its enforcement.

With regard to the FCA's performance, both the Gloster report into the FCA's regulation of London Capital and Finance Plc, and Andrew Green's report into the FSA's enforcement actions following the failure of HBOS have underlined deficiencies in the way the authority handles investigations and whether it has the capacity to enforce its rules robustly where necessary. In recent years the FCA has had some successes in imposing large regulatory fines on organisations for financial crime, but it has also faced criticism for serious regulatory failures and for its lack of apparent willingness to use its prosecutorial powers under the FSMA framework. A review of the FCA's enforcement capabilities under FSMA needs to be conducted and consideration given to whether prosecutorial responsibility for serious and complex cases of financial crime should be more clearly assigned to a beefed up prosecutor, such as the Serious Fraud Office, in a similar way to which those from the Competition and Markets Authority have been since October 2020.

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?

4a. Regulators' overarching statutory objectives should not be extended to include secondary commitment to promote competitiveness

Introducing the statutory objective to promote competitiveness would come into conflict with regulators' primary responsibility to ensure the integrity of markets, the financial health of firms and consumer protection. An excessive focus on competitiveness in the financial sector resulting in a 'light-touch' approach to regulation and supervision led to the creation of systemic risk in the industry and was a major catalyst for the 2008/09 financial crisis. Any return to embedding high-risk practices in the sector to 'promote competitiveness' would undermine the post-2008 regime that has strengthened resilience and so far protected the sector from further public intervention and bank recapitalisations.

Research and survey evidence from the private sector continues to rank the City as the world's second most competitive jurisdiction after New York, a status which is underpinned by the quality of the UK's infrastructure, human capital and the overall business environment. These factors are now seen as major factors to ensuring competitiveness rather than simply reducing regulation. The recent drift of UK financial services activity to other jurisdictions since the end of the transition period had notably been to jurisdictions with strong regulatory regimes and robust enforcement. We welcome the signals given by the head of the FCA¹ that maintaining high standards is the most effective strategy to preserve the City's status over a specific competition mandate.

Spotlight on Corruption supports the position taken by the All-Party Parliamentary Group on Financial Markets & Services in its recent report on parliament's role in the future regulatory framework for financial services that decisions relating to overall competitiveness, and any potential trade off between prudential stability and customer protection, are inherently political and should be taken by parliament.

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

Regulators' mandate should be extended to include a commitment to protect and promote the public interest

Consideration should be given to expanding regulators' mandate to include a specific commitment to acting in the public interest in line with OECD principles for better regulation.² As part of a recent review, The Law Society has proposed enshrining a commitment to protecting and promoting the public good as an integral

¹ <https://www.reuters.com/article/uk-britain-regulator/high-standards-will-keep-london-competitive-incoming-fca-chief-says-idUKKCN24N22D?edition-redirect=uk>

² Regulatory Policy and Governance: Supporting Economic Growth and Serving the Public Interest. OECD.

part of the Legal Services Board's (LSB) new three year strategy. This strategy should be adapted for the financial services regulators.

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?

Reassessment of accountability, scrutiny and engagement arrangements must be a primary objective of the next stage of the review.

Spotlight on Corruption welcomes the broad commitment to ensure that integrity remains a statutory objective and will be carried over into the new framework. There remain many outstanding issues affecting regulation in its current form including:

6a Overall regulatory effectiveness including supervision and enforcement must be improved

Properly functioning regulatory bodies must have the appropriate legal powers and resources to provide robust supervision and enforcement. Part of this function is to ensure regulated firms are made aware of the types of conduct permitted and that where violations of rules occurs regulator will intervene and use the full range of their legal powers to sanction firms and individuals, and to provide an effective deterrent for others.

The recent Gloster report³ examining the FCA's regulation of London Capital & Finance plc concluded that there remains significant weaknesses in the FCA's policies and practices, which are exacerbated by gaps in the regulatory regime. The report found that the FCA's regulatory perimeter was "unduly limited" resulting in London Capital being able use its FCA-regulated status as a badge of respectability to underpin its promotion of risky, and potentially fraudulent, non-regulated investment products to unsophisticated retail investors. Spotlight on Corruption supports Dame Elizabeth's recommendation that HM Treasury should consider enhancing the FCA's remit so that it can intervene promptly and effectively to limit the trading of high-risk financial products.

As mentioned in response to questions 1, we believe there should be a full review of whether the FCA is using its criminal enforcement powers to full effect, and whether serious and complex cases should be more clearly assigned to a prosecutorial body.

6b Ensuring independence of the regulators

Guaranteeing the independence of regulatory bodies and curtailing executive interference is essential to maintain integrity across the supervisory regime. Spotlight on Corruption agrees with the proposals put forward by the Treasury Select Committee⁴ for it to be provided with a statutory veto on regulatory appointments and dismissals, with the objective of strengthening the independence of the regulator. This veto should apply at the pre-appointment stage in order that parliamentary scrutiny is applied as early as possible which in turn will bolster the legitimacy of the appointment.

6c Establishing a new independent oversight body

The government should establish an independent oversight body with the remit of working toward aligning the interests of consumers and wider society with the financial services sector. The body would aim to enhance regulatory stability, mitigate against risk in the markets, increase transparency, protect regulation from executive interference and ensure that no industry group could have an outsized influence over the policy making process.

³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf

⁴ <https://publications.parliament.uk/pa/cm201516/cmselect/cmtreasy/811/81104.htm#footnote-027-backlink>

More specifically, the body would achieve these aims by scrutinising FCA and PRA operations and policies and reporting annually to parliament its assessment as to whether FCA and PRA is achieving regulatory effectiveness. The board would have specific powers to request information from executive boards concerning any matter touching on consumer welfare or the potential for harmful practices and report back to parliament on a regular basis any matter of concern. The body should be afforded powers to request information from the executive boards and to summon individual executives to present information in person. To discharge these duties the body should be given the necessary resources to make use of independent experts and support staff.

An independent body would only function properly if its independence from the executive were guaranteed. This would require an open competition for appointments which would then be confirmed by parliament. A prohibition should be put in place to prevent current or former members of the FCA and PRA as well as members of regulated entities from joining the board in order to guarantee a plurality of views and experience.

6d Conflicts of interest and the ‘revolving door’

Regulators must not be affected by conflicts of interest, both real and perceived, between their public duties and personal interests. To mitigate any potential conflicts, an effective system should be put in place that includes requirements for officials to declare any potential conflicts during the selection process and to make regular disclosures during their tenures. This information should be made available to the public and should be attached to other disclosures such as on individuals’ financial interests, minutes of meetings with external parties, along with gifts and hospitality databases.

Spotlight on Corruption believes that the recommendations made by the Committee on Standards in Public⁵ in its 2016 report on Upholding the Seven Principles of Public Life in Regulation should be implemented in full and without delay.⁶ Additionally, post-employment rules for financial regulators should be clearly benchmarked with OECD standards on post public employment⁷ and be supplemented by additional safeguards including prohibitions on disclosing confidential information, restrictions on contact with the regulator, and ‘cooling off’ periods between departing a regulator and taking up a position with a regulated entity.

6e Significantly improve the framework for handling whistleblowers in the financial sector

Evidence from whistleblower support groups suggests that the current system for handling whistleblowers is unfit for purpose, puts individuals at risk and is a factor in maintaining the City’s reputation as a “safe place” for financial crime.⁸ The post-EU framework presents an opportunity to redraw the rules on whistleblowing to ensure that it performs as a corrective tool that promotes integrity while protecting individuals that come forward. There are real questions as to whether the FCA itself should play the role of regulator and Prescribed Person simultaneously.⁹ An independent Office of the Financial Services Whistleblower (housed within the proposed new independent oversight body) should be established with the powers to develop arrangements that facilitate whistleblowing within the financial services industry and enshrine legal protections for individuals coming forward. The Office would act as the initial point of contact and assist individuals during the tribunal process including through the establishment of a legal fund and recommend sanctions for entities found to have treated individuals unfairly.

⁵ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/554817/Striking_the_Balance__web__-_v3_220916.pdf

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https://www.transparency.org.uk/sites/default/files/pdf/publications/Cabs_for_HireY_Fixing_the_Revolving_Door_between_Government_and_Business.pdf

⁷ <https://www.oecd.org/gov/post-public-employment-9789264056701-en.htm>

⁸ <https://bankconfidential.com/wp-content/uploads/2020/06/BC-WB-REPORT.pdf>

⁹ <https://www.reuters.com/article/britain-fca-whistleblower-idUSL8N1PB6BM>

6f Lobbying transparency

The public should have up to date information on lobbying groups holding meetings with regulatory bodies including overviews of discussions, conflict of interest disclosures, and a gifts and hospitality register that would remove any suspicion of impropriety around routine meetings between regulators and industry bodies.

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

Parliament must play a key role scrutinising regulators' activities in the new framework to ensure consistency between statutory objectives and regulatory practices. In order to do so, a specialised Parliamentary committee should be established with a specific mandate to scrutinise financial sector regulators.

The committee should be issued with the relevant powers to initiate independent inquiries, play a role in appointing directors and chief executives to bodies and produce technical reports on the overall impact of regulatory functions and policy changes. The committee should be able to access expertise from HM Treasury and call on outside experts from industry, academics and CSO groups.

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?

Spotlight on Corruption welcomes deepening coordination between the Treasury and the regulators at the early stages of policy formulation, but any increase in cooperation must be bolstered by additional safeguards to curtail executive interference. Where Treasury Ministers send recommendations to regulators through remit letters, protections should be put in place to prevent policy creep away from more topical issues onto more substantial concerns such as on matters relating to competitiveness. Regulators should not be obliged to report back to Ministers on how such remit letters have been taken into account, while any deepening of coordination should not slow down the ability for regulators to act independently and decisively where needed to safeguard financial stability or protect consumers.

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?

9a Commitment to transparency during the policy making process

Financial services regulators should conform with the principle that individuals have a right to know about how public authorities take decisions that affect the public. To achieve this, regulators should implement a specific transparency policy to make sure the public have access to information.

In terms of procedural transparency, the public should be provided with information on the development of new regulatory standards and appointments which should be provided under the presumption of disclosure with a limited number of exemptions.

9b Stakeholder participation should be prioritised during the early stages of policy development

High levels of stakeholder participation underpinned by a diversity of views from disparate groups during policy development is vital to ensure accountability and legitimacy. The complexity of financial services regulation means that stakeholder participation must be prioritised at the outset of the process.

9c Citizen panels should be used to coordinate and assist public participation

The use of non-industry stakeholder panels should be extended in order for citizens and CSOs to participate in the policy making process thereby gaining more technical knowledge of policy process. These panels

have, to some degree, already been adopted by the regulators such as at the Bank of England's citizen's panels, and the FCA's Financial Services Consumer Panel but with limited scope for CSO involvement in comparison to better resourced lobbying groups. Where similar arrangements are already in place such as at the FCA's Financial Services Consumer Panel (FSCP), panels have had an overly limited remit and could benefit from deepening ties with the Treasury Select Committee such as through presenting an annual report on its work.

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