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# FINANCIAL SERVICES FUTURE REGULATORY FRAMEWORK REVIEW – PHASE II CONSULTATION

This is Third Generation Environmentalism (E3G)'s response to Phase II of HM Treasury's Financial Services Future Regulatory Framework Review, closing on the 19<sup>th</sup> of February 2021.

## About E3G

E3G is a not-for-profit public interest organisation with offices in London, Brussels, Berlin and Washington DC. E3G's mission is to accelerate the global transition to a climate-safe world. E3G has a track record of experience and expertise on sustainable finance and international climate finance.

## Overview

The Financial Services and Markets Act 2000 (FSMA), and the model of regulation introduced by that Act, continues to sit at the centre of the UK's regulatory framework. The government believes that this model, which delegates the setting of regulatory standards to expert, independent regulators that work within an overall policy framework set by government and Parliament, continues to be the most effective way of delivering a stable, fair and prosperous financial services sector.<sup>1</sup>

We welcome the recognition by HMT of the 'importance of the UK as a financial centre, and the role it plays in the global financial system'. We also note that in the Chancellor's Financial Services Statement of 2020, he set out an aim for post-Brexit UK to put "the full weight of private sector innovation, expertise and capital behind the critical global effort to tackle climate change and protect the environment."<sup>2</sup>

In the following consultation response, we propose that an overarching

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<sup>1</sup> **Future Regulatory Framework (FRF) Review: Consultation - GOV.UK ([www.gov.uk](http://www.gov.uk))**

<sup>2</sup> Financial Services Statement to the House of Commons, 2020, <https://www.gov.uk/government/speeches/chancellor-statement-to-the-house-financial-services>



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requirement for regulators should be enshrined in the future regulatory framework for financial services which ensures alignment with the UK's target of net-zero emissions by 2050, and with the goals of the Paris Agreement. If underpinned by a robust governance mechanism to ensure effective operationalisation, this addition offers a clear opportunity to establish the UK as a world leader in green finance.

## Outline

Our response addresses the following consultation questions:

- **Question 2:** The proposed framework outlines a clear process for integrating public policy issues into the regulatory agenda at a high-level. There is, however, limited articulation of how the approach taken with areas of policy leadership, such as green finance, would differ to that for any lower priority issues.
- **Question 4:** We propose an overarching requirement for regulators to ensure that firms demonstrate alignment with the UK's Net Zero target and with the goals of the Paris Agreement. This principle would complement and sit above the activity-specific regulatory principles proposed.
- **Question 6:** It is vital that there are open and clear communication channels between governments and regulators, and that the central regulatory guide is reflective of and in harmony with the government's broader policy objectives, such as levelling up, net-zero and resilience.
- **Question 9:** Ensuring a rigorous approach to regulators' policy-making processes, particularly in the context of our suggested overarching requirement for Paris Agreement and net-zero alignment, will be dependent on establishing robust consultation processes to allow for consistent input from a range of stakeholders who have the relevant expertise to hold regulators to account.

## Consultation Response

2. **What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:**
  - a. **What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?**



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- b. 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?**
  - c. Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?**

In the framing and articulation of the proposed post-Brexit financial services future regulatory framework, the UK's history of innovating and leading the financial services sector is deservedly prominent. This is mirrored in a contemporary context by the UK government's appetite to establish a global leadership position when it comes to the integration of broader public policy issues within financial regulation.

'Green Finance and a low carbon future' is mentioned as the first example of an area for policy leadership. It is implied that climate change will be a policy issue that feeds into financial regulation through the proposed framework. However, without a more detailed articulation of HMT's vision for green finance, it is unclear what policy leadership will look like in practical terms. It is also unclear how the approach taken to green finance and a low carbon future, in a regulatory context, would differ to that for any lower priority public policy issues.

The framework proposed in the consultation proposal outlines a clear process for integrating public policy issues into the regulatory agenda at a high level, with HMG and Parliament feeding issues in to be addressed at the discretion of the regulators. From this it can be inferred that it would be through the activity-specific policy framework legislation that questions around climate change and other green finance related public policy issues would be posed to regulators when deemed relevant.

As outlined in the consultation proposal, it is crucial that regulators are required to demonstrate how they have considered public policy issues (identified by HMG and Parliament) in the constitution of regulation. Clear governance and communication mechanisms, through which the progress and evolution of regulatory requirements can be monitored, are central to this.

- 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?**



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Given the scale of the challenge climate change presents, we propose that an overarching requirement for regulators to ensure alignment with net-zero emissions and the goals of the Paris Agreement, including *Article 2.1.c Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*<sup>3</sup>, is enshrined formally in the framework.

Establishing this as an overarching requirement for regulators to consider at a high-level, tailoring as required to the specifics of the financial services being regulated, will ensure that Paris Agreement and net-zero alignment is continuously in scope for consideration. This would complement, and sit above, the activity-specific regulatory principles proposed as an area of policy leadership – mirroring the leadership ambition articulated in the consultation proposal around ‘Green finance and a low carbon future.’

The integral value of this requirement, and its impacts, to the financial system should be clearly articulated, and a clear set of parameters within which this requirement works should be defined (e.g. goals, enforcement powers, tools) so that regulatory alignment can be evaluated over time.

Integrating addressing climate change into the regulatory process in such a way offers the UK the opportunity to carve out a clear leadership position on finance internationally. It would also help pave the path to operationalising recommendations made by the Advisory Group on Finance (AGF), formed by the Climate Change Committee (CCC), on the role of finance in delivering the 6<sup>th</sup> carbon budget<sup>4</sup>. These included recommendations that the UK should commit to becoming the world’s first net-zero financial system and that it should fully integrate climate risk and net-zero into financial regulation and monetary policy.

**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?**

The consultation proposal states that ‘the government recognises that this will involve delegating a very substantial level of policy responsibility to the UK financial services regulators.’ Sufficient oversight must remain as to the direction of travel for these bodies to ensure accountability, scrutiny and public

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<sup>3</sup> [https://unfccc.int/files/meetings/paris\\_nov\\_2015/application/pdf/paris\\_agreement\\_english\\_.pdf](https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf)

<sup>4</sup> <https://www.theccc.org.uk/publication/the-road-to-net-zero-finance-sixth-carbon-budget-advisory-group/>



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engagement. It is vital that there are open and clear communication channels between government and regulators as to the financial landscape, and that the central regulatory guide is reflective of and in harmony with the government's broader policy objectives like levelling up, net-zero and resilience.

A central reference source of regulatory requirements is welcomed in terms of providing clarity on exactly what is being asked for, but it is important that other mechanisms are put in place to allow for ongoing engagement by relevant stakeholders.

In the context of the proposed addition of an overarching Paris Agreement and net-zero alignment requirement this should include giving a specific remit for Parliamentary committees, as a vehicle for other external perspective and expertise, to question regulators on how Paris Agreement and net-zero alignment has been considered in the development of regulation. Regular questioning, as an overarching and standing issue to be raised and addressed, will help embed this requirement and ensure it is being fulfilled by regulators. To ensure this is robustly executed, the flow of climate expertise into Parliamentary committees should be formalised, ensuring that science-based decisions can be made. This could involve the creation of an advisory position for the Climate Change Committee (CCC).

**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?**

An overarching Paris Agreement and net-zero alignment requirement for regulators to consider would be strengthened by the creation of mechanisms to ensure ongoing input from a broad range of stakeholders with relevant expertise. This would help to ensure that a rigorous approach is taken to considering alignment with the Paris Agreement and the UK's net-zero ambition in the constitution and implementation of regulation.

As detailed in our response to Question 6 above, this could initially include giving a specific remit to Parliamentary committees to question regulators on how this requirement has been met. Developing an additional mechanism through which to formally gather stakeholder perspectives and expertise on the implementation of public policy issues, applicable to this overarching requirement as well as other policy areas, would further strengthen the



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effectiveness of the requirement and would reinforce the UK's leadership position on green finance.

**E3G, February 2021**

**Contact: [charlotte.slaven@e3g.org](mailto:charlotte.slaven@e3g.org)**