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FINANCIAL SERVICES FUTURE REGULATORY FRAMEWORK REVIEW: PROPOSALS FOR REFORM

This is Third Generation Environmentalism's (E3G) response to the Proposals for Reform for the Financial Services Future Regulatory Framework (FRF), closing on the 9th of February 2022.

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

E3G is pleased to submit its response to Her Majesty's Treasury's Proposals for Reform for the Financial Services Future Regulatory Framework. This builds on our response during the previous consultation round in 2021¹.

We welcome HM Treasury's proposal to implement a climate-focused regulatory principle for the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA), including its specific reference to the achievement of the UK's net zero by 2050 target. We, however, recommend that HMT elevates this to a statutory objective for the regulators that also includes reference to interim targets between now and 2050 – reflecting the urgency of action required for the UK to meet its net zero target and ensure a just transition to a low-carbon economy.

As they stand, HM Treasury's proposals of an "international competitiveness" statutory objective pose considerable risks to the stability of the UK market. We encourage HM Treasury and the regulators to work together to articulate a new definition of "competitiveness" for the UK. This should be rooted in the delivery

¹ <https://www.e3g.org/publications/financial-services-future-regulatory-services-review-phase-ii-consultation/>



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of the UK’s ambition to be the first “Net Zero Aligned Financial Centre” as announced by the Chancellor of the Exchequer Rishi Sunak at COP26 in Glasgow².

The UK has a clear opportunity to demonstrate global leadership by reflecting this ambition in the remit and objectives of the regulators and working to not only be the “first” but the best “Net Zero Aligned Financial Centre”. This will require rebalancing the emphasis and enforceability of requirements on competitiveness and climate change. HM Treasury should elevate climate change to a statutory objective and downgrade competitiveness to a regulatory principle. There is a strong risk that without this happening, that the unfettered pursuit of growth and competitiveness could set the UK market on a trajectory aligned to that preceding the 2008 Financial Crisis, that will severely impede the delivery of Net Zero and the creation of a stable and attractive UK market. This would be in direct conflict with the priorities detailed in the consultation document of having “...a regulatory approach which commands confidence internationally...”³.

Outline

Our consultation response addresses the following two questions, with a short summary of our answers provided below:

- **Question 1:** The proposals to add new growth and international competitiveness secondary objectives for the PRA and the FCA, as currently written, are directly at odds with, and could severely threaten progress against, the delivery of the UK’s Net Zero by 2050 commitment and the Paris Agreement. Unless climate change and a net zero economy are given equal to or greater weighting than “competitiveness” the UK may fail to deliver its climate commitments and set itself on a trajectory not dissimilar to that preceding the 2008 financial crisis. We recommend that a financial services joint committee is created to oversee and scrutinise new financial regulations and policy.
- **Question 2:** Further regulatory action is required if the UK is to match its ambition to be the world’s first Net Zero Aligned Financial Centre and deliver its commitment to achieve a net zero economy by 2050. The proposal to amend the existing regulatory principle for sustainable growth to reference climate change and a net zero economy is a good step

² <https://www.gov.uk/government/speeches/cop26-finance-day-speech>

³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf



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forward. However, the accompanying proposal of new growth and competitiveness secondary objectives calls into question the future efficacy of the regulatory principle itself. We suggest that the regulatory emphasis on climate change is bolstered and elevated from a regulatory principle to a statutory objective.

Consultation Response

Q1. Do you agree with the government’s approach to add new growth and international competitiveness secondary objectives for the PRA and the FCA?

The proposals, as currently written, to add new growth and international competitiveness secondary objectives for the PRA and the FCA are directly at odds with, and could severely threaten progress against, the delivery of the UK’s Net Zero by 2050 commitment and the Paris Agreement.

The commitment made by Rishi Sunak at COP26 in Glasgow in November 2021 underscored the UK’s ambition to demonstrate global leadership by being the first Net Zero-aligned Financial Centre. If this ambition is to be realised in a credible way, it is fundamental that climate change is put at the centre of the agenda for regulators and requires a reconceptualization of what is understood as “international competitiveness”. A truly competitive and attractive UK market over the coming years will need to be one where financial institutions and real economy companies are encouraged and supported in actively decarbonising their existing businesses and expand low carbon, and Net Zero-aligned, portfolios and product offerings.

Accordingly, in attributing objectives and principles for the FCA and the PRA it is vital the articulation of “competitiveness” from HM Treasury conveys the pursuit of this should intrinsically complement and support the achievement of Net Zero by 2050, and the appropriate interim targets set by the UK Government. Without a reconceptualization of “competitiveness”, we risk the UK financial system being set on a trajectory that would mirror the one which led to the 2008 financial crisis.

To do this effectively and cement the UK as the world’s first Net Zero-aligned Financial Centre, we recommend that HM Treasury reconsiders the proposed balance of the weighting given to “international competitiveness” and that given to climate change and a net zero economy. This should involve elevating climate change and a net zero economy to a statutory objective and incorporating



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“international competitiveness” within a regulatory principle. Rebalancing of the regulatory emphasis between these two issues would centre greening finance within the work of regulators and will be vital if the UK is to successfully deliver Net Zero by 2050.

Given the increased power of UK regulatory bodies, improvements in accountability and transparency are necessary to ensure the public interest is protected. Robust parliamentary scrutiny is also critical to ensure democratically accountable financial sector policymaking. Given the complexity of the industry, we agree with the recommendation that a new financial services joint committee is set up in Parliament tasked with scrutinising new legislation and regulation. Functions should include ‘debating any new legislation, probing the selection of senior leaders appointed to regulatory bodies, responding to regulatory consultations, and assessing and reviewing the effectiveness and impacts of regulation’⁴. This committee should be transparent and balanced, avoiding conflict of interests by not being dominated by representatives with close ties to the finance industry.

As we detail further in our response to Q2 of this consultation, it is also vital to underscore the opportunity for international leadership and market competitiveness that the UK can leverage by being a first mover on climate and greening the financial system.

Q2. Do you agree that the regulatory principle for sustainable growth should be updated to reference climate change and a net zero economy?

We are pleased to note HM Treasury’s underscoring of the opportunity to further strengthen the UK’s regulatory regime relating to climate⁵ and we agree that acting on this opportunity is a crucial next step for the UK.

As detailed in our response to Q1 of this consultation, however, further action is required if the UK is to match its ambition to be the world’s first Net Zero-aligned Financial Centre and deliver its commitment to achieve a net zero economy by 2050. The proposal to amend the existing regulatory principle for sustainable growth to reference climate change and a net zero economy is a good step forward, but its proposal alongside that of new growth and competitiveness

⁴ [Civil Society responds to Treasury’s proposed financial sector reforms - The Finance Innovation Lab](#)

⁵ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf



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secondary objectives calls into question the future efficacy of the regulatory principle itself.

The language used by HM Treasury in the consultation document that “*such growth should occur in a sustainable way that is consistent with the government’s commitment to achieve a net zero economy by 2050 to meet the obligation set out in section 1 of the Climate Change Act 2008*” should instead be translated into an explicit statutory objective focused on climate change and a Net Zero economy. If regulators are tasked with centring growth and international competitiveness without an equal or greater enforceable need to align with Net Zero, there are significant risks that the UK market will fail to attract the types of financial investment and activities necessary to robustly deliver Net Zero by 2050.

The UK’s laudable commitment at COP26 to be the world’s first Net Zero-aligned Financial Centre underscored its ambition to be a world leader in greening finance. As HM Treasury looks to define what this will look like in practical terms, beyond mandatory net zero transition plans, it is vital that the regulatory and governance regimes feature substantively in these plans. This is vital in not only creating the regulatory environment required to encourage the right types of investment and activities in the UK but to establish standards of what a Net Zero-aligned Financial Centre should look like and encouraging replication in other jurisdictions to scale an international Net Zero-aligned Financial System.