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The Rt Hon Jeremy Hunt MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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20 July 2023

Dear Chancellor,

Section 1JA recommendations for the Financial Conduct Authority (FCA)

Your remit letter dated 8 December 2022 sets out recommendations to the FCA about aspects of the Government's economic policy to which we should have regard when considering how to advance our objectives and discharge our functions, namely:

(i) supporting the government's objective of medium to long-term economic growth in the interests of consumers and businesses

(ii) supporting the government's objective to promote the international competitiveness of the UK

Advancing our primary objectives creates a trusted, stable and internationally open environment. An environment in which firms can compete, innovate and invest in support of the UK economy and where consumers can use financial services with confidence. We have been supporting growth by showing speed and agility in our interventions, providing regulatory certainty and responding quickly to changes in markets. And we have been adapting how we operate to support the implementation of the new secondary international competitiveness and growth objective when it comes into force.

Our 3-year Strategy (2022 to 2025) and our Business Plan 2023/24 set out key areas of focus for the FCA. By working in partnership with others to reduce and prevent serious harm, we aim to reduce the drag on growth from fraud, misconduct and firm failure. By setting and testing higher standards, we improve trust and confidence in financial services and drive effective competition in consumers' interests. And by promoting competition and positive change, we support UK growth and innovation.

Supporting medium to long-term economic growth in the interests of consumers and businesses

Securing better outcomes for consumers, including through improved competition in the interests of consumers and having regard to the needs of different consumers

For economic growth to be sustainable, it is essential that consumers get good outcomes from the financial services they rely on and trust their providers to put their needs first. This is especially so for vulnerable consumers who can least afford to overpay or lose money.

- We are implementing the Consumer Duty, in line with the Financial Services Act 2021, which raises the bar for firms to ensure good consumer outcomes are central to their business. By requiring firms to act in good faith towards retail customers, to support them in making good financial decisions and to avoid causing them foreseeable harm, the Duty helps create an environment for healthy competition among firms in the interest of consumers, boosting innovation in products and services. Being outcomes based, the Duty should allow us to have greater flexibility and fewer prescriptive rules in future. This should help both new entrants to the market and existing firms adapting their business models.

- We are approaching the first anniversary of regulating pre-paid funeral plans, bringing higher standards. We have introduced bans on cold calling and commission payments to intermediaries such as funeral directors improving competition in consumers' interests. Our rules also require improved financial soundness of funeral plan providers. Our authorisation gateway has excluded firms and individuals who do not meet our standards. A significant proportion of funeral plans with providers who were not authorised (or who did not apply for authorisation) have been successfully transferred to authorised firms.

- We continue to take action to protect consumers from misleading financial promotions. In August 2022 we published our final policy and rules on the promotion of high-risk investments and strengthening the regime for firms approving financial promotions. Two weeks after the first set of new rules came into force, we reviewed 67 crowdfunding and peer-to-peer firms to assess whether they had complied with the new requirement for an enhanced risk warning. Of those firms, we found 60% had failed to comply with the new standards. We took immediate action to ensure the firms remedied this. The majority of firms were compliant within 2 weeks of our engagement with 100% compliance within 2 months.

- We have been supporting the Government's statutory review and call for evidence of the Payment Services Regulations 2017 and Electronic Money Regulations 2011. As asked by the Government, we are planning to publish a consultation on strengthening the requirements for safeguarding funds (held by payments and e-money firms to meet customer entitlements) in 2023 with final rules and Policy Statement in 2024.

- We launched our latest ScamSmart campaign on 6 October 2022. We highlight 'misdirection' tactics, such as 'free pension review' offers, to tackle increased vulnerability to scams among consumers tempted to draw down early on pensions in the face of cost-of-living pressures. Our ScamSmart campaigns increase consumers' awareness of fraud tactics and encourage consumers to check the FCA Warning List and reject unsolicited investment opportunities.

- We have continued to publish data about UK consumers so they can be better served. Our data provides valuable insight about the financial products consumers hold, their experiences with financial services providers, and their financial situation and resilience. We published early data of our latest 'Financial Lives' survey in October 2022 and will publish a full 'Financial Lives 2022' survey report in summer 2023.

- Through our credit information market study we are aiming for a higher quality of credit information, so that lending decisions better reflect people's underlying financial circumstances. This should help make sure that consumers such as first-time buyers are not denied credit they could afford or given credit they cannot afford.

- We have acted to secure better outcomes for consumers by reducing harm across all sectors where appointed representatives (ARs) operate. We are requiring principals to give us better information on ARs, strengthening scrutiny at the gateway and intensifying supervision of principal firms. We are also taking appropriate enforcement action to help ensure principals do adequate due diligence on prospective ARs and improve ongoing oversight of their conduct.

- We worked closely with the Government and other regulators to prevent harmful outcomes to consumers and businesses from stress events such as the resolution of Silicon Valley Bank UK.

- To improve value for money for pension schemes, we, the Department for Work and Pensions and The Pensions Regulator published a joint consultation in January 2023 on requirements to disclose, assess and compare the value for money of pension schemes.

- We are helping to protect consumers during the current cost of living pressures by clarifying to firms how they should support customers struggling with higher living costs. For example, we consulted about protections for insurance customers in financial difficulty in January 2023 and published new rules banning debt packagers from receiving referral fees in June 2023. We also reminded insurance firms to ensure customers are protected from unnecessary products or add-ons and unfair penalties.

- We continue our work in reducing harm to buy-now-pay-later consumers. We plan to consult on FCA rules following the conclusion of the Government's consultation on the proposed draft legislation to bring buy-now-pay-later products into FCA regulation.

- We issued good practice and areas of concern about firms' monitoring policies on repeated overdraft users, to strengthen the benefits for vulnerable customers from our improved overdraft rules. By reducing high fees for unarranged borrowing, removing complex charging structures and introducing help for those who were repeatedly using their overdraft, our 2019 rule changes have saved UK customers almost £1 billion since April 2020.

Fostering a well-functioning housing market and helping first time buyers access mortgages

Mortgage borrowers and potential first-time buyers faced significant uncertainty and volatility in mortgage rates in the last year. We acted together with the Treasury and lenders to maintain consumer confidence in the mortgage market and ensure that affected borrowers benefitted from tailored support. For example:

- We have been working with the Money and Pensions Service, consumer groups and lenders to raise awareness of the help available as interest rates increase. In December 2022, we published new information for consumers, including information for prospective first-time buyers about how the rising costs of living might affect any mortgage application. This information also explains that while lenders will focus on ensuring first-time buyers are able to afford their new mortgage going forward, they may also ask about previous rental payments to help understand a borrower's finances.

- We continued working with lenders to help ensure borrowers get the support they need. In March 2023, we published Finalised Guidance for firms supporting existing mortgage borrowers affected by rising living costs. In May 2023, we consulted on changes to FCA sourcebooks to provide a stronger framework for firms to better support customers facing payment difficulties.

- In June 2023, the Treasury, together with us and representatives from UK banks agreed a new Mortgage Charter containing a series of commitments from lenders to further support their regulated residential mortgage borrowers. We introduced changes to our Handbook, including enabling lenders to allow mortgage borrowers to reduce their capital repayments for up to 6 months without a new affordability assessment. We also warned borrowers if they can keep up with mortgage payments, they should, as changing the contract could lead to higher payments down the line.

Facilitating investment in productive assets, long-term investment and sustainable finance

We support these aims by strengthening the UK's position in global wholesale markets and taking a proactive stance on sustainable finance issues.

- Following Lord Hill's UK Listing Review, we continue to lead wide-ranging reforms to improve the effectiveness of UK primary and secondary wholesale markets. By removing regulatory barriers, improving transparency and reducing complexity, we are incentivising markets to become more efficient, accessible, and attractive for issuers to invest; innovative firms to grow; and private companies to consider listing at an earlier stage, while maintaining high standards of market integrity.

    - During 2022, we led a discussion on what form of listing regime would serve the UK market best in future as part of the FCA's strategy to promote competition and positive change. We set out further, far-reaching consultation proposals in May 2023 designed to make UK-listed markets more accessible and attractive for commercial companies and give investors more choice. We will develop these proposals during 2023.

    - As part of our implementation of the Government's Prospectus Regime Review, we are exploring ways to reduce the costs associated with raising capital and to ensure a regime that is better tailored to the size and nature of issuers and the information needs of investors.

    - We consulted on rules to reduce compliance and operational costs on firms and improve trade execution and post-trade transparency for investors in secondary equity markets. We published the Policy Statement in May 2023.

- We consulted, and published the Policy Statement and final guidance in July 2023, on the trading venue perimeter to ensure that firms have more certainty about the permissions they require and that the trading venue regime is applied consistently. This seeks to address common queries that firms have about regulatory permissions.

- We identified competition issues in our Trade Data Findings Report. We are also developing a consolidated tape framework that will help to improve the overall cost, quality and accessibility of wholesale data, making the market more accessible for smaller firms, and more attractive generally. We published our consultation proposals for a bond consolidated tape framework in July 2023, with the consultation also covering aspects of the future framework for an equity consolidated tape.

- We have launched the wholesale data market study to assess potential competition issues in benchmarks, credit rating data and market data vendors. This will help improve wholesale data markets and outcomes for data users and investors.

- To create an environment where investors can more easily and efficiently invest in long-term assets, we have launched the new Long Term Asset Fund (LTAF) regime and authorised its first funds. This new category of authorised funds is designed to invest in a wide-range of long-term illiquid assets, such as unlisted securities and interests in property and infrastructure. This will support economic growth and the transition to net zero. We consulted on bringing retail access to LTAF to a wider group of retail investors and pension schemes in August 2022, and published our policy statement in June 2023.

- Our February 2023 Discussion Paper sought feedback on how to reframe UK asset management regulation for the future. As part of this we are positioning the UK to be at the cutting edge of market developments by asking for comments on the regulatory barriers that could affect firms' ability to invest in tokenised financial instruments that may represent fractional interests in projects such as infrastructure projects.

- Building on our leadership in sustainable finance, our October 2022 consultation sought feedback on our proposals to improve transparency in sustainability disclosure requirements and investment labels. We gave an update on this in March 2023. Our February 2023 Discussion Paper sought views on sustainability-related governance, incentives and competence in regulated firms, in support of the Government's 'Roadmap to Sustainable Investing'.

- We have been actively shaping the Government's Transition Plan Taskforce (TPT), including work to road-test the draft Disclosure Framework. We also continue to promote a global baseline of sustainability-related reporting standards under the International Sustainability Standards Board (ISSB). We do this by closely collaborating with international regulators and the International Organization of Securities Commission (IOSCO), where we are Vice-Chair of their Sustainable Finance Task Force workstream. This will help to ensure firms can deliver for UK consumers while maintaining interoperability with international standards.

- We support the Government's proposal to bring environmental, social, and governance (ESG) ratings providers within our regulatory perimeter. Ahead of potential regulation of these providers, we announced the formation of an industry group in November

2022 to develop a voluntary Code of Conduct to support greater transparency and trust in the market for ESG data and ratings services.

- Working with the Government we completed a joint review of the UK criminal market abuse regime. The review identified a number of areas of the criminal regime which it would be appropriate to update and strengthen. The Government will consider changes to the criminal regime when it considers changes to the Market Abuse Regulation.

Smart regulatory reform

We have worked closely with the Treasury to make considerable progress in preparing for, and progressing, the repeal of firm-facing requirements in retained EU law and their replacement with regulator rules. As I set out further below, enacting the repeal of retained EU law enables us to set rules and regulate in a way that is properly adapted to the needs of UK firms, markets, and consumers.

Promoting the international competitiveness of the UK

By focusing on outcomes, maintaining an agile and responsive regulatory approach, developing fresh ideas with stakeholders and committing to internationally respected approaches, we are supporting the international competitiveness of the UK as a global financial centre that is efficient, effective and embraces innovation. In addition to the measures above where strong economic growth will enhance the competitiveness of the UK economy, our current and recent work includes:

Implementing the outcomes of the Future Regulatory Framework (FRF) Review

In its December 2022 statement on 'Building a smarter financial services framework for the UK', the Government set out its approach to repealing and replacing the retained EU law on financial services. It also noted that it expects to make significant progress on the delivery of certain files by the end of 2023. We continue to work closely with the Treasury on this. On 9 December 2022 we published our approach to implementing the outcomes of the FRF Review. This covers the transfer of responsibility for certain firm-facing requirements from retained EU law to us, as well as other changes to our scrutiny and accountability framework, including our new secondary objective, the new cost benefit analysis panel, and a new rule review framework.

Our progress to date includes:

- Alongside the Government's consultation on repealing the PRIIPs Regulation, we published a Discussion Paper in December 2022 to design and develop new disclosure rules which meet the needs of the UK market and support investors to make informed investment decisions.

- We plan to consult on strengthening the requirements for safeguarding funds held by payments and e-money firms to meet customer entitlements in 2023, with final rules and Policy Statement in early 2024. We have been working with the Government on the preparation of the Illustrative Statutory Instrument which amends the Payment Services Regulations 2017 and the Electronic Money Regulations 2011 to ensure that we have sufficient powers to make our rules.

- We have been working with the Government and the Prudential Regulation Authority on the preparation of the Illustrative Statutory Instrument which will provide the legislative provisions to repeal the Securitisation Regulation. We have been developing our proposals to replace most firm-facing requirements in the Securitisation Regulation with our rules taking into account the reforms identified in the Government's 2021 Review of the Securitisation Regulation, and expect to consult on them shortly.

- We have been working with the Government on the preparation of the Illustrative Statutory Instrument which illustrates how the Designated Activities Regime will be used to create a new Prospectus and Public Offer Regime.

- We have been working with the Government and engaging with the market to consider what changes could be made to the UK short selling regime to better tailor it to the UK market in support of the Government's Short Selling Review: Call for Evidence, which was published in December 2022 and closed in March 2023.

On 23 March 2023, we hosted a webinar to set out our programme of work to implement the reforms, and enable stakeholder understanding of our approach. We also expect to keep stakeholders updated on our plans through our website and the Regulatory Initiatives Grid, most recently updated in February 2023. In producing the Regulatory Initiatives Grid, we work with our fellow regulators to assess the potential impact of the regulatory pipeline on stakeholders. This includes developing ways to reflect changes resulting from the repeal and replacement of retained EU law.

Encouraging trade, inward investment and attracting internationally active financial services firms and activity

We strengthen the international competitiveness of the UK by ensuring our markets are attractive to participate and invest in:

- We are committed to upholding high international standards and to maintaining open markets. We promote good regulatory practice globally and encourage regulatory cohesion to reduce frictions to international trade through our programme of engagement with international regulators, such as IOSCO, the Financial Stability Board, the OECD and the IMF.

- To support the Government's trade strategy, we have worked closely with the Treasury to help deliver robust financial services chapters for the UK-Australia, UK-New Zealand and CPTPP free trade agreements (FTAs). FTAs with countries including India, Canada, Mexico and the Gulf Cooperation Council are progressing and all hold potential to lock in or improve on existing trading conditions for financial services providers. The trade agreements increase regulatory certainty, providing a more stable environment and additional incentives to invest.

- We have supported the development of deference arrangements including the Swiss Mutual Recognition Agreement, and the UK Overseas Funds Regime. We have also worked with overseas regulators to ensure firms can make use of existing decisions, where appropriate.

- We are considering ways to improve the effectiveness of the remuneration regime and jointly consulted with the Prudential Regulation Authority in December 2022 to remove limits on the ratio between fixed and variable compensation. We also consulted on proposed changes to the remuneration rules for dual-regulated firms in May 2023 to ensure the rules are proportionate to risks posed to consumers and markets in the UK.

- Our joint FCA/Bank of England Policy Statement published in February 2023 sets out new rules for trade repositories in relation to the derivatives reporting framework under the UK European Market Infrastructure Regulation (UK EMIR). This aims to enable authorities to better monitor for financial stability risk and to help firms coordinate responses to regulators.

Supporting innovation, new developments in financial markets and new technology

With the ambition of setting the gold standard for regulatory innovation globally, we have actively continued to encourage new developments in financial markets and technology:

- Since the launch of our innovation services in 2014, we have received 2,499 applications and supported over a third (over 870 firms through the Regulatory Sandbox and Innovation Pathways, including over 700 firms in Innovation Pathways) that met the eligibility criteria. Over £7bn total funding has been received by these firms: regulatory sandbox firms are 50% more likely to raise funding than their peers, and raise 15% more on average.

- Together with the Government and other regulators we have set out recommendations to realise the full potential of open banking and to develop it in a safe, scalable and economically sustainable way that broadens access to data, supports innovation and competition and drives new products and services in the market. We also continued engaging with the industry to explore the key considerations for supporting the development of open finance.

- We have launched a cutting-edge 'synthetic data' work programme to explore how technology can be used to share data in a way that is lawful. We and the Payment Systems Regulator jointly ran an Authorised Push Payment Fraud TechSprint, together with 120 industry participants, to prototype technology solutions to combat fraud and reduce risks in data-sharing, using synthetic data sets generated from 3 banks' real-world data.

- Jointly with the Bank of England we published a Discussion Paper on artificial intelligence (AI), supported by an empirical survey on the use of machine learning in UK financial services in October 2022. These provide a comprehensive perspective on the challenges associated with using AI and machine learning in UK, including the steps that need to be taken to best support its safe and responsible adoption.

- As part of our pro-competitive approach to digital markets, in October we published a Discussion Paper on Big Tech examining the potential competition benefits and harms that large technology providers can bring to financial services.

- We consulted on our proposed rules for cryptoasset financial promotions and expect in our final rules to hold crypto firms to the same standards as for other high-risk investments. This includes specific risk warnings and positive frictions (such as a 24-hour cooling off period) in consumer journeys.

- Through our leadership of the Global Financial Innovation Network, an international group of 80 financial regulators and related organisations, financial services firms have the opportunity to pilot innovative products across more than one jurisdiction, to help support financial innovation in the best interests of consumers.

- Together with Ofcom, the Competition Markets Authority and the Information Commissioner's Office we have formed the Digital Regulation Cooperation Forum (DRCF). Under this year's plan, we are co-leading on tackling illegal online financial promotions, leading a network to join up the use of regulatory technologies and supervisory technologies, leading the technology horizon scanning programme and co-leading on how regulators can enable innovation.

- Teams across the FCA have been working with the Government and the Bank of England on the secondary legislation to deliver the creation of a Financial Market Infrastructure (FMI) sandbox, supporting firms to use new technology (eg distributed ledger technology) in infrastructure services in financial markets.

- To deepen our engagement with the industry, in February we launched the Innovation Advisory Group to seek input from leading industry, academic, and consumer body representatives on our innovation agenda.

<u>Our other work to support firms wanting to conduct UK financial services business</u>

- Our expanded Early and High Growth Oversight approach has provided closer support for over 300 newly authorised businesses. We have helped new firms to transition effectively to operating as regulated entities, potentially enhancing their capital raising capacity, and supported new firms that are looking to scale up.

- Alongside this, we have continued to improve the service standards of authorisations while maintaining a robust gateway for firms and individuals to carry out regulated activities. Our updates on operating service metrics published in October 2022 and March 2023 indicate substantial improvement in service timelines with pending authorisations casework reduced by more than 60% since December 2021. They also set out our approach for future enhancement, including digitisation of application forms and systems improvements.

<u>Our external engagement on policy formulation with a focus on outcomes</u>

- We are engaging in new ways to work in partnership with the industry and other stakeholders in our policy formulation process, with a focus on outcomes and early testing of proposals. For example, we meet with the representatives from our statutory panels to seek their views before public consultation of our FRF proposals. In addition, we have established a cross-panel working group to meet 'on demand' to discuss proposals around the repeal and replacement of retained EU law, and the wider reform measures (such as competitiveness, and rule review). We carried out online consumer behaviour testing which informed our proposals for high-risk investments. We also collaborated with nearly 200 industry figures in our first policy sprint developing ideas on how to regulate cryptoassets.

We will continue to take account of the Government's economic policy and the recommendations set out in the remit letter and support the growth and competitiveness of the wider UK economy when considering how to exercise our general functions in future.

Yours sincerely,

Nikhil Rathi

Chief Executive