MHP Group

MHP Group: Financial Services

Edinburgh Reforms: summary and reaction

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The Edinburgh Reforms – in brief

Summary

On Friday 9th December, the Chancellor announced a package of reforms for the UK financial services industry. The regulatory changes are designed to make the UK the world's most innovative and competitive global financial centre and include over 30 regulatory reforms due to be passed by parliament by the end of 2023.

Dubbed "the Edinburgh Reforms", the measures aim to "seize the benefits of Brexit" by delivering what many are touting to be the biggest shake-up in the financial sector for 30 years. The reforms mark the next stage in what Rishi Sunak termed the UK's "Big Bang 2.0" which seeks to unlock investment opportunities, turbocharge growth and deliver a "smarter" and "home grown" framework for the UK.

The Chancellor highlighted the UK government's ambition to cultivate a financial services sector that is "open, sustainable and technologically advanced", and these are key themes that are threaded throughout the regulatory proposals.

Opening up financial frameworks

- Building on the Future Regulatory Framework (FRF) Review and subsequent Financial Services and Markets (FSM) Bill, Hunt outlined plans to make substantive legislative progress over the next 12 months on repealing and replacing EU-era legislation – including Solvency II. The new framework will be "tailored to the UK" and seize on "post-Brexit freedoms".
- One such freedom is the removal of the cap on bankers' bonuses, and an updating of the "ring fencing" regime to benefit customers, the financial services industry and the economy. The current rules – intended to separate risky investment banking from retail operations – will be relaxed in a boost for retail-focussed and challenger banks. Likewise a regime that "terrified" senior bankers by holding them responsible for errors that happened on their watch – the senior managers regime – will be reviewed. Any changes will be preceded by a public Call for Evidence in the first few months of 2023.
- Other proposed alterations include moving forward wholesale reform of the Consumer Credit Act (CCA); reviewing Mifid II to enable greater investor attention; removing rules for the capital deduction of certain non-performing exposures (NPEs) held by banks; launching a Call for Evidence on reforming Short Selling Regulation; giving UK building societies greater flexibility to raise wholesale funds; repealing the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation; increasing the pace of consolidation in DC pension schemes; consulting on reform to the VAT treatment of fund management; and more.

Bolstering sustainable finance solutions

- The Chancellor set out the government's intention to build the premier financial centre for sustainable finance and make the UK the best place in the world for responsible and sustainable investment.
- Recognising that the sector plays a major role in the delivery of the UK's 2050 net zero target, the government has confirmed its plan to release an updated Green Finance Strategy in early 2023. In addition, Hunt announced that a consultation will open in Q1 2023 to bring ESG ratings providers into the regulatory perimeter.
- HM Treasury will also join the industry-led ESG Data and Ratings Code of Conduct Working Group, recently convened by the FCA, as an observer. These services are increasingly a component of investment decisions, and the government wants to ensure improved transparency and good market conduct.

Enabling financial services innovation

- At the same time, Hunt set out the government's intention to ensure that this renewed regulatory framework will boost innovation and the adoption of cutting-edge technologies.
- The government will promote leadership in emerging areas of finance, building on the FSM Bill, which seeks to establish a "safe" regulatory environment for cryptoassets and stablecoins. This will bring a broader range of investment-related cryptoasset activities into the regulatory perimeter and also see

the conclusion of the consultation on expanding the Investment Manager Exemption to include cryptoassets – a consultation which closed in July.

- The publication of a consultation exploring the case for a UK central bank digital currency (CBDC) alongside the Bank of England will be published "in the coming weeks", alongside its potential design. In addition to this, a new class of wholesale market venue operating on an intermittent trading basis will be established.
- To foster greater innovation, and as referenced in the FSM Bill, the government will also establish a Financial Market Infrastructure Sandbox in 2023 to enable firms to test new technology and innovations.

Reaction

Generally, industry figures welcomed the reforms and recognised the need for the UK to enhance its status as a competitive financial services hub. However, others have raised concerns that the UK was at risk of forgetting the lessons of the global financial crisis by doing away with regulation which underpins the stability of the sector.

In an interview with the Financial Times on Friday, the Chancellor said the package was "considered and balanced" and acknowledged that "we have to make sure that we don't unlearn the lessons of 2008. But at the same time, recognise that banks today have much stronger balance sheets, [and] we have a much more developed resolution system if things do go wrong."

How did the industry respond to the announcement?

- In favour of Hunt's announcement, **UK Finance chief executive, David Postings**, said: "The comprehensive package of reforms the Chancellor has announced today, coupled with the landmark Financial Services and Markets Bill, form a major step in ensuring the sector remains strong and internationally competitive."
- Likewise, **Dr Kay Swinbourne, vice chair of KPMG UK financial services** welcomed the proposals by saying: "The UK's laws and regulations are, in large part, what makes the UK an attractive place to do business, so the reforms are a step closer to making regulation more efficient rather than a race to the bottom. The proposed data-led reviews are a welcome way of ensuring any changes going forward are both necessary and meaningful."
- Commenting on Hunt's measures aimed at fostering innovation in the financial services sector, **Janine Hirt, CEO of Innovate Finance,** said: "These reforms continue to maintain UK competitiveness as a leading global center for innovation in financial services. They should further enhance the UK as a positive investment environment with increasing growth capital for FinTechs, as a leading center for digital assets, and as a regulatory regime that supports innovation."
- Less in favour, **Bank of England Governor Andrew Bailey** poured cold water on the government's ambitious plans, saying he "would…caution that the notion we're past the financial crisis, and we therefore don't need the regulations that we had post the financial crisis, I would not go along with that view."
- **Ex-MPC economist Sir John Vickers** – who led a government review of the banking industry after the 2008 crash – also disagreed with the reforms, arguing that last week's proposals were potentially an "extremely dangerous and wrong path". Vickers told The Guardian that the ring-fencing regime, first proposed by George Osborne in 2011 and implemented in 2019, is the "bedrock of how we regulate banks in the UK" and that Hunt must ensure his changes to the regulation aren't too radical.
- And in a similar vein, **Tulip Siddiq, the shadow City Minister,** called the proposed reforms a "race to the bottom" and added: "Introducing more risk and potentially more financial instability because you can't control your backbenchers is this Tory government all over. Reforms such as Ring Fencing and the Senior Managers Regime were introduced for good reason. The City doesn't want weak consolation prizes for being sold down the river in the Tories' Brexit deal, nor more empty promises on deregulation."

Conclusion

The reforms can be described as an ambitious recalibration of the UK's financial services regulatory regime, prioritising competitiveness and growth. By casting aside a number of unfavoured EU directives, the UK government is hoping to finally unlock a new chapter for the sector.

However, with several of the measures announced as proposed consultations, it remains to be seen what form they take over the coming months once parliamentarians, regulators and the industry have had their say.