FINANCIAL SERVICES GROWTH & COMPETITIVENESS CALL FOR EVIDENCE: FLA RESPONSE

INTRODUCTION

1. The Finance & Leasing Association (FLA) is the leading trade body for the UK business finance (leasing and hire purchase), consumer credit and motor finance sectors. In 2023, members of the Finance & Leasing Association (FLA) provided £151.2 billion of new finance to UK businesses and households, £52.4 billion of which helped consumers and businesses buy new and used cars, including 78% of private new car registrations. £112.5 billion was in the form of consumer credit, accounting for almost a third of all new consumer credit written in the UK. £38.7 billion of finance was provided to businesses and the public sector to support investment in new equipment, representing almost a third of UK investment in machinery.

2. We have only responded to the most relevant questions.

OVERVIEW

3. The most critical condition for growth across FLA member markets is regulatory certainty, which in turn will make the sector attractive to external investment. The open consultation on modernising the redress system is important. Completing reform of the Consumer Credit Act during this Parliament would be a further step in right direction. Beyond these, it is essential regulators create the right environment for lenders to support green household and business investment and to facilitate innovation.

QUESTIONS

Chapter 3 – Objectives and Approach
Objectives and Approach:

Question 3.1: Do you agree with the proposed objectives set out in paragraph 3.6?

4. We welcome the importance placed by the Government on achieving growth generated by financial services. We agree that the right objectives have been identified. Of particular importance is the need to attract international investment into unsecured lending markets.

Growth and Competitiveness:

Question 3.2: [For Financial Services Organisations] For firms operating in more than one jurisdiction, what are the main drivers affecting your decisions on where to invest?

5. The local regulatory environment (to determine long-term planning) is the most critical aspect. Other determining factors include political stability, the risk of redress/class actions and ultimately financial returns on investment.

Future of Financial Services:

Question 3.3: What do you consider to be the most important trends or changes likely to affect the financial services industry over the next 10 years?

6. Two changes stand out: technological and green finance. The regulatory framework must be flexible enough to adapt to this. It is therefore essential that the Government completes reform of the 50-year-old Consumer Credit Act (CCA) during this Parliament. See below for further detail.

7. In addition, how regulatory policy evolves over the next 10 years will also affect the financial services industry and its investability – either positively or negatively.

Question 4.1: Do you agree with the list of policy pillars that the Government intends to focus on? Are there other areas that should be included?

Question 4.2: Please rank the list of pillars in order of importance to your business or organisation for i) day-to-day operations and ii) longer-term plans for investing in the UK:
1. Innovation & Technology
2. Regulatory Environment
3. Regional Growth
4. Skills & Access to Talent
5. International Partnerships & Trade

8. The policy pillars outlined make sense. The regulatory environment is the most critical on both counts. Given its changing nature, Innovation and technology are also important.

Question 4.3: How well is competition currently working in the financial services sector, and how can it be improved?

9. Competition could be improved across FLA member markets by designing a more flexible and less prescriptive CCA. A more collaborative and open regulatory regime, where the regulator is also more willing to give guidance, will support a more level playing field and more confident investment. This will encourage innovation and new market entrants.

10. The FLA is working with the FCA's Interim Working Group to create a new Credit Reporting Governance Body as part of the Credit Information Market Study. This project provides the opportunity to help improve competition and data sharing within the credit information sector by introducing mandatory data sharing based on simpler and more standardised reporting formats that drive greater transparency.

11. To increase access to finance to SMEs, the Commercial Credit Data Sharing mandated by the Government requires reform: since its establishment new banks have entered the market and the need for increased data sharing has become evident, as it helps for better decision-making by lenders: the more information they have the better the outcome. We recommend that the new banks who have entered the market are included; that way, data collected is standardised and lenders are encouraged to share data beyond the current cap.

Question 4.4: What is your assessment of how effectively the UK supports innovation and the adoption of new technology? What could be improved in the financial services sector?

Question 4.5: Which technologies do you think have the most potential to transform financial services over the next 10 years? And in which financial services sectors or functions do you see these being applied most effectively?

12. Over the next decade, technologies like Artificial intelligence (AI), Blockchain, and Quantum Computing are likely to transform financial services. In particular, AI in the form of machine learning and 'Natural Language Processing' (NLP) is likely to be used enhance areas such as fraud detection, customer service, and personalised financial advice.

13. In terms of Blockchain, this has the potential to revolutionise payments, trade finance, and compliance through its ability to enable secure, transparent, and fixed transactions – this is likely to reduce costs and settlement times for certain payments. Similarly, blockchain-based 'smart contracts' could transform lending and other areas like insurance by automating processes and ensuring greater transparency.

14. The onset of 'Quantum Computing' appears to still be in its infancy, but this technology could redefine risk management and financial modelling platforms through greater processing powers. This could help firms to optimise portfolios and to perform high-speed modelling practices, although this is likely to be more prevalent in the investment banking / asset management sector.

15. A combination of these technologies could also be seen in banking (for personalised services), payments (to enhance efficiency), and compliance (for more robust processes). However, full-scale adoption of these innovations may be dependent on the regulatory constraints that are linked to innovation.

Question 4.6: What is your assessment of the UK's current regulatory environment?

16. The regulatory regime for consumer credit is disjointed with the requirements of the CCA, the Consumer Credit Sourcebook (CONC) and the Consumer Duty pulling in different directions. Lenders would like a single consistent set of rules where there is no ambiguity. Chief amongst the problems is the quasi-regulatory role of the Financial Ombudsman Service (FOS) which adjudicates on the basis of what is “fair and reasonable” rather than what is set out in rules and guidance. This leads to unpredictability and deters international investment in the sector. The recent motor finance commissions Court of Appeal judgment illustrates the dangers that arise where these requirements are inconsistent and/or unclear. It is also worth noting that the UK is an outlier within the OECD in having to grapple with common and statute law provisions that diverge from one another.

17. We are working closely with HM Treasury officials to reform the CCA. Examples of problems include:

    a. CCA Sections 56 and 75 which create legal risk or lender liability when things go wrong and may be amplified by financing unproven technologies or partner suppliers going out of business. Past mis-selling of solar panels, which gave rise to FOS claims, has also made lenders averse to participating in this market.
    b. The unfair relationships provisions (Section 140A), which create inconsistency in that the courts may intervene and apply a different standard to that in FCA rules. These provisions have notably been used by claims management companies (CMCs) to rule against conduct that had been permitted by FCA rules
    c. The current sanctions regime which creates complexity, customer confusion, stifles innovation, creates poor customer journeys and a disproportionate administrative burden and cost for the industry (particularly for the financial resilience of smaller firms) and courts. It prioritises tick box compliance over good customer outcomes often resulting in poor customer journeys.

Question 4.7: How can regulation support responsible and informed risk-taking?

18. If the Government’s growth mission is to be achieved then a modern, future-proofed CCA must be completed during this Parliament. If this is achieved in the right way, then it will facilitate innovation, new market entrants and the widening of consumer protections, for example to Islamic Finance. CCA reform will also support innovative new approaches to designing and communicating products and services, as well as how firms offer forbearance. This will provide a firm foundation for improving access to credit and financial inclusion, a key element of the Government’s proposed National Financial Inclusion Strategy.

19. Regulation for consumer credit markets must be aligned with other financial services products under the Financial Services and Markets Act 2000 via CONC. Firms are adapting to the outcomes-based approach under the new Consumer Duty but would welcome best practice guidance from the FCA.

20. We welcome the FCA/FOS Call for Input on Modernising the Redress System, which will be a key part to resetting the dial towards a more predictable environment for lenders and investors. A more collaborative and open regulatory regime, where the regulator is also more willing to give guidance, will support a more level playing field and more confident investment.

21. We also welcomed the PRA's decision to adopt a proportionate approach to Basel 3.1 to avoid adversely hitting SME lending.

Question 4.9: How can we capitalise on synergies between different regional financial services hubs to support growth?

22. The key to increase growth is to ensure that smaller businesses can access information about finance and other issues. This will enable them to find the right finance that they seek. We have long recommended the creation of government-backed information hub, potentially funded by the private sector. This would ensure its objectivity.

Question 5.2: Which of the following business areas and activities do you see:
a) For financial services firms: As high growth opportunities for your firm?

23. The consumer credit sector has seen a decline in investability in recent years, driven by regulatory factors. There are therefore significant growth opportunities to be realised from reversing this. Responsible and sustainable consumer credit fulfils a critical social function across society by enabling people to access the goods and services they need in order to play an active role in society and the economy. This is increasingly critical in the non-prime segments, where risk appetite has been negatively affected by regulatory policies.

24. One notable opportunity is to develop a UK ecosystem of Sharia-compliant financial services and products that operate on a level playing field with other products and services. This is important not only for the UK's almost four million Muslims, who are current under-served and under-protected by the CCA, but also for other consumers who, as recognised by the Consumer Duty, pursue their financial objectives in new and different ways.

Fintech

Question 5.3: What do you see as the most important ingredients for a thriving UK fintech sector in coming 10 years?

25. To ensure a thriving UK fintech sector, firms require regulatory support and clarity on what can be achieved from a practical perspective. It is clear that the UK is keen to maintain its position as a global leader in regulatory innovation as demonstrated via the FCA's regulatory Sandbox initiatives, which help to promote a safe environment for agile approaches to emerging technologies.

26. In addition, technology requires an appropriate level of investment in digital infrastructure (such as high-speed connectivity and new systems), both from firms using this technology and from the Government to help enable digital transformation.

27. Separately, access to skilled talent will also be critical component of a thriving UK fintech sector in the longer term.

Question 5.4: Which are the critical factors for success that are specific to the fintech sector to enable innovative businesses to succeed?

28. To help drive success in the UK's fintech sector, a robust ecosystem for collaboration is essential. By this, we mean fruitful partnerships between fintech firms, traditional financial institutions, and technology providers to help leverage strengths and to create new and innovative solutions.

29. Linked to the above, fintech firms are likely to be interested in scaling their initiatives in a way that can help them to enter more mainstream markets. To support this, fintech firms may require access to funding at all stages of their growth cycle, along with support for navigating regulatory hurdles as they expand into new markets.

30. In line with the FCA's Consumer Duty rules, consumer trust is a key determinant of success for this sector. Fintech firms will likely need to prioritise data protection, cybersecurity, and transparent communication to help build and maintain trust with their customers.

31. From an ongoing compliance perspective, firms will also need to adapt to changing regulatory developments. This means that they will need to balance flexibility with being innovative. This balance could define the fintech sector's long-term resilience and growth.

Question 5.7: What are the opportunities and barriers for the financial services sector in developing the products and/or services necessary to facilitate investment into the net zero transition?

For each opportunity, please provide an indication of the type of intervention required, for example developing guidance, or supporting the development of further capabilities.

32. As outlined in paragraph 16, the CCA presents a barrier to green lending. A more measured approach to the application of the deleterious provisions would be beneficial.

33. Increasing accessibility of private financing solutions will be critical for expanding the reach of retrofit. Property-linked finance, inspired by the US PACE model, has been advocated by the Green Finance Institute. This model links the cost of energy improvements to the property rather the individual. Other jurisdictions offer innovate solutions too. The FLA has put forward to the Department for Energy Security and Net Zero a Green Interest Relief at Source (GIRAS) scheme, based

on the 1980s Mortgage Interest Relief at Source (MIRAS), which gave tax relief by way of interest reclaimed on mortgages and, for a period, was extended to home improvement loans.

34. For middle and lower income households, the reality is that from 2030 there will an insufficient supply of electric vehicles (EVs). The zero emission vehicle (ZEV) mandate has resulted in European manufacturers building fewer petrol and diesel vehicles so they do not fall foul outside permitted ratios of these vehicles with EVs. The total car parc is falling. This means that fewer cars will come onto the second-hand market and fewer of these will be EVs.

35. The UK EV market has been propped up by salary sacrifice schemes for business fleets to the benefit of better off consumers. The used EV market has not taken off in part because residual values have been unpredictable in contrast to petrol and diesel vehicles where historical data is plentiful. Price parity is closer than ever before but the lack of demand for EVs is a major concern. In our recent Budget submission, we called for the tax relief to be cut to 20% but it expanded to used EVs. We do hope the Chancellor will consider this as it has the potential to generate demand for used EVs.

36. The British Business Bank's support schemes enable FLA members to provide finance to businesses who wish to acquire green or greener assets. We have welcomed the Government's recently announced additional resources for the Bank as it is critical it is adequately funded so that it can continue to deliver in this way. The Bank must be able to provide flexible solutions, which is why we have recommended a green finance guarantee, variant on the Growth Guarantee Scheme or inbuilt flexibility to the scheme itself.

10 December 2024