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Funding our future

Enabling financial services to deliver prosperity across the UK

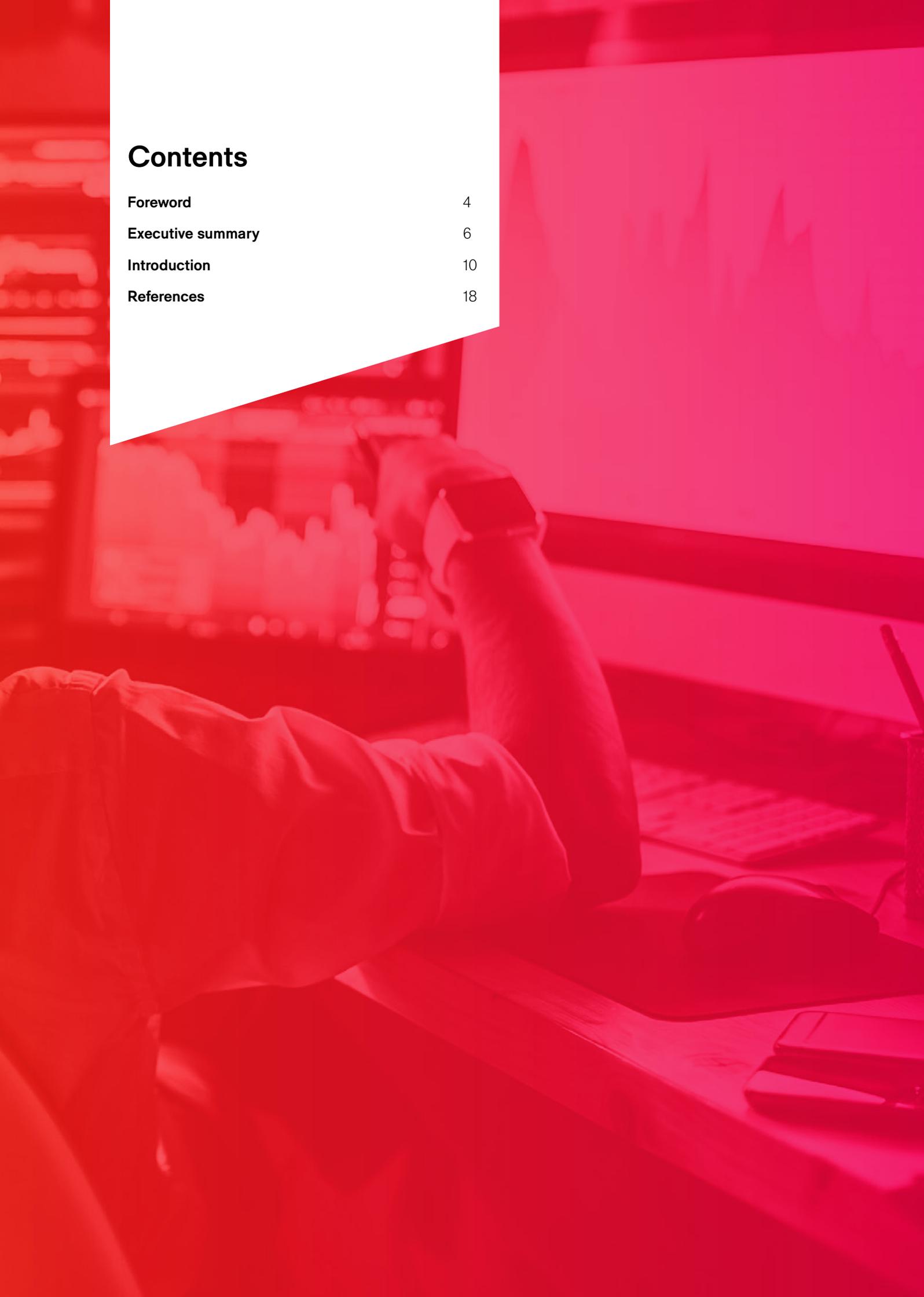
March 2020

Tax and Regulation



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Foreword

Financial services matter, both for the whole economy and in their own right. From helping risks to be managed, wages to be paid, and payments to be made, financial services is an essential enabling industry.

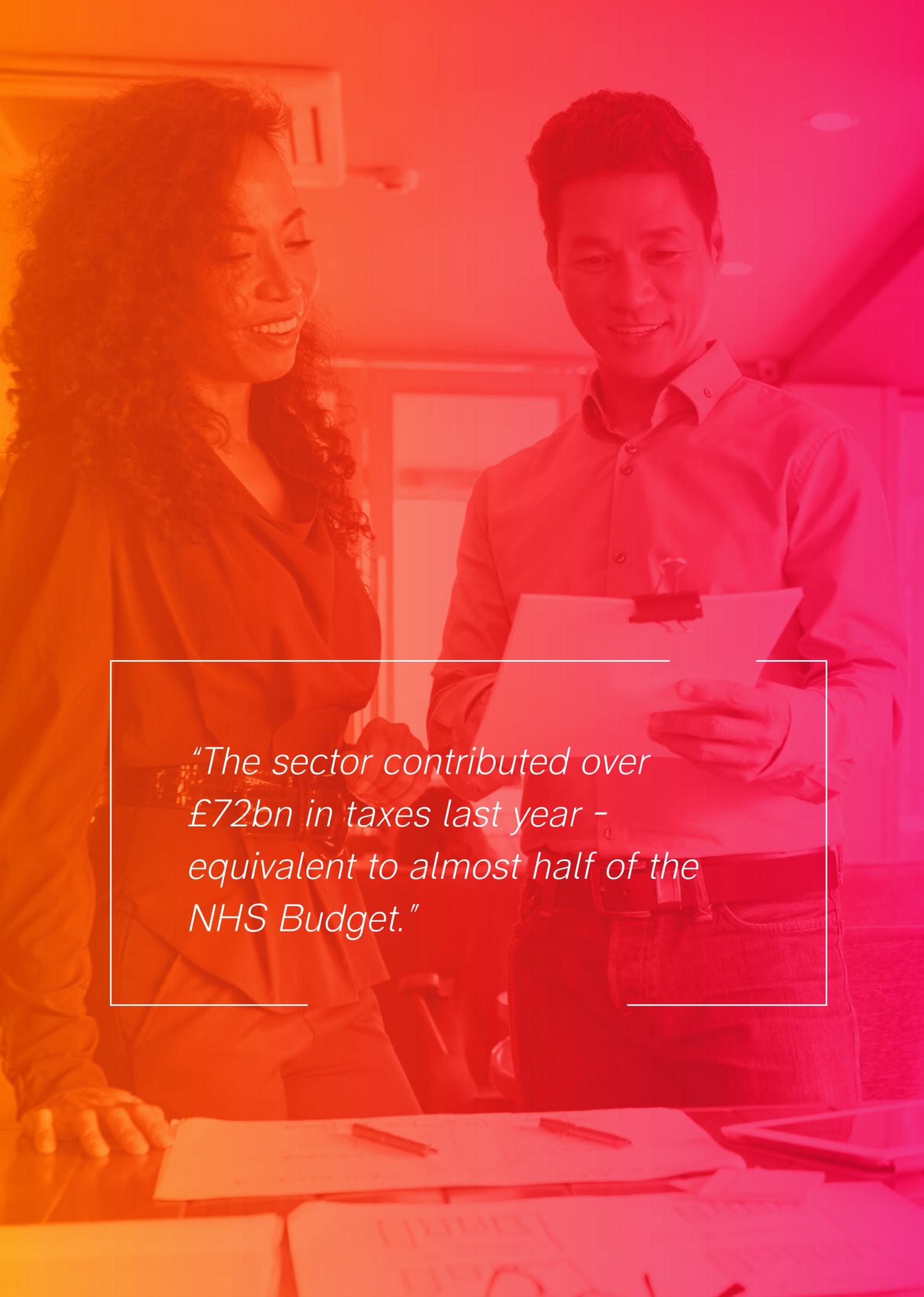
The products and services provided by this critical sector keep the economy moving, driving prosperity and boosting productivity. Along with providing 1.1 million high-skilled, productive jobs across the regions, the sector contributed over £75bn in taxes last year - equivalent to almost half of the NHS Budget. Yet the UK's vibrant world-leading sector faces a host of challenges. It is vital that the UK retains its long-term attractiveness as a place to do business and preserving the competitiveness of financial services is key to the UK's global competitiveness.

While Brexit dominates the headlines, the research for this report has revealed a complex picture of a sector grappling with rapid technological change alongside new risks, new entrants and customer demands. If the UK is to remain a globally competitive centre, it needs an agile and robust tax and regulatory regime that continues to be match fit to deal with these challenges. The CBI hopes this report makes a valuable contribution to current debates about what the future of UK financial services should look like, realising its potential as a tool for future economic ambitions in all regions and devolved nations. By putting customers first, engaging actively on the global stage and embracing innovation the UK can seize the opportunities presented by getting our financial services strategy right.



Rain Newton-Smith
Chief Economist, CBI





*"The sector contributed over
£72bn in taxes last year -
equivalent to almost half of the
NHS Budget."*

Executive summary

Financial services provide a vital platform for growth across the whole economy. Whether it is the products and services provided, or its contribution in terms of jobs, tax revenues and innovation, the financial services sector matters to the health and prosperity of the UK economy. By seizing the opportunities presented by technology as well as getting the UK's financial services strategy right, the sector will be better placed to support future growth.

The UK economy continues to suffer from sluggish productivity growth. This matters because productivity is the foundation of wages, living standards, and prosperity. For the UK to have more sustainable growth, better standards of living and greater global competitiveness, it needs improved productivity growth. More productive UK businesses can pay their staff more, grow faster and invest more effectively, driving the whole economy forward.

Businesses right across the economy rely on enabling industries that allow products, services, people, information and capital to move around. Improving the productivity of such enabling industries will therefore drive growth across the whole economy.

Financial services matters, both for the whole economy and in its own right

Financial services is a pivotal enabling industry. Through its products and services, the sector supports economic growth right across the UK, from enabling businesses to finance growth and manage their risks, to paying their staff and suppliers. With over 1.1 million people working directly in the sector across every region and nation of the UK,¹ financial services contributed over £75.5 billion in taxes last year – 10.5% of total UK Government tax receipts.² This is equivalent to almost half the planned NHS Budget across the whole UK.

The UK is a world-leader in financial services, a sector which is transforming rapidly as it adopts new technologies to serve its customers better. It is an industry we all have a stake in through the products and services we use in our daily life. For example, the UK's insurance and pension sector provides pensions to 21 million people and insures the contents of 20 million homes across the UK.³





A changing environment, driven by technology, requires a tax and regulation regime that can keep pace

In completing this report, the CBI engaged with over 80 financial services members of every size across every region and nation of the UK, as well as leading sector associations. It has also discussed with non-financial services members their experience as customers of financial services. A complex picture has emerged of a sector grappling with technological change, shifting regulatory expectations and tax policy, as well as emerging risks, particularly around cybersecurity. This vibrant sector has made significant strides to rebuild trust with customers, whilst innovating to deal with evolving customer needs and expectations of financial products and services.

The UK government and regulators have been working actively with financial services firms to tackle developments such as the increasing importance of FinTech, developing a regulatory sandbox and new global relationships. Members have welcomed these initiatives and the active collaboration with government and regulators associated with them, and were clear that they want to see more. At the same time, they were clear on what isn't working. In some cases, regulatory requirements make it harder for them to invest in growth firms or critical infrastructure. Regulation is critical to protecting customers of financial services against financial crises, but members are clear that what is required is smarter, fit-for-purpose regulation. As financial services continue to change, with new entrants offering new services, more needs to be done to help the sector deal with changing regulatory and taxation requirements.

An uncertain tax environment and lack of outcomes-orientated regulatory policy, against a backdrop of technological change and weak productivity, could ultimately impact on customers.

With technology rapidly transforming the financial services sector, the UK needs an agile and robust regulatory and taxation regime to deal with new challenges, risks and customer demands to enable financial services to support UK growth

The CBI believes that keeping the UK competitive and at the forefront of global financial services requires:

A change in approach to put customers first

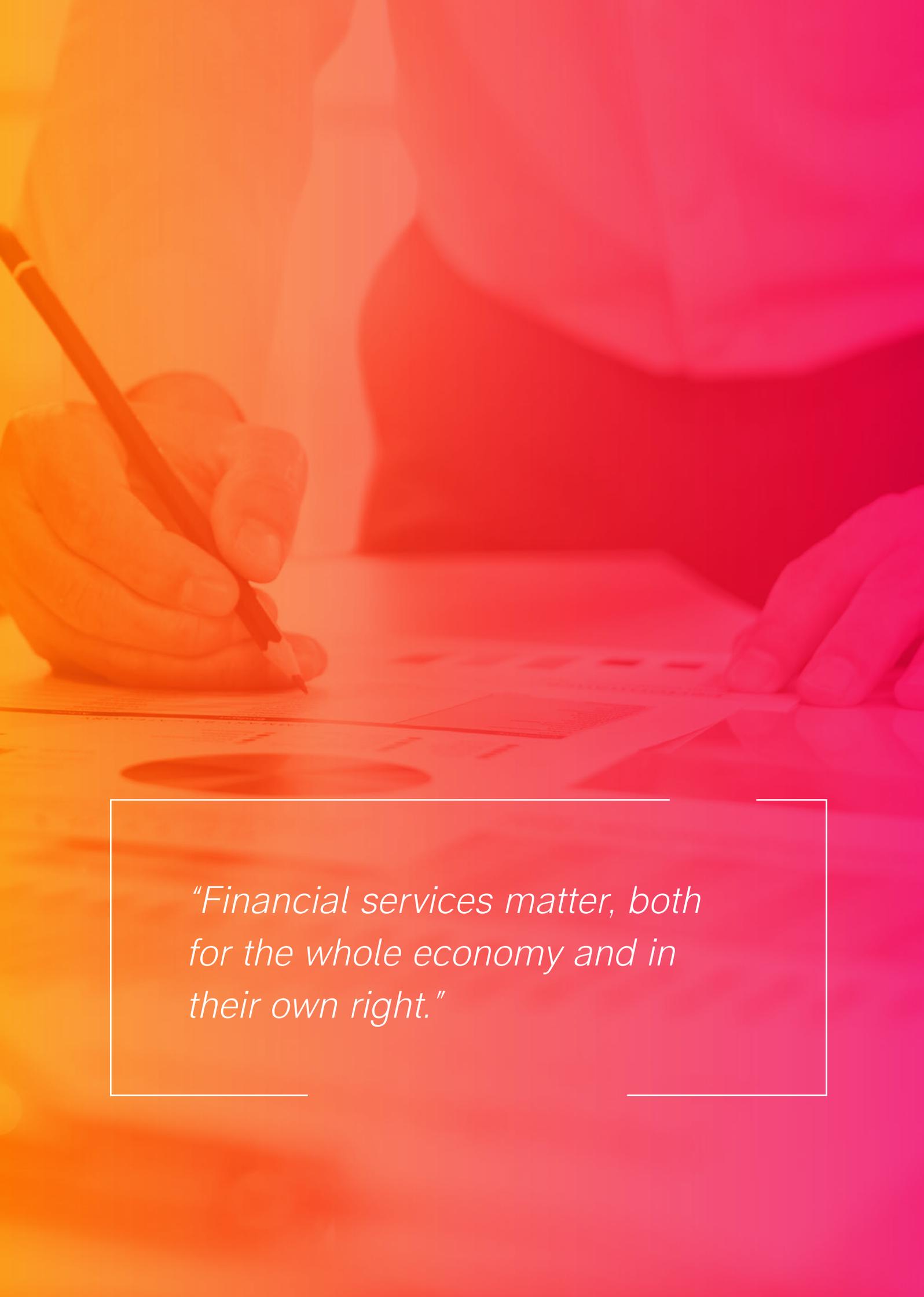
1. Change impact assessments to put more emphasis on the customer experience.
2. Set up a new collaborative framework with industry and publish a financial services engagement strategy to ensure the impact of regulation and taxation on customers is considered alongside changing technology.
3. Set up fresh mechanisms to provide effective scrutiny on the impact of regulation and taxation policies as the UK prepares to leave the EU; this could include a new Treasury Select Committee financial services sub-committee.

Government and regulators to work better with the global financial services industry to avoid unintended consequences of regulation

4. Remain committed to a leading role to keep the UK at the centre of financial services regulatory and taxation policy at the global level.
5. Continue engagement in international dialogues to ensure UK financial services firms can embrace global challenges.
6. Ensure government, regulators and financial services actively promote international regulatory cooperation to reduce regulatory inconsistency and associated inefficiencies.

An acceleration of efforts to ensure the regulatory environment supports rather than stifles innovation

7. Maintain a supportive environment that promotes innovation, the adoption of digital technology, and collaboration across the sector.
8. Create a cross-sector financial services hub to encourage regional adoption of new technologies.
9. Regulators to adopt digital innovations to help regulatory implementation and compliance, and keep pace with digitisation across the financial services industry.



*"Financial services matter, both
for the whole economy and in
their own right."*

Introduction

Financial services are an important enabler of the UK's future ambitions to become a competitive, world-leading economy. When the sector is firing on all cylinders, everyone stands to benefit.

But ten years on from the global financial crisis, despite much progress, the financial services sector continues to face several important challenges. From dealing with rapid technological developments to evolving regulatory expectations and tax policy, the sector is working hard to meet changing customer needs and expectations. The poor productivity performance of financial services since the crisis, with productivity shrinking by 2.1% a year since 2008,⁴ has been a significant contributor to the slowdown in UK productivity growth.

The sector also plays an increasingly important role in shaping public policy to deal with the economic challenges of the future, such as demographic changes and addressing the savings gap, while making a real impact on everyday life in terms of helping businesses grow and expand and supporting job creation right across the economy.

This report sets out the contribution the sector makes, some of the challenges the sector faces, and the key steps to enable financial services to support UK growth and promote world-class financial services that will deliver great customer outcomes.

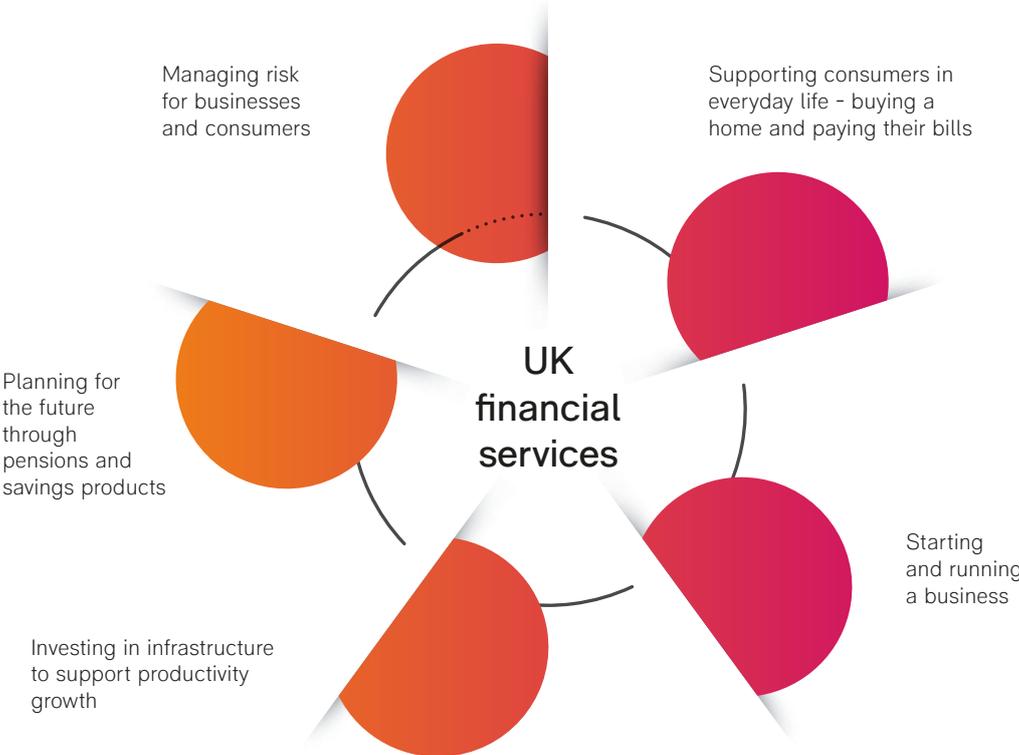
Spotlight: Introduction to the UK's regulatory and taxation regime

The UK's regulatory regime refers to the regulators responsible for supervising financial services firms and overseeing financial markets, as well as the body of regulations that apply to firms. In this report, the CBI considers the regulatory regime alongside taxation, HM Treasury's policy approach to the financial services sector and the activities of HM Revenue and Customs (HMRC), to provide an all-encompassing perspective on how the UK's regulatory regime and regulators' supervisory functions should interact with tax policies. This is also driven by the prevailing tax and regulatory policy culture, which refers to the ideas, customs and behaviours adopted by government, tax authorities, politicians and the financial services firms themselves.

Following the crisis, the UK's regulatory regime has been underpinned by the 'twin peaks' approach, with the Financial Conduct Authority (FCA) regulating conduct (the behaviour of those involved in the market) and the Prudential Regulation Authority (PRA) responsible for the prudential regulation of deposit-takers such as banks and credit unions, as well as insurers and major investment firms, ensuring firms hold sufficient capital and control risks so that firms and therefore the system as a whole can withstand shocks. As the regulatory landscape has evolved ten years on from the crisis, the regime now reflects more of a series of summits with the Payment Systems Regulator (PSR), the Competition and Markets Authority (CMA), Financial Ombudsman Service (FOS) and Information Commissioners Officer (ICO) all having a major role.

UK financial services supports the whole economy

Figure 1 The economic role of UK financial services





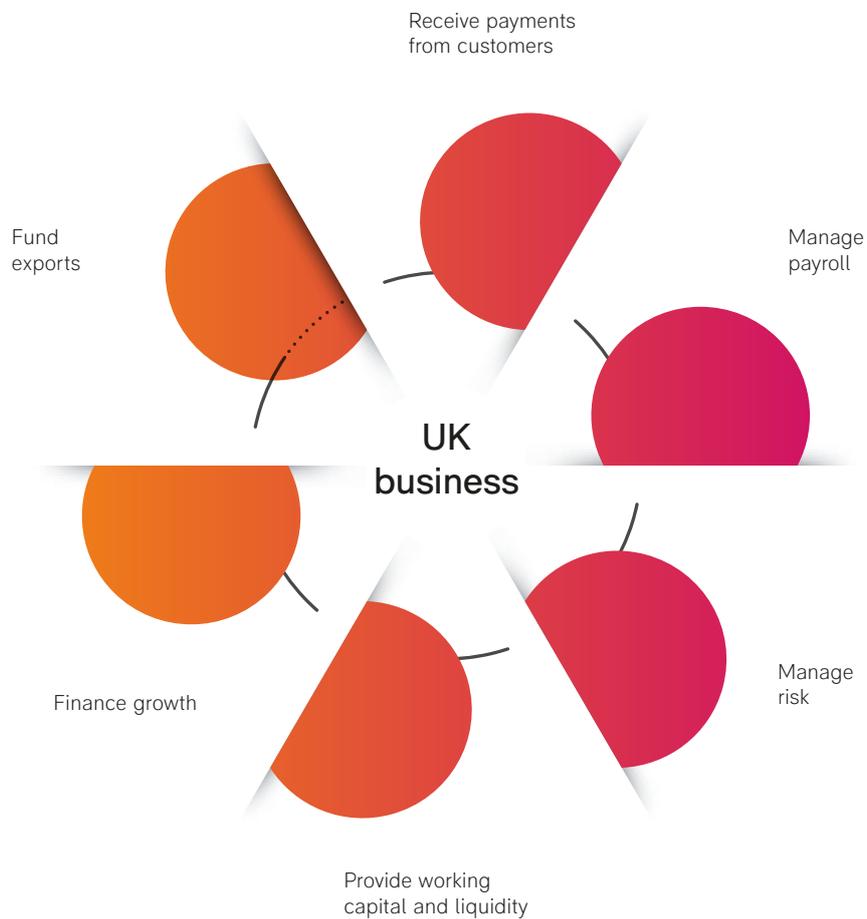
Financial services are the lifeblood of a healthy economy, supporting all other sectors to develop, innovate and grow. Building societies, banks, insurers, pension providers, payment firms, and asset managers provide a wide range of products and services that support UK businesses and households. By offering firms and investors access to deep and liquid global capital markets, the UK financial services sector's position at the heart of the global financial system enables the whole UK economy, from manufacturing to the creative industries, to compete globally.⁵

- **An essential partner for business** – The sector helps businesses grow, manage risk and ensure suppliers and wages are paid. UK banks alone lent an average of £14.4 billion to UK businesses each quarter in 2018.⁶ Over 1,603 equity finance deals with an investment value of £6.7 billion also helped smaller businesses grow in 2018.⁷ Trade credit insurers covered £314 billion of turnover, giving business the confidence they need to export and expand overseas.⁸ The sector processed 4.4 billion business payments in 2018.⁹
- **Globally-competitive consumer products and services** – The sector helps individuals buy a home, save for the future, buy goods and services, and insure their belongings.¹⁰ For example, the UK's insurance and pension sector provides pensions to 21 million people and insures the contents of 20 million homes across the UK.¹¹
- **High-quality jobs** – Financial services are an important UK employer. With over 1.1 million people working directly in the sector across every region and nation of the UK, financial services account for 3.2% of all jobs in the UK.¹² According to the latest ONS figures, there are a hundred parliamentary constituencies across England, Wales and Scotland with at least 2,000 jobs in the financial services sector.
- **Tax** – Financial services contributed an estimated £75.5 billion in taxes last year – 10.5% of total UK Government tax receipts.¹³ This is equivalent to almost half the planned NHS Budget across the whole UK.
- **Generating business demand for other goods and services** – Financial services spend £138 billion annually purchasing goods and services from other suppliers, accounting for 7% of overall demand for other sectors' goods and services. For example, the financial sector is the largest buyer of tech services in the UK (computer programming, telecommunications and information services).¹⁴

The financial services sector underpins prosperity and therefore how it functions matters to the whole economy.

Financial services enabling business growth

Figure 2 A UK business and financial services



A typical UK business will work with the sector in several ways. They will use financial services to receive payments from customers, pay suppliers, manage their payroll and employees' pensions, manage their risks, and fund growth and exports.



The challenge: an uncertain tax environment and lack of outcomes-orientated regulatory policy, against a backdrop of technological change and weak productivity, impacting customers

Technological change

Technology is rapidly transforming financial services, bringing challenges as well as opportunities. The way customers pay for goods, manage their money and interact with their bank, insurers, and pension funds is evolving. For example, in 2017 more people paid for goods and services in the UK via debit cards than cash for the first time, with contactless payments increasing significantly.¹⁵ At the same time, expectations in terms of quality, standards and products in a digital economy have been set by the FinTech revolution sweeping across the sector. Businesses and consumers increasingly want to access and manage their finances on their terms, with clear and simple terms and products with user friendly interfaces: 63.1% of consumers across the world have started using FinTech products and services.¹⁶ The FinTech sector has also received increasing support from governments, regulators and investors:¹⁷ since 2014, FinTechs have seen close to \$1.5 billion in investments into banking, insurance and asset management each year.¹⁸

Tax and regulation

While dealing with new technologies, new ways of working and new entrants to the market, the financial services sector is also continuously working with regulators, government and HMRC to implement new regulation and deal with changing tax requirements. Although many of these reforms are needed, these have also raised concerns that small- and medium-sized financial services providers have been disproportionately impacted, resulting in increased costs to users, reduced product choice and poor customer experiences.

Key to addressing this challenge is smarter regulation. This refers to regulation that is fit for purpose, safeguards financial stability and protects consumers, without infringing on the space businesses require to grow and innovate. It is proportionate and targeted regulation, with the benefit of cooperative, collaborative and engaged supervision.

In 2016, the CBI called for smarter regulation in the UK by the regime adopting a practical approach to regulatory change, providing certainty to financial services firms at a time of great challenge to maintain their global competitiveness.¹⁹

There has been progress in the intervening years, with some improved engagement, but it is clear that the scale and pace of technological change requires a renewed focus on this approach.



The regulatory and taxation regime for the financial services sector needs to adapt to shifting circumstances, even as the sector embraces technology to deliver for customers whilst managing changing requirements.

The CBI believes that many of the principles set out in Smarter regulation remain relevant. The rest of this report addresses these outstanding challenges in more detail.

Weak productivity

Finally, these changes are also occurring in an environment with persistently low productivity: productivity growth in the UK has slowed to an average of 0.4% a year since 2009.²⁰ The reasons for this are manifold, but one major driver of UK productivity has been the financial services sector's poor productivity performance since the crisis: since 2008, the sector's productivity has shrunk by 2.1% a year, acting as a drag on overall UK productivity.²¹

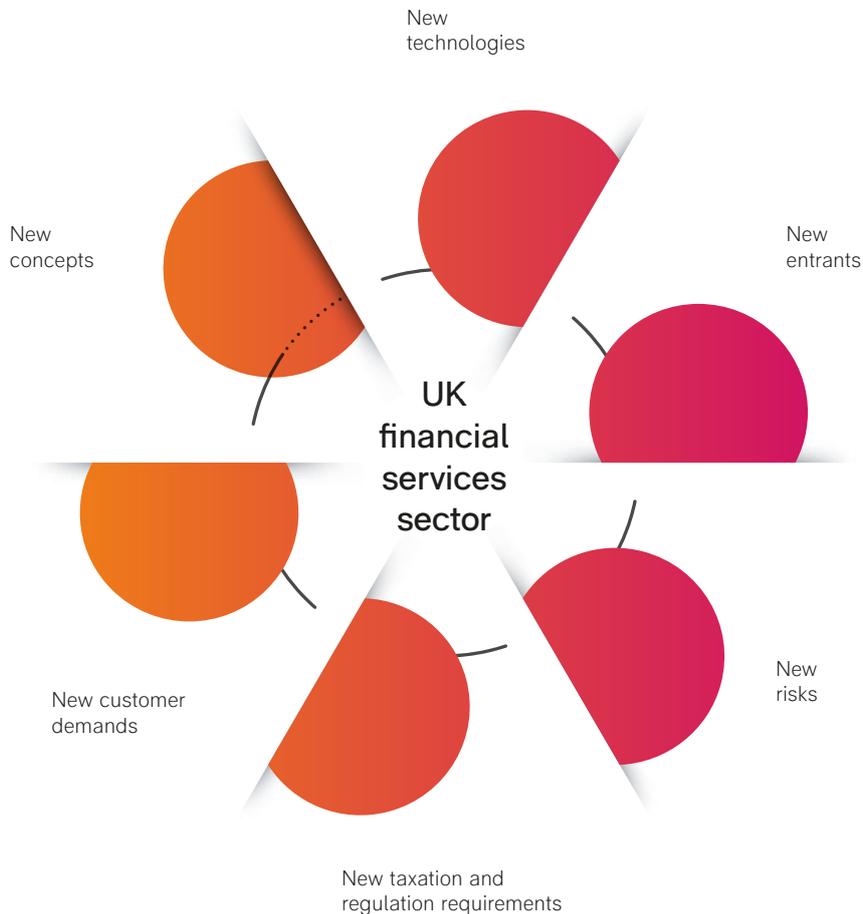
Closing the productivity gap between the best and worst-performing firms can address this challenge: CBI research found that if low-productivity firms adopted tried and tested technologies to match their more productive peers, it could reduce the difference between the highest and lowest earners in the UK, adding over the £100bn to UK GVA.²²

This is where a practical and stable tax and regulatory regime can help provide a supportive environment for investing in innovation to boost sector productivity and deliver great customer outcomes. By helping small- and medium- sized firms adopt tried and tested technologies, they will be better placed to deal with changing requirements and serve their customers.

Steps to improve the financial services sector ability to meet the demands of customers will make it easier for products, people, information and capital to move around across the whole economy.

Keeping pace with change in financial services

Figure 3 Change in the global financial services sector

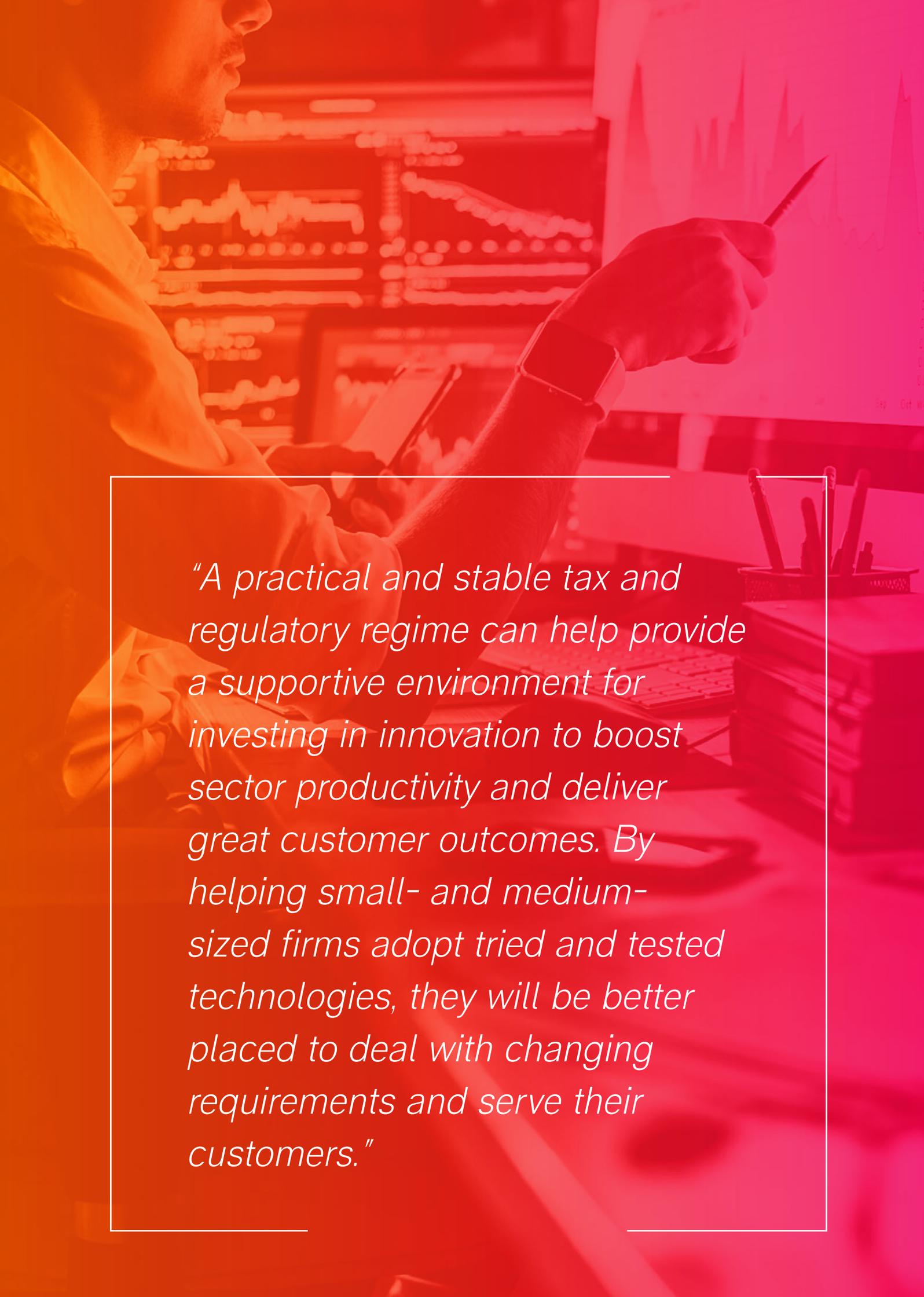


The goal: world-class financial services that deliver great customer outcomes

To maintain global standards, government and regulators need to act now to build a strong and agile environment that protects customers and promotes stability while allowing firms to thrive.

In a digital age, the UK needs a financial services sector that delivers for businesses and customers, and the people they employ. Regulators, government and industry understand that a financial services sector fit for working Britain must be supported by regulation and taxation policies that are best-in-class and put customers first.

World-class financial services that deliver for customers and the UK economy are in all our interests.



"A practical and stable tax and regulatory regime can help provide a supportive environment for investing in innovation to boost sector productivity and deliver great customer outcomes. By helping small- and medium-sized firms adopt tried and tested technologies, they will be better placed to deal with changing requirements and serve their customers."

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