A response to the

PRA's CP 4/23

The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime firms

May 2023

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to the PRA's proposals in CP4/23 on its approach to Liquidity and Disclosure Aspects of the Strong and Simple framework, which we very much support.

Q1: Do you have any comments on the proposed implementation date and whether it would strike an appropriate balance between allowing firms to implement the measures set out in this CP quickly and providing sufficient time to implement the measures?

We recognise and appreciate the PRA's commitment to developing a Simpler-regime for less systemically important firms.

In parallel to this initiative, we are working with the PRA to implement Basel 3.1 in the UK, which will demand the deployment of significant resources by the PRA and our members. We welcome the development of the optional Transitional Capital Regime (TCR) exemption which will mean that firms that meet the Simpler-regime criteria will not have to prepare for Basel 3.1. Ideally all aspects of the Simpler-regime would be ready for implementation at the same time as the Basel 3.1, which we expect to be at the beginning of 2025. So, we encourage the PRA to expedite the release of its proposals for capital requirements, which for Pillar 1 credit risk, we understand will be based on the Basel 3.1 approach. For most simpler-regime firms this credit risk will be the main determinant of their capital requirements.

We understand that the PRA will be consulting on changes to Pillar 2 within 12 months but would not expect simpler-regime firms to be subject to significant Pillar 2 add-ons, as Basel 3.1 has corrected previously observed deficiencies in Pillar 1. Nonetheless our members would appreciate understanding the PRA's views on this as soon as possible.

Q2: Do you have any comments on potential future changes to the content, clarity, and presentation of PRA rules and policies that could help to achieve the aims of Strong and Simple?

As we noted in our response to CP 16/2, at present, it is extremely difficult, particularly for small firms, to understand which capital rules apply to their firm as they are distributed across onshored EU legislation, the PRA Rulebook and other regulatory publications such as Statements of Policy, Supervisory Statements and others. This is relevant to the PRA's proportionality principle and competition objective as it puts smaller firms at a relative disadvantage, although we do recognise the constraints imposed by the current UK legislation regarding EU legislation.

In our view the entirety of the Simpler-regime would be better included in the PRA Rulebook itself, incorporating an appropriate mechanism for regulatory consent. This would provide firms with higher levels of clarity and transparency and provide a 'one-stop golden source' enabling simpler-regime firms to better understand the regulatory processes involved.

Q3: Do you have any comments on the PRA's proposals for the scope and level of application for the simplifications set out in this CP?

We welcome the possibility that a firm that is part of a group based outside the UK, but which cannot meet all the simpler-regime criteria, may apply nonetheless to be subject to the proposed provisions. We think this is very helpful and this initiative will support the competitiveness by encouraging such candidate firms to locate and operate in the UK, which we very much welcome.

We wonder if a similar mechanism could be applied to UK regulated subsidiaries of third country banks. They typically have a relatively higher proportion of their activity based outside UK, and indeed this is one of their reasons for locating in London - the opportunity to access the capital market product manufacturing capability of its internationally significant financial centre and provide sophisticated solutions to their group's wider client base.

Many of the foreign banks, which are UK undertakings, with simple business models meet all the proposed threshold conditions of the Simpler-regime, except for the non-UK activity test. Such firms may be unduly burdened by the requirement to implement Basel 3.1. Consideration should be given to permitting such third county owned UK banks with a balance sheet size of say, less £10 Billion and at least 60% of their assets in the UK, to access the simpler-regime using the mechanism described in Appendix 2 to the CP.

Our members also reflect that immaterial regulated firms that are party of UK groups could benefit from the application of the Simpler-regime at solo level. We encourage the PRA to consider the benefits of this. Could, for instance, where the parent reports on the subsidiary's activities on a consolidated basis, the solo firm apply to be part of the simpler-regime?

Q4: Given the simplified approach to stable funding under the Simpler regime that is set out in this chapter, do you have any comments on the appropriateness and proportionality of the proposed approach to the sNSFR?

We support the PRA's proposals to not apply the NSFR depending on certain conditions being met, recognising that only a few firms currently opt to use the sNSFR.

We share the PRA's concern about over-reliance on wholesale sources of funding, the risks of which has been highlighted by the recent rapid withdrawal of uninsured deposits from some mid-tier banks in the United States.

We share the PRA's view that the tipping point to being wholesale funded is correctly set in its proposals at 50%.

Our members favour the use of the Article 411(2) definition of retail deposit.

Modifying the definition of a simpler-firm retail deposit in light of the failure of SVB UK

We understand that the Bank of England is currently considering possible reforms to the UK's bank deposit insurance guarantee scheme (DGS) in the light of its experience as regulator of Silicon Valley Bank UK. Its parent had experienced sudden and significant withdrawal of deposits in the US which rapidly spilled over into the UK.

We understand that a particular concern at the time was that SVB UK SME customers would have lost access to the working capital held in their current accounts. This may be the central issue that the Bank's possible reforms to the DGS may seek to solve for; a problem for which a blanket increase in the DGS coverage limit would not be appropriate.

We have therefore considered how the definition of retail deposit for simpler regime firms could be modified. These suggestions are presented as possible options, rather than recommendations.

- 'Sight' deposits placed via deposit aggregators could be excluded where the deposit aggregator holds the deposit accounts on trust for their customers instead of the depositor being the firm's direct customer, unless the firm can demonstrate through behavioral analysis that deposits raised via this source are stable.
- SME current account balances, in excess of the DGS limit, could be excluded where the firm is not aware that the SME also holds a transactor account[1] with another firm. We recognise that this would make the simpler-regime more complex and be difficult to operationalise without a 'national register' of business bank accounts. (Alternatively, although this is out with the scope of this consultation, the deposit guarantee limit for transaction accounts only could be increased.)

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[1] Using the MREL definition of Transactor account, being accounts from which withdrawals have been made nine or more times within a three-month period.

The SME Business Finance Monitor contains some credit balance data that could size the number of the SME current accounts that might be excluded from the proposed RDR definition. Of the circa 5.2 million SMEs in the UK about 312,000 hold balances in excess of £85,000, but it is not possible to identify how this is split between transactor accounts and deposit accounts, nor between simpler-regime firms and more systemically important ones.

Other anecdotal data suggest that about a third of SME credit balances are held in savings accounts, with the rest in transactor accounts.

Calculation of RDR average

The calculation of the RDR as a rolling quarter average is welcomed. As the PRA notes this will avoid the firm flipping in and out of the simpler liquidity regime. We agree that firms should promptly notify the PRA if they cease to meet the RDR condition and that a one-year implementation date is appropriate. We further welcome the PRA's proposal that newly authorised firms may apply for a modification to disapply the NSFR and that the sNSFR should be removed from the Rulebook as an option for small and non-complex firms.

It is important to note that, whilst firms may no longer be required to meet the requirements of the NSFR, Fundamental Rule 4: *A firm must at all times maintain adequate financial resources* and Fundamental Rule 8: *A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services* will ensure that the firm's board, supported by its Asset and Liability Committee and relevant senior managers will ensure its funding remains resilient and appropriate for its business model.

Pillar 2 liquidity

In light of recent events which have impacted regional banks in US, some members noted the importance of the PRA continuing to review a firm's ILAAP document and where warranted, in the case of particular material idiosyncratic risks, for instance a reliance on uninsured deposits, apply relevant Pillar 2 liquidity guidance add-ons.

Liquidity reporting

The removal of the majority of the ALMM returns is welcome. As we note above firms will continue to monitor the liquidity and funding profile of their firm, but comment that the ALMM returns they currently compete are not used in their internal liquidity monitoring process but are purely seen as a reporting burden.

Disclosure (Pillar 3)

Q5: Are there any factors or stakeholders the PRA has not identified or considered sufficiently in respect of the proposed exclusion of non-listed Simpler-regime Firms from Pillar 3 requirements?

No. We welcome the change which will allow simpler-regime Firms to free up resources otherwise spent on producing this document.

Of course, we would be delighted to discuss our response, or any questions arising from it, with the PRA Strong and Simple team if this would be helpful.

Responsible executive

✉ simon.hills@ukfinance.org.uk
☎ *+44 (0) 7921 498183*