

Prudential Regulation Authority consultation on its approach to policy CP27/23

Date: 8 April 2024

Introduction

1. UK Finance is the collective voice of the banking and finance industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.
2. We are pleased to have the opportunity to respond to this consultation and welcome the progress the Prudential Regulation Authority (PRA) has made since it published its Discussion Paper in December 2022.
3. Financial services regulation has undergone significant change. The Financial Services and Markets Act 2023 (FSMA 2023) establishes the legal basis for a new approach to regulation, where most technical rules will be made by an operationally independent PRA and Financial Conduct Authority (FCA). Given the step change in the PRA's rule making responsibilities, its right that the regulator considers the approach it takes to its policy work within this new regulatory framework.
4. However, although the regulator has made some progress, there remain a number of issues with the PRA's proposed approach. This consultation response highlights these remaining concerns and recommends the action the regulator should take to address them. We have grouped our comments using the key themes highlighted by the PRA as having undergone the most significant change since the Discussion Paper was published.
5. If you have any questions relating to this response, please contact Matthew Young, Principal, Strategic Policy, at matthew.young@ukfinance.org.uk

Regulatory Principles

6. We strongly support the PRA's framework of objectives. While we support the operational independence of the PRA, it is right that Government, and by extension, Parliament, retains its role to set the regulator's primary and secondary objectives through legislation. The objective framework provides a clear and unambiguous understanding of the PRA's purpose and its priorities when discharging its regulatory duties.
7. Furthermore, the use of regulatory 'principles' is a useful way to reflect current policy challenges in the PRA's consideration of its duties. The Government can modify these principles through different means including primary and secondary legislation as well as through the annual remit letters that HMT sends to the regulators, meaning that the regulator's remit can be optimised to support the Government's efforts to tackle wider policy challenges. For example, we support the extension of the Net Zero Have Regard to include the Environmental Targets set out in the Environment Act 2021, helping to ensure that the PRA gives due weight to pursuing nature and environmental outcomes through its work, as it already does for Net Zero.

8. Indeed, there are other regulatory principles provided to the PRA that we support, including the requirement that regulatory resources should be used in the most efficient and economic way, that burdens or restrictions should be proportionate to the benefits and the principle that regulators should exercise their functions as transparently as possible, amongst others.
9. However, despite our support for select principles that should be retained, we believe that, overall, they have become too numerous to allow for effective policy development and will cloud the PRA's efforts to deliver against its primary and secondary objectives. This view is shared by the House of Lords Industry and Regulators Committee who stated in a recent report that some regulators have been given too many issues to have regard to by government and Parliament, without a clear sense of priority.¹ Therefore, while we support the PRA's decision to cluster the principles into similar themes, this is only a short-term solution to organise an ever-increasing list of pressures on the regulator. Although it is not in the PRA's gift, we would like to see the Government and the PRA consider what its absolute priorities should be and cut back the number of principles accordingly.
10. The roll out of the Smarter Regulatory Framework (SRF) is an opportune time to consider the PRA's regulatory principles and is in keeping with the ambition of SRF to deliver a 'more agile, streamlined, and accessible' regulatory framework for financial services. If the Government and PRA adopt this proposal, it is important that the list of principles remains under constant review. The default should be to remove and replace certain principles as policy priorities change, not to add new requirements to an ever-growing list.

Secondary competitiveness and growth objective

11. UK Finance is very supportive of the PRA's secondary competitiveness and growth objective that FSMA 2023 assigns to the regulator. The new objective sends a clear signal that the UK is open for business and open to the world. Knowing that competitiveness will be a consideration in the PRA's decision making will give businesses the confidence to invest in the future and support the growth of the real economy, not just the financial services sector.
12. We are pleased to see that the PRA has committed to taking a proactive approach to implementing the secondary competitiveness and growth objective into its policy development. Consistent with this proactive approach, we encourage the PRA to launch a flagship policy initiative to advance the new objective, which should involve reviewing areas in which the PRA has gone beyond existing international standards to assess the extent to which they are acting as an impediment to growth. This initiative should match the level of impact and ambition of the PRA's Strong & Simple project in support of its secondary competition objective, and should cover the domestic and international firms that have not benefited from the PRA's Strong & Simple work. In carrying out this work, we would encourage the PRA to recognise that requirements can be removed without leading to a lowering of standards below the level required to achieve the necessary level of financial stability, particularly where those requirements are duplicated by other existing rules.
13. As we said in our response to HMT's *Measuring Success* Call for Proposals, which sought views on how the success of the objective should be measured, it is vital that regulators, like all public bodies, be accountable for meeting their statutory objectives. With that in mind, the final metrics, published as an annex to this consultation, are a useful first step in ensuring that accountability. It is important to point out that the PRA should not mark its own homework in assessing whether it has effectively delivered against its secondary objective, and so we are pleased to see that the PRA will ensure accountability, including reporting annually on how the objective has been advanced. Going forward, we would like HMT to work with the PRA to agree further accountability

¹ <https://committees.parliament.uk/publications/43211/documents/215050/default/>

mechanisms, such as appointing a judicial body to review any updated metrics before they are published.

14. We see the metrics as an initial list that can be built upon and improved over time. For example, the PRA states that it will use information on banking resilience, drawn from Financial Policy Committee (FPC) analysis, to measure whether it has appropriately calibrated standards and its international alignment in pursuing the objective. It is our assumption that this is based on a comparison of bank capital evolution over time and does not include consideration of other jurisdictions. If that is the case, it would be more effective to include data from a direct international comparator here so the PRA's approach to banking resilience can be compared with its international peers.
15. Furthermore, as the PRA note in the consultation paper, excessively high standards can hamper economic growth by constraining the provision of financial services to the real economy. It will therefore be important that the metrics evolve to measure this. In this respect it would be helpful to augment the metrics to focus on capital flows, e.g. outward reinsurance.
16. Although the metrics are useful, they alone are not enough to drive real change within the PRA with regard to its adherence to the new objective. We were disappointed to see that the PRA does not set out in the Approach Document how it plans to change the culture and working level mindset within its organisation. We disagree with its assessment in the supporting literature to this consultation that organisational structure is out of the scope of this consultation, especially given the recent comments of Sam Woods, CEO of the PRA, to the Treasury Select Committee setting out his view that the internal change is 'very important' to embedding the new objective. We agree the right internal culture is essential to delivering effective policy that delivers against the regulator's statutory requirements. Given the changes to the regulatory framework brought about by FSMA 2023, how the PRA organises itself and the mindset it promotes internally amongst itself are critical to its success as a regulator. We would like the Approach Document to include the references to internal training and specialised teams, including at Board level and within decision making committees, that the PRA has mentioned elsewhere in relation to how it will deliver this new objective. Ultimately, we would like the PRA to move to a position where every internal policy decision takes account of growth, which is the approach taken by the Monetary Authority of Singapore.
17. Separately, we are also concerned that the three 'regulatory foundations' – that the PRA will use to strengthen the 'transmission channels' to drive growth and international competitiveness – reflect an overly narrow interpretation of the new secondary objective and fail to recognise the PRA's role in driving growth by ensuring its regulation does not impede efficient capital allocation. We therefore propose that a fourth regulatory foundation entitled 'Calibrating regulation to remove impediments to growth' is incorporated into the Approach Document. Among other things, it should reflect the need for the PRA to appropriately prioritise its policy work and the subsequent burden/costs imposed on industry, taking account of firms' ability to absorb those costs and their wider operating environment (including requirements/costs imposed by other regulators).
18. Finally, we stress the importance of distinguishing between 'facilitating effective competition', as required by FSMA s2H(1), and 'facilitating competition'. The draft Approach Document uses both interchangeably (notably omitting 'effective' in 2.3, 3.8, 3.18, 3.41). Members recognise that these are likely to be drafting errors, and that the PRA dedicates several paragraphs to defining 'effective competition'. But given the importance of the distinction, and the importance of that distinction being deeply embedded in the PRA's internal culture, it is important to ensure it is reflected in the Approach Document.

International standards

19. International engagement is critical to sound domestic policy development; allowing UK regulators to draw on the best practice of international peers and measure themselves against their performance. We also note the increase in Financial Dialogues or Regulatory Working Groups between the UK Authorities and selected jurisdictions but would appreciate more information on the regulatory approach and aims in these Financial Dialogues.
20. While in principle we support the PRA's approach to seek a 'largely compliant rating' with international standards, we believe the PRA should provide much more clarity about precisely what level of compliance it will seek to achieve. This is because an overall rating of 'largely compliant' could capture a wide range of different outcomes, given the assessment process does not offset instances of super-equivalence against instances of sub-equivalence. The Basel Committee on Banking Supervision's (BCBS) Regulatory Consistency Assessment Programme (RCAP) Handbook for Jurisdictional Assessments explains that "domestic measures that are stricter than the minimum Basel requirements are fully in line with the nature of the international agreements, which are intended to set minimum requirements, and will therefore be considered as compliant. However, they will not be considered to compensate for inconsistencies or gaps identified elsewhere".
21. Under this system, it is foreseeable that the PRA could implement an approach that is stricter than international standards in many areas, including requirements that may act as a drag on UK growth and competitiveness such as UK-specific buffers, and still be rated only 'largely compliant' on the basis of relatively immaterial line-by-line deviations from the Basel framework. Targeting a 'largely compliant' rating does not provide the required level of specificity or assurance that the PRA will avoid such an approach – and is therefore too vague to gauge the PRA's intended overall level of requirements and their impact on the PRA's secondary objectives.
22. We also wish to highlight the PRA's approach to equivalence assessments, which is judged on outcomes rather than being based on line-by-line compliance with international standards. Given that it is the outcomes delivered by the PRA's overall regulatory framework that are most important to regulated firms, it is curious that the PRA should not adopt a similar outcomes-based approach to implementing international standards. Such an approach, where the PRA seeks to largely achieve the outcomes sought by international standards, would be preferable to that currently set out in the Approach Document. A situation in which foreign jurisdictions are judged on a more holistic basis than the basis on which the PRA is judging its own approach could also risk undermining the secondary competitiveness and growth objective.
23. If the PRA maintains its approach to being largely compliant, then that will have serious ramifications for its ability to go beyond the Basel standards, where it decides it needs to, without having negative impacts on banks' ability to lend to the real economy. The PRA will also need to continually monitor the implementation in other jurisdictions and consider how to ensure UK standards are met where other jurisdictions are operating significantly below "largely compliant" for an extended period.
24. At the very least, we encourage the PRA to ensure the Approach Document explains in considerably more detail how the 'largely compliant' target will apply in practice, and how it relates to the overall outcomes delivered by the PRA's wider regulatory framework. The PRA also needs to explain in more detail how it relates to assessments undertaken by bodies that use different rating scales (e.g. the IMF).
25. That said, we are broadly supportive of the approach to engagement activities that the PRA has set out in its Approach Document. We are particularly pleased to see the PRA set out how it is prioritising proactive engagement, through exchanging information with international partners and engaging in the development of international standards. It would be helpful if the PRA could additionally include within its Approach Document how, in contributing to the development and

adoption of international standards, that it takes into account UK competitiveness, growth and existing agreed domestic policy.

26. However, there is more that the PRA can do to improve its engagement. In particular, we would like to see the PRA set out in its Approach Document how it proposes to learn from other jurisdictions in terms of balancing resilience and competitiveness, as well as on individual approaches to policy (and supervision). Observing other countries' approach to financial services regulation – including successes, failures as well as analysis of certain actions taken – is an important way to calibrate our own regulatory approach. It would be helpful for the PRA to set out a framework to properly capture this analysis in a systematic way.
27. Moreover, the PRA includes tracking the degree of alignment with international standards (IMF FSAP and BCBS RCAP) as one of the metrics to measure its implementation of its new secondary objective in its metrics framework. However, the Approach Document only references international alignment in relation to the secondary competitiveness objective in passing, stating that the PRA will consider adjustments to its implementation of international standards where it may have implications for the objective. We would like the PRA to set out how it will make this assessment in greater detail within the Approach Document itself.
28. Finally, the PRA states that it also plans to use its regulatory principles as another measure against which to consider making adjustments to the implementation of international standards. We have said already that the number of regulatory principles are too numerous to positively influence policy making and should be cut down. Therefore, only the PRA's statutory objectives should be used to make this assessment and not its regulatory principles - at least until the Government agrees that the number of principles should be significantly cut.

Cost Benefit Analysis

29. UK Finance has been public about its support for the creation of new cost benefit analysis (CBA) panels ever since FSMA 2023 was going through Parliament. CBA panels will support a proportionate approach to policy making by providing analysis on the effectiveness of proposed policy.
30. We were pleased to see the PRA set out its approach to CBA in the Approach Document, though we note that this approach will be ultimately heavily influenced by the outcomes of the PRA's impending consultation on the creation of the panels. We urge the PRA to release the consultation as soon as is practical so that the outcome of this separate consultative process can be fed into its final Approach Document. Given, the CBA consultation and outcomes of the PRA's Rule Review Framework consultation will impact the final Approach Document, we urge the PRA to consider scheduling another chance for industry to offer comments before the final Approach Document is published.

Evaluation

31. Evaluating the effectiveness of the PRA's current rules has become an important exercise as the SRF rolls out. The new roll out repeals many existing retained EU law (REUL) rules and, in some cases, mandates their reform. Although many of these rules have already been identified, it is important that the PRA adopts a robust system for evaluating its rules on an ongoing basis to ensure they remain fit for purpose.
32. Alongside monitoring the effectiveness of the current rulebook, we recommend that the PRA should develop a model that measures the effectiveness of prudential regulation following the changes to the regulatory framework under FSMA 2023, against the previous framework. It will be useful for the regulator to assess the agility and responsiveness of the new regulatory environment to spot lingering inefficiencies in the new system.

Data

33. Although we accept that the PRA's accountability requirements have changed since FSMA 2023 was enacted, it is important that the PRA works to minimise the burden on firms to provide new data. Increasing the data burden on firms would increase their regulatory burden and run counter to the PRA's new competitiveness objective. Wherever possible, we would like the PRA to use internal data sources to conduct its regulatory work.
34. Although this CP is policy focused, such data requests tie in with an adjusted Supervisory Approach under the new Secondary Objective.

Stakeholder engagement

35. We were pleased to see the PRA set out its proposed approach to stakeholder engagement in the Approach Document. It is especially useful to see that the PRA proposes adopting a flexible approach to its engagement. While we support flexibility, given that different policy challenges will require different engagement with stakeholders, we would welcome further clarity on the precise methods of engagement that will be deployed and in what circumstances. We respect the need for the PRA to take a case-by-case approach, but this should not be used as an excuse for failing to provide sufficient guidance and clarity to stakeholders, limiting their ability to engage effectively with the policymaking process. We believe this links directly to the PRA's "adopting effective regulatory processes and engagement" regulatory foundation.
36. For example, on what kind of policy files is the PRA more likely to conduct roundtables or create standing committees? We would also welcome more detail on how the PRA's engagement approaches will be different to those adopted up to now to reflect the new growth and international competitiveness objective, and would suggest a stronger commitment to early engagement would be a useful enhancement to make.
37. That said, we were disappointed that the PRA did not commit to creating a substantial new channel of communication for stakeholders when it published its final Rule Review Policy Statement, given we expect the Policy Statement to feed into and influence the final overall Approach Document. Although we are supportive of a new dedicated email inbox for stakeholders to provide feedback, we would like to see the PRA create a new formal mechanism for making a representation to the regulator about the need to review a particular rule (or set of rules) to ensure stakeholders views are given due weight within the rule review process. In other words, we suggest that stakeholders should have input into the prioritisation of policy reviews. As we set out in our response to the PRA's consultation on its rule review, we suggest that representative bodies (such as trade associations or consumer bodies) be formally able to make representations to the PRA about the need to review a rule, on behalf of a cohort of different stakeholders. The regulator would then be required to respond to such representations, setting out its assessment of the case for a review.
38. We would also like to see the use of working-level standing groups for priority or fast-evolving policy areas, to provide a degree of real-time dynamism in the policy-making process, and a shift away from static and lengthy consultation processes for new areas of risk and policy-making. In this respect, technology and sustainability would be a good example where a more dynamic approach might suit.

PRA Rulebook

39. We are broadly supportive of the innovations to the PRA's Rulebook set out in the Approach Document.

40. However, we urge the PRA to keep its Rulebook under review and consider whether there is scope to develop its design further as the SRF is rolled out. We would expect the Rulebook to need further revisions to reflect the PRA's increased regulatory independence.
41. Linked to this, the PRA should set out how it expects the SRF to impact the design of its Rulebook going forward, and to what timetable. The roll out of the SRF is a multiyear process, with several tranches and their timetable yet to be published. The PRA should work in lockstep with HMT to update its plans for the Rulebook as future details of the SRF become clear.
42. With this in mind, the PRA should consider expanding the three principles that guide its approach to its Rulebook. We agree that ease of access, efficiency and usability and clarity are sensible and appropriate targets. However, we recommend that a fourth principle – relevancy – should be added. It's vital that the Rulebook remains relevant to the regulatory environment and that it is designed to take account of the PRA's increased independence.
43. Finally, it is important that the PRA demonstrate in the Approach Document how its rulebook will link to the supervisory side of its work. Having a world class rulebook is not enough, so the PRA should set out how its revamped rulebook will support the enforcement side of its activities.