Bank of England PRA

Summary of the PRA's conference on the role of financial regulation in international competitiveness and economic growth

Bank of England, 19 September 2023

The conference was formed of three sessions, featuring speeches by Vicky Saporta, Professor Philippe Aghion, Sir Howard Davies and Professor Catherine Schenk, as well as two panels chaired by Professor Julia Black and Nikhil Rathi respectively. This document has been published to serve as a comprehensive account of conference discussions and to provide transparency about the views presented by a wide range of stakeholders at the event. This summary was produced by the PRA with input from the speakers at the conference.

Session one:

Competitiveness and growth: continuing the conversation

Vicky Saporta - Executive Director, Prudential Policy, PRA

Following the opening remarks by Sam Woods (Deputy Governor, Bank of England and CEO of the PRA), Vicky Saporta delivered her speech: **Competitiveness and growth: continuing the conversation**. The speech set out the PRA's interpretation of the new secondary competitiveness and growth objective (SCGO), and invited feedback on this through the conference discussions. Vicky explained the PRA's view that the new objective is about harnessing the UK's strengths as a global financial centre, by strengthening three regulatory foundations: maintaining trust in the PRA and the UK prudential framework, adopting effective regulatory processes and engagement, and adopting a responsive approach to UK risks and opportunities. She outlined ways to strengthen these regulatory foundations, informed by the focus areas identified in the PRA's SCGO **pilot survey**: maintaining trust through strong standards, improving the PRA's operational efficiency, making the rulebook more accessible and being more responsive to UK risks and opportunities, such as industry's innovation. The speech committed to a PRA-hosted innovation roundtable.

Finance, innovation and growth

Professor Philippe Aghion – INSEAD, College de France, LSE

Professor Aghion delivered an academic keynote speech, emphasising the critical role of innovation and creative destruction (defined as the process whereby new innovations displace old technologies) in addressing the interplay between finance and growth. Professor Aghion explained that the innovator is motivated by the prospect of monopoly rents, but ex-post these rents can be used to prevent future innovation to block new entry. The regulatory problem is how to manage these contradictions. Financial policy that is too tight slows growth by restricting entry, however, financial policy that is too lax makes it easier for inefficient firms to remain in the market and protect their rents, which also limits the scope for new innovative firms to enter. Thus, financial policy that is too lax is likely to reduce growth rather than promote it. Furthermore, Professor Aghion considered creative destruction and its role in financial policy and promotion of green growth, again showing that creative destruction plays a key role in understanding how to foster green innovation.

Session two:

Morning panel: Problems of measurement and how do you allocate success due to the role of the financial regulator?

- **Professor Julia Black** (Panel Chair) - External Member, Prudential Regulation Committee, Bank of England and Director of Innovation, LSE
- **Leonardo Gambacorta** - Head of the Innovation and the Digital Economy Unit, BIS
- **Marcus Lim** - Assistant Managing Director, Monetary Authority of Singapore
- **Charles Randell** - Former Chair of the FCA and former External Member of the Prudential Regulation Committee, Bank of England
- **Yael Selfin** - Chief Economist, KPMG
- **William Wright** - Managing Director, New Financial, London

The panel discussed the importance of regulatory accountability, but also the challenges in measuring the direct impact of prudential regulation on growth, including some of the limitations in using models to evaluate potential impacts. Evidence was presented on the positive effect of using regulatory sandboxes to support innovation by financial institutions.

Panel members gave their perspectives on the design of metrics to hold the PRA accountable against the SCGO. Panellists remarked that metrics could potentially distract from actual activities and should be designed to avoid generating perverse incentives or unintended consequences. The panel also discussed the dual role of the City of London: a domestic financial centre, that channels investment into the UK economy, and a host venue for international financial activity. These two roles would impact the type of metrics to focus on. Furthermore, panellists remarked that the SCGO requires regulators to engage with the question of whether and how different types of finance contribute to competitiveness and growth, and whether the sustainability of that growth is contingent on the distribution of the benefits.

Panel members commented that a wide range of factors affect the competitiveness and growth of a financial centre and an economy, many of which are outside the direct control of the prudential regulator, such as talent development, rule of law and infrastructure. Discussions noted that the PRA should be held to account on factors that are under its direct control. There was also a question, without a clear answer, of why regulators are not being asked to publish metrics against their primary responsibilities. The use of surveys was suggested as a helpful tool to capture market feedback and improve communication with firms and relevant stakeholders.

The panel discussed the UK's approach to implementing international standards. It was noted that divergence from international standards can add to firms' compliance costs. Mutual access to global markets continues to be important for UK firms. Moreover, interoperability between standards from across jurisdictions, for example around environmental, social and governance (ESG) regulations, is required to alleviate the burden on firms. Furthermore, the panel highlighted the benefits of the UK leading on the implementation of international standards, particularly in new policy areas where it is often the first to devise new regulatory solutions, while recognising the potential trade-off of missing out on learning from the experience of other jurisdictions.

The panel mentioned that the speed of supervision and authorisations were factors that were partially within the PRA’s control and could contribute to the competitiveness of the UK. Speakers proposed enhanced proportionality and simpler requirements for non-systemic firms as ways to reduce timescales.

Session three:

Will a new focus on competitiveness make our controllers cross-eyed?

Sir Howard Davies - Chair, NatWest Group

Sir Howard Davies delivered a keynote speech in which he outlined seven propositions to guide the PRA in its approach to the SCGO going forward:

1. Competitiveness should be applied to international activities and negotiations, noting that the PRA should strike the balance between alignment and divergence.
2. Regulators should understand that firms are not, as sometimes characterised, in favour of weak regulation; they want their counterparties to be well-regulated.
3. Regulators should be independent from political influences.
4. It may be necessary for regulators to be critical of government in certain instances.
5. Regulators should consider the language and articulation of risk to allow for a more informed public debate.
6. The PRA, having calibrated its prudential framework, should avoid ad-hoc policy interventions where justifications for doing so are unclear.
7. The PRA should have greater regard for the profitability of regulated firms and the viability of the financial system – in this context, Sir Howard cited the Bank/PRA's strong emphasis on recovery and resolution plans.

Competitiveness and complementarity: international financial centres in the long run

Professor Catherine Schenk - University of Oxford

Professor Catherine Schenk delivered a speech examining the development of international financial centres throughout history. Professor Schenk submitted that whilst London starts from a position of strength due to its history and human capital, the UK has not maintained its competitiveness through inertia and agglomeration alone. Rather the financial services sector has reinvented itself several times in response to the changing global environment, most strikingly in the innovation of the Eurodollar market in the 1960s and after the introduction of the Euro in the 1990s. This demonstrates the UK's enduring resilience in the wake of challenges. The regulator should try to regulate upwards (ie increasing standards, promoting higher value services and encouraging the best players to relocate). Professor Schenk also emphasised the concept of complementarity, rather than competitiveness between international financial centres, showing for example how Amsterdam and London at the end of the 18th century mutually reinforced each other's growth as a financial centre.

From this she drew the conclusion that competitiveness should not be considered a zero-sum game.

Afternoon panel: What makes a successful global financial centre and how does it sustain competitive advantage?

- **Nikhil Rathi** (Panel Chair) **-** CEO, FCA
- **TS Anil** - CEO, Monzo Bank
- **Amanda Blanc** - Group CEO, Aviva
- **Fernando Restoy** - Chair of the Financial Stability Institute, BIS
- **David Sansom** - Chief Risk Officer, Lloyd's of London
- **Clare Woodman** **-** CEO, Morgan Stanley & Co International

The panel outlined how a robust regulatory framework, a stable and predictable environment, and innovative thinking by regulators can contribute to the success of a financial centre. Panellists noted the importance of robust standards in instilling trust and confidence in the financial system and the appropriate subordination of the SCGO to safety and soundness. The panel also highlighted the importance of proportionality in regulatory requirements.

The panel stressed that effective communication of firms with supervisors, efficient regulatory processes and predictability on authorisations and approvals can contribute to competitiveness and growth. It was observed that an effective implementation of the new objective therefore required a shift in culture of all PRA actions, not only in policymaking, including adopting a more commercial and less process-driven mindset for decision-making. It was highlighted that the SCGO should mean making the approach to other PRA functions, such as authorisations and supervision, more efficient.

The panel commented that the PRA has a role to play in supporting innovation in the financial services sector. Regulatory sandboxes, mobilisation and fast track authorisation were suggested as initiatives that could help with this. It was also noted that whilst regulation can foster safe innovation, a no-failure regime discourages the risk appetite of firms.

The importance of alignment with international standards was raised again, as well as strong supervisory coordination. Discussions noted that the implementation of international standards should consider the specificities of jurisdictions and where it is appropriate to deviate. The panel remarked that there is sufficient flexibility in global standards so they can be adapted to the idiosyncratic needs of individual jurisdictions.

The panel highlighted the importance of cost benefit analysis (CBA) in policymaking but also the limitations embedded in this tool: some impacts can be quantified but others, especially on the benefits side, might be more challenging to quantify (eg the impact of policies on financial stability).

Closing remarks

Vicky Saporta concluded the conference by setting out some of her key takeaways from conference discussions:

- Many of the themes related to the PRA’s three regulatory foundations, outlined in her opening speech, were raised in subsequent discussions. There was a general recognition among speakers that the task of facilitating competitiveness and growth in not obvious or easy, but the UK can grasp the opportunity to do so from a position of strength.
- Increased financial easing is not necessarily beneficial for growth, as explained by Professor Aghion, and there is a balance to be struck. What the prudential regulator can learn from this is that it is important to facilitate entry and innovation, but also exit.
- There was a consensus that finding metrics that can be attributed to the prudential regulator is difficult. It is important that metrics measure things under the PRA’s control.
- Vicky addressed the concern raised that the PRA is overly focussed on recovery and resolution plans. Recovery plans are needed to facilitate the exit of firms, which is important for innovation as Professor Aghion had noted.
- Competitiveness is not a zero-sum game between financial centres. Professor Schenk presented evidence that there is complementarity between financial centres and advised the PRA to regulate to the top (ie raising standards).
- There was a consensus that Parliament was wise to give competitiveness and growth a secondary nature.
- Discussions supported the importance of the UK having a stable and open regulatory environment to sustain its position as a major international financial centre.
- A consensus emerged that the UK should lead in shaping international standards.
- The PRA should consider the implications of London’s dual role as a domestic financial centre and a host venue for international firms in its approach to the SCGO.
- Additionally, the PRA should reflect on the question raised about whether the new objective concerns competitive outcomes in the financial system, or outcomes of the financial system on the real economy.