



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

The PRA's response to the Independent Evaluation Office's evaluation of the PRA's approach to its secondary competition objective

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1 Introduction

1.1 The Prudential Regulation Authority (PRA) welcomes the Independent Evaluation Office's (IEO's) evaluation of the PRA's approach to its secondary competition objective (SCO).¹ The PRA accepts the findings and recommendations of the evaluation in full, and its response to the recommendations is set out below.

1.2 Chapters 2-4 set out a brief description of the SCO and what in practice it means for the PRA, as well as setting out the background to the IEO evaluation and a summary of its main findings. Chapters 5-6 set out the IEO's recommendations and the PRA's response and conclusion.

2 The PRA's secondary competition objective

2.1 On 1 March 2014 the PRA was given a secondary objective to act, so far as is reasonably possible, in a way that facilitates effective competition in the markets for services provided by PRA-authorized firms carrying out regulated activities. The secondary objective applies when the PRA is making policies in pursuit of its primary objectives: the safety and soundness of deposit-takers, insurers and major investment firms; and insurance policyholder protection. This means that when the PRA is considering options for new regulation, it should assess the extent to which there is scope to facilitate effective competition and consider options that do so as far as is reasonably possible. The PRA can also consider changes to existing policies as it reviews them to facilitate effective competition as long as its primary objectives are not undermined.

2.2 In many cases the PRA's primary and secondary objectives are aligned: for example, reducing 'too big to fail' distortions have made both the financial system safer and competition more effective. Nevertheless, cases might exist where, within the range of prudential regulation options available to the PRA, there may be some which would deliver greater benefits to competition and others which would deliver greater benefits to safety and soundness or policyholder protection. The existence of the SCO means that the PRA should consider — but is not necessarily required to adopt — those options which would deliver greater benefits to competition for a given objective of safety and soundness or policyholder protection. So an added advantage to looking at prudential regulation through a competition lens is that it provides a check on whether prudential interventions are being applied sensibly and proportionately.

2.3 The 2015 Q4 edition of the Quarterly Bulletin contained an article on the PRA's secondary competition objective.² The article sets out in detail the rationale for the objective, how the PRA interprets it, and what it means for the PRA's regulation of banks and insurers. It also explains how the PRA's responsibilities are complementary to, but distinct from, the role of the Competition and Markets Authority (the CMA), the Financial Conduct Authority (the FCA) and the Payment Systems Regulator (the PSR).

3 Summary of the IEO's evaluation

3.1 In early 2015, the IEO was asked by the Bank of England's Court of Directors to assess the PRA's approach to the SCO to facilitate oversight of the strategy adopted. The IEO evaluation

1 Independent Evaluation Office's (IEO's) evaluation of the PRA's secondary competition objective (SCO), available at: www.bankofengland.co.uk/about/Pages/ieo/publications.aspx.

2 Quarterly Bulletin, 2015 Q4, available at: www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2015/q4.aspx.

was conducted primarily between April and October 2015, just over a year after the SCO came into force. This offered the IEO an early opportunity, on behalf of Court, to take stock of steps already taken by the PRA to embed competition considerations into its policy decision making, and consider whether there were aspects of the approach that could be strengthened.

3.2 The IEO's evaluation encompassed three workstreams:

- (i) a review of the framework and processes adopted by the PRA to meet its SCO;
- (ii) case studies of key PRA policy initiatives;¹ and
- (iii) linguistic analysis of papers sent to the PRA's policy committees.

3.3 The PRA's emerging strategy and approach to the SCO were assessed against whether they were: clearly articulated; proportionate; consistent; proactive; and influential.

4 Summary of the IEO's findings

4.1 The IEO evaluation recognised that the PRA has invested in its approach to the SCO, with positive results for the flow of new policies. It also highlighted the delivery by the PRA of substantive reforms to authorisations policy to address potential barriers to entry into banking in the run-up to the SCO coming into effect in March 2014. The evaluation found that competition issues are receiving airtime, and gaining traction, at all levels of the organisation, and found that numerous aspects of the SCO are well understood across policy staff. Furthermore the IEO evaluation recognised that the PRA's approach to the SCO supports both the consistent treatment of competition issues for different types of policies, as well as a broadly appropriate degree of prioritisation. Finally, the IEO recognised the fact that the PRA has signalled its intention to take a proactive stance in, for example, international negotiations in the prudential policy sphere that may additionally impact upon effective competition. A key finding of the IEO's evaluation was that in case studies of key policy initiatives, the PRA had succeeded in advancing both its primary objectives and the SCO.

4.2 Alongside these positive findings, the IEO also found limited evidence of initial misgivings about the SCO, possibly reflecting legacy concerns about the potential for the SCO to conflict with the PRA's primary objectives. In the view of the IEO, such concerns may have slowed the PRA's early progress in embedding and communicating on the SCO.

5 The IEO's recommendations and the PRA's response

5.1 The IEO has set out its recommendations under three broad headings:

- (i) inputs into policy decisions;
- (ii) infrastructure supporting policy decisions; and
- (iii) outputs of policy decisions.

¹ The case studies covered the following policy areas: FPC recommendation on loan to income ratios; Pillar 2A capital requirements; Solvency II transitional deductions from technical provisions; creation of the PRA Rulebook; structural reform; and reforms to Authorisations policy.

5.2 The recommendations are set out in full below, followed by the PRA's response, a summary of which is presented in Appendix 1.

Inputs into policy decisions

Recommendation one: Identification and prioritisation of competition issues

- Refine processes to ensure competition issues are consistently identified early in policymaking, including by:
 - developing 'trigger' questions to help identify where additional analysis is needed; and
 - strengthening existing horizon-scanning exercises.
- Ensure research focuses on the questions the PRA needs to answer, including on the relationship between the PRA's primary and secondary objectives.
- Keep the adequacy of existing specialist competition resources under review.

PRA response

5.3 The PRA agrees that internal processes that ensure early identification by policy makers of competition issues are key and the use of 'trigger' questions will help in this regard. In light of the IEO's findings, the PRA's policy making processes, as set out in an internal policy guide, have been revised and updated. This includes, for example, guidance aimed at ensuring, as recommended by the IEO, that the PRA's senior advisor on competition and/or the PRA's in-house experts, attend meetings of the PRA Policy Strategy Forum at which new policy issues are aired for the first time and are subsequently able to provide challenge at meetings of the PRA's policymaking committees. The internal policy guide will also include a set of supporting 'trigger' questions.

5.4 The PRA has an active research programme, with projects overseen at both Directorate level and as part of the Bank of England's 'One Bank Research Agenda'. A number of projects related to competition have been approved and are now in progress. These aim to develop the PRA and wider Bank's understanding of the relationship between prudential regulation, financial stability and effective competition. For example, initial work to develop indicators of competition in UK retail banking markets is well advanced and will provide the building blocks for further analysis of the relationship between competition, safety and soundness and financial stability.

5.5 Although starting from a strong base in the area of research, the PRA accepts that it will need to be proactive in maintaining momentum and ring-fencing resources to ensure the delivery of high priority research projects aimed at advancing the PRA's SCO.

5.6 The PRA recognises the importance of having competition expertise on which to draw and has recruited additional competition specialists to its Prudential Policy function and, in 2015, appointed a PRA Senior Advisor on Competition. The PRA agrees that it is important to monitor the adequacy of its existing expert resources on an ongoing basis. As such, the PRA considers that there is scope to go further by actively building and maintaining expertise in the area of competition through secondments, training programmes and dedicated research (further detail is provided below). This will enable the PRA to not only further enhance its depth of expertise, but provide intellectual leadership as well as disseminate knowledge more widely with a view to hardwiring it within the organisation.

Infrastructure supporting policy decisions

Recommendation two: Clear articulation of the PRA's approach to the SCO

- Ensure sufficient clarity among PRA policy staff on the statutory requirements of the SCO and the PRA's intended approach to delivering on them.
- Improve internal dissemination of recent thinking on the SCO, including potential synergies with the PRA's primary objectives, and the interpretation of 'effective' competition.
- Accelerate 'learning by doing' by consolidating what is known about competition issues that commonly arise in policy design.

PRA response

5.7 The PRA sees merit in enhancing the clarity of articulation of its approach to the SCO. To that end, it is rolling out a series of awareness raising sessions for its policy staff supplemented by a half-day training course on competition as part of its core training programme. These sessions will be led by our in-house competition experts as well as drawing on relevant seconded expertise. The awareness raising and training sessions are designed specifically to address the need to ensure clarity of understanding on the statutory requirements of the SCO and the PRA's approach to meeting them. Both sessions will be integrated into the PRA's induction processes for new joiners and offered to existing staff on an ongoing basis.

5.8 Work on potential synergies between competition and safety and soundness, the PRA's interpretation of effective competition and lessons learnt will be included in the staff presentations and inform part of the training course. These will be disseminated through a dedicated intranet site on competition that will be easily accessible to all Bank of England and PRA staff.

Recommendation three: Embedding the SCO into policymaking

- Update internal guidance to stress that the SCO is relevant throughout policymaking, not just in cost benefit analysis, and that it implies developing competition-facilitating policy options.
- Use internal guidance to reinforce the intended proactive approach to the SCO when influencing the development of prudential policy, including in domestic and international fora.

PRA response

5.9 The PRA has updated its policy guide to include clear guidance on the need to consider the SCO throughout policy making, including consideration of competition-facilitating policy options.

5.10 Taking on board the IEO recommendation, the revised policy guide also highlights the importance of the PRA keeping the SCO in mind when influencing prudential policy making. The PRA's response to the European Commission's review of the impact of the CRR and CRD IV on long-term financing, in which the PRA put forward the case for a more proportionate treatment of small firms, is an example of this.¹

¹ Response to the European Commission's public consultation on the possible impact of the CRR and CRD IV on bank financing of the economy, available at: www.bankofengland.co.uk/prd/Documents/crdiv/responsecrrcrdivbankfinancingannex2.pdf.

Recommendation four: Governance

- Enhance the effectiveness of the six-monthly updates to PRA Board, including through more systematic reporting on policy initiatives.
- Demonstrate consistent compliance with the SCO across internal and external policy materials.

PRA response

5.11 The PRA Board has received six-monthly updates on competition since the SCO was activated in March 2014. The updates have included reports on policy initiatives raising competition issues, such as the PRA's work to implement ring-fencing requirements, as well as progress towards embedding the SCO in the PRA.

5.12 The PRA agrees that it is important to ensure it can demonstrate consistent compliance with the SCO both internally, given its obligations to report to the Bank's Court of Directors on how it is meeting its statutory obligations, and in its external communications, for example in its Annual Report and, specifically from 2016 onwards, in its Annual Competition Report (ACR). To do so, information about competition issues arising in policy making should always be made available to the PRA's Board and policy committees. Where appropriate, the PRA's internal guidance for policy makers taking papers through its policy committees has been revised to ensure that competition considerations are properly identified to further facilitate discussion by the PRA's policy committees.

Recommendation five: External co-ordination with competition regulators

- Build understanding of the PRA's remit, and invest further in co-ordination, with relevant competition regulators.

PRA response

5.13 The PRA agrees with the importance of working effectively with competition regulators, in particular with the FCA and CMA. Arrangements include regular senior-level bilaterals of the PRA and FCA with competition as a standing agenda item and use of secondments. These arrangements are complemented by a formal PRA-FCA Memorandum of Understanding, which has been updated to reflect the existence of the PRA's SCO and the acquisition by the FCA in April 2015 of concurrent competition law powers. These revisions now ensure all elements of the MoU are fully aligned.

Outputs of policy making

Recommendation six: External communications

- Use forthcoming communication vehicles (eg new ACR) to set out more fully the PRA's recent experience and evolving thinking towards the SCO.
- Find opportunities to communicate on the PRA's approach to the SCO to a suitably wide set of stakeholders.

PRA response

5.14 The PRA agrees that transparency and accountability are essential for effective policy. As such it wholly accepts the IEO's recommendation to seek proactively opportunities to engage with a wider set of stakeholders. In this regard, the PRA has set out its approach to the SCO in a Quarterly Bulletin article published in December 2015; has updated its Supervisory Approach

documents (in March 2016 to further embed the SCO);¹ and has used speeches and responses to external publications to deliver key messages on competition issues. These include the PRA CEO Andrew Bailey's Mansion House speech in autumn 2015² and the Bank of England's response to the European Commission's CRD IV review.³

5.15 Communication will also be enhanced by the publication of the PRA's ACR which affords it the opportunity to give a clear articulation of how it interprets the SCO, how the SCO interacts with the PRA's primary objectives, and how it is delivering against the SCO both in terms of policy initiatives and in its general supervisory rulemaking, such as the improved process for authorising and nurturing new entrants being delivered via the joint PRA and FCA New Bank Start-up Unit.

6 Conclusion

6.1 The PRA welcomes the IEO's evaluation which presents an accurate assessment of the steps the PRA has taken to date in its early implementation of the SCO. The IEO found many positive aspects to the PRA's approach to the SCO and identified the challenges faced by the PRA in seeking to embed its new objective. The IEO's evaluation has helped focus the PRA's thinking on key aspects of its evolving approach to the SCO. The PRA is fully committed to delivering the actions set out in this paper in response to the IEO's recommendations, and in doing so enhancing its accountability to Court. The PRA believes that these initiatives will establish a benchmark of good practice on prudential interventions being applied sensibly and proportionately by considering prudential regulation through a competition lens. They will significantly enhance the PRA's ability to meet this important aspect of its statutory duties and help reinforce the PRA's contribution to the UK Government's wider economic policy agenda which places particular importance on the role of competition in fostering efficient market outcomes.

1 The PRA approach document, available at:

www.bankofengland.co.uk/publications/Pages/other/prasupervisoryapproach.aspx.

2 Progress on prudential regulation and three areas to complete - speech by Andrew Bailey, available at www.bankofengland.co.uk/publications/Pages/speeches/2015/854.aspx

3 Response to the European Commission's public consultation on the possible impact of the CRR and CRD IV on bank financing of the economy, available at www.bankofengland.co.uk/pradocuments/crdiv/responsesecrrcrdivbankfinancingannex2.pdf.

Appendices

1 Summary of PRA response

Appendix 1: Summary of PRA Response

Inputs into policy decisions	Infrastructure supporting policy decisions	Outputs of policy decisions
<p>1. Identification and prioritisation of competition issues</p> <ul style="list-style-type: none"> • Update internal policy guide to give clear role for competition experts in earliest stages of policy identification and prioritisation and include a set of trigger questions to help all staff identify material competition issues in the course of developing policy. • Use policy-focused horizon scanning to prioritise selection of research projects and use the Research Hub to ensure resources are properly ring-fenced. • Deepen expertise, provide intellectual leadership and disseminate knowledge more widely through provision of training, use of secondments and dedicated research. 	<p>2. Clear articulation of the PRA's approach to the SCO</p> <ul style="list-style-type: none"> • Enhance clarity of internal articulation of the PRA's approach to the SCO through use of presentations, bespoke training courses, seminars, inclusion in staff induction programmes and intranet pages dedicated to competition. <p>3. Embedding the SCO into policymaking</p> <ul style="list-style-type: none"> • Update internal policy guide to ensure competition issues are identified, analysed and articulated throughout the policy making process. • Take proactive approach to influencing policy making with the SCO in mind, both domestically and when pursuing the PRA's international strategy. <p>4. Governance</p> <ul style="list-style-type: none"> • Strengthen systematic reporting on policy initiatives to ensure the PRA Board receives the information it needs to raise, challenge and debate relevant competition issues. • Update internal policy guide to ensure that discussions and decisions relating to competition are properly identified to facilitate discussion by the PRA's policy committees. <p>5. External co-ordination with competition regulators</p> <ul style="list-style-type: none"> • Strengthen links with competition regulators for example through regular senior level engagement, including competition as a standing agenda item for senior level bilaterals with the FCA, and use of secondments. • Ensure PRA-FCA MoU remains up to date. 	<p>6. Enhance external communications</p> <ul style="list-style-type: none"> • Set out approach to SCO in Quarterly Bulletin article, Approach Documents, speeches and Bank submissions to external policy reviews. • Use Annual Competition Report to reinforce key messages and showcase illustrative examples of the impact of the SCO in practice.