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News release

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The revolution is over. Long live the revolution! – Speech by Sam Woods

At the Mansion House City Banquet, Sam Woods gives his first speech as Deputy Governor for Prudential Regulation and Chief Executive of the Prudential Regulation Authority (PRA). He welcomes the post-crisis revolution in regulatory standards and commits to completing their implementation, so that firms can adapt their business models to the new world.

Sam describes the PRA's goals as: a strong and stable banking system with no taxpayers' money spent on bailing out a PRA-regulated financial institution, and a resilient insurance sector which does not pass risks back to policyholders when they crystallise. Sam says, "I think those goals are in sight, and the remaining path to them is now largely set. Therefore, while I cannot speak for other countries, my assessment is that here in the UK we have reached the end of the revolutionary period in which major reforms to prudential standards were required in response to the 2008 financial crisis. Of course, there is important work to finish off in Basel, and constant *evolution* will be necessary as firms and financial markets themselves evolve. No regime is or ever will be perfect, but I think the one we are settling on is a massive improvement on the old one".

Recalling Zhou Enlai's famous comment in 1972 on the impact of the Paris riots a few years before – originally mistaken as referring to the French Revolution of 1789 – Sam says it is "too early to say" how business models will shape up in the future. "For insurers, the low rate environment and persistent soft conditions in many segments of general insurance are creating real pressures. And judging from their persistent low profitability and price-to-book ratios, developing sustainable business models remains a major challenge for many banks". One important element of this is misconduct, "where the peak of the crisis for banks has arisen more slowly than the prudential crunch in 2008", but it is only part of the picture. Sam points to a recent study by Sarin and Summers, highlighting the market metrics by which the banking system still looks fragile. He warns that "we would be unwise to ignore these signals". Many banks have simply not yet adapted to the new prudential constraints or the lower-rate environment. "This is now a first-order issue for us as the PRA and FPC".
Sam describes his own approach as "firm but fair, using all of the latest analytical tools and techniques, together with a healthy dose of common sense". He emphasises his commitment to the PRA's statutory objectives, which "form a complete and coherent whole". In Sam's view, our mixed economy system is

“much better than the alternatives of a financial sector owned by the taxpayer or a laissez-faire, tick-box regime – especially because history teaches us that the latter may well lead to the former”. Some of the pleas for changes to the reforms agreed over the last eight years are not the modest “tweaks” they are claimed to be: we are “wise to the disguise”. As memories of the last crisis fade, the PRA will continue to ask searching supervisory questions of each firm (“that is the bread and butter of our role”) and – with the FPC – make sure the system is robustly regulated whatever the outcome of the government’s negotiations with the European Union (“no bonfire”).

Sam makes clear, “for the avoidance of doubt: what was intended will be implemented”. Among the significant ongoing implementation work, Sam highlights bail-in, on which the Bank will shortly publish its final policy, and ring-fencing, which is “full steam ahead” as firms work to implement their plans in time for the government’s 2019 deadline. “Another way we will preserve the progress that has been made is to recruit the forces of market discipline to our cause”. Sam announces that next week we will launch a new quarterly statistical release which will show – on a consistent basis – levels of capital and risk-weighted assets for the UK banking sector, with breakdowns of the movements in different tiers of capital and risk exposure types. In addition, the PRA plans next summer to publish a Discussion Paper seeking an open exchange of views on a disclosure framework for banks’ and insurers’ regulatory data.

The PRA will identify and pursue opportunities to address unintended consequences, giving “a smoother finish to the reforms”. Sam welcomes the prospect of an EIOPA review of the risk margin’s role in the context of Solvency II. Turning to the banking reforms currently being discussed in Basel, Sam says he has long been troubled by the gap in risk-weights for low-LTV mortgages between firms who use models to calculate them and (typically smaller) firms who use the standardised weighting provided by regulators. He hopes the UK will be able to secure a significant lowering of the latter. He also intends that the PRA will bring forward proposals under the UK’s Pillar 2 regime which should reduce the risk that capital standards are overly prudent for smaller firms using the standardised approach to credit risk, and will deliver what was promised in the PRA’s Annual Competition Report this summer, improving the process by which small firms can transition to internal models.

Sam concludes that “by remaining true to the revolution – while not wasting our time and energy in refighting it – we can all turn our attention to the challenges of the future. In this way we will reinforce the stability of the financial system, for the good of the people of the United Kingdom. The revolution is over. Long live the revolution!”

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