

Bank of England

Prudential Regulation Authority

The Prudential Regulation Authority's approach to policy

Discussion Paper | DP4/22

September 2022



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Responses are requested by Thursday 8 December 2022.

The PRA prefers responses to be sent via email to: DP4_22@bankofengland.co.uk

Foreword

Since 2020, the government has been considering how the financial services regulatory framework in the UK should be shaped following our departure from the European Union, through the Future Regulatory Framework (FRF) Review. The outcomes of this review are now being implemented through the Financial Services and Markets Bill (FSM Bill). This Bill will repeal most retained EU law in financial services and enable the regulators to make new rules in relevant areas. As a result, the Prudential Regulation Authority (PRA) expects to take on new responsibilities in several areas that are currently regulated by retained EU law. We are publishing this document outlining how we intend to operate following the reforms, in order to help inform the debate as Parliament scrutinises the FSM Bill.

The FRF Review proposed moving back to a more British style of regulation based on the Financial Services and Markets Act 2000 (FSMA), with most of the technical rules made by operationally independent regulators subject to a revised accountability framework. Given our expected extra responsibilities, we recognise the importance of and welcome additional accountability, including through the new measures set out in the FSM Bill.

The FSM Bill does not make changes to our primary objectives, which would therefore remain the safety and soundness of firms and policyholder protection. This means maintaining robust prudential standards, which are a cornerstone of UK financial stability and the international reputation of the UK as a safe and attractive place to do financial services business. The FSM Bill introduces an additional secondary objective to facilitate, subject to alignment with international standards, the international competitiveness of the UK economy and its growth in the medium to long-term. Given the anticipated expansion in the PRA's role, we will approach this new secondary objective in a fully engaged and proactive manner – as we have done for our current secondary competition objective.

We intend to take full advantage of the opportunities that the reforms will create. In doing so, we aim to address risks and opportunities in a responsive and dynamic manner, appropriately tailored to the circumstances of the UK. Indeed, we are already taking action where we can, for example through the work we have underway to simplify the prudential regime for small banks and building societies through our 'strong and simple' initiative.

We also recognise the regulatory framework is complex and fragmented. We want to change this, by making our policies more accessible and easier to understand. We have taken a first step on that front by publishing a Prudential and Resolution Policy Index, which should make it much easier for users to find relevant policies by topic area. The provisions in the FSM Bill will enable us to do more over time.

This discussion paper (DP) explains our ideas about how we can best realise that vision. It has been developed based on the FSM Bill as introduced in Parliament on Wednesday 20

July. The DP therefore does not cover the 'intervention power', which the government has since stated it intends to introduce through the parliamentary process as an amendment to the FSM Bill. We hope the DP will help inform Parliament as it considers the FSM Bill, and any other stakeholders with an interest in how the PRA makes policy. Your responses will help us finalise our proposals for a future consultation on the PRA's approach to policy-making.

We look forward to receiving your comments on the paper.



Sam Woods

CEO of the Prudential Regulation Authority and Deputy Governor for Prudential Regulation,
Bank of England

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Executive summary

The introduction of the FSM Bill is an important moment for the PRA. The FSM Bill implements the FRF Review. The reforms introduced under the FSM Bill will broaden our responsibilities, which the government has judged beneficial when it considered how the financial services regulatory framework should adapt for the future, reflecting the UK's position outside the EU. We will use this opportunity to refine the way we make policy, ensuring we consistently deliver on our responsibilities in a strong, accountable, responsive and accessible way.

Our position as an operationally independent regulator is an important safeguard for the UK financial system, allowing us to take a long-term, independent view of risks and the measures needed to address them. The International Monetary Fund (IMF) recognised the importance of independence in supporting our effectiveness as a regulator in its most recent Financial Sector Assessment Programme (FSAP), published in February this year.¹ Our independence also underpins the stability and predictability of the UK's regulatory regime, which helps make the UK an attractive place to do business for firms.

Strong standards

We regulate firms in accordance with the framework set by Parliament. Under the current framework, we have two primary objectives: a general objective to promote the safety and soundness of the firms we regulate; and an objective specific to insurance firms, to contribute to ensuring that policyholders are appropriately protected. We also have a secondary objective to facilitate effective competition in the markets for services provided by PRA- authorised firms. This is engaged as we pursue our primary objectives – either when making new policy or updating existing policy. In pursuing our objectives, we work closely with other authorities with responsibility for regulating other aspects of the UK's financial sector, such as the Financial Conduct Authority (FCA).

Our primary objectives will remain the same under the reforms introduced by the government. Strong prudential standards support the stability of regulated firms, and are an essential component in achieving financial resilience and mitigating against financial shocks. A resilient financial system with safe and sound banks and insurers is required to support the sustainable provision of financial services, and a strong and dynamic economy overall. Strong standards and a resilient financial system also support the UK's competitiveness by providing firms, customers and counterparties with reassurance that they can do business here with confidence.

The global financial crisis (2007-08) illustrated the consequences of insufficient resilience in the financial system, resulting in widespread economic distress and taxpayer funded bailouts

¹ Available at: <https://www.imf.org/en/Publications/CR/Issues/2022/02/22/United-Kingdom-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513442>.

of financial institutions – with total government support for the financial system in cash and guarantees of almost £1.2 trillion at its peak.² Beyond the global financial crisis, there have also been a range of other financial failures, including those of Barings Bank, the Bank of Credit and Commerce International, and the subsequent small banks crisis of the early 1990s. These failures had a significant impact on depositors, the wider financial system, and the reputation of the UK as a financial centre - reinforcing the importance of strong prudential standards. Similarly for insurance, previous events such as Equitable Life and the problems at Lloyd's in the 1990s illustrate the potential for significant safety and soundness issues to affect the insurance sector, and the adverse impact such events can have on policyholders, and on availability of insurance coverage.

We take a proactive approach to pursuing our secondary competition objective, recognising the role that effective competition plays in improving the supply of financial services to the real economy. Effective competition encourages innovation and efficiency among firms, bringing benefits for both the financial sector and consumers. Our proactive approach, which has actively influenced policy outcomes, is embedded in our internal policy-making and supervisory processes, and we carefully consider the potential impact on competition when deciding between policy options.

The FSM Bill introduces a new secondary objective that will sit alongside our existing secondary objective. It will require the PRA to act in a way which, subject to aligning with relevant international standards, facilitates the international competitiveness of the UK economy (including in particular the financial services sector through the contribution of PRA-authorized persons), and its growth in the medium to long-term.

The long-term competitiveness of the UK is underpinned by a robust and effective prudential regime, built around global standards, in a way that instils trust and confidence in the UK as a place to do business. We will also be proactive in our approach to the secondary competitiveness and growth objective and will look for opportunities to advance it. We will look more broadly at the ways in which the PRA can facilitate competitiveness and growth, taking advantage of the additional opportunities we will have under the FSM Bill to review areas of policy that have previously been fixed in UK legislation. That includes: providing firms with predictability over potential changes; being open to international firms and business; considering the market impact of our proposals on UK competitiveness and growth relative to approaches taken in other jurisdictions; and making our regulatory framework more accessible and user-friendly.

The UK is an important part of a deeply interconnected global financial system, and therefore the risks that we face often emerge beyond our borders. The size and international importance of the UK financial system has led the IMF to refer to UK financial stability as a 'global public good'. We therefore work closely with our international partners to ensure the UK maintains a strong reputation internationally, so we are able to address shared challenges and pursue our objectives. This work frequently involves the creation of

² Bank rescues of 2007-09: outcomes and cost (parliament.uk):
<https://researchbriefings.files.parliament.uk/documents/SN05748/SN05748.pdf>.

international standards, which support a level playing field and a globally resilient financial system.

Our standing as a member of the international regulatory community, and our ability to influence international standards, is underpinned by our operational independence. Our position as an operationally independent regulator is an important safeguard for the UK financial system, allowing us to take a long-term, independent view of risks and the measures needed to address them.

Our influence in the international standard-setting process enables us to ensure UK interests are reflected in the standards agreed with our international partners, which supports the UK's medium to long-term competitiveness. Having exited the EU, we now have the opportunity to implement international standards in a manner that is more appropriate for the UK market.

As an operationally independent regulator, we are committed to the faithful implementation of international standards, and we support their implementation by our international partners. When implementing international standards, we do so in a manner that advances our objectives, including the new secondary competitiveness and growth objective which references alignment to international standards, and is consistent with our regulatory principles.

Accountability

We act within a strong policy and accountability framework set and overseen by Parliament, advancing the objectives Parliament and the government have given us. We are accountable to Parliament for delivering those objectives and work closely with HM Treasury ('HMT') to ensure that the regulatory regime functions efficiently. We also engage with industry and civil society stakeholders through the policy-making process.

As we take on wider responsibilities, we recognise the importance of appropriate accountability, greater transparency, and clearly communicating the reasoning underpinning our judgements. We will continue to engage with HMT, and will enhance our engagement in certain areas in response to reforms introduced in the FSM Bill, such as HMT's power to require regulators to review their rules.

We will continue to explain how our interventions advance our objectives and conduct analysis of our decisions against our regulatory principles. In doing so, we will support Parliament in holding us to account by explaining how we have come to our decisions. As part of being transparent, we already conduct cost benefit analysis (CBA) of proposed rules. We will publish our methodology for CBA, and our approach to engaging with the new CBA panel comprised of external members, in line with the provisions of the FSM Bill.

Responsive approach

As we take on wider rule-making responsibilities, we will have the opportunity to be more responsive when making policy. The ability to update rules directly in the PRA Rulebook will

allow us to respond quickly to changes in the external environment. We will have more scope to adapt our rules to account for new risks and innovations (for example from climate change or in fintech), and to calibrate our approach in a way that better reflects the characteristics of our regulated firms and the UK financial system.

We are already taking steps in this direction. For example, the ‘Strong and Simple’ initiative for small firms with a domestic focus aims to support the dynamism of the UK’s financial sector, as well as being good for competition.³ The broader changes being implemented through the FSM Bill will allow us to be more flexible in our response to risk: choosing from a range of responses when we decide to act, from policy to supervision. Importantly, this more responsive approach does not mean constantly changing requirements for firms or reducing our strong standards; it means acting swiftly, proportionately, and in a targeted manner.

We value stakeholders’ engagement as we develop policy, particularly the provision of data and evidence, which helps us understand the practical implications of our proposals. We want to increase the amount of engagement with stakeholders through the policy-making cycle, and we also want to engage a broader range of stakeholders. Our expected broader rule-making responsibilities, more responsive approach, and the requirement in the FSM Bill to establish a new CBA panel, will mean that we need more data from our stakeholders to inform our policy-making. This will help us better understand the anticipated costs and benefits of our proposals, and enable us to calibrate our approach to reflect the UK financial system. At the same time, we also have a programme of work to review regulatory reporting. We have already streamlined reporting requirements in insurance, with full reviews of data collection to follow in both insurance and banking.

Evaluation is also an important part of being responsive. It informs future policy development and improves existing policies. But we need to weigh up the benefits of reviewing current policies and those of identifying and addressing new policy issues. We aim to strike a balance that allows us to pursue our objectives most effectively. As part of our work to enhance our approach to external engagement, we are committed to improving our engagement with our stakeholders in the evaluation phase of the cycle. As stipulated by the FSM Bill, we will publish a framework for evaluation setting out how we will review our rules in the future.

Accessible rulebook

The regulatory framework is currently complex and difficult to navigate, partly because it sits across a range of sources, including retained EU law as well as PRA requirements. We will use the opportunities under the FSM Bill and our new policy-making approach to streamline the current framework, and deliver a first-rate Rulebook. This will involve reforms aimed at improving the accessibility, efficiency, usability and clarity of our policies. Our aspirations for Rulebook reform will take some time to deliver. The speed of implementation will depend on

³ Discussion Paper 1/21 ‘A strong and simple prudential framework for non-systemic banks and building societies’, April 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks>.

the approach the government chooses to take to the repeal and replacement of relevant retained EU law into PRA Rules, including the complexity of the relevant retained EU law. In the interim, we will deliver early benefits to stakeholders, such as the publication of the Prudential and Resolution Policy Index, which allows users to more easily find relevant policies from a variety of sources by topic area.⁴

Next steps

Our intention is that our approach to prudential policy-making will always be proportionate, and suited to the circumstances. We will aim to follow the steps and processes explored in this document, where possible. But we also stand ready to act rapidly where necessary to support the resilience of the UK's financial system, as we did in responding to the Covid-19 pandemic in 2020.

We want to start a conversation with our stakeholders to help shape our approach to policy-making. This DP is the first in a series of planned publications as we develop our approach. We welcome views from all our stakeholders.

⁴ PRA Policy Index: <https://www.bankofengland.co.uk/prudential-regulation/prudential-and-resolution-policy-index>.

1. Introduction

1.1 We, the PRA, as part of the Bank of England (the Bank), are the UK's prudential regulator for deposit-takers, insurance companies, and designated investment firms. Our primary objectives are to promote the safety and soundness of firms, and to contribute to securing an appropriate degree of protection for insurance policyholders. We work closely with other bodies with responsibilities for the resilience of other parts of the UK financial services sector, including the FCA.⁵

1.2 A vibrant financial sector underpins core economic activities and supports a healthy and growing economy. But to ensure that consumers and businesses can borrow, invest, and manage risk with confidence, it is vital that the financial system and individual institutions within it are sufficiently robust to withstand shocks. The effective pursuit of our primary objectives helps lead to a resilient and stable financial system, which helps to create and preserve the conditions to allow sustainable long-term growth across the whole economy. As explained below, reforms introduced by the government mean we will have new opportunities to make policy in ways that promote resilience, while supporting dynamism and innovation within the financial sector.

1.3 This DP is the first in a planned series of publications which will set out our approach to policy-making as changes to the framework within which we operate are implemented. We aim to establish and maintain published policy material (i.e. rules and other materials such as supervisory statements) that is consistent with our objectives, clear in intent, straightforward in presentation, and as concise as possible.

1.4 This work is taking place within the wider context of the government's FRF Review, which considered how the financial services regulatory framework should adapt for the future, in particular to reflect the UK's new position outside the EU. The FSM Bill,⁶ which implements outcomes of the FRF Review, was recently introduced to Parliament. As a result of the FSM Bill, and the government's proposals regarding the use of the powers in the FSM Bill, the PRA expects to have expanded policy-making and rule-making responsibilities for most areas of prudential policy within our remit. The approach set out in this document is predicated on the terms of the FSM Bill as introduced in Parliament.

1.5 The reforms represent a fundamental increase in the scope of our policy-making responsibilities. We are publishing this DP to start a conversation on how we approach policy-making following the repeal of retained EU law and as we take on new responsibilities.

⁵ The mandates of the PRA and the FCA are different. The integrity of the provision of financial services to users falls under the mandate of the FCA.

⁶ The FSM Bill may be found here: <https://bills.parliament.uk/bills/3326>.

This builds on our existing approach under the framework established by the Financial Services and Markets Act 2000 (FSMA). Since the global financial crisis (2007-08), the PRA has been involved in a number of significant reforms, including implementing the Basel III reforms under the Financial Services Act 2021 (FS Act 2021), introducing the Ring-Fencing Regime under the Financial Services (Banking Reform) Act 2013, and implementing the Senior Managers and Certification Regime (SMCR). We now aim to take the opportunities presented by the reforms in the FSM Bill to refine the way we make policy, ensuring we consistently deliver in a strong, accountable, responsive and accessible way.

1.6 In this spirit, the DP outlines the PRA's initial thinking on its approach to policy-making once the FSM Bill has passed. The DP focusses on how we propose to make policy and communicate with our stakeholders, along with our aspirations for the PRA Rulebook. It is not about the substance of specific policies.

1.7 This DP is intended to begin a process of dialogue as our approach takes shape. We welcome views from our stakeholders and we have included questions throughout the DP. The DP will be followed by a consultation paper (CP) after the FSM Bill receives Royal Assent. Responses to the CP will then inform our final Policy Approach document, which we intend to be the policy equivalent of the PRA's Approach to Supervision publications.⁷ We will also publish separate documents on our approach to CBA and how we review our rules.

Discussion paper structure

1.8 Chapter 2 summarises our current framework of objectives and regulatory principles.

1.9 Chapter 3 describes how we approach our current primary and secondary objectives, and take into account our regulatory principles, along with the interactions between them. The chapter also outlines how we will take a proactive approach to the new secondary objective, and how we envisage this fitting within the existing framework.

1.10 Chapter 4 describes why and how we engage internationally to pursue our objectives, including through the development and implementation of international standards. It discusses how the integration of the global financial system benefits the UK financial system while also creating risks, and sets out how we respond to these risks. It also describes how we take an outcomes based approach to 'equivalence' advice.

1.11 Chapter 5 describes our approach to creating and maintaining our prudential policy framework, which we refer to as the 'policy cycle'. Much of this will remain consistent with our

⁷ Available at on PRA's approach to supervision of the banking and insurance sectors: <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

current approach, though we also outline areas where our approach will change – for instance in relation to stakeholder engagement.

1.12 Chapter 6 outlines the PRA’s ambition to deliver a first-rate Rulebook for the UK, by moving towards a more accessible, usable, efficient, and clearer set of policies. It summarises four key areas of reform that will facilitate this outcome, and explains the interaction with the repeal and replacement of retained EU legislation into PRA Rules.

Responses and next steps

1.13 This DP closes on Thursday 8 December 2022. The PRA invites feedback on the topics discussed in this DP. Please address any comments or enquiries to

DP4_22@bankofengland.co.uk.

2. Our objectives and regulatory principles

This chapter describes the framework of objectives and regulatory principles within which we currently operate, and how it will change after the FSM Bill 2022 receives Royal Assent.

The current framework of objectives and regulatory principles

2.1 Under the FSMA 2000 (as amended), we have two primary objectives when making policy:

- when discharging our general functions, we must, so far as is reasonably possible, act in a way which advances our general objective of promoting the safety and soundness of PRA-authorised persons; and
- in relation to insurance activity, we must also, so far as is reasonably possible, advance the insurance objective of contributing to the securing of an appropriate degree of protection for policyholders.

2.2 FSMA requires that we advance the general objective primarily in three ways: by seeking to ensure that the business of PRA-authorised persons is carried out in a way that avoids any adverse effect on the stability of the UK financial system; by seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system, and by seeking continuity of provision of core banking services by ring-fenced bodies. The primary objectives do not, however, require the PRA to ensure that no PRA-authorised firm fails.

2.3 These primary objectives rank above our other considerations when making policy. When acting to pursue the general objective and insurance objective, we must also, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by the firms that we supervise. This secondary objective is engaged when we are proposing to take action in pursuit of the general objective and insurance objective, and does not rank above these.

2.4 There are a set of regulatory principles to which we must have regard. For our purposes 'regulatory principle' is defined as the principles in section 3B of FSMA and other matters that the PRA is required or should have regard to. These are described below. FSMA requires that we must 'have regard' to a number of regulatory principles when discharging our general functions. These principles relate to: the efficient use of our resources; the proportionality of our regulation; sustainable growth; consumer responsibility; responsibility of firms' senior management for compliance; recognition of differences between businesses; publication of information; and the transparent exercise of the PRA's functions.

2.5 Under provisions introduced into FSMA by the FS Act 2021, we must also ‘have regard’ to certain regulatory principles when making ‘CRR rules’⁸ which replace CRR provisions or implement Basel standards. These include: the relevant Basel standards; the relative standing of the UK as a place for internationally active banks and investment firms to be based or carry on activities; the provision of finance to UK businesses and consumers on a sustainable basis; and the 2050 net-zero target in the Climate Change Act 2008 (for rules made after 1 January 2022). We must also consider, and consult HMT on, the likely effect of CRR rules on relevant equivalence decisions. The FSM Bill deletes the CRR rules framework including the regulatory principles on competitiveness and climate change (as these are replaced by other provisions in the FSM Bill), subject to commencement by HMT.

2.6 In addition to the requirements in FSMA, the Bank of England Act 1998 provides that the Prudential Regulation Committee (PRC) should have regard to aspects of the government’s economic policy recommended by HMT when considering how to pursue its objectives and apply the regulatory principles. HMT makes these recommendations in a letter to the PRC. HMT’s current recommendations are set out in its 2021 PRC recommendations letter,⁹ covering: competition; growth; competitiveness of the UK; innovation; trade and inward investment; better outcomes for consumers; and climate change. The FSM Bill introduces a requirement for PRC to respond to the recommendations letter. The FSM Bill also replaces the existing regulatory principle on the desirability of sustainable growth, with a new principle to achieve compliance with the government’s 2050 net-zero target. In April 2022, HMT added a recommendation in relation to the UK government’s energy security strategy.¹⁰ For simplicity, we refer to all of the above as ‘regulatory principles’ in this document.

2.7 Other cross-cutting legal requirements also apply to regulatory policy-making, including:

- the public sector equality duty in the Equality Act 2010;
- having regard to the principles of good regulation and the regulators’ code under the Legislative and Regulatory Reform Act (LRA) 2006; and
- having regard to the conservation of biodiversity under the Natural Environment and Rural Communities Act (NERCA) 2006.

How the PRA’s framework of objectives and regulatory principles will change under the FSM Bill

2.8 The FSM Bill 2022 makes three key amendments to the framework of objectives and regulatory principles under which we operate.

2.9 The FSM Bill introduces an additional secondary objective which, subject to aligning with relevant international standards, facilitates the international competitiveness of the UK

⁸ ‘CRR’ refers to the Capital Requirements Regulation.

⁹ Available at: [Recommendations for the Prudential Regulation Committee: March 2021 - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/1067015/Recommendations_for_the_Prudential_Regulation_Committee_March_2021_-_GOV.UK_(www.gov.uk).pdf).

¹⁰ Recommendation for the Prudential Regulation Committee, April 2022: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1067015/Recommendations for the Prudential Regulation Committee April 2022 final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1067015/Recommendations_for_the_Prudential_Regulation_Committee_April_2022_final.pdf).

economy (including in particular the financial services sector through the contribution of PRA-authorized persons), and its growth in the medium to long-term. As with the secondary competition objective, this new secondary objective is engaged where we are acting or proposing to take action in pursuit of our general objective and insurance objective.

2.10 The FSM Bill also replaces the sustainable growth regulatory principle under FSMA with a new principle, so that we must ‘have regard’ to the government’s 2050 net-zero target.

2.11 The FSM Bill creates a new power for HMT to add further, activity specific, regulatory principles through secondary legislation. This power creates the possibility that further regulatory principles will apply to us in future.

Proposed framework of PRA objectives and regulatory principles

2.12 Table 1 summarises the overall framework of objectives and regulatory principles set to be in place after the FSM Bill receives Royal Assent. This includes considerations in legislation specific to the PRA, and cross-cutting legal requirements that apply to regulatory policy-making in general. As the FSM Bill gives HMT a new power to add activity specific regulatory principles, the total number of regulatory principles could change.

2.13 We have grouped factors that are relevant to each other, in order to support our analysis and presentation of regulatory principles. At the same time, we recognise – and carefully consider – the nuances of individual regulatory principles. Whether we group the regulatory principle is a case-by-case decision and depends on the circumstances. The dark shading shows those which relate to our secondary competition objective, and the light shading shows those which relate to the new secondary objective. This reflects the approach that we intend to take in practice (see Chapter 3). As a comparison, in relation to monetary policy the Bank has a secondary objective of supporting the government’s economic policy, which consists of four factors to which it must ‘have regard’.¹¹

Table 1 – The PRA’s objectives and regulatory principles ¹²

Primary objectives	Source
Promote safety and soundness	FSMA 2000

¹¹ These are: operationally independent monetary policy, responsible for maintaining price stability and supporting the economy; a credible fiscal policy, maintaining sustainable public finances, while providing the flexibility to support the economy; structural reform to level up opportunity in all parts of the UK and to transition to an environmentally sustainable and resilient net zero economy, including through regulation, and an ambitious programme of investment in skills, infrastructure and innovation, in order to sustain high employment, raise productivity and improve living standards; maintaining a resilient, effectively regulated and competitive financial system that supports the real economy through the provision of productive finance and critical financial services, while protecting consumers, safeguarding taxpayer interests and supporting the transition to a net zero economy.

¹² Noting that the FSMA regulatory principle relating to CRR rules, as legislated for by the FSM Bill 2021, will be removed by the FSM Bill.

Contribute to the securing of an appropriate degree of protection for policyholders	FSMA 2000
Secondary objectives	
Facilitate effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities	FSMA 2000
Facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector through the contribution of PRA-authorized persons), and its growth in the medium to long-term.	FSM Bill 2022
PRA-specific considerations	
Competition grouping	
Competition	PRC letter
Innovation	PRC letter
Better outcomes for consumers	PRC letter
Proportionality of our regulation	FSMA 2000
Recognition of differences between businesses	FSMA 2000
Consumer responsibility	FSMA 2000
Growth and competitiveness grouping	
Competitiveness of the UK	PRC letter
Growth	PRC letter
Trade and inward investment	PRC letter
Relevant Basel standards (for CRR rules)	FSMA 2000
Relative standing of the UK (for CRR rules)	FSMA 2000
HMT consultation on relevant equivalence decisions (for CRR rules)	FSMA 2000
Provision of finance to UK businesses and consumers on a sustainable basis (for CRR rules)	FSMA 2000
HMT notification on international trade obligations	FSM Bill 2022
Consider and consult HMT on notified deference decisions	FSM Bill 2022
Climate grouping	
2050 net-zero target in the Climate Change Act 2008 (for CRR rules)	FSMA 2000
Climate change	PRC letter

UK government's energy security strategy	PRC letter
Net-zero carbon target by 2050	FSM Bill 2022
Regulatory Best Practice	
Transparent exercise of the PRA's functions	FSMA 2000
Publication of information	FSMA 2000
Efficient use of resources	FSMA 2000
LRRA principles of good regulation	LRRA 2006
Others (not grouped)	
Responsibility of firms' senior management for compliance	FSMA 2000
Any sector specific requirements	FSM Bill 2022
Cross-cutting statutory legal requirements	
Public sector equality duty	Equality Act 2010
Conservation of biodiversity	NERCA 2006

3. Our approach to our objectives and regulatory principles

This chapter describes the approach that we take to pursuing our objectives, including our early thinking on how we will approach the new secondary objective introduced in the FSM Bill. It also describes our approach to considering our regulatory principles.

Approach to our primary objectives

3.1 The UK is a globally open financial centre. The UK is the world's largest net exporter of financial services,¹³ with a surplus of financial services trade of £46 billion in 2020.¹⁴ The size and international importance of the UK financial system has led the IMF to refer to UK financial stability as a 'global public good'.¹⁵

3.2 The financial services sector is an important part of the UK economy. It generated 8.6% of UK GDP in 2020, the third largest proportion among OECD nations.¹⁶ The UK financial sector supports the wider economy through its provision of vital services. Companies and households rely on financial firms to save and invest, borrow, make payments, and distribute and pool risks. In fulfilling these critical functions, UK financial firms underpin core economic activities, as well as facilitate innovation. A well-functioning financial system supports a healthy and dynamic UK economy overall.

3.3 A resilient financial system is better able to withstand shocks, rather than amplify them, while ensuring the sustained provision of vital services – in particular those which are ring-fenced.¹⁷ Strong prudential standards are an essential component of achieving wider financial stability, mitigating the risk of financial crises such as the global financial crisis (2007-08). That crisis led to severe economic distress and taxpayer bailouts of financial

¹³ [Barriers to Trade in Financial and Insurance Services: Evidence from the United Kingdom \(imf.org\)](https://www.imf.org)

¹⁴ [Financial services: contribution to the UK economy - House of Commons Library \(parliament.uk\)](https://commonslibrary.parliament.uk)

¹⁵ United Kingdom: Financial Sector Assessment Program-Financial System Stability Assessment: <https://www.imf.org/en/Publications/CR/Issues/2022/02/22/United-Kingdom-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513442>

¹⁶ Financial services: contribution to the UK economy - House of Commons Library (parliament.uk): <https://commonslibrary.parliament.uk/research-briefings/sn05748>.

¹⁷ Available on the ring-fencing webpage: <https://www.bankofengland.co.uk/prudential-regulation/key-initiatives/ring-fencing>.

institutions. At its peak, total government support for the financial system in cash and guarantees amounted to almost £1.2 trillion.¹⁸

3.4 Academic studies demonstrate the importance of reducing the risk of financial crises in light of their high economic cost, and the value of regulatory independence in reducing that risk. The independence of supervisors from governments is one of the pillars of the Basel Committee's core principles for effective banking supervision (Basel Committee on Banking Supervision, 2012),¹⁹ and compliance to this principle is regularly assessed by the IMF and the World Bank.

Box 1: financial crises and the role of regulatory independence in financial stability

There is clear evidence that financial crises are costly, and that regulatory independence promotes financial stability.

a) The cost of financial crises

There is a substantial body of literature estimating the economic costs of banking crises, in terms of GDP forgone, to be very large on average. Differences between the results of these studies relate to – among other things – the persistence of such losses, the countries included in the sample, and the approach used to define a crisis.

The Basel Long-term Economic Impact (LEI) study (BCBS, 2010) reviewed academic studies that used various approaches to measure the cost of banking crises. The LEI study found that around half of the studies reviewed had allowed for GDP to be on a permanently lower path following a crisis. The remaining studies had measured the crisis cost by considering the period from peak GDP to the point output catches up with its pre-crisis peak, or by assuming that crises last a fixed number of years.

The LEI study reports a median drop in output of 9% (across studies which compare GDP levels at the beginning of the crisis to the trough or to the point when its growth recovers to its pre-crisis trend). Studies that found a permanent gap between the pre- and post-crisis implied growth path estimate this gap to be between 2 and 10%, with a median of 6%.

The LEI study also highlighted that the literature examining the cumulative costs of banking crises find large losses. The median cumulative output loss across comparable studies is 63% of pre-crisis output. The average loss is higher, exceeding 100%. For studies that assess cumulative costs of crises over a specified period (Hoggarth et al., 2002; Laeven

¹⁸ [Bank rescues of 2007-09: outcomes and cost - House of Commons Library \(parliament.uk\)](#).

¹⁹ Similarly, the Financial Stability Board includes the need for sufficient independence for supervisors among its recommendations to improve the intensity and effectiveness of supervision (Financial Stability Board, 2010).

and Valencia, 2008; Haugh et al., 2009; Cechetti et al., 2009), which implicitly assume that effects are only transitory, the median cumulative loss estimate is 19%. Studies that explicitly allow for permanent effects (Boyd et al., 2005; Haldane, 2010) have a much higher median estimate of cumulative loss, equal to 158%.

Romer and Romer (2015) estimate the costs of crises for advanced economies. Such economies generally experience lower costs of crises, as they tend to have greater capacity to use monetary and fiscal policy to offset the negative impact of a crisis. They estimate peak-to-trough losses to be 4% of GDP (below the LEI's 9%), and long-run losses equal to 3% (below the LEI's 6%). The LEI study considered a mix of advanced and emerging market economies, where such capacity is less likely.

Brooke et al (2015) extended Romer and Romer (2015) to tailor estimates to the UK. They estimate average peak-to-trough losses to be 5% of GDP and long-run losses be 4% of GDP for a generic advanced economy with characteristics closer to the UK. Assuming crises have permanent costs and an effective resolution regime, Brooke et al. estimate the cumulative cost of crisis to be 43% of GDP - lower than the 63% estimated by the LEI, which assumed crisis cost to have a less permanent effect.

b) The role of regulatory independence in financial stability

Since the global financial crisis (2007-08) financial regulators and supervisors have been given increased independence, and there is evidence that this operational independence contributes to long-term growth by promoting financial stability.

Quintyn and Taylor, (2002) and Herrera et al., (2019) find that delegating responsibility for regulation and supervision to independent agencies can have a beneficial effect by insulating regulation and supervision from electoral cycles. Das et al (2002) note that if banking executives know in advance that insolvent banks will be closed – and that lobbying efforts will fail – they will behave more prudently, thereby reducing the likelihood of bank failures and a financial crisis. Building on work by Klomp and de Haan (2009) and Dincer and Eichengreen (2014), Fraccaroli et al. (2020) explore the impact of regulatory independence on the stability of the banking system. They use a dataset of reforms to regulatory and supervisory independence for 43 countries from 1999-2019, combined with an index with bank-level data, to investigate the impact of reforms to independence on financial stability. From this, they find that reforms that bring greater regulatory and supervisory independence are associated with fewer non-performing loans (an indicator for financial stability) in banks' balance sheets. In addition, they provide evidence that these improvements do not come at the cost of bank efficiency and profitability. Overall, their results show that operational independence of regulators and supervisors is beneficial for financial stability.

Finally, greater financial stability (ie smoother domestic or global financial cycles) is likely to lead to smoother business cycles since these two cycles are synchronised (Claessens et al. (2012); Gerba (2015); Aldasoro et al. (2020)). This is relevant to the effect of regulatory independence in reducing (macro)economic volatility.

This is consistent with the literature examining the link between regulatory/supervisory independence and long-term economic outcomes through the promotion of higher prudential standards. Barth et al. (2013) find that supervisory independence is positively associated with bank efficiency. Furthermore, they find that the effect of supervisory independence on bank efficiency is particularly strong in countries where the regulator has greater supervisory powers, underlining the importance of the link between regulatory and supervisory independence, higher prudential standards and bank efficiency.

3.5 Strong prudential standards therefore support the sustainable provision of financial services, and a strong and dynamic economy overall. Strong standards, together with healthy competition in the financial sector, and consideration of the UK's long-term output and growth, collectively underpin the success of the UK as an international financial centre, and the ability of the financial sector to support the economy.

3.6 Because of the interconnected nature of the global financial system and the potential for financial distress to spread across borders, there are circumstances where our objectives are most effectively advanced through international standards. International standards support a globally resilient financial system, and reduce competitive inequalities between countries, enabling firms to compete on a level playing field. The importance of international standards is reflected in the new secondary objective, as well as in our regulatory principles. As an operationally independent regulator, we are committed to the faithful implementation of international standards, and we support their implementation by our international partners. When implementing international standards, we will do so in a manner that advances our objectives, including the new secondary competitiveness and growth objective which references alignment to international standards, and is consistent with our regulatory principles. Our approach to international engagement and implementation of international standards is described in Chapter 4.

3.7 In future, we aim to be even more responsive to risks and opportunities when using policy to pursue our primary objectives. While the UK was a member state of the EU, we were constrained by the necessity of agreeing collective policy responses which were appropriate for the EU as a whole. When retained EU law is repealed, this will enable us to make rules that better tailor our regime for the needs of the UK and respond faster to emerging risks, and opportunities, in the UK financial sector.

3.8 To achieve this, we will select the tools we use to address risks effectively and proportionately. Rule-making is only one of the options available to us to pursue our objectives, alongside other tools such as supervisory expectations and firm supervision (see Chapter 5).

3.9 As we take on wider responsibilities, we will also have more flexibility to tailor regulation to the UK: designing policies with UK financial risks and opportunities in mind, and which more closely reflect the unique features of the UK market as whole. This will be done in a manner which maintains the consistency and stability of regulation in the UK. Chapter 5 sets out how this more responsive approach to policy-making will manifest through the policy cycle.

Approach to secondary objectives

3.10 We have an existing secondary objective to facilitate effective competition between firms when pursuing our primary objectives.²⁰ The FSM Bill introduces an additional secondary objective which will require us to facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector through the contribution of PRA-authorized persons), and its growth in the medium to long-term.

3.11 There is a complementary relationship between our primary objectives, secondary competition objective, and the new secondary objective. Our approach to pursuing our primary objectives is grounded in maintaining a strong and dynamic UK economy, and effective competition, by supporting the efficient delivery of vital services, is an important part of this. Additionally, the resilience and dynamism of the financial sector reinforce long-term growth and contribute towards a competitive UK economy.

3.12 The secondary objectives are engaged when we pursue our primary objectives. For example, we make rules setting capital and liquidity requirements, which are important tools in the pursuit of our primary objectives. When doing so, we consider whether different policy options would have a positive or negative effect on competition, and will do the same for our new objective. In a given case, where different options are available, we will choose the option that appropriately promotes our secondary objectives while also pursuing our primary objectives. We will also consider the potential for conflict between the primary and secondary objectives, and aim to balance the different considerations when finalising our policies.

3.13 We take a proactive approach to pursuing our current secondary objective, and will do the same for the new secondary objective introduced in the FSM Bill. We identify

²⁰ See p 338-339 for definition of effective competition: Bank of England Quarterly Bulletin 2015 Q4: <https://www.bankofengland.co.uk/quarterly-bulletin/2015/q4/the-pra-secondary-competition-objective>.

opportunities to advance our secondary objectives through our practical supervisory experience, industry feedback, analysis, or research.

Approach to our secondary competition objective

3.14 Our existing secondary objective requires that effective competition between firms is facilitated, so far as is reasonably possible, as we pursue the primary objectives. Effective competition can improve the supply of financial services to the real economy, and encourage innovation and efficiency among firms.

3.15 In facilitating 'effective competition', we pursue stable competition, which encourages the long-term viability of firms and the products and services provided by customers. It does not aim to create an environment where firms can gain short-term competitive advantages through unsustainable business practices. Unstable competition, where firms adopt business models that are not viable, can undermine the objectives of the prudential regulator.

3.16 We have identified effective competition as being characterised by conditions where:

- Suppliers compete to offer a choice of products or services on the most attractive terms to customers, such as lower prices or better quality. At the same time, suppliers appropriately price in the risks associated with their businesses such that they have confidence in their ability to meet their service obligations.
- Customers have the confidence to shop around thanks to the fact that firms are subject to strong and proportionate prudential standards. Products and services can be obtained, and customers receive the products and services they expect, at a price that allows suppliers to earn a return on their investment commensurate with the level of risk taken.
- It is possible for suppliers, including those offering new products and services, to enter the market and to expand; and suppliers offering products or services on unattractive terms, or which are unable to meet their obligations, to exit the market in an orderly fashion.

3.17 Our proactive approach to the secondary competition objective is embedded in our internal policy-making and supervisory processes in several ways.²¹ Our Annual Competition

²¹ This includes: (i) Competition considerations are taken into account from an early stage of policy development, with all formal governance papers including analysis of the proposed policy on competition. (ii) Periodic review of firms' responses to regulation are undertaken to promote consistent interpretation of our rules and guidance, supporting a level playing field and thus advancing competition. (iii) Research is undertaken to better understand how PRA policies can affect competition. (iv) Bi-annual updates on competition issues are undertaken and provided to the PRC.

Reports set out the programme of work we have undertaken, and how this has materially influenced policy outcomes.²²

3.18 This proactive approach to the secondary competition objective has actively influenced policy outcomes. The PRA has launched initiatives to facilitate effective competition in retail banking. It achieved this by making the calculation of regulatory capital requirements more proportionate, levelling the playing field across the sector, and reducing barriers to entry.²³ This included narrowing the gap between capital requirements based on standardised approaches (SA) to credit risk and those based on internal ratings-based (IRB) models where they are unduly large. We also established the New Bank Start-up Unit (NBSU), and the New Insurer Start-up Unit (NISU), and recently we began developing the ‘Strong and Simple’ initiative, which will simplify the prudential framework for small banks and building societies.²⁴

Approach to the competitiveness and growth objective

3.19 The FSM Bill 2022 introduces a secondary objective to facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector through the contribution of PRA- authorised persons), and its growth in the medium to long-term.

3.20 We have already been taking international standards, competitiveness, and long-term growth into account as regulatory principles. For example, the PRA implemented a UK Net Stable Funding Ratio (NSFR) that includes targeted amendments to the relevant international standard to make it more appropriate and risk sensitive for activities that are important for UK economic growth or competitiveness.²⁵ With its new status as a secondary objective, UK competitiveness and growth will carry greater weight in our decision-making. The formulation of the objective recognises the role that the competitiveness of the financial sector can play in contributing to economic growth. It does not support courses of action that may deliver short-term benefits to growth but are detrimental to medium to long-term economic prosperity.

3.21 Our approach to our competitiveness objective will be consistent with the facilitation of effective competition. We should not reduce prudential standards for potential short-run improvements to firms’ competitiveness. Doing so may bring benefits to the current owners

²² For example, we published the Annual Competition Report 2020 on pages 47-57 of the PRA Annual Report 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-annual-report-2019-20>.

²³ For further information on these initiatives, please visit the Bank’s webpage to find its Annual Report on the secondary competition objective: <https://www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective>.

²⁴ Discussion Paper 1/21 - A strong and simple prudential framework for non-systemic banks and building societies, April 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks>.

²⁵ For further information please see Policy Statement 17/21 – Implementation of Basel Standards: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards>.

and managers of affected firms in the short-run, but may undermine financial stability, and therefore economic growth, over the medium to long-term. Strong prudential standards instil trust and confidence among key stakeholders, including international investors, firms, and regulators, and therefore support the attractiveness of the UK as a place to do business.

3.22 In developing our approach, we will consider the academic literature (summarised in Box 2) on the role of regulation in facilitating the level of economic activity in the economy, and its contribution to realised growth out into the medium to long-term. Financial regulators can facilitate economic activity through actions that reduce the likelihood of financial crises and improve the efficiency of the financial system. We will focus on facilitating economic activity in the medium to long-term. We will avoid taking steps that might support short-term economic activity at the expense of financial stability and long-term economic prosperity.

Box 2: The economics underpinning the PRA's new secondary objective²⁶

The PRA has reviewed the economic literature on financial sector competitiveness. The literature identifies three main ways in which the financial sector can facilitate the international competitiveness of the economy of the UK and economic activity, and its contribution to realised growth out into the medium to long-term.

First, the financial sector can affect the UK economy through the size, frequency, and nature of financial crises. Financial crises, especially when preceded by credit expansion, are typically associated with deep recessions, slower recoveries and permanent reductions to economic activity (eg see Box 1). Given the large size of the financial sector relative to the rest of its economy, financial crises can have a particularly severe impact in the UK. The PRA seeks to facilitate economic activity in the medium to long-term, rather than in the short-term. If the PRA were to take action to support credit expansion in the short-term at the expense of sound prudential standards, this might increase economic activity in the short-term, but it would not improve the underlying growth potential of the UK economy, and it could ultimately create instability and be detrimental to medium term economic activity. This demonstrates the importance of policy action that seeks to prevent or reduce the probability and impact of financial crises.

Second, the financial sector might improve the economic activity of the UK economy in the medium to long-term through, for example, how the financial sector allocates savings to productive investments within the economy (Beck, Levine, and Loayza, 2000; Schumpeter, 1934). Accordingly, improvements in the efficiency of the financial system, driven by effective competition, can facilitate improvements in economic activity. An efficient financial sector is one that enables resources to be allocated to their best use without imposing unnecessary costs on households and businesses (Talbot, 1984). An efficient financial

²⁶ See Appendix 1 for full references for table.

sector enables savers and borrowers to share risks in a way that improves economic performance. Efficiency improvements, driven by effective competition, lead to lower costs of financial intermediation and greater access to external finance (Philippon, 2015). This is particularly relevant for companies reliant on external financial resources (Demirguc-Kunt and Maksimovic, 1998; Rajan and Zingales, 1998), such as smaller firms that need to overcome financing constraints to grow faster (Beck, Demirguc-Kunt and Maksimovic, 2005; Beck, Demirguc-Kunt, Laeven and Levine, 2004).

Third, the financial sector can also directly increase economic activity by exporting financial services abroad. The ability of the UK financial sector to export financial services to the rest of the world is supported by the competitiveness of the UK economy. The provision of international financial services has historically concentrated in a few global hubs, due to so-called agglomeration forces (Porter, 1990; and Krugman, 1991). Financial stability and economic resilience (as captured, for example, by the host country's sovereign credit rating) are among the key factors that contribute to the development of international financial centres, as well as economic freedom and dynamism (Eichengreen and Shah, 2020; and Moosa et al., 2016). This suggests that lowering prudential standards is unlikely to improve the competitiveness of a global financial centre like the UK. At the same time, it is important to avoid the 'stability of the graveyard' or regulation that disproportionately undermines the efficiency and dynamism of the financial sector. The competitiveness of the UK depends on the capacity of its financial sector to innovate and improve which is driven by effective competition. Companies gain advantage against the world's best competitors because of pressure and challenge. The international competitiveness of the UK economy and its growth in the medium to long-term will therefore be supported by a vibrant and competitive financial sector, where firms are spurred to become more efficient and seek innovative ways to win customers' business not only domestically, but also abroad.

3.23 As with our secondary competition objective, we will be proactive in our approach to the new secondary objective – including looking for specific opportunities to pursue it. We will look for ways in which the PRA can facilitate the UK's competitiveness and growth in its wider approach. That could include: providing firms with predictability over potential changes, such as through the grid produced by the cross-authority²⁷ Financial Services Regulatory Initiatives Forum (RIF);²⁸ maintaining our 'safe openness' to international firms and business; considering the market impact of our proposals for UK competitiveness and growth, relative to other jurisdictions; improving our regulatory interactions with firms and responsiveness to

²⁷ The Forum is comprised of the Bank, PRA, Financial Conduct Authority, Payment Systems Regulator, Competition and Markets Authority, Information Commissioner's Office, Pensions Regulator and the Financial Reporting Council, with HMT attending as an observer member.

²⁸ This is available at: <https://www.bankofengland.co.uk/report/2022/fifth-edition-of-the-regulatory-initiatives-grid>.

market developments, such as through streamlining application processes; and making our regulatory framework more accessible and user-friendly.

3.24 We will fully integrate the new secondary objective into our internal processes, including embedding it through the policy cycle. In particular, we will: embed competitiveness considerations from an early stage of policy development; include analysis of the impact of the proposed policy on competitiveness in all formal internal committee papers; and, we will explain how the judgements we have made are expected to impact on our new secondary objective in our CPs and PSs (see Chapter 5). We also undertake research to understand the impact that our actions have had on our new secondary objective, and policy will be evaluated to explore how we may have advanced it further.

3.25 This proactive approach will reflect the elevation of ‘competitiveness’ and ‘growth’ from regulatory principles to the status of a secondary objective. Though we have already considered these factors as regulatory principles, we expect this elevation to materially impact policy outcomes. We will set out how we have advanced the competitiveness and growth objective as part of our annual report.

3.26 Our more responsive approach to regulation will help us pursue our primary objective. It will also support the international competitiveness of the UK economy and its growth in the medium to long-term. Once relevant retained EU law is repealed and replaced as appropriate with measures in regulators’ rulebooks, we will be able to respond more quickly to emerging risks and technologies. We will be able to introduce strong prudential standards to cover new practices more quickly, increasing confidence and supporting growth in areas of innovation.

Approach to our regulatory principles

3.27 In pursuing our objectives, we must take into account regulatory principles which capture a wider set of public policy considerations that we must turn our minds to as we take decisions, including the FSMA regulatory principles, updated with additional considerations in the FS Act 2021, and the aspects of the government’s economic policy set out in the PRC Recommendations letter. The list of our regulatory principles is set out in Chapter 2.

3.28 When pursuing our objectives, we review all the regulatory principles, identify which are significant to the proposed policy and judge the extent to which they should influence the outcome. For each policy proposal, some regulatory principles will be particularly significant, while others less so. We judge this on a case-by-case basis.

3.29 In deciding how significant a regulatory principle is to a particular decision, we consider several factors. These include the impact of the proposal at a market level, and on individual firms in scope. We leverage the data and tools available to us to form these judgements. Where the regulatory principle is significant to the policy proposal, we seek to accommodate the consideration as we pursue our objectives.

3.30 Some regulatory principles are closely linked to the objectives. As noted in Chapter 2, 'innovation' and 'trade' are examples of regulatory principles which relate to our new secondary objective. Some considerations are explicitly captured as both an objective and a regulatory principle, such as competition. In such instances, analysis undertaken in consideration of the secondary objective can help us with consideration of the regulatory principle, though we consider differences of emphasis in the wording accordingly.

3.31 Further, similar regulatory principles may be clustered for the purposes of undertaking and presenting analysis (see Table 1 in Chapter 2). This supports our internal efficiency, and therefore agility, as a policymaker. We recognise – and carefully consider - the nuances of the individual regulatory principles. We use our judgment when deciding on the most relevant regulatory principles and how to approach the analysis and presentation. This is a case-by-case decision, as different regulatory principles may support different policy proposals. This judgement is informed by our analysis of the available data and wider evidence. We also use our judgement when considering the appropriate level of detail for undertaking and presenting our analysis.

3.32 It is important for accountability that we provide transparent explanations of how regulatory principles have influenced our policy decisions. A recent example of our approach can be seen in our implementation of updated Basel standards in February 2021.²⁹ We aim to focus our explanations on the most significant regulatory principles to the proposal, to aid understanding, and will continue to refine our approach in this respect. We also recognise that as we take on responsibility over a wider range of issues, the regulatory principles will influence a broader scope of policy-making.

Invitation for response

We would value your views on our approach to our objectives and regulatory principles. In particular, we would be interested in responses to the following questions:

Q.1 Do you have views on whether we are correct to adopt a proactive approach to our new secondary objective? If so, do you have views on the ways in which we could pursue our new secondary objective, as part of a proactive approach?

Q.2 Do you agree that the approach to our objectives and regulatory principles, including on clustering regulatory principles and focusing detail on the most significant in each case, effectively supports Parliament in holding us to account?

²⁹ Appendix 12: Detailed analysis of objectives and regulatory principles, available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards>.

Q.3 Do you have views on our approach to clustering regulatory principles for undertaking and presenting analysis?

4. Our approach to international engagement and collaboration

This chapter describes why and how we engage internationally to pursue our objectives, including through the development and implementation of international standards. It discusses how the integration of the global financial system benefits the UK financial system while also creating risks, and sets out how we respond to these risks. It also describes the approach we take to advising HMT on 'equivalence' determinations.

4.1 The UK is a globally systemic, open, and integrated financial centre. Many UK firms have operations overseas, and many firms domiciled abroad have operations in the UK. About one fifth of global banking activity takes place in the UK, and the UK is the world's largest host jurisdiction to foreign financial firms as subsidiaries or branches.³⁰

4.2 The UK's financial services sector and the wider UK economy benefit from openness. UK firms can grow and diversify by accessing opportunities in markets abroad. Similarly, international firms can promote dynamism and competition in the UK by innovating and improving consumer choice. Greater competition from foreign firms should also result in more productive domestic firms, and there is substantial evidence that increased openness can raise economic growth and boost living standards.

4.3 However, there are risks associated with openness. In open financial systems, distress can emerge in firms abroad and spread across borders. This process is known as contagion, the consequences of which were illustrated by the global financial crisis (2007-08), which began with localised problems in certain segments of financial markets. As a leading international financial centre, the UK is likely to be particularly vulnerable to the propagation of shocks that affect the global financial system. Conversely, the UK itself has the potential to be a source of instability for other countries given the large number of systemically-important global financial institutions located here. The IMF considers that the stability of the UK financial system is therefore a global public good.³¹

4.4 Risks can also arise when international firms operating in the UK gain a competitive advantage due to weaker prudential requirements in their home market. This can result in

³⁰ Bank of England Quarterly Bulletin: "Why is the UK banking system so big and is that a problem?" [Bank of England Quarterly Bulletin 2014 Q4](https://www.bankofengland.co.uk/quarterly-bulletin/2014/q4); United Kingdom: Financial Sector Assessment Program-Financial System Stability Assessment, available at: <https://www.imf.org/en/Publications/CR/Issues/2022/02/22/United-Kingdom-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513442>.

³¹ United Kingdom: Financial Sector Assessment Program-Financial System Stability Assessment, available at: <https://www.imf.org/en/Publications/CR/Issues/2022/02/22/United-Kingdom-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513442>.

pressure on domestic firms to compete in an unsustainable way. There are also risks which originate outside of the financial sector that have implications for firms and their international operations; for example, climate change, geopolitical conflict and the Covid-19 pandemic.

4.5 Therefore, for openness to work well, it must be accompanied by strong regulatory and supervisory standards. We refer to this as safe openness.

4.6 Given the international nature of the financial services industry, there are circumstances in which safe openness is most effectively achieved through international cooperation.

Consequently, we take a proactive approach to international engagement and working with our international partners. This includes:

- Exchanging information and sharing best practice with international partners to inform policy development (as well as supervisory action). In doing so, we can learn from our international counterparts, alert them to risks emerging in our financial system or their own, and develop comprehensive responses to shared challenges. We are committed to maintaining an effective level of international engagement and co-operation with our international partners.
- Engaging in the development of international standards. International standards set minimum regulatory and supervisory requirements across jurisdictions with a view to establishing a globally resilient financial system and a level playing field for international firms. A globally resilient financial system reduces the UK's vulnerability to international financial shocks, and provides assurances that cross-border activity can be conducted safely. A level playing field supports the competitiveness of the UK by reducing competitive inequalities that arise due to differences in regulatory standards across jurisdictions. Under the FSM Bill, we will be assuming wider responsibilities for making rules, including in areas covered by international standards, and will therefore implement them in a manner that advances our objectives effectively.

4.7 We also engage internationally when advising HMT on their equivalence determinations. This engagement involves assessing the regulatory and supervisory framework of third countries to provide advice to and inform decisions by HMT on whether the third country can be considered equivalent.³² Where HMT determines other jurisdictions to be equivalent, this is reflected in the calibration of the regulatory and supervisory treatment of UK firms' international business. This can facilitate cross-border transactions. In paragraph 4.31 we describe our approach to advising HMT on equivalence determinations.

³² Guidance document for the UK's approach to equivalence: [Guidance Document for the UK's Equivalence Framework for Financial Services - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/614211/Guidance_Document_for_the_UK_s_Equivalence_Framework_for_Financial_Services_-_GOV.UK_(www.gov.uk).pdf). In certain cases, the PRA also assesses the equivalence of other jurisdictions for different purposes; for example, for the purposes of authorisation and supervision by the PRA of subsidiaries and branches of international groups. The PRA's approach in this respect is explained in SS5/21 'International banks: The PRA's approach to branch and subsidiary supervision'.

Our international engagement

4.8 We engage across international institutions and networks, and also directly with partner countries.³³ The fora and networks we engage with include the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Markets Infrastructure (CPMI), the Network for Greening the Financial System, the International Association of Insurance Supervisors (IAIS), and the Sustainable Insurance Forum (SIF).³⁴

4.9 We engage to share best practice, address common challenges, and develop and influence international standards. We adopt a collaborative approach and place significant value on our working relationships with institutions and partner countries. We will continue working closely with our partners as the UK's regulatory framework evolves.

4.10 In banking, the leading international standard-setting authority we engage with is the BCBS. BCBS is the primary global standard-setter for the prudential regulation of banks, with a mandate to strengthen the regulation, supervision, and practices of banks worldwide to enhance financial stability. The most recent package of reforms, Basel III (supplemented through Basel 3.1), was developed in response to the global financial crisis (2007-08) and has made the global banking system more resilient, reducing the vulnerability of the UK - and other jurisdictions - to risks arising from the international activities of banks. Work is also underway at BCBS to assess and understand emerging risks that may undermine common interests such as cyber and climate related financial risks.

4.11 In insurance, we advance our objectives primarily through engagement with the IAIS, which includes authorities from more than 200 jurisdictions. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry. Our work with IAIS has included the development of Insurance Core Principles (ICPs), which encourage the maintenance of consistently high supervisory standards in IAIS member jurisdictions. Building on the ICPs, IAIS has also developed the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), which establishes supervisory standards and guidance focusing on Internationally Active Insurance Groups (IAIGs). As part of ComFrame, IAIS has developed and is currently monitoring the Insurance Capital Standard, which will apply to internationally active insurers after the end of the monitoring period in 2024.

4.12 The international bodies we engage with play an important role in the production of research, which can inform policy and supervisory action affecting PRA-regulated firms. We

³³ The PRA is not the only UK authority that engages internationally in the field of prudential regulation. The Bank of England acts internationally in pursuit of financial stability, and participates in many of the same international networks as the PRA. HMT and the FCA are also represented at certain fora, and the Bank and PRA work with them to promote common objectives.

³⁴ Financial Stability Board; <https://www.fsb.org/>, Basel Committee on Banking Supervision; <https://www.bis.org/bcbs/>, International Association of Insurance Supervisors; <https://www.iaisweb.org/>, Committee on Payments and Market Infrastructures; <https://www.bis.org/cpmi/about/overview.htm>, Network for Greening the Financial System; <https://www.ngfs.net/en>, Sustainable Insurance Forum; <https://www.sustainableinsuranceforum.org/>.

are an active participant in international research and value our engagement with international partners.

4.13 Given the scale and nature of subsidiaries and branches of foreign firms in the UK, we cooperate closely on a bilateral basis with supervisors in other jurisdictions. We attach great importance to these relationships, which play an important role in helping us identify risks that require a policy response. Our engagement involves the establishment of co-operation agreements, which facilitate day-to-day supervision. The Bank (in its capacity as the PRA) currently has in place 70 supervisory cooperation and information sharing Memoranda of Understanding with authorities across 56 countries.

4.14 Supervisory colleges are an important part of our supervisory engagement. A supervisory college is a forum for cooperation between the 'home' and 'host' supervisors of international firms, and where we are the home supervisor, we act as chair of the college. We encourage full transparency in our role as chair, and tackle instances where we believe firm activity abroad could undermine our objectives at home. We also recognise that the stability of UK firms has implications for other jurisdictions, and we therefore encourage our international partners to challenge our supervisory approach if they have concerns. In line with our commitment to safe openness, we continue to be open to firms branching into the UK with limited additional requirements. Branching is facilitated when we can place reliance on the regulatory regime of the jurisdiction where the firm is headquartered. However, we require subsidiarisation where a firm operating as a branch is not capable of being effectively supervised. Our international supervisory strategy is set out more fully in Supervisory Statement (SS5/21 – International banks: The PRA's approach to branch and subsidiary supervision'.³⁵

4.15 We also cooperate with international partners to understand risks emerging outside of the financial sector that have implications for PRA regulated firms. This is particularly important where understanding of the risk is not fully developed and the exchange of expertise can enable more informed responses.

4.16 For example, work is ongoing at an international level to understand and mitigate climate-related risks, and we are supporting this work. We are a member of the Sustainable Insurance Forum (SIF), which is a network of regulators and supervisors working to strengthen responses to sustainability issues facing insurers. And we are a founding member (alongside the wider Bank) of the NGFS which is a network of central banks and supervisors working to support the global response required to meet the goals of the Paris Climate Accords. We have also been active in climate related discussions at the FSB, BCBS, IAIS, and CPMI. The FSB is an international body that monitors and makes recommendations about the global financial system, and the CPMI is an international standard-setter that promotes, monitors and makes recommendations about the safety and efficiency of payment, clearing, settlement and related arrangements. Work with international bodies informs action

³⁵ July 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pru-approach-to-branch-and-subsiary-supervision-ss>.

taken by the PRA in a domestic context. For example, the PRA has set out its expectations that firms will develop an approach to climate disclosure in line with the FSB's Task Force on Climate-related Financial Disclosures framework.

4.17 More informal engagement between PRA officials and international partners occurs outside international bodies. Senior officials meet regularly with their counterparts at other central banks and regulatory bodies. These meetings are an opportunity for intelligence sharing and discussions on emerging risks. The development of these relationships supports cooperation, and more coordinated and efficient responses. This is particularly important during periods of global distress.

4.18 The Bank also engages internationally in the field of prudential regulation, and we work closely to ensure our approaches are coordinated and consistent. Examples of the institutions with which the Bank engages include the BIS, the FSB, the IMF, and the Organisation for Economic Co-operation and Development (OECD). The Bank is a member of BCBS alongside the PRA, and also supports the government's work to deliver its agenda at international political summits - such as the G7 and G20.

4.19 Recognising that UK financial stability has implications for countries around the world, the Bank and PRA work to provide international authorities with information and insight into how the UK financial system is functioning, and how we regulate and supervise firms. For example, both the Bank and PRA actively engage with the IMF to inform its FSAP - a comprehensive and in-depth analysis of a country's financial system. Positive FSAP assessments support the UK's credibility as an international financial centre and enhance its appeal as a jurisdiction for international firms. The most recent FSAP recognised the effectiveness of the UK's financial stability framework and the resilience of the UK financial system in light of recent challenges.

Our approach to implementing international standards

4.20 Chapter 3 describes how we are motivated in our policy-making by the pursuit of our objectives. Due to the systemic importance and openness of the UK financial system, and its linkages to other jurisdictions, there are circumstances where our objectives are most effectively pursued through the development and implementation of international standards.³⁶

4.21 International standards mitigate the risks associated with openness by creating a globally resilient financial system. A financial system that is resilient across jurisdictions reduces the vulnerability of the UK and its partners to financial shocks emerging abroad. International standards are of particular importance for the UK in light of its status as one of the world's largest and most open financial centres.

³⁶ The PRA's engagement in the development of international standards is one of the ways it meets its cooperation duty in s354B FSMA.

4.22 As well as stability, international standards support competitiveness by creating a level playing field. A level playing field is one where firms compete on an equal footing, gaining market share over competitors through innovation and efficiency improvements. A global financial system in which jurisdictions generated competitive advantages for firms through lower regulatory or supervisory standards would ultimately become unstable, undermining the PRA's objectives and those of our international partners.

4.23 The PRA's record of implementation has enhanced the UK's credibility as a financial centre, providing our international partners with assurances that their firms can operate here under a robust prudential framework. The importance of international standards to the UK is reflected in the PRA's new secondary objective. A further reason why firms find the UK an attractive place to do business is the stability and predictability of the regulatory regime which, combined with adherence to global standards, facilitates firms' global business. Our operational independence is an important part of maintaining this regulatory predictability.

4.24 UK financial stability will require levels of resilience at least as great as those put in place since the global financial crisis and required by international baseline standards, and in some cases greater. Recognising the importance of the UK as a global financial centre, we will remain at the forefront of efforts to strengthen international standards where necessary.

4.25 As we obtain wider rule-making responsibilities, our approach to implementing international standards is changing. When the UK was an EU member state, decisions regarding implementation that affected the UK were made with 27 other member states. The understandable need to harmonise practice across member states meant that the implementation of international standards was not always designed to support our objectives. We now have the opportunity to implement international standards in a manner that is more appropriate for the UK market. We also have more scope to determine which firms to apply international standards to.

4.26 There may be certain circumstances where we adjust our implementation of international standards. We will consider this where market developments mean the standard is no longer proportionate to the risk; or where our international partners have adjusted their implementation in a manner that has implications for our new secondary objective or regulatory principles; or where the evidence shows that the standard does not account for the UK's specific market circumstances. We place great importance on faithful alignment and, therefore, adjusting implementation is not a course of action we would pursue lightly. When considering alternative approaches, we will make judgements based on the evidence and data available to us. Moreover, we recognise that adjusting implementation can create challenges for internationally active firms, as operationalising different requirements across jurisdictions can increase costs.

4.27 We also have more scope to determine which firms to apply international standards to. In doing so, we will reflect on the standards in question and assess which firms they are relevant to. The application of international standards to domestic firms can impose high costs without delivering sufficient benefits in respect of our objectives. While certain international regimes require the application of international standards to domestic firms,

there may be opportunities in other areas for a more proportionate and risk-sensitive approach.

4.28 Our approach in this respect is illustrated by our work to simplify the prudential regime for small domestically orientated banks and building societies with simple business models. Currently, the Basel framework established by BCBS is broadly applied to all banks and building societies in the UK. This was the approach adopted by the EU when the UK was a member state. While it does allow certain prudential rules to be made simpler, it does this to a lesser extent than the approaches taken in some other jurisdictions. For example, Australia, Canada, Switzerland, and the United States have recently introduced tailored prudential frameworks. We are therefore assessing ways to create a simpler and more proportionate prudential regime in the UK that achieves the same overall level of resilience for small banks and building societies as the current rules, while remaining consistent with the Basel Core Principles for Effective Banking Supervision. We set out our vision for a ‘Strong and Simple’ prudential framework in a DP³⁷ published last year, and we recently published a CP,³⁸ which sets out our proposals for defining which firms will be eligible for the simpler prudential regime.

4.29 We have a range of methods to implement international standards, from a policy-focused approach to a supervision-focused approach. We will consider which method is appropriate for implementing the relevant standards. In doing so, we will at least meet the level of resilience intended by the relevant international standard.

4.30 We recognise the need for our international partners to adopt their own approach to implementation, subject to aligning with international minimum standards. We support efforts to monitor and assess implementation of minimum standards, and support deeper engagement between international partners to discuss implementation and address areas of shared concern.

Our approach to informing equivalence assessments

4.31 We also pursue our objectives in an international context when advising HMT on equivalence determinations and other deference determinations. Equivalence is a mechanism by which one jurisdiction recognises relevant standards in another jurisdiction as equivalent to its own. Equivalence determinations can reduce the regulatory burden on firms by calibrating more appropriately the treatment of exposures to assets and counterparties in the relevant jurisdiction. This can support financial integration in some cases by facilitating market access between equivalent jurisdictions. The government has prioritised enhancing the UK’s position as a financial centre, and views equivalence as an important tool in facilitating open and resilient financial markets.

³⁷ April 2021, <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks>.

³⁸ CP5/22 – The Strong and Simple Framework: a definition of a Simpler-regime Firm, April 2022: <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/april/definition-of-a-simpler-regime-firm>.

4.32 In certain areas, HMT is responsible for determining whether other jurisdictions can be considered equivalent to the UK. We participate in this process by providing technical information and advice to support HMT's decisions.³⁹ Given equivalence can result in a different prudential treatment for certain exposures and deeper financial integration, it is important that, when providing advice, we assess the potential impact of the proposed determination on our objectives. The FSM Bill also introduces new accountability mechanisms requiring the regulators to assess whether there would be material impact on, or incompatibility with, relevant deference arrangements and trade agreements.

4.33 We adopt an outcomes-based approach to preparing equivalence information and advice. In general, and subject to the specifics of the applicable legal test, an outcomes-based approach means assessing the equivalence of a third country's prudential framework based on whether its laws and regulations provide an equivalent outcome to the corresponding UK regulatory framework. The implementation of relevant international standards by the partner jurisdiction is an important consideration in our assessment.

4.34 Our outcomes-based approach is proportionate and judgement based. We expect other jurisdictions to maintain a prudential and supervisory framework which achieves the equivalent outcome as the UK's. However, we recognise that other jurisdictions can use different methods to achieve equivalent outcomes.

Invitation for response

We value your views on our approach to implementing international standards. In particular, we welcome views on the following questions:

Q.4 Do you agree that a strong commitment to implementing international standards is an effective way of pursuing our objectives?

Q.5 What do you view as the costs and benefits of adjusting our implementation of international standards to account for UK market circumstances?

Q.6 Do you support the PRA's international engagement strategy?

³⁹ <https://www.gov.uk/government/publications/memorandum-of-understanding-equivalence-and-exemptions>

5. The policy cycle

This chapter describes our approach to creating and maintaining our prudential policy framework, which we refer to as the ‘policy cycle’. Much of this will remain consistent with our current approach, though we also outline areas where our approach will change – for instance, on stakeholder engagement. We describe how our approach to policy-making consists of four phases.

Introducing the policy cycle

5.1 We make prudential policy to pursue our objectives. For example, we may make policy to reduce the risk or impact of market failures,⁴⁰ improve the effectiveness of regulation,⁴¹ or respond to wider systemic crises.

5.2 Promoting safety and soundness at the level of the individual firm reduces the risk of firms failing, and protects against wider systemic consequences. Our policies form a framework of robust prudential standards that promote the UK’s financial stability (in line with the Bank’s financial stability objective) and support the attractiveness of the UK as a global financial centre.

5.3 In this chapter, we set out how we intend to make policy after the FSM Bill receives Royal Assent. Our fundamental approach remains robust and fit for purpose. We can enhance our approach in the below areas to take full advantage of the new opportunities once relevant retained EU law has been repealed.

5.4 **Transparency and accountability:** as we take on greater responsibilities, we recognise the importance of increasing transparency, and explaining our judgements. We will continue to explain how our interventions pursue our objectives. In particular, we share this analysis during consultation, modifying and justifying our proposals in light of feedback received.

5.5 Increased transparency and clear lines of accountability will assist Parliament in holding us to account, and support our stakeholders in understanding and providing feedback on our proposals. This approach document enhances transparency on our processes and our Rulebook aspirations will enhance accessibility (see Chapter 6). In accordance with the new accountability mechanisms proposed in the FSM Bill, we will need to notify the Treasury

⁴⁰ Market failures might result from issues with externalities, information asymmetries, or market power.

⁴¹ Policy-making is inherently uncertain, and the PRA cannot always accurately predict the impact of its policy either before implementation or when market conditions change over time. Policy changes may be made where a policy is no longer effectively addressing an issue relevant to the pursuit of the PRA’s objectives.

Select Committee (TSC) when we publish a consultation, and respond in writing to parliamentary committees' formal responses to consultations.

5.6 Flexibility: Once requirements are set out in PRA Rules rather than retained EU legislation, we could review all rules relevant to a policy area holistically, providing us with greater flexibility to tailor our response. We could respond quickly, when needed, to changes in the external environment, and reflect the characteristics of our regulated firms and the UK financial system. We will have a greater ability to, where appropriate, deploy supervisory alternatives, instead of making rules (as previously required to implement some EU Directives). We will also have the ability to waive or modify a rule for individual firms where appropriate.

5.7 External engagement: We value stakeholders' engagement in our policy development, and rely on them to provide data to understand the practical implications of our proposals. We engage to understand the relative costs and benefits of our proposals and to gain different perspectives on our judgements. This provides us with a valuable input to the policy-making process. We then come to a decision, which considers the full range of evidence available to us, and which is consistent with our obligations as an independent regulator.

5.8 We already engage with the financial services industry, and we benefit from the perspectives and challenge this engagement offers. For example, we participate in the cross-authority Financial Services Regulatory Initiatives Forum (RIF). Every six months, the Forum publishes the RIF Grid, which sets out the regulatory pipeline, providing firms with an overview of the timing of forthcoming regulatory initiatives, over a 24-month horizon. However, effective policy-making requires us to understand and give appropriate weight to evidence from a range of stakeholders. We aim to increase the breadth and scope of our engagement. We aim to engage with a wider range of stakeholders from across society (including industry, academia, and consumer groups). We also plan to consider different ways to engage stakeholders throughout the policy-making process, including in the pre-consultation stage and evaluation stages.

5.9 We have developed the following principles to guide our future engagement approach:

- Engagement across the cycle: we will aim to engage with stakeholders more frequently, and in each stage of our policy-making process. In particular, we will increase our outreach efforts during the Initiation Phase, to allow stakeholders to provide their views earlier on the nature of the risk or opportunity, and the type of response we select. We are considering the most effective ways to support enhanced engagement.
- Wider engagement: we will seek to engage with a broader range of relevant stakeholders from across civil society (for example with consumer protection groups) and academia, whilst continuing our strong engagement with industry.

- Varied channels: we will seek to engage using a wider range of forums and products, to best facilitate responses from stakeholders.

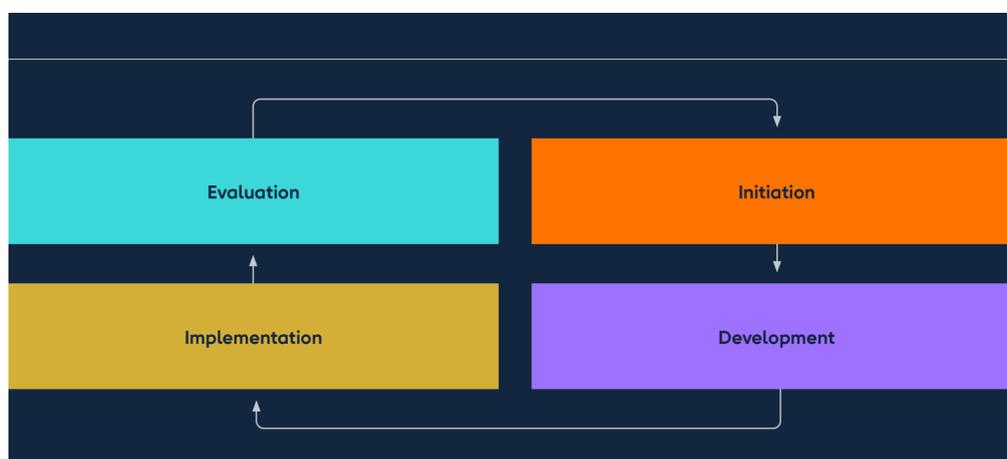
5.10 Broader external engagement will provide more opportunities to explain our judgements. This will increase our transparency and accountability. We will be reliant on stakeholders providing high quality information to inform our policy-making. We welcome respondents' views on our external engagement and how they can best contribute to our policy-making process.

Overview of the policy cycle

5.11 Our approach to policy-making consists of four phases:

1. **Initiation:** identifying and monitoring risks and opportunities, assessing whether taking action would further our objectives, and if so, considering the appropriate type of response;
2. **Development:** developing policy proposals based on the available evidence;
3. **Implementation:** inaugurating and embedding the new policy; and
4. **Evaluation:** assessing whether the policy has achieved its objectives and, as a result, whether revisions or enhancements should be made.

Diagram 1: Overview of the Policy Cycle



5.12 We combine evidence and judgement to make policy that pursues our objectives. We collaborate across our policy-making and supervisory functions, and work closely with the Bank's financial stability and resolution functions. We also engage with HMT and the FCA.

5.13 We consider whether it is appropriate for us to intervene on a given issue before acting. We consider evidence, insights from our experience and apply our judgement. We also consider the accountability framework set by Parliament, including whether a response advances our objectives and supports the Bank's financial stability objective. These elements

provide a holistic overview of the case for and against intervention. The balance between inputs will vary depending on the nature of the risk. In some cases, we may rely on our judgement more heavily where there are information gaps and we need to intervene to pursue our objectives.

5.14 If we conclude that intervention is necessary, we have a range of possible responses, including policy and supervisory responses. This allows us to be timely and proportionate in how we act.

5.15 We aim to establish and maintain policy material that is consistent with our objectives, clear in intent, straightforward in presentation and as concise as possible. Our policy framework aims to set out what outcomes we expect, so that firms can meet these expectations.

5.16 The policy cycle provides an overarching methodology for how we make policy. In order to pursue our objectives, we take an agile and pragmatic approach to policy-making. Our approach varies on a case-by-case basis, reflecting the nature of the risk and its urgency. This ensures that we can respond rapidly and effectively to emerging risks. For example, the need to act quickly in times of crisis may require us to expedite some steps of our policy-making process. The remainder of this chapter explores the four phases of our approach in more detail.

Phase 1: initiation

Overview

5.17 Initiation is the first step in our policy-making approach. We identify potential reasons to act, consider possible responses, and conduct an initial assessment of the case for and against intervention. This phase does not always conclude with further policy development.

5.18 When we identify a potential cause for action, we undertake initial research to understand the nature of the issue, and the likelihood and severity of any impact on our objectives. As set out in Chapter 4, we also consider the presence of appropriate international standards. We use these outputs to identify the ways we could respond and assess the case for intervening.

When might we act?

5.19 We aim to monitor a wide range of sources to identify where we might need to act (see Table 2 for examples). There is a high degree of interconnectedness between the sources.

Table 2 – examples of where we may need to act

Source (not ranked)	Why might the PRA need to act?	Example
Supervisory input	The PRA's supervisory function may identify an emerging risk through interactions with firms, or receive reports from firms of a developing issue.	The PRA's Supervisory Statement on 'New and Growing Banks' (SS3/21). ⁴²
Evaluation of existing policy	The PRA may identify an issue with current regulation, which requires intervention or amendment to make the policy more effective or less burdensome.	The PRA's refinements to the Pillar 2A capital framework (PS22/17). ⁴³
Horizon scanning	The PRA carries out horizon scanning to identify new and emerging risks. When these could impact firms and the PRA's objectives, we might intervene.	The PRA's expectations on risk weight floors for residential mortgages. ⁴⁴
Research	The PRA conducts an ongoing program of research which may identify risks that needs addressing or aspects of policy which may not be effective.	Staff Working Paper No. 922 'Measure for Measure: evidence on the relative performance of regulatory requirements for small and large banks' ⁴⁵ influenced the PRA's publications on the future 'Strong and Simple' framework. ⁴⁶

⁴² April 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/new-and-growing-banks-ss>.

⁴³ PS22/17 'Refining the PRA's Pillar 2A capital framework' October 2017: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/refining-the-pra-pillar-2a-capital-framework>.

⁴⁴ PS16/21 – Internal Rating Based UK mortgage risk weights: Managing deficiencies in model risk capture, July 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/internal-ratings-based-uk-mortgage-risk-weights-managing-deficiencies-in-model-risk-capture>.

⁴⁵ Measure for measure: evidence on the relative performance of regulatory requirements for small and large banks: <https://www.bankofengland.co.uk/working-paper/2021/measure-for-measure-evidence-on-the-relative-performance-of-regulatory-requirements>.

⁴⁶ April 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks>.

Significant events	The PRA may need to respond to rapid changes in market conditions caused by low-probability high-impact events to protect safety and soundness or avoid significant adverse effects.	The PRA's response to the Covid-19 pandemic.
International standards	The PRA implements international standards to pursue the PRA's objectives, as set out in Chapter 4.	The PRA's implementation of Basel III International Standards. ⁴⁷
UK legislation	The PRA may take action in pursuit of the goals of legislation made by Parliament.	PRA's implementation of bank 'Ring Fencing' legislation ⁴⁸ (introduced via the Financial Services (Banking Reform) Act 2013). ⁴⁹
Direction from HMT under the new rule review power	The PRA may need to act under directions received from HMT to review specific rules.	N/A (not yet implemented).
Recommendation or direction given by the Financial Policy Committee (FPC)	The FPC may suggest or direct (where there is a macro-prudential tool) the PRA to intervene to address a risk they have identified.	The PRA's implementation of the FPC's 2016 recommendation to exclude certain exposures from the leverage ratio. ⁵⁰

47 PS22/21 – Implementation of Basel standards: Final rules, October 2021:

<https://www.bankofengland.co.uk/prudential-regulation/publication/2021/october/implementation-of-basel-standards>.

48 PS20/16 – The implementation of ring-fencing: prudential requirements, intragroup arrangements & use of Financial Market Infrastructures, July 2016: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-implementation-of-ring-fencing-prudential-requirements-intragroup-arrangements>.

49 Available at: <https://www.legislation.gov.uk/ukpga/2013/33/contents>.

50 PRA statement on the leverage ratio, August 2016: <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/prs-statement-on-the-leverage-ratio>

Initial analysis

5.20 Where we identify a potential need to intervene, we undertake initial analysis, proportionate to the complexity and urgency of the issue. We also consider any possible implications for relevant deference arrangements and trade agreements'.⁵¹

5.21 Our analysis is supported by data. We collect different data for different purposes. We request data to support policy development, to assess the costs and benefits of our policy proposals, and to design policy in a manner that accounts appropriately for the circumstances of firms and the UK financial system. We also collect supervisory data, which helps us understand how firms have implemented policies. These data enable us to review the practical impact of policies, including identifying unintended consequences. Data can be qualitative – for example, information gained via interaction with external stakeholders; or data can be quantitative – for example, firms' regulatory reporting. We have internal processes which support a consistent approach to the analysis of data and interpretation of results. These processes aim to make sure our data is as relevant and reliable as possible, that our analysis is well-documented, and that our results are correctly interpreted and clearly communicated.

5.22 We expect that there will be an increase in the data we collect to support our policy development. We will need more data to facilitate more responsive and dynamic policy-making, and to allow us to account more effectively for the characteristics of UK firms and the UK financial sector. The FSM Bill introduces a requirement to establish a CBA panel, which may require more data on the costs to firms of implementation and ongoing compliance with policy amendments. We will also need additional data to support our consideration of the new secondary objective, and any additional regulatory principles. Firms will ultimately benefit from more responsive policy-making and better informed CBA.

5.23 As part of being more responsive, we also have a programme of work to review regulatory reporting. This represents an opportunity to realise some of the opportunities available as we take on wider responsibilities. Work is already underway to reduce duplicative requests and eliminate redundant reporting in insurance. We have taken the first step to improving insurance reporting by streamlining Solvency II requirements by 15% on average.⁵² And we are undertaking a full review of insurance reporting data in 2022. In addition, we are also targeting a review of data collection in banking starting in 2023. As with insurance, we will target redundant data collections and aim to improve proportionality. More broadly, the Bank is working jointly with the FCA to improve and streamline data collection

⁵¹ Once we have our policy proposal (at the 'development' stage) we will notify HMT of any material impacts or risks we had identified for relevant overseas deference arrangements and trade agreements.

⁵² PS29/21 – Review of Solvency II: reporting (Phase 1), December 2021:

<https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/review-of-solvency-ii-reporting-phase-1>.

through the Transforming Data Collection initiative, which aims to ensure we get the data we need at the lowest possible cost to industry. The RIF Grid provides information to enable stakeholders to understand and plan for the implementation of initiatives that may have a significant operational impact. It also provides information on forthcoming consultations, which can help manage firms’ expectations regarding possible forthcoming data asks.

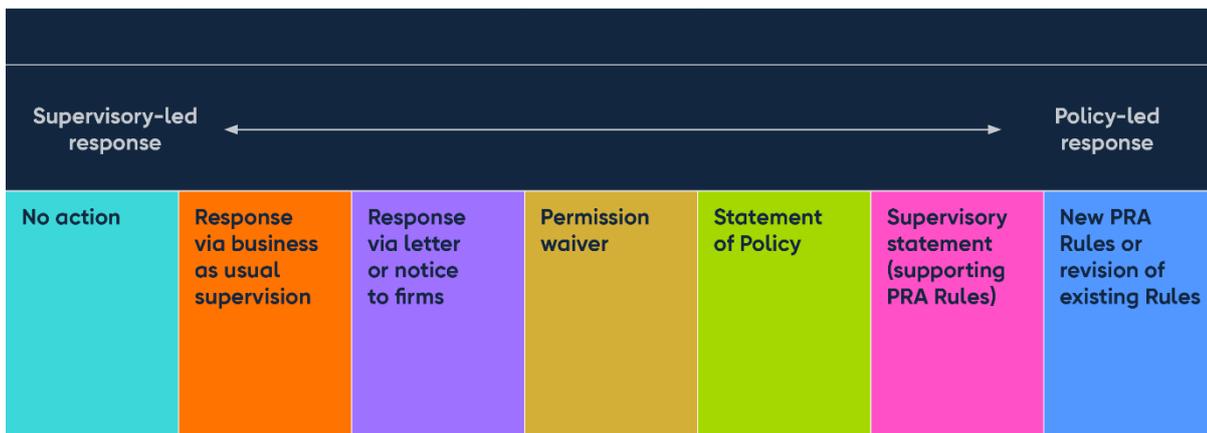
Identifying response options

5.24 Our next step is to identify one or more possible response options. As set out in Diagram 2, we have a variety of types of response at our disposal.

5.25 The nature of the issue (including the number of firms it affects) will determine which type(s) of response are suitable. In each case, we consider the most appropriate types of response in pursuit of our objectives. A supervisory response may be more appropriate where the issue affects a smaller number of firms. The PRA may also consider whether to issue a ‘letter to CEOs’ to set out the PRA’s views on specific supervision or policy focused issues. A policy response⁵³ may be more appropriate when the issue is more broadly applicable, and where enforceable requirements would deliver our aims most effectively.

5.26 We aim to conduct an initial assessment of the impact of each response option, proportionate to the scale of the potential intervention, and the relevant issue.

Diagram 2 - the spectrum of response types



5.27 Where there are different options, we consider the likely impacts of each option, and weigh up their ‘pros’ and ‘cons’ for our objectives and regulatory principles requirements.

⁵³ For the purposes of this chapter, a ‘Policy Response’ refers to either new PRA Rules, a revision of existing PRA Rules, a supervisory statement. In some cases, this might include a ‘Dear CEO’ letter.

Decision on next steps

5.28 We consider whether the evidence, and our confidence in our judgement, is sufficient to justify action, and the existence of any potential for the market to ‘self-correct’. Through this, we determine whether we should intervene and, if so, which type of response we should use.

5.29 When deciding whether to address specific risks or opportunities, we must prioritise across all risks and opportunities. This means placing a higher priority on taking action to address the most material risks to our objectives. We welcome external input regarding the risks we should prioritise.

5.30 The FSM Bill confers a power upon HMT to direct the regulators to make rules in certain areas. As a result, regardless of our envisaged approach to initiation of policy set out above, if HMT directs us to make rules or policy in certain areas, we may need to re-prioritise other risks accordingly.

Phase 2: development

Overview

5.31 The Development Phase starts once we determine that we need to act, and that a policy response is appropriate.

5.32 We develop a policy proposal by analysing the options for new policy, and assessing their relative costs and benefits. Our policy and supervisory functions work together to understand the impact of different options on firms and their business models. Insights from the Bank’s financial stability function allow us to understand the potential broader, economic effects of a policy. Where appropriate, we may also consider approaches developed by other jurisdictions to address similar issues. Ultimately, we produce a refined policy proposal, which delivers what we judge to be the best mechanism for addressing the issue, while pursuing our objectives.

5.33 We consult on our policy proposals via a CP, and consider all responses before finalising our policy. Diagram 3 illustrates the stages within the Development Phase.

Diagram 3 - Stages within the Development Phase (excluding the DP phase, which comes before this)



Policy option design

5.34 We start the Development Phase by examining the policy options in detail. We aim to set out one or more initial policy approaches, and articulate their aims, scope and mechanisms. In all cases, we prioritise how we can most appropriately pursue our objectives. We also consider the impact of the proposal on our regulatory principles.

5.35 Once we have described our initial policy approach(es), we analyse and refine these. The nature of the respective risk or opportunity will shape this process. Where we need to act urgently to meet our objectives, we might expedite some of these steps.

Cost-benefit analysis

5.36 The economic case for policy intervention depends on there being a policy response where the benefits exceed the costs. We examine this via CBA, where we aim to explore the costs arising from our policy approaches.⁵⁴ We compare these with how the increase in economic efficiency from our intervention translates into beneficial market impacts (such as the reduction in the likelihood of financial crises). CBA provides an insight into how effectively policies address their goals and highlights possible unintended consequences.

5.37 We will enhance our approach to CBA as we take on wider policy-making responsibilities. We will establish the CBA Panel, which will be implemented by the FSM Bill, and we will publish a framework setting out how we will conduct future CBA and how we will engage the CBA Panel. The CBA Panel's role is to provide advice in relation to cost benefit analysis. We will seek input from the CBA Panel and other stakeholders as we develop our framework.

⁵⁴ We also have a statutory obligation to conduct CBA when making or amending PRA Rules under section 138J of FSMA.

5.38 CBA is an integral part of developing the optimum policy approach, and the results shape our policy-making. We use the findings to adjust and refine our initial policy approach. If the CBA suggests that policy intervention is too costly, in comparison with its benefits, we may return to the initiation phase to consider the most appropriate response.

Cooperation between policy and supervisory functions

5.39 Our policy and supervisory functions aim work closely together throughout the policy-making process. Supervisory input assists in scoping the CBA, applying specialist firm knowledge to identify areas that the CBA should explore, and sourcing key data.

5.40 Our supervisory function provides important input into policy development, which strengthens the analysis and identifies areas for further work. Our supervisory function can identify potential thematic issues across firms. Our supervisory and policy-making functions also work together when applying policies to subsidiaries and branches of international firms. Our supervisory function provides insight into the feasibility, complexity and cost of implementation.

Internal governance

5.41 We then take our policy recommendations through our internal governance. We summarise the issue we have identified, describe our policy proposals, and explain how they assist us in pursuing our objectives – and the likely consequences of inaction. We present the results of the CBA, and regulatory principles analysis, and outline how we arrived at the proposed policy design. We highlight any trade-offs we have made, particularly in relation to regulatory principles requirements.

5.42 Various internal committees, culminating in the PRC for the most material decisions, weigh up the arguments before taking a decision. This may be to pursue with the policy proposal as presented or to conduct further analysis, before returning with a new proposal. PRC is responsible for agreeing any rule changes, and ensuring that the overall impact of any proposal sits within the PRA's risk appetite. Where appropriate, we take proposals to the Financial Policy Committee (FPC).

External engagement

5.43 Engagement with industry has always played a key role in our approach to making policy during the Development Phase.

5.44 Currently, external engagement in the Development Phase can be considered in two stages. The first stage is the outreach we undertake as we are refining our initial policy proposals. We engage with HMT, and the FCA, to solicit their feedback. In the future, we will

also engage with the TSC's sub-committee to help it scrutinise regulatory proposals.⁵⁵ Where other jurisdictions have identified similar risks, we may reach out to our counterparts in these countries, to learn from their experiences. We may also engage with some firms directly to request data inputs for our CBA (e.g. compliance cost surveys).

5.45 Where our policy approach is at an earlier stage, we may publish a DP, prior to formally consulting on specific policy proposals. This allows stakeholders to provide views on the general direction of policy development. In the future, we intend to make greater use of DPs.

5.46 We coordinate the PRA Practitioner Panel and Insurance Sub-Committee (the 'Panel'), which is made up of industry representatives. When it is feasible to share draft policy proposals, the Panel provides feedback on their likely impact on regulated entities, which we incorporate as appropriate within the policy proposal. The PRA Practitioner Panel Annual Reports explain how we consult with the Panel.⁵⁶ The FSM Bill introduces a requirement for us to publish further information on our engagement with the Panel, covering engagement during the relevant reporting period and information on pre-consultation.

5.47 We continuously assess the effectiveness of the Panel, including how to maintain effective information sharing. We ensure Panel membership reflects the PRA-regulated practitioners it represents. It is likely that the Panel and its Insurance Sub-committee will evolve as we take on additional policy-making and rule-making responsibilities. Under the FSM Bill, the Insurance Sub-committee will be put on an equal statutory footing to the PRA Practitioner Panel and work is underway to ensure we provide clear and consistent communication on our engagement with the Panels across all our work. Additionally, in order to ensure that the membership of the Panels represent the full diversity of stakeholders, the FSM Bill introduces a requirement for the PRA to maintain statements on the processes for appointing members to Panels.

5.48 The second stage of engagement during development is consultation.⁵⁷ We publish our proposals, along with CBA, and explain how the proposals pursue our objectives and regulatory principles. We generally invite any interested parties to provide responses within three months.

Reviewing responses

5.49 After consultation, we consider all responses. We are receptive to changing our policy approach (a recent example is included in Table 3). We record all responses to our

⁵⁵ Future Parliamentary scrutiny of financial services regulations (June 2022). Available at: <https://publications.parliament.uk/pa/cm5803/cmselect/cmtreasy/394/report.html>.

⁵⁶ Available on the Practitioner Panel and Insurance Sub-committee webpage: <https://www.bankofengland.co.uk/prudential-regulation/pra-practitioner-panel>.

⁵⁷ We also have a statutory requirement to consult when making or amending PRA Rules under section 138J of FSMA.

consultations and our responses. Where we make substantive changes to our policy approach, we will consider whether to undertake a supplemental CBA or whether to publish a new consultation.

5.50 We are heavily reliant on respondents providing evidence to support their responses, if they assert that the PRA should pursue a different approach. When respondents provide robust evidence, this allows us to consider alternative points of view most effectively.

Table 3: An example of how we reflect industry responses in our final policy

Original proposal	Industry concern	PRA action
<p>Basel III implementation Treatment of derivative client clearing under net stable funding ratio (NSFR). The PRA proposed to introduce a permission that would allow certain asset and liability items to be exempt from the NSFR where strict criteria were met that ensure that the liability could not fall due while the asset remains on the balance sheet.</p>	<p>Some respondents considered the proposed approach not to be proportionate given the characteristics of this activity. The characteristics that respondents highlighted included that clearing members generally do not derive a funding benefit from the initial margin they receive from clients, that the activity does not generate a funding requirement, and that client clearing appears to be eligible for the interdependent assets and liabilities (IA&L) permission in other jurisdictions.</p>	<p>The PRA weighed the potential effect on its objectives and compliance with international standards against the other matters to which it must have regard, in particular the proportionality of the proposals and their potential impact on competitiveness and the standing of the UK, finance for the UK real economy, and growth.</p> <p>The PRA decided to amend its approach to derivative client clearing. The PRA exempted from the NSFR derivative client clearing activities with qualifying CCPs (QCCPs), provided that the institution does not provide to its clients guarantees of the performance of the QCCP and does not incur any funding risk.</p>

		Where derivative clearing clients post assets as excess initial margin, and those assets are on the balance sheet of the firm and provide a potential funding benefit for the firm (beyond being available to post to the QCCP), the relevant Required Stable Funding (RSF) factor will apply.
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Phase 3: implementation

Overview

5.51 The Implementation Phase starts when we publish our final policy documents, which explain the final policy and any changes from the initial proposal. We give feedback on responses within scope of the consultation and explain where and why we have, or have not, made changes.

Final policy

5.52 Once we have finalised our approach, we publish a policy statement. Where appropriate, this will be accompanied by final rule(s), supervisory statement(s), or statements of policy.⁵⁸ These documents contain the final policy, explain our approach to addressing responses, including if the proposals have changed since consultation. Our supervisory function, supported by our policy function, works with firms to ensure the policy is implemented effectively.

5.53 As our supervisory function is closely involved in the Initiation and Development Phases, we aim for the final policy to reflect any practical implementation challenges. However, we do not generally expect firms to comply instantly with new requirements, especially where there may be complex and / or costly implementation requirements. Where appropriate, we may

⁵⁸ New Policy or Supervisory Statements are published on the Bank of England website: <https://www.bankofengland.co.uk/news/prudential-regulation>.

include a transitional period before a policy comes into force and / or an implementation timeline, with milestones for firms to meet ahead of the final implementation.⁵⁹

5.54 Firms are responsible for effectively implementing PRA policy by the 'policy effective from' date. Our supervisory function engages with firms throughout the implementation period to assess whether firms are on track. This may include, where appropriate and proportionate, requests for firms to provide updates at certain points ahead of the policy implementation date.

5.55 After the implementation date, our supervisory function may assess how firms have implemented the policy as set out in the PRA's Supervisory Approach.⁶⁰ This may involve one or more of the following where appropriate: regular meetings with the appropriate business areas and risk functions at supervised firms, deep dives on specific topics review of regulatory data, and peer analysis across firms. Assessments of a firm's implementation of policy areas may be fed back, especially where the firm is judged to be at the weaker end of the peer group. Every firm supervised by the PRA will be subject to a regular internal review, and this is then the subject of formal communication to the firm's senior management. Where relevant, some of this feedback may concern policy implementation. Where similar policies have been implemented in other jurisdictions, our supervisory function may also engage with other regulators, to compare experiences and outcomes. This engagement should enable us to understand how successfully the new policy has been embedded, and the impact on firms.

Phase 4: evaluation

Overview

5.56 In this stage, we aim to assess the impact of the implemented policy. This includes considering whether the policy has been successful in meeting its intended outcomes, whether it is still relevant and required, and if it has produced any unintended consequences. We assess policies objectively, and aim to look actively for areas for improvements or clarifications.

5.57 The FSM Bill will require us to publish a statement of policy which sets out how we will review our rules in the future. We also plan to explain how we will strike the right balance between evaluating existing policies and addressing new and emerging risks and opportunities. We will seek input from stakeholders as we develop our statement of policy.

⁵⁹ For example, for firms in scope of PS11/15 (CRD IV: Liquidity: <https://www.bankofengland.co.uk/prudential-regulation/publication/2014/crd-iv-liquidity>), Liquidity Coverage Ratio requirements were gradually increased in 10 p.p. increments between 2015 and 2018.

⁶⁰ Available on the PRA's approach to supervision of the banking and insurance sectors webpage: <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

Evaluation process

5.58 We use evaluation to assess whether our policies are operating effectively and are delivering their intended impact. A policy may be revised because: it is not as effective in addressing an issue as initially envisaged; it has produced unintended consequences; there have been developments in international standards; the structure of the financial system or economy has evolved; firms are avoiding or arbitraging the rules in unanticipated ways; or the nature of the issue has changed. Evaluation can result in major policy changes or minor adjustments that refine the policy, depending on the result of our evaluation. We monitor the implementation of policy on an ongoing basis and make clarification-focused updates when appropriate (for example, through publishing Occasional Consultation Papers).⁶¹

5.59 As part of our work to enhance our approach to external engagement, we are committed to improving our engagement with our stakeholders in the evaluation phase of the cycle. We are considering the best way to structure this engagement, to ensure that firms have an effective forum to provide us with feedback directly.

5.60 The appropriate time to evaluate a policy depends on many factors. These include:

- the size and complexity of the policy;
- the length of any implementation period;
- the length of time that needs to elapse for the full impact of the policy to be observable;
- the existence of any statutory review requirements;⁶²
- whether a policy has interdependencies with others – if so it is important to ensure they are jointly evaluated;
- there had been uncertainty at the time of implementation; and
- emerging evidence of unintended and undesirable consequences.

We need to weigh up the benefits of reviewing current policies and those of identifying and addressing new policy issues. We aim to strike a balance that allows us to pursue our objectives most effectively. We are likely to prioritise a policy for evaluation if we become aware of any significant issues, or if there was a greater degree of uncertainty at the point of implementation.

5.62 We draw on different sources of information to identify where existing policies are not meeting their aim. This includes regulatory data, firm reporting, and reviews of 'skilled

⁶¹ See CP3/22 – Occasional Consultation Paper – March 2022: <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/march/occasional-consultation-paper-march-2022>.

⁶² For example, the requirement to review rules implementing bank 'Ring-Fencing' legislation after five years - Financial Services (Banking Reform) Act 2013 (legislation.gov.uk).

person(s)' reports. Our supervisory function provides practical evidence from their oversight of firms.

5.63 The FSM Bill will give HMT a power to require the regulators to review their rules where the government considers that it is in the public interest. We understand that the government expects that the power would only be used in exceptional circumstances, for example, where there has been a significant change in market conditions.⁶³ We will need to take into account any directions from the government alongside the approach to evaluation above.

5.64 Once we select a policy for evaluation, we compare the intended impact of the policy intervention with the result. We consider whether the policy is effectively advancing our objectives, and then whether it is having the expected impact on our regulatory principles.

5.65 If we identify an issue with existing policy, we may decide to return to the Initiation Phase. We engage closely with our supervisory function to understand the issues, and the impact and practicalities of implementing further policy changes in the relevant area.

5.66 Evaluation allows us to learn which policy measures are most effective at addressing specific problems and risks. We investigate and understand unexpected outcomes. We use evaluation to inform future policy development and improve existing policies. For example, in 2017, the PRA reviewed the Pillar 2A capital framework and made a number of refinements.⁶⁴

5.73 In addition, the Bank and PRA engage in reviews of international standards, coordinated by international institutions. This supports our work to shape effective international standards, and build close relationships with our regulatory counterparts. For example, we are currently supporting the BCBS evaluation of the effectiveness of Basel III, and participating in the BCBS's and FSB's efforts to evaluate the lessons from Covid-19 for prudential frameworks and financial stability.⁶⁵ We have participated in FSB evaluations on SME financing⁶⁶ and on infrastructure finance.⁶⁷

⁶³ Letter from Rt Hon. John Glen MP to Rt Hon Mel Stride MP (as Chair of the Treasury Select Committee), Future of Financial Services session follow-up, 1 April 2022: <https://committees.parliament.uk/publications/21974/documents/163368/default/>.

⁶⁴ See PS 22/17 'Refining the PRA's Pillar 2A capital framework' October 2017: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/refining-the-pra-pillar-2a-capital-framework>.

⁶⁵ Initial Lessons report by BCBS: <https://www.bis.org/bcbs/publ/d521.pdf>.

⁶⁶ FSB publishes final SME financing evaluation report: <https://www.fsb.org/2019/11/fsb-publishes-final-sme-financing-evaluation-report/>.

⁶⁷ Evaluation of the effects of financial regulatory reforms on infrastructure finance: Overview of responses to the consultation: <https://www.fsb.org/2018/11/evaluation-of-the-effects-of-financial-regulatory-reforms-on-infrastructure-finance-overview-of-responses-to-the-consultation/>.

Invitation for response

We would value your views on our approach to the policy cycle. In particular, we would be interested in responses to the following questions:

Q.7 Do you have any views on the PRA's approach to policy-making?

- a) Do you have any views on how PRA should approach prioritising which of its existing policies to evaluate?

Q.8 Do you have views on how the PRA could enhance its approach to external engagement, and our proposed guiding principles?

- a) Which groups of stakeholders should the PRA seek to engage during the policy-making process?
- b) Do you have any views on how stakeholders should be engaged at each stage of the policy-making process?
- c) Do you have any suggestions for new forms of engagement that the PRA could consider adopting?

Q.9 Do you have any views on the PRA's future data collection? How can the PRA engage with you most effectively, whilst it is developing its approach?

6. Our approach to delivering a first-rate PRA Rulebook

This chapter outlines our ambition to deliver a first-rate Rulebook for the UK through improving the accessibility, efficiency, usability and clarity of our policy material. It summarises four key reforms which are consistent with this outcome. The full implementation of our reform aspirations depends upon when the repeal of retained EU law takes effect, and when we make rules to replace it.

6.1 Implementing the outcomes of the FRF Review will have the effect of delegating the setting of most regulatory standards to the operationally independent regulators, in accordance with the legislative framework. This is already the case in many areas, but the repeal of retained EU law will increase the scope of the PRA's policy-making responsibilities, and will allow us to absorb the majority of the firm-facing regulatory requirements, which are set out in retained EU law, into the PRA Rulebook. Absorbing the firm-facing regulatory requirements will provide us with a unique opportunity to improve the current, fragmented policy landscape, and to deliver significant reforms to make our Rulebook more accessible. In addition, once retained EU law is repealed, we will be able to review and amend our policies in particular areas, which will enable us to make policy in an even more responsive way.

6.2 The FSM Bill provides a legal framework for HMT to commence the deletion of retained EU law. This process will involve close co-ordination across HMT, the FCA (for shared legislation), and the Bank as FMI Regulator and Resolution Authority. We are already working with HMT and the other regulatory authorities on the repeal and replacement of retained EU law.

6.3 The process for repealing retained financial services legislation and replacing it in regulators' rules will require careful thought. The length of the process, and therefore the PRA's ability to deliver reforms to the Rulebook, will depend in part on the decisions taken by Ministers on the repeal and replacement of retained EU law.

6.4 This chapter is structured as follows:

- The first section provides context on the current, complex regulatory landscape which has evolved over time and through the onshoring process.
- The second section sets out our aspirations for improving the current regulatory framework, and subsequently our Rulebook, through four key reforms to our policy suite. It also covers how we could deliver the reforms over time, and the dependency on commencing the repeal of retained EU law. We expect that the full implementation

of this vision will only be possible after all relevant retained EU law is repealed and replaced in PRA Rules. We will need control over all relevant regulatory material to deliver comprehensive reforms to their style and structure. The four reforms are intended to improve the accessibility, efficiency, usability and clarity of our policy suite by:

- a) bringing our policies together on one user-friendly website and re-organising them by topic areas
 - b) streamlining our policy document formats
 - c) adopting a coherent approach to our policies' structure and language
 - d) better explaining the purpose and intention of our policies
- The third section outlines the process of repealing and replacing retained EU law in PRA Rules, and sets out the PRA's initial ideas on this.

A complex regulatory landscape

6.5 The current regulatory landscape is complex following the process of 'onshoring.' This process transposed the body of EU legislation that applied directly in the UK onto the UK statute book through the European Union (Withdrawal) Act 2018.⁶⁸ This body of legislation, together with UK legislation that implemented EU law, is now referred to as 'retained EU law' and covers a wide range of legislation.

6.6 Onshoring provided legal certainty by ensuring that retained EU law relating to financial services operated effectively following the UK's withdrawal from the EU. It was not designed to provide an optimal, long-term approach to financial services regulation.⁶⁹ Having retained EU law in the UK statute book means that regulatory material on prudential regulation is located across a range of different sources (as illustrated in Table 4).

Table 4 - List of current sources for regulatory material on prudential regulation

Source	Location
i. UK legislation	Includes primary legislation, statutory instruments and retained EU law; available on the UK legislation website. ⁷⁰
ii. PRA Rules	Available on the PRA Rulebook website. ⁷¹

⁶⁸ Financial Services Future Regulatory Framework Review: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf.

⁶⁹ Financial Services Future Regulatory Framework Review: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf.

⁷⁰ Legislation website: <https://www.legislation.gov.uk/>.

⁷¹ PRA Rulebook Online: <https://www.prarulebook.co.uk/>.

iii. UK Technical Standards	Originally drafted by European Supervisory Authorities (ESAs). The onshored text is available on the UK legislation website; ⁷² PRA amending instruments on the Bank's website.
iv. PRA Supervisory Statements and Statements of Policy	Available on the Bank's website.
v. Guidelines, Recommendations and Q&As	Originally drafted by European Supervisory Agencies (ESAs). ⁷³ While no longer applicable in the UK, firms should 'make every effort to comply' with existing Guidelines and Recommendations that are applicable as at the end of the transition period, to the extent that these remain relevant. Q&As 'may continue to be relevant, and the Bank and PRA may have regard to these as appropriate.' A Bank and PRA Statement of Policy provides a non-exhaustive list of guidelines. ⁷⁴

6.7 The fragmentation of regulatory material means that stakeholders can find the process of identifying and understanding the regulatory framework for different policy areas time-consuming and costly. Moreover, EU-derived legislation uses different styles and structures compared to the UK regulatory framework, sometimes using different language to refer to the same concepts. For example, references to 'own funds' in EU-derived legislation are equivalent to UK references to 'capital.' Finally, the regulatory framework is inefficient, as regulatory material on particular areas is sometimes repeated in different policy documents.

Four key reforms

Our aspirations

6.8 To address the current, fragmented policy landscape, we are considering four key reforms across our policy suite. These reforms will involve a series of measures which are aimed at improving the accessibility, efficiency, usability and clarity of our policy suite. Reforming our policies will facilitate the necessary evolution of the Rulebook, and will pursue our objective of promoting the safety and soundness of the firms we regulate as policy materials will be easier to follow and comply with. Our aspirations for each of the four key reforms are outlined below.

⁷² Legislation website: <https://www.legislation.gov.uk/>.

⁷³ Statement of Policy – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU, April 2019: <https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop>.

⁷⁴ Statement of Policy – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU, April 2019: <https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop>.

(a) Bringing our policies together on one user-friendly website and re-organising them by topic areas

6.9 We plan to deliver a more user-friendly website for the PRA Rulebook, hosted on the Bank's website. This will eventually streamline the number of locations where prudential regulation sits, by bringing together all relevant regulatory material into one place.

6.10 We aim to deliver an updated website for the Rulebook by the end of 2023. This will provide us with greater flexibility to update the content of our regulatory material, which will be vital as we implement future policy changes. The website will also bring a series of improved functionalities for stakeholders, which are aimed at making our policy material more accessible over time. This includes digitising regulatory policy material, such as supervisory statements and statements of policy, as well as updating the links to related documents to provide easier access to source materials for rules. Further details on upcoming improvements and future changes, including the digitisation of other regulatory materials, can be found in our recent DP 'PRA Rulebook website: planned updates.'⁷⁵

6.11 We will look to re-organise our policies into a more efficient and coherent structure, by grouping relevant policy material into topic areas. This will further improve the accessibility and usability of our policies, as well as bringing time and efficiency benefits for stakeholders.

6.12 As a first step towards that vision, the PRA and the Bank as Resolution Authority have published a Prudential and Resolution Policy Index, which divides our policies into sectors and topic areas. For each topic area, a dedicated webpage lists relevant policy material and provides quick access links, allowing stakeholders to identify and browse our policies more easily.

(b) Improving the efficiency of our policies by streamlining our policy document formats

6.13 The current regulatory framework includes different document formats inherited from the EU, including UK Technical Standards, Guidelines, Recommendations, and Q&As. While their content remains applicable in most cases, these formats duplicate the functions of PRA document formats (for example, UK Technical Standards have equivalent legal standing to PRA Rules). To improve the efficiency and clarity of our policies, we aim for all relevant material to be in PRA-developed formats, rather than in equivalent EU documents. This will involve deleting any relevant material from EU inherited documents and replacing it in the appropriate PRA document format, and deleting any unnecessary or duplicative material. In the future, we intend to use three formats for policy-making:

⁷⁵ November 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/november/pru-rulebook-website-updates>.

- PRA Rules, which are legally enforceable and give effect to PRA policies by setting out requirements with which firms must comply;
- supervisory statements, which contain PRA expectations and provide additional guidance on how firms can comply with the requirements imposed by rules and meet the intended outcomes;
- statements of policy, which set out our approach to policy on a particular matter.

(c) Adopting a coherent approach to our policies' structures and language

6.14 Following onshoring, we have an existing body of policies drafted with different structures and terminologies. To address this, we aim to improve the usability and clarity of our policies by adopting a more coherent approach to the structure and language we use. In line with reducing our policy document types, we intend for each of our policies to follow a clearer PRA structure (eg moving from EU article numbers to parts, chapters and rules as in the current PRA Rulebook). Over time, we will look to phase out the use of EU terminology and intend for our policies to be written in plain English, using PRA terminology and inclusive language.

(d) Better explaining the purpose and intention of our policies

6.15 FSMA requires us to explain the purpose of proposed rules when consulting on new policies. We comply with this duty when developing new rules, and publish their intended purpose in CPs. We do not retain these explanations in the Rulebook. To allow stakeholders to understand the purpose of the rules and how they advance our objectives, we are exploring ways in which we could improve the clarity of our policies by explaining their overarching purpose and intention in a more durable manner.

6.16 As individual policies can be grouped into wider policy areas (eg remuneration), one possibility would be to introduce explanatory 'purpose statements' for each policy topic area. We could use these statements to summarise the purpose of the PRA's policies in the policy area, including how it helps us pursue our objectives. Purpose statements could explain how different policies in each regulatory area fit together in contributing to that purpose, as well as links between different policy areas.

Timing of the reforms

6.17 We aim to progress these reforms as fast as is practicable with a view to delivering a more accessible, usable, efficient, and clearer Rulebook. This will allow us to pursue our vision to be a more responsive and accessible rule-maker. We will need control over all relevant regulatory materials to deliver the aspirations above in a comprehensive and coherent manner.

6.18 In the interim, we will look to make progress towards our aspiration of a first-rate Rulebook ahead of the completion of the repeal and replacement of relevant retained EU law in PRA rules. We have already implemented some improvements and will continue to deliver short-term measures where possible.

6.19 On the delivery of a more user-friendly website which is organised by topic area, this includes:

- The publication of the Prudential and Resolution Policy Index on the Bank's website. This makes it easier to find relevant policies by dividing them into sectors and topic areas, with each area having a dedicated webpage listing relevant policy material.
- Work is underway to deliver early accessibility changes (such as the digitisation of supervisory statements and statements of policy, basic machine-readability, and an improved user interface) to the Rulebook website by the end of 2023.⁷⁶

6.20 We have also taken initial steps to streamline our policy document formats, including:

- An intention not to issue any new Technical Standards, unless alternatives such as making rules would not be effective or appropriate.
- A consultation proposing to delete UK Technical Standards for own funds regulations with a view to replicating relevant material in the PRA Rulebook.⁷⁷
- A consultation proposing to delete thirteen EU guidelines that are no longer relevant.

6.21 On adopting a coherent approach to our policies' structure and language:

- We will look to explore how PRA terms and EU terms could be better aligned for policy areas which we have control over (eg governance and accountability policy). For example, we plan to consult on using the PRA term 'Board member' rather than the EU term 'member of management body' in our policy material.
- For policy areas where some material remains in legislation, we may continue to use two different terminologies to guarantee that cross-references continue to operate effectively. We will explain this clearly in our policy material.⁷⁸

⁷⁶ Further information on upcoming changes and potential future changes can be found in DP3/21, November 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/november/pru-rulebook-website-updates>.

⁷⁷ CP2/22 – Definition of capital: updates tot PRA Rules and supervisory expectations, February 2022: <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/february/definition-of-capital-updates>.

⁷⁸ For example, in our recent Consultation Paper on Definition of capital (CP2/22: <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/february/definition-of-capital-updates>), we clarified that the EU term 'own funds' was synonymous and used interchangeably with the term 'capital,' but that it was necessary to use the EU terminology in certain instances, to ensure coherence with retained EU law.

Approach to the repeal and replacement of direct regulatory requirements in the PRA Rulebook

6.22 The FSM Bill creates a framework for HMT to commence the deletions of retained FS EU law repealed by Parliament. As above, decisions relating to both the repeal and the replacement of retained EU law, or the decision to not replace it, are for HMT. Following these decisions, the regulators will replace EU laws with appropriate policies. This process could take place over a number of years,⁷⁹ and will be a resource-intensive exercise.

6.23 The repeal and replacement of all relevant retained EU law will allow us to address the complex policy framework, and will enable us to deliver our aspirations for making the PRA Rulebook more accessible by delivering the full suite of reforms set out above. It will also allow for more responsive policy-making, as we will be able to respond to emerging risks and future regulatory change more effectively and efficiently (as discussed in Chapter 5).

6.24 The length of the process, and therefore delivery of reforms to the Rulebook, will depend in part on the decisions taken on the timing of legislation, the approach, and the number of statutory instruments used. The approach taken to the Basel III repeal and replacement in January 2022 illustrates that this may be a complex exercise.⁸⁰ The approach taken ensured we aligned as closely as possible with the date of implementation in other jurisdictions. However, it did not allow for meaningful reform of the Rulebook. Box 3 provides a summary of the lessons learned from this exercise.

Box 3 - Implementation of Basel III

The FS Act 2021 gave us the power to implement a set of Basel standards⁸¹ (Basel III). We worked closely with HMT to complete the repeal of the relevant legislation and introduce new PRA Rules for these standards in January 2022. HMT repealed equivalent retained EU law provisions from the UK Statute book at the same time. Through this process, we were able to tailor a number of requirements for UK firms to make regulation as clear as possible. We were also able to provide further clarity on requirements in EU law (where these may be ambiguous).

⁷⁹ Financial Services Future Regulatory Framework Review: Proposals for reform: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf. (p.58)

⁸⁰ PS17/21 – Implementation of Basel standards, July 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards> and PS22/21 - Implementation of Basel standards: Final rules, October 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/october/implementation-of-basel-standards>.

⁸¹ Standards adopted by the Basel Committee on banking supervision.

However, there were a number of factors which made the repeal and replacement complex. First, we needed to prioritise the speed of the process alongside delivering significant policy reforms. This was due to the need to align as closely as possible with the date of implementation in other jurisdictions. Ahead of implementation, we needed to provide adequate time for consultation, and for firms to prepare to implement the reforms. Second, the repeal and replacement did not include the remainder of the banking legislation, including Basel 3.1 and the remainder of the Capital Requirements Regulation ('CRR'). This meant that rules for banking would be split across retained EU legislation and PRA Rules.

As a result, policy reforms were made to some banking regulatory requirements, but generally the style and structure of retained EU law was kept in place in the new PRA Rules. It was therefore not possible to deliver some of our Rulebook aspirations during the repeal and replacement process, and this will have further complicated the way in which stakeholders navigate our policies.

6.25 Our ability to deliver the full suite of substantive rulebook reforms depends upon the approach to, and timing of, the repeal and replacement of relevant retained EU law. We are working closely with HMT and the other regulatory authorities to progress the overall programme of repealing retained EU law.

Invitation for feedback

We would value your views on our approach to the Rulebook. In particular, we would be interested in responses to the following questions:

Q.10 Do you consider that the PRA's proposed approach to the four key reforms outlined above will create a more accessible, efficient, usable and clearer Rulebook? What could we do differently or in addition?

Q.11 How can the PRA most effectively use 'Purpose Statements' or similar non-technical explanations to improve the clarity of our policies?

Q.12 Do you consider that there are other effective ways to tackle the complex regulatory landscape?

Questions

The full list of questions addressed to stakeholders through this DP are set out below.

Chapter 3: Our approach to our objectives and regulatory principles

Q.1 Do you have views on whether we are correct to adopt a proactive approach to our new secondary objective? If so, do you have views on ways in which we could pursue our new secondary objective, as part of a proactive approach?

Q.2 Do you agree that the approach to our objectives and regulatory principles, including on clustering regulatory principles and focusing detail on the most significant in each case, effectively supports Parliament in holding us to account?

Q.3 Do you have any views on our approach to clustering regulatory principles for undertaking and presenting analysis?

Chapter 4: Our approach to international engagement and collaboration

Q.4 Do you agree that a strong commitment to implementing international standards is an effective way of pursuing our objectives?

Q.5 What do you view as the costs and benefits of adjusting our implementation of international standards to account for UK market circumstances?

Q.6 Do you support the PRA's international engagement strategy?

Chapter 5: The Policy Cycle

Q.7 Do you have any views on the PRA's approach to policy-making?

- b. Do you have any views on how PRA should approach prioritising which of its existing policies to evaluate?

Q.8 Do you have views on how the PRA could enhance its approach to external engagement, and our proposed guiding principles?

- a. Which groups of stakeholders should the PRA seek to engage during the policy-making process?
- b. Do you have any views on how stakeholders should be engaged at each stage of the policy-making process?
- c. Do you have any suggestions for new forms of engagement that the PRA could consider adopting?

Q.9 Do you have any views on the PRA's future data collection? How can the PRA engage with you most effectively, whilst it is developing its approach?

Chapter 6: Our approach to delivering a first-rate PRA Rulebook

Q.10 Do you consider that the PRA's proposed approach to the four key reforms outlined above will create a more accessible, efficient, usable, and clearer Rulebook? What could we do differently or in addition?

Q.11 How can the PRA most effectively use 'purpose statements' or similar non-technical explanations to improve the clarity of our policies?

Q.12 Do you consider that there are other effective ways to tackle the complex regulatory landscape?

Appendices

Appendix 1 – references for Box 1

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