BANK OF ENGLAND

Speech

The PRA's Approach to Enforcement

Speech given by

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It is now more than six years since the creation of the Prudential Regulation Authority. In that time, the PRA has developed a distinctive approach to enforcement. This supports the PRA's prudential mandate, reflects the fact we are a supervision-led organisation, and reflects too the environment in which we operate – the numbers and types of firms we supervise, and the risks they pose.[1]

Our approach to enforcement can be divined through the PRA's various publications and of course through its decisions and actions. However, to draw it all together, I will take this opportunity:

- First, to explain the rationale for PRA enforcement;
- Second, to give examples of 'enforcement in action' and key themes, including in relation to individuals;
- Third, to offer some thoughts on our 'agenda'.

Rationale and approach

It would be trite to observe that prudential supervision did not begin with the creation of the PRA. But the creation of the PRA, as an arm of the Bank of England, provided an opportunity to consider our prudential approach afresh. And that included thinking about the function of enforcement.

By enforcement I mean the classic formal use of powers by a public authority to punish, protect and deter: financial penalties, restrictions on business and – in the case of individuals – prohibition.

Now, the Bank of England, during its first period as bank supervisor, had little scope to consider this kind of enforcement. The reason was to do with the law. Neither the 1979 nor the 1987 Banking Acts had given the Bank any civil enforcement powers whatsoever. There were a number of examples of misbehaviour, such as unlicensed deposit-taking, and misleading the Bank of England, to which a criminal sanction attached. But apart from those, sanctions were purely supervisory, such as removal of a banking licence.[2]

The position was different in other parts of the regulated financial services sector. The Financial Services Act 1986 included some statutory enforcement powers, relating primarily to investment business, and these were built up further through FSMA 2000.[3] This Act encoded in statute the full array of civil enforcement powers, in the hands of the then-new regulator, the FSA, which for the most part are recognisable today.

The PRA was then endowed with broadly the same enforcement powers upon its creation in 2013.

[1] For completeness, the Bank of England has certain enforcement powers in its capacities as Resolution Authority, supervisor of Financial Market Infrastructure, and as overseer of Scottish & Northern Irish Banknotes. This speech only considers the PRA aspect.
[2] See Banking Act 1979, sections 1(7) 5(3), 12(5) and 16(7), amongst others; and Banking Act 1987 sections 3(2), 18(3), 19(6), 41(9) amongst others.
[3] Financial Services and Markets Act 2000

Since then, the PRA has developed how it goes about deploying those powers, in the context of its prudential supervisory remit. Because it is not enough that the PRA has an arsenal of practical supervisory tools. Any regulator, needs (for want of a better phrase) a "hard backstop". It has to, for serious breaches, and for those who do not, or will not, comply with its regulations.

From there, we can sketch out our Enforcement Approach:

- We take the PRA's statutory objectives as our lodestar. These are: primarily, promoting the safety and soundness of the firms that the PRA regulates, and contributing to securing appropriate protection for insurance policyholders; secondarily, to act in a way which facilitates effective competition.

- We work with the grain of the PRA's supervision-led approach. This emphasises forward-looking and judgement-based supervision, focusing on the areas of greatest risk to our objectives. Targeted enforcement action supplements this, but does not supplant it.[4]

- Our priorities are those of the PRA as a whole. The PRA sets strategic goals every year, and these are embedded in our Referral Criteria for opening investigations.[5] There is no autonomous 'enforcement agenda'.

- On a practical level, we liaise extremely closely with supervision and policy colleagues on all key decisions. For example, decisions to open investigations typically involve a joint assessment process with supervisors.

- In targeting our enforcement efforts, we balance the liability of firms with the importance of driving accountability amongst senior-level individuals.

- We don't 'jump' to investigation. We assess potential investigations on the basis of 'can we?' and 'should we?' – that is, are there legal grounds to investigate; and should we actually do so. To help explain this, the PRA recently published its referral criteria, a set of considerations to which we have regard.[6] The PRA uses these to consider *whether or not* to investigate. We fully explore the alternatives with supervisors. It is a rounded decision. Equally, it means we do not only investigate as a 'last resort' once all else has failed.

- Following investigation, the decision on whether to seek settlement is made by senior PRA executives *independent of the investigation team*. The case team presents its findings and gives its

[4] This is, the approach by which, in practice, the PRA pursues its statutory objectives through supervising firms. It is set out in Prudential Regulation Authority (2018): *Approach to Banking Supervision* and *Approach to Insurance Supervision*
[5] Prudential Regulation Authority (2019): *Business Plan 2019/20*; and Prudential Regulation Authority (2019): *PRA Investigation Referral Criteria*
[6] Prudential Regulation Authority (2019): *PRA Investigation Referral Criteria*

recommendations – but Enforcement itself does not decide.[7] This is consistent with the investigators being, primarily, lawyers nested within the Legal Directorate of the Bank – advising separate decision-makers.

- We recognise that many situations call for response from multiple regulators and other enforcement agencies, and seek to co-operate with them at every opportunity. This has involved building relationships, and strengthening links, for example through secondment arrangements.

- We operate transparently, and increasingly so. Our publications, from the Referral Criteria which we published in March, to our Regulatory Investigations Guide,[8] to our statutory policies, set out the process we follow and the built-in safeguards to ensure the independence of our decision-making. This independence and scrutiny was enhanced last year by the creation of the Bank's Enforcement Decision-Making Committee (EDMC), chaired by Sir William Blair, which operates at arm's length from the PRA on contested cases.[9] The EDMC is currently in the process of determining its first matters and we look forward to learning its decisions.

- And as a final point which goes without saying, we approach all investigations with an open mind. We always have regard to evidenced, relevant representations from the subjects of our investigations and those who speak for them.

Track record and current portfolio

A look at our track record illustrates how this approach has been put into practice.

To give some idea of scale, since April 2013, the PRA has:

- Opened 22 separate cases. This has involved opening investigations into 17 firms and 32 individuals.

- Of those, 12 cases have been (or are being) carried out jointly with the FCA. In practice, joint cases can take a number of forms, ranging from those in which the FCA has led the investigative work through to others which are more like parallel but co-ordinated investigations. It depends on the facts and respective objectives of the two regulators.

- Out of all those investigations opened into firms, seven investigations have concluded with a settled outcome, two closed with no enforcement action and eight are ongoing.

[7] See paragraphs 72-81 at pages 13-15 of the Statement of the PRA's policy on statutory notices and the allocation of decision making under the Act, within Prudential Regulation Authority (2019): *The PRA's Approach to Enforcement: statutory statements of policy and procedure*
[8] Prudential Regulation Authority (2019): *Regulatory Investigations Guide*
[9] See Bank of England *Press Release* announcing membership of the EDMC.

- And of those opened into individuals – all senior individuals – 19 are ongoing, seven have been closed with no PRA enforcement action, and six have resulted in a formal sanction. The statistics may give you some assurance that we are quite willing to close a matter if that is the rational, appropriate course of action. There is no 'enforcement travellator' leading ineluctably from investigation to sanction.

We currently have 12 cases spread across the full spectrum of the PRA community: across all sizes of firm, insurers and deposit-takers, international and local.[10] Our policy is that we will not normally make the fact of investigation into an individual or firm public. We are mindful of the risk of any potential damage or unfairness that may be caused by publicising investigations, prior to determining whether or not a sanction is appropriate.[11]

In substance, you will see that our cases have tended to fall into two broad sets:

- First, those where conduct by a firm and/or an individual could impair our ability to supervise properly; or represents behaviour outside the bounds of what the PRA considers acceptable; and
- Second, where there has been a crystallised 'risk', action or public event which could have a direct impact on the PRA's statutory objectives.

In the first of these, examples of relevant PRA actions are:

- Bank of Tokyo Mitsubishi UFJ Ltd/Mitsubishi UFG Securities EMEA plc,[12] and related individuals. Here, the firm and individuals failed to notify us adequately of a potential change to its senior management. As we said then, the PRA assesses safety and soundness not just against current risks, but also against those that could plausibly arise further ahead, and requires firms to engage in open dialogue with the PRA. This includes requiring firms to take the initiative to ensure the PRA has all relevant information at an early stage.
- Qatar Islamic Bank (QIB),[13] from 2016, where the firm failed to identify that it had to comply with certain financial resources requirements; and – and this is key – it failed to report properly certain of its large exposures. Without that reporting, the PRA lacked the crucial sight-line into the firm's risk, hampering our ability to supervise properly.
- Our 2015 action against the Co-operative Bank.[14] This arose from historical events at that bank between 2009 and 2013, which are well-known and documented. The PRA faced a potential crystallised risk but the thrust of our action was against the mis-match between the apparently 'prudent' stance articulated by that firm, and the more aggressive accounting techniques it had actually employed in that period.

[10] Numbers are correct as at 30 June 2019. An investigation is considered 'ongoing' if neither a Final Notice has been issued, nor a notice of discontinuance.
[11] Prudential Regulation Authority (2019): *The PRA's Approach to Enforcement: statutory statements of policy and procedure*
[12] Prudential Regulation Authority 2017: Final Notice Bank of Tokyo Mitsubishi
[13] Prudential Regulation Authority 2016: Final Notice QIB
[14] Prudential Regulation Authority 2015: Final Notice Co-op Bank

In the second group, where there has been a crystallised risk or public threat to our objectives, I would place the very first PRA enforcement case, into RBS in respect of an IT outage.[15] The Final Notice issued recently to Raphaels Bank, on similar matters, is another of this type.[16] Our action against Millburn Insurance[17] and its former CEO followed that firm entering into insolvency, with our investigation subsequently uncovering a number of defects in the way it had been run.

The Senior Mangers Regime and enforcement against individuals

I said I would advert to this. For context, the Senior Managers Regime (SMR) is the name given to a collection of laws and rules and processes designed to improve governance and accountability at firms. Although it continues to evolve, it came into effect in March 2016.

I'll start with one very simple point. And it is that senior managers – by that we mean the people who are responsible for running the firms we regulate – have always been, and will continue to be, squarely within our appetite and interest. It is why the PRA Business Plan refers to holding "firms, and the individuals who run them, to account."

On which, I would note that accountability is not the same as culpability. Nor is accountability the same as punishment. Accountability means having the duty to give an account of matters for which you are responsible, to explain your actions. Where appropriate, a sanction may be the consequence *where the individual has failed to meet the standards we expect.* I labour this point because it is critical: a lack of a sanction does not mean a lack of accountability.

This approach has been central to the PRA from its inception. Since 2013 the PRA has taken the following actions against some of the most senior individuals in their firms:

- Colin McIntosh – former CEO of Millburn Insurance: fined and prohibited.[18]
- Barry Tootell – former CEO, the Co-Operative Bank: fined and prohibited.[19]
- Keith Alderson – former Director, the Co-Operative Bank: fined and prohibited.[20]
- Akira Kamiya – former Chair, Mitsubishi Securities: fined.[21]
- Tamiko Onodera – former Director, Mitsubishi Securities: fined.[22]
- James Staley – CEO, Barclays: fined.[23]

[15] Prudential Regulation Authority 2014: Final Notice RBS
[16] Prudential Regulation Authority 2019: Final Notice Raphaels Bank
[17] Prudential Regulation Authority 2016: Final Notice Millburn Insurance
[18] Prudential Regulation Authority 2016: Final Notice Colin McIntosh
[19] Prudential Regulation Authority 2016: Final Notice Barry Tootell
[20] Prudential Regulation Authority 2016: Final Notice Keith Alderson
[21] Prudential Regulation Authority 2018: Final Notice Akira Kamiya
[22] Prudential Regulation Authority 2018: Final Notice Tamiko Onodera
[23] Prudential Regulation Authority 2018: Final Notice James Staley

In passing, note that none of these, strictly speaking, required the introduction of the Senior Managers Regime for the enforcement action to proceed to its conclusion.

Indeed, five of these PRA actions against individuals were achieved in relation to conduct preceding the introduction of the SMR and on the basis of the rules as they then existed. The sixth was on the basis of a specific individual conduct rule, that of exercising due skill, care and diligence, which itself pre-dated the SMR.

So, although the SMR may be an enormously important turning point in our regulatory system, it would be a mistake to think that, *for the PRA*, its impact lies primarily in the sphere of enforcement. It doesn't. It lies in the SMR's many other aspects – such as the duties on firms to assess fitness and propriety of senior staff, to provide regulatory references; the power for the PRA to make conditional and time-limited approvals; to specify responsibilities more clearly, and a host of other attributes.

Set in that context, commentary on enforcement cases which proceeds on the basis that this one or other case is "an important test of the Senior Managers Regime", in my view suffers from looking at the regime through the wrong end of the telescope.

Agenda and conclusion

I hope I have made it clear that our working agenda in Enforcement is not distinct from the PRA's agenda. Enforcement is an aspect of the PRA's supervisory approach, and focuses on investigations which buttress the PRA's objectives and strategic goals. None of that will change.

As a result my own immediate priorities tend towards the operational.

The first is, introspectively, to ensure the PRA has the independent operational capability to pursue whatever cases it needs to. We continue to look for opportunities to improve our effectiveness, whether through use of technology, nurturing talent, or importing 'best practice' from peers – something I am very keen to push further.

The second is more of a 'public law' one. I referred to the EDMC earlier. I also referred to our settlement decision-makers, panels composed of senior PRA staff independent of the enforcement team. Now, these are two separate organs and – rightly – operate independently, but it is crucial from a public law perspective that there is consistency between the two, in the way they interpret our rules and policies. The PRA is a single authority and our subjects ought to expect broadly the same treatment on the same facts from those two parallel decision-making bodies.

For that reason, the proposal in our recent Consultation Paper (CP10/19) [24] on changes to our settlement policy includes provision for the EDMC to review settled cases after the event.

While this will cover process, it will also I hope give us an opportunity to explore different viewpoints and ensure the EDMC and the PRA executive remain independent but aligned. It is something I welcome and look forward to.

The third priority, I have attempted this evening, which is to continue to foster understanding of our approach in the communities which matter most directly – firms and their legal advisers. We know from experience that our investigations run more efficiently when our subjects and their legal advisors 'know where we are coming from'. That is one reason we published our Regulatory Investigations Guide. We believe our enforcement actions are more impactful the better they are understood in context. And I believe that you are better placed to advise your clients accordingly.

That is why I am extremely pleased to have had the opportunity to speak to members of the FSLA tonight, and why I hope we can continue to engage, to mutual benefit – to the benefit of the PRA and also to the benefit of the firms you represent – in future.

[24] Prudential Regulation Authority (2019): *Consultation Paper 10/19*

References

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