AFME-ISDA joint response

PRA Consultation Paper (CP27/23) - The Prudential Regulation Authority's approach to policy

March 2024

Introduction

AFME and ISDA (hereafter "the industry") welcome the opportunity to comment on the PRA's Consultation Paper (CP) on its Approach to Policy.

The industry supports the continuation of structured policy development built on ongoing dialogue and consultation between policymakers and industry that delivers the clarity, certainty, and predictability that international businesses and investors seek while maintaining systemic financial stability. The industry's response set out in this document supports the objectives of the PRA in its Approach to Policy. Yet, the industry finds that there are gaps and limitations highlighted in the current CP and provides feedback on specific areas that warrant further improvement. Importantly, the feedback set out in this document will facilitate the PRA's mandate in upholding the secondary competitiveness and growth objective under the Financial Services and Markets Act (FSMA) 2023.

In providing our feedback, we have focussed on the three main areas highlighted in the consultation while presenting additional items:

The secondary competitiveness and growth objective

The industry emphasises the importance of considering UK market specificities as part of meeting its secondary competitiveness and growth objective. The industry adds that while considering UK market specificities, the PRA should not penalise international firms that operate in the UK as this can hinder competitiveness, growth, and financial stability.

Implementing international standards

Although the industry generally agrees with the approach set out by the PRA on implementing international standards, the industry identifies gaps and further scope for improvement, as well as emphasises the importance of considering UK market specificities. We set out the need to address Memorandums of Understanding (MoUs) and the challenges of over-calibration and coherence of regulation, including the requirement for more detail and clarity on the PRA's proposal to seek to target "largely compliant" outcomes.

Stakeholder engagement

Stakeholder engagement with the PRA is an important element raised in the CP and how this can be further enhanced to ensure efficiency, transparency, and dialogue between the industry and PRA. The industry is very supportive of growing this engagement and identifies key areas where stakeholder engagement can be improved. A key ask of the industry, is for the re-establishment of standing groups and horizon risk scanning groups, as this allows for dynamic discussion and complements the existing engagement channels. In addition, during the initiation phase of the policy cycle, the industry seeks greater cooperation with regulators, for planned and ad-hoc policy initiatives alike, to ensure that policy development is efficient and results in the desired outcome envisioned by regulators to address future risks.

Other issues

Additional issues highlighted in this paper other than those grouped in the three main themes highlighted above include Cost-Benefit Analysis (CBA), data collection, and shortcomings of the existing Policy Index.

The secondary competitiveness and growth objective

Addressing UK specificities and considering costs to UK and international firms.

The PRA should outline in its draft policies and/or consultations how it arrives at its policy decisions which account for UK market specificities. At the same time, policies that are developed and implemented by the PRA should not penalise international firms that operate in the UK, and the costs of such policies on the ability of both domestic and international firms to drive growth should be carefully evaluated.

Reducing the burden on all firms that operate in the UK will support the PRA's vision of enabling growth while maintaining financial stability and making the UK a more attractive region to conduct business.

If there are differences in costs to firms that operate in the UK, whether they are international or domestic firms, this will distort and undermine the secondary competitiveness and growth objective of the PRA.

THE PRA's "Regulatory Foundations"

We note the PRA's articulation of the main channels through which it can facilitate growth and international competitiveness, and the "regulatory foundations" that it proposes to strengthen in order to do so. We are concerned that these foundations reflect an overly narrow interpretation of the new secondary objective, notably with respect to the "capital allocation" channel the PRA has identified.

We believe the proposed regulatory foundations fail to recognise the PRA's ability to facilitate growth and international competitiveness by ensuring the overall regulatory framework does not impede efficient capital allocation. In addition, the price at which capital can be allocated will impact banks' ability to contribute to growth and support competitive, sustainable capital markets. We see this as a fundamental foundation through which the PRA can further its new objective, and one that should be explicitly recognised in its Approach Document.

We, therefore, propose a fourth regulatory foundation entitled "Calibrating regulation to remove impediments to growth" which should be incorporated into the Approach Document. Among other things, this should note the importance of the PRA prioritising its policy work and managing the costs that its policy initiatives can create for industry. It should also take account of firms' ability to absorb those costs, and the wider environment in which they operate (including requirements/costs imposed by other regulators). This would link directly to the PRA's "capital allocation" transmission channel, given that allocating capital towards compliance with unnecessary, duplicative, poorly coordinated, or disproportionately burdensome regulation does not represent efficient capital allocation. We also note that strengthening this regulatory foundation would serve to advance the PRA's safety and soundness objective, given that lowering costs for firms without increasing riskiness makes them more robust, and that firms are most resilient when they can make profits and sustainably generate capital. Both of these points are recognised in the Governor's January 2024 response to the Chancellor's PRC Remit Letter.

In our view, the PRA's third regulatory foundation entitled "Taking a responsive and responsibly open approach to UK risks and opportunities" is not as broad as its title suggests. Paragraphs 3.28–3.33 of the draft Approach Document explain that this foundation relates to taking a proportionate approach to innovation, openness, and emerging risks. The foundation does not appear to cover capital allocation and pricing, or the importance of responsible risk-taking for creating growth. In light of this, we suggest it is renamed to be more specific as to which risks and opportunities it relates to. A more appropriate title may be "Taking a responsive and responsibly open approach to UK prudential risks and opportunities to innovate".

Finally, we encourage the PRA to launch a flagship policy initiative to advance the Growth and Competitiveness objective, which should involve reviewing areas in which the PRA has gold-plated existing international standards to assess the extent to which they are acting as an impediment to growth. This project should match the level of impact and ambition of the PRA's Strong & Simple project in support of its secondary competition objective. This would be consistent with the PRA's intention to take a proactive approach to the new objective, which we welcome.

Implementing international standards

PRA's international engagement strategy

Industry supports the PRA's international engagement strategy set out in the CP which is sensible. However, we note that in the CP there was no mention of the PRA's intent to enhance the MoUs with different jurisdictions. We believe this will be an important area of supporting UK growth in the long term which aligns with the secondary competitiveness and growth objective mandated by FMSA 2023.

Furthermore, we ask that the PRA sets out how it would approach collaboration with jurisdictions with which the UK has agreed to a mutual recognition agreement in financial services, including how the PRA proposes to enhance regulatory and supervisory cooperation with such jurisdictions. We would also request more detail on the strategic aims and prioritisation considerations behind the expanding financial dialogues meetings between UK Authorities and their counterparts in selected jurisdictions.

Coherence and Calibration

The PRA aims to be "largely compliant" concerning international standards, but this may restrict the regulator's response when approaching policy-making. If there are concerns of over-calibration in a particular policy area, the ability to solve or initiate remedial actions will be inhibited by the PRA's target of being "largely compliant". The industry documents that since the financial crisis, post-crisis reforms have addressed bank risk management practices where there is a pronounced effect on capital formation, in terms of quantity and quality. Yet, such reforms have led to more stringent and often convoluted regulations, which produce unintended consequences. For policies to produce their intended outcome(s), there must be the right mix of calibration and coherence. In addition, UK market specificities must be considered when applying international standards rather than blanket enforcement of regulations without regard for the UK market. As seen with other major jurisdictions, the industry finds that similar jurisdictions do not strictly align with international standards, as they account for their national market specificities. In line with the implementation of international standards, the industry advocates for there to be a periodic review of the international standards in the PRA rather than for them to become static over time. Without effective reviews, the PRA will be limited in its ability to go beyond Basel standards and adjust when required, which it considers appropriate to do so without raising capital levels in a way that could have an adverse effect on the real economy.

We also suggest that the PRA should provide additional clarity on the level of compliance with international standards it is seeking. This is because an overall rating of "largely compliant" could be given to widely different outcomes because the assessment process does not trade-off super-equivalence with instances of sub-equivalence. This is explained in the Basel Committee on Banking Supervision's (BCBS) Regulatory Consistency Assessment Programme (RCAP) Handbook for Jurisdictional Assessments, which notes that:

"Domestic measures that are stricter than the minimum Basel requirements are fully in line with the nature of the international agreements, which are intended to set minimum requirements, and will therefore be considered as compliant. However, they will not be considered to compensate for inconsistencies or gaps identified elsewhere."

The methodology described above means that the PRA would not be given 'credit' for exceeding international standards to offset any areas in which the PRA is not fully compliant. The PRA could implement an approach that is stricter than international standards in several areas, including UK-specific buffers and other requirements that could harm growth and competitiveness, and still be rated "largely compliant" on the basis of a comparatively immaterial line-by-line deviations from the Basel framework. A target of "largely compliant" does not provide any material clarity on whether the PRA will avoid such an approach.

Ultimately, it is the outcomes delivered by the PRA's overall regulatory framework that matter most to regulated firms. Indeed, we note that the PRA's approach to equivalence assessments is judged on outcomes as opposed to being purely based on compliance with international standards or line-by-line compliance. We believe adopting a similarly outcomes-based approach to implementing international standards, whereby the PRA seeks to largely achieve the *outcomes* sought by those standards, would be preferable to that currently proposed in the PRA's Approach Document.

However, if the PRA is not minded to adopt an outcomes-based approach, we consider that much more detail is required on the precise level of alignment to international standards being targeted. We also note that the PRA's target of being "largely compliant" appears to be specific to the BCBS rating scale, so we would encourage the PRA to ensure the Approach Document explicitly sets out how this maps to the rating systems used by other bodies (e.g. the IMF).

<u>Stakeholder engagement</u>

We outline proposals below to further stakeholder engagement. It is worth emphasising, that we do not view effective dialogue between the industry and regulator in isolation and believe it as a key component in ensuring risks are well understood. As such, we view effective dialogue / communication as a key contributor to ensuring greater efficiency in capital allocation within banks and across the system as a whole, and as outlined below, we support the PRA's plan for enhanced and more frequent engagement with stakeholders.

Standing group and Horizon risk

We agree with the proposal to engage with stakeholders more frequently and at every stage of the policy cycle. We also agree that there is value in increasing outreach efforts in the initiation phase. This is the stage where external input can have the most value, reduce the need for engagement later in the policy cycle, and ultimately provides effective and more targeted policies that produce the desired outcome. In line with the initiation phase, regulators must ensure that there is transparency and communication with industry when developing ad-hoc consultation responses that have not been previously discussed or proposed by regulators. Any consultation response that has been proposed, or consultations that are ad-hoc in nature due to unforeseen emerging risks require industry engagement to ensure a more efficient process with key insights from industry to help achieve shared objectives.

Consultations are an important and transparent form of engagement. These can be supplemented with direct engagement such as through roundtable meetings, conferences, or standing advisory committees.

In this respect, the industry strongly believes that the PRA should re-instate standing groups – as previously operated by the Financial Services Authority (FSA). These are groups chaired by the PRA with a panel of industry subject matter experts that meet regularly to discuss relevant issues e.g. a Credit Risk Standing Group. These Groups can help enable more regular and closer dialogue intended by the PRA. In the CP, there is a short reference to the use of standing groups which was raised by the respondents. Nonetheless, the CP does not provide any more detail or clarity on the use of standing groups as a form of effective stakeholder engagement. Therefore, the industry recommends that the PRA consider reinstating the use of standing groups, which should serve as a compliment for stakeholder engagement rather than a substitute.

As well as risk-specific groups e.g. Credit Risk Standing Group, we also recommend the creation of a Horizon Risk Standing Group that would seek to identify and consider how to address upcoming/future risks. Ultimately, these groups may be governed by an oversight group, such as an Industry Engagement Group which helps guide the mandate of the risk-specific groups. Industry would welcome further discussion on the form/structure of these groups.

The standing groups we recommend should not replace the existing bilateral engagement, which we believe is very effective between the PRA and individual banks, but should be an additional and dynamic avenue for engagement. Dynamism is particularly needed in rapidly-developing areas of policy where traditional consultation methods may risk falling behind market developments. We believe it will help to enhance the transparency of rulemaking as well as give the PRA an additional channel to receive timely input and provide real-time feedback to the industry, thus fostering increased transparency and market confidence.

Additional Items

Regulatory principles: Clustering

When clustering regulatory principles and focusing detail on the most significant in each case, we recommend that evidence/justification be provided as to how the PRA has identified which of the regulatory principles are most significant. This will facilitate transparency and accountability, and help foster consistency in the consideration of regulatory principles over the medium-long term.

Cost benefit analysis (CBA) for different approaches to achieving a given regulatory outcome.

We support the increased focus on CBA and welcome the comments made in the CP to enhance and make the CBA process more transparent. We see CBA as a critical tool in assessing the merits of a proposal. We strongly encourage the PRA to ensure all policy proposals are accompanied by a CBA, even where it is not required by statute. We note the PRA's consultation on its approach to enforcement (CP9/23) as a recent example of this practice of conducting a CBA even where it is not legally required. We encourage the PRA to continue to take this approach as a matter of course, and to commit to doing so in its Approach Document. In addition, we welcome the PRA's published Statement of Policy (SoP) on their approach to appointing members to our statutory panels. Such actions allow panels to effectively scrutinise the PRA's CBA.

Furthermore, to ensure that all relevant factors are included in the PRA's decision to amend or draft new regulations, a decision tree could be used by the PRA which would include full consideration of each of the relevant factors. It would also be valuable for the CBA analysis and full consideration of relevant factors to be performed for all approaches considered in consultation, and not simply as a justification for the preferred option. This would provide greater transparency on how all of the possible approaches have been considered/ assessed by the PRA.

We welcome the PRA's aim to increase the breadth and scope of its stakeholder engagement throughout the policy cycle. However, we would note that different stakeholder groups will have varying degrees of insight on various topics. For instance, academia can provide valuable insights into the theoretical side of topics and can be of great use in helping to identify topics for regulatory focus, determining data sets, undertaking analysis and research, and challenging the status quo. However, they may not have as much insight into practical implications or in the functioning of markets or banks' operating models.

Data collection and engagement with the industry

With reference to the data collection, the CP states:

"Respondents highlighted the importance of communicating the rationale for data asks clearly and engaging with industry in advance to focus our requests. Our proposed approach, therefore, is to provide as much context as circumstance allows so that firms can understand what we are looking for".

We welcome the PRA's approach to providing as much context as possible so firms have a firm understanding of the PRA's objectives, although this objective can be further improved by being more open and transparent with the data collection process by feeding the results to the industry, as this allows the industry to develop recommendations and provide feedback on ensuring a more efficient data collection process, thus reducing the burden on the limited resources available to the PRA and industry. Although this CP is policy-focused, such data requests tie in with an adjusted Supervisory Approach under the new Secondary Objective.

Furthermore, the industry asks that it be consulted on the structure of the data templates in any data collection exercise, as this will support the efficient process of data collection and can reduce the burdens for the regulators and industry. AFME and ISDA can provide support and facilitate the data collection process which aids the PRA's effort in collecting data as well as enabling the process to be more open and transparent.

Shortcomings of the existing Policy Index

We welcome the PRA's approach to the Policy Index (rulebook) and the efforts to enhance its accessibility and usability. More specifically, the CP states they will continue *"to increase accessibility by developing an easy-to-use website"*. The industry looks forward to this proposal and seeks open dialogue to ensure feedback is provided on the ease of accessibility.

In addition, it is important to retain access to EU laws that are revoked, revised, or replaced. This is important, as it allows interested parties to trace regulations that were once implemented and followed. The PRA should consider producing an archive of regulatory guidelines that were once implemented, which users can access via a hyperlink.

Regarding the consolidated list of waivers, CRR, and Solvency II permissions that are granted to PRA-authorised firms, the response letter from the industry highlights that this is no longer being published. Nonetheless, the CP has not provided any feedback on this matter. As such, we seek further clarity regarding the publication of this information in the future.

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About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76. Information about AFME and its activities is available on the Association's website: www.afme.eu.

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