



HM Treasury

Bank of England Bill:

response to the consultation

October 2015



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1 Introduction

1.1 From 21 July to 11 September 2015, the government held a technical consultation on proposed changes to the governance of the Bank of England. The Treasury received and considered a total of 14 responses from both organisations and individuals. A list of respondent organisations is included at Annex A.

Summary of respondents' views

1.2 Respondents overwhelmingly supported the changes proposed in the consultation paper. A number of questions were raised by respondents, particularly in relation to the proposals to end the Prudential Regulation Authority's (PRA) status as a subsidiary. Many respondents also used the opportunity afforded by the consultation to argue for additional measures they considered could be included in the Bill.

1.3 These questions and additional proposals from respondents and the government response to each are the focus of this document.

Next steps

1.4 This response was published in co-ordination with the introduction of the Bank of England and Financial Services Bill, which includes the measures consulted upon, to the House of Lords on 14 October 2015. The Bill will now proceed through the normal legislative process. It can be read, its progress can be tracked, and additional documents and debate records can be viewed at www.parliament.uk/Bills.

2 Summary of responses

2.1 This chapter summarises the key proposals and questions from respondents to each chapter of the consultation (chapter 1 was the consultation's introduction). In each case, the government's response is set out below.

Chapter 2: Strengthening the regulatory architecture

2.2 The consultation document set out the government's proposal to end the PRA's status as a subsidiary and integrate it further within the Bank, while retaining its independence.

2.3 Respondents broadly welcomed this change and the clear accountability and increased potential for cooperation across the Bank's functions it would bring (though many emphasised the importance of protecting the operational independence of the PRA under the new arrangements, see below). One respondent supported the end of the PRA's status as a subsidiary but cautioned that silos and barriers to information flows could remain even after de-subsidiarisation. Only one respondent was opposed to ending the subsidiary status of the PRA, arguing that the current structures are working well.

Proposals and questions from respondents

PRA independence

2.4 Nearly all respondents noted the criticality of maintaining the PRA's independence in rule-making, policies and supervisory decisions and clear separation between the PRA's costs and those of the wider Bank. In particular, one respondent stated that "it is imperative for the PRC to retain its independence in making rules, policies and supervisory decisions in order to comply with legal requirements and international standards...as well as preserve investors' trust in the UK financial regulatory system." One respondent suggested the Bank report on this separation in its Annual Report. Another considered that the government should also set out clearly how maintaining separation interacts with the Bank's aim to be 'one Bank'. Respondents variously also requested a clear process for decision-making, increased transparency around fees and the levy-setting process, and publication of criteria for decision.

2.5 *Government response:* The government agrees with the importance of preserving the PRA's operational independence and maintaining the clear separation of its responsibilities with those of the Bank. The Bank will only be able to exercise its prudential regulation functions through the new Prudential Regulation Committee, which will have a majority of external members and clear processes for decision making. Every year, the Committee will report on its resources and the independence of its operations. The Bill will also ensure a strong statutory role for the PRA's Chief Executive and require the Bank to ensure separation between resolution and supervisory functions (in line with European requirements).

2.6 The use of the levy will continue to be limited to meeting the costs of the PRA functions and the Bill will require the Bank's external auditor to state whether the Bank has complied with statutory requirements in relation to the levy. The Bill will also require the Bank to produce a separate statement of accounts for its PRA functions to ensure continued transparency.

Representation of insurers

2.7 Three respondents were concerned about the representation of insurers on the new Prudential Regulation Committee. Respondents were concerned that further integration with the Bank would reduce the extent to which the interests of insurers were represented by shifting the

focus of regulation towards banking or that distinctions between the insurance and banking sectors would falter.

2.8 *Government response:* The new Prudential Regulation Committee will have a majority of external members appointed by the Chancellor to ensure a wide range of expertise and external challenge on the committee. The Bank and the government have ensured that the current PRA Board includes insurance expertise, and this range of experience will continue once the Prudential Regulation Committee is formed. However, the government does not believe that any member of the Committee need act as a representative of a particular sector to ensure all members take account of the range of views throughout the financial services sector. The PRA Practitioner Panel, which includes representatives of the insurance sector will still operate as a means of ensuring that the interests of industry can be communicated to the PRA.

Financial Conduct Authority

2.9 One respondent highlighted the importance of the PRA adopting a joined-up approach with the Financial Conduct Authority (FCA) and the Financial Reporting Council. Another additionally suggested that the integration of the PRA within the Bank should be replicated for the FCA.

2.10 *Government response:* The government agrees with the need for a joined-up approach between the PRA and the FCA. A number of measures to ensure co-ordination between authorities currently exist and these will be continued in the new arrangement. For example, the Chief Executive of the FCA will sit on the new Prudential Regulation Committee and the general co-ordination mechanisms will remain in place, including a duty on the PRA and FCA to co-ordinate the exercise of their functions and the requirement to maintain a Memorandum of Understanding.

2.11 However, the government does not agree that the FCA should be integrated within the Bank of England. Prudential and conduct of business regulation have different end goals and require different approaches and cultures. The Financial Services Act deliberately moved away from the combined remit of the old Financial Services Authority, in part because ordinary consumers of retail products did not always get the degree of regulatory focus or the protection they may have expected or required. An independent, separate FCA helps ensure that the interests of consumers are given the priority they deserve.

Climate change

2.12 Three respondents identified the long-term risk of climate change to investors and the wider financial system and therefore called for these risks to be incorporated into the analysis of the Bank's committees. Two of these respondents requested measures allowing the Bank to increase requirements for firms to report on their exposure to climate change risk.

2.13 *Government response:* The Financial Policy Committee has a mandate to consider any and all systemic risks to financial stability. Since its establishment, the FPC has considered a wide range of risks, including those posed by climate change. The Committee has broad powers of recommendation, which can be used with regard to the firm-level regulators or directly to industry. On 29 September 2015, the Governor of the Bank of England gave a speech highlighting the risks that climate change poses to financial stability, the role of financial policymakers in ensuring the resilience of the financial system in the transition to a low-carbon economy, and calling for more and better disclosure to allow investors to account for these risks in their decisions.

Economic growth

2.14 Two respondents asked for all committees of the Bank to set out how they plan to support economic growth and report on their success. One respondent felt that the government should use the Bill to legislate for an objective to ensure a diversity of business models in the financial services industry. Another requested an additional statutory objective for the PRA to consider the international character of financial services and the UK's competitiveness.

2.15 *Government response:* The Bank of England Act 1998 already sets out a secondary objective for the MPC and the FPC of supporting the economic policy of the government, including its objectives for growth and employment. The Act requires the government to specify these objectives at least once a year, by updating the remit for the MPC and remit and recommendations for the FPC. The government's proposals do not seek to alter this requirement.

2.16 The PRA has three objectives, all of which support growth. They require the PRA to promote the safety and soundness of firms it regulates, contribute to protecting insurance policyholders and (secondarily) to facilitate effective competition. The PRA is also required to have regard to the principles of proportionality, the desirability of sustainable economic growth in the UK and the desirability of recognising "differences in the nature of, and objectives of, businesses". The government's Productivity Plan¹ announced that remit letters for the PRA and FCA will outline the government's priorities for increasing competition and innovation in financial services, for ensuring that the UK remains an attractive location for financial services businesses, and for securing London's role as the leading international financial centre. The PRA remit letter will be provided for in this Bill.

Status disclosures

2.17 Two respondents expressed concern about potential costly changes to status disclosures mentioning the PRA in firms' documentation.

2.18 *Government response:* The Bill will not require firms to change their documentation. The government wants the PRA's interactions with firms to continue without disruption.

Existing aspects of the PRA

2.19 One respondent detailed concerns that statutory safeguards and disciplines might be watered down as a result of the changes. They emphasised the importance of retaining the PRA's existing obligations around consultation, preparing cost-benefit analyses and having regard to the differential impact of PRA rules on different types of firms. Two respondents requested that the role of practitioners (through the PRA Practitioner Panel) and consumers (through the FCA Consumer Panel) are maintained, while another highlighted the need for a continued commitment to proportionate regulation. Finally, one respondent requested that the PRA continue constructive engagement with European institutions.

2.20 *Government response:* The government intends to preserve all these aspects of the PRA.

Chapter 3: Protecting tax payers from firm failure

2.21 The government proposed to strengthen the framework for resolution policy and crisis management.

2.22 All respondents who commented welcomed these changes.

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443898/Productivity_Plan_web.pdf

Proposals and questions from respondents

Role of the Treasury

2.23 One respondent highlighted the importance of government maintaining the clear division of responsibilities between the Bank and the Treasury so as not to introduce the Treasury as an additional decision-maker determining resolution strategies. This respondent also called for additional detail on when the Treasury and Bank might hold official-level meetings to review public fund risks and argued that specific requests for regulatory information should respect confidentiality, be exercised in limited circumstances and, outside a crisis situation, should require the relevant firm's permission.

2.24 *Government response:* Through the Financial Services Act 2012, the government set out clear and separate roles for the Treasury and Bank in managing firm failure and the associated risks to financial stability and public funds. The measures proposed in the consultation do not alter the Bank or the Treasury's roles and responsibilities, but ensure the Treasury has the information needed to inform decisions on the use of public funds in line with its existing responsibilities. More broadly, the measures serve to strengthen communication and coordination arrangements between the Bank and the Treasury in the interests of financial stability. Regulatory information is shared between the Bank and the Treasury on a confidential basis for the purposes of maintaining financial stability; these arrangements will be unchanged under the measures proposed in the consultation.

Chapter 4: Strengthening governance and accountability

2.25 The government proposed to strengthen and simplify the Court, make changes to the MPC and FPC, and bring the Bank within NAO oversight.

2.26 Respondents welcomed the changes that bring the Court into line with best practice corporate governance and agreed with the government's aim to implement the recommendations of the Warsh Review.

2.27 All respondents who commented expressed support for bringing the Bank into the purview of the NAO for value for money studies.

Proposals and questions from respondents

Accountability for resources

2.28 Two respondents argued that the NAO should also perform the Bank's audit instead of a commercial auditor and one requested more information on the process for selecting the external auditor.

2.29 *Government response:* Section 7 of the Bank of England Act 1998 sets out the requirement for the Bank to appoint an external auditor. The new proposals will oblige the Bank to consult the NAO before appointing an auditor and for the auditor to consult the NAO on the audit plan. It will be for the Bank and the NAO to agree how to fulfil this new requirement.

The Court of the Bank

2.30 One respondent urged the government to ensure no non-executive director serves on the Court for a continual term of more than nine years. One respondent considered that current arrangements for NED appointment and performance-monitoring may not be sufficiently rigorous and argued that the legislation should set out a series of firm criteria covering, among others, candidates' integrity, freedom from conflicts of interest, political impartiality and ability to meet time commitments.

2.31 *Government response:* Appointments of NEDs to the Court are made in line with the OCPA Code of Practice for Ministerial Appointments to Public Bodies. This includes principles on merit and probity and stipulates that no appointee will serve in a single post for more than ten years. With the exception of allowing for terms to be extended by six months, the government does not propose to change non-executive term limits in this Bill.

Changes from the consultation

Policy committees

2.32 In addition to the proposals to simplify governance listed in the consultation, the government has also decided to take the opportunity afforded by the Bill to harmonise the provisions around conflicts of interest for the MPC, FPC and new Prudential Regulation Committee. Further transparency will be provided by a requirement for each committee to publish a code of practice detailing how potential conflicts of interest will be managed.

2.33 The consultation document stated that the Bill will transfer responsibility for setting the Bank's financial stability strategy from the Court to the FPC. After further consideration, to ensure all relevant areas of the Bank's work can feed into this strategy, the government has decided instead to make the financial stability strategy the responsibility of the Bank. This ensures that aspects of its preparation can be delegated so the full expertise of the Bank can assist in its production.

Accountability for resources

2.34 The consultation document stressed the importance of safeguarding the Bank's independence while extending the scope of NAO value for money studies. As proposed, the Bill will explicitly exclude consideration of the merits of the Bank's policy from the NAO's remit, but will provide a stronger mechanism than the exemption detailed in the consultation document to ensure confidence in this protection. The Bank will be able to notify the NAO of concerns that a proposed study would question the merits of its general policy. The Bank would be required to consider the views of the NAO, but ultimately it will be for the Court to determine what constitutes a matter of general policy for these purposes. When such a difference of opinion prevails, the NAO must make public the disagreement. This provides continued assurance of the Bank's critical policy-making independence. The NAO will continue to have independence in determining a value for money programme within this framework.

A List of respondents

Association of British Insurers
British Bankers' Association
Building Societies Association
Carbon Tracker Initiative and Sandbag
City of London Law Society Regulatory Law Committee
Financial Conduct Authority Consumer Panel
Institute of Directors
Legal & General Group
Lloyd's
Royal & Sun Alliance Insurance
UK Sustainable Investment and Finance Association
Virgin Money

Two responses were also received from individuals.

HM Treasury contacts

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