



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

8 March 2017

Mark Carney
Governor
Bank of England
Threadneedle Street
London
EC2R 8AH

Dear Mark,

RECOMMENDATIONS FOR THE PRUDENTIAL REGULATION COMMITTEE

The Bank of England Act 1998 requires the Treasury, at least once in each Parliament, to make recommendations to the Prudential Regulation Committee (PRC) about aspects of the economic policy of the government to which the PRC should have regard when considering how to advance the objectives of the Prudential Regulation Authority and when considering the application of the regulatory principles set out in the Financial Services and Markets Act 2000.

This letter and the accompanying annex constitute the recommendations for the PRC.

I confirm that the government's economic policy objective is to achieve strong, sustainable and balanced growth. Price and financial stability are essential prerequisites for strong, sustainable and balanced growth in all regions and sectors of the economy. The specification of the government's economic strategy to deliver this objective, found in section A of the annex to this letter, has been updated to reflect the new fiscal framework announced at the Autumn Statement and reiterated at today's Budget.

The PRC's main contribution to this economic policy is by promoting the safety and soundness of firms, thereby maintaining and enhancing financial stability in the UK. The PRC should, as appropriate, work with the Financial Policy

Committee, Monetary Policy Committee and the Financial Conduct Authority. A strong, stable and competitive financial system supports economic growth, facilitates productive investment and underpins the UK's position as an important global financial centre.

Central to this government's economic policy is our proposed industrial strategy, which aims to build a high-skilled, competitive economy that benefits people throughout the UK. The *Building our Industrial Strategy* Green Paper sets out ten pillars. Of particular relevance to the PRC are the pillars relating to:

- **supporting businesses to start and grow** where the PRC has an important role to play in ensuring that effective competition in financial services can create the right conditions for access to finance and long-term investment and new ways of raising capital;
- **investing in science, research and innovation, and cultivating world-leading sectors**, where the PRC has a role in ensuring there is a diversity of business models within the financial sector that creates the conditions for industries in the UK, such as the growing fintech sector, to prosper and remain competitive;
- **encouraging trade and inward investment** by considering carefully how your regulations could impact on growth and making sure that the cost of regulation is justified by the benefits and that regulation is consistent and transparent so as to give investors confidence that the regulators act in a proportionate way.

The government is committed to UK financial services being effectively regulated; securing the right balance between a financial sector that is globally competitive, works for consumers, and is secure over the long-term.

The PRC supports this vision by working to lower barriers to entry to create a regulatory environment where new entrants and smaller firms can more easily enter, expand and compete with incumbents in a way that acknowledges the impact of their growth on systemic risk. Key to this has been the establishment of the New Bank Start-up Unit to help prospective new banks enter the market and through the early days of authorisation, with 10 brand new UK banks authorised since May 2015 alone.

I welcome the PRC's intention to improve the process by which small firms can transition from the internal ratings based capital approach, and its proposals to modify the Pillar 2 regime to reduce overcapitalisation.

The government also welcomes the work being undertaken to examine the design of the risk margin feature in the insurance regulation to limit the

sensitivity to changes in the risk-free interest rates, which will have beneficial macroprudential and financial stability impacts.

As you will be aware, the government will soon begin the formal process of leaving the European Union (EU). While the UK's strong and dynamic economy means we are well-placed to make the most of the opportunities presented by withdrawing from the EU, there may be challenges as well.

The government acknowledges these challenges and is determined to minimise any legal uncertainty by ensuring that there is a fully-functioning legal and regulatory framework for financial services at the point the UK leaves the EU. It will be vital that government and regulators continue to work together closely so that the government can ensure a smooth transition and maintain the UK's position as the world's leading provider of financial services for the good of the UK and broader EU economy. The expertise of the regulators will be critical during this period, and I look forward to working with you on these issues over the coming years.

I am grateful to you and all the members of the PRC for your continuing good work and dedication.

A handwritten signature in black ink, appearing to read 'Philip Hammond', with a stylized flourish at the end.

Philip Hammond

RECOMMENDATIONS FOR THE PRUDENTIAL REGULATION COMMITTEE

The Financial Services and Markets Act 2000 (“the Act”) sets out the objectives of the Prudential Regulation Authority (“the PRA”).

The PRA has a single general objective of promoting the safety and soundness of the firms it regulates, through ensuring that firms’ business is carried on in a way which avoids any adverse effect on the stability of the UK financial system and minimising the risk they pose to financial stability. The PRA has an additional insurance objective of contributing to the securing of an appropriate degree of protection for those who are or may become policyholders.

The PRA has a secondary competition objective which requires it, when discharging its general functions in a way that advances its objectives, so far as is reasonably possible, to act in a way which facilitates effective competition in the markets for services provided by the firms it regulates.

In discharging its general functions, the PRA must also have regard to the regulatory principles set out in Section 3B of the Act, which are:

- the need to use the resources of each regulator in the most efficient and economic way;
- the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
- the desirability of sustainable growth in the economy of the United Kingdom in the medium or long term;
- the general principle that consumers should take responsibility for their decisions;
- the responsibilities of the senior management of persons subject to requirements imposed by or under this Act, including those affecting consumers, in relation to compliance with those requirements;
- the desirability where appropriate of each regulator exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of person such as mutual societies and other kinds of business organisation) subject to requirements imposed by or under this Act;
- the desirability in appropriate cases of each regulator publishing information relating to persons on whom requirements are imposed by or under this Act, or requiring such persons to publish information, as a means of contributing to the advancement by each regulator of its objectives;

- the principle that the regulators should exercise their functions as transparently as possible.

Section 30B of the Bank of England Act 1998 (“the 1998 Act”) allows the Treasury to make recommendations to the Prudential Regulation Committee (PRC) about aspects of the economic policy of Her Majesty’s government to which the Committee should have regard when considering—

- how to advance the objectives of the PRA, and
- the application of the regulatory principles in section 3B of the Financial Services and Markets Act 2000 .

This document discharges the Treasury’s duties under section 30B of the 1998 Act.

A. The government’s economic policy

The government’s economic policy objective is to achieve strong, sustainable and balanced growth. Price and financial stability are essential pre-requisites for strong, sustainable and balanced growth in all regions and sectors of the UK economy.

To achieve this objective, the government’s economic strategy consists of:

- operationally independent monetary policy, responsible for maintaining price stability and supporting the economy;
- a credible fiscal policy, returning the public finances to health, while providing the flexibility to support the economy;
- addressing long-term economic weaknesses in order to sustain high employment, raise productivity, and improve living standards for people across the UK; and
- continuing to strengthen the financial system, improving the regulatory framework to reduce risks to the taxpayer and building resilience, so that it can provide finance and financial services to the real economy and realise better outcomes for consumers, supporting sustainable economic growth and encouraging productive investment.

B. Matters about aspects of the government’s economic policy to which the Prudential Regulation Committee should have regard.

When the PRC considers how to advance the objectives of the PRA and apply the regulatory principles it should, where relevant and practical, take the following considerations into account, in their assessment of the costs, burdens and benefits of potential rules or policies.

i. Competition

The government is keen to see more competition in all sectors of the industry, particularly retail banking. This includes minimising barriers to entry and ensuring a diversity of business models within the industry.

ii. Growth

The government wishes to ensure financial services markets make a positive contribution to sustainable economic growth in the UK economy in the medium and long term, through the facilitation of finance for productive investment and as a productive sector of the UK economy.

iii. Competitiveness

The government wishes to ensure that the UK remains an attractive domicile for internationally active financial institutions, and that London retains its position as the leading international financial centre. The government considers that achieving this aim in a manner that is consistent with robust institutions and a resilient system will support its aims for sustainable economic growth.

iv. Innovation

The government is keen to see innovation in the financial services sector and how this can support the wider economy, through new methods of engaging with consumers of financial services and new ways of raising capital. This includes recognising differences in the nature and objectives of business models and ensuring burdens are proportionate.

v. Trade

The government aims to encourage trade and inward investment to the UK that can help boost productivity and growth across our economy. This can be supported by improved competition opening the UK to new ways of doing things and being seen as a good place to do business.

vi. Better outcome for consumers

The government wants to see financial services work in the best interests of the consumers and businesses they serve. This is supported by improved competition in financial services and the securing of an appropriate degree of protection for consumers, including policyholders.