

Bank of England

The Rt Hon Rachel Reeves
Chancellor of the Exchequer
HM Treasury
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London
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Andrew Bailey
Governor

18 December 2024

Dear Rachel,

As Chair of the Prudential Regulation Committee (PRC), I am responding to your letter dated 14 November setting out your recommendations to the Committee. This letter also satisfies the requirement for PRC to respond under section 30B(2A) of the Bank of England Act 1998.

Your letter conveys the Government's determination to deliver sustainable economic growth in the UK, and to encourage responsible risk-taking in support of that goal. We recognise that the Prudential Regulation Authority (PRA) has an important role to play as a prudential regulator of the UK's banks, building societies, credit unions, insurers and designated investment firms.

The PRA's primary objectives are to promote the safety and soundness of the firms it regulates and to contribute to securing an appropriate degree of protection for insurance policyholders. The PRA also has secondary objectives to facilitate effective competition in relevant markets, and to facilitate, subject to aligning with relevant international standards, the international competitiveness and medium to long-term growth of the UK economy.

To support growth, regulation must be robust and proportionate. It must also be open to responsible risk-taking and innovation, which play an important role in driving growth. In advancing its primary and secondary objectives, the PRA supports economic growth in a number of ways. Most importantly, we maintain financial stability, which is the foundation for growth, gives confidence to households and businesses making investment decisions, enables reliable financing to the real economy and builds trust in the UK as a global financial centre. We also ensure that our rules are tailored appropriately to the UK context, and we adopt effective and efficient regulatory processes that limit operational costs on firms. Combined, these measures support economic growth.

Following the 2007-08 global financial crisis, UK and global regulatory standards were strengthened to safeguard against future crises and their profound economic and social consequences. The reforms that we, and others, implemented have resulted in more resilient financial institutions. The benefits of these reforms have been evident through recent market shocks and events such as the Covid crisis, when the financial system was able to support the economy effectively.

Our role is not to regulate away all risk. But we must not lose sight of the benefits of appropriate resilience now, as we look for opportunities to review the proportionality of some aspects of the regime to support UK growth and competitiveness while maintaining the stability of our financial system.

Advancing our secondary competitiveness and growth objective (SCGO)

We have taken concrete actions to advance growth and competitiveness since the SCGO came into force last year. For example, in banking, we made important changes to our implementation of Basel 3.1. Our changes were designed to support lending and growth in the wider economy, and to ensure that the package is tailored to account for the needs of the UK financial system. We have also made significant progress on work to streamline the prudential regime applying to small banks and building societies, increasing their ability to compete and to finance productive economic activity.

In insurance, we have introduced reforms to the Solvency UK regime which will provide insurers with greater flexibility to invest in productive UK assets. Our reforms also make a material cut to reporting requirements, reduce bureaucracy in other parts of the regime such as the approval of internal models, and include a mobilisation regime which provides new entrants with flexibility to operate under more proportionate requirements while they are in the early stages of their development.

In addition to these two major initiatives, we continue to review the stock of our existing policies to help support competitiveness and growth. For instance, following our abolition of the bankers' bonus cap we recently announced further plans to adjust the remuneration regime, which will help firms attract and retain top talent. We are working with your officials to enhance the efficiency and effectiveness of the Senior Managers and Certification Regime (SM&CR) and the ring-fencing regime. We are also developing the regime for UK Insurance Special-Purpose Vehicles (UK ISPVs), including through putting in place a much faster 10-day approval process, and we intend to review our approach to the collection of regulatory data. Looking ahead, we are committed to exploring further opportunities to advance competitiveness and growth as we learn from our experiences and listen to stakeholders. We will provide updates on this work in our annual report, business plan and second report on the SCGO.

In addition to policy development, we also support the UK's competitiveness and growth through strong engagement in international regulatory fora. We are active in engaging with our international partners and in shaping international standards. Aligning with these standards bolsters the UK's reputation as a leading financial centre and makes the UK an attractive destination for international firms to operate and invest.

Your letter also emphasises the importance of accelerating adoption of the SCGO at an organisational level. We recognise this and we have been making changes to ensure that competitiveness and growth considerations are thoroughly embedded throughout our policymaking processes and our approach to supervision. The PRC and PRA executive team are setting the tone from the top and ensuring the SCGO is championed at all levels of the organisation, and we are improving our engagement with industry so that we can harness insights on competitiveness and growth. We are also taking opportunities to further improve productivity and efficiency throughout the organisation. As with any new responsibility or objective, our approach will evolve as we learn from experience.

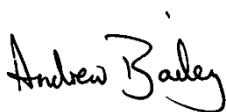
We take our responsibility to be transparent with stakeholders seriously and will enhance clarity on our approach to advancing our objectives (including the SCGO) when we publish our final Policy Approach document early next year.

Having regard to the Government's recommendations

Part B of the annex to your letter sets out six recommendations on Government economic policy to which the PRC should have regard. Consistent with our statutory duties, and to the extent relevant and practicable, the PRC will take into account these recommendations and the Government's economic programme more broadly when considering how to advance its objectives and the application of the regulatory principles in section 3B of the Financial Services and Markets Act 2000.

Further detail on the work the PRA is taking, or planning to take, in support of these recommendations is available in the annex below. We are working closely with other financial regulators on many of the initiatives listed, in particular the Financial Conduct Authority (FCA), as well as HM Treasury (HMT). We look forward to working together across a range of issues, including in support of the Government's upcoming financial services growth and competitiveness strategy.

Yours sincerely,



Annex

We have set out below how our actions support the recommendations in Part B of the annex to the Government's letter. Our programme of work is more closely related to the first three recommendations, because these recommendations are focused on competitiveness and growth considerations, which are already highly relevant to our existing framework of objectives and 'have regards'. Each of the six recommendations will be embedded into the PRA's policymaking processes and considered appropriately over the coming period.

(i) The vital contribution of the financial services sector to overall economic growth

- *Strong and Simple*: In September, the PRA published its consultation paper on the second phase of the Strong and Simple regime, setting out our proposals for simplifying capital requirements, and additional liquidity simplifications. One important aim of the Strong and Simple regime is to enhance effective competition by simplifying the regulatory regime for small, domestic-focused banks and building societies, reducing their costs while maintaining their overall level of resilience. Effective competition between firms supports economic dynamism and growth of the economy.
- *Basel 3.1*: Also in September, we published the second of two near-final Policy Statements on the implementation of outstanding Basel III standards ('Basel 3.1') in the UK. In the Statement, we made important changes based on UK data that will support growth in the UK, particularly by facilitating lending to small businesses and infrastructure projects.
- *Ring-fencing*: In January, the PRA published the conclusions of its review on its ring-fencing rules. The review identified opportunities to improve proportionality by amending the operation of some rules to offer more flexibility to ring-fenced groups. We are also supporting HMT as it implements reforms focused on improving competition and competitiveness, while maintaining financial stability.
- *Solvency UK*: When finalising the Solvency UK reforms, we specifically targeted opportunities to simplify overly complex requirements, improve the flexibility of the regime, and enable insurance firms to play a bigger role as investors in the UK economy, supporting its growth over the medium-long term.
- *Operational resilience (firms' reliance on third parties)*: Firms and Financial Market Infrastructures increasingly rely on a small number of third parties to support aspects of their operations. This system-wide concentration could create risks to financial stability, and therefore growth. The PRA, working jointly with the Bank of England, FCA, and HMT, recently published new requirements and expectations to mitigate these systemic risks.

(ii) Creating a regulatory environment which facilitates growth

- *Banking Data Review*: Subject to availability of funding, we are preparing plans for a Banking Data Review, which will streamline data collected from banks and improve efficiency. We plan to consult in the summer of next year on reforms resulting from the first phase of the review, which will cover changes to reporting on Counterparty Credit Risk and explore the scope for returns that the PRA can delete outright.
- *New approach to stress-testing*. Together with the Financial Policy Committee (FPC), the PRC has approved a new approach to stress-testing banks. As part of that, the Bank will move from an annual to a biennial frequency for its main bank capital stress test, with lighter exercises in the intervening years. This will help us deliver stress testing in a more proportionate way and will yield considerable efficiency gains for firms without compromising our assessment of the stability of the banking system.
- *Senior Managers & Certification Regime (SM&CR)*: We are working closely with HMT and the FCA to review the effectiveness, scope, and proportionality of the SM&CR, which applies to both insurance and banking firms. We plan to consult in the coming months on proposals to increase the efficiency of the regime by providing greater flexibility and clarity to firms and individuals. This is intended to reduce administrative burdens and compliance costs, and facilitate attracting talent into UK firms, without undermining individual accountability. We have already introduced improvements to internal operating procedures for Senior Manager applications that have delivered greater proportionality and flexibility in how the regime operates. Since Q3 2023, the PRA has been determining 98% or more of Senior Managers application cases within the three-month statutory target.
- *Transfer of assimilated law*: We are taking advantage of the repeal and replacement of assimilated law to simplify the PRA Rulebook and improve its accessibility. For example, we are streamlining our policy document formats and organising our regulatory material more efficiently and coherently so that stakeholders can navigate the Rulebook more easily.
- *Engaging firms on innovation*: We are engaging closely with external stakeholders to better understand the role we can play as a regulator to support firms to innovate safely for the benefit of the wider UK economy. For example, in Q3 2024 we held an innovation roundtable with industry and experts to gather views on how we can facilitate innovation in the UK financial sector.
- *Blockchain technology*: We are working on implementing the Basel standard on the prudential treatment of banks' exposure to cryptoassets. This will ensure the UK's regulatory regime is adapted to give UK firms certainty over how cryptoasset exposures should be treated, thereby mitigating the risks that may arise from cryptoassets, while also supporting innovation.

- *Matching Adjustment:* In addition to previous substantive reforms to the Matching Adjustment (MA) framework, we are considering ways to enhance the framework to help support innovation in the life insurance sector. For example, we have engaged industry via Subject Expert Groups (SEG) to discuss an MA sandbox. The outcomes of the SEG led us to consider the “MA Investment Accelerator” for policy development. This would allow firms to self-certify eligibility for MA of a limited portion of assets prior to a formal MA application, enabling firms to more readily take advantage of new investment opportunities. We will consult on proposals relating to the MA Investment Accelerator in the first half of next year.
- *Start-ups:* We are continuing to support new entrants to the UK market, including those with novel uses of technology and innovative business models, through our New Bank Start-up and Insurer Start-Up units. In addition, alongside its current mobilisation regime for banks, the PRA has introduced a new mobilisation regime which will facilitate entry and expansion for new insurers.
- *Payments and settlements:* We will continue to contribute to the Bank of England’s broader work on innovation in money and payments, which in 2024/25 will include work on wholesale payments and settlements – and their interaction with retail payments. This work can support safe innovation, which is vital to the growth of the UK economy.

(iii) Maintaining and enhancing the UK’s position as a world-leading global finance hub

- *Implementing international standards:* Aligning with international standards supports the UK’s standing as a leading global financial centre by building trust in the UK’s regulatory framework. For example, the proposals in our second near-final Policy Statement on the implementation of ‘Basel 3.1’ in the UK maintain high standards, appropriately aligned with the international approach, while also including adjustments which reflect the needs of the UK financial system. We have also recently supported the agreement of the first international capital standard (ICS) for internationally active insurers (IAIGs), with which Solvency UK is consistent.
- *International engagement:* We will continue to play a leading role in influencing international regulatory standards, and to participate actively in global standard-setting bodies such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, and the Financial Stability Board, as well supporting HMT’s financial dialogues with key jurisdictions. The PRA will also continue to actively engage with international partners, including other central banks and supervisors, on matters of mutual interest.
- *Engagement with Lloyd’s of London:* We have modified our approach to engaging with Lloyd’s Managing Agents, which should reduce duplication and regulatory costs, supporting the competitiveness of the London Market (without compromising on prudential standards), and its status as a leading financial centre.

- *Remuneration:* We are also building on initial reforms to the remuneration regime. Last year the PRA made adjustments to rules on bankers' remuneration, including removing the bonus cap. This will support the ability of the UK to attract talent. In November, the PRA published CP16/24, which consulted on proposals to reduce complexity, ensure that the remuneration regime is appropriately tailored to the UK market, and bring the UK's requirements closer to those in other jurisdictions. Notably, the UK has become an outlier in the length of deferral required for some senior bankers' bonuses (with periods of up to eight years required). We propose to reduce all senior bank managers' deferrals to five years and other relevant managers' deferrals to four years.
- *Responsible openness:* The UK's openness to hosting international financial services firms as branches or subsidiaries, subject to strong standards of regulation, supports the competitiveness of the UK's financial centre and the growth of the UK economy. When we published the consolidated and clarified policy regarding our approach to authorisation and supervision of insurance branches, we took an approach of 'responsible openness' that supports strong international participation in the UK insurance markets, recognising the benefits that these international insurers can bring to the UK economy. Similarly, we are currently consulting on targeted changes to SS5/21, which sets out our approach to supervising the branches and subsidiaries of international banks operating in the UK. The reforms will be consistent with the PRA's broader approach to responsible openness, which underpins the UK's status as a dynamic global financial centre.
- *Insurance reporting requirements:* At the end of this year, as part of Solvency UK, we will remove certain capital and reporting requirements from insurance and reinsurance undertakings that have a UK branch. This could enhance the international competitiveness and growth of the UK as a safe and attractive place to do insurance business.
- *International assessments:* We, along with colleagues from the Bank of England, continue to support HMT on the Berne Financial Services Agreement and remain ready to input into other assessments of jurisdictions' regulatory frameworks.

(iv) Leading the world in sustainable finance

- *Climate:* In line with the government's ambition, we will continue to work with industry through the Climate Financial Risk Forum, which the PRA co-chairs with the FCA, to produce practical guides and tools that help financial firms embed the financial risks from climate change into their operations. The Committee will continue to consider how risks from climate change could impact financial stability. We also intend to update our supervisory expectations of firms in this area during the coming year.

(v) Ensuring the UK's capital markets are competitive and support UK growth

- *Insurance special purpose vehicles (ISPVs)*: Because the UK ISPV regime has not seen as much activity as envisaged, we are committed to reforming the regime in line with our primary and secondary objectives to the full extent allowed by the legislative framework. In November we published a consultation paper proposing reforms that would speed up approvals and allow for a wider range of transaction structures. The proposed reforms are intended to enhance the safety and soundness of the insurance sector by making more diversified reinsurance capital available to cedants while also furthering the PRA's secondary competitiveness and growth objective by making authorisation of UK ISPVs faster and easier.

(vi) Reinforcing financial inclusion and supporting home ownership

- *Strong and Simple*: Reforms that support effective competition can also reinforce financial inclusion by resulting in lower prices and or/improved delivery of services. Facilitating effective competition is an important aim of the PRA's Strong and Simple initiative. In September, the PRA published its consultation paper on the second phase of the Strong and Simple regime, setting out proposals for simplifying capital requirements, and additional liquidity simplifications for eligible firms.
- *Basel 3.1*: Similarly, the PRA's implementation of Basel 3.1 will support effective competition in banking by, among other things, introducing more proportionate requirements in some areas for smaller and less complex firms, and reducing the potential competitive advantage that firms using internal model approaches have relative to firms using the standardised approach.
- *Start-ups*: Work to support new entrants to the UK market through our New Bank and Insurer start-ups can help support financial inclusion by facilitating the entry and expansion of firms which are focused on underserved consumers.
- *Restatement of Capital Requirements Regulations (CRR)*: In October, the PRA consulted on the restatement of the remainder of relevant CRR requirements in PRA policy materials. The PRA proposed changes in some areas, including the capital treatment of retail residential mortgage loans granted under HM Government's Mortgage Guarantee Scheme. These proposals would result in more proportionate requirements for these mortgages, in line with the government's aim to support first-time buyers who struggle to save for large deposits.