

Bank of England

Prudential Regulation Authority

Rt Hon Mel Stride MP
Chair of the Treasury Committee
House of Commons
London
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Dear Mel,

Thank you for your letter of 10 August with follow-up questions to your hearing with challenger banks and industry representatives on the Strong and Simple framework consultation. Your letter raised four important issues which we continue to consider as part of our work on Strong and Simple.

Our initial consultation on the definition of a Simpler-regime Firm closed on 22 July, and we received 19 responses which we are currently considering. The issues you raise chime with the comments we have received. Given we are at this stage of considering the responses, and therefore yet to bring recommendations back to the Prudential Regulation Committee (PRC) for policy decisions, I can provide thoughts on all the points you raise but not yet firm positions. Given this timing I am hopeful that any views of the Treasury Committee Sub-Committee will be available in time to inform the PRC's thinking.

1. The lack of clarity on what the PRA's overall strategy would be when developing the Strong and Simple Framework meant that firms did not know whether the Simpler-firm regime thresholds were appropriate.

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In our discussion paper in April 2021 (DP1/21¹), we envisaged a graduated framework in which firms could migrate from a simple prudential regime through to the full Basel standards as they grew or engaged in activities that are more complex. In view of the scale of the task to create this Strong and Simple framework, and the time that it would take, we decided it would be sensible to develop, as a first step, the simplest regime for the smallest firms rather than implement the framework in one go once we had developed all of the constituent layered regimes. This approach has made it possible to make good progress and begin to provide more early transparency on the direction in which the project is heading.

Our discussion paper (DP1/21) set out the need for the framework and the principles of how it could operate. We outlined the reasons why overly complex prudential regulations can negatively affect the PRA's objectives, and explained that the objective of the Strong and Simple framework would be to simplify prudential regulation for non-systemic and non-internationally active firms while maintaining their resilience and not increasing the barriers to growth these firms face.

In this context, we think that a framework comprised of more than one layer may be appropriate because the population of non-systemic firms is heterogeneous. This means it is unlikely to be optimal to have a single set of strong and simple rules applying to all of these firms, because the degree of simplification that could be achieved while maintaining resilience would in effect be limited by the larger or more complex firms within the population. For instance, treating the smallest and medium-sized firms as a single cohort might restrict the room we have for simplification for the former.

The recent consultation paper (CP5/22) was intended to provide clarity about the nature of the firms in scope of the bottom layer of this framework.² These would be firms for which the current prudential requirements may be especially over-complex. Stakeholders will have further opportunities to comment on this proposed definition or iterations of it, for instance when we consult on requirements for this layer of the framework.

¹ PRA Discussion Paper 1/21 'A strong and simple prudential framework for non-systemic banks and building societies': <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/discussion-paper/2021/dp121.pdf?la=en&hash=BAF03DB89BF248EE72D75096249C796B84916CFF>.

² PRA Consultation Paper 5/22 'The Strong and Simple Framework: a definition of a Simpler-regime Firm': <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2022/cp522.pdf?la=en&hash=C67A3EEB87BD5109CEECC67A809F434E33D5F592>.

Our current plan is, once this definition is settled, to publish a consultation focused mainly on non-capital aspects of the simpler regime in the first half of 2023 and capital-related elements in 2024. Together, the three consultations would provide the description of the prudential regime of the simplest firms. (More broadly on timing, I share the desire of many stakeholders to move as quickly as possible with this important project, but at the same time we are in effect creating a new banking regime for large numbers of UK deposit-takers and it's important that we get it right. We are also managing the interaction between this work and our implementation of the so-called "Basel 3.1" package, on which we plan to consult before year-end – in particular, we are trying to schedule the work so that Simpler-regime Firms would not have to move onto Basel 3.1 before moving to the Strong and Simple capital regime, but would be able to opt for Basel 3.1 if they wanted to.)

I recognise the argument made to the Sub-Committee that there may be opportunities to tailor rules for larger, non-systemic domestic firms. Our current thinking is that these firms may belong in a higher layer of the framework, but we are considering these policy and implementation issues further including in light of the consultation responses. At this point, I think it likely that there will be at least one other layer between the simplest firms captured in CP5/22 and the full Basel standards that apply to the largest firms.

2. The £15 billion balance sheet cap on the Simpler-firm regime should be—at least—brought into line with the minimum requirement for own funds and eligible liabilities (MREL) £25 billion balance sheet threshold, to prevent additional complexity

CP5/22 proposes that the simpler regime will apply to firms with less than £15 billion in assets, providing other criteria are met. Assets would be calculated as an average of the previous 36 months, and would be based on data already collected in the current financial reporting framework. This limit is at the upper end of responses to DP1/21 (summarised in Feedback Statement FS1/21³), where suggestions ranged from less than £1 billion to £15 billion, with £5 billion being the most common suggestion. In CP5/22, we explained that we considered that a £15 billion ceiling adequately captures the firms that might find prudential regulation overly complex, while giving them ample headroom to grow within the regime.⁴ We are looking carefully at the arguments about the calibration of the size criterion provided within the responses we received to our consultation, and will take those into account in making the final policy.

³ PRA Feedback Statement 1/21 'Responses to DP1/21 'A strong and simple prudential framework for non-systemic banks and building societies': <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2021/december/fs121.pdf>.

⁴ CP5/22, Chart 1.

On MREL, the Bank of England's indicative total assets threshold you refer to ranges from £15 billion to £25 billion, above which the Bank as UK resolution authority judges a bail-in preferred resolution strategy is more likely to be considered appropriate. In addition, the Bank takes a number of factors into account in determining a preferred resolution strategy, including an indicative transactional bank accounts threshold currently set at 40,000 to 80,000 accounts.⁵

I have an open mind on this Strong and Simple threshold question. The crucial point to appreciate, however, is that where we set this threshold will not set the limit of which firms will experience some simplification in the regime through time. It will simply set the limit for the first layer of simplification. It might make sense to set it at a higher level than the £15 billion consulted on, but the higher the threshold is set the more likely it is that the degree of simplification would have to be reduced – in short, a higher threshold might be good for those additional firms brought in by it, but less good for smaller firms who might then experience less simplification. Finding the right balance on this will I think be a key consideration for the PRC.

3. By setting upper limit thresholds within the Strong and Simple Framework, cliff-edges are being created, and it is not yet clear how firms would transition between layers within the framework

So far we have only consulted on the proposed definition of a Simpler-regime Firm, and not yet on how firms would transition between requirements that apply to Simpler-regime Firms and requirements that apply to other banks and building societies. But I am aware that firms would appreciate more clarity on how they will transition smoothly between sets of rules, and we will consult on this when we consult on prudential requirements for Simpler-regime Firms.

I am very alert to the broader issue of cliff-edges, and set out some thoughts on it in 2020.⁶ In designing the Strong and Simple framework we will need to consider the potential trade-offs between simplifying regulation for specific types of firm and not adding to barriers to growth for firms wanting to grow. We set out some of our thinking about the issue in DP1/21⁷, and this thinking was reflected in the proposals in CP5/22. Our proposal that the size limit applies to total assets averaged over a 36 month period

⁵ Bank of England Statement of Policy 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)': <https://www.bankofengland.co.uk/-/media/boe/files/paper/2021/mrel-statement-of-policy-december-2021-updating-2018.pdf?la=en&hash=513F77100E9424C7F4019928FEFA42AC2C025AA0>.

⁶ 'Strong and Simple', speech given to the Mansion House, 12 November 2020: <https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/strong-and-simple-speech-by-sam-woods.pdf>.

⁷ Paragraph 3.7 and chapter 5 in DP1/21.

was designed to give growing firms time to prepare to leave the simpler regime. We also considered that the size limit of £15 billion would ensure firms have room for growth within the future simpler regime since a high number of smaller firms have average total assets significantly below £15 billion.

As I see it, the basic challenge here is that we can't develop a simpler regime for smaller firms without introducing new thresholds of some kind. My feeling is that those new thresholds are a price worth paying, but that when we come to design details we need to ensure that they are as smooth as possible for firms to climb over when they grow.

4. The requirement for 85% of a firm's obligors to be based in the UK in order for a firm to qualify for the Simpler-firm regime may lead to existing customers who live abroad being de-banked by their lender, or prospective customers living abroad having fewer lenders from which to secure a mortgage or loan.

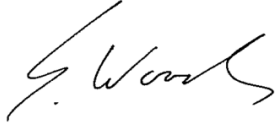
We are aware of concerns about the impact of the proposed design of the domestic activity criterion on customers living abroad. We are considering carefully how the proposed design of this criterion might affect specific types of customer – as you know, the PRC is required to consider the outcomes rules or policies will have on consumers, as one of the recommendations made to the PRC by HMT in its recommendations letter.

As we consider the responses, we will also continue to have regard to relevant international standards from the Basel Committee. Basel standards are designed in principle for internationally active banks, and we consider that the UK's adherence to the Basel standards for these banks makes an important contribution to UK and global financial stability, and also supports the international standing of the UK financial services industry which is vital in the context of competitiveness. However, to deliver material simplification for smaller banks and building societies, we may choose to depart from some Basel standards for those firms, while remaining faithful to the Core Principles for Effective Banking Supervision which apply to the whole banking sector.⁸ Consequently, in designing the domestic activity criterion, we need to design a criterion that does not unintentionally enable internationally active banks to avoid the Basel standards. I expect there will be a way to do this which doesn't cause undue problems for bank customers living abroad but we will study the evidence on this carefully when reaching decisions.

⁸ <https://www.bis.org/publ/bcbs230.pdf>.

Please let me know if we can provide the Sub-Committee with any more information or assistance at this stage.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'S. Woods', written in a cursive style.

Sam Woods

Deputy Governor and CEO, Prudential Regulation Authority