

Bank of England

Lord Bridges of Headley MBE
Economic Affairs Committee
House of Lords
London
SW1A 0PW

Andrew Bailey
Governor

30 August 2023

Dear George,

Thank you for your letter of 26 July on the implementation of measures in the Financial Services and Markets Act 2023 (the Act).

The Act makes significant changes to the Bank's powers and responsibilities to ensure the regulatory framework is fit for the future. We welcome these changes and are working closely with counterparts in HM Treasury and the FCA to implement them. We are confident that they can be delivered in a way that supports our statutory objectives and is sustainable.

Please find some more detailed responses to the specific questions you raised in your letter below.

Implementation of FSMA responsibilities

PRA

The PRA intends to take a proactive approach to the new secondary competitiveness and growth objective (SCGO). We will consider the SCGO when making PRA rules while continuing to make sure that we always maintain strong prudential standards. We will be holding an international conference of practitioners, regulators, academics and other stakeholders on 19 September 2023 to deepen our understanding of the links between prudential regulation, international competitiveness, and growth.

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Bank of England | Threadneedle Street, London, EC2R 8AH
+44 (0)20 3461 4444 | www.bankofengland.co.uk



We published a discussion paper in September 2022 which set out our broad approach to policymaking. We will consult on our approach, including to the SCGO and the regulatory principles, in autumn 2023. The PRA will report annually on how it has complied with the new secondary objective.

The Act makes a number of enhancements to the PRA's accountability framework which the PRA is working to implement. For example, we commenced recruitment for the Cost Benefit Analysis (CBA) panel before the summer and are now in the process of appointing a chair as well as other members. The consultation on the PRA's approach to rule review is also underway.

Bank as Financial Market Infrastructure (FMI) regulator

The changes in the Act as they relate to the Bank as regulator of central counterparties (CCPs) and central securities depositories (CSDs) are significant. At present, the Bank has limited powers to set rules for CCPs and CSDs: the majority of the key requirements are in retained EU law which, until the passing of the Act, could only be changed by primary legislation. The introduction of a general rulemaking power for CCPs and CSDs under the Act will align the Bank's regulatory powers in respect of CCPs and CSDs with the PRA and FCA's powers in respect of the firms they regulate. This will allow the Bank to be more agile and responsive to changing market conditions and to maintain alignment with international standards. We intend to use this new rulemaking power to create an internationally respected, proportionate and robust regulatory framework.

With this increase in power and responsibility, it is appropriate that the Bank is also subject to an enhanced accountability framework. The Act provides for a statutory FMI Committee similar to the Prudential Regulation Committee (PRC), which is discussed in further detail below. Other accountability mechanisms are aligned with the PRA's new accountability framework with appropriate differences based on the nature of the firms regulated by each regulator and their objectives. These provisions in the Act will need to be commenced by HM Treasury at a date to be agreed. The Bank is preparing to implement these changes.

Stablecoin/digital assets

The changes in the Act relating to new forms of digital money, referred to as digital settlement assets, are a significant step forward in ensuring the Bank's regulatory frameworks are fit for purpose and agile enough to capture new and innovative types of critical financial infrastructure. To implement these new responsibilities, the Bank is designing a regulatory framework to capture issuers and other entities in systemic stablecoin arrangements, with plans to publish a discussion paper this year setting out the key design features of the upcoming regulatory regime.

This regime will deliver against the Financial Policy Committee's (FPC's) expectations for payments regulation and ensure consistency with our approach of "same risk, same regulatory outcome".

The Bank's powers in relation to traditional payment systems remain unchanged as the Bank already has extensive rulemaking powers in this area. In their response to their call for evidence on payments regulation and the systemic perimeter, HM Treasury committed to expanding the Bank's systemic payments perimeter when the next legislative opportunity allows. When these reforms happen, HM Treasury have committed to applying similar accountability and governance changes to the Bank as the regulator of systemic payment systems.

New powers to oversee Critical Third Parties (CTPs)

The Act enables HM Treasury (in consultation with the supervisory authorities) to designate certain third parties as CTPs, where a disruption to the services those third parties provide to firms and FMIs would threaten financial stability. The Act gives the Bank, PRA and FCA direct powers over CTPs. CTPs are likely to comprise a very small percentage of the total number of third parties providing services to firms and FMIs.

The Bank and PRA published a discussion paper in 2022 to provide insights into how the new critical third party oversight regime will work in practice. We will build on this with a planned consultation paper to set out our approach further. Our approach to implementation will be proportionate and risk based focusing on those third parties who pose the greatest risk to UK financial stability. The regime also limits supervisory authorities' powers over CTPs to the services they provide to firms and FMIs, which helps ensure proportionality and recognise the cross-sectoral nature of many CTP's services.

The Act includes an explicit obligation on the supervisory authorities to coordinate when exercising their proposed powers over CTPs. We will publish in due course a draft Memorandum of Understanding which will detail how the Bank, PRA and FCA will coordinate the exercise of our functions under the Act in relation to CTPs, as required by the Act. We also see international cooperation as an essential part of effective oversight of CTPs and are seeking to achieve a coordinated approach with other jurisdictions.

Additional responsibilities in the context of existing statutory requirements

You asked how the Bank is planning to manage the balance of these additional responsibilities provided by the Act with its other primary and secondary objectives and whether we anticipate further challenges as a result.

The updated objectives, regulatory principles and extension of powers in some areas in the Act mean that a broader set of issues must be carefully considered in the Bank's policymaking. The Bank views this as appropriate and in line with its new rulemaking powers. It is however essential to recognise that the updated objectives and have regards are ultimately anchored in the Bank's primary objectives which rank above other considerations when making policy.

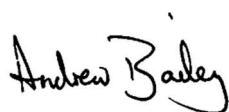
When making policy to pursue our primary objectives, we must also, so far as is reasonably possible, act in a way which facilitates our secondary objectives. In pursuing our objectives, we must take into account the regulatory principles and other 'have regards' which capture a wider set of public policy considerations. This may in some areas make policymaking more complex and resource intensive. When deciding how to deploy our resources we will of course prioritise actions to address the most material risks to our primary objectives.

Developing a transparent and efficient decision-making structure to include the new Financial Market Infrastructure Committee

The provisions in the Act relating to the FMI Committee will need to be commenced by HM Treasury at a date to be agreed. The Bank is currently developing its approach to the Committee and aims to publish the Committee's Terms of Reference by the end of the year. The Bank will consider proportionality when establishing the Committee to ensure that the Committee's processes reflect its narrower remit compared to other Bank committees such as the PRC and FPC. In developing the Committee arrangements, the Bank will take account of the lessons learnt from operating the FMI Board with its existing independent members and from precedents set by statutory committees. Once established, the new Committee will be subject to the Bank's updated set of objectives and regulatory principles and will be required to respond to any written recommendations from HM Treasury in relation to aspects of economic policy to which the Bank should have regard when exercising its FMI functions.

We look forward to continuing working with the Economic Affairs Committee as we implement the measures in the Act and tailor financial services regulation to the UK.

Yours sincerely

A handwritten signature in black ink, reading "Andrew Bailey". The signature is written in a cursive, slightly stylized font. The first name "Andrew" is written in a larger, more prominent script, and "Bailey" follows in a similar but slightly smaller script. The signature is positioned below the "Yours sincerely" text.