

Written evidence submitted by UK Finance

1. UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms across the industry, many of which are either banks or building societies regulated by the Prudential Regulation Authority (PRA), we act to enhance competitiveness, support customers and facilitate innovation.
2. We are pleased to provide evidence to the Treasury Sub-Committee on Financial Services Regulations' inquiry into the PRA's proposed Strong and Simple Framework.¹

The Strong and Simple Framework proposal generally and the PRA's consultation

3. We, and one of UK Finance's predecessor organisations, the British Bankers Association, have long called for a more proportionate approach to banking regulation and supervision. Applying a simplified regime to less systemically important banks and building societies would recognise that the benefits and associated costs of regulatory compliance differ widely across firms of different size and business model. In particular, understanding, interpreting and operationalising the current set of complex prudential requirements, which apply equally to small and large firms, is more challenging for smaller firms which, in our view, do not pose significant risks to the safety and soundness of the UK's financial system.
4. The PRA's approach to developing a Strong and Simple regime is sensibly multi-stepped:
 - November 2020 Sam Woods' speech announcing the Strong and Simple regime²
 - April 2021 PRA discussion paper³
 - July 2021 UK Finance response⁴
 - December 2021 PRA feedback statement⁵
 - April 2022 PRA consultation paper CP5/22 on a definition of a Simpler-regime Firm⁶
5. This measured approach has allowed the industry to engage with the PRA about its plans for a strong and simple framework. To date this engagement has been full and interactive.
6. The liquidity and capital requirements that would apply to simpler regime firms will be consulted on over the next couple of years. Of course it is not until these consultations have been concluded that Simpler-regime Firms will be able to assess their impact on their own capital and liquidity requirements.
7. We welcome the PRA's statement that it will in due course put forward proposals for a 'Large and Simple' regime.

¹ <https://committees.parliament.uk/work/6798/the-strong-and-simple-framework/>

² <https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/strong-and-simple-speech-by-sam-woods.pdf>

³ <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/discussion-paper/2021/dp121.pdf>

⁴ <https://www.ukfinance.org.uk/system/files/UKF-response-to-the-PRA-DP1-21.pdf>

⁵ <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks>

⁶ <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/april/definition-of-a-simpler-regime-firm>

The scope of the Strong and Simple Framework

Whether activities excluded from the Strong and Simple Framework should be included

Whether activities included within the Framework should be excluded

8. The scope of the simpler firms regime should ensure that those firms are indeed undertaking simple activities which are more straightforward for senior managers and the regulator to fully understand and, where appropriate, apply risk mitigation techniques.
9. The exclusion of certain types of activity from the simpler-firm regime, for instance the provision of certain clearing, settlement and custody services or undertaking of trading activities above (low) threshold levels, is sensible and their classification unambiguous.

Whether the classifications of firms that are included or excluded are appropriate

10. Yes, the exclusion of any firm with assets in excess of £15 billion, regardless of the simplicity of its business model, will unduly restrict the application of the simpler firm regime.
11. Our understanding of the PRA's plans for the development of a 'Large and Simple' regime is that it will proceed in parallel, but to a lagged timetable. In our view the simple expedient of increasing the total asset threshold proposed in CP5/22 from £15 billion to £25 billion would include more banks that do in fact operate simple business models within the scope of the simpler firm regime and more quickly. This would align with the top end of the asset size test (£15-25 billion), above which the Bank of England would consider implementing a bail in strategy for a failing firm.
12. The Sub-Committee should note that we believe that the lower end (£15 billion) of the current bail in threshold range, above which firms must start issuing expensive MREL capital, is set too low, a point we made in our response⁷ to the Bank's 2021 consultation on MREL.⁸ We suggested MREL requirements be introduced on a sliding straight-line scale from £25 billion to £50 billion of total assets excluding central bank deposits.

Whether the Strong and Simple Framework proposals are appropriate to safeguard financial stability, and the safety and soundness of individual firms

13. The PRA's general objective of promoting the safety and soundness of firms it regulates, thus forestalling any adverse impact on the stability of the UK financial system, must be balanced against avoiding regulation that is unnecessarily complex and prevents smaller firms from competing effectively. This will support the PRA's pursuit of its secondary competition objective of facilitating effective competition in the markets for services provided by firms it authorises in carrying on regulated activities.

⁷ https://www.ukfinance.org.uk/system/files/UK-Finance_BoE_MREL-CP-response.pdf

⁸ <https://edu.bankofengland.co.uk/-/media/boe/files/paper/2021/the-boes-review-of-its-approach-to-setting-a-mrel-cp.pdf>

14. We believe the PRA's proposals about the scope of the simpler firms regime will continue to safeguard financial stability. They may even enhance it as the regulator will be able to redeploy supervisory resource to those larger, more systemically important firms that might cause more disruption to the UK's financial system in the event of their failure.
15. We do not foresee the Strong and Simple regime creating any threat to the safety and soundness of individual firms within the scope of the simpler firms regime. The Bank plans for the resolution of every bank and building society and reviews these plans annually. This process, coupled with firms' own regulatory obligations about recovery planning, for instance in relation to scenario texting and recovery options (albeit that smaller firms have more proportionate recovery planning requirements), should minimise this risk.
16. While smaller firms may not, idiosyncratically, be plausibly able to pose a threat to systemic safety and soundness there is a risk that they could collectively pose a systemic risk should they act in the same way, for instance by financing a large proportion of car loans. We believe that the PRA's competency in horizon scanning and its ability to analyse firms' regulatory returns to conduct peer group analysis gives it the ability to identify and mitigate such 'collective action' systemic risk.

Whether the Strong and Simple framework proposals sufficiently simplify the rules for affected firms

17. CP 5/22 proposes the *scope* of the simpler firms regime. The PRA has yet to follow up with concrete suggestions about the nature and quantum of the regulatory *capital* and *liquidity* requirements that firms in the simpler regime would have to meet.
18. Until an indication of these requirements is available the degree of simplification of the regime will not be fully evident and firms will be unable to make the implicit trade-off between the benefits of a simplified rulebook and the costs of the higher capital and liquidity requirements to which they would be subject.
19. We note that smaller firms will be able to opt out of the 'default' simpler regime if they wish and we look forward to learning more from the PRA about how this waiver process would work.
20. We note that although the simpler firm regime will be the default option the PRA will retain the right to compel firms that would otherwise be in scope to comply with more onerous capital and liquidity requirements. We believe this is sensible.

How the proposals should be implemented in the context of the Basel 3.1 Standards on Banking Supervision and/or any other relevant international rules or requirements

21. We support the PRA's recent clarification that it does not intend to implement Basel 3.1 in the UK until the beginning of January 2025. This will give the PRA sufficient time to consult on its plans and respond to industry comments before finalising its Rule Book. This Rule Book currently applies to all firms regardless of size, so the PRA's confirmation that firms considering moving to the simpler firms regime may stay on the current Rule Book rather than complying with the evolved Basel 3.1 Rule Book in 2025, until the simpler firm regime is finalised, is welcome. This will avoid smaller firms having to comply and then de-comply with new rules that will be complex and emphasises why the prompt completion of this 'scope' consultation is important.

How the proposals should be implemented in the context of firms using their own Internal Ratings Based models

22. We agree that a firm using Internal Ratings Based (IRB) models should not be eligible for the simpler regime and welcome the statement that simple regime firms on the pathway to IRB approval may stay on this regime until they are granted their IRB model waiver.

The effect of the Strong and Simple Framework on competition within the UK market

23. We welcome the PRA's statement that it will in due course put forward a 'Large and Simple' regime but note that until this is created, which we expect to be some years off, the largest, more systemically important firms will likely retain their significance in the UK banking market.
24. The majority of firms that are likely to be eligible for the simpler-firms regime are specialist lenders, serving niche markets, often without ambitious growth targets. The few, mainly newer fintech based firms that do have plans to grow to compete with mainstream firms, may choose to 'opt-up' to the Basel 3.1 framework, due to be implemented at the beginning of 2025.
25. They and their fellow, more established challenger banks have less complex business models compared to larger competitors, but because of their projected or actual asset size will be above the £15 billion asset ceiling proposed in CP5/22 and so unable to benefit from the simpler firms regime. Where such firms do have a low-risk business model we think that they should be able to benefit from it. As we note above this could be achieved by increasing the asset size threshold to £25 billion, without greatly

impacting the safety and soundness of the UK financial system while at the same time improving competition.

26. Alternatively the PRA could consider changes to its approach to setting incremental Pillar 2a capital which is in itself a complex and subjective process. Changes to its approach to concentration risk, the requirement to use external data for calculating operational risk and simplified regulatory reporting would all be helpful in this regard.

The wording of the draft instrument giving effect to the proposal

27. We believe the wording of the draft instrument to be effective and complete.

July 2022