Association of Foreign Banks – Written evidence (SCG0026)

The Association of Foreign Banks (AFB) is a trade body which represents the interests of non-UK headquartered banks operating in the UK to industry stakeholders, including the Government, regulatory bodies, and financial services organisations. AFB has around 170 international banking group members, representing around 80% of the UK's foreign banking market, providing financial services through branches, subsidiaries, and representative offices in the UK.

AFB members, by definition, operate internationally. For this reason, they are uniquely positioned to offer insights on the regulators' approach to regulation in the UK with respect to the Secondary International Competitiveness and Growth Objective (SICGO). AFB members must make the case to group or head office to do business in the UK as opposed to other jurisdictions and have first-hand experience of other regulators/regulatory regimes.

As the Chancellor set out in her Mansion House speech on 14 November 2024, regulation should be designed to support growth, rather than focusing solely on limiting risk. Given this statement, we support the Committee's inquiry into how the PRA and FCA (the Regulators) are embedding the SICGO in their ongoing work.

Below we set out some general comments on the UK's regulatory regime/the approach of the Regulators. AFB members feel greater consideration should be given by the Regulators to the UK's international competitiveness and its effects on growth.

We then set out some specific policy areas where members believe the Regulators have not given sufficient consideration to the SIGCO, in order to provide the Committee with examples.

In this way we seek to respond to the questions put by the Committee in the Call for Evidence.

General comments

- **Costs of compliance**

AFB members cite stability and predictability as attractive features of the UK regulatory regime, which have historically incentivised non-UK headquartered banks to establish and grow their business activities in the UK.

However, they also believe that a regulatory regime's level of costs of compliance significantly impacts its attractiveness. Where there is divergence from international standards as well as gold plating/higher standards in the UK vis à vis other regimes or the Regulators create a more complex regime (such as the Senior Managers & Certification Regime (SM&CR)), the UK loses the advantages it holds against its international counterparts. Members have reported over the longer term that increased regulatory complexity is relegating the UK/London to be a second choice when it comes to strategic investment from their home offices, falling behind other major centres, such as New York and Singapore.

- **Proportionality**

Whilst the need for proportionate regulation has been recognised by the Regulators, their current approach does not go far enough in ensuring regulatory requirements are proportionate to the level of systemic risk. Many AFB members are represented by small branches/subsidiaries in the UK, and for these banks the scope of regulation and costs of compliance are high.

For example, the PRA's requirements for the Small Domestic Deposit Takers regime were disappointing as many smaller entities are not in scope. The regime also effectively rules out UK subsidiaries of foreign entities from being eligible to join, as they are unlikely to satisfy a number of criteria (such as the UK domestic activity threshold and foreign exchange position) which are needed to qualify for the foreign firm exception.

AFB believes that such requirements disadvantage international banking firms and are disproportionate to the level of risk they may pose to UK financial stability. Accordingly, smaller institutions, which contribute to growth, competition, and innovation, may decide either not to expand or to enter the UK market, due to greater level of regulatory obligations.

- **Regulators' approach to their objectives**

AFB supports the notion that the relationship between the Regulators' primary and secondary objectives should be complementary, without the primary detracting from the secondary.

However, AFB believes the Regulators also need to acknowledge that high regulatory standards are not the sole component in securing the competitiveness of the UK, and that a regulatory focus on mitigating risk does not in and of itself enhance the UK's competitiveness and can in fact harm it.

AFB members consider that the Regulators' policy proposals frequently do not show sufficient consideration given to the UK's international competitiveness and growth. For example, the PRA's Dear CEO letter on its 2024 priorities for the supervision of international banks only discusses managing risks, without mention of international competitiveness or growth, even though this set of firms has significant potential for making a contribution to the UK's financial sector and wider economy.

We also recommend that the SICGO would have greater impact if regulatory policy were more segregated by market type. Wholesale markets should have a different regulatory focus than retail markets.

Beyond this, the Regulators 'set the tone' by generally taking a risk-averse approach. This has a knock-on effect, as banks observe this approach and become cautious in providing capital.

AFB notes that the Regulators both maintain in their 2024 annual reports on the secondary objective that they have a supportive approach towards emerging technologies in financial services, as they have not introduced new restrictive rules. However, AFB would note that, aside from formal policies, the conduct/tone of the Regulators when communicating with firms has a significant impact. AFB members report that during their supervisory engagements with the Regulators the staff maintain a cautious approach and often express hesitation when firms take steps to adopt these technologies, such as new GenAI models. Members feel their ability to embrace innovative technologies, especially where they may be 'first-movers', is also hampered by concerns that the Regulators are quick to penalise errors occurring in the 'learning period' after adoption. They ask that the Regulators release more detailed guidance at earlier stages which sets out good/bad practices and gives them a better understanding of tolerance levels, such as by publishing details of more anonymised cases where firms were penalised for failing to manage new technologies adequately.

- **Regulatory efficiency**

For international banks, their 'day-to-day' experiences engaging with the Regulators is a key factor in deciding where to expand and invest in the future.

AFB members acknowledge that the FCA's most recent metrics have shown some improvement, such as reduced time taken for SM&CR approvals.

However, AFB members continue to report that they face challenges with the speed and quality of communications from the FCA, and the speed of authorisations.

Although the FCA has taken the positive step of investing in staff training on the secondary objective (as noted in its annual report on the objective), AFB members feel that it is equally important for the FCA to improve the knowledge of staff dealing with SM&CR and banking license authorisations.

Further, as the results of the FCA and Practitioner Panel Survey 2023-2024 show, firms are not confident in the FCA's ability to deliver on its SICGO. The results also show that a significant proportion of firms do not completely understand what the FCA is trying to achieve through its SICGO. Although the FCA has engaged with firms and industry associations on the SICGO we believe that the focus on competitiveness and growth is only partially embedded in the FCA's (and the PRA's) culture. It continues to be as considered an external requirement, which is one of the many remits held by the Regulators.

This is reinforced by the language and content presented in both the FCA and PRA's reports on the SICGO. Competitiveness and growth are considered to be primarily a result of policies aiming at regulatory stability and predictability, rather than an objective to be pursued in and of itself during the design of policy. AFB suggests that the Regulators should be required to state how their policies comply with the SICGO, what options they evaluated during the policy making process, and how they believe stakeholders will be impacted, in order to show their commitment to promoting growth and enhancing competitiveness in the UK.

Whilst we believe that predictability and stability are necessary conditions to fuel growth, they are not sufficient conditions. Relying exclusively on them to promote competitiveness and growth would cause the UK to fall behind international competitors in terms of its attractiveness for businesses. We believe that the argument that growth and competitiveness are advanced by policies that promote stability is a sign that the Regulators lack the growth mindset that regulators elsewhere have (e.g., in Singapore).

AFB agrees with the statement made on this topic by the Chancellor of the Exchequer referred to above. Regulation is currently too risk averse. Although we understand that time is needed for the SICGO to embed into the practices and decisions of the Regulators, we think that the work done by the Regulators since the introduction of the new secondary objective does not show a significant enough focus on this objective.

AFB believes that whilst operational responsibility lies with the Regulators, governmental action is needed to recalibrate the risk-appetite of financial policymakers and ensure that they design policy to support growth rather than eliminate all systemic and non-systemic risks in specific policy areas.

Specific Comments

Below are some policy areas where we believe the Regulators have not given enough consideration to the SICGO in terms of proportionality, approach to risk, costs, and additional requirements in their policies.

- **Consumer Duty/Removal of duplicative rules**

Removing rules (following the introduction of Consumer Duty) and replacing them with high-level rules does not in and of itself advance the SICGO. It is also important in the context of the SICGO that the removal of rules does not lead to inconsistency with international standards where detailed rules are derived from international agreements.

We note that whilst reducing the overall cost of compliance by simplifying rules and removing duplication could further the SICGO, the operational impact on non-UK banks and the legal uncertainty caused by the removal of existing rules or move to high-level rules may in some instances hinder international competitiveness.

- **Senior Managers and Certification Regime (SM&CR)**

Whilst foreign banks are broadly supportive of the SM&CR and its aims, in their experiences the authorisation processes are too onerous and frequently still require too long to receive approval, especially compared to other financial centres. This deters foreign banks from recruiting for, and expanding in, the UK. Some banks have also voiced that there is reluctance from senior individuals based overseas to take SMF positions in the UK, again due to the regime's complexity and disincentives (e.g. excessive personal liability and approval times), which reduces the international talent pool available to banks in the UK.

To enhance the UK's international competitiveness, without undermining the original aims of the SM&CR, AFB supports improvements to the regime including introducing mutual recognition/equivalence/deference with select overseas regulators for non-UK senior managers and exempting certain categories of SMF applications from the requirement to receive approval prior to beginning an SMF role.

We support the Chancellor's recent commitment to make changes to the certification regime. This offers a real opportunity for the Regulators to enhance the UK's competitiveness.

- **FCA's proposal to publicise investigations**

Industry/broader opposition to the proposals is well known to the committee.

In our submission to the Committee on this topic we highlighted the risk of prudential and reputational damage should the FCA's enforcement proposals proceed. In the proposed form Head Offices of international banks would consider this risk when global strategies are being assessed, likely resulting in parent entities deciding not to expand their UK business and in the diversion of investment away from the UK.

During the 13 November 2024 oral evidence session of the House of Lords Financial Services Regulation Committee on the FCA enforcement guidance consultation, FCA CEO Nikhil Rathi stated that the regulator would move forward with "fundamentally reshaped proposals". AFB believes that the fact that they are to be amended shows that the SICGO is not currently embedded in the policy making processes of the FCA.

- **Basel 3.1**

Although AFB are supportive of the updates to the Basel 3.1 regulation published by the PRA in September 2024 to support SMEs, trade finance, and to lower capital requirements, we note the potential non-adoption of the Basel requirements in the US. The PRA should monitor its approach to the Basel 3.1 framework and its implementation timeline to ensure that the UK remains internationally competitive. We note that the SIGCO does not apply to the PRA's implementation of the Basel standards, but the implementation of the standards will have a fundamental impact on the relative competitiveness of the UK.

Significantly stricter rules in the UK than in the US, and other jurisdictions, would disproportionately impact non-UK headquartered banks operating in the UK. Such banks would incur additional personnel and operational costs to update their risk management and capital adequacy calculation models to comply with UK rules, thus making them less competitive and disincentivising investment in the UK.

- **Metrics (& comparison to other jurisdictions)**

We believe it is important to introduce metrics including medium term trends of the costs of compliance, as well as comparative metrics benchmarking the UK to other financial centres.

More specifically, international banks would also like to see metrics comparing the UK with other international financial centres to understand the costs and benefits of maintaining operations in the UK with respect to other jurisdictions. These metrics would highlight the strengths (and weaknesses) of the UK and could induce firms to expand or stabilise their activities in the country. Moreover, they would require the Regulators to benchmark themselves against other emerging and established centres. Creating clear KPIs and medium-term targets for the Regulators would be useful to document their progress and ensure that the regulatory trend is aligning/will align with the SICGO.

As mentioned above, international banks' perspective on the operational effectiveness, efficiency, and conduct of regulators is a key factor in deciding where to locate and invest in future business. Therefore, these metrics would help provide a more detailed picture of the UK regulators' overall contribution (or barrier/harm) to the UK's international competitiveness.

29 November 2024