Dr David Murphy – Written evidence (SCG0057)

Scope

This response specifically addresses one of the Committee's questions regarding bank prudential regulation in the UK. The question is:

1. To what extent are the regulators focused on the objective to promote international competitiveness and growth? Are there areas where the ability of the regulators to fulfil their secondary objectives might be constrained by having to fulfil their primary objectives?

Regulators' primary objective

The primary objective for the PRA is to promote the safety and soundness of PRA-authorised firms (with an objective specific to insurance firms for the protection of policyholders).

This is a safety at any price mandate. It could, for instance, be fulfilled by ensuring that regulatory burdens are so high that regulated firms seldom fail.

The secondary objectives

There have been various changes to regulators' mandates since 2008. In 2014, with the creation of the PRA, a secondary objective to facilitate effective competition was introduced, and in 2023 the need to consider the international competitiveness of the UK economy was added too. But these secondary objectives are just that – secondary. Keeping PRA-regulated firms safe is primary. As Bank of England Governor Andrew Bailey put it in 2024, "secondary objectives are only considered subject to achieving the primary objectives".[1]

The question therefore naturally arises whether the current structure of a primary safety-first mandate with other secondary objectives is fit for purpose.

As the Committee has heard, notably from PRA CEO Sam Woods in January 2025, regulators believe that it is.[2] I question this, for three reasons.

Safety and soundness should be on a par with competitiveness

[1] Bank of England, 'Letter from Andrew Bailey to Lord Bridges of Headley ref Economic Affairs Committee report', 26 January 2024.
[2] Oral evidence before the Financial Services Regulation Committee, 8 January 2025.

Suppose the PRA's primary mandate was recast to focus on ensuring that the UK financial system provides key economic functions efficiently and robustly in all conditions. This would balance financial stability and efficiency: a failing firm cannot provide economic functions robustly, but a stable one does not necessarily serve the economy's needs. The Committee might like to consider whether a mandate balancing safety with efficiency such as this one would better serve the UK than the current tiered structure.

The PRA's unwillingness to deviate from international accords

A great deal of bank prudential regulation was written in response to the 2008 global financial crisis, at global, EU and UK levels. The resulting structure is hugely complex. It contains duplicative requirements and ones which, while globally agreed, are not optimal for the UK financial system. The existence of both ring-fencing and resolution requirements for banks is a prominent and burdensome example of the former; the application of the leverage ratio to borrowing secured by gilts is one of the latter.[3] The PRA has proved very reluctant to deviate from any international commitments even where there is strong evidence of its impact on the UK. Safety first is not working.

Boundary issues

The result of the current, overly burdensome system of prudential regulation for banks has been that the provision of systemically important functions has left the regulated system. The growth of private credit, despite its lack of locus on the long-term success of the borrower, is an important example of this. Another is that banks no longer play a central role in intermediating many capital markets, even though their replacements, such as hedge funds, are more fragile and likely less willing and able to support markets in stress. [4]

Conclusions

The Committee's inquiry into the secondary competitiveness and growth objective is very welcome. I would encourage the Committee the focus of the 'secondary' nature of this objective, and whether the UK would benefit from recasting both primary and secondary objectives to better define the kind of financial system we need to support growth *and* provide stability.

23 January 2025

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[3] As a Bank of England staff working paper found "gilt repo liquidity worsened during the period when UK leverage ratio policy was announced". See Andreea Bicu, Louisa Chen and David Elliott, *The leverage ratio and liquidity in the gilt and repo markets*, Bank of England Staff Working Paper No. 690, 2017.
[4] See Bank of England, *Proprietary Trading Review*, September 2020.