Written evidence submitted by the Bank of England

Introduction

This document sets out the response of the Bank of England (including the Prudential Regulation Authority (PRA)) to the Treasury Committee's call for evidence on the Future of Financial Services. The Bank welcomes the opportunity to contribute to this important inquiry, which raises fundamental questions on both the framework in which financial regulations are made, and the approach for future regulatory reform. We are answering through the lens of our statutory objectives, including the Bank's financial stability objective and the PRA's primary objectives of safety and soundness and insurance policyholder protection.

Strong standards are therefore at the centre of our response. The Financial Policy Committee (FPC) is 'committed to the implementation of robust prudential standards in the UK. This will require maintaining a level of resilience that is at least as great as that currently planned, which itself exceeds that required by international baseline standards, as well as maintaining UK authorities' ability to manage UK financial stability risks'.[1] The UK's reputation for strong standards and financial stability increases its attractiveness as a place to do business: predictable and independent regulation is a way of attracting business to the UK, as well as promoting effective competition. It allows the financial system to act as a source of strength for the economy, helping to absorb rather than amplify economic shocks, such as the shock caused by Covid. From our discussions with industry, we believe this view is widely shared.

At the same time, leaving the European Union gives us an opportunity to tailor the UK's approach to financial services policy and regulation. We should consider how regulation can facilitate innovation, so that the UK can seize opportunities from new areas of growth and productive investment in financial services as they emerge – noting that these features are also supportive of long-term resilience. This could include digitisation of the economy, the need to transition to net zero and technological financial innovations. Regulation should also promote competition, for example by ensuring that standards are proportionate to firms' business models.

Safe openness to firms from other jurisdictions who are seeking to access the UK market, based on international collaboration and standards, will be another key element in the UK's future success. That approach ensures that we can support openness while mitigating the risks through regulatory assessments of deference, regulatory and supervisory cooperation, and a commitment to common international standards.

It will be for Parliament to determine what future regulatory framework can best achieve these goals. We agree with the Government that there are significant benefits from a model where the technical details of regulatory standards are set by expert, independent regulators. Such a model puts a particular weight on the regulators acting in a transparent and accountable way. Parliament will have a vital ongoing role in any future framework. Parliament – not least the Treasury Committee itself – is the body that holds the regulators to account for achieving their objectives. This is crucial for the democratic legitimacy of the regime. We are committed to providing whatever information or other assistance is needed to help Parliament fulfil this role.

Our detailed response to the call for evidence is structured as follows:

- **Part 1** covers questions relating to the future regulatory framework for the UK.
- **Part 2** covers questions relating to the UK's position as a global financial centre and its relationships with other jurisdictions.
- **Part 3** discusses how the UK regulatory regime can support innovation, competition and proportionality.

[1] See for example the Bank's December 2020 Financial Stability Report, page ii (link)

Part 1 – The Future Regulatory Framework[2]

This part covers the following questions from the call for evidence:

- *What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?*
- *Through what legislative mechanism should new financial regulations be made?*
- *What role does Parliament have to play in influencing new financial services regulations?*
- *How should new UK financial regulations be scrutinised?*
- *Should the mandate and statutory objectives of the financial services regulators change to include wider public policy issues?*
- *How important is the independence of regulators and how might this best be protected?*
- *What are the strengths and weaknesses of the European Union model of scrutinising financial services legislation?*
- *Should the UK seek to replicate the EU's model for drafting and scrutinising financial services regulation?*

Overview

The UK's withdrawal from the EU gives us an opportunity to tailor financial regulation for the UK, where rules in many areas were previously developed at EU level and reflected the need to harmonise across 28 countries in the single market. However, much of the UK's regulatory regime is currently 'locked' in primary (or in some cases secondary) legislation, and cannot be updated without an Act of Parliament.[3] This is a result of necessary 'onshoring' work to mitigate cliff-edge risks associated with leaving the EU. However, onshoring was never intended as a permanent solution. There are significant costs to locating detailed technical regulation in primary legislation. Making legislative amendments to update these rules would be time consuming, which in view of constraints on parliamentary time, may limit the agility of the regime to respond to new risks and opportunities. Resolving this issue is one of the aims of HM Treasury's (HMT's) review of the Future Regulatory Framework (FRF).

Senior Bank policymakers have previously set out the benefits of a regulatory framework in which the high-level objectives, responsibilities and powers of regulators are set out by Parliament and Government, while the technical requirements to achieve those objectives are designed and maintained by operationally independent regulators accountable to Parliament.[4] This would reflect international best practice, and would be a return to the style of regulation the UK had previously followed in areas not reserved to the EU. It is similar to the approach taken in other jurisdictions such as the United States, Canada and Singapore. Benefits of such a system include:

- **Dynamism**. As noted above, regulatory rules can be more easily updated than primary and secondary legislation.
- **Expertise**. The Bank and PRA have deep technical knowledge of the UK financial sector and prudential frameworks. This stems from our responsibility for implementing and enforcing regulations in practice through supervision, and our role in the international bodies where global standards are developed.
- **Time-consistency**. Insulation from short-term political pressures allows regulators to focus on achieving the long-term goals of prudential policy. This is similar to the argument for operational independence in the setting of monetary policy. There is a body of research setting out the

[2] Please note: in discussing HMT's consultation on the Future Regulatory Framework for financial services, we have focused on PRA regulation, in line with the focus of the consultation. However, we note that the HMT will consider in due course whether, and to what extent, the proposed approach should be extended to other areas of financial services regulation.
[3] On-shored EU regulations have equivalent status to UK primary legislation.
[4] See for example Woods, S (2019), Stylish Regulation (link).

benefits of delegating prudential policy to independent regulators.[5] Reflecting this, the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors both include operational independence in their core principles for effective supervision.

- **Reduced Fragmentation**. The UK's prudential regulation regime is currently fragmented, with some regulations currently sitting in primary and secondary legislation, others in onshored European technical standards, and others in the regulators' rules. Transferring firm-facing requirements into the regulators' rulebooks would deliver a simpler, more navigable and coherent regime for regulated entities.

HMT's proposals in the FRF consultation are consistent with this approach.[6] Subject to the outcome of the consultation, and any decisions of Parliament, we look forward to working with HMT to develop the framework so that its benefits for the UK can be realised as soon as practicable.

The role of Parliament

Parliament will determine the appropriate mechanisms through which to influence regulation, and the Bank (and PRA) will support Parliament in whatever determination it makes. As set out above, there are benefits to delegating responsibility to the regulators for setting detailed rules. In such a model, Parliament would set the overarching regulatory framework, including regulators' objectives, powers, and desired outcomes to be pursued, and then the regulators would be accountable for advancing those objectives and achieving the outcomes. This approach is analogous to the one taken to monetary policy, where elected politicians set the framework and goals, and hold the Monetary Policy Committee to account for its performance.

Regulators have an important role to play in facilitating effective parliamentary scrutiny. The senior staff of the PRA, and Prudential Regulation Committee (PRC) members, appear in front of parliamentary committees frequently. We are also committed to carrying out our policymaking role in a transparent way, which helps facilitate scrutiny by Parliament. We produce a wide range of documents that parliamentarians can use to aid their scrutiny, from high-level policymaker speeches setting out our strategy for future regulation,[7] to detailed explanations for individual policy decisions,[8] to forward-looking plans for our future policy agenda.[9] On the latter, we would particularly highlight the Regulatory Initiatives Grid, which we publish jointly with the FCA and other financial services regulators, and which gives a consolidated view of the full set of policy initiatives planned for financial services.[10] All of these practices could be used, and adapted as needed, to support Parliament's role in the future.

The EU Parliament's role in making financial services regulation is not the same as in other jurisdictions with major financial services sectors. Rule-making responsibility is incorporated into a legislative process that aims to harmonise across multiple industries and member states. During this process, the European Parliament co-legislates with the Council, reviewing and approving each piece of legislation. However, this process can be slow. For example, the Capital Requirements Regulation (CRR) took years to agree. There is also a risk that ex-ante scrutiny of every file weakens the independence and responsiveness of the regulators.

[5] For more details on the theoretical and empirical case for independence in regulatory policy, see Saporta, V (2020), The ideal post-EU regulatory framework (link).
[6] For more details, see HMT's consultation on the FRF review (link)
[7] A recent example is Woods, S (2020), Strong and simple (link)
[8] A recent example is the PRA's consultation on the implementation of Basel standards (link)
[9] The PRA publishes its business plan annually, and sets out in its annual report how it is achieving its objectives from the previous year's business plan. (link)
[10] https://www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid-september-2020.pdf

Wider stakeholder engagement and scrutiny

We are committed to a transparent and open policymaking process, with a key role for engagement with industry and other stakeholders. The proposed future approach to regulation in HMT's FRF review makes this all the more important.

Public consultation is a vital component of high-quality regulation, and is the key mechanism by which industry and the public can scrutinise proposals for new regulations. The PRA wants to run its consultation processes to the highest standards. Consistent with statutory and non-statutory requirements applicable to consultations, we think that some of the features of a good consultation process are:

- **Openness.** We are clear and transparent about our proposals and their rationale, with detailed explanations for proposed rules. These explanations should make clear how proposed policies are expected to advance our objectives, while also explaining how we have considered our 'have regards' (proportionality, economic growth, etc.) and what impact these have had. This includes making appropriate use of cost-benefit analysis.

- **Engagement.** We take the submissions that are made to our consultations seriously, and look proactively for opportunities to gather the views of a wide range of stakeholders. This includes the PRA's Practitioner Panel and Insurance Sub-committee, which are independent statutory panels that represent the interests of practitioners from the areas of the financial industry that the PRA regulates.[11]

- **Proportionality.** The approach to public consultation should be tailored to the policy. For major policy changes, this means structured, multi-stage engagement processes with speeches and discussion papers well in advance of consulting on specific rules. At the other end of the spectrum, it is important to maintain the flexibility to introduce changes quickly in response to shocks – a key benefit of having standards in regulators' rulebooks.

- **Independence.** It should remain clear where responsibility – and accountability – lies for regulatory decisions. Processes for engagement and scrutiny should not dilute the clarity of decision-making responsibilities, nor should they seek to supplant Parliament's overall role in holding the regulators to account.

The regulators' objectives

The PRA will pursue whatever objectives Parliament sets us. It is also important for the Government to be able to communicate its policy priorities to the regulators and for the regulators to take these into account appropriately. In our view, regulation works best if regulators' objectives are clear and focused, ensuring a transparent division of responsibilities and accountability. In that context, we do see some risk that proliferating objectives and 'have regards' could dilute our effectiveness – but it is a question of balance and it seems reasonable to expect that our objectives and 'have regards' might evolve somewhat as our role changes. For instance, the Government has proposed a number of new 'have regards' for the PRA in the Financial Services (FS) Bill, which is currently being considered in the House of Lords. This is a matter for Parliament but in our view these strike a good balance between directing the PRA to consider new policy priorities and ensuring that our objectives and 'have regards' remain clear.

The FRF review also states: 'The government will be reviewing the existing cross-cutting regulatory principles set out in FSMA… [d]ealing with a profusion of activity-specific regulatory principles ['have regards'] could become a disproportionate resource challenge for the regulators, leading to ineffective

[11] Details of the panels' role is set out on the Bank's website (link).

outcomes, and could be confusing for stakeholders.' We support the Government's intention to review this area.

Regulatory independence

As noted above, regulatory independence brings significant benefits to the regime. Several features of the framework today support regulatory independence, and HMT propose to maintain these for the future framework. One important aspect is that regulators retain authority to take decisions without a political 'veto'.[12] Regulators can maintain confidence in their independence by giving clear, public explanations of their policy decisions, which are linked back to their statutory objectives and 'have regards'. Parliament also has a key role to play in maintaining regulatory independence by ensuring that regulators are held to account for their decisions.

Regulatory independence should not mean the creation of regulatory siloes. There are important processes to ensure coordination between regulators and Government (e.g. the Regulatory Initiatives Forum) that do not impinge on independence. Transparency around the purpose, rule of operation, and outputs of such processes can help to preserve confidence in ongoing regulatory independence. Similarly, there are important public policy issues that inevitably cut across both regulatory and Government policy, where consultation between regulator and Government is vital. The current framework includes public mechanisms for the Government to communicate its priorities to the PRA through the PRC remit letter, which the PRA has a duty to consider when making policy.[13,14] The FS Bill also proposes that the PRA should consult HMT about the impact of proposed CRR rules on equivalence decisions.

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[12] There are limited cases in the current framework where power for ministers to direct regulators does exist, but these operate within legal limits for clearly-defined purposes such as the protection of public funds.

[13] The most recent PRC remit letter is available on Gov.uk (link)

[14] The Chancellor also sends the FPC an annual 'remit and recommendations' letter. The most recent such letter is available here.

Part 2: The UK's position as a global financial centre and relationships with other jurisdictions

This part covers the following questions from the call for evidence:

- *How can the UK financial services sector take advantage of the UK's new trading environment with the rest of the world?*
- *What should the Government's financial services priorities be when it negotiates trade agreements with third countries?*
- *Should the UK open its financial services markets to external competition from countries outside of Europe, or should the UK maintain the current regulatory barriers that apply to third countries?*
- *What progress has the Government and regulators made in facilitating key financial services equivalence agreements with third countries; and would an alternative mechanism serve the interests of the UK market better?*

Safe openness

The UK already has a very open financial services sector, which attracts a large number of international players, including from outside of Europe:

- **International banks** represent around half of UK banking sector assets. The UK currently hosts around 90 bank subsidiaries, 150 branches, and 66 EEA banks who are seeking authorisation as third country branches in the Temporary Permissions Regime (TPR). These institutions come from over 50 countries. Banks from non-EEA countries account for over £5.5trn of UK banking assets, and banks from the EEA for around £1trn.
- **International insurers** also make up a significant proportion of the UK insurance system, with around 60 subsidiaries of international insurers, 30 branches, and 180 EEA insurers who are seeking authorisation as third country branches through TPR. The UK is the single largest market for specialist non-life insurance globally, with £75bn of annual premium (equating to c.7% of global insurance premiums) written through the London Market. 85% of this business was undertaken in the UK by insurers domiciled overseas.[15]
- A number of UK-supervised **financial market infrastructures** have considerable international usage and international presence. In 2019, 50% of the global market in swaps and 43% of forex trading took place in the UK. In addition, the UK established temporary regimes to ensure that important international infrastructures were able to continue providing services in the UK following the UK's withdrawal from the EU. These schemes are currently being used by 48 Central Counterparties (CCPs) and 16 central securities deposits.[16]

Since 2013, the PRA has approved 24 new foreign bank subsidiaries and branches, and 35 new insurance entities (including new UK insurers, Lloyd's Managing Agents, and Insurance Special Purpose Vehicles). Overseas firms may also access the UK's markets by providing cross border investment and insurance services under the Overseas Persons Exclusion.[17]

This financial openness increases dynamism, innovation and choice for consumers and businesses in the UK. Through international diversification, it also enables more effective risk sharing and should lead to a more resilient and competitive UK financial system. However, openness can also create challenges, by making the UK economy more vulnerable to international financial shocks. Openness should therefore be accompanied by financial and operational resilience.

This 'safe openness' should be at the core of the UK's global approach.[18] Internationally, the UK should continue advocating for robust common regulatory standards, and ensure those standards are

[15] London Market Group report 'London Matters 2020' (link)

[16] Cunliffe, J (2020), Governance of Financial Globalisation (link)

[17] HMT Call for Evidence on the Overseas Framework (link)

effectively supervised, including through effective information-sharing and cooperation between jurisdictions. The alternative, where countries turn inwards and trust and cooperation diminish, could see concerns about the risks of openness to domestic financial stability intensify.

Domestically, the UK should remain committed to the application of these international standards and continue ensuring that its financial system remains open and accessible to international firms while protecting UK consumers and serving the needs of the UK economy.

The PRA's approach to regulation and supervision of international firms[19]

The PRA's approach to regulation and supervision of international firms operating in the UK rests on the principle of safe openness. It is tailored to firms based on an assessment of their nature and potential impact on UK financial stability and varies depending on the legal form of their UK operations.[20]

For subsidiaries of overseas firms, the PRA applies the same regulatory requirements as for UK-headquartered firms. It also applies the same risk-based and proportionate supervisory approach but tailors it to take into account links between the subsidiary and the rest of the group of which it forms part.

For branches, which form part of a legal entity incorporated outside the UK, the PRA's supervision is proportionate, and places an appropriate degree of reliance on the prudential supervision of the overseas firm by the home state supervisor, subject to appropriate safeguards. This reliance on other supervisors takes into account the degree of transparent implementation of international standards and the effectiveness of supervisory cooperation. This approach rests on a risk-based assessment against the PRA's objectives for both banks and insurers:

- **Branches of overseas banks** in the UK are able to obtain permissions to undertake investment business. In addition, unlike a number of peer countries, the PRA does not apply local liquidity or capital requirements to bank branches. The PRA may require an overseas bank to use a UK subsidiary to undertake retail deposit taking activities beyond *de minimis* levels, rather than a branch. For branches undertaking wholesale business, which are judged to be systemically important, the PRA will assess whether the firm is capable of being effectively supervised and may impose additional requirements.

- **Branches** are already used by 30 **overseas insurers** to access the UK market, with the large majority of the 180 EEA insurers in TPR also expected to seek authorisation as branches. While the PRA retains the power to insist that an overseas insurer sets up a subsidiary rather than a branch, it has stated that this is most likely to be the case where the insurer exceeds a threshold of £500m in FSCS-protected liabilities (as a proxy for its exposure to UK retail policyholders).[21] Overseas branches in the UK are currently required to calculate branch capital, but the Government is considering removing these requirements as part of its review of Solvency II[22]. This might make it easier for overseas insurers to establish and maintain branches in the UK.

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[18] Safe openness is discussed in Bailey, A (2021), The case for an open financial system (link).

[19] This section focuses on the PRA's approach to supervising international firms. Please note that the Bank also supervises a number of financial market infrastructures (FMIs) under several legislative regimes. For further information on the Bank's approach to supervising FMIs, please see the Bank's most recent FMI annual report (link)

[20] For more on this see the PRA's 2018 Supervisory Statements, 'International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision' (link), the current consultation in CP2/21 - International banks: The PRA's approach to branch and subsidiary supervision (link), and 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision' (link).

[21] From the PRA's Supervisory Statement, 'International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision' (link)

By applying a risk-based approach and relying on overseas supervisors where appropriate, the PRA's 'safe openness' approach reduces the regulatory burden for firms, ultimately increasing the relative accessibility of the UK as a place to do business.

The PRA is also actively seeking to make its expectations of banks more transparent through its consultation on the supervision of international bank branches and subsidiaries.[23]

The UK's current approach to equivalence determinations

Equivalence determinations can provide for a range of preferential treatment for UK and overseas firms. In some instances they also facilitate market access to the UK. Under the onshored equivalence regimes, HMT is responsible for taking new equivalence decisions, with advice from the appropriate UK regulatory authorities. Where there is a recognition or registration requirement for individual firms to provide services under equivalence determinations, this is the responsibility of the relevant regulatory authority. The UK has also generally incorporated the EU's existing equivalence determinations for third countries into UK law. This provides continuity for firms who rely on the application of the EU's equivalence determinations. The exception is the decisions on CCPs where HMT are conducting new assessments of relevant third countries. Recognition of individual non-UK CCPs is a matter for the Bank.

Recent changes to the EU equivalence regime for CCPs under EMIR provided additional supervisory powers for ESMA over non-EU CCPs deemed systemically equivalent. These changes have also been incorporated into UK law and the Bank is currently considering its policy approach to implementing these new features of the regime in respect of non-UK CCPs.

The Chancellor announced on 9 November 2020 that the UK has granted equivalence for EEA states under 17 equivalence provisions, including in respect of CCPs. HMT granting these equivalence decisions (subject to Bank recognition of individual entities where relevant), provides a range of benefits, including supporting well-regulated open markets, facilitating effective pooling and management of risk, and supporting UK and EEA clients' access to financial services and market liquidity.

The UK equivalence framework and decisions, carried over from the EU, are not generally underpinned by structured processes for withdrawal and can in principle be withdrawn with very little notice. In certain circumstances, such an abrupt withdrawal of equivalence could have adverse effects on financial stability and lead to market disruption.

The Bank's favoured approach to equivalence determinations going forward

To provide greater stability for trade in financial services on the basis of equivalence, therefore, the Bank supports the view that autonomous equivalence decisions should be accompanied by structured and transparent processes – in particular for the withdrawal of equivalence, to provide confidence that any withdrawal of equivalence will be orderly. It would ensure that industry has time to adapt to any changes, thereby maintaining confidence in equivalence decisions as a reliable platform on which firms can plan and conduct their business. This is especially important where equivalence decisions provide a basis for market access, as they do for CCPs under EMIR Article 25 and for cross-border investment services under Title VIII of MiFIR.

HMT has outlined the principles and processes that will govern the UK's equivalence framework going forward. In particular, it highlights the UK's commitment to an outcomes-based model of equivalence, which operates in a transparent manner, providing predictability and stability over time to UK industry, overseas jurisdictions and firms. An outcomes-based approach facilitates stable equivalence as it recognises that overseas jurisdictions can be equivalent without the need for identical rules or

[22] The Government's call for evidence on the Review of Solvency II (link)
[23] The PRA's Consultation Paper on international banks is available on the Bank's website (link)

supervisory practices. Rather they can achieve equivalent outcomes to the UK while taking a different approach that better reflects their domestic system.

HMT has launched a call for evidence to gather information on how our current overseas framework, of which equivalence is a part, supports the UK's position as a global financial centre. The aim is to ensure that our legislative and regulatory regimes for overseas access to the UK achieve the goal of attracting liquidity and activity to the UK while supporting financial stability and openness in financial markets. Among other aspects of the UK regime, the HMT call for evidence may elicit views on the role of equivalence and how it might evolve in future.

Use of other mechanisms for market access, including trade agreements

Equivalence is one of a number of mechanisms available to the UK in facilitating market access into the UK and/or prudential treatment for firms. Others include mutual recognition agreements (MRAs) and free trade agreements (FTAs). When the UK negotiates new trade agreements, whether FTAs or MRAs, the Bank will provide technical advice to HMT on whether the proposed agreements are consistent with meeting its statutory objectives.

Each mechanism has different characteristics that lends each to different circumstances and objectives. For example, equivalence is set out in domestic legislation and can be applied to all overseas jurisdictions, whereas MRAs and FTAs are trade agreements with specific partners that would need to be implemented in domestic law. In general, where activities are inside the regulatory perimeter, making market access conditional on a regulatory assessment that the home regulatory and supervisory framework achieves comparable outcomes to those in the UK – including, where relevant, meeting common international standards – is an approach we would support. This regulatory assessment is a fundamental underpinning of both MRAs and equivalence. This contrasts with FTAs, which, as a result, tend to offer limited new cross-border market access for financial services and tend not to include much activity that is within the regulatory perimeter.

The 'safe openness' approach highlighted earlier supports outcomes-based reliance on home regulatory regimes. It relies on regulators setting sufficiently high regulatory requirements to mitigate risks, and supervising effectively to those standards, including through supervisory cooperation with regulatory counterparts. It should also promote multilateralism by encouraging adherence to common international standards by the UK's trading partners. In line with this approach, the Bank should ensure that any new agreements signed that include more formal recognition arrangements do not cut across our ability to regulate and supervise effectively, to cooperate independently with overseas regulators, or to engage in international standard-setting and implementation.

Part 3: The UK regulatory regime's support for innovation, competition and proportionality

This primarily relates to this question from the call for evidence:

- *How can Government policy and the UK regulators facilitate the emergence of FinTech and new competition; develop new areas of growth for the financial services sector; and promote the UK as the best place to incubate new financial technologies and firms?*

And touches on:

- *What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?*
- *How can the balance between lighter touch regulation and prudential safeguards be best secured?*

Tailoring the UK prudential regime

The FRF proposals discussed in Part 1 will be an essential building block in ensuring that our regulatory regime can support innovation, competition and proportionality, as it will allow the PRA to deliver key initiatives such as:

1) **A 'Strong and Simple' regime for smaller banks.** As announced in Sam Woods' November 2020 Mansion House speech, in 2021 the PRA will publish a discussion paper on a new regulatory regime for small domestic banks and building societies.[24] This framework would allow us to move away from the EU's one-size-fits-all approach to banking regulation by ensuring a proportionate approach. The package would support UK challenger banks, including FinTechs, as they grow and scale up.

2) **The Solvency II review of insurance regulation**. The Government's review aims to support a vibrant, innovative, and internationally competitive insurance sector, while protecting policyholders and maintaining safety and soundness. While HMT and the PRA remain supportive of the principles of Solvency II, the review is an opportunity to address aspects of the current regime which may be disproportionate, insufficiently tailored to the circumstances of the UK market, or which unduly constrain the PRA's ability to exercise its supervisory judgement. Examples of the areas under review include the risk margin and matching adjustment, the operation of capital requirements and internal models, the scope to reduce regulatory reporting requirements, and increased proportionality for new and smaller insurers and branches of overseas firms.

We also intend to explore options to rationalise UK prudential standards without weakening them. The combination of the EU regulatory frameworks, which has been locked into primary-level legislation as a result of the onshoring process, and the extant PRA rulebook means that the current body of prudential regulation can be unclear, unwieldy, and time-consuming to update. HMT's proposal to transfer most onshored standards into the regulators' rulebooks gives us the opportunity to move towards a more coherent prudential regime and make the rules more accessible.

A supportive environment for the FinTech sector

The UK is already an attractive place for FinTech firms to launch. The Bank of England, alongside the other UK authorities, is working to produce an environment and infrastructure on which private sector firms can innovate. Below are some examples of initiatives that will be key to creating a supportive environment for firms as they seek to grow and scale up to become leaders in their sector, without being subject to an undue regulatory burden.

a. **An open data platform for SME finance**, to help SMEs and lenders navigate the next phase of the COVID lending schemes by sharing up-to-date information. This would demonstrate the

[24] Woods, S (2020), Strong and simple (link)

value to lenders and borrowers of linking various data sources via existing technologies (e.g. Open Banking and accounting software APIs) to share a richer picture of SMEs' financial performance with lenders. This could help SMEs to refinance Government-backed loans or work with their lenders on repayment plans; it could help lenders to manage collections on their extensive BBLS portfolio cost-effectively; and it could help HMRC understand how best to support struggling businesses. As an additional longer-term benefit, it would also reduce information asymmetries in the SME lending market, making it easier for non-bank lenders to compete and offering greater choice for SMEs.

b. **Encourage uptake of legal entity identifiers (LEIs)** for all corporates and small businesses, starting with a focus on CBILS and BBLS borrowers. The LEI offers a consistent, transparent and verified means to identify any corporate entity involved in any economic transaction, thereby enabling businesses to move around the financial system seamlessly. It would immediately help to properly identify the businesses that have borrowed emergency loans. And since the LEI is a global standard, it will also support the cross-border payments roadmap and help businesses access finance for cross-border trade. Given the wider benefits, the authorities could go further by contributing to the cost of these LEIs or require LEIs from all companies that file accounts at Companies House.

c. **Promote the development of digital identity in financial services and the real economy** across the public and private sectors. The UK is currently lagging behind many other countries in developing the appropriate infrastructure for digital identities and digital verification, a shortcoming exposed in the COVID crisis. Enabling consumers to prove their identities online securely and efficiently offers multiple opportunities for digital finance. It will reduce financial crime, reduce the cost of KYC checks for financial institutions, and improve the customer experience of switching providers or accessing new products and services - thereby facilitating greater competition and innovation in the financial system. DCMS has taken a lead on developing a trust framework for Digital ID, which is an essential first step, but HMT can show leadership in developing the standards for a digital ID in financial services, which would speed up adoption in the wider economy.

d. **Enable direct-to-bank retail payments as an alternative to card payments to drive greater consumer choice, resilience and price competition**. UK payments are heavily (and increasingly) reliant on the card networks. Other countries have found that direct-to-bank payment technologies have been widely adopted for peer-to-peer payments and at the point of sale. And there are resilience benefits to having a diverse and competitive set of payment options. The Payments Landscape Review and independent strategic FinTech review offer a suitable and resilient vehicle to address the lack of a viable alternative to card payments in the UK. But given industry incentives around card networks, the authorities will need to press hard to understand (and address) the technical and commercial barriers, including those within the Faster Payments Service.

The Bank of England will also consider a more graduated access to its balance sheet, supported by a sound and graduated regulatory regime. This would constructively sit alongside the new banks and insurers start up units, and the FCA's sandbox and Global Financial Innovation Network initiatives.

Digital currencies

The UK is also responding to the potential development of digital currencies, including systemic stablecoins and a central bank digital currency. Systemic stablecoins could become widely used for payments in the UK. This could offer innovative payment services and bring benefits to consumers, but also pose risks to financial stability and monetary policy. The FPC has made clear that regulation needs to be in place for systemic stablecoins to ensure equivalent standards to commercial bank money.[25] HMT have published a consultation[26] on the UK's regulatory approach to cryptoassets and

[25] From the Record of FPC Meeting on 13 December 2019. (link)

stablecoins. A regulatory framework will support innovation in payments by making regulatory expectations clear and ensuring sustainable designs are adopted.

The Bank is also considering the potential introduction of a central bank digital currency (CBDC) in the UK – an electronic form of central bank money that could be used by households and businesses to make payments. CBDC could bring a number of benefits (e.g. continued access to and utility of central bank money as cash declines, and support resilience, innovation, and competition in payments) but also risks (e.g. impact on commercial bank business models and credit provision).

The Bank issued a discussion paper[27] in March 2020 to seek views from a wide range of stakeholders on the concept of a CBDC and a possible design. The Bank is planning to issue a further discussion paper which will develop these points further, including how to regulate systemic stablecoins, and how CBDC and stablecoins might interact.

March 2021

[26] UK regulatory approach to cryptoassets and stablecoins: consultation and call for evidence (link)
[27] Central Bank Digital Currency: Opportunities, Challenges and Design (link)