
AFME-ISDA joint response

PRA Discussion Paper (DP4/22) - The Prudential Regulation Authority's approach to policy December 2022

Introduction

AFME and ISDA (hereafter “the industry”) welcome the opportunity to comment on the PRA’s Discussion Paper (DP) on its approach to policy.

We support the continuation of the Financial Services and Markets Act 2000 (FSMA) model of independent regulators acting to advance objectives set for them by Parliament as the most appropriate legislative framework. Moreover, we support a clear allocation of responsibilities in the future regulatory framework between Parliament, the Government and regulators.

The PRA notes within the DP that the introduction of the FSM Bill, which implements that FRF Review, is an important moment for the PRA. It will broaden the responsibilities of the PRA and allow for financial services regulatory reform to be adapted to reflect the UK’s position outside of the EU. In this regard, we support the PRA’s statement that its position as an operationally independent regulator is an important safeguard for the UK financial system, as corroborated by the International Monetary Fund (IMF) in its most recent Financial Sector Assessment Programme (FSAP) report from February 2022. With recent market instability, it is ever more important to maintain stability and predictability of the UK’s regulatory regime, underpinned by the independence of the PRA – this is key to ensuring investor confidence to facilitate market stability, future investment and growth.

We would like to emphasise here that the industry supports the open dialogue that is currently maintained between the PRA and the industry and is encouraged by the intent to increase the level of engagement in this regard, and to embed its new secondary objective. As such, the comments provided hereto are in support of the proposed approach to policy outlined by the PRA, with recommendations for how this could be operationalised in a post-Brexit era.

The industry supports the continuation of structured policy development built on ongoing dialogue and consultation between policymakers and industry that delivers the clarity, certainty and predictability that international businesses and investors seek.

Chapter 3: Our approach to our objectives and regulatory principles

Q.1 Do you have views on whether we are correct to adopt a proactive approach to our new secondary objective? If so, do you have views on ways in which we could pursue our new secondary objective, as part of a proactive approach?

The industry welcomes the introduction of a new secondary objective on international competitiveness and economic growth for financial services regulators. This approach will ensure high regulatory standards are maintained while also putting an appropriate level of focus on competition. The culture and approach of regulators to implementing regulation and supervising compliance has a significant impact on UK competitiveness.

Industry is supportive of the PRA adopting a proactive approach to the new secondary objective.

A key package for the PRA to implement is the finalisation of post-financial crisis reforms i.e. Basel 3.1. This will provide an opportunity to review the existing framework to ensure that it is appropriately calibrated in its entirety, removing duplicative, overlapping or overly conservative requirements that had acted as safeguards whilst the framework was phased in.

As part of this review, a balance should also be reached in applying international standards, including coordinating timelines internationally, whilst making adaptations to reflect regional specificities as has been the case in other major jurisdictions. As such, in anticipation of the FSM Bill's adoption, there is a strong expectation from industry that the PRA will consider the additional objective for the purposes of the Basel 3.1 package.

Industry's full set of positions related to the anticipated Basel 3.1 package can be found here: <https://www.afme.eu/Key-issues/Basel-31-UK>.

More broadly, a useful output for both the PRA and for industry may be for the PRA to conduct and publish an annual review of how it has considered international competitiveness and economic growth in its review and development of regulatory policy, and how it has furthered this objective through enhancements to the regulatory framework. This would allow both the regulator, government and industry to take stock of the effectiveness of the secondary objective, and the direction of development of UK financial services.

Q.2 Do you agree that the approach to our objectives and regulatory principles, including on clustering regulatory principles and focusing detail on the most significant in each case, effectively supports Parliament in holding us to account?

Q.3 Do you have any views on our approach to clustering regulatory principles for undertaking and presenting analysis?

Industry agrees with the approach to objectives and regulatory principles.

In addition, when clustering regulatory principles and focussing detail on the most significant in each case, we recommend that evidence / justification be provided as to how the PRA has identified which of the regulatory principles are most significant. This will facilitate transparency and accountability, and help foster consistency in the consideration of regulatory principles over the medium-long term.

Chapter 4: Our approach to international engagement and collaboration

Q.4 Do you agree that a strong commitment to implementing international standards is an effective way of pursuing our objectives?

Q.5 What do you view as the costs and benefits of adjusting our implementation of international standards to account for UK market circumstances?

We believe a strong commitment to implementing international standards is an appropriate starting baseline, not only in relation to traditional banking / prudential standards, but also in other areas such as data, AML,

sustainability, digital assets and operational resilience. International standards, such as those set by international bodies such as the Financial Stability Board, the Basel Committee for Banking Supervision and the International Organization of Securities Commissions, play a key role in the global system by promoting regulatory consistency, fostering exchange between supervisors and promoting financial stability. In certain circumstances however, it is evident that the international standards require review and adjustment. In such instances, the PRA should encourage such changes to be made to the relevant international standard(s), and should not hesitate to address these regionally before an international review.

An example of where it is evident an international standard requires review is in the case of the standardised approach for counterparty credit risk (SA-CCR). However, the international timeline is not certain, whilst the issue of SA-CCR miscalibration and the resultant impact is a current issue in the UK. As such, the UK should seek to address the standard as soon as possible, with other major jurisdictions already taking measures in this regard e.g. the US has revised the standard (including resetting the alpha factor to 1 for commercial end users), whilst the EU is discussing and negotiating proposals to address the impact of SA-CCR as part of the CRR3 package. At the same time, the UK should seek to increase the priority of a review of the standard by the Basel Committee.

Elsewhere, the prudential standards should take better account of market specificities and the makeup of the UK financial services sector. The UK is a major financial hub and therefore should remove barriers to the free-flow of capital and liquidity that were inherent pre-Brexit by applying standards at a consolidated level and removing intragroup barriers. In line with this, the industry view is that the Basel 3.1 output floor should apply at the level of UK consolidation to avoid unnecessary complexity and constraints to business models and structures within the UK.

We are encouraged that both the issue of SA-CCR calibration and the application of the output floor are under consultation (CP16/22 – Implementation of the Basel 3.1 standards).

In addition, certain market / product structures in the UK are different to other major jurisdictions and requires specific consideration, such as the treatment of specialised lending, which will underpin a large part of the UK's plans to meet its net zero targets and international obligations such as the Paris Climate Agreement.

In performing its cost and benefit analysis, we believe that the PRA's analysis needs to be robust, and the PRA should explain in detail in draft policies / consultations how it arrives at policy decisions which account for specific UK market circumstances, including consideration of the costs for international firms, not just UK entities. In addition, the PRA should maintain a similar approach to explaining its rationale for introducing new policies in areas which go beyond or deviate from international standards (e.g. trading activity wind down).

Q.6 Do you support the PRA's international engagement strategy?

Industry supports the PRA's international engagement strategy.

The international engagement strategy set out in the Discussion Paper is a sensible one. It is important that the PRA continues to fulfil the strategy across different areas. These include:

- Continuing to build close relationships with other regulators to make efficient and effective decisions on branching and subsidiarisation of foreign firms in the UK.
- Maintain and enhancing MoUs with different jurisdictions
- Playing a leading role in influencing international bodies on sustainable finance
- Giving the best advice possible to HM Treasury regarding equivalence decisions

When the international engagement does not result in consistent implementation of Basel standards across jurisdictions, the PRA may need to consider adjustments to the UK implementation to ensure competitiveness.

Further to the above, we ask that the PRA clearly sets out how it would approach collaboration with jurisdictions with which the UK has agreed a mutual recognition agreement in financial services, including how the PRA proposes to enhance regulatory and supervisory cooperation with such jurisdictions.

Chapter 5: The Policy Cycle

Q.7 Do you have any views on the PRA's approach to policy-making?

We support the increased focus on cost benefit analysis, including through the CBA Panel which will be legislated for in the FSM Bill.

To provide greater insights for industry and for the CBA Panel, it may be beneficial for the PRA to include CBAs for different approaches to achieving a given regulatory outcome, rather than as an input to a binary decision on an overall regulatory policy. This would better inform all stakeholders on the options available and the impacts of those options.

Further, to ensure that all relevant factors are included in the PRA's decision to amend or draft new regulations, a **decision tree** could be used by the PRA which would include full consideration of each of the relevant factors, which should include, at a minimum:

- 1. Existing tools** – The regulators should include a detailed consideration of whether the desired regulatory outcomes could already be achieved by leveraging existing regulations or sections contained therein, or is already covered by existing high-level principles. This is especially relevant in the UK where regulators have put in place broad-based principles in its risk-based and outcomes-focused regulations.
- 2. International landscape** – To serve the UK competitiveness objective and avoid market dislocation effects, the regulators should conduct an assessment of the proposed policy initiatives against global standards as well as against the existence of equivalent rules in other key jurisdictions, in order to determine whether local idiosyncrasies fully justify additive new regulation, deviation from, or front-running of global standards or equivalent jurisdictions' approaches.
- 3. Read across to existing regulation for impact analysis** – The regulators should undertake a look across and detailed analysis of the interplay of the new regulatory initiative with other existing regulations to ensure that any overlap, conflict or undesirable cumulative effects of existing and new regulations is identified. In addition, this review should consider the cumulative impact of relevant policies on firms, not just the marginal impact (and costs) of the policy itself.

4. Extension of CBA to include qualitative factors – In case the consideration of the above three factors renders a positive result for the new regulatory initiative, a CBA should be conducted which should not just be based on a purely numerical exercise, but clearly and transparently outline the pros and cons of the new regulations. This is relevant because it is often challenging for industry to estimate the costs of implementation and maintenance of a new standard and equally challenging for the PRA to estimate quantitative benefits. Such extended CBA could be discussed and finetuned in a PRA-industry roundtable and commented upon by other stakeholders such as governments and academics.

We welcome the PRA's aim to increase the breadth and scope of their stakeholder engagement throughout the policy cycle. However, we would note that different stakeholder groups will have varying degrees of insight on various topics. For instance, academia can provide valuable insights into the theoretical side of topics and can be of great use in helping to identify topics for regulatory focus, determining data sets, undertaking analysis and research and challenging the status quo. However they may not have as much insight into practical implications or in the functioning of markets or banks' operating models.

The Discussion Paper rightly includes *evaluation* in the policy cycle. It is important that policy is evaluated against its original objectives and expected costs and benefits. Evaluation allows the PRA to see if there are unintended consequences or if the costs and benefits are different to those anticipated, and respond accordingly. We believe this will also provide greater transparency as the current consideration of cost-benefits in the existing rulemaking process provides high-level justification of financial stability outweighing cost to firms, whilst a more detailed analysis would provide greater clarity and accountability of this evaluation.

b. Do you have any views on how PRA should approach prioritising which of its existing policies to evaluate?

Industry believes that a core factor in approaching prioritisation is to consider the impact to financial stability. Those policies that are most impactful from a financial stability perspective should receive a higher priority.

The standing groups suggested under Q8 would also provide an opportunity for industry to input into the PRA's assessment of priorities to evaluate.

More broadly, the programme of revocation, replacement and review of retained EU law envisaged by the FSM Bill will be a significant challenge for industry. The Discussion Paper does not give firms any indication of the likely prioritisation, sequencing and pace of the programme in a way that would enable them to begin planning the allocation of their own resources. This issue will be more urgent for firms if HM Treasury decides to accelerate its work to try to revoke a substantial part, if not all, of the retained EU law on financial services covered by the FSM Bill by end-2023, as has been suggested by the Economic Secretary to the Treasury.

The industry requests that both the regulators and HM Treasury provide - in a coordinated way - further clarity to the industry on the specifics of the prioritisation, sequencing and pace of the programme under the FSM Bill, in particular to help firms identify what they will need to respond to during the period to end-2023.

Q.8 Do you have views on how the PRA could enhance its approach to external engagement, and our proposed guiding principles?

b. Do you have any views on how stakeholders should be engaged at each stage of the policy-making process?

We agree with the proposal to engage with stakeholders more frequently and in every stage of the policy cycle. We also agree that there is value in increasing outreach efforts in the initiation phase. This is the stage where external input can have the most value and may reduce the need for engagement later on.

Consultations are an important and transparent form of engagement. These can be supplemented with direct engagement such as through roundtable meetings or conferences.

c. Do you have any suggestions for new forms of engagement that the PRA could consider adopting?

Industry believes the PRA should re-instate standing groups – as previously operated by the Financial Services Authority (FSA). These are groups chaired by the PRA with a panel of industry subject matter experts that meet on a regular basis to discuss relevant issues e.g. a Credit Risk Standing Group. These Groups can help enable the more regular and closer dialogue intended by the PRA. These would allow for industry to raise any questions that may arise when implementing standards, which typically arise when those standards are new or when considering how to apply existing standards to new products, and would allow for the PRA to provide feedback to the industry as a whole, thereby ensuring a consistent understanding.

As well as risk specific groups e.g. Credit Risk Standing Group, we also recommend the creation of a Horizon Risk Standing Group that would seek to identify and consider how to address upcoming / future risks. Ultimately, these groups may be governed by an oversight group, such as an Industry Engagement Group which helps guide the mandate of the risk specific groups. Industry would welcome further discussion on the form / structure of these groups.

The standing groups we recommend should not replace the existing bilateral engagement, which we believe is very effective between the PRA and individual banks, but should be an additional avenue for engagement. We believe it will help to enhance transparency of rulemaking as well as give the PRA an additional channel to receive and input and provide feedback to industry.

Q.9 Do you have any views on the PRA's future data collection? How can the PRA engage with you most effectively, whilst it is developing its approach?

Data is critically important to ensure understanding of the impact of regulatory reform, including the implications on competition. This is important not only for the PRA, but also for those participating in the data collection exercise and the industry more widely. As such, we believe it is important that results of such exercises are fed back to the industry. For example, the PRA undertook a short data exercise to understand the impact of CVA exemptions but the results were never widely shared or discussed at an industry level. Furthermore, we believe the data will be of most benefit when data is submitted in a consistent manner. As

such, industry should be consulted on data templates used for data collection exercises. AFME and ISDA can play an important role in this regard in facilitating the industry review and input into these templates to help improve the quality and consistency of data received by the PRA. This will also have the added benefit of making data collection exercises more open and transparent.

Chapter 6: Our approach to delivering a first-rate PRA Rulebook

Q.10 Do you consider that the PRA's proposed approach to the four key reforms outlined above will create a more accessible, efficient, usable, and clearer Rulebook? What could we do differently or in addition?

The industry believes the PRA's proposed approach to the four key reforms noted will create a more accessible, efficient, usable and clearer Rulebook. This is a high priority item for the industry. Industry has noted that navigating UK rules post-Brexit has been difficult and has a strong expectation that the PRA will prioritise the delivery of a long-term solution via this first-rate rulebook.

The interim step of creating the PRA index has been well received and welcomed by industry, making it easier to navigate relevant PRA policy publications and related UK legislation. The PRA has set out its timings relating to the delivery of a more user-friendly website by end-2023 and this will be an important milestone for creating a Rulebook that is significantly more accessible. Further work to streamline policy document formats and adopting a coherent approach to the PRA's policies' structure and language should seek to follow an accelerated timeline as these will be important contributors to making the Rulebook more efficient, usable and clearer.

The industry encourages the PRA to take note of the following shortcomings in the existing Policy Index (and Rulebook):

- The Index does not provide links to discussion papers; consultation documents; policy statements relating to past or future planned changes to rules; supervisory statements, Dear CEO letters or similar communications stating PRA expectations or concerns with respect to the implementation of rules. Firms often need to be able to refer to these documents but they are often difficult to locate on the PRA's website;
- The regulatory history of individual rules and statements will become even more important when existing provisions of retained EU law are revoked, revised and replaced. It seems likely that the Policy Index (and Rulebook) in their current form would not provide firms with the ability to trace the regulatory history of individual rules. For example, this may adversely affect the ability of firms operating in both the UK and the EU (e.g., through consolidated subsidiaries) to assess the extent of divergence between UK and EU rules.
- As of April 2021, the consolidated list of Waivers, CRR and Solvency II Permissions granted to PRA- authorised firms is no longer being published (see statement [here](#)). The Policy Index does give some indication of available waivers and modifications in particular areas and individual waivers and modifications obtained by firms are usually available via the financial services register for individual firms. However, unless firms are able to identify the other firms that might benefit from a waiver or modification (so that they can search the register for that firm), they are now no longer able to readily see how often the PRA has granted particular types of modifications or waivers or the form that they

have taken in the past. This is a significant step backwards in transparency as to the PRA's approach. This will be of even greater concern in the future as the PRA will have powers to modify and waive on an individual basis many more of the requirements that apply to banks (currently, the PRA has very limited powers to waive or modify requirements in UK CRR or binding technical standards – in contrast, FSMA gives the PRA a general power to modify or waive its own rules at a firm's request).

Q.11 How can the PRA most effectively use 'purpose statements' or similar non-technical explanations to improve the clarity of our policies?

The rule implementation often requires judgment. Interpretive guidelines, purpose statements, and examples would help banks better comply with the spirit of the rule in instances where judgment is required.

Q.12 Do you consider that there are other effective ways to tackle the complex regulatory landscape?

Industry believes that regular engagement between the PRA and industry will ensure agility in tackling the complex regulatory landscape. In this regard, the use of standing groups, as detailed under Q8 would be an effective way for this engagement to be undertaken.

Para 6.21 of the Discussion Paper notes that the PRA will look to explore how PRA terms and EU terms could be better aligned for policy areas which it does not have control over (eg governance and accountability policy). This links to a wider issue as to the extent to which HMT and the UK regulators plan to change UK legislation and regulators' rules to move away from EU-specific concepts and terminology (such as "undertaking" and "established"). This could be helpful given that retained EU case law and Level 3 guidance will no longer be relevant to interpreting these terms. However, there is a significant risk that these changes could give rise to unexpected and unintended changes to the requirements that apply to firms. If there are to be such changes, it will be important that there is appropriate consultation and that HMT, the PRA and the FCA coordinate their approach (across different files), to reduce the burden on firms.

In addition, replacing, restating and revising rules will make it even harder for firms to assess the continued relevance in the UK of legacy EU 'Level 3' material, in particular the EBA Q&As. The PRA should specifically state its approach to this in a way that enables firms to plan for any resulting changes in requirements.

Contacts

AFME

Sahir Akbar
Managing Director
Deputy Head of Prudential Regulation
sahir.akbar@afme.eu

ISDA

Toby Coaker
Assistant Director
UK Public Policy
TCoaker@isda.org

About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76. Information about AFME and its activities is available on the Association's website: www.afme.eu.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 66 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.