Bank of England PRA

Appendices to CP11/23 – PRA statement on the review of rules

Consultation paper | CP11/23

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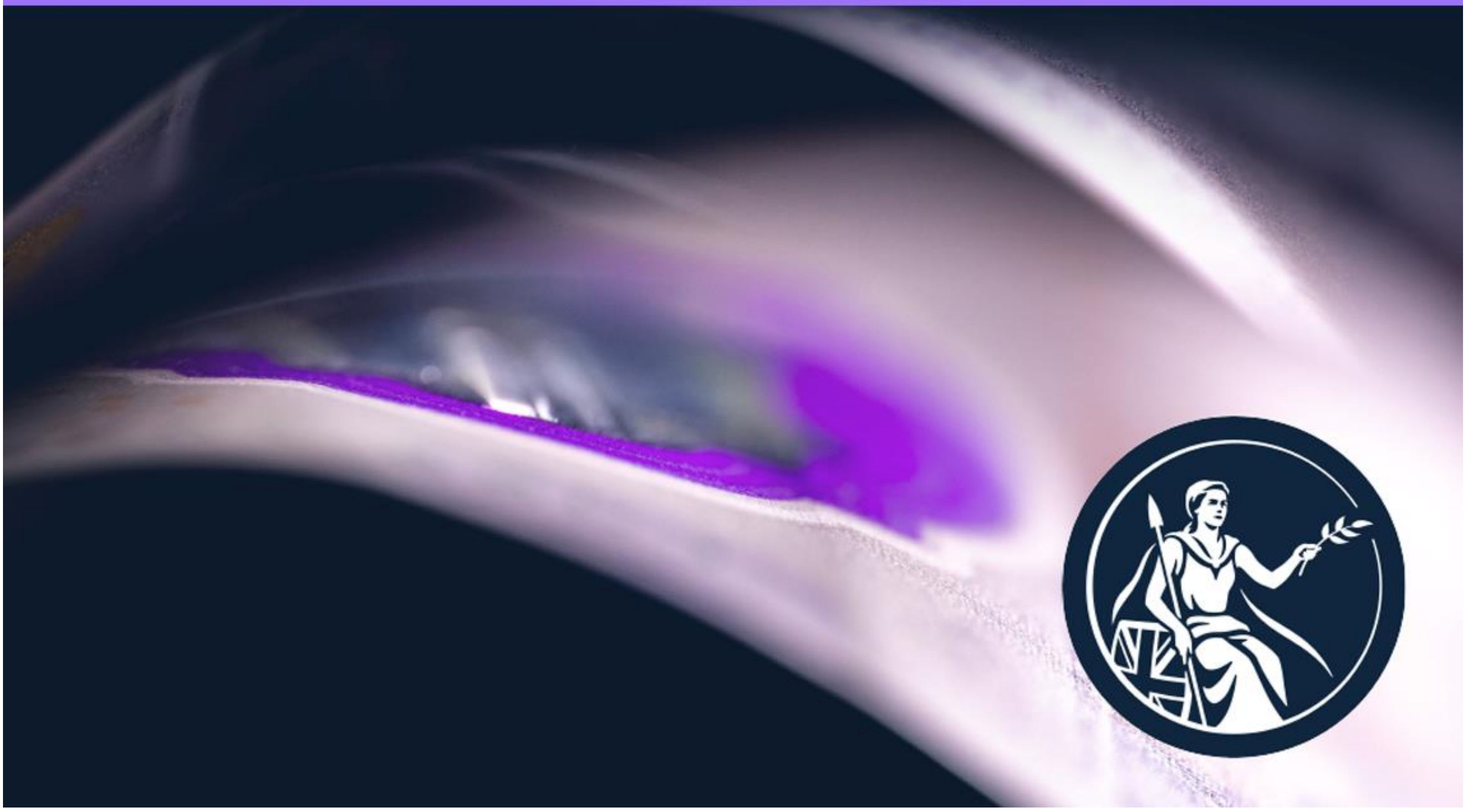

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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

1: PRA statement on the review of rules

1.1. Introduction

1. As a prudential regulator, the PRA creates rules to advance its statutory objectives. The PRA has two primary objectives: a general objective to promote the safety and soundness of PRA-authorised firms; and an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for policyholders. The PRA also has two secondary objectives: to facilitate effective competition in the markets for services provided by PRA-authorised firms; and to facilitate, subject to aligning with relevant international standards, the UK economy's international competitiveness and its growth over the medium to long term.

2. Before introducing or amending rules the PRA analyses the expected costs and benefits of a policy intervention. If the expected benefits outweigh costs, then the PRA may propose the introduction or amendment of a rule or a set of rules. The PRA consults on such proposals and considers stakeholder feedback before publishing its final policy. Once rules have been implemented, the PRA keeps them under review. The PRA refers to this process as 'rule review' or evaluation. The PRA may review rules if:

   - the rules have not adequately addressed the risk for which they were designed or new information emerges to inform the calibration of the rules compared to the risk they address;
   - the rules have given rise to unintended consequences;
   - firms are arbitraging or avoiding the rules in unanticipated ways;
   - the structure of the economy or financial system has evolved;
   - relevant international standards affecting the rule have changed; or
   - the nature of the issue addressed by the rules has evolved.

3. The process of rule review enables the PRA to update its assessment of the impact of its rules on its objectives, stakeholders, such as firms and households, and on the wider economy. With the benefit of evidence about implementation, reviews enable the PRA to understand impacts with greater accuracy as compared to the expected impacts set out in the cost-benefit analysis (CBA) when the rule was introduced. Through this process of learning, the outputs from rule reviews can also inform future CBA. In this way, rule review complements CBA and increases the PRA's effectiveness in delivering its objectives.

4. The remainder of this appendix is structured as follows:

- section 1.2 describes the PRA's framework for undertaking rule reviews;
- section 1.3 sets out how the PRA communicates its rule review work to the public;
- section 1.4 explains how stakeholders can engage with the PRA on rule reviews; and
- section 1.5 explains how the PRA intends to co-ordinate with other public bodies on rule reviews covering areas of shared responsibility.

1.2. Framework for rule review

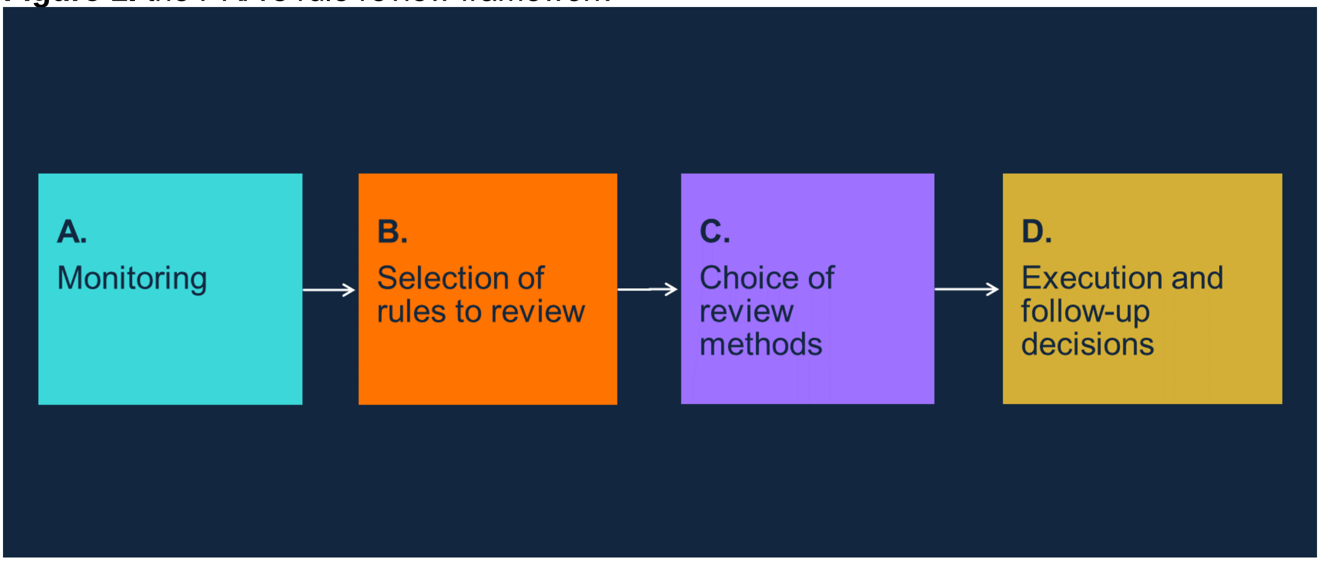
Scope

5. The rule review framework ('framework') applies to PRA rules, as required by the FSM Act. The PRA also applies the framework to supervisory statements which are linked to its rules. It is relevant to any person who is or may be subject of a PRA rule, which includes all PRA-authorised persons - banks, building societies, credit unions, insurers and designated investment firms - as well as the parent entities of these that are subject to PRA rules.

The four steps of the PRA's rule review framework

6. The framework consists of four key activities, as shown in Figure 1.

Figure 1. the PRA's rule review framework



A. Monitoring

7. The PRA regularly screens for indications that suggest a rule, or a set of rules, may warrant review. The PRA undertakes this monitoring exercise to ensure that rules are

advancing its objectives, being correctly interpreted and continue to be fit for their intended purpose.

8. As part of its monitoring process, the PRA draws on the following sources:
   a. direct feedback from stakeholders − this includes, but is not limited to, direct engagement with firms, industry associations, and other organisations as well as feedback received via the PRA's dedicated email address for rule review;
   b. direct feedback from relevant panels such as the PRA Practitioner Panel and the PRA Insurance Practitioner Panel;
   c. supervisory intelligence − supervisors may have insights gained by interacting with firms on how useful and practical the rule has been and how fully they think firms have enacted the rule;
   d. changes in market and economic conditions;
   e. material developments in international standards for the regulation of financial firms;
   f. insights and trends in applications for permissions, waivers or modifications of PRA rules – for example, evidence that multiple firms are applying for waivers or modifications to a rule may indicate that the rule is not working fully as intended;
   g. reports on specific firms and thematic reviews; and
   h. other relevant evidence, including internal data analysis and research, including external academic research on policy impacts.

9. The PRA also takes into account its legal obligations and other commitments made with respect to rule reviews. These include requirements in legislation, directions from HM Treasury, commitments made to international standard bodies, or obligations made via other channels.

10. Once the PRA identifies a rule (or a set of rules) that could potentially be reviewed, it assesses if there is sufficient evidence to justify a rule being considered for selection. The PRA examines if there is evidence that the underlying risks and/or underlying assumptions within the CBA have changed since the rule was implemented. For example, the PRA considers other jurisdictions changing their prudential standards which could point to a need to review corresponding PRA rules.

B. Selection of rules to review

11. From the set of rules the PRA has identified for potential review through its monitoring process, it further considers those rules that meet any of the conditions outlined in paragraph 2. It then prioritises reviews based on the following criteria: legal requirements, scale of impact, timing, contribution to meeting the PRA's secondary objectives, learning potential, the evidence base and other considerations.

Legal requirements

12. The PRA prioritises rules for which there are statutory requirements or other legal obligations to review. HM Treasury also has the power to require the PRA to review specific rules where the government considers that it is in the public interest. An example of a previous review undertaken by the PRA due to a legal requirement is the PRA's review of proprietary trading.[1]

Scale of impact

13. The PRA considers the magnitude of the impact of the rule on its statutory objectives. In particular, the PRA prioritises reviews where the safety and soundness of PRA-authorised firms and/or the protection of insurance policyholders are at most risk.

Timing

14. The PRA considers the time passed since the implementation of the rule. For some rules the full impact may only be observable several years after implementation, when there is enough evidence on how the rule is functioning in practice. For other rules, it may be easier to observe evidence that they are not functioning as intended, are unclear, or are leading to unintended consequences soon after implementation. While the appropriate timing varies on a case-by-case basis, the PRA would not expect to review a rule until sufficient time has elapsed since implementation to properly assess its impact.

Contribution to secondary objectives

15. The PRA considers the potential contribution of a review in advancing the PRA's secondary objectives in terms of facilitating competition and/or the UK economy's international competitiveness and growth. This includes the degree to which a review might lead to a simpler prudential framework, improve understanding, and/or ease unnecessary burden on firms. The PRA gives greater weight on prioritising the review of

1 Proprietary Trading Review: www.bankofengland.co.uk/prudential-regulation/publication/2020/proprietary-trading-review.

those rules that provide an uncertain contribution to the PRA's secondary objectives, taking into account the need to continue to advance the PRA's primary objectives.

Learning potential

16. The PRA considers the extent to which a review has a high potential for filling a strategically important evidence gap. Relevant factors include:

- the extent to which reviews could support the development of international standards;
- if the outcome of a review could be useful for other areas in the Bank of England, such as informing the Bank of England's financial stability considerations;
- interactions and interdependence between rules;
- the degree to which there are gaps of unaddressed risks in its rulebook;
- the degree of uncertainty at the point of implementation;
- evidence of unanticipated effects;
- evidence of regulatory arbitrage when firms adjust their activities in a way that reduces the impact of regulation without a corresponding reduction in the underlying risk;
- the degree to which it can inform the quality of the PRA's future CBAs. For example, analyses from reviews of rules in novel areas can provide the PRA with better evidence on the expected impacts of similar but new rules.

Evidence base

17. The PRA prioritises reviews where there is a good evidence base to support the possibility that the costs outweigh the benefits of the rule under consideration. Evidence-based feedback can come from a variety of sources, including practitioners, supervisors, and market intelligence. The evidence base enables the PRA to assess the extent to which a review may make a meaningful difference. It would consider, among other factors, feedback from PRA-regulated firms about the costs of implementing and complying with the rule(s).

Other considerations

18. In addition to the points above, the PRA considers other factors, such as:

- the balance of rule reviews undertaken across policy areas in recent periods.

- how to make efficient use of PRA resources: The PRA only conducts reviews where the expected benefit is likely to outweigh the expected costs of conducting them. The PRA coordinates with other parts of the Bank of England, government, other regulators, and relevant international stakeholders to make use of synergies.
- overall policy priorities: The PRA will seek to find an appropriate balance between reviewing existing rules and addressing new and emerging risks and opportunities;
- overall resource burden on firms of regulatory change, for example evidence from the Regulatory Initiatives Grid on the pipeline of existing regulatory initiatives.

C. Choice of methods

19. When a rule has been selected for review, the PRA will select the method(s) to use. A review method is the process through which the PRA collects and analyses information to assess the impact of the rule and to answer review questions. The PRA considers a wide range of review methods (Appendix 2 provides an overview).

20. The framework distinguishes between:

- **Qualitative methods** that do not rely heavily on analysis of data. Such methods include surveys or interviews; and
- **Quantitative methods** that rely mainly on analysis of quantitative data. Such methods include difference in differences or regression discontinuity designs.

21. Reviews can involve a combination of both qualitative and quantitative methods. The PRA is likely to make more use of qualitative methods when the observable outcomes that originate from the rule are rather qualitative. Such outcomes relate to perceptions, behaviours, and underlying reasons for certain phenomena. The PRA has used surveys and interviews to understand if changes to rules on the governance of regulated firms have led to intended and meaningful changes in the behaviour of these firms.

22. The PRA may also use qualitative methods when there is a sense of urgency to understand if the current prudential framework captures new, emerging risks and when quantitative evidence is not readily available.

23. By contrast, the PRA is likely to make more use of quantitative methods when rules give rise to outcomes that are measurable in numerical values (such as capital and liquidity requirements or balance sheet characteristics). The PRA has used the difference in differences method to estimate the impact of changes to minimum capital requirements of

regulated firms, such as refinements to the PRA approach to setting Pillar 2A capital requirements, on their balance sheets. It has also used this method to study the effects of ring-fencing reforms on the risk perception and the risk appetite of the banking groups subject to it. The PRA can use a regression discontinuity design to estimate the effect of rules on firm behaviour when they are assigned at discrete thresholds, for example if they only apply to large firms with total assets above a certain value.

24. Data help the PRA to employ quantitative reviews. The PRA recognises the costs to firms from existing data and reporting frameworks. When making and reviewing rules, the PRA seeks to make as much use as possible of existing data that are available. In most cases, the PRA expects its existing data to provide sufficient evidence for rule review. In some cases, rule review may require additional data, which may require further requests to firms. The PRA's approach to any additional data collection for rule review depends upon the likely costs of the request and the benefits of reviewing the rule.

D. Execution and decision on follow-up actions

25. Following the selection of a rule for review, the identification of the appropriate rule review method and the gathering of data, the PRA will conduct an analysis. This execution of the review culminates in the PRA deciding whether to propose any changes to the rule in question.

26. In conducting the review, the PRA typically seeks to draw on subject-matter experts to support with the assessment. In suitable cases, the PRA may seek stakeholder feedback on potential changes, for example through a Discussion Paper[2] or expert groups with market practitioners to gain insights and better understand market impacts.

27. The PRA considers how to communicate the outcomes of the review. This includes any legal requirements to publish the outcomes. In the future, the PRA aims to increase stakeholder engagement on rule reviews. Any proposed changes to the PRA's rules arising from a rule review would be subject to public consultation in the usual way.

[2] For example, DP1/23 – **www.bankofengland.co.uk/prudential-regulation/publication/2023/march/review-of-the-senior-managers-and-certification-regime**.

1.3. Stakeholder engagement on rule review

28. The PRA is committed to engaging with a broad range of stakeholders to seek input on rule reviews. This includes academia, civil society organisations, market participants (including PRA-authorised firms), public institutions and other interested stakeholders.

29. There are existing channels that stakeholders can use to engage with the PRA on rule reviews:

- stakeholders can respond to public consultations and discussion papers on specific topics;
- PRA-regulated firms can engage via their supervisors;
- firms can engage via the PRA Practitioner Panel and Insurance Practitioner Panel;
- firms can engage with the PRA via bilateral meetings, industry roundtables and/or trade-bodies representing their interests.

30. The PRA will create new channels for stakeholders to engage with the PRA on rule review. These include creating a dedicated email address as a vehicle for stakeholders to provide continuous feedback on the existing PRA Rulebook to inform future rule reviews.

1.4. Communication on rule review

31. The PRA is committed to being transparent about the review work it undertakes. It may choose to publish the outcomes of some of its reviews on a case-by-case basis. To that end, the PRA uses a range of publication types. These include:

   a. standalone reports. For example, the PRA published a standalone report on its review of proprietary trading.[3] Moreover, the PRA published a standalone report on the outcome of its evaluation of the Senior Managers and Certification Regime.[4]
   b. reports by international standard setters for the prudential regulation of banks and insurance firms that the PRA has contributed to. This includes reports published by the Task Force on Evaluations (TFE) of the Basel Committee on Banking Supervision. For example, the TFE published an evaluation of the impact and efficacy of the Basel III reforms.[5]

[3] Proprietary Trading Review: **www.bankofengland.co.uk/prudential-regulation/publication/2020/proprietary-trading-review**.
[4] Evaluation of the Senior Managers and Certification Regime (SM&CR): **www.bankofengland.co.uk/prudential-regulation/publication/2020/evaluation-of-the-senior-managers-and-certification-regime**.
[5] Evaluation of the impact and efficacy of the Basel III reforms: **www.bis.org/bcbs/publ/d544.htm**.

c. other types of publication such as discussion papers, consultation papers, policy statements which can also include analyses of existing rules.

32. The PRA has a webpage dedicated to its rule review activities which is easily accessible to its stakeholders. It provides a single point of access to relevant information relating to the PRA's rule review activities. The PRA uses it to disseminate such information to its stakeholders. The webpage includes information on:

- outcomes of past reviews of rules; and
- ongoing reviews to help stakeholders better understand the review work that the PRA is undertaking at any given point in time.

1.5. Co-ordination with other public bodies

33. The PRA contributes to and supports rule reviews conducted by international bodies, such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) or the Financial Stability Board (FSB).

34. Some PRA rules are in areas of shared responsibility with other regulators – notably the Financial Conduct Authority (FCA), as the regulator of conduct by both retail and wholesale financial services firms, and the Bank of England, as regulator of financial market infrastructure.[6] Where the PRA proposes to review a rule in an area of shared responsibility, or where the PRA is directed to do so by the Treasury, the PRA will work with the affected regulators to agree the best way to carry out the review. Areas of joint responsibility between the FCA and PRA include rules around remuneration, governance, and controls. Co-operation with other regulators can result in joint publications such as discussion papers or consultation papers.

[6] The PRA and the FCA have a Memorandum of Understanding (MoU) that sets out a framework to co-ordinate and co-operate in carrying out its respective responsibilities. Available at: **www.bankofengland.co.uk/about/governance-and-funding**.

2: Rule review methods

This appendix describes a non-exhaustive list of review methods that are commonly used by the PRA.

Qualitative methods

Method	Brief description
Desk-based reviews	A review of reports, documents and studies related to the rule which is being evaluated.
Interviews	In-depth exploration of a rule with relevant participants, which allows for specific views to be obtained.
Triangulation	Integration of multiple findings around a specific theme or evaluation.

Quantitative methods

Method	Brief description
Regression discontinuity design	Quasi-experimental method where assignment of treatment and control to units is based on 'cut-off values'.
Difference in differences	Econometric method that compares trends in outcomes between treated and untreated groups, before and after the implementation of a rule. Requires differences between treatment and control units to be stable prior to treatment (policy) assignment.
Instrumental variables	Method used to draw causal inference when treatment and control cannot be seen as randomly assigned. Relies on the use of an instrumental variable that correlates with treatment (*relevance*) and does not correlate with other unobserved variables (*exclusion*).

Synthetic control	Econometric method where counterfactual control unit is created using a weighted average of other untreated units prior to the policy.
Social cost-benefit analysis	Quantification and monetisation of the costs and benefits of a specific intervention.

Methods that can be either qualitative or quantitative

Method	**Brief description**
Surveys	Process through which participants' views on a certain topic are collected and analysed through a questionnaire.
Case studies	Focused study of a specific event or subject. Case studies themselves can make use of other methodologies in its execution, allowing for qualitative and quantitative approaches.
Thematic reviews	In-depth review of a specific theme connected to policy implementation and effectiveness.