Competing for growth – speech by Sam Woods

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Speech

Regulation, competitiveness and growth

A lot has been said about the UK financial regulators' new secondary competitiveness and growth objective, so I hesitate to add to the chat.[1] Our focus is on actions because they are said to speak louder than words. However, it is regularly reported to me that some stakeholders doubt that we are taking any meaningful action to deliver our new objective – and from this I have learned that sometimes in life it is necessary to tell people what actions you are taking, as well as taking them!

I will also attempt a little myth-busting, because I have observed that the debate on regulation can be dominated by extremes. On the one hand, it is surprisingly often asserted that the regulators are trying to remove all risk from the system and don't care about their impact on the wider economy. It is easy to demonstrate that this is nonsense. On the other hand, it's simply not true that any change to our regulations will unleash financial mayhem, and there is plenty in our regime that can be improved without undermining stability.

So if you take only two things from this speech, I hope they are these:

- first, that we are strongly committed to our new objective, and are taking concrete steps to improve our regime's contribution to UK growth and competitiveness;
- and second, that we are going about this in a careful, balanced way – reducing bureaucratic processes and some excess conservatism while preserving financial stability.

Before getting into this, I'd like to make a more personal point. It has occasionally been suggested that we regulators don't like our new competitiveness and growth objective, are secretly opposed to it and will do as little as possible to deliver it while talking a good game in public. As it happens, in my own case – other than talking a good game in public, which I do regularly attempt with mixed results – this view is completely untrue. I have always thought it perfectly reasonable that if we take an activity – rule-making – which has for many decades in this country been largely done under direct political oversight because that is the way the EU system works, and give it instead to operationally independent regulators – then the regulators' objectives need to be adjusted to take account of that

[1] To quote the statute: 'The competitiveness and growth objective is: facilitating, subject to aligning with relevant international standards – (a) the international competitiveness of the economy of the United Kingdom (including in particular the financial services sector through the contribution of PRA-authorised persons), and (b) its growth in the medium to long term.'

change.[2] That Parliament has done this, and the specific way in which Parliament chose to do it in 2023, both strike me as eminently sensible – and this view is shared by my colleagues at the PRA.

But there is a deeper point here, which is often missed. Unelected officials should not have pet objectives of their own. The core policy agenda in the UK is set, thankfully in my view despite inevitable travails along the way, by elected officials who can be removed at the ballot box. The agenda for unelected officials is set either directly by the government, for those in the civil service, or through objectives set by both houses of Parliament, together with remit letters from government, for those who work for an institution such as the PRA.[3] The job of an unelected official is simply to deliver those objectives, to the best of their ability. Of course, in order to do that well they need to have an enthusiasm for their work, which I do feel on most days at least – but they should not have an agenda of their own somehow outside the objectives they have been set through the democratic process. If they find those objectives incompatible with their own beliefs, then they should say so and step aside.

So coming back to our new objective, this much is simple – Parliament has spoken, and we will deliver.

Taking action

A new objective is no small thing for an independent regulator – everything we do flows from the statutory framework of objectives and 'have regards' set for us by Parliament.

At the outset of delivering our new objective the PRA team has quite sensibly asked: how do we actually affect competitiveness and growth?

The first and most obvious point is that we impact economic growth by maintaining financial stability.[4] The 2008 crisis remains the biggest growth-destroying event in recent economic history, and avoiding a repeat of that is by far the most important contribution we can make to growth. That's why safety and soundness is our primary objective.[5]

But beyond maintaining stability, we can have other (relatively smaller but still important) impacts on economic growth. We think this happens primarily in three ways: we affect the allocation of capital in the economy; we affect how well UK financial services firms are

[2] I would note that the new objective – like our existing objectives – applies to all of our 'general functions', which includes rule-making and some other activities like the setting of standards, codes and general policies and principles.
[3] The Government makes recommendations to the PRA, to which is must have regard: **Recommendations for the Prudential Regulation Committee: December 2022 - GOV.UK (www.gov.uk)**
[4] My colleague Sarah Breeden recently spoke about our approach to financial stability, including its impact on growth: **Financial stability at your service − speech by Sarah Breeden | Bank of England**
[5] We also have a primary objective to protect insurance policyholders.

equipped to compete overseas; and we affect how attractive the UK is as a location for financial services firms from other countries. How *much* we affect each of these three elements can be debated. But that we do affect all of them in some way is clear and I like this approach because it is simple, intuitive, and provides a straightforward way to test policy proposals for their impact on our new objective.

Armed with this framework we have taken steps to re-wire the organisation in order to deliver the new objective. We've been pulling expertise and insights from the best minds around the globe – hosting a major conference with academics and industry, making fact-finding missions to places like Singapore, setting up an internal centre of expertise, hosting innovation discussions with industry, rolling out new training for staff, commissioning new research and hard-wiring the objective into all of our policy-making.[6] The Court of the Bank of England has also already put the PRA through the gruelling mill of an assessment by the Bank's Independent Evaluation Office, who have published their report and provided some valuable steers about how we can lift our game.

This is all vital work because it provides the basis for us delivering on growth and competitiveness in an enduring way. However, all the frameworks and training in the world won't make a jot of difference without concrete actions being taken. Indeed, I can palpably sense some members of today's audience thinking "blah, blah, blah" – in fact I think someone over there is actually saying it. You are only allowed to do that during Nikhil's speech, and definitely not during the Lord Mayor's comments. I have therefore been at great pains to ensure that we make concrete progress in the first period of our new objective – while we re-wire ourselves we need to be getting some early runs on the board.

As I mentioned a moment ago, from time to time I hear it asserted that the PRA is not doing anything to advance its new objective. Let me be blunt: people who make that claim are simply not paying attention. Parliament foresaw this problem and required us to publish a report setting out what we are doing. We did this in July and it's a real page-turner, perfect for reading on your sun-lounger on the beach. But just in case you had other things to read in August, or became a little drowsy before getting all the way through it, let me very briefly pick out a few things from the list of what's been done so far.[7]

I'll start with our decision to scrap the bankers' **bonus cap**. Believe you me, this was not an easy thing to get rid of and a wise member of the Treasury Select Committee was probably right to ask me if this was the single most unpopular thing the PRA might ever have done – to which my answer was yes! (This was in fact great news as it allowed me to pull ahead of Nikhil in our competition to be the most unpopular regulator in the land). But I was nonetheless keen to make this change early in the life of our new objective. We have

[6] In fact, it now appears on the front page of the advice that goes to our rule-making committees.
[7] **Competitiveness and growth: embedding the PRA's new secondary objective | Bank of England**

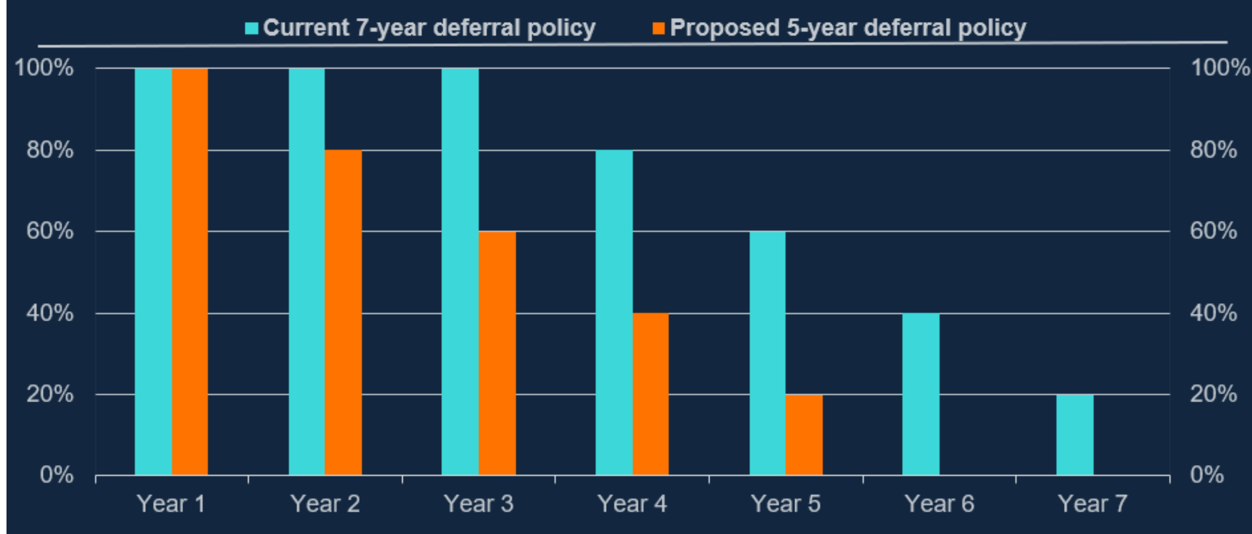
always seen this piece of regulation as being completely unnecessary for prudential purposes – in fact actively counterproductive, as it encouraged higher base salaries which were harder to adjust in response to shocks. And it was clearly damaging for competitiveness across two of our three channels – it made the UK a less attractive location for global firms and talent, and gave UK firms a disadvantage in attracting talent in their foreign operations. More than this, precisely because scrapping the cap is unpopular getting rid of it was an important early signal of intent, that we are serious about changing regulations where they don't do something useful and are bad for competitiveness and growth. And I can tell you that this move was noticed at the highest level in major international banks across the world.

I will stick with the topic of bankers' pay for a moment longer, at the risk of making myself even more unpopular. I am convinced that the pay systems we had in many of our banks before the global financial crisis, with bonuses often paid 100% in cash at year end with no further questions asked, was a very dangerous way to incentivise senior bankers and was an important factor in the collapse of our banking system at that time. It would therefore be a big mistake ever to go back to that system, and we should keep the safeguards we now have including **deferral** of bonuses so they can be cancelled if that trade which looked such a winner at year end turns out to be a loser in the longer-term.

However, I would also observe that the UK has become something of an outlier in terms of the length of deferral that we require, and that this may well be damaging for competitiveness. And there is evidence that our deferral periods are longer than they need to be to create the right incentives for safety and soundness.[8] We will therefore bring forward proposals to reduce deferral periods, while making sure they remain long enough to promote financial stability. We will propose to move to a five-year deferral period for all senior managers, down from the eight years some are subject to at present, and to a four-year deferral for others captured by the regime.[9] In addition, under the current rules, there is no vesting whatsoever for some senior managers until three years after a bonus award is made. We propose to allow vesting on a pro rata basis from year 1. (**Chart 1** illustrates how vesting schedules could look before and after our proposals.)

[8] There is a balance to be struck in the length of deferral periods. On the one hand PRA research (**measuring the effects of bank remuneration rules: evidence for the UK**) found evidence that long bonus deferral periods were associated with increases in fixed pay, which reduces the ability of firms to absorb losses in a downturn, potentially undermining safety and soundness. On the other hand, deferral periods need to allow sufficient time for adverse outcomes to crystalise so that remuneration incentives reflect the long-term performance of a firm. Our assessment is that while no cutoff will capture every single incident, a 5-year deferral window should capture the majority of incidents for the purposes of applying malus and to act as an effective deterrent to reckless behaviour.

[9] More precisely: at present the maximum deferral period is seven years for higher-paid senior managers, plus a 6-12 month retention period (which we propose to abolish as part of this reform). Higher-paid senior managers are individuals whose total remuneration exceeds £500,000, or who earn variable remuneration which exceeds 33% of their total remuneration.



(a) 7-year deferral currently applies to higher-paid Senior Managers; in addition, variable remuneration awarded in the form of instruments is subject to a retention period of up to a year.

These proposals will support growth and make our regime more competitive without undermining financial stability. I anticipate a lively reaction to them and look forward to it.

Moving away from bankers' pay, our major recent policy packages have all been tailored for competitiveness and growth. And more widely, we have been looking carefully at the vast corpus of existing regulation – much of which we've inherited from the EU – to see what opportunities exist to tailor and refine, removing redundant or unnecessary burdens while maintaining safety and soundness. I expect that much of what we will do to deliver our new objective in coming years will be actions which come from looking afresh at rules we've made over the last decade or so, and asking ourselves whether there are adjustments we can make which would make our regulation more efficient and less burdensome without any negative effect on our primary objectives.[10]

This would become an overly long speech if I listed everything we've done already on this score, which is all set out in our report to Parliament. I of course would love to give an enormously long speech but I am fearful of incurring the wrath of the Lord Mayor so instead I will just touch on a few elements. First, the big policy packages – Basel 3.1 and Solvency UK.

[10] I should say though, that we are very aware that change for change's sake imposes costs on firms and makes doing international business more difficult. So where we do make adjustments, it will be for good reasons. We have set out our approach to reviewing rules in a policy statement: **PS4/24 – PRA statement on the review of rules | Bank of England**.

Our **Basel 3.1** package is in fact governed by competitiveness and growth "have regards" rather than our new objective, but we paid particular attention to those have regards given the objective which has now come into force. We have been clear that aligning with the Basel standard is important both for stability and competitiveness reasons, given our role hosting one of the largest international financial centres in the world.[11] Our package achieves this alignment in the spirit and the letter without us having to make a material tightening in aggregate capital requirements.

We have also made important changes to take on evidence provided in response to our consultation, and have used our discretion to take into account sensitive areas of lending such as infrastructure, SMEs and trade finance – all of this while remaining compliant with the standard. To be a bit blunt again – I'm not sure what's got into me this evening Lord Mayor, I'm normally far more polite – I'm happy to challenge anyone who asserts that we have not taken competitiveness and growth very seriously in where we have landed on Basel 3.1.[12]

On the **Solvency UK reforms** to insurance regulations, the perception of our work here has understandably been dominated by the quite colourful argument we had with parts of the life industry about the design of part of the regime called the "matching adjustment". This spectacular row,[13] which I think one or two politicians rather enjoyed and which the PRA lost hands-down, rather obscured the fact that the entire rest of the reform package we have delivered is focused on competitiveness and growth, stripping unnecessary bureaucracy out of the regime in numerous ways (for example, we have cut reporting requirements faced by insurers by around a third) and supporting insurers in making investments into the economy by widening the set of assets for which the matching adjustment applies.

Aside from these two very large bits of work we are then implementing a range of reforms that advance competitiveness and growth across different parts of our regime. One of the most significant moves is our "**Strong and Simple"** framework, which will radically reduce the burden and complexity of regulations for smaller banks and building societies, while maintaining strong standards. I see this simplification as primarily advancing our competition objective, but by improving competition it should contribute to growth.[14]

Alongside all this we are taking actions to make the retail ring-fence work more efficiently without undermining it, will bring forward proposals to streamline some of the

[11] In that context it's worth noting that our new objective is to facilitate growth and competitiveness, *subject to alignment with international standards.*
[12] **Implementing Basel 3.1 in the UK − speech by Phil Evans | Bank of England**
[13] The debate was so colourful it was even referenced in a TV debate between then-prime ministerial candidates Rishi Sunak and Liz Truss – surely a first for prudential regulation of insurers!
[14] In general, there is a strong complementarity between our new secondary objective, and our long-standing secondary objective to facilitate competition in the banking and insurance sectors.

administrative aspects of the Senior Managers regime and are considering an approach to indexing thresholds in our regime in order to avoid "prudential drag" in which fixed thresholds become more biting over time as the economy grows.

And it's not just policy-making that is changing. We're on a mission to make our regulation as efficient as possible, by removing unnecessary frictions and inefficiencies so that we can achieve our objectives with minimal costs to the real economy. In particular: we've improved the speed and efficiency of regulatory processes, with the timeliness of authorisation of new senior managers now running consistently at very close to 100%; we're revamping our rule-book to make it easier to navigate; and we are reviewing the banking data we collect with the aim of streamlining reporting, ensuring we get the data we need, but no more than we need, at the lowest cost to firms.

Now reasonable people can debate whether we are doing enough, too much, the right or the wrong things to advance the new objective given to us by Parliament. Unreasonable people are also welcome to debate those points, and I'm sure they will. But if you want to argue that the PRA is simply not doing much on competitiveness and growth, you are just straightforwardly wrong.

Busting myths

But while I'm focused on actions, I'm also aware that perceptions matter.

We should be held to account for our support for growth and competitiveness, and so it's important that people can see what we are doing. Part of that is about explaining what we're doing, but another part is busting some persistent myths about our work.

The first myth is that prudential regulation is fundamentally at odds with risk-taking.

I've heard many versions of this in my 8 years in this job. Strangely enough, it comes from both sides of the debate:

- Those arguing for looser regulation often claim that prudential regulators have a technocratic focus on eliminating all risk, and fail to see the bigger picture. Worse yet, we are sometimes accused of having infected the wider financial sector with a culture of 'safetyism' as a result, damaging investment and growth.
- On the other hand, those arguing for tougher standards often seem to suggest that any crystallised risk – and in particular any failure of a regulated firm – represents a failure of prudential regulation.

In response, I would make a number of points.

First, if we have really been trying to reduce risks to zero, then we have unambiguously failed. Consider these simple points: we run a banking system which is leveraged to a

level of around 20 times; we have managed the demise of over 20 banks since the PRA was created, some very dramatic such as Silicon Valley Bank UK, others managed quietly; at the same time we have authorised another 38 banks and 28 insurers;[15] and according to the IMF we are the world's largest host jurisdiction to foreign financial firms, not least given the large number of international bank branches we welcome.[16]

But more importantly, it is absolutely not the job of prudential regulators to reduce risks to zero. We may have no appetite for causing a financial crisis. But that doesn't mean we have no appetite for risk. Risk is the lifeblood of a thriving capitalist economy, fuelling growth and innovation. The whole point of having a strong financial system is to enable society to take risks: by providing capital to promising (but uncertain) opportunities, and allowing business and households to pool their risks via insurance and hedging products.[17]

Our role as regulators is not to eliminate risk, but to ensure risks are properly managed, so that individual failures will not bring down the whole system. A mature debate on prudential regulation needs to recognise this basic fact – though of course people can and do differ on what good risk management looks like.

As for "safetyism", I recognise that there is a broader debate to be had about risk appetite in society, and whether we can rely more on *caveat emptor* especially in wholesale markets. But honestly if Parliament puts the word "safety" into our primary objectives, then you should expect us to be proud growth-oriented safetyists!

The second myth is that enhancing competitiveness means a bonfire of regulations.

Again, there are two versions of this myth:

- One often hears from lobbyists and commentators that the 'regulatory pendulum' has swung too far, and it's time for a re-balancing. The logic is that following the 2008 crisis, zealous lawmakers and regulators over-corrected for past excesses, building an overly stringent regulatory regime that has hampered growth since.
- On the other side of the debate, I sometimes detect a fear that any update to the post-crisis regime will unleash the dark forces of financial instability. Some even worry that the mere presence of a secondary objective for competitiveness and growth represents unacceptable backsliding.

The truth is more balanced.

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[15] 38 de novo UK-headquartered banks, and 28 new insurers (excluding Lloyds managing agents, ISPVs, and post-Brexit authorisations of new branches/subsidiaries for overseas insurers).
[16] The IMF's 2022 FSAP report found that the UK 'is the largest host jurisdiction to foreign financial firms as subsidiaries or branches' and that the large size of our international branches 'puts the United Kingdom in a category by itself as a large host of international activity'. See **United Kingdom: Financial Sector Assessment Program-Financial System Stability Assessment (imf.org)**
[17] I would note that our statutory objectives are drafted so as to explicitly rule out a 'zero failure' regime.

On the one hand, I don't see any compelling evidence for the idea that the big planks of the post-crisis regulations – capital, liquidity, accountability and operational resilience measures – have been fundamentally mis-calibrated. In retrospect the rapid build-up of bank credit growth before the GFC seems to have been unsustainable, culminating in a sharp deleveraging which brought the economy down with it. By contrast, bank lending in recent years seems to have been driven by the economic fundamentals rather than the other way round. More importantly, we now have a banking system which is sufficiently resilient to support rather than de-stabilise the economy through material shocks, such as Covid, the Russia-Ukraine war and the cost of living crisis.

It's true that general macroeconomic performance since the financial crisis has been disappointing, at least when compared with pre-crisis trends, and tackling this is rightly a top priority for public policy. But I think it's a bit of a stretch to attribute this to prudential regulation. The Basel banking standards have been applied relatively consistently across advanced economies, but growth outcomes have diverged significantly. In particular, the US has outperformed European economies despite holding its global banks to similar – indeed if anything, higher – capital standards. And in the UK's case, it is difficult to see how our financial sector could remain quite so large and open without the protection that is afforded by strong global standards.

Now, there is certainly room for a debate on the right calibration of the regulatory regime. In fact, researchers have tried a few times to calibrate what the economically-optimal level of bank capital is. These results are highly uncertain, and there is a wide range of calibrations that could be considered optimal. But our current regime lies within this range, and generally towards the lower end. Similarly, I'm not aware of any economy that has reshaped its fundamental growth prospects by slashing important prudential requirements. On the contrary, attempts to do so tend to end in disaster.

So I don't see much reason to think that the core elements of our regime are over-egged. On the other hand, it would be a major error to rule out scope to make our regime more efficient in support of competitiveness and growth.

The post-crisis reforms were developed at speed in response to a once-in-a-generation disaster. They were developed at multiple levels (national, EU, and global) and by multiple institutions (governments, central banks, regulators of various stripes). And all of us can see that the resulting regime is very voluminous and very complex. It is inevitable that, as we have learned more about operating the regime, we can discover redundancies, unintended consequences and areas where our risk appetite has proved too conservative.

Beyond anything else, there is plenty of inherited bureaucracy in the regime, which we can usefully declutter.

So while I don't see a case for a fundamental re-calibration of the core planks of our regime, I do see plenty of scope for revising unhelpful regulations in a pro-growth fashion.

This brings me to the third myth, which is to overestimate the costs – or the benefits – of regulation.

Rigorous cost-benefit analysis is a vital foundation of regulatory policy. And that requires us to be realistic about both the costs and benefits of what we're doing.

But often the debate falls into one of two extremes.

Some commentators seem to assume that all regulations are always costly, relative to some free market benchmark. Under this line of thinking, regulations make it more expensive for firms to do business. These costs are passed on to customers, and thus to the economy as a whole. And so, if we want to minimise costs, we should minimise regulations.

This argument makes the basic mistake of confusing private and social costs.

In a world without prudential regulation, costs would not be minimised – instead they would be borne by depositors, borrowers and ultimately taxpayers, who were left holding the bag when the system blew up in 2008. The social cost of that episode was vast.

Regulations impose a cost on individual firms. But by ensuring that risk-takers properly manage their own risks rather than leaving a mess for someone else to clean up, they can lower overall costs for society.

That being said, it would be equally misguided to take the opposite extreme position: that any regulation that reduces the possibility of a financial crisis, even if only by a fraction of a fraction of a per cent, must be worth doing. Taken to the limit that logic could actually lead us to remove too much risk from the system – and that way lies the stability of the graveyard.

Moreover, badly-designed regulations can impose social costs. And we should also have careful regard to the private costs of regulation, to ensure these are justified, proportionate and no bigger than they have to be to meet the public interest. As I described earlier, we have a major programme of work underway to avoid unnecessary regulatory burdens across the sector.

So it's important to take a balanced view of costs and benefits and not to over-claim for either. And going forward our efforts will I hope be very much aided by our new cost-benefit analysis panel, a group of independent experts who will bring considerably more weight to bear on this part of our work.

The fourth myth is that regulators are unaccountable and don't listen.

As unelected policy-makers, we take incredibly seriously our responsibility to be open, responsive and accountable. Our legitimacy – and hence the long-term viability of our regulatory regime – relies on this.

When we make policy, we consult widely and openly. We set out our direction of travel early and often, using speeches and discussion papers to start debates, and host roundtables and bilateral policy discussions with industry and other stakeholders.

We weigh carefully the feedback we get – including when we formally consult on new proposed rules. The data we receive from industry is vital, if we are to get our cost-benefit analyses right. It is a sign of strength, not weakness, when we change our approach in response to evidence. You can see this clearly in our Basel 3.1 rules, which evolved in many important respects from our consultation proposals, following industry and other stakeholder feedback. But it does take evidence to convince us.

At the same time, we will sometimes have to disagree with industry – as our job is to represent the interests of the public, and in particular to pursue our statutory objectives. There will therefore be disagreements about our policy choices from time to time, and this a natural part of delivering our mandate – aiming to avoid any such disagreements would be dangerous.

Our accountability is ultimately to Parliament, and in my experience Parliament plays this vital role very assiduously and vigorously. I can tell you that if you are grilled in Parliament as often and as thoroughly as I am you know that these claims that we are unaccountable are not well-founded. We will of course continue to engage proactively with any form of scrutiny Parliament considers appropriate for our work. And we will also continue to liaise closely with the government, in particular with Treasury ministers who have an important role in setting the wider agenda and expecting us to deliver our part of it.

Looking ahead

Let me finish with what I hope is a more substantive point.

Financial regulation has been in something of an expansive mode since the global financial crisis in 2008. This is natural, both because the regulation which allowed that event to occur was clearly too weak and contributed to a huge hit to economic growth and welfare – and because this is generally what happens after financial crises. But I think it implausible that healthy business models, which are a fundamental foundation of a safe and sound financial sector, will thrive in an environment of ever-expanding regulation. Regulation always needs to develop and adapt to accommodate changes in markets and

wider public policy priorities but it can’t be forever becoming more stringent, a race to the top if you like.

The history of prudential regulation is more the other way round – that as memories of the last crisis fade, a race to the bottom sets in until the next blow-up. It’s important that efforts to improve regulation do not morph into a general backsliding on the system’s fundamental resilience: all our efforts to support growth and competitiveness would be wasted if we fail to maintain financial stability.

It is possible, just possible, that the UK can find a sweet spot in financial regulation in the coming period: consolidating the gains for financial stability since the financial crisis while making regulation more efficient, evidence-based and effective in support of competitiveness and growth. That is what we should aim for.

My thanks to Hugh Burns and colleagues across the Bank and PRA for their help in preparing this speech.