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19 March 2021

Dear Earl Howe,

Financial Services (FS) Bill 2019-2021

You have drawn my attention to two questions raised in the ongoing debate on the FS Bill in the House of Lords: how climate change is factored into the regulators' decision-making, and parliamentary scrutiny of regulators' rules. I thought it might be helpful to set out what we currently do on both of these points. While these topics have been raised in the specific context of the prudential measures in the current FS Bill, they are clearly issues that cut across all areas of financial regulation, including HMT's recent consultation on the long-term Future Regulatory Framework. The points below therefore aim to put the current measures into that wider context.

Climate change

The Bank (and Prudential Regulation Authority (PRA)) has recognised for some time the threat posed by climate change to the UK economy and the financial system.[1] In the context of the PRA's work, the physical effects of climate change and the transition to a net-zero economy both create financial risks that can affect financial stability and the safety and soundness of the firms we regulate. Climate change is therefore already an important consideration in the PRA's supervision and regulation of banks and insurers under our existing statutory objectives.

It is on this basis that we have already aimed to play an appropriately significant role in this area. For example, in 2019 we became the world's first prudential regulator to set out specific and detailed supervisory expectations for banks and insurers on their approaches to managing the financial risks from climate change.[2] We will also launch our first climate change scenario exercise – sometimes referred to as a climate stress test – for the UK's largest banks and insurers in June this year.[3] The goal is to assess the resilience of the financial system and individual banks and insurers to different climate scenarios. Those scenarios are in turn based on work we have led through the international Network of Central Banks and Supervisors for Greening the Financial System (NGFS), where we have collaborated with our peers, climate scientists and climate modellers.[4]

More broadly, we are also helping to shape climate-related financial regulatory policy at an international level through our roles in the climate workstreams of the Financial Stability Board, the Basel Committee on Banking Supervision, and the International Association of Insurance Supervisors. Domestically, we are working closely with the UK Government, the Financial Conduct Authority (FCA) and other regulators to

[1] The Bank published reports on the impact of climate change to the UK insurance sector in 2015 and the UK banking sector in 2018.
[2] PRA Supervisory Statement 3/19 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'.
[3] The Bank will launch the Climate Biennial Exploratory Scenario (CBES) in June 2021.
[4] The Bank is the Chair of the NGFS Macrofinancial workstream that produced climate reference scenarios.

coordinate our approaches. For example, we are part of the UK Joint Government-Regulator Task Force on climate disclosure that has recently published a roadmap for mandatory disclosure requirements.[5]

As I hope these examples demonstrate, we do not feel that our existing remit has constrained our prudential work or prevented us from pursuing suitably ambitious goals. Nonetheless, I welcome the Government's commitment to incorporate climate considerations in the next remit letter for the Prudential Regulation Committee (PRC), as it has recently done for the Monetary and Financial Policy Committees. Looking ahead, we intend to take full advantage of the opportunities in 2021 to accelerate policy development and build on our climate work further through our roles supervising UK banks and insurers, maintaining financial stability, and supporting the UK's presidency of the G7 and the UN COP26 conference.

Parliamentary scrutiny and accountability

Under the approach proposed by HMT in the FS Bill, the setting of technical rules to implement financial reforms (including the remaining internationally-agreed Basel standards for UK banks) would be delegated to operationally independent regulators. We have previously stated that we are supportive of this approach,[6] but recognise that it is a decision for Parliament. We also understand that any increase in the regulators' powers is likely to put a renewed emphasis on how we account for our activities to Parliament – in particular in relation to our technical rule-making activity.

Our legitimacy depends on the role and powers Parliament chooses to allot to us and how we then action that role and powers, and we are absolutely committed to working with Parliament (including its committees) to ensure it has the information necessary to hold us fully to account. The senior staff of the PRA, and PRC members, appear frequently in front of parliamentary committees – most often in front of the Commons Treasury Committee, through which we are primarily accountable to Parliament. We are also committed to making our policy-making role as transparent as possible. This includes publishing information that parliamentarians can use to aid their scrutiny, from high-level speeches setting out our strategy for future regulation,[7] to detailed explanations for individual policy decisions, to forward-looking plans for our future policy agenda, to our annual business plans and reports.[8]

When we publish consultations, we always stand ready to engage with Parliament. Consultation is a vital component of high-quality regulation, and is a key mechanism by which Parliament, industry and the public can scrutinise proposals for new regulations. We are committed to ensuring that our consultations provide the information they need to scrutinise our proposals – including detailed explanations for our policy choices, and how we have considered the wider policy issues to which Parliament and HMT have asked us to 'have regard'. In that regard, I would draw peers' attention to our ongoing consultation on the implementation of Basel standards, which we have also shared with the staff of the Lords Economic Affairs Committee, Lords EU Services Sub-Committee and Commons Treasury Committee.[9] We welcome, and take full account of, any feedback from parliamentarians on this and future consultations.

We are also happy to discuss our plans with parliamentarians ahead of the consultation phase, to the extent desired by Parliament. To help inform these discussions, I 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]

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[5] In November 2020, the Task Force published a report and roadmap for mandatory climate disclosures in the UK.
[6] This proposed approach to regulation is in line with international best practice and the academic literature. For more detail on this, see Saporta, V (2020), The ideal post-EU regulatory framework (link) and Woods, S (2019), Stylish regulation (link).
[7] A recent example is Woods, S (2020), Strong and simple (link).
[8] 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).
[9] Available on the PRA website (link).
[10] Available on the FCA website (link).

We also welcome scrutiny of whether or not our policies have succeeded in achieving the goals Parliament has set for us. To support such scrutiny, we have published evaluations of major policy reform programmes.[11] We take seriously any feedback from Parliament and its committees on previously-implemented policies. For example, we took forward all of the actions from Treasury Committee's 2017 inquiry into our implementation of Solvency II.[12]

More broadly, looking to the future regulatory framework it would seem natural to us that, if some rule-making responsibilities previously conducted at EU level move to us, Parliament might choose to evolve the way it scrutinises that activity and to enhance the expectations it places on us to help Parliament to fulfil its role in this area. Clearly this will be entirely for Parliament to decide but we think that all of the practices set out above could perhaps be used, and adapted as needed, to support Parliament's role in the future.

I would be very happy to discuss any of the issues covered in this letter with your colleagues in the House of Lords at your convenience.

I am copying this letter to the Economic Secretary to the Treasury and the Chairs of the Lords Economic Affairs Committee, the Lords EU Services Sub-Committee and the Commons Treasury Committee. I understand that your intention is to place a copy of this letter in the House of Lords Library.

Yours sincerely

Sam Woods
Deputy Governor and CEO, Prudential Regulation Authority

[11] For a recent example see our evaluation of the Senior Managers and Certification Regime, published in 2020 (link).
[12] Our response to the TSC review is available on the PRA website (link).