Positive Money welcomes the opportunity to respond to the PRA's Discussion Paper on its future approach to policy.

We are a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

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?

We do not believe the PRA is correct to adopt a proactive approach towards a new secondary objective to facilitate the international competitiveness of the UK economy.

This secondary objective, as currently defined in the Financial Services and Markets Bill, seeks to require the PRA to place particular emphasis on increasing the international competitiveness of the financial services sector. We fear that requiring the PRA to increase the competitiveness of the UK's financial sector in particular may mean a watering down of regulations that the industry may consider 'burdensome'. We share concerns over the wording of the objective with former chair of the Independent Commission on Banking, Sir John Vickers, who writes that "far from advancing the growth of the economy as a whole, the special favouring of the financial services sector implied by the bill could be detrimental to it, as we all saw 15 years ago."[1]

It is difficult to see how the PRA could proactively contribute to increased international competitiveness and growth other than by loosening standards for financial regulation. Furthermore, facilitating both the growth of the UK economy and the financial sector appears to be a contradictory objective for the PRA to pursue, as there is a wealth of empirical evidence showing that, above a certain threshold, there is a negative relationship between financial sector growth and the growth of the wider economy.[2] We fear that the objective's emphasis on the financial sector will see the rest of the economy lose in this trade-off.

As Bank of England governor Andrew Bailey remarked when chief executive of the FCA, "the Financial Services Authority (FSA) was required to consider the UK's competitiveness, and it didn't end well, for anyone including the FSA", referring to the 2008 crisis.[3] Worryingly, pre-2008 regulators only needed to consider competitiveness, whereas current proposals would see competitiveness elevated to a stronger statutory objective.

It is not the role of regulators to become cheerleaders for the financial services sector. Even

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[1] https://www.ft.com/content/33f73a5a-9c11-4f59-a7f9-ddd1e56cffbd

[2] See for example: Cecchetti, S. G. and Kharroubi, E. (2012) 'Reassessing the Impact of Finance on Growth.' BIS Working Paper No. 381. *Bank for International Settlements*; Arcand, J. L., Berkes, E. and Panizza, U. (2015) 'Too Much Finance?' *Journal of Economic Growth*, 20, 105–148; Rousseau, P. and Wachtel, P. (2017) 'Episodes of Financial Deepening: Credit Booms or Growth Generators?' *Financial Systems and Economic Growth*, 52, 52-75; Epstein, G. and Montecino, J. (2018) 'The UK's finance curse? Costs and processes.' Report. Sheffield Political Economy Research Institute (SPERI), University of Sheffield; Sturn, S., Zwickl, K. (2016) A reassessment of intermediation and size effects of financial systems. *Empirical Economics* 50, 1467–1480 (2016)

[3] https://www.fca.org.uk/news/speeches/future-financial-conduct-regulation

as a secondary objective, a new emphasis on competitiveness could impede on the PRA's ability to carry out its primary objectives. This is particularly worrying when emerging developments pose uncertain risks to the financial system and the public. For instance, a focus on competitiveness may leave UK consumers more exposed to risky financial instruments such as crypto-assets or SPACs, as regulators are compelled to take a lighter touch approach so as not to stifle the international competitiveness and growth of these industries in the UK.

Likewise, with issues like climate change, which are characterised by radical uncertainty, experts have made the case for a 'precautionary approach',[4] which may conflict with an objective to increase competitiveness. The PRA may inadvertently facilitate a climate-finance 'doom loop'[5] by not taking a prudent approach to climate risk early enough for fear of undermining competitiveness, which would lead to worse outcomes for financial stability. As the PRA recognises, climate change has implications for financial stability, with the Bank of England's recent climate stress test estimates that climate change could cost UK banks up to more than £340 billion in a severe physical risk scenario in which climate action is delayed.[6] HMT has rightly highlighted climate as relevant to its duties in its 2021 recommendation letter for the PRC, while the FSM Bill introduces a new regulatory principle to achieve compliance with the government's net zero target. This regulatory principle risks being undermined by the stronger statutory objective for competitiveness.

A pertinent example of the dangers of financial regulators being compelled to promote the growth and competitiveness of the sector they regulate is the WireCard scandal, in which Germany's BaFin failed to adequately supervise the firm for fear of undermining its competitiveness and growth as a success story for the German financial sector.

A focus on competitiveness may therefore cause regulators to err against strong regulation when risks are uncertain (as they usually are due to the very nature of finance), ultimately making the financial system less safe and putting the public at much greater risk. As the 2008 crash showed, the risks of financial crises can easily overshadow any rewards offered by a more competitive sector. It is the role of regulators to guard against those risks, not enable them.

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

Yes, the PRA should not take part in an international race to the bottom in standards. Part of the reason Britain was particularly exposed to the banking crash is that the country was known for having lighter standards, which encouraged firms to undertake riskier business here.

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

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[4] https://www.ucl.ac.uk/bartlett/public-purpose/publications/2019/dec/climate-related-financial-policy-world-radical-uncertainty

[5] https://www.finance-watch.org/publication/breaking-the-climate-finance-doom-loop/

[6] Bank of England, 'Results of the 2021 Climate Biennial Exploratory Scenario (CBES)', 24 May 2022

As above, costs may arise from the PRA loosening regulation to increase the financial sector’s international competitives, justified by perceptions of unique ‘UK market circumstances’ which may prove unfounded.

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

> **a. Which groups of stakeholders should the PRA seek to engage during the policymaking process?**
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> **b. Do you have any views on how stakeholders should be engaged at each stage of the policy-making process?**
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> **c. Do you have any suggestions for new forms of engagement that the PRA could consider adopting?**

The PRA should particularly seek to engage civil society organisations who don’t have a vested commercial interest in particular regulatory outcomes and can therefore offer a more ‘objective’ appraisal of policymaking, in addition to stakeholders who represent the interests of consumers. The main barrier for these stakeholders is that they are much less resourced to proactively engage with the PRA than large financial firms with well-funded lobbying operations. Anything the PRA could do to actively seek out engagement from civil society and to help overcome these barriers would be hugely beneficial to the policymaking process.