

Consultation Paper | CP5/22

The Strong and Simple Framework: a definition of a Simpler-regime Firm

April 2022



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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Responses are requested by Friday 22 July 2022.

The PRA prefers all responses to be sent by email to: CP5_22@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

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1 Overview

1.1 As set out in Discussion Paper (DP) 1/21, the Prudential Regulation Authority (PRA) is seeking to mitigate the ‘complexity problem’ that can arise when the same prudential requirements are applied to all firms. The PRA aims to achieve this through its ‘strong and simple’ initiative that would seek to simplify the prudential framework for non-systemic domestic banks and building societies, while maintaining their resilience.^{1,2} Since this would be a major change in prudential policy applying to banks and building societies in the UK (hereafter ‘firms’), taking a number of years to develop and implement, the PRA is starting to achieve its aim by developing a ‘simpler regime’ for the smallest firms. This approach aims to ensure the benefits of simplification are experienced by the largest number of firms as soon as possible.

1.2 In this Consultation Paper (CP) the PRA sets out its proposals for introducing a definition of a ‘Simpler-regime Firm’.³ The PRA’s implementation of this proposed definition would be the first step in designing a strong and simple framework.

1.3 The proposals in this CP would introduce a new definition, Simpler-regime Firm, in the PRA Rulebook.

1.4 The CP is relevant to PRA-authorised banks and building societies, and prospective entities interested in, and currently applying for, authorisation as a deposit-taker.

1.5 The proposals in this CP relate to a definition of a type of firm – a Simpler-regime Firm – that would be subject to a simpler, but robust, set of prudential rules in the future. That regime would advance the PRA’s safety and soundness, and secondary competition objectives. The PRA considers that publishing the proposed definition also provides the benefit of giving firms early visibility of a key building block of the future simpler regime. The PRA considers the introduction of the Simpler-regime Firm definition should not create significant additional costs because the criteria in the definition should be based on information that firms are already having to collect or are required to report.

1.6 The PRA has considered the interaction between its primary and secondary objectives and the have regards, including in relation to international standards, relative standing of the UK, and finance for the real economy. Overall, the PRA considers the proposals in this CP to be a necessary and appropriate step towards the introduction of future measures to enhance the proportionality of the PRA’s regulatory framework, while maintaining firms’ safety and soundness.

Background

1.7 In DP1/21, the PRA sought views on developing a simplified prudential framework for firms that are neither systemically important nor internationally active. The combined objectives of this framework would be to maintain the resilience of those firms, and the stability of the UK financial sector, while using simplified prudential regulation. This could enhance effective competition, and enable a dynamic and diverse banking sector in the UK.

1.8 DP1/21 described how prudential regulation could give rise to a complexity problem, when the same requirements are applied to all firms. This problem exists when the costs of understanding, interpreting, and operationalising prudential requirements are higher in comparison to the

¹ April 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks>.

² The PRA would also seek to ensure that the UK continues to meet the Basel Core Principles for Effective Bank Supervision (<https://www.bis.org/publ/bcbs230.pdf>).

³ ‘Simpler-regime Firm’ is a working term that might be revised in due course. The PRA would welcome views on the proposed name.

contributions those requirements make to safety and soundness for smaller firms than for larger firms. The complexity problem arises because there are economies of scale to understanding, interpreting, and operationalising prudential requirements, or because the factors driving small and larger firm distress are different, but the requirements have been designed with larger firms in mind. This problem could have adverse effects on PRA objectives because it could reduce the resilience of small firms and diminish effective competition.

1.9 DP1/21 suggested the PRA could construct a strong and simple framework of a series of layered prudential regimes, over which requirements would expand and become more sophisticated as one or both of the size or complexity of firms increase. This approach would reflect the diversity of sizes and business models of firms that the PRA does not consider systemically important or internationally active.

1.10 Given this new framework would represent a significant shift in the design of prudential regulation of firms, the PRA is proposing to develop the layer for the smallest firms first (the simpler regime) since they are most likely to experience the complexity problem.

1.11 The PRA considers its proposal to introduce the Simpler-regime Firm definition a necessary step towards the establishment of the simpler regime. Early visibility on how the scope of the simpler regime would be determined should also be beneficial to firms. Therefore, rather than consulting simultaneously on all aspects of the proposed regime (which would include a set of simplified prudential requirements), the PRA has chosen to adopt a phased approach to the delivery of its proposals. A further reason for consulting on the definition of a Simpler-regime Firm first is that prudential regulation is still evolving.

1.12 In addition to developing its proposals for the application of simplified prudential requirements to Simpler-regime Firms, the PRA intends to consider whether and how these firms should be in scope of application of other future prudential requirements, including the Basel 3.1 reforms on which the PRA intends to consult in the fourth quarter of this year.⁴ The PRA is seeking to ensure small firms only experience one change to the applicable risk-based capital framework. Accordingly, the PRA intends to consult on an approach that would enable Simpler-regime Firms to remain subject to requirements substantially the same as the currently applicable UK Capital Requirements Regulation (CRR) during any interim period between the PRA's implementation of Basel 3.1 and the implementation of measures under the simpler regime. In addition, the PRA intends to consult on permitting a firm that meets the Simpler-regime Firm definition to choose to be subject without delay to the PRA's implementation of the Basel 3.1 reforms. This would ensure the Basel 3.1 reforms could apply to firms at the earliest opportunity in the cases where they considered it appropriate given the nature and scale of their activities.

1.13 Notwithstanding the intention to consult on this basis, there may be circumstances in which the PRA might consider this position to be inappropriate for a firm that meets the Simpler-regime Firm definition. Where it advances the PRA's general objective to promote the safety and soundness of the firms it regulates, the PRA may, on a case-by-case basis, consider using its powers under section 55M of Financial Services and Markets Act 2000 (FSMA) to require firms to comply with the prudential requirements that apply to firms that do not meet the definition.

1.14 The PRA plans to publish proposals for simplified prudential requirements under the simpler regime in two distinct phases. Phase 1 is likely to focus mainly on aspects of prudential regulation

⁴ Basel 3.1 is the final package of banking prudential reforms developed in response to the 2008/09 financial crisis. It will make significant changes to the way firms calculate Risk Weighted Assets. For further information, please see: <https://www.bankofengland.co.uk/news/2022/march/implementation-of-basel-standards>.

that are not related to capital requirements (eg liquidity regulation). The PRA expects to publish these proposals within the first half of 2023. Phase 2 is likely to focus mainly on capital requirements. The PRA expects to publish those proposals in 2024. The PRA would be interested in views on what further information about timings stakeholders would find useful.

1.15 Once its proposals for the simpler regime have been significantly progressed, the PRA would consider whether and how to build out higher layers of the strong and simple framework. In particular, as it develops its proposals for simplified prudential requirements under the simpler regime, the PRA will consider whether its objectives would be advanced by applying any of these proposals to a wider range of non-systemic firms than just Simpler-regime Firms.

Summary of proposals

1.16 The proposals in this CP are intended to introduce a definition of a Simpler-regime Firm.

Implementation

1.17 The PRA plans to consult on other aspects of the simpler regime layer of the strong and simple framework, including the requirements that would apply under this regime, within the first half of 2023. The second set of proposals are likely to follow in 2024.

1.18 The PRA will publish a Policy Statement (PS) on the definition of a Simpler-regime Firm later in 2022 or 2023.

1.19 The PRA would also need to take account of other changes to prudential regulation that are planned.

Responses and next steps

1.20 This consultation closes on Friday 22 July 2022. The PRA invites responses on the proposals set out in this consultation. Please address any comments or enquiries to CP5_22@bankofengland.co.uk. Please indicate in your response if you believe any of the proposals in this consultation paper are likely to impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be.

1.21 Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.⁵

⁵ For further information please see: <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>.

2 Proposals

2.1 The simpler regime is intended for small firms that are not systemically important and are focused on deposit-taking from, and lending to, households and corporates in the UK. As such, the PRA's proposals for a definition of a Simpler-regime Firm and the criteria in this definition (the 'scope criteria') are designed relative to the aims of the regime, reflecting the attributes that are indicative of smaller, less complex firms. For example, the proposed criteria are designed and calibrated to include smaller firms that operate primarily in the UK domestic markets, and do not necessarily need to be subject to complex prudential requirements to ensure their safety and soundness. In practice, the proposed definition of a Simpler-regime Firm would capture existing firms and small firms entering the market focused on providing banking services to UK households and corporates.

2.2 The PRA proposes to introduce a number of objective and transparent criteria for assessing whether a firm meets the definition. The PRA proposes a firm must meet all of the below criteria to be considered a Simpler-regime Firm.

Size

2.3 In DP1/21, the PRA explained that smaller firms tend to face higher average costs of understanding, interpreting, and operationalising prudential regulation. Since the simpler regime would be intended for those firms that experience the complexity problem most acutely, the PRA considers it necessary to include in the Simpler-regime Firm definition a size criterion based on an objective and easily observed measure.

2.4 The PRA proposes a maximum size threshold of £15 billion of total assets, where total assets are as defined in the financial reporting framework (FINREP)⁶ and calculated using the average of the firm's total assets it was required to report during the previous 36 months in accordance with Rule 7.1 of the Regulatory Reporting Part of the PRA Rulebook. For example, a firm that has been operating for at least three years, and is required to report its total assets quarterly, would use the average of the 12 quarterly values reported in the previous 36 months,⁷ whereas a firm that has been operating for less than three years would use the average of those quarterly values it has reported during the time it has been operating. A firm that has not been required to report its total assets at least once in the previous 36 months would meet the criterion if it forecasts that it will meet the size threshold on the first occasion it is required to report. This means it would be possible for small new firms that have not yet reported total assets to meet the size criterion.

2.5 The PRA also recognises that in the case of a merger, acquisition, a disposal of entities or activities, or similar circumstances, using a three-year average to calculate total assets could lead to an inappropriate assessment of whether a firm meets the size criterion. Therefore, in future consultations on the prudential requirements for Simpler-regime Firms, the PRA intends to set out its proposals for how a firm would be treated in such circumstances to deliver the appropriate outcome.

2.6 The PRA proposes to use total assets averaged over a 36 month window in order to smooth out the impact of any fluctuations in total assets when considering whether a firm meets the Simpler-regime Firm definition and to give a growing firm time to prepare for ceasing to meet the definition.⁸

⁶ FINREP Template 1.1, Balance Sheet Assets (Template code F01.01) at cell 03080.

⁷ In accordance with the reporting frequencies requirements in Rule 7.2 Chapter 7 of the Regulatory Reporting Part of the PRA Rulebook.

⁸ This is because a firm whose total assets increase from below £15 billion to above £15 billion would not necessarily cease to meet the definition immediately, but only after its total assets have been above £15 billion for long enough for its 36 month average total assets to exceed the threshold.

The PRA considers these consequences of using total assets averaged over a 36 month window would be beneficial for firms that meet the definition when the simpler regime has been introduced.

2.7 A threshold of £15 billion would ensure firms have room for growth within the future simpler regime, since a high number of smaller firms have total assets significantly below £15 billion. While the PRA is seeking to choose a size threshold that covers the firms that are likely to experience the complexity problem most acutely, the PRA also wants to avoid creating new barriers to growth for small firms and it would be interested in views on whether the proposed threshold is high enough to achieve this outcome. The PRA considers its proposal makes use of a definition of total assets used for existing regulatory reporting, and therefore should be straightforward for all firms to calculate.⁹

Limited trading activity

2.8 The PRA considers that trading activity is not an activity consistent with the aims of the simpler regime, since it necessitates relatively complex prudential requirements that capture the range of financial instruments that firms might trade, different factors affecting the value of a position (for example, specific market risk versus general market risk), and the nature of a position (such as residual maturity, whether it is short or long). Consequently, in order to achieve meaningful simplification of the prudential framework for firms, the PRA considers it appropriate that only firms with no or minimal trading books should be in scope of any future simpler regime.

2.9 The PRA proposes to align the limited trading activity scope criterion to the thresholds already used in the Trading Book (CRR) Part of the PRA Rulebook to define small trading book business.¹⁰ A firm meeting this definition is permitted to use the credit risk framework to calculate capital requirements for its trading book business, rather than also being required to calculate market risk capital requirements for interest rate and equity position risk. However, the derogation does not exempt firms from calculating market risk capital requirements for foreign exchange and commodities risks (whether those risks arise from trading book or banking book positions). This is discussed in more detail in paragraphs 2.12 and 2.13.

2.10 In order to be considered a Simpler-regime Firm, the PRA proposes that a firm must have an on-and off-balance sheet trading book business that would be equal to, or less than, both of the following thresholds:

- 5% of the firm's total assets; and
- £44 million.

2.11 In accordance with the definition of a small trading book business in the CRR, whether a firm meets these thresholds should be based on an assessment carried out on a monthly basis using the data as of the last day of the month.

2.12 For the purposes of the Article 94 Derogation for Small Trading Book (in the Trading Book (CRR)), firms are required to exclude foreign exchange positions and commodities positions from the calculation of the size of their trading book business.¹¹

2.13 The PRA does not consider significant foreign exchange or any commodity positions consistent with the aims of the simpler regime. Given this consideration, and its aim to deliver meaningful

⁹ Rule 7.1 Chapter 7 of the Regulatory Reporting Part of the PRA Rulebook.

¹⁰ Article 94.1 of the Trading Book (CRR) Part of the PRA Rulebook, Annex B, Chapter 3.

¹¹ Article 94.1 of the Trading Book (CRR) Part of the PRA Rulebook, Annex B, Chapter 3.

simplification of the prudential framework for firms, the PRA proposes that to be a Simpler-regime Firm:

- the sum of a firm's overall net foreign exchange position, as defined in Article 351 in CRR, must be equal to or less than 2% of the firm's own funds; and
- a firm must have no commodity positions.

No internal ratings based approach

2.14 The PRA considers that internal ratings based (IRB) models can be complicated to develop and validate, and consequently are generally only used by firms that have sufficient scale and skilled resource to be able to meet the development and model approval process costs. The PRA further considers IRB model approval for regulatory capital calculation purposes is governed by an extensive set of prudential rules and guidance, significantly expanding the number and complexity of requirements applying to these firms. For this reason, the PRA proposes a firm must not have any IRB approvals to meet the definition of a Simpler-regime Firm. This would mean that when the definition is used to determine the scope of the simpler regime, the PRA would be able to deliver more simplification than would otherwise be the case, without reducing safety and soundness.

2.15 However, the PRA also considers there are benefits of IRB modelling for a firm's understanding of its prudential risks, and that a more risk-sensitive allocation of regulatory capital can be a key input for the product pricing systems needed to deliver a balanced credit portfolio that is within the firm's risk appetite. For this reason, the PRA proposes that firms that wish to develop IRB models and submit an IRB application would be able to do so, while continuing to meet the Simpler-regime Firm definition. A firm would only cease to meet the definition when the model has regulatory approval, and hence will be using the model to calculate its capital requirements going forward.¹²

Exclusion of firms providing certain clearing, settlement, and custody services

2.16 The PRA considers that firms with specialist business models that focus on the provision of certain types of services to other banks and building societies are not within the target population for a simpler regime, due to their increased interconnectivity with the wider financial system and the specific types of risk that their business model poses. The PRA further considers that the inclusion of firms with such specialist business models within a simpler regime may also limit the extent to which prudential requirements could be simplified for other Simpler-regime Firms, since more complex rules would need to be included in the regime to maintain the safety and soundness of all Simpler-regime Firms.

2.17 The PRA proposes therefore to exclude from the definition of a Simpler-regime Firm:

- firms that, as any part of their business activity, provide clearing, settlement, custody or correspondent banking services (including by acting as an intermediary) to another bank or building society, wherever based. The affected services would include providing the other bank or building society with access to the facilities or services of financial market infrastructure (FMI) of which the firm is a direct or indirect member or participant, and also providing access

¹² Application under Article 143 of Regulation (EU) No 575/2013 for permission to use the IRB Approach.

to an exchange, other trading facility, payment system of any other financial market utility or infrastructure; and

- firms that operate payment systems.

2.18 While this exclusion would apply to the provision of services to other banks and building societies, the PRA intends to monitor developments in the payments clearing market to determine whether, in future, it should be extended to cover payment and transaction settlement services provided to other types of counterparty.

Domestic activity

2.19 The PRA considers that a firm's geographical footprint is a relevant factor for whether a firm should be considered a Simpler-regime Firm. The extent of international banking activity may be an indicator of firm's complexity. A further consideration is that Basel standards are designed in principle for internationally active banks; therefore, the PRA would not deviate from those standards by applying a simpler regime to firms that are domestically focused. The PRA considers that UK adherence to the Basel standards for internationally active banks contributes to global financial stability, which in turn supports the safety and soundness of PRA-authorized firms, and UK financial stability.

2.20 Consequently, the PRA considers that only firms whose activity is primarily based in the UK, and focused on UK-based customers or counterparties, should be considered Simpler-regime Firms. The PRA proposes that at least 85% of a firm's credit exposures must be to obligors located in the UK for a firm to be a Simpler-regime Firm, where exposures means the exposures reported in COR001a, table C 09.04. In calculating these exposures to UK obligors and to obligors in all countries, a firm should use the geographical location of exposures reported in COR001a, table C 09.04, and exclude the exposure classes referred to in points (a) to (f) of Article 112 of the CRR.

2.21 The PRA considers that this definition of exposures should provide an accurate assessment of a small firm's geographical footprint. A further reason for basing the proposed criterion on the measure used in the COR001a C 09.04 return is that the return is completed by all firms, whereas other existing regulatory returns that provide a geographical breakdown of exposures are currently not required of all firms.¹³

Level of application of scope criteria

2.22 The PRA proposes that standalone firms that are not part of a UK consolidation group would apply the scope criteria on a solo basis.

2.23 Subsidiaries of large groups may be less likely to face the complexity problem than comparably sized standalone firms because they may be able to access group resources to help them understand, interpret, and operationalise prudential requirements. In those cases, the costs of understanding, interpreting, and operationalising prudential requirements may be more likely to be proportionate to the public policy benefits. Therefore, to ensure firms meeting the Simpler-regime Firm definition advances the PRA's objectives, the PRA considers that the broader group should be taken into account when determining whether a firm meets the definition; ie the simpler regime would apply to small banks and building societies, not small units of large groups.

¹³ Paragraph 3.4.3.1. in Annex II: instructions for reporting on own fund and own fund requirements: <https://www.bankofengland.co.uk/prudential-regulation/regulatory-reporting/regulatory-reporting-banking-sector/banks-building-societies-and-investment-firms>.

2.24 Therefore, the PRA proposes that whether a firm is a Simpler-regime Firm should be assessed at the highest level of the UK consolidation group. This would mean a firm meets the definition if it and the UK consolidation group of which it is part, and all the banks and building societies within the UK consolidation group, meet the scope criteria. This is achieved when:

- the scope criteria other than those in paragraph 2.17 are met by the firm, the UK consolidation group on a consolidated basis, and each of the banks and building societies within the UK consolidation group; and
- the scope criteria in paragraph 2.17 are met by the firm and each of the banks and building societies within the UK consolidation group.

2.25 The PRA's approach to the supervision of international banks is one of 'responsible openness'.¹⁴ The PRA is open to international banks operating in the UK as long as they meet the standards the UK expects and are capable of being effectively supervised. Consistent with this approach, the PRA considers that the simpler regime could be the appropriate prudential regime for a firm that is a UK subsidiary of a group based outside of the UK (including a firm that has a holding company outside of the UK) if it suffers from the complexity problem.

2.26 As explained above, whether a firm that is part of a group based outside of the UK – be that a subsidiary of a foreign-headquartered banking group or a firm with a foreign holding company – suffers from the complexity problem may depend, in part, on the size and activities of the group outside of the UK; that is, it would be necessary to look beyond the highest level of consolidation in the UK. The proposed definition of a Simpler-regime Firm would not operate effectively beyond the UK consolidation level because it may be more complex to apply the criteria at the global level of groups to which firms belong and balance-sheet data at the global level of these groups are not reported to the PRA. However, the PRA intends that a firm that meets the scope criteria on the basis set out in paragraph 2.24, and is part of a group based outside of the UK would be able to apply for a waiver or modification to be treated in the same way as a Simpler-regime Firm for the purpose of applying Basel 3.1 and the simpler regime. In the assessment of an application for a waiver or modification, it would be possible to consider in each specific case whether the size and activities of the group at a global level are consistent with the firms suffering from the complexity problem.¹⁵ Where this is the case (and subject to the statutory tests being met) the PRA would expect that the firm would likely be able to access the simpler regime through this route, despite firms that are part of groups based outside of the UK not being included in the proposed definition. When the PRA consults on the use of the Simpler-regime Firm definition in rules determining the scope of application of prudential requirements, it intends to provide transparency around the PRA's policy considerations that would inform its assessment of an application for waiver or modification.

Application of the scope criteria

2.27 The PRA considers that the simpler regime should be the default prudential regime for Simpler-regime Firms. Consequently, the PRA is minded to propose in future consultations that a Simpler-regime Firm would be automatically in scope of the intended simpler regime and any interim capital requirements referred to in paragraph 1.12. However, in certain circumstances the PRA may need to assess a Simpler-regime Firm's eligibility on a case-by-case basis and may seek to exclude such a firm from the regime. For example, this could arise where the PRA does not have sufficient assurance

¹⁴ July 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pr-a-approach-to-branch-and-subsi-dary-supervision-ss>.

¹⁵ The assessment will be against the statutory tests.

that a Simpler-regime Firm's complexity or risk profile is consistent with the aims of the simpler regime and the PRA's objectives.

2.28 In addition, and as suggested in DP1/21, the PRA would look to consult on a mechanism that allows a firm to opt out; for instance, a rapidly growing firm that does not anticipate being eligible for those rules for a considerable period of time. The PRA may also consider introducing notification or reporting requirements, or both, if the PRA considers this necessary in order for it to verify that a firm is a Simpler-regime Firm.

2.29 The PRA intends to set out proposals for how a firm would transition from one set of rules to another when it becomes or ceases to be a Simpler-regime Firm (or treated in the same way as a Simpler-regime Firm as explained in paragraph 2.26). The PRA also intends to set out proposals for how a firm would be treated if it unexpectedly and temporarily becomes or ceases to be a Simpler-regime Firm.

Objectives and justification of proposals

2.30 Enacting the proposals set out in this chapter would enable the PRA to proceed with developing the simpler regime. The PRA considers that the simpler regime would advance its statutory objective to promote the safety and soundness of firms by simplifying prudential regulation for small firms, while maintaining their resilience. The PRA considers the simpler regime would also help to support effective competition in the UK banking sector.

2.31 The PRA has considered the have regards in relation to the proposals in this chapter, including growth and competition, the relative standing of the UK, relevant international standards, proportionality and different business models, and the efficient and economic use of resources. The PRA considers its proposals would not result in significant additional costs for firms because they are based on measures or information that firms should already be collecting.

3 The PRA's statutory obligations

3.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. The PRA has a statutory duty to consult when introducing new rules (FSMA s138J) or new standards instruments (FSMA s138S). When not making rules, the PRA has a public law duty to consult widely where it would be fair to do so

3.2 The PRA fulfils its statutory obligations and public law duties by providing the following in relation to the proposed policy:

- (i) **a cost benefit analysis;**
- (ii) **compatibility with the PRA's objectives:** an explanation of the PRA's reasons for considering that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective,¹⁶ insurance objective¹⁷ (if applicable), and secondary competition objective;¹⁸
- (iii) **FSMA regulatory principles:** an explanation of the ways in which having regard to the regulatory principles has affected the proposed rules;¹⁹
- (iv) **CRR rules:** in addition to the above, FSMA requires the PRA to 'have regard' to several further matters when making CRR rules.²⁰ It also requires the PRA to explain how the new 'have regards' have affected its proposed rules.²¹ Furthermore, when making CRR rules, the PRA is required to 'consider, and consult the Treasury about, the likely effect of the rules on relevant equivalence decisions';²²
- (v) **impact on mutuals:** a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons;²³
- (vi) **HM Treasury recommendation letter:** the Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury;²⁴ and
- (vii) **equality and diversity:** the PRA is also required by the Equality Act 2010²⁵ to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services, and functions.

3.3 Appendix 2 lists the statutory obligations applicable to the PRA's policy development process. The analysis in this chapter explains how the proposals have had regard to the most relevant matters listed in paragraph 3.2, including an explanation of the ways in which having regard to these matters has affected the design of the scope criteria.

¹⁶ Section 2B of FSMA.

¹⁷ Section 2C of FSMA.

¹⁸ Section 2H(1) of FSMA.

¹⁹ Sections 2H(2) and 3B of FSMA.

²⁰ Section 144C(1) of FSMA. Part 9D FSMA (s144) defines CRR rules as PRA general rules related to either (i) provisions of the UK CRR revoked by HMT or (ii) 'CRR Basel standards' (as defined under s4 of the FS Act 2021). CRR rules also include rules made under section 192XA, which gives powers to the PRA to make rules in relation to specific matters and applying to financial holding companies and mixed financial holding companies that are approved or designated by the PRA ('Holdco rules').

²¹ Section 144D of FSMA.

²² Section 144C(3) of FSMA.

²³ Section 138K of FSMA.

²⁴ Section 30B of the Bank of England Act 1998.

²⁵ Section 149.

Definition of a Simpler-regime Firm

3.4 The PRA is proposing a definition of a Simpler-regime Firm. The PRA considers that the proposed definition would be a necessary first step towards creating a simpler prudential regime for small firms, the first layer of the strong and simple framework that the PRA intends to build.

3.5 The PRA considers that its proposed definition – including the criteria that a firm must satisfy to be a Simpler-regime Firm – would advance its primary objective, ensuring any burden on firms is proportionate to benefits.

Cost Benefit Analysis

3.6 This section sets out an analysis of the costs and benefits of introducing the proposed definition of a Simpler-regime Firm.

3.7 The PRA considers that its analysis does not include quantitative estimates of the costs of and benefits that could arise were the definition used to determine the scope of application of prudential rules in the future. When the PRA proposes to do that, the associated costs and benefits will be accounted for in the cost benefit analysis in the respective consultations of those proposals.

3.8 The baseline for the calculations in this section is that the proposed definition of a Simpler-regime Firm and the simpler regime are not introduced.

Affected firms and markets

3.9 The PRA has sought to estimate the number of firms that would be Simpler-regime Firms, were the proposals in place now. The estimates are presented in Table 1, below. The estimates suggest 61 of the 198 firms in the sample could be Simpler-regime Firms. 34 of these firms are building societies.

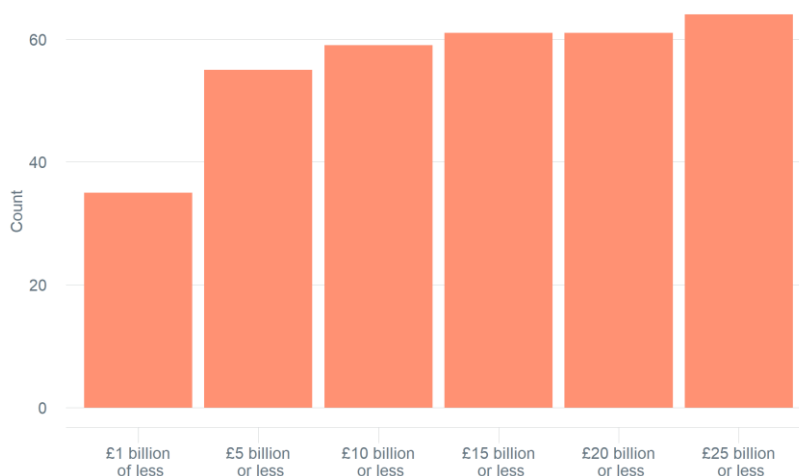
Table 1 Estimates of the number of Simpler-regime Firms²⁶

Type of firm	Number
All	61
of which:	
Building societies	34

Source: PRA; Bank of England calculations.

3.10 Chart 1 shows the impact of the calibration of the size threshold on the estimated number of Simpler-regime Firms. Many firms have total assets less than the proposed threshold of £15 billion, which means that many firms would have room to grow while remaining in the simpler regime under the proposal. Not many additional firms would meet the scope criteria if the size threshold were set at a value higher than £15 billion.

²⁶ The table is based on the lists of banks incorporated in the UK and building societies that the PRA regulates as of 1 December 2021, which are available at <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/authorisations/which-firms-does-the-pra-regulate/2021/list-of-banks/banks-list-2112.pdf> and <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/authorisations/which-firms-does-the-pra-regulate/2021/list-of-building-societies/building-societies-list-2112.pdf>. The estimates are based on regulatory returns data and staff judgement.

Chart 1: Impact of varying the size threshold on the estimated number of Simpler-regime Firms

Source: PRA; Bank of England calculations.

3.11 Under the proposed definition, Simpler-regime Firms will be focused on deposit-taking, and retail and commercial lending in the UK. They will not be active in wholesale markets. They represent a relatively small share of the UK banking sector.

Benefits

3.12 The PRA considers that a direct benefit of consulting on the Simpler-regime Firms definition is that it gives stakeholders early visibility on this key building block of a simpler regime.

3.13 Since the proposed definition is a building block of the simpler regime, the PRA considers the proposed definition could generate indirect benefits. The PRA considers that its future simpler regime should make prudential rules simpler for firms meeting the proposed definition without reducing standards of safety and soundness. This could reduce costs faced by small firms, which should increase their resilience. It could also encourage greater entry into the UK banking sector, which would increase competition.

3.14 The PRA is not consulting on rules that depend on whether a firm meets the definition of a Simpler-regime Firm in this CP. Therefore, the PRA considers the indirect benefits of the proposals cannot reasonably be estimated here.²⁷ When the PRA proposes rules, which use this definition to determine the application of the rule, the PRA will produce estimates of the benefits of doing so.

Costs

3.15 The PRA considers that to determine whether it is a Simpler-regime Firm, a firm will need to calculate the measures that underpin the proposed scope criteria. Firms may incur additional costs as a result.

3.16 However, the PRA does not consider there would be significant additional costs for firms in particular, because the PRA has sought as far as possible to use existing definitions and measures in the design of the proposed scope criteria. The proposed size and domestic criteria are based on measures that all PRA-authorized firms are required to calculate for reporting purposes.²⁸ The proposed limited trading activity criterion is based on measures that all firms are required to

²⁷ Section 138J of FSMA, paragraph 8.

²⁸ Article 5 Individual Basis – Quarterly Reporting - Prudential Regulation Authority: <https://www.prarulebook.co.uk/rulebook/Content/Chapter/413595/29-04-2022>.

calculate in order to understand how the CRR applies to them. All firms should know whether they have approval to use internal models for the purposes of calculating their capital requirements, and whether they are providing clearing, settlement, and custody services to banks and building societies or operating a payment system.

PRA objectives

3.17 The PRA's proposal will enable it, in the future, to propose changes to prudential regulation for Simpler-regime Firms that will simplify regulation for these firms while maintaining their resilience.

3.18 Prudential requirements that are overly complex for small firms²⁹ could increase those firms' costs, thereby potentially reducing their safety and soundness. Higher costs may induce small firms to increase their risk taking, which could reduce their safety and soundness. Therefore, a simpler prudential regime that maintains resilience should benefit the PRA's statutory objective to promote safety and soundness.

3.19 The PRA considers a simpler prudential regime would furthermore facilitate effective competition, thereby supporting its secondary competition objective. Potential higher costs (due to overly complex prudential regulation) could deter new entrants, which in turn could impede the PRA's secondary competition objective.

Have regards

3.20 To a certain extent the PRA's consideration of the have regards extends beyond the Simpler-regime Firm definition, and reflects the PRA's wider objectives for a future simpler regime, and the strong and simple framework as a whole. However, the PRA's consideration of the have regards has particularly affected its proposals concerning the definition.

FSMA Regulatory Principles

3.21 In developing these proposals, the PRA has had regard to the regulatory principles. The following principles are of particular relevance.

3.22 The need to use the resources of the PRA in the most efficient and economic way: The PRA considers the proposed definition would be a key building block of the simpler regime, which firms would need to understand in order to respond to future consultations on the simpler regime and the Basel 3.1 reforms. In addition, the PRA is aiming to reduce pressure on its resources by consulting on the Simpler-regime Firm definition through this CP, rather than at the same time as it consults on the Basel 3.1 reforms later in 2022.³⁰ Furthermore, by considering the interdependencies between the simpler regime and other future policy proposals, as well as further powers required to implement the simpler regime, the PRA is minded to consult on the regime with a phased approach, as set out in paragraph 1.14.

3.23 The principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden: The PRA considers that the scope criteria have been designed to capture the greatest number of firms experiencing the complexity problem. This would ensure as many firms as possible could benefit from the simpler regime, and to be based on measures and information that firms already collect. In addition, the PRA considers its layered approach to the strong and simple framework

²⁹ As set out in paragraph 1.1 of this CP.

³⁰ March 2022: <https://www.bankofengland.co.uk/news/2022/march/implementation-of-basel-standards>.

reflects the diversity of sizes and business models of firms that are not considered systemically important or internationally active.

3.24 The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term: The PRA has identified that small firms suffer most from a complexity problem. The PRA considers that a simpler regime that mitigates the complexity problem may reduce small firms' compliance costs, promoting longer-term growth. Therefore, in designing the size criterion proposals, the PRA has proposed a maximum size threshold of £15 billion of total assets. Since a significant number of Simpler-regime Firms have total assets below £15 billion, the PRA considers the threshold of £15 billion would ensure that firms have room for growth within the simpler regime. In addition, the PRA considers its proposal to calculate assets based on the average, over a 36 month period, should enable firms to grow for longer within the regime.

3.25 The desirability, where appropriate, of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried out by different persons: The PRA considers the proposed scope criteria has been designed to capture as many firms that may experience the complexity problem as possible. However, in designing the proposed criteria on no use of IRB, exclusion of firms providing certain clearing, settlement, and custody services, and limited trading activity, the PRA considers that firms with specialist business models would require specific rules to ensure their safety and soundness, which could introduce further complexity to the simpler regime. The proposed regime would be intended for small firms focused on deposit-taking from, and lending to, households and corporates in the UK. As noted above, the PRA considers that prudential requirements that are overly complex for small firms could increase those firms' costs, which could reduce their safety and soundness. Consequently, the PRA proposes excluding firms from the regime based on these criteria.

3.26 The principle that the regulators should exercise their functions as transparently as possible: While this consultation does not make any operative proposals, and only seeks to consult on a proposed definition, the PRA intends to use the proposed definition in future operative proposals and any consultations on the application of the definition to future prudential requirements. Therefore, the PRA considers the definition of a Simpler-regime Firm to be a key building block of the simpler regime, and that it is therefore appropriate to consult on this definition.

CRR Rules

3.27 This CP does not propose making any CRR rules, however, the definition of a Simpler-regime Firm may be used in future CRR rules, therefore the PRA has considered the additional have regards applicable to CRR rules. The following have regards are particularly relevant in the design of the scope criteria.

3.28 Finance for the real economy, growth, and sustainable growth: See above, in paragraph 3.24.

3.29 Relative standing of the UK: The PRA intends that UK firms that are subsidiaries of foreign groups could be treated in the same way as Simpler-regime Firms, provided they experience the complexity problem. This is consistent with the PRA's approach of responsible openness to the supervision of international banks. However, to ensure appropriate firms are in the simpler regime, for the reasons set out in paragraph 2.26, the PRA also proposes the use of an application for a waiver or modification that would allow the PRA to assess whether a firm that is part of a group based outside the UK can be treated in the same way as a Simpler-regime Firm. The PRA considers that allowing firms that are part of foreign groups to access the simpler regime via waiver or modification should not put these firms at a competitive disadvantage, therefore maintaining the relative standing of the UK as a place for international firms to do business.

3.30 Relevant international standards: The PRA considers that it has designed the domestic activity criterion with regard to the relevant standards recommended by the Basel Committee on Banking Supervision. Basel standards are designed in principle to be applicable to internationally active banks. Therefore, the PRA considers that it would not depart from these standards by applying the simpler regime to firms that are domestically focused. The Basel Core Principles for Effective Banking Supervision are expected to be applied to the whole banking sector, but allow for proportionality in their application. Therefore, the PRA considers that applying a simpler regime to firms that are domestically focused would be consistent with the Core Principles. The PRA considers that UK adherence to the Basel standards for internationally active-banks and the Basel Core Principles for Effective Banking Supervision contributes to global financial stability, which in turn supports the safety and soundness of PRA-authorised firms and UK financial stability.

3.31 Climate change Act 2008 (Carbon Target for 2050): The PRA does not consider that the proposals will have any adverse impact on the carbon target for 2050 as set out in section 1 of the Climate Change Act 2008.

3.32 The PRA has considered the remaining matters to which it should have regard when making CRR rules (see references in Appendix 2), and considers that they are less significant in the PRA's analysis of the proposal.

Impact on mutuals

3.33 FSMA requires that the PRA assess whether, in its opinion, the impact of the proposed rules on mutuals will be significantly different from the impact on other firms, and if so, provide details of the difference. The PRA expects the proposed definition would capture mutuals, which would benefit from a simpler prudential regime.

HM Treasury recommendation letter

3.34 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.

3.35 Competition: The PRA considers that small firms suffer most from a complexity problem. A simpler regime that mitigates that problem may reduce small firms' compliance costs. The PRA considers this would allow small firms to compete more effectively and to attract entry to the UK banking sector.

3.36 Growth: See above, in paragraph 3.24.

3.37 Competitiveness: See above, in paragraph 3.29.

3.38 Better outcomes for consumers: improved competition in the banking sector (see above, in paragraph 3.35) could lead to better outcomes for consumers.

3.39 Innovation: as set out above in paragraphs 3.23, 3.25, and 3.35, the PRA considers the simpler regime will be more proportionate for small firms, recognise the differences in the nature of their business models, and would allow small firms to compete more effectively and attract new entry. Consequently, the proposals may improve innovation.

3.40 Climate change: as set out above in paragraph 3.31, the PRA does not consider the proposals will have any adverse effect on the carbon target for 2050, or on the Government's energy security strategy set out in the letter from the Chancellor to PRC.³¹

3.41 Trade: The PRA has considered this aspect of the Government's economic policy and considers that is less significant in the PRA's analysis of the proposals.

Equality and diversity

3.42 In making its rules and carrying out its policies, services, and functions, the PRA is required by the Equality Act 2010 to have due regard to the need to eliminate discrimination, to promote equality of opportunity, and to foster good relations between persons who share a protected characteristic and those who do not. In line with its responsibilities under the Equality Act, the PRA has performed an assessment and considered the equality implications in formulating its proposals. The PRA will continue to consider the equality and diversity implications of the proposals during the consultation period and in relation to further consultations concerning future operative proposals.

³¹ April 2022:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1067015/Recommendations_for_the_Prudential_Regulation_Committee_April_2022_final.pdf.

Appendices

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1 Draft [PRA Rulebook Instrument]

PRA RULEBOOK: SIMPLER-REGIME FIRMS (DEFINITION) INSTRUMENT 20xx

Powers exercised

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
 - (1) section 137G (The PRA’s general rules); and
 - (2) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Simpler-regime Firms (Definition) Instrument 20xx

- D. The PRA makes the rules in the Annex to this instrument.

Commencement

- E. This instrument comes into force on [DATE].

Citation

- F. This instrument may be cited as the PRA Rulebook: Simpler-regime Firms (Definition) Instrument 20xx.

By order of the Prudential Regulation Committee

[DATE]

Annex

AMENDMENTS TO GLOSSARY

In this Annex, the text is all new and not underlined:

...

Simpler-regime firm

means a *UK bank* or *building society* in respect of which the following conditions are satisfied:

- (1) Either
 - (a) if the *firm* has been required, in accordance with Chapters 6 and 7 of the Regulatory Reporting Part, to report its total assets using template F.01.01 of Annex III or IV to the Reporting (CRR) Part on one or more occasions in the preceding 36 *months*, the arithmetic mean of the total assets which it was required to report on those occasions does not exceed £15 billion; or
 - (b) If the *firm* has not yet been required to report its total assets as described above, the *firm* reasonably forecasts that, on the first occasion on which it will be required to do so, the figure that it will be required to report will not exceed £15 billion.
- (2) At least 85% of the *firm's* relevant credit exposures are located in the *UK*, as determined in accordance with the instructions in point 3.4.3 of Part II of Annex II to the Reporting (CRR) Part for the completion of template C 09.04 of Annex I to that Part.
- (3) On the last day of the preceding *month* the size of the *firm's* on- and off- balance-sheet trading book business was equal to or less than both 5% of the *firm's* total assets and £44 million, on the basis of the assessment set out in Article 94(3) of Chapter 3 of the Trading Book (CRR) Part.
- (4) The *firm's* total net foreign exchange positions, calculated using the method set out in Article 352 of the *CRR*, do not exceed in value 2% of its own funds, where own funds has the meaning given in the *CRR*.
- (5) The *firm* does not hold positions in commodities or commodity derivatives.
- (6) The *firm* does not apply the Internal Ratings Based Approach to calculate its risk-weighted exposure amounts for credit risk.
- (7) The *firm* does not provide clearing, transaction settlement, custody or correspondent banking services to a *UK bank* or *building society*, or to a *credit institution* whose registered office or, if it does not have a registered office, whose head office, is outside the *UK*, including by acting as an intermediary for a *UK bank* or *building society* or such a *credit institution* to access the facilities or services of:
 - (a) a *payment system*, *CSD*, *third-country CSD*, *SSS* or *central counterparty* in which the *firm* is a direct or indirect participant or member, or
 - (b) an exchange, other trading facility, clearing house or any other financial market utility or infrastructure, either directly or indirectly.
- (8) The *firm* is not an *operator* of a *payment system*.
- (9) Any *undertaking* of which the *firm* is a *subsidiary* is a *UK undertaking*.
- (10) If the *firm* is a member of a *consolidation group*:

(a) conditions (1) to (6) are satisfied in respect of:

(i) the *CRR consolidation entity* on a *consolidated basis*, and

(ii) each *UK bank* and *building society* in the *consolidation group*,

and for this purpose references in those conditions to the *firm* are to be read accordingly;
and

(b) conditions (7) and (8) are satisfied in respect of each *UK bank* and *building society* in the *consolidation group*, and for this purpose references in those conditions to the *firm* are to be read accordingly.

...

CSD

has the meaning given in Article 2(1)(1) of *CSDR*.

...

CSDR

means Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

...

operator

in relation to a *payment system* has the meaning given in section 183 of the Banking Act 2009.

...

payment system

has the meaning given in section 182 of the Banking Act 2009.

...

SSS

has the meaning given in Article 2(1)(10A) of *CSDR*.

...

third-country CSD

has the meaning given in Article 2(1)(2) of *CSDR*.

...

2 PRA statutory obligations

The statutory obligations applicable to the PRA's policy development process are set out below. This CP explains the policy assessment of relevant considerations.

- Purpose of the policy proposals (FSMA s138J(2)(b)).
- Cost benefit analysis (FSMA s138J(2)(a) and (7)(a)); and an estimate of those costs and benefits (if reasonable) (FSMA s138J(8)).
- Analysis of whether the impact on mutuals is significantly different to the impact on other authorised firms (FSMA s138J(2)(c) and 138K).
- Compatibility with the PRA's primary objectives (FSMA s138J(2)(d)(i), 2B and 2C).
- Compatibility with the PRA's secondary competition objective (FSMA s138J(2)(d)(ii) and 2H(1)).
- Compatibility with the regulatory principles (FSMA s138J(2)(d)(ii), 2H(2) and 3B).
- Have regard to the HMT recommendation letter (BoE Act s30B).
- Have due regard to the public sector equality duty (Equality Act s149).
- Have regard, subject to any other requirement affecting the exercise of the regulatory function, to the principles of good regulation and when determining general policy or principles to the Regulators Code (Legislative and Regulatory Reform Act 2006 s21 & 22)
- Have regard, so far as consistent with the proper exercise of those functions, to the purpose of conserving biodiversity. Conserving biodiversity includes, in relation to a living organism or type of habitat, restoring or enhancing a population or habitat (Natural Environment and Rural Communities Act 2006, s40).
- Consultation of the FCA (FSMA s138J(1)(a)).
- *Where the consultation proposals a PRA rule change or amendment to onshored BTS that affects the processing of personal data - consultation with the Information Commissioner's Office (article 36(4) General Data Protection Regulation).*
- *For UK Technical Standards Instruments only:* FSMA s138J(1)(a) is replaced with: consultation of the FCA and/or Bank, where that Regulator has an interest in the technical standards (FSMA s138P(4) and (5)).
- *For UK Technical Standards Instruments only:* notice given to HMT of the consultation on the UKTS ('best efforts' basis).
- *For CRR rules only:* subject to certain exceptions, have regard to:
 - relevant standards recommended by the Basel Committee on Banking Supervision from time to time

- the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active credit institutions and investment firms to be based or to carry on activities. For these purposes, the PRA must consider the United Kingdom's standing in relation to the other countries and territories in which, in its opinion, internationally active credit institutions and investment firms are most likely to choose to be based or carry on activities

- the likely effect of the rules on the ability of CRR firms to continue to provide finance to businesses and consumers in the United Kingdom on a sustainable basis in the medium and long term

- the target in section 1 of the Climate Change Act 2008 (carbon target for 2050)

(s144C (1) & (2) FSMA – exceptions in s144E FSMA).

- *For CRR rules only* – explanation of the ways in which having regard to the matters specified above has affected the proposed rules (s144D FSMA).
- *For CRR rules only* – publication of a summary of the proposed CRR rules.
- *For CRR rules only* – consideration and consultation with the Treasury about the likely effect of the rules on relevant equivalence decisions (s144C (3) & (4) FSMA).