

# SUPERVISORY EXPECTATIONS FOR INTERNATIONAL BANKS IN THE UK



## INTRODUCTION

On 11 January 2021, the Prudential Regulation Authority (PRA) published a set of documents to outline its approach to international banks (including designated investment firms) operating in the UK, covering both subsidiary and branch structures.

This was expected.

After the end of the Brexit transition period in 2020, UK regulators were expected to outline the contours of the post-Brexit regulatory regime through a number of policy announcements. We see these documents as the first raft of policy and guidance pronouncements that will provide greater clarity about regulatory expectations over 2021 and beyond.

# WHAT DOCUMENTS HAVE BEEN ISSUED

The package of pronouncements include:

- Draft Consultation Paper, CP2/21 [“International banks: The PRA’s approach to branch and subsidiary supervision”](#)
- Draft Supervisory Statement, [“International banks: The PRA’s approach to branch and subsidiary supervision.”](#) This statement replaces SS1/18 [‘International banks: the Prudential Regulation Authority’s approach to branch authorisation and supervision’](#).
- Speech by David Bailey, [“Responsible openness: The PRA’s approach to supervising banks.”](#)

These documents outline the overall set of expectations from international banks operating in the UK, including them meeting threshold conditions. They also outline the PRA’s expectations regarding the receiving of information concerning the risks in the wider group and co-operation from other supervisory authorities.

## Applicability

These documents apply to PRA-authorized banks and designated investment firms that are headquartered outside of the UK or are part of a group based outside of the UK. Such firms are referred to as ‘international banks’ and include firms operating in the UK through a branch.

As the SS notes, the “PRA recognises that firms operating with deemed authorisations under the temporary permissions regime (TPR) may need additional time to adjust. Accordingly, these firms will not need to meet the expectations in this SS immediately, but will need to do so as soon as practicable and in any event by the time they are authorised by the PRA and exit the TPR.”

The PRA proposes that the implementation date for the final policy would be in the second quarter of 2021.

## Responding to the consultation

This consultation closes on Sunday 11 April 2021. The PRA invites feedback on the proposals set out in this consultation.

# KEY DRIVERS FOR THESE PROPOSALS

We see two key drivers for these updated expectations being published by the PRA:

**Driver 1:** The more immediate driver is Brexit and the need for the UK regulators to give further clarity around the post-Brexit expectations of international banks operating in the UK.

As the CP notes, “The proposals set out in this CP have been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.”

Equally, to clarify, **these expectations do not only apply to EU banks** operating in the UK through subsidiaries and branches but all international banks.

**Driver 2:** The second, and more secular driver, is the greater participation of international banks in the UK financial system over the last several decades. Currently, there are approximately 150 branches and 90 banking subsidiaries of international groups operating in the UK.

Furthermore, according to David Bailey, Executive Director for International Banks Supervision at the Bank of England, *“66 former EEA passported branches have entered the Temporary Permissions Regime and are applying for authorisation as third-country branches.”*<sup>1</sup>

The increasing presence and size of international banks in the UK financial sector over the last decade demonstrates the importance of efficient and effective supervision and regulation of international banks both operating and intending to operate in the UK in the future.

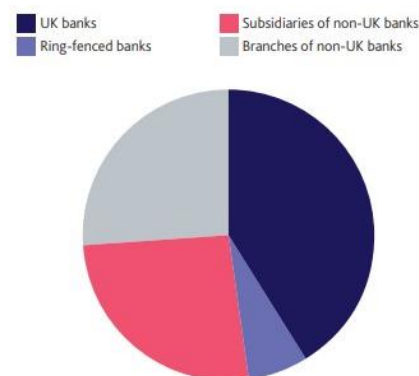
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<sup>1</sup>Bailey, D. (Presenter). (2021, January 11). *Responsible openness: The PRA’s approach to supervising banks* [Transcript]. Speech presented at Bank of England

Figure 1 highlights the breakdown of new bank authorisations in the UK with 24 subsidiaries and branches of foreign firms while Figure 2 maps the breakdown of the UK financial sector demonstrating extensive involvement of international banks in the sector.

While Figure 2 is based on 2015 figures, it gives insight into the internationalisation of the UK financial system over the years and the concomitant need to regulate international banks more closely.

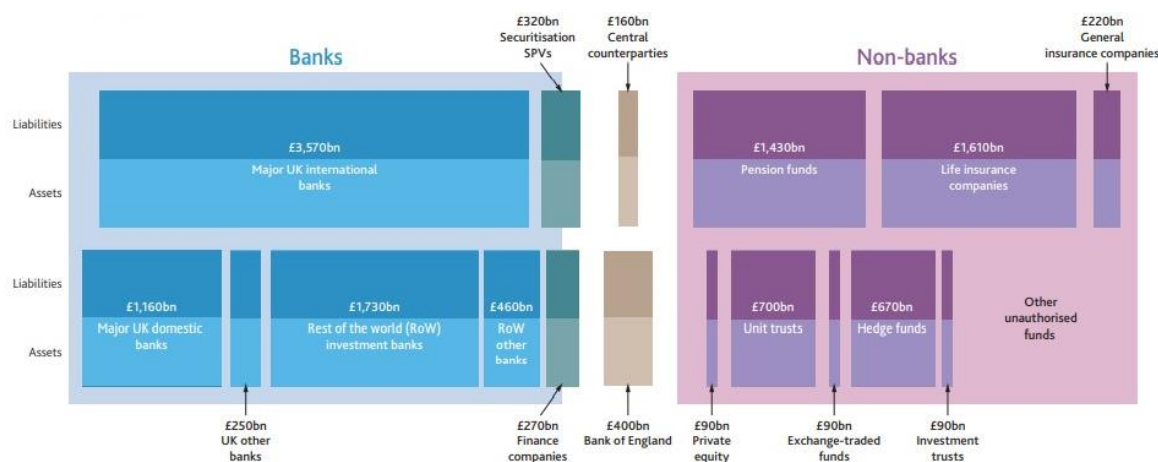
**Figure 1:** New bank authorisations since April 2013<sup>3</sup>



Source: Bank of England.

(a) Branches of non-UK banks includes one branch authorised as a result of structural reform.

**Figure 2:** Constituents of the UK financial system based on total financial assets excluding derivatives and cross-border exposures<sup>2</sup>



## KEY PROPOSALS

The PRA establishes that the supervisory expectations surrounding international banks operating in the UK will remain largely unchanged with a greater focus placed on improving the transparency of these expectations in the post-Brexit regime.

UK subsidiaries will continue to face the same regulatory requirements and supervisory framework as UK-based firms with attention paid to the links between the subsidiary and the rest of the group to determine the nature, scale and complexity of its UK operations. This will be influenced by the PRA's initial assessment of their operations.

For UK branches, PRA authorisation will apply to the whole firm and will thus require supervisory communication and information sharing with the home state supervisor. Branches will need to ensure that they review all local applicable requirements (e.g. regulatory permissions, reporting) at all times.

The PRA will assess the size, systemic importance, intended banking activities, and degree of independence of international banks operating in the UK to determine the appropriate authorisation category for each firm. Figure 3 highlights the PRA's expectations for international firms operating in the UK post-Brexit.

<sup>2</sup> Burrows, O., & Low, K. (2015). *A map of the UK financial system* [Infographic]. <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2015/mapping-the-uk-financial-system.pdf?la=en&hash=D595EEF9DB86963D2C97709A9ACC0D8BD3E79F03>

<sup>3</sup> *Breakdown of new bank authorisations since April 2013* [Chart]. (2019). Bank of England. <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2019/how-banks-are-authorised-in-the-uk.pdf?la=en&hash=05BEB568A11EE9F81BB077B3C7F74F501F97001E>

**Figure 3: PRA expectations for effective supervision<sup>4</sup>**



As noted above, where certain defined thresholds are crossed (e.g. total gross assets exceeding £15bn for wholesale businesses), the PRA will consider requiring a branch to be authorised as a subsidiary in the UK. Firms are required to review their current and planned business to ensure that they have sufficient time to organise their affairs appropriately in case they need to consider subsidiarisation. See Figure A in Appendix for additional considerations for branches.

### INTEGRATION AND INDEPENDENCE

As part of its supervisory review of international banks, the PRA will make an assessment of their integration with group/affiliate operations and their independence.

Based on the business model, risk profile and legal entity structure, these assessments will enable the PRA to effectively supervise international banks.

<sup>4</sup> Prudential Regulation Authority. (2021, January). International banks: The PRA's approach to branch and subsidiary supervision. Prudential Regulation Authority.

Figure 4: PRA's factors for assessing the degree of operational integration<sup>5</sup>

Factor	Summary Expectations
Governance	<ul style="list-style-type: none"> <li>• PRA expects a greater degree of independence of governance committees of subsidiaries</li> <li>• PRA expects some key positions on the subsidiary Board to not be occupied by executive members of the group or parent Board</li> <li>• For smaller firms where this expectation cannot be met, firms will be expected to justify how its governance arrangements satisfy expectations of independent oversight</li> <li>• The PRA could require certain actions (e.g. the proportion of independent nonexecutive directors on the board of the international bank)</li> <li>• To ensure effective supervision over UK branches, additional governance requirements may be required such as the assignation of additional branch SMFs</li> </ul>
Capital and Liquidity	<p><b>Capital</b></p> <ul style="list-style-type: none"> <li>• PRA will consider the risks of the wider group when assessing the systemic importance and degree of integration of the international bank, particularly regarding the PRA's capital buffer. A capital buffer is not required for branches</li> <li>• Firms which are determined to have weak risk management and governance structures may be required to hold a risk management and governance capital requirement as part of their PRA buffer</li> <li>• Firms with exposures to own group entities may be subject to large exposure limits but can apply for a non-core large exposures group permission with the PRA</li> </ul> <p><b>Liquidity</b></p> <ul style="list-style-type: none"> <li>• Liquidity guidance for a firm will be determined by the PRA on a case-by-case basis, considering integration of its activities and quality of its relationship with its home-regulator.</li> <li>• PRA may set additional branch liquidity requirements for firms.</li> </ul>
Booking risk management (See Figure B Appendix)	<ul style="list-style-type: none"> <li>• PRA will accept a wide range of booking models and will allow UK trading activity to be run on a global business model</li> <li>• The UK entity must remain responsible for ensuring a sufficient risk management level even if it relies extensively on its affiliates</li> <li>• PRA may require greater UK-based risk management or limited connectivity with the group for firms that fail to meet the following expectations: <ul style="list-style-type: none"> <li>○ Its controls are not commensurate to the risks posed by a complete booking arrangement</li> <li>○ There is inadequate visibility of the group risk profile, inadequate information sharing, or inadequate home state cooperation</li> <li>○ Booking arrangements would impede the execution of the resolution plan</li> </ul> </li> </ul>
Operational resilience	<ul style="list-style-type: none"> <li>• PRA expects firms to have high standards for managing operational resilience</li> <li>• If the PRA does not have sufficient understanding of how operational resilience is assured when a firm is dependent on group or overseas systems and processes, the PRA could ask the firm to become less dependent on those systems</li> </ul>
Resolution strategy	<ul style="list-style-type: none"> <li>• Firms which do not meet the following criteria may be supervised on a standalone basis until the PRA has confidence in the resolvability of the subsidiary: <ul style="list-style-type: none"> <li>○ Group resolutions are credible and feasible</li> <li>○ It is clear that the firm can rely on the home resolution authorities to execute the group's resolution strategy, including the home resolution authority's operational capability to implement a resolution and put in place adequate coordination mechanisms between home and host authorities</li> <li>○ There are no concerns regarding the delivery of an orderly resolution that is broadly comparable as those set out in the Bank of England's Statement of Policy (this does not apply to UK branches)</li> </ul> </li> </ul>
Structural profitability	<ul style="list-style-type: none"> <li>• At a minimum, UK subsidiaries should be working to become structurally profitable as standalone entities.</li> <li>• UK retail and wholesale businesses are expected to inform the PRA on the degree of cross-subsidy between the firm and the Group</li> <li>• Firms may still use the group service companies so long as operational resilience and continuity expectations are met.</li> </ul>

<sup>5</sup> Prudential Regulation Authority. (2021, January). International banks: The PRA's approach to branch and subsidiary supervision. Prudential Regulation Authority.

## **INFORMATION, COOPERATION AND CONTROLS**

As noted before, the proposals in relation to the supervisory expectations for branches and subsidiaries in the UK will vary according to the initial assessment of the size and systemic importance of the business as well as its degree of integration with overseas activities.

The PRA expects all firms operating in the UK to provide baseline information with additional disclosure requirements for highly integrated subsidiaries and systemic wholesale branches.

## **CONCLUSION**

These proposals signal to the market that the UK banking market remains open to business with appropriate, proportionate safeguards and mechanisms that UK regulators will enforce.

International branches and subsidiaries wishing to operate in the UK must re-evaluate existing business operations and risk management practices to ensure regulatory compliance under the PRA's clarified regime.

## **HOW CAN AVANTAGE REPLY ASSIST?**

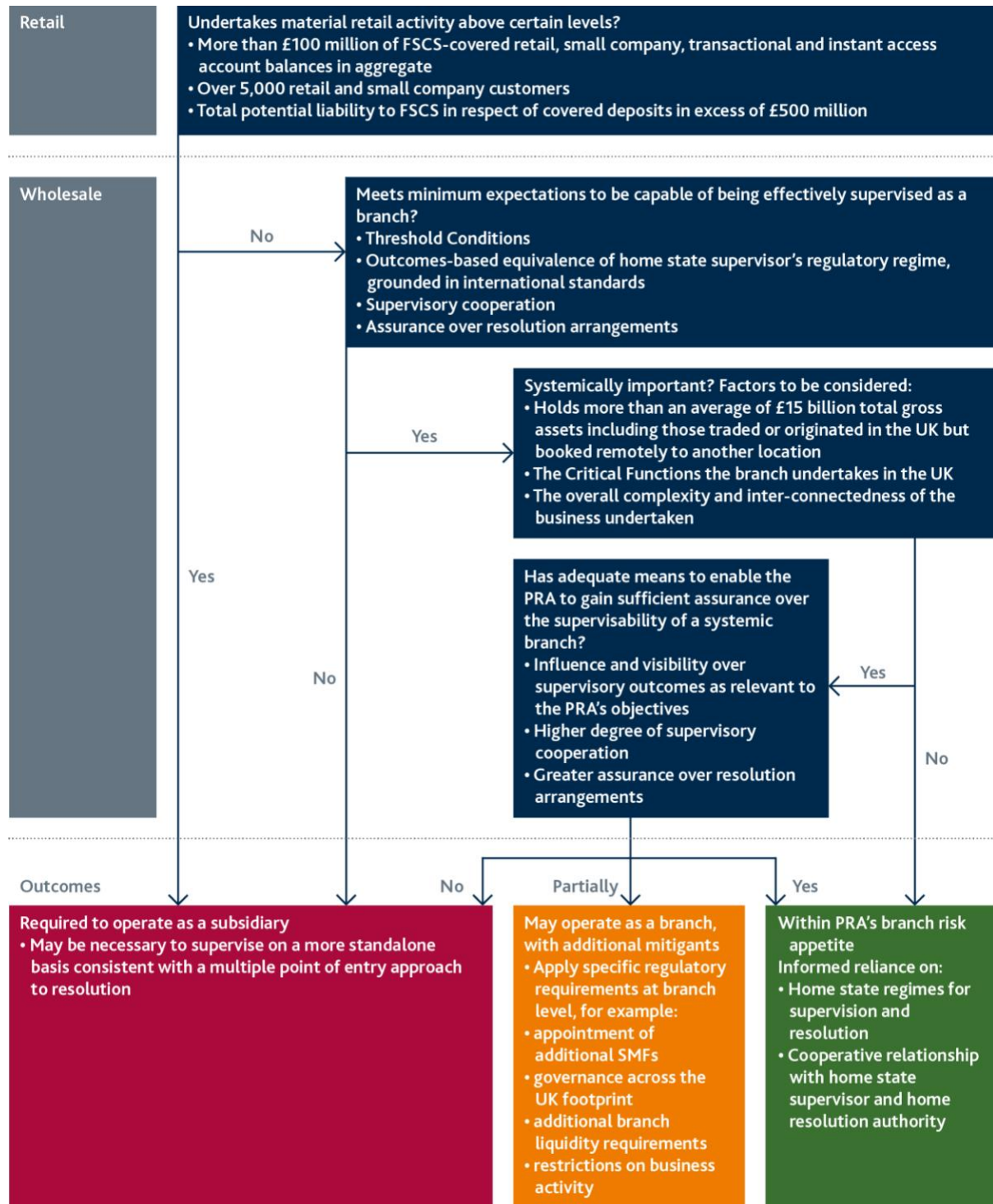
Avantage Reply have deep experience in working with international banks in relation to their risk, regulatory and compliance requirements.

Some of the key areas where we work with international banks:

- End to end review and development/enhancement of their compliance for prudential regulatory obligations (across capital, liquidity, recovery and resilience planning) and supporting alignment with regulatory expectations and industry practices;
- Supporting banks through TPR requirements and transitions;
- Supporting Target Operating Model (TOM) design and execution;  
Supporting a comprehensive view of international banks' reporting obligations and helping with implementation of industry leading solutions;
- Supporting international banks with an assessment of their regulatory fee obligations and liabilities;
- Summary self-assessments to help banks develop their programme of enhancement for regulatory and risk initiatives; and
- Programme management, transformation and delivery for "change the bank" initiatives.

# APPENDIX

Figure A: PRA considerations for branch authorisation and subsidiarisation



**Figure B:** *Expectations around booking arrangements*

*Expectations around booking arrangements<sup>1</sup>*

1. Firms with large-scale trading businesses should ensure that all risks, potential impacts, and risk management techniques are clear to both the PRA and home state supervisor
2. Firms should set out a clear rationale for their booking arrangements, document the booking arrangements, and have them approved by the appropriate governance body
3. Firms should have adequate systems and controls in place to ensure that intended booking arrangements are followed in practice
4. Firms with major trading activities should ensure that responsibility for ensuring that there are appropriate controls in place to manage its booking arrangements, including remote booking, is allocated to a senior management function (SMF)
5. The international bank should have an appropriate local risk management capability
6. There should be a broad alignment of risk and returns at the entity level
7. The firm's booking arrangements should not be an impediment to the firm's recovery and resolution or to any plan to wind down trading in a solvent and orderly fashion



## CONTACTS



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Audrey joined Avantage Reply after graduating from Cass Business School with a Master's degree in Actuarial Science and the University of Exeter with a Bachelor's in Economics and Finance. Audrey has recently supported the UK branch of an EU bank with its post-Brexit regulatory reporting requirements.

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### AVANTAGE REPLY

Avantage Reply, part of the Reply Group, specialises in Financial Services consulting with a focus on Risk Transformations, Treasury and Capital, Quantitative Modelling and Regulatory Advisory. With offices across Europe, Avantage Reply counts some of the world's most significant financial groups among its clients, including in Investment, Retail and Commercial Banking, Custodian Banking, Insurance and Investment Management.