Supervisory Statement | SS8/16

Ring-fenced bodies (RFBs)

December 2017

(Updating February 2017)

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BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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Contents

1 Introduction

1.1 This Prudential Regulation Authority (PRA) supervisory statement is aimed at ring-fenced bodies (RFBs), as defined in Section 142A of the Financial Services and Markets Act 2000 (the Act), parent undertakings of RFBs as defined in Section 192JA of the Act and other PRA-authorised persons that are members of a group containing an RFB. This supervisory statement is also aimed at firms currently below the core deposits threshold for ring-fencing of £25 billion but which may approach that threshold over time. The purpose of this statement is to set out the PRA's expectations of an RFB and members of its group in relation to the ring-fencing of core activities and services.[1]

1.2 This statement should be read alongside the PRA Rulebook, the Capital Requirements Regulation (CRR)[2] and ring-fencing legislation set out in the Act and statutory instruments.[3] The Ring-fenced Bodies Part of the PRA Rulebook in particular sets out PRA rules applicable to RFBs.

1.3 The Financial Services (Banking Reform) Act 2013 amended the PRA's general safety and soundness objective to the effect that, when discharging its general functions in relation to ring-fencing, RFBs and groups containing RFBs, the PRA should seek to:

- ensure that the business of RFBs is carried on in a way that avoids any adverse effect on the continuity of the provision in the United Kingdom of core services;

- ensure that the business of RFBs is protected from risks (arising in the United Kingdom or elsewhere) that could adversely affect the continuity of the provision in the United Kingdom of core services; and

- minimise the risk that the failure of an RFB or of a member of an RFB's group could affect the continuity of the provision in the United Kingdom of core services.[4]

1.4 The legislation also requires the PRA to make rules to ensure the effective provision to an RFB of services and facilities it requires in relation to carrying on a core activity (which is the regulated activity of accepting deposits) and to make provision for the group ring-fencing purposes,[5] which are to ensure as far as reasonably practicable that:

- the carrying on of core activities by an RFB is not adversely affected by the acts or omissions of other members of its group;

- in carrying on its business an RFB:

- is able to take decisions independently of other members of its group; and

- does not depend on resources which are provided by a member of its group and which would cease to be available to the RFB in the event of the insolvency of the other member; and

1 On 1 February 2017, this SS was updated – see the Appendix for details.
2 Regulation (EU) No 575/2013.
3 SI 2014/1960 The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014; SI 2014/2080 The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014; and SI 2015/547 The Financial Services and Markets Act 2000 (Banking Reform) (Pensions) Regulations 2015.
4 See section 2B of the Act.
5 See section 142H of the Act.

- the RFB would be able to continue to carry on core activities in the event of the insolvency of one or more other members of its group.

1.5 The PRA's general approach to implementing ring-fencing focuses on the outcomes to be achieved, which are informed by the PRA's general safety and soundness objective in relation to ring-fencing and the group ring-fencing purposes. The PRA has made provision for the group ring-fencing purposes in the Ring-fenced Bodies Part of the PRA Rulebook. The PRA's general safety and soundness objective in relation to ring-fencing and the group ring-fencing purposes are also reflected in the PRA's group restructuring powers.[1]

1.6 This statement is structured as follows:

- Chapter 2 sets out the PRA's expectations in relation to the legal structure of banking groups containing one or more RFBs.

- Chapter 3 sets out the PRA's expectations in relation to the application of requirements to an RFB on a sub-consolidated basis, including the circumstances in which it requires the establishment of an RFB sub-group, the composition of an RFB sub-group, and how prudential requirements are applied on a sub-consolidated basis.

- Chapter 4 sets out the PRA's expectations in relation to the application of capital and liquidity requirements to RFB sub-groups, in particular the Internal Capital Adequacy Assessment Part of the PRA Rulebook (ICAA rules) and the Internal Liquidity Adequacy Assessment Part of the PRA Rulebook (ILAA rules). It also sets out the PRA's expectations concerning an RFB's use of internal risk models when calculating risk-weighted exposure amounts or own funds requirements.

- Chapter 5 sets out the PRA's expectations regarding an application by an RFB, or any other PRA-authorised person that is a member of a group containing an RFB, for a permission in relation to intragroup large exposures exemptions, an individual consolidation permission or an intragroup liquidity permission (intragroup concessions).

- Chapter 6 sets out the PRA's expectations in relation to Ring-fenced Bodies 11 of the PRA Rulebook on the notification that must be made in relation to distributions to group entities that are not members of an RFB sub-group.

- Chapter 7 sets out the PRA's expectations with respect to intragroup commercial relationships, and the management of intragroup exposures.

- Chapter 8 sets out the PRA's expectations on the arrangements that an RFB and its ring-fenced affiliates[2] may make where they receive services and facilities from other group entities or third parties outside of their group.

- Chapter 9 sets out the PRA's expectations in relation to an RFB's participation in financial market infrastructures (FMIs), in particular inter-bank payment systems, central securities depositories (CSDs) and central counterparties (CCPs).

- Chapter 10 sets out the PRA's expectations with respect to an RFB's exceptions policies.

- Chapter 11 sets out the PRA's expectation in relation to reporting requirements for RFBs.

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1 See section 142K of the Act.

2 'Ring-fenced affiliate' is defined in the Ring-fenced Bodies Part of the PRA Rulebook in relation to a ring-fenced body as 'any member of the sub-consolidation group of which the ring-fenced body is a member, other than the ring-fenced body itself'. 'Sub-consolidation group' refers to the RFB sub-group. Chapter 3 of this statement sets out more detail on the establishment of an RFB sub-group.

2 Legal structure and holdings of capital

2.1 The PRA sets out below its expectations in relation to the structure of banking groups containing one or more RFBs, in particular in relation to ownership structure and holdings of capital instruments within the group.[1] This chapter also sets out some of the factors that the PRA will take into consideration when deciding whether or not to impose requirements in relation to the group structure of such banking groups.

Expectations of banking group structures containing an RFB

2.2 The PRA seeks to ensure the continuity of the provision of core services by an RFB. Where an RFB's group structure or holdings of capital instruments in group entities could adversely affect the safety and soundness of the RFB and therefore pose risks to the continuity of provision of core services, the PRA may use its powers under section 55M or section 192C of the Act to impose requirements on such an RFB or give a direction to a qualifying parent undertaking respectively.

Expectations of the types of group entity in which an RFB may own or hold capital instruments

Holdings in excluded activity entities in the group

2.3 The PRA expects an RFB not to have ownership rights or hold capital instruments in an entity in its group that undertakes activities that, if it were an RFB, would contravene a prohibition or be excluded activities under the Act (for the purpose of this statement: an 'excluded activity entity'). The PRA will take into account the exemptions and exceptions provided for in the legislation when assessing whether an entity is an excluded activity entity. An RFB should also not hold capital instruments in a subsidiary of an excluded activity entity in its group. For the purpose of this statement, ownership rights include voting rights and other rights to participate in the capital or profits of the relevant entity; and capital instruments are those instruments designed to provide loss absorbency to the issuer, ie those which qualify for recognition under the minimum requirement for own funds and eligible liabilities (MREL) (including Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments under the CRR and PRA rules) or which would qualify if the entity was a PRA-authorised person.[2]

2.4 The PRA similarly expects that where an RFB sub-group is formed (see Chapter 3) all ring-fenced affiliates should meet these expectations, ie the PRA expects that ring-fenced affiliates should not have ownership rights or hold capital instruments in an excluded activity entity or a subsidiary of an excluded activity entity in the group. These expectations reduce the risk of losses associated with, for example, investment banking activity weakening the RFB directly or through entities in its RFB sub-group.

2.5 The PRA will adopt this approach in a manner it considers to be proportionate to achieve the outcomes set out by the group ring-fencing purposes of the Act. In doing so, the PRA will assess, on a case-by-case basis, the risks that such ownership stakes might pose to the RFB's resilience and resolvability and to the PRA's general safety and soundness objective in relation to ring-fencing.

1 'Group' is defined in section 421 of the Act.
2 See Article 45 of Directive 2014/59/EU.

Holdings in group entities that are not excluded activity entities

2.6 In principle, the PRA does not necessarily object to an RFB or its ring-fenced affiliates owning entities that are not excluded activity entities or holding the capital instruments of such entities. Such holdings would, however, be considered on a case-by-case basis, based on the risks that they might pose to the RFB's resilience and resolvability, the PRA's general safety and soundness objective in relation to ring-fencing and the group ring-fencing purposes.

Expectations of the types of group entity that may own an RFB or hold an RFB's capital instruments

2.7 Within a UK group (that is, the group headed by the ultimate UK parent), the PRA does not expect an excluded activity entity, or a subsidiary of an excluded activity entity, to have ownership rights or hold capital instruments in an RFB or its ring-fenced affiliates. As noted above, the PRA will take into account the exemptions and exceptions provided for in the legislation when assessing whether an entity is an excluded activity entity. This policy supports the group ring-fencing purposes outlined in the Act, in particular: the RFB's ability to take independent decisions; insulating the RFB from the acts or omissions of its group; and limiting the reliance of the RFB on resources provided by other members of its group. It may also reduce the complications of successfully resolving an RFB or its group.

2.8 The PRA will adopt this approach in a manner it considers to be proportionate to achieve the outcomes set out by the group ring-fencing purposes in the Act. In doing so, the PRA would assess, on a case-by-case basis, the risks that such ownership stakes might pose to the RFB's resilience and resolvability and to the PRA's general safety and soundness objective in relation to ring-fencing. The PRA expects that the owner of an RFB may:

- maintain or establish a non-European Economic Area (EEA) branch;
- have an ownership interest or hold capital instruments in a non-EEA undertaking;
- have an ownership interest or hold capital instruments in an excluded activity entity; or
- have an ownership interest or hold capital instruments in an entity where the holding does not qualify as a participating interest.[1]

2.9 In assessing whether an entity that is not an excluded activity entity should be restricted from owning an RFB (or its ring-fenced affiliates) within the UK group, the PRA will consider, as part of the assessment required under the Act, the resilience and resolvability of the RFB and risks posed to the continuity of provision of core activities. This assessment will include the extent to which:

- the RFB is able to take decisions independently of group entities where required by the Act;
- the RFB is not reliant on resources in group entities (for example capital resources) which may cease to be available in the event of insolvency of that group entity; and
- the RFB is sufficiently insulated from risks in the rest of the group, so as to ensure it is not adversely affected by the acts or omissions of group entities.

1 'Participating interest' is defined in section 421A of the Act.

3 Establishment of an RFB sub-group and application of requirements on a sub-consolidated basis

3.1 This chapter sets out the PRA's approach to requiring an RFB to meet prudential requirements on a sub-consolidated basis, including the circumstances in which it will constitute an RFB sub-group and how it decides the composition of an RFB sub-group. An RFB sub-group is a sub-set of related group entities within a consolidated group, consisting of one or more RFBs and other legal entities, which is established when the PRA gives effect to Article 11(5) of the CRR.

3.2 The chapter also sets out the process by which the PRA will give effect to the application of prudential requirements on a sub-consolidated basis.

Establishment of an RFB sub-group

3.3 Article 11(5) of the CRR permits competent authorities to require firms to comply with prudential requirements on a sub-consolidated basis in certain circumstances, in addition to the application of requirements to firms on an individual and consolidated basis. These circumstances include where the Member State has adopted national laws requiring structural separation of activities within a banking group.[1]

3.4 The PRA expects that, in general, it will exercise the discretion in Article 11(5) of the CRR to require an RFB to meet prudential requirements on a sub-consolidated basis, in respect of its RFB sub-group. Further detail on the membership of an RFB sub-group and the boundary for sub-consolidation is set out in paragraphs 3.10 to 3.18.

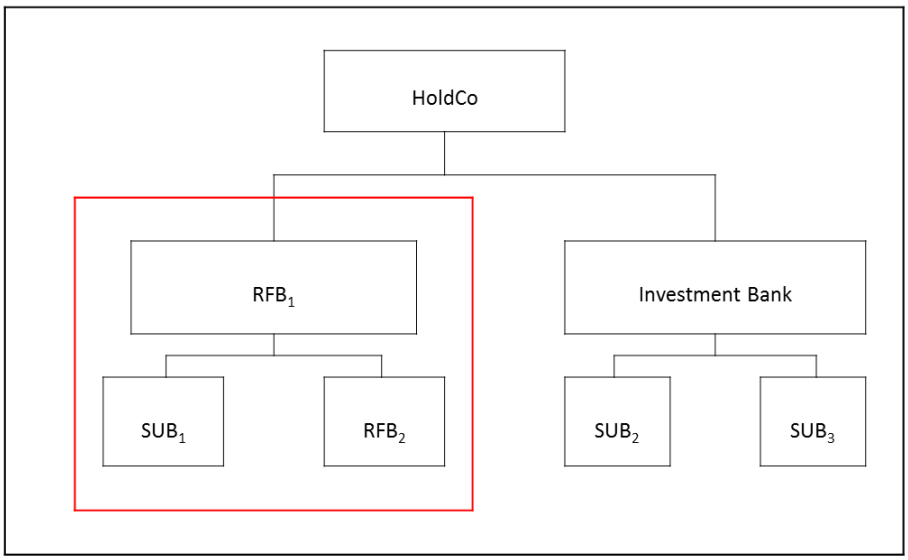
3.5 This ensures that prudential requirements are also applied to an RFB in respect of business undertaken by entities that are closely linked to it, including, but not limited to, its subsidiaries. Financial weakness in these entities may harm the RFB, and by extension its ability to continue to provide core services.

3.6 Application of requirements to an RFB on a sub-consolidated basis ensures that an RFB is able to meet those requirements relating to its sub-group without relying on resources in entities that are not members of the RFB sub-group, including excluded activity entities.

3.7 Figure 1 overleaf illustrates a simplified banking group structure including an RFB sub-group.

1 The CRR defines 'sub-consolidated basis' in Article 4, paragraph 1(49).

Figure 1



RFB sub-group

RFB_1 and RFB_2 are ring-fenced bodies (RFBs)

$SUBs_{1-3}$ are entities that are not authorised or regulated by the PRA

HoldCo is the parent holding company of the Group in the UK

Application of prudential requirements and other PRA policy to an RFB sub-group

3.8 Where the PRA has determined that prudential requirements should apply to an RFB on the basis of its RFB sub-group, the RFB must meet the requirements of Parts Two to Four and Parts Six to Eight of the CRR on a sub-consolidated basis. An RFB will also need to meet PRA rules transposing Title VII of the Capital Requirements Directive (CRD) on a sub-consolidated basis, as well as some related PRA rules where the PRA has decided that such rules are integral to the effective application of the prudential framework.[1] The rules that an RFB must meet on a sub-consolidated basis are set out in Ring-fenced Bodies 18 of the PRA Rulebook.

3.9 Where it has been established, an RFB sub-group is also relevant in the context of the application of other elements of the PRA's ring-fencing rules and related policy, including the Ring-fenced Bodies Part and this supervisory statement.

1 Directive 2013/36/EU.

Defining the composition of an RFB sub-group and the boundary for sub-consolidation

3.10 In determining the composition of a prospective RFB sub-group, the PRA will assess the appropriateness of the inclusion of each legal entity in the RFB sub-group against both the provisions of the CRR and its obligations under the Act in respect of ring-fencing. The PRA will undertake this assessment in advance of the establishment of an RFB sub-group and on an ongoing basis as part of its supervision of the RFB.

3.11 The PRA expects the composition of an RFB sub-group generally to be consistent with the legal entity structure around the RFB, and with the governance and management arrangements that apply to those legal entities. In general, the PRA expects alignment between the RFB sub-group and the RFB's group legal entity structure, but recognises that this may not be possible or desirable in all cases. The PRA will determine the most appropriate approach to the application of its policy to such entities on a case-by-case basis.

3.12 Typically, the PRA expects that an RFB sub-group is headed by an RFB. In some circumstances, it may be appropriate for an RFB sub-group to be headed by a UK entity other than an RFB. For example, the RFB sub-group might be headed by an intermediate parent holding company.

3.13 There may be circumstances in which it would be inappropriate for an entity to be located in an RFB sub-group. The PRA expects to apply the same principles to its assessment of the appropriateness of the membership and composition of an RFB sub-group as set out in Chapter 2 with respect to ownership and holdings of capital. Therefore, the PRA expects an RFB sub-group not to contain an excluded activity entity.[1]

3.14 The PRA will take into account the following factors when assessing whether the inclusion of an entity in the RFB sub-group is acceptable:

- an entity in which an RFB may not have ownership rights or holdings of capital instruments should not be included in the RFB sub-group, including excluded activity entities;
- entities that may not have ownership rights or holdings of capital instruments in an RFB should not be included in the RFB sub-group; and
- where the inclusion of an entity could affect adversely the continuity of provision of core services by the RFB, it should not be included in the RFB sub-group.

3.15 The PRA will also consider the impact of the inclusion of an entity on the management and governance arrangements that are applied to the RFB sub-group and any other relevant factors.

3.16 In general, the PRA expects that the level of scrutiny it will apply to the appropriateness of the composition of a potential RFB sub-group will increase in line with the complexity of the legal entity structure surrounding the RFB, and/or the level of risk arising from the business undertaken by the RFB's subsidiaries or other affiliates.

3.17 If the PRA were to determine that it is inappropriate for an entity to be included in an RFB sub-group, the PRA would generally expect to require that such an entity be removed from the sub-group legal structure.

1 See paragraph 2.3 for the definition of an 'excluded activity entity'.

3.18 In other circumstances, where the PRA judges that the activities of an entity pose a risk to the RFB, but not to the extent that the entity needs to be removed from the sub-group, the PRA may use its powers under section 55M of the Act or to give a direction to a qualifying parent undertaking under section 192C of the Act, in order to address the risk. The PRA may take account of the activities of the entity in considering any application for intragroup concessions made by an RFB or any other PRA-authorised person that is a member of its RFB sub-group.

Mechanism for establishing an RFB sub-group

3.19 Provision for the application of prudential requirements on a sub-consolidated basis is set out in Article 11(5) of the CRR. To give effect to Article 11(5) of the CRR, the PRA constitutes an RFB sub-group, and mandates sub-consolidation, by use of a requirement under section 55M of the Act. The PRA anticipates that the structure and content of RFB sub-groups are likely to vary between different groups and the approach to implementation enables the PRA to adopt a tailored approach to each group based on its circumstances.

Application of requirements where no RFB sub-group is formed

3.20 There may be circumstances in which it would be inappropriate to apply prudential requirements on a sub-consolidated basis, in which case the PRA would not use Article 11(5) to constitute an RFB sub-group. For example, if an RFB has no subsidiaries or only has very small subsidiaries whose activities are judged to present immaterial risk to the RFB, then it may be disproportionate to apply prudential requirements on a sub-consolidated basis. Similarly, if the UK banking group has no excluded activity entities, it may not be appropriate to ring-fence a sub-group of entities.

3.21 The PRA will consider the following factors when deciding whether it would be appropriate to constitute an RFB sub-group, for the purposes of applying prudential requirements to an RFB on a sub-consolidated basis:

- the size of the subsidiaries and/or sister entities both in absolute terms and relative to the RFB;
- the size of the sub-group relative to the UK consolidated group; and
- the nature of the activities of the subsidiaries and/or sister entities and the risks they pose to the RFB.

3.22 If the PRA does not constitute an RFB sub-group, an RFB would have no ring-fenced affiliates and would need to comply with a number of the requirements in the Ring-fenced Bodies Part of the PRA Rulebook on an individual basis. As an alternative, an RFB could apply to the PRA for a modification to the PRA's ring-fencing rules in order that requirements (and the PRA's related policy) be applied to the RFB's UK consolidated group as if it were an RFB sub-group.

3.23 The PRA would consider granting such rule modifications on a case-by-case basis, based on its judgement of the risks posed to the RFB's resilience and resolvability and the PRA's objectives. In particular, the PRA would only be likely to grant such rule modifications where it is satisfied that the composition of the RFB's UK consolidated group meets the PRA's expectations on the composition of an RFB sub-group, as set out in the section 'Defining the composition of an RFB sub-group and the boundary for sub-consolidation' in this chapter. The PRA would also assess the appropriateness of any such rule modifications on an ongoing basis as part of its supervision of the RFB.

4 Application of capital and liquidity standards to an RFB sub-group

4.1 This chapter sets out the PRA's expectations in relation to the application of capital and liquidity requirements to RFB sub-groups, in particular the ICAA rules and the ILAA rules. It also sets out the PRA's expectations concerning an RFB's use of internal risk models when calculating risk-weighted exposure amounts or own funds requirements, 'RFB group risk'[1] and recovery planning.

Application of the ICAA rules

4.2 RFBs are required to meet the capital requirements set out in the CRR and related PRA rules, including those set out in the Definition of Capital Part of the PRA Rulebook, the Capital Buffers Part of the PRA Rulebook, the ICAA rules and related reporting obligations. Where an RFB sub-group is formed, the RFB will also need to ensure that the requirements of the CRR and PRA rules are met by the RFB on the basis of its RFB sub-group. The RFB should have regard to the contents of relevant PRA supervisory statements and statements of policy in relation to the capital requirements of the RFB sub-group, including:

- SS7/13 'CRD IV and capital';[2]
- SS6/14 'Implementing CRD IV: Capital buffers';[3]
- SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)';[4]
- SS32/15 – 'Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082';[5] and
- Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'.[6]

4.3 Where an RFB is not a member of an RFB sub-group, the PRA may require an RFB to meet the ICAA rules on an individual basis by making use of its powers under section 55M. The PRA will set this requirement where it considers it necessary to ensure continuity of the provision of core services.

4.4 An RFB required to comply with obligations on the basis of its RFB sub-group must similarly meet the ICAA rules on the basis of that RFB sub-group. The RFB will therefore need to ensure the overall financial adequacy rule, the overall Pillar 2 rule, the ICAAP rules, the risk control rules and requirements in respect of reverse stress testing set out in the ICAA rules are met on the basis of its RFB sub-group. In relation to the ICAAP, an RFB will therefore need to:

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1 PRA Supervisory Statement 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' (see footnote 4) defines 'RFB group risk', in relation to a consolidation group containing an RFB sub-group, as the risk that the financial position of a firm on a consolidated basis may be adversely affected by the minimum capital and buffers applicable at the level of the RFB sub-group, such that there is insufficient capital within (or an inappropriate distribution of capital across) the consolidated group to cover the risks of the consolidated group.

2 PRA Supervisory Statement 7/13 'CRD IV and capital', December 2013: www.bankofengland.co.uk/pra/Pages/publications/crdcapital.aspx.

3 PRA Supervisory Statement 6/14 'Implementing CRD IV: capital buffers', April 2014: www.bankofengland.co.uk/pra/Pages/publications/capitalbuffersss614.aspx.

4 PRA Supervisory Statement 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', February 2017: www.bankofengland.co.uk/pra/Pages/publications/ss/2017/ss3115update.aspx.

5 Supervisory Statement 32/15 'Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082', February 2017: www.bankofengland.co.uk/pra/Pages/publications/ss/2017/ss3215update.aspx.

6 Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital', February 2017: www.bankofengland.co.uk/pra/Pages/publications/sop/2017/p2methodologiesupdate.aspx.

- perform an ICAAP at the level of the RFB sub-group; and

- perform ICAAP stress testing on the RFB sub-group and include relevant stress test results in its ICAAP.

4.5 In meeting these requirements, the PRA expects an RFB to perform a full assessment of the risk and capital requirements of its RFB sub-group, treating any exposures to (or positions in, or arrangements with) group entities that are not members of the RFB sub-group in the same way it would if these were to a third party. The RFB should not, for example, simply assess its capital requirements for a particular risk based on a share of the group's requirement.

4.6 Implicit within the requirement that an RFB must meet the ICAA rules on the basis of its RFB sub-group is the requirement that an RFB must assess group risk.[1] The requirement set out above that an RFB must perform an ICAAP at the level of the RFB sub-group, and the expectation that it should treat exposures to entities outside the sub-group as equivalent to third parties, does not remove the obligation on the RFB to assess group risk as part of its ICAAP. On the contrary, the PRA expects an RFB to pay particular attention to ensuring it has assessed the risks arising from its arrangements with other group members. These include the risks arising from arrangements where an RFB has joint and several liability with other group members, such as those in respect of certain taxes (eg UK value-added tax (VAT) group membership) or in respect of pension arrangements (see section on 'pension obligation risk' overleaf).

4.7 As a consequence of meeting the ICAA rules at the level of the RFB sub-group, the PRA expects an RFB to:

- manage the risks of the RFB sub-group within its risk appetite under business-as-usual and stress conditions;

- ensure the RFB sub-group has sufficient capital to meet capital requirements under business-as-usual and stress conditions, including capital to cover exposures to entities that are not members of its RFB sub-group; and

- view intragroup exposures to entities that are not members of the RFB sub-group as equivalent to any third party exposures in the context of its risk and capital assessment.

Application of the PRA's Supervisory Review and Evaluation Process (SREP) to an RFB sub-group

4.8 Consistent with the requirement that an RFB must meet the ICAA rules on the basis of its RFB sub-group, where an RFB sub-group is formed the PRA conducts a SREP on the RFB sub-group. In conducting this SREP, and in particular in the context of setting Pillar 2A capital for concentration risk, the PRA considers exposures to intragroup counterparties not included in the RFB sub-group in the same way as if they were to third parties. The PRA believes this approach furthers the PRA's general safety and soundness objective in relation to ring-fencing and the group ring-fencing purposes.

1 'Group risk' is defined in the ICAA rules as the risk that the financial position of a firm may be adversely affected by its relationships (financial or non-financial) with other entities in the same group or by risk which may affect the financial position of the whole group, including reputational contagion.

4.9 The PRA will therefore:

- assess Pillar 2A capital requirements and set individual capital guidance (ICG) for the RFB on the basis of its RFB sub-group;
- conduct a PRA buffer assessment for the RFB on the basis of its RFB sub-group and may set a PRA buffer at that level; and
- assess the Risk Management and Governance (RM&G) arrangements for the RFB on the basis of its RFB sub-group and may set an RM&G add-on at that level.

4.10 The PRA believes this approach is appropriate to enable it to assess whether the RFB has sufficient capital on the basis of its RFB sub-group to cover its risks on a business-as-usual basis and under stress. This approach will also reinforce other requirements placed on an RFB in relation to the adequacy and independence of its governance arrangements.

4.11 This is in addition to SREPs performed on a consolidated and individual basis.

Stress testing

4.12 The PRA expects an RFB to develop its stress testing capability in order to be able to understand the impact of stresses on its business and, where applicable, that of its RFB sub-group, and the associated capital implications, and to be able to provide the PRA and the Bank of England (the Bank) with the data required to perform or assess stress tests.

4.13 The requirement to put in place appropriate stress testing capability is implicit in the application of the ICAAP rules to the RFB, but the PRA believes it is appropriate to reiterate this explicitly.

4.14 The PRA expects RFBs to ensure they have in place not only appropriate risk resources but also relevant financial planning resources and related systems and control processes to meet these requirements.

Pension obligation risk

4.15 Ring-fencing secondary legislation restricts the ability of an RFB to be a party to certain types of pension arrangements relating to multi-employer schemes and shared liability arrangements from 1 January 2026.[1] RFBs may therefore need to make changes to their pension arrangements to meet these requirements. An RFB's assessment of its pension obligation risk from 1 January 2019 to 1 January 2026 could therefore be particularly complex.

Assessment of pension obligation risk at the level of the RFB sub-group

4.16 The PRA expects an RFB to conduct a full assessment of the capital required to support the risks arising from the pension arrangements of its RFB sub-group. An RFB should assess this risk in the manner set out in SS31/15.[2] An RFB should also ensure it has fully and appropriately considered group risk arising in respect of its pension arrangements when conducting its assessment of pension obligation risk (see para 4.6).

4.17 The PRA expects an RFB to consider all relevant factors when performing its assessment, including, but not limited to, its current share of group pension obligations, and its expected future share where it is making changes to its pension arrangements. However, an RFB's

1 SI 2015/547 The Financial Services and Markets Act 2000 (Banking Reform) (Pensions) Regulations 2015.
2 These include the sections in Supervisory Statement 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' covering 'Pension obligation risk', 'Pension obligation risk in firms and groups' and 'Pension obligation risk: addressing the risk of increased pension losses near the point of resolution'.

assessment should not be limited to a simple allocation of a share of the group's pension obligation risk. A full assessment may therefore result in a higher capital requirement than if the RFB were to apply such a 'share-of-group' approach, particularly in the period prior to 1 January 2026. This might be the case where, for example, an RFB has joint and several liability with group entities that are not members of the RFB sub-group, or where it has other guarantees, contributions or other arrangements in place with group entities that are not members of the RFB sub-group.

4.18 An RFB may consider mitigating actions other than holding capital in its assessment of pension obligation risk. Where an RFB intends to rely on such actions, it should consider whether they would be affected by the acts or omissions of group entities outside the RFB sub-group, and how realistic these are likely to be in cases of stress. An RFB should ensure its RFB sub-group holds sufficient capital in respect of pension obligation risk based on such a full assessment.

4.19 The PRA will apply the same approach outlined above in conducting its assessment of pension obligation risk capital as part of its SREP for the RFB sub-group. The PRA may also consider transitional arrangements on a case-by-case basis for an RFB.

Assessment of pension obligation risk for a banking group containing an RFB

4.20 The PRA expects firms to apply existing policy, as set out in SS31/15, when assessing the pension obligation risk of a consolidated group containing an RFB. The PRA therefore expects the capital requirements for pension obligation risk at group level to be unaffected by the assessment of the pension obligation risk for the RFB sub-group.

Pension obligation risk at entity level

4.21 The PRA will continue to apply its existing policy outlined in SS31/15 that, where pension obligation risk capital is assessed at group level, firms must allocate pension obligation risk capital to entities within the group in a way that adequately reflects the nature, level and distribution of the risks to which the group is subject.[1] In these cases, firms should continue to allocate pension obligation risk capital to group entities that are not members of the RFB sub-group based on the group level assessment of pension obligation risk.

4.22 An RFB should allocate pension obligation risk capital to entities in its RFB sub-group based on the pension obligation risk capital of the RFB sub-group (not the group assessment). The RFB should perform this allocation in a way that adequately reflects the nature, level and distribution of the risks to which the RFB sub-group is subject.

Reverse stress testing

4.22A The PRA expects an RFB to assess the impact of a failure of group entities that are not members of the RFB sub-group as part of reverse stress testing. An RFB should focus on those cases where the failure of the group entity may have a material impact on the RFB. The PRA expects this analysis to include direct impacts on capital, liquidity, funding, income, profitability and franchise value. It should also include an assessment of how its business model may need to change as a result of the failure of group entities that are not members of the RFB sub-group.

4.22B As part of this assessment, the PRA also expects an RFB to consider any dependencies on group entities that are not members of the RFB sub-group, such as on joint income and product offerings, how these would be impacted under stress and what management action would be taken where dependencies occurred. Consistent with wider reverse stress testing,

1 See Supervisory Statement 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' paragraph 2.33 (see footnote 4, page 13).

the design and results of an RFB's assessment should be reviewed and approved at least annually by the firm's senior management or governing body.

Application of the ILAA rules

4.23 RFBs are required to meet the liquidity requirements set out in the CRR, the Liquidity Coverage Ratio (LCR) set out in the LCR Delegated Act[1] and the rules contained in the ILAA rules. These requirements apply to a firm on an individual basis, and also on a consolidated basis where firms are required to comply with Part Six of the CRR on a consolidated basis.

4.24 Where an RFB sub-group is formed, the RFB also needs to ensure that the requirements of the CRR, the LCR Delegated Act and the PRA rules, including the ILAA rules, are met by the RFB sub-group. The RFB should also have regard to the contents of SS24/15 The PRA's approach to supervising liquidity and funding risks in relation to the RFB sub-group, as the PRA also applies this approach to the RFB sub-group.[2]

Liquidity management function of an RFB

4.25 The LCR Delegated Act requires a firm to ensure that, as part of structuring its operational arrangements and processes in relation to the management of liquidity and funding, its liquid assets are under the control of a specific liquidity management function within the firm.[3] An RFB will need to meet this requirement on an individual basis and on a sub-consolidated basis where an RFB sub-group is in place. An RFB will also need to ensure that the arrangements and processes surrounding the management of liquidity meet other operational requirements set out in a number of Parts of the PRA Rulebook, including the ILAA rules, the Outsourcing Part, the Operational Continuity Part, and the Ring-fenced Bodies Part.

Application of the PRA's Liquidity Supervisory Review and Evaluation Process (L-SREP) to an RFB sub-group

4.26 Where an RFB sub-group is formed, the PRA will perform an L-SREP and determine the individual liquidity guidance (ILG) for the RFB sub-group. This is in addition to the L-SREP that will be performed on the RFB on an individual basis and any L-SREP performed on a consolidated basis.

Membership of the Sterling Monetary Framework (SMF)

4.27 The Bank provides liquidity insurance to participants in the SMF through a number of separate but related facilities.[4] Participation in the SMF is open to various types of entity, including banks and PRA-regulated investment firms. It is also possible for participants to access some and not all of the SMF facilities.

4.28 The PRA expects that an RFB should be a direct member of SMF facilities (in particular the Discount Window Facility (DWF)) or should access these through a member of its RFB sub-group.

4.29 Similarly, the PRA expects that where a banking group contains an RFB, group entities that are eligible for the SMF (ie banks or PRA-authorised investment firms) and that are neither RFBs nor entities in an RFB sub-group should either be direct members of the Bank's

1 European Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions.
2 PRA Supervisory Statement 24/15 'The PRA's approach to supervising liquidity and funding risks' June 2015: www.bankofengland.co.uk/pra/Pages/publications/ss/2015/ss2415.aspx.
3 Article 8(3) of the LCR Delegated Act.
4 The Bank of England's Sterling Monetary Framework paragraph 39 www.bankofengland.co.uk/markets/Documents/money/publications/redbook.pdf.

SMF facilities or be able to demonstrate that they are able to access the Bank's liquidity facilities through a group member that is neither an RFB nor an entity in an RFB sub-group.

4.30 Where firms do not meet these expectations, the PRA may use its powers under section 55M of the Act to impose requirements on an RFB or other PRA-authorised person that is a member of its group, or its powers under section 192C of the Act to give a direction to a qualifying parent undertaking.

4.31 In addition, as set out in SS24/15, the PRA will normally expect firms to pre-position collateral assets at the Bank, as part of wider contingency funding arrangements and may provide explicit guidance as to minimum expected levels. This would also apply to RFBs.

Internal risk model permissions

4.32 The CRR permits a firm, subject to conditions, to apply to the PRA for a number of permissions to use internal systems and risk models for the purpose of calculating risk-weighted exposure amounts or own funds requirements (a CRR model permission).[1] An RFB with, or applying for, a CRR model permission will also need to comply with the requirements of all relevant parts of the PRA Rulebook in its use of internal models, including the Operational Continuity Part, the Outsourcing Part and the Ring-fenced Bodies Part.

Attestation of model compliance by an RFB

4.33 Where an RFB makes an attestation related to meeting the requirements for a CRR model permission, as referred to in the relevant PRA supervisory statements, the attestation should be given by a suitable RFB senior manager.[2]

RFB group risk

4.34 The application of prudential requirements at the level of the RFB sub-group could expose the consolidated group (to which the RFB belongs) to the risk of having insufficient capital resources (of appropriate quality and distribution across it) to cover the risks it faces ('RFB group risk').[3] The consequential contagion risk, in the event of a stress outside the RFB sub-group, increases the vulnerability of the RFB and its ring-fenced affiliates, posing risks to the group ring-fencing purposes under the Act.

4.35 The PRA therefore expects a firm that is a member of a consolidation group containing an RFB sub-group to ensure that meeting prudential requirements at the level of the RFB sub-group does not result in the consolidated group having insufficient capital within it (or an inappropriate distribution of capital across it) to cover its risks.

4.36 In order to ensure that RFB group risk is adequately covered in consolidated group capital, the PRA expects firms to take account of this type of group risk when carrying out an ICAAP on a consolidated basis. In making this assessment of RFB group risk, firms should have

1 See CRR Articles 143(1), 151(4), 283, 312(2) and 363.
2 PRA Supervisory Statement 11/13 'Internal ratings-based (IRB) approaches', November 2015: www.bankofengland.co.uk/pra/Pages/publications/ss/2015/ss1113update.aspx;
PRA Supervisory Statement 12/13 'Counterparty credit risk', July 2016: http://www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss1213update.aspx.;
PRA Supervisory Statement 13/13 'Market risk', July 2016: http://www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss1313update2.aspx; and
PRA Supervisory Statement 14/13 'Operational risk', December 2013: www.bankofengland.co.uk/pra/Pages/publications/operationalrisk.aspx.
3 PRA Supervisory Statement 31/15 defines 'RFB group risk', in relation to a consolidation group containing an RFB sub-group, as the risk that the financial position of a firm on a consolidated basis may be adversely affected by the minimum capital and buffers applicable at the level of the RFB sub-group, such that there is insufficient capital within (or an inappropriate distribution of capital across) the consolidated group to cover the risks of the consolidated group.

regard to SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' and the PRA's Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'.[1]

Recovery planning

4.37 The PRA expects a group containing an RFB to include recovery options for the RFB sub-group in the group recovery plan. The indicator framework, design of scenarios and governance arrangements set out in the group recovery plan should have regard to recovery planning for the RFB sub-group as well as for the group as a whole. This supervisory statement should be read in conjunction with the Recovery and Resolution Part of the PRA Rulebook and Supervisory Statement 9/17 'Recovery planning'.[2]

5 Intragroup concessions

5.1 The PRA sets out below its expectations regarding an application by an RFB, or any other PRA-authorised person that is a member of a group containing an RFB, for a permission in relation to intragroup large exposures exemptions, an individual consolidation permission under Article 9 of the CRR, or an intragroup liquidity permission under Article 8 of the CRR and the LCR Delegated Act.

Large exposures

5.2 This section sets out the PRA's approach to an application by an RFB, or a PRA-authorised person that is a member of a group containing an RFB, to include undertakings within a core UK group (CRR Article 113(6)) or a non-core large exposure group (CRR Article 400(2)(c)). This section should be read in conjunction with the specified CRR articles, the requirements in the Large Exposures and Ring-fenced Bodies Parts of the PRA Rulebook, Supervisory Statement 16/13 'Large exposures',[3] and the high-level expectations outlined in the PRA's approach to banking supervision.[4]

CRR Article 113(6): core UK group applications

5.3 CRR Article 113(6) permits a firm, subject to conditions, to apply a 0% risk weight to exposures to certain entities within its consolidation group. CRR Article 400(1)(f) requires that exposures that would be assigned a 0% risk weight under CRR Article 113(6) are fully exempted from the large exposures limit stipulated in CRR Article 395(1).[5,6]

5.4 Where a firm making the application is a member of a banking group that includes an RFB, the PRA will consider the application in light of the ring-fencing obligations placed on the RFB and any other members of its group, and also the obligations placed on the PRA by the Act in relation to ring-fencing. In particular, where the PRA considers that the granting of the approval would be inconsistent with the PRA's general safety and soundness objective in relation to ring-fencing or the group ring-fencing purposes, the PRA does not expect to grant the approval.

1 See the 'Supporting materials – ring-fencing' webpage: www.bankofengland.co.uk/pra/Pages/supervision/structuralreform/suppmaterials.aspx.
2 December 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss.
3 PRA Supervisory Statement 16/13 'Large exposures' July 2016: www.bankofengland.co.uk/pra/Pages/supervision/structuralreform/suppmaterials.aspx.
4 PRA Approach documents: www.bankofengland.co.uk/publications/Pages/other/pra/supervisoryapproach.aspx.
5 Group exposures that are not assigned a 0% risk weight shall be treated as exposures to a third party.
6 CRR Article 395(1) sets the large exposure limit, after applying the effect of the credit risk mitigation in accordance with CRR Articles 399 to 403, to a counterparty or group of connected clients at 25% of eligible capital.

5.5 The PRA does not therefore expect to approve an application made by an RFB, or a PRA-authorised person that is a ring-fenced affiliate, to apply a 0% risk weight to exposures to other entities within its consolidation group that are not also members of that RFB sub-group, even if the RFB, or the PRA-authorised person that is a ring-fenced affiliate, is able to demonstrate that conditions in CRR Article 113(6) are met.[1] Similarly, the PRA does not expect to approve an application made by a PRA-authorised person that is a member of a group containing an RFB, but is not itself a member of the RFB sub-group, to apply a 0% risk weight to exposures to the RFB or its ring-fenced affiliates. Such intragroup exposures are to be treated as exposures to a third party and will be subject to the large exposures limit.

5.6 If an RFB sub-group exists, the RFB, or a PRA-authorised person that is a ring-fenced affiliate, wishing to apply a 0% risk weight for exposures to entities included in the RFB sub-group may make a formal application to the PRA, through which they should seek to demonstrate how the conditions in CRR Article 113(6) are met.

CRR Article 400(2)(c) – non-core large exposures group exemptions (trading book and non-trading book)

5.7 Where a firm making an application for permission to use the non-core large exposures group exemptions is a member of a banking group that includes an RFB, the PRA will consider the application in light of the ring-fencing obligations placed on the RFB and any other members of its group, and also the obligations placed on the PRA by the Act in relation to ring-fencing. In particular, where the PRA considers that the granting of the approval would be inconsistent with the PRA's general safety and soundness objective in relation to ring-fencing or the group ring-fencing purposes, the PRA does not expect to grant the approval.

5.8 The PRA does not therefore expect to exercise the discretion provided by CRR Article 400(2)(c)[2] to exempt trading book or non-trading book exposures incurred by an RFB or a PRA-authorised person that is a ring-fenced affiliate, to other entities not in the RFB's sub-group but covered by the same supervision on a consolidated basis, from the large exposures limit stipulated in CRR Article 395(1).[3] Similarly, the PRA does not expect to exercise the discretion provided by CRR Article 400(2)(c) to exempt trading book or non-trading book exposures incurred by a PRA-authorised person that is a member of a group containing an RFB, but is not itself a member of the RFB sub-group, to the RFB or its ring-fenced affiliates. Such intra-group exposures are to be treated as exposures to a third party and will be subject to the large exposures limit.

5.9 If an RFB sub-group exists, the RFB, or a PRA-authorised person that is a ring-fenced affiliate, may apply to the PRA for a non-core large exposures group exemption covering undertakings in the RFB sub-group. To have an application approved the RFB, or the PRA-authorised person that is a ring-fenced affiliate, must demonstrate how the conditions set out in CRR Article 113(6) are met, except for the condition to be established in the United Kingdom – CRR Article 113(6)(d). An application by an RFB, or by a PRA-authorised person that is a ring-fenced affiliate, for a non-core large exposures exemption should also demonstrate how they comply with the conditions set out in the Large Exposures Part of the PRA Rulebook.

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1 This is in line with the PRA's supervisory statement on large exposures (SS16/13), where it states that the PRA will still make a wider judgement whether it is appropriate to grant this treatment even where the conditions in CRR Article 113(6) are met (see paragraph 2.4 of SS16/13). An exception to this approach might be justified in cases where the PRA judges that applying prudential requirements to an RFB on a sub-consolidated basis is inappropriate, and no entity within the consolidated group undertakes excluded or prohibited activities.

2 Competent authorities may partially or fully exempt exposures by an institution to its parent undertaking, subsidiaries of that parent undertaking or to its own subsidiaries.

3 In cases where the PRA judges that applying prudential requirements to an RFB on a sub-consolidated basis is inappropriate, and no entity within the consolidated group undertakes excluded or prohibited activities, the PRA may consider exempting the RFB from the proposed approach.

Individual consolidation method

5.10 Article 9 of the CRR empowers the PRA to permit, on a case-by-case basis, a parent institution to incorporate subsidiaries in the calculation of its requirement under Article 6(1) of the CRR ('individual consolidation') provided specified conditions are met.

5.11 Where an application for a permission for individual consolidation is made by a PRA-authorised person that is a member of a group containing an RFB, the PRA will consider the application against both the conditions for the exercise of the discretion in the CRR and in light of the ring-fencing obligations placed on the RFB and any other members of its group, and also the obligations placed on the PRA by the Act in relation to ring-fencing.

5.12 The PRA does not expect to grant a permission for individual consolidation where the parent or subsidiary is a member of an RFB sub-group but the other entity is not. Where the application concerns an RFB that is not a member of an RFB sub-group, the PRA will assess the application in light of the firm's specific legal structure.

Intragroup liquidity concessions

5.13 This section sets out the PRA's approach to the assessment of intragroup liquidity concessions in the CRR and the LCR Delegated Act where such an application is made by a member of a banking group that includes an RFB.

5.14 This section should be read in conjunction with the specified CRR articles, the specified articles in the LCR Delegated Act, the requirements in the ILAA rules and the Ring-fenced Bodies Part of the PRA Rulebook and related supervisory statements.

CRR Article 8: Derogation from the application of liquidity requirements on an individual basis

5.15 A firm may apply to the PRA for a permission under CRR Article 8 for the PRA to waive (in full or in part) the application of the liquidity requirements in the CRR to it and instead to supervise the firm together with other institutions in its group as a single liquidity sub-group. Where the relevant conditions in CRR Article 8 are met, including that the institutions have entered into contracts that provide for the free movement of funds between them and that there are no material practical or legal impediments to the fulfilment of these contracts, the PRA is able to grant the permission. The PRA is not required to grant the permission where the conditions specified are met, and may take into account a wider set of considerations.

5.16 Where an application by a PRA-authorised person under CRR Article 8 includes an institution that is an RFB or a ring-fenced affiliate, the PRA will consider whether the CRR conditions are met in light of the ring-fencing obligations placed on the RFB and entities in the RFB sub-group. The PRA will also consider the obligations placed on it by the Act in relation to ring-fencing. In particular, where the PRA considers that the granting of the approval would not be consistent with the PRA's general safety and soundness objective in relation to ring-fencing or the group ring-fencing purposes, the PRA does not expect to grant the approval.

5.17 Although the PRA will assess each application in light of the specific facts applicable in that situation, where:

- an RFB sub-group is in place and a PRA-authorised person proposes to form a liquidity subgroup consisting solely of institutions that are members of that RFB sub-group the PRA expects that, subject to meeting the conditions of CRR Article 8, it is likely to grant the permission;

- the firm proposes to form a liquidity sub-group consisting of institutions that are members of an RFB sub-group and institutions that are not, the PRA expects that it will not approve the application. This is because the PRA does not expect that the firm will be able to meet the conditions set out in CRR Article 8 and, in addition, that the granting of such a permission would not be consistent with the PRA's general safety and soundness objective in relation to ring-fencing; and

- no RFB sub-group has been established, the PRA will assess the application in light of the specific obligations placed on that firm.

LCR Delegated Act Articles 29, 33(2) and 34: Intragroup concessions in respect of liquidity outflows, liquidity inflows and the cap on inflows

5.18 Subject to the approval of the PRA, a PRA-authorised person may apply a preferential treatment to certain intragroup transactions for the purposes of calculating liquidity outflows, liquidity inflows and the cap on liquidity inflows under Articles 29, 33(2) and 34 of the LCR Delegated Act, respectively.

5.19 Where a firm seeking the approval is a member of a banking group that includes an RFB, the PRA will consider the application in light of the ring-fencing obligations placed on the RFB and any other members of its group, and also the obligations placed on the PRA by the Act in relation to ring-fencing. In particular, where the PRA considers that the granting of the approval would be inconsistent with the PRA's general safety and soundness objective in relation to ring-fencing or the group ring-fencing purposes, the PRA does not expect to grant the approval.

5.20 Although the PRA will assess each application in light of the specific facts applicable in that situation, the PRA expects that where:

- an RFB sub-group is in place and a firm seeks approval for a preferential treatment in respect of transactions between members of that RFB sub-group, subject to meeting the requirements of the LCR Delegated Act, the PRA is likely to grant the approval;

- an RFB sub-group is in place and a firm seeks approval for a preferential treatment in respect of transactions between members of that RFB sub-group and entities that are not members of that RFB sub-group, the PRA is unlikely to grant the approval; and

- no RFB sub-group has been established, the PRA will assess the application in light of the specific obligations placed on that firm.

6 Distributions

6.1 The PRA sets out below its expectations in relation to Ring-fenced Bodies 2 and 11 of the PRA Rulebook on the notice that an RFB or an entity in its RFB sub-group must give to the PRA in relation to proposed distributions to group entities that are not members of the RFB sub-group.

6.2 Where such proposed distributions have a significant adverse effect on the capital position of an RFB that could adversely affect the continuity of the provision of core services in the United Kingdom, the PRA may use its powers under section 55M of the Act or to give direction to a qualifying parent undertaking under section 192C of the Act to prevent the making of such distributions.

Notification period

6.3 Ring-fenced Bodies 2 and 11 of the PRA Rulebook require an RFB, or an entity in its RFB sub-group, to provide reasonable notice to the PRA of its intention to make any distributions to allow supervisors to assess the impact of the proposed distributions, and to discuss any concerns the PRA may have in advance of such distributions.

6.4 In determining a reasonable notice period, the PRA expects firms to take into account the type (eg dividends), the frequency and the amount of the distributions.

6.5 Where the proposed distribution poses a significant risk to the capital position of the RFB, the PRA expects the notice to be at least 30 days in advance of the intended payment.

Distributions to person(s) external to the group

6.6 A distribution to any person external to the consolidated group to which the RFB belongs is not in the scope of this rule. However, the PRA may still request information on these external distributions, when needed, in pursuing its objectives under the Act.

Relevant information to be submitted with the notification

6.7 Ring-fenced Bodies 11 requires the notice to include, amongst others, any relevant supporting information for the proposed distribution, including any impact of the proposed distribution on each RFB's current and forecast capital position.

6.8 The relevant information to support the analysis should include the following where applicable:

- impact on current key regulatory ratios (eg Common Equity Tier 1 ratio and leverage ratio), taking into consideration other discretionary payments (eg Additional Tier 1 payments, variable remuneration payouts) up to the expected payment date;

- impact on PRA buffer and/or ICG requirements; and

- other relevant information (eg forecast dividends, and capital levels over a three year time horizon and glide path to future requirements).

6.9 In line with the PRA's Fundamental Rule 2.7, the PRA expects to be informed of any material change to the information submitted with the notification as soon as possible.

Interaction with the notification requirement under the Capital Buffers Part of the PRA Rulebook

6.10 Capital Buffers 4.3(9) of the PRA Rulebook requires a firm, including an RFB, that does not meet the combined buffer to notify the PRA, and provide a set of information, at least one month in advance of its intended date of payment or action referred to in Capital Buffers 4.3(2)(a), (b) and (c).

6.11 The PRA considers that Capital Buffers 4.3(9) and Ring-fenced Bodies 11 serve different objectives, although there are some overlaps in the required information to be submitted to the PRA. If Capital Buffers 4.3(9) applies in respect of a proposed distribution, firms may submit all the required information under both rules in a single notification and clearly identify that the notification is given for both purposes.

7 Intragroup transactions and exposures

7.1 This chapter sets out the PRA's expectations of an RFB and its ring-fenced affiliates in relation to intragroup transactions, exposures and arrangements, particularly those covered by Ring-fenced Bodies 2, 3.5 and 12 to 15 of the PRA Rulebook. These expectations supplement other requirements, including CRR and other PRA rules, and RFBs are reminded of the need to apply such requirements appropriately in the context of an RFB's intragroup relationships.

Ring-fenced Bodies 3.5 (the 'general third party rule')

7.2 The general third party rule requires an RFB to apply the same standards to the management of exposures to, and arrangements with, group entities that are not members of the RFB sub-group as it would to third parties. The general third party rule embodies a key principle that should underpin an RFB's approach to all transactions, arrangements and exposures with its wider group: that an RFB and its ring-fenced affiliates interact with the rest of the group as they would with a third party.

7.3 The PRA acknowledges that certain intragroup transactions may be unique to the relationship between members of a banking group and may not exist in the market. The PRA does not necessarily consider the rule to prohibit intragroup transactions on the sole basis that an RFB or its ring-fenced affiliates do not have identical transactions with a third party. However, the PRA expects an RFB and its ring-fenced affiliates to apply the same robust standards of assessment, risk management and oversight of intragroup transactions with group entities that are not members of the RFB sub-group as they would to third parties. As part of this, an RFB and its ring-fenced affiliates should assess intragroup transactions and arrangements against its risk appetite, both in advance of undertaking the transaction or putting in place the arrangement, and at appropriate intervals thereafter, and take action where appropriate.

7.4 The PRA does not expect an RFB or its ring-fenced affiliates to apply precisely the same risk appetite, monitoring and oversight policies and procedures to its intragroup transactions, arrangements and exposures with group entities that are not members of the sub-group as it applies to third parties, though if this is the case it is more likely that the general third party rule is being met. If an RFB applies policies and procedures of a weaker standard to its intragroup transactions, arrangements and exposures than those it applies to third parties, it is likely to be contravening the rule. The PRA also does not expect that policies and procedures in place to meet the general third party rule should necessarily be identical across all classes of intragroup transactions with group entities that are not members of the RFB sub-group.

Management of intragroup exposures

7.5 As part of meeting the general third party rule and the requirements of Ring-fenced Bodies 2 of the PRA Rulebook, an RFB and its ring-fenced affiliates should manage not only individual arrangements with other group entities that are not members of the RFB sub-group but also overall exposure levels to these group members.

7.6 The PRA will take action where firms do not manage intragroup exposures appropriately. In addition, the PRA will consider implementing further measures (including lowering the large exposure limits specified in CRR Article 395(1)) if it observes that RFBs do not appropriately manage their intragroup exposures.

Secured intragroup exposures

7.7 All PRA-authorised persons are required to have sound collateral management systems and processes to meet their obligations under existing prudential requirements (including the CRR and the Risk Control Part of the PRA Rulebook). Consistent with the general third party rule and Ring-fenced Bodies 2 of the PRA Rulebook and existing prudential requirements, the PRA sets out below its expectations in relation to collateral received from other group members:

(a) Where an RFB or a ring-fenced affiliate receives collateral from group entities that are not members of the RFB sub-group, the PRA expects the RFB or its ring-fenced affiliate to assess and manage the collateral it receives as if it had received it from persons outside its group. This includes putting in place policies and procedures with respect to the types of collateral accepted as well as volume, pricing, valuation and margining requirements.

(b) In order to be recognised in the calculation of the effect of credit risk mitigation, CRR Article 194(3)(b) requires that the assets received be 'sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved'. Therefore, where applicable, the PRA expects an RFB and its ring-fenced affiliates to demonstrate the liquidity and the values of the collateral received from other group entities that are not members of the RFB sub-group through sale or repurchase agreements in both normal and stressed scenarios.

(c) CRR Article 207 sets out the requirements for financial collateral to qualify as eligible collateral. Therefore, where applicable, the PRA expects an RFB and its ring-fenced affiliates to be able to demonstrate that the value of collateral received does not have a material positive correlation with the credit quality of the obligor.

(d) Where applicable, in order to qualify as eligible collateral, an RFB and its ring-fenced affiliates must ensure that they satisfy the requirements of CRR Article 207(5) which requires that the residual maturity of the financial collateral received shall be at least as long as the underlying intragroup exposure. In its assessment of the effectiveness of the collateral taken, firms should assess the behavioural characteristics of the underlying maturity profile of the funding provided.

(e) Where an RFB or its ring-fenced affiliate outsources all or part of its credit risk mitigation management to a party that is not a member of the RFB sub-group, the RFB would still be expected to manage those risks effectively in compliance with the requirements in the Operational Continuity Part of the PRA Rulebook.

(f) Where collateral is held in custody by third parties, the PRA expects an RFB and its ring-fenced affiliates to be able to demonstrate clearly that these assets are appropriately segregated, where applicable, in accordance with CRR Article 207(4)(3).

Dependence on intragroup and shared customer income

7.8 Ring-fenced Bodies 2 and 13 of the PRA Rulebook require an RFB and its ring-fenced affiliates, as far as reasonably practicable, not to become dependent on intragroup income or the income generated from a customer that is likely to be contingent on services continuing to be provided to that customer by a group entity that is not a member of the RFB's sub-group, in a manner that would undermine the ability of the RFB to conduct core activities.

7.9 In order to achieve this intended outcome effectively, the PRA expects an RFB and its ring-fenced affiliates to:

- identify intragroup and shared customer income;

- assess the extent to which there may be a risk to the continuity of the provision of core services if such income were to cease or reduce significantly; and

- manage this risk in advance of such dependence occurring.

7.10 For the purposes of this statement, shared customer income refers to any income generated from a customer of the RFB or its ring-fenced affiliates that is also a customer of a group entity that is not a member of the RFB's sub-group. Ring-fenced Bodies 13 of the PRA Rulebook focuses on the element of this income that is contingent, or likely to be contingent, on services continuing to be provided to that customer by group entities that are not members of the RFB's sub-group (contingent shared customer income).

7.11 The PRA expects that an RFB and its ring-fenced affiliates should either reduce dependence, or have a credible plan to recover from the loss of or significant reduction in, intragroup and contingent shared customer income streams where there is a risk that they will become dependent on such income. As part of meeting this expectation, an RFB need not assess individual customer relationships that are likely to be immaterial but should group together customers that share relevant characteristics and are likely to behave in a similar way in the event of discontinuation of services by group entities that are not members of the RFB's sub-group.

7.12 The PRA expects that, when setting the business strategy of an RFB or its sub-group, an RFB's management should have regard to the risk of becoming dependent on intragroup or contingent shared customer income. The PRA also expects an RFB's management to set a risk tolerance with respect to the reliance of the RFB and its ring-fenced affiliates on intragroup and contingent shared customer income associated with the RFB sub-group's business strategy and to determine key ratios and figures to enable internal monitoring of the associated risks.

Availability of shared collateral

7.13 In relation to Ring-fenced Bodies 2 and 15 of the PRA Rulebook, the PRA recognises that there are situations where an RFB or its ring-fenced affiliates could have joint claims on the same collateral (eg property) provided by customers or counterparties with other group entities that are not members of the RFB sub-group. In these cases, the RFB and its ring-fenced affiliates should ensure that they have adequate policies and procedures in place to identify their share of any collateral, enable them to exercise their claims on the collateral, and access it when required. This will help to prevent collateral becoming unavailable to the RFB in the event of the failure of other group entities that are not members of the RFB sub-group.

7.14 The PRA expects the policies and procedures governing such shared collateral to include:

(a) a clear risk appetite on the extent of the use of shared collateral, including the circumstances in which its use is appropriate;

(b) an explanation of how shared collateral will be assessed initially, and on an ongoing basis, to ensure the share available to the RFB or RFB sub-group member remains in line with its credit risk appetite; and

(c) a standardised approach to documentation of shared collateral arrangements.

7.15 The PRA expects an RFB to be able to demonstrate that:

(a) the use of shared collateral and the protections surrounding it are consistent with Ring-fenced Bodies 15 and the general third party rule;

(b) shared collateral is managed consistently as part of the wider collateral management expectations set out earlier in this chapter; and

(c) the use of shared collateral will not mean an RFB is unable to continue to carry on core activities as a result of the acts, omissions or insolvency of another group member.

Arm's length requirements

Transactions with group entities that are not members of the RFB sub-group

The use of frameworks within the arm's length policy

7.16 The PRA does not object to an RFB or its ring-fenced affiliates putting in place framework agreements to aggregate transactions of a common type when meeting requirements under Ring-fenced Bodies 12 of the PRA Rulebook, provided that transactions are grouped in a meaningful way. In particular, the PRA expects that, where an RFB makes use of framework agreements, it should aggregate transactions in a manner that:

- allows it to meet requirements under PRA rules, including the Operational Continuity Part of the PRA Rulebook;
- facilitates restructuring activity in recovery or resolution; and
- allows the RFB and its ring-fenced affiliates to disaggregate balances to individual transactions and individual entities if required.

7.17 Where the PRA has concerns that the level of aggregation of transactions could be inappropriate, it will consider taking appropriate action to address the risks.

Intragroup transactions between an RFB and its ring-fenced affiliates

7.18 The Ring-fenced Bodies Part of the PRA Rulebook does not require an RFB to transact with its ring-fenced affiliates only on arm's length terms. The PRA reminds RFBs of their obligations under other Parts of the PRA Rulebook that are relevant to their interactions with ring-fenced affiliates, including:

(a) Fundamental Rules Part 2.1-2.8;

(b) Risk Control Part 2.1;

(c) Ring-fenced Bodies Part 3.1-3.3;

(d) Compliance Part 2.2 and Internal Audit Part 3.1;

(e) General Organisational Requirements Part 4.2;

(f) ICAA rules 2.1 and ILAA rules 2.1; and

(g) for RFB transactions with ring-fenced affiliates involving critical services, an RFB must comply with the requirements in Operational Continuity 3.1 and 3.3.

7.19 The PRA expects that, as a consequence of complying with requirements in the PRA Rulebook, including those set out above, an RFB will maintain appropriate oversight of intragroup transactions with its ring-fenced affiliates, and be able to identify and manage the

risks to the RFB from intragroup transactions with its ring-fenced affiliates. Where the PRA has concerns that an RFB is not appropriately managing its transactions with its ring-fenced affiliates, the PRA will consider taking appropriate action to address the risks.

8 Continuity of services and facilities of RFBs

8.1 This chapter sets out the PRA's expectations on the arrangements that an RFB and its ring-fenced affiliates may make where they receive services and facilities from other group entities or third parties outside of their group.

Group service arrangements

8.2 As set out in Ring-fenced Bodies 9 of the PRA Rulebook, an RFB and its ring-fenced affiliates may receive services and facilities only from other group entities where such entities are group services entities[1] or are ring-fenced affiliates.

8.3 'Services and facilities' includes the following types of services and facilities that support the business of the RFB: data-processing services; property management services; information technology; data centres; and back office functions (including FMI-related back office functions). Note that this is not an exhaustive list.

8.4 Financial or commercial transactions between the RFB and other group members, such as derivative transactions or underwriting risk, are not 'services and facilities' and therefore not within the scope of this chapter or the rules in Ring-fenced Bodies 9 of the PRA Rulebook.

8.5 An RFB would also need to meet any obligations that apply to it under the Outsourcing and Operational Continuity Parts of the PRA Rulebook, and consider relevant PRA expectations in SS9/16 'Ensuring operational continuity in resolution'.[2]

8.6 The PRA expects RFBs and ring-fenced affiliates to be able to demonstrate that they are appropriately managing the operational risk associated with any services and facilities they outsource. Factors supporting this could include:

- group services entities are financially and operationally resilient to an insolvency or resolution event involving the group entities they provide services to;
- there are appropriate contingency arrangements in the event of there being disruption to the RFB's outsourcing arrangement; and/or
- the services and facilities being provided to the RFB are substitutable.

Group and third-party service arrangements

8.7 The provision of services and facilities from other group entities and third parties to an RFB that are required by the RFB to carry on its core activities should not be capable of being disrupted through the acts, omissions, or insolvency of other group members.

8.8 It is expected that this could be achieved through RFBs ensuring that:

1 A 'group services entity' is defined in the Ring-fenced Bodies Part of the PRA Rulebook.
2 PRA Supervisory Statement 9/16 'Ensuring operational continuity in resolution' July 2016: www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss916.aspx.

- their contractual arrangements do not contain clauses such as set off rights, security interest, netting arrangements, and material adverse event provisions that could be triggered as a result of the acts or omissions of other group members. Note that this is not an exhaustive list of relevant contractual provisions; and

- a material deterioration in the financial circumstances of another group entity, or an insolvency or resolution event, does not disrupt any arrangements the RFB has with relevant parties that are necessary for the RFB to conduct its core activities.

9 Use of financial market infrastructures

9.1 The Act requires an RFB to participate directly in inter-bank payment systems, subject to a number of exceptions.[1] This chapter sets out the PRA's expectations in relation to an RFB's participation in inter-bank payment systems, including applications by an RFB to access payment systems through an intermediary. It also sets out expectations in relation to an RFB's participation in other financial market infrastructures (FMIs), in particular central securities depositories (CSDs) and central counterparties (CCPs), and expectations in relation to ring-fenced affiliates' access to FMIs.

Participation in inter-bank payment systems

9.2 Article 13 of SI 2014/2080 The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014 (the Order) prohibits an RFB from entering into any transactions enabling it to use services provided through an inter-bank payment system unless:

- it is a direct participant in the system; or

- where it is not a direct participant in the system, at least one of the conditions set out in Article 13(2) of the Order is satisfied.

9.3 One of the conditions specified in Article 13(2) refers to where the PRA has, following an application from an RFB, granted permission for it to access the services provided by an inter-bank payment system through an intermediary proposed by the RFB. The Order specifies that an application for permission must be made in such a manner and accompanied by such information as the PRA may direct. It also specifies that the PRA may only grant permission where it considers that the RFB needs to access the services provided by the inter-bank payment system in question due to exceptional circumstances and after the PRA has published a statement containing guidance on what is meant by 'exceptional circumstances'.

9.4 This chapter is intended to meet the statutory requirement in Article 13(9) of the Order on the PRA to provide guidance on what is meant by 'exceptional circumstances'. It also sets out what the PRA seeks to achieve in respect of RFBs' access to inter-bank payment systems and what will be required of RFBs.

9.5 Article 13 of the Order also sets out that, if the PRA decides to refuse or withdraw permission, an RFB may refer the matter to the Tribunal, in accordance with Part 9 of the Act.

Exceptional circumstances

9.6 The PRA considers that, for the purposes of granting permission for an RFB needing to access the services of an inter-bank payment system through a proposed intermediary, relevant 'exceptional circumstances' may include:

1 See Article 13 of SI 2014/2080 The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014.

- disproportionate burden: where being a direct participant in the system would result in a disproportionate level of cost, risk or other burden for the RFB, its customers or the system, having regard to the PRA's general safety and soundness objective in relation to ring-fencing under the Act.

- For example, where an RFB needs to access a particular inter-bank payment system in order to provide services to its customers, or to manage its own risks, but the use of that system typically only generates low or infrequent payments activity (such as in respect of some foreign currency inter-bank payment systems for some RFBs).

- temporary excessive burden: where an RFB is not a direct participant in the system and joining the system during a particular period would result in a level of cost, risk or other burden for the RFB, its customers or the inter-bank payment system significantly greater than would be the case if it becomes a direct participant at a later planned specified date and the PRA considers that granting permission is consistent with its general safety and soundness objective in relation to ring-fencing.

- For example, where an RFB is undergoing significant firm-specific business, strategic or operational change, and becoming a direct participant in the system would generate significant additional cost, risk or burden compared to becoming a direct participant at a later, specified date. Significant business, strategic or operational changes might be the result of, for example, recent changes in the RFB's ownership or action the RFB is taking under the direction of a resolution authority.

9.7 The examples provided above are illustrative and non-exhaustive. The PRA may assess that a particular circumstance for a firm is not exceptional, even where it appears to have similarities to the examples described. In addition, the PRA may consider circumstances other than those described above to be exceptional.

9.8 The PRA will assess any application from an RFB on its individual merits, and based on the information provided by the applicant in a relevant application form, as provided for in Ring-fenced Bodies 19 of the PRA Rulebook. The PRA will assess the application against the group ring-fencing purposes, and the likely impact on the ability of the PRA to meet its general safety and soundness objective in relation to ring-fencing under the Act.

9.9 In particular, the PRA will examine the alternative arrangements the RFB proposes to direct participation. This will include an assessment of the risks to the resilience and resolvability of the RFB, including any additional credit, liquidity, operational or other risks that the use of an intermediary may give rise to, and the potential impact on the continuity of core services arising from the use of the intermediary the RFB has proposed. The PRA may choose to grant permission subject to conditions. If so, it will impose requirements under section 55M of the Act in support of its decision.

Expectations for participation in central securities depositories and central counterparties

9.10 Central securities depositories (CSDs) and central counterparties (CCPs) can be important pieces of financial market infrastructure for RFBs. Access to such systems can be through direct participation, or by accessing the CSD or CCP indirectly through an intermediary. The use of an intermediary can be cost effective, in particular where an RFB's use of the system is low, and can be associated with lower operational and other risks. However, such indirect participation can generate two main risks for an RFB: i) an operational and liquidity dependence on another party; and ii) additional credit exposures.

9.11 Where these risks are significant, they could threaten the resilience of the RFB. If the intermediary is an entity within the same banking group as the RFB, they may also be inconsistent with the group ring-fencing purposes.

9.12 The PRA expects an RFB to participate in CSDs and CCPs in a manner that is appropriate given the activity and business model of the RFB. The PRA expects an RFB to participate directly in CSDs and CCPs where it has significant activity or where use of the system supports an important area of the RFB's business. An RFB should consider the operational and other benefits of direct participation and consider scenarios where direct participation may be essential to ensure continuity of access during periods of financial market stress, when reliance on intermediaries may not be guaranteed. This approach supports the PRA's general safety and soundness objective in relation to ring-fencing to ensure that the business of RFBs is protected from risks that could adversely affect the continuity of the provision in the United Kingdom of core services, and is consistent with the approach that applies to all regulated firms.[1]

9.13 The PRA recognises, however, that the costs and risks associated with direct participation may be prohibitive in certain circumstances in respect of some CSDs and CCPs, and that there may be cases where an RFB does not meet the relevant participation requirements. The PRA expects an RFB to demonstrate, in cases where it is able to satisfy the relevant participation requirements but it is not a direct participant, that it has undertaken a careful examination of the costs and risks of indirect participation, including the risks associated with the proposed intermediary.

9.14 Ring-fenced Bodies 16 of the PRA Rulebook imposes a requirement on the manner by which an RFB should access CCPs and CSDs. For CCPs based in the EEA, an RFB that is not a direct participant may meet this requirement by using an individually segregated account or an omnibus account where the margin requirement for the account is calculated as the sum of the margin required to cover separately the positions of each client within the omnibus account. For CSDs based in the EEA, an RFB that is not a direct participant may meet this requirement by using an individually segregated account. For CCPs and CSDs based outside of the EEA, Ring-fenced Bodies 16 requires an RFB to take necessary steps to ensure its positions, if applicable, and assets are separately identifiable from those of other entities by measures that deliver comparable outcomes to those specified for EEA-based CCPs and CSDs.

9.15 Article 14 of the Order prohibits an RFB from incurring a financial institution exposure unless it meets one of the specified exemptions. One of these is that an RFB may incur a financial institution exposure where the exposure concerned is a payment exposure and the RFB has complied with any rules or requirements imposed by the Financial Conduct Authority or the PRA under the Act in relation to payment exposures. The PRA considers that the rules made in Ring-fenced Bodies 16 of the PRA Rulebook include rules in relation to payment exposures.

Application of requirements to entities in an RFB sub-group

9.16 The PRA expects that entities in an RFB sub-group will access inter-bank payment systems directly, or through an RFB in the sub-group. Where this is not possible, or would result in a disproportionate level of cost, risk or other burden, then the PRA accepts that entities in an RFB sub-group would participate in an inter-bank payment system through an

1 In particular, the Risk Control Part of the PRA Rulebook requires that 'a firm must adopt effective arrangements, processes and mechanisms to manage the risk relating to the firm's activities, processes and systems, in light of [its] level of risk tolerance' (Risk Control 2.1 and 2.2 of the PRA Rulebook).

intermediary other than an RFB in the same group. The PRA expects members of an RFB sub-group to take a similar approach in respect of membership of other FMIs.

10 Exceptions to excluded activities and prohibitions

10.1 An RFB has a duty under section 142G of the Act not to perform excluded activities and not to contravene prohibitions. The Order sets out the details of excluded activities and prohibitions, and also permitted exceptions. RFBs will need to put in place policies and procedures in relation to their use of exceptions under the Order in order to meet the requirements of the Compliance and Internal Audit Part of the PRA Rulebook and Ring-fenced Bodies 3.4 of the PRA Rulebook (the demonstration of compliance rule).

10.2 These requirements are supplemented by rules in Ring-fenced Bodies 17 of the PRA Rulebook, which require an RFB to develop and implement exceptions policies which set out in detail when it will make use of the hedging exceptions, the liquid asset exceptions and the collateral exceptions in the Order (these terms are defined in the Ring-fenced Bodies Part).

Expectations in relation to exceptions policies

10.3 The Order sets out the criteria for an RFB to be able to make use of particular exceptions. The requirements in Ring-fenced Bodies 17 do not affect whether particular transactions are permitted as exceptions under the Order or not, but place obligations on an RFB to put in place policies and procedures where it makes use of the relevant exceptions. The PRA expects an RFB's exceptions policies to specify all matters relating to its use of the relevant exceptions under the Order in detail, and not to be written in general terms. In particular, the exceptions policies should be sufficiently detailed to enable the RFB to determine easily whether a transaction meets the requirements for use under the relevant exception in the Order.

10.4 The exceptions policies must cover at least those matters set out in the Ring-fenced Bodies Part but an RFB may include additional details or descriptions of related policies or procedures where appropriate.

10.5 Ring-fenced Bodies 17.1(3) of the PRA Rulebook requires an RFB to set out how it determines the purpose of an exceptions transaction. The Order requires the purpose of a transaction to be determined at the time the RFB enters into the transaction. It is possible that the purpose of a transaction may change over time or in light of changing circumstances. The PRA expects an RFB to be alert to such potential changes and to implement its policies and procedures so as to identify transactions where this may be the case and to take appropriate action immediately.

10.6 Where an RFB undertakes transactions within the scope of its exceptions policies those transactions are likely to introduce other risks that need to be managed. For example, where an RFB enters into a transaction with a counterparty in order to hedge interest rate risk, that transaction could itself introduce counterparty risk; similarly transactions undertaken for the purpose of managing liquidity risk might introduce interest rate risk or currency risk. The PRA expects an RFB to identify and manage such additional or second-order risks introduced by exceptions transactions. The PRA expects that in meeting this requirement firms will be alert to the range of risks that are introduced by exceptions transactions and will ensure that these are subject to the RFB's risk management processes. The PRA expects that an RFB would be particularly alert to transactions that are unnecessarily complex or that introduce excessive risk.

10.7 The PRA expects an RFB to ensure that its exceptions policies and procedures are kept up to date, implemented effectively and subject to appropriate oversight.

Application of requirements to entities in an RFB sub-group

10.8 The rules to develop exceptions policies in Ring-fenced Bodies 17 of the PRA Rulebook only apply to RFBs as the Order only applies to RFBs. The PRA expects that where an RFB is a member of an RFB sub-group, the RFB will apply the relevant parts of its exceptions policies to the other entities in its RFB sub-group or assess their activities against its exceptions policies. The PRA expects an RFB to do this as part of assessing whether it is meeting the PRA's expectations in relation to legal structure, in particular whether it owns entities that perform activities that would be excluded activities or contravene prohibitions if those entities were RFBs (see Chapter 2 'Legal structure and holdings of capital').

11 Reporting requirements

11.1 The PRA sets out below its expectations in relation to reporting requirements for RFBs. This Chapter should be read alongside the Regulatory Reporting Part of the PRA Rulebook.

Financial reporting by an RFB sub-group

11.2 The application of CRR Part Two to the RFB sub-group means that, where the RFB meets the criteria set out in CRR Article 99(2), the RFB must satisfy CRR financial reporting requirements (FINREP) on a sub-consolidated basis. Where the RFB does not meet the criteria set out in CRR article 99(2), the PRA expects to require that the RFB should nonetheless comply with FINREP requirements on a sub-consolidated basis. Similarly, the PRA expects to require the parent entity in an RFB sub-group to submit to the PRA audited group accounts, produced in line with the requirements outlined in the Companies Act 2006, if these would not otherwise be produced under the requirements set out in that Act.

Application of Remuneration Part of the PRA Rulebook

11.3 Ring-fenced Bodies 18 applies the Remuneration Part of the PRA Rulebook to an RFB on a sub-consolidated basis. Within the Remuneration Part, there are reporting requirements relating to Remuneration Benchmarking and High Earners reporting requirements. The PRA expects information collected through existing remuneration annual review processes would satisfy these requirements for an RFB on a sub-consolidated basis, and would not expect an RFB to submit additional sub-consolidated information using pre-defined templates.

Annual Senior Management Function attestation of the inclusion of intragroup over-the-counter (OTC) derivative transactions into the scope of the own funds requirements for Credit Valuation Adjustment (CVA) risk

11.4 The PRA expects that an appropriate individual performing a Senior Management Function in the RFB provides to the PRA, on an annual basis, written attestation that for the purposes of calculating the own funds requirement for CVA risk:

- on an individual basis, the RFB has included intragroup OTC derivative transactions undertaken with group members that are outside of the RFB sub-group; and

- on a sub-consolidated basis, the RFB has included intragroup OTC derivative transactions undertaken by all PRA-regulated entities within the RFB sub-group that are required by the CRR to calculate own funds requirements for CVA risk with group members outside of the RFB sub-group.

11.5 Similarly, the PRA also expects that each PRA-regulated entity within the RFB sub-group that is required to calculate own funds requirements for CVA risk on an individual basis should ensure that an appropriate individual performing a Senior Management Function provides to the PRA, on an annual basis, written attestation that the firm has included

intragroup OTC derivative transactions undertaken with group members outside of the RFB sub-group.

11.6 In all of the cases above, the PRA expects this additional responsibility to be expressly reflected in the Statement of Responsibilities of the relevant appropriate individual performing a Senior Management Function.

Core deposits

11.7 Notifications 12.2 of the PRA Rulebook requires a UK deposit-taker to notify the PRA within 30 days if its core deposits or, if it is a member of a group, the aggregate core deposits of each relevant group member, exceed, or have decreased to below, £25 billion. Notifications 12.3 also requires a UK deposit-taker to notify the PRA within 30 days if it reasonably expects or has information that reasonably suggests that it will meet or cease to meet the core deposit level condition within the next three years. Core deposit has the meaning given in article 1(3) of the Core Activities Order[1] ('the Order'). The core deposit level condition has the meaning given in articles 11(1)(d) and 12 of the Order.

11.8 Core deposits may represent a subset of a firm's total deposits. The PRA therefore expects firms to consider this proportion when assessing the extent to which they need to actively monitor core deposits. The PRA would expect this monitoring to increase as appropriate as a bank's deposit level increases, depending on, among other factors, their proportion of core deposits and the rate of deposit growth. The PRA expects firms to consider the core deposit level condition as part of their general business planning, taking into account the expected growth in deposits over time.

1 SI 2014/1960 The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities Order.

Appendix – SS8/16 updates

This appendix details the changes made to this SS following its initial publication in July 2016 following PS20/16 'The implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures'.[1]

2017

11 December 2017

The PRA updated this SS for the expectation that group recovery plans should have regard to recovery planning for the RFB sub-group (rather than just the RFB).

This SS was also updated to correct an error in numbering paragraph 4.22A.

These updated expectations take effect from 1 January 2019.

1 February 2017

This SS was updated following publication of Policy Statement 3/17 'The implementation of ring-fencing: reporting and residual matters – responses to CP25/16 and Chapter 5 of CP36/16'. The changes made are to:

- reflect new or revised expectations relating to recovery planning (paragraphs 4.37), reverse stress testing (paragraphs 4.22A and B) and RFB group risk (paragraphs 4.34-6); and

- reflect new reporting requirements for an RFB (in added Chapter 11) with supervisory expectations relating to financial reporting by an RFB sub-group, the application of the Remuneration Part to an RFB sub-group, an annual Senior Manager attestation of the inclusion of intragroup OTC derivative transactions into the scope of the own funds requirement for CVA risk and the notification requirement relating to core deposits.

Several paragraphs were updated, specifically to include firms below the core deposits threshold to the scope of the SS (paragraph 1.1), make reference to RFB groups risk and recovery planning (paragraph 4.1) and FMI-related back office functions (paragraph 8.3).

These updated expectations take effect from 1 January 2019.

1 www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps2016.aspx.