



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP4/14

Supervising international banks: the Prudential Regulation Authority's approach to branch supervision

February 2014

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Contents

Introduction	5
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Draft supervisory statement	6
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Box 1 The United Kingdom's distinction between international branches and subsidiaries and factors in a firm's choice of legal form	7
Box 2 FCA requirements	7
Box 3 PRA non-EEA branch risk appetite	9
Subsidiaries	10
<hr/>	
Non-EEA branches	10
<hr/>	
Box 4 Critical economic functions (CEFs)	11
Supervision of non-EEA branches	12
<hr/>	
EEA branches	12
<hr/>	
Costs and benefits	13
<hr/>	
Annex: Branch rules instrument 2014	

Introduction

1. In this Consultation Paper (CP), the Prudential Regulation Authority (PRA) seeks views on its proposed approach to supervising international banks, with a specific focus on branches from outside the European Economic Area ('non-EEA branches').
2. The proposals are relevant to all existing and prospective PRA-supervised deposit-takers and designated investment firms⁽¹⁾ operating in the United Kingdom which are not UK headquartered firms ('international banks').
3. The CP includes a draft supervisory statement which sets out the PRA's approach to supervising international banks, a summary of the purpose of the statement, the purpose of the proposed rules, and an analysis of the costs and benefits and other impacts of the policy. It also includes proposed changes to the PRA's rules, in the Annex, to support its supervision of branches.
4. Firms should read the CP in its entirety to understand the PRA's proposed policy in this area.

Purpose of the supervisory statement

5. The draft supervisory statement sets out the PRA's approach to branch supervision. International branches form an important part of the UK banking sector, and the statement is not intended to materially change this. Instead, it makes clear to firms the way in which the PRA will authorise and supervise branches and is intended to advance the PRA's objective of promoting safety and soundness, in order to ensure the stability of the UK financial system. This statement expands on the PRA's general approach as set out in its banking approach document.⁽²⁾
6. The final statement will be a comprehensive document relevant to all existing PRA-supervised deposit-takers and designated investment firms of non-UK headquartered firms operating in the United Kingdom, or wishing to operate in the United Kingdom in the future.
7. The Financial Conduct Authority (FCA) is the conduct regulator for all banks operating in the United Kingdom. All branches are subject to the FCA's conduct of business rules; these are not impacted by the policy in this CP.

Purpose of the draft rules

8. The PRA intends to introduce a rule requiring all deposit taking and/or designated investment firms that operate through EEA and non-EEA branches to complete a new data collection return to be effective from 2015.
9. The purpose of the twice yearly return is to enhance the PRA's understanding of the potential impact that branches could have on UK financial stability. The return will gather

quantitative information on economic functions being performed by all branches in the United Kingdom. The return is intended to reduce the number of *ad hoc* requests for data by the PRA.

10. The PRA intends to ask a sub-set of branches to complete the return during 2014 as part of the consultation process to assess its practicability and get detailed feedback. The return contents will then be subject to further development by the PRA, in particular to take into consideration feedback received as part of the consultation. The PRA will also ensure the return is consistent with the European Banking Recovery and Resolution Directive (BRRD).

11. For EEA branches this approach is consistent with article 40 of CRD IV,⁽³⁾ which allows host authorities to require information to assess whether a branch is significant.

12. The PRA is also proposing to introduce a rule that will require that non-EEA firms take all steps within their control to have adequate provision made in resolution plans for UK branches. The purpose of this draft rule is to support the policy by which the PRA will assess the adequacy of the Home State authority's resolution planning in terms of its potential impact on UK financial stability. The draft rule should be read alongside the proposed fundamental rule consulted on in January 2014, which if made, will apply to all firms, and require them to prepare for resolution so that, if the need arises, the firm can be resolved in an orderly manner with the minimum disruption of critical services.⁽⁴⁾ The draft rule in this CP makes more detailed provision than the proposed fundamental rule in requiring that the plan is adequate for resolution of the UK branch. A firm that does not comply with the proposed rule would likely fail to satisfy the Threshold Condition requiring that the firm have adequate non-financial resources (TC 5E(4)(e) provides that the firm's non-financial resources must be sufficient to enable the firm to comply with requirements (which includes rules) imposed on the firm by the PRA), or otherwise conduct its business prudently.

13. The process of assessing whether a Home State Supervisor (HSS) meets the PRA's standards for equivalence will not be provided for in rules. Similarly, the division of responsibilities between the PRA and home regulators will be a matter of bilateral agreement. The draft supervisory statement sets out proposals for how this process will operate, and in general terms which matters will be the subject of PRA supervision and

(1) www.bankofengland.co.uk/pr/Pages/publications/designationinvestmentfirms.aspx.

(2) www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1304.pdf.

(3) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

(4) Proposed FR8, see CP2/14 The PRA Rulebook at paragraphs 3.30 to 3.34: (www.bankofengland.co.uk/pr/Pages/publications/rulebookcon.aspx). Proposed FR 8 says: 'a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services'.

which home state supervision. In these respects the PRA is following the approach previously employed by the Financial Services Authority.⁽¹⁾

14. Firms which are from countries whose regulators are assessed not to be equivalent will fail the Threshold Condition that requires that the firm must be capable of being effectively supervised by the PRA (TC 5F). Firms from countries assessed not to be equivalent will not be authorised. Firms must always be in compliance with the PRA's Threshold Conditions, so if the assessment of the equivalence of a HSS changes, the firm can have its permission varied or cancelled. Similarly, if the assessment of equivalence varies according to the degree of activity in critical economic functions (CEFs), the firm can have its permission cancelled or varied or requirements attached to the permission, so as to respond to the equivalence issues that the circumstances warrant.

15. Draft rules (including the template for the proposed branch return) can be found in the Annex.

Draft supervisory statement

Background

16. In April 2013 the PRA set out its approach to the supervision of deposit-takers and significant investment firms that operate in the United Kingdom in its banking approach document.⁽²⁾ The PRA explained how the approach would be anchored in its objective to ensure the safety and soundness of firms, and thereby reduce the threat to the stability of the UK financial system.

17. The document briefly outlined the PRA's international approach, and noted that a fuller statement would be published outlining the approach to the supervision of international banks operating in the United Kingdom in due course. This draft supervisory statement builds on the original approach document. It summarises the PRA's approach to international bank supervision, and clarifies how the PRA will supervise branches.

18. This statement is relevant to all PRA-supervised firms operating in the United Kingdom which are not UK headquartered firms, as well as any firm looking to operate in the United Kingdom in the future.

International banks in the United Kingdom

19. International headquartered banks can either operate in the United Kingdom as subsidiaries or branches. A subsidiary is a separate legal entity from its parent, and as such requires its own governance and risk management, as well as meeting capital and liquidity requirements in the United Kingdom. A branch forms part of the same legal entity as its head office, and therefore will not have its own capital base or board as this is covered in the head office, though local governance is required.

20. This structure is also mirrored in relation to supervisory powers. For subsidiaries the PRA has the same legal powers and follows broadly the same supervisory framework as for UK headquartered firms.⁽³⁾ However, the responsibilities for prudential supervision of branches are split between the supervisor where the bank is headquartered (the HSS) and the PRA. This CP is therefore primarily focused on the PRA's approach to branches. In terms of establishing a branch in the United Kingdom, non-EEA deposit-taking branches need to be authorised by the PRA (ie the whole firm is required to meet the Threshold Conditions) whereas EEA firms have EU treaty rights to passport into other Member States.

21. In promoting its statutory objective of safety and soundness, the PRA focuses primarily on the harm that firms can cause to the stability of the UK financial system. A stable financial system is one in which firms continue to provide CEFs (see Box 4 for explanation) — a precondition for a healthy and successful economy. The PRA's view is that the ability for financial services firms to branch into other countries is, if done safely, an important component of an open world economy which in turn benefits the UK economy.

22. Currently there are 145 branches of international banks operating in the United Kingdom. In aggregate,⁽⁴⁾ they account for 31% (£2.4 trillion) of the total assets of the UK banking system, equivalent to around 160% of annual UK GDP. However, as **Chart 1** demonstrates, the United Kingdom is by far the most open developed financial market for international banks to operate branches, which provides important context for the policy discussed in this CP. Indeed many international banks operate in the United Kingdom and are significant providers of financial services to the UK economy. UK supervision of branches (where the PRA is the host supervisor) and co-operation with the supervisor in the country where the firm is headquartered (HSS) have always been important for UK supervisors.

23. Whilst the branches that operate in the United Kingdom have a range of business models, in the main these tend to be focused on wholesale banking activities. This is not unexpected given London's role as a key global financial centre.

24. The Financial Conduct Authority (FCA) is the conduct regulator for all banks operating in the United Kingdom. All branches are subject to the FCA's conduct of business rules; these are not impacted by the policy in this CP.

(1) This was set out in BIPRU 1.1.10 G, in force until 31 December 2013.

(2) www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1304.pdf.

(3) This approach is set out in 'The Prudential Regulation Authority's approach to banking supervision', April 2013.

(4) As at September 2013.

Box 1

The United Kingdom's distinction between international branches and subsidiaries and factors in a firm's choice of legal form

A branch is not a separate legal entity from the bank of which it is a part. It is mainly supervised by the home authorities as part of supervision of the bank as a whole. It is also not separately capitalised. And, eligible (mostly retail) deposits of an EEA branch, if any, will be covered by the home rather than host country deposit guarantee scheme.⁽¹⁾ However, eligible deposits⁽²⁾ placed in UK branches from outside the EEA are covered by the UK deposit guarantee scheme.

In contrast, subsidiaries are separate legal entities from their parents. Like domestically owned banks, they are authorised and separately regulated and supervised by the UK supervisory authorities. They are also separately capitalised and their eligible deposits are protected by the UK deposit guarantee scheme.

A number of factors determine whether a bank operates abroad through a branch or a subsidiary:

- i. Attitudes of national authorities to the presence of foreign branches differ across jurisdictions. The UK authorities have adopted an open approach to branches, particularly where the home country regulatory regime is broadly equivalent to that of the United Kingdom. In addition, under EU law, any bank that is incorporated in an EEA country has the right to open a branch in another EEA country, including the United Kingdom.
- ii. The regulatory and taxation arrangements applied to branches and subsidiaries differ across host authorities.
- iii. The bank's business model may also play a key role. Everything else being equal, banks with wholesale market operations may prefer to operate cross-border through a branch structure as funding costs to such a group are likely to be lower given the flexibility to move funds easily and cheaply across the bank. There are occasionally exceptions, particularly where there are restrictions in place eg exchange controls.
- iv. In contrast to iii) a subsidiary structure puts limits on the bank's ability to transfer funds across borders within the bank. Therefore a global retail bank may prefer a more decentralised subsidiary model focused on raising deposits from host retail customers and lending to the host economy.

Despite these factors and, although the legal distinction between a branch and subsidiary is clear, the business models branches and subsidiaries adopt, in practice, sometimes overlap. It is also common for firms to operate both a subsidiary and a branch in the United Kingdom with different business activities in each entity.

(1) In a small number of cases, EEA branches undertaking investment services may obtain 'top up cover' from the FSCS (see www.fscs.org.uk/industry/eea-top-ups/).

(2) Eligible deposits refer to those deposits which are covered by the Financial Services Compensation Scheme. Covered deposits refer to eligible deposits up to the compensation limit of £85,000 per eligible depositor per authorised deposit-taker. Eligibility under the FSCS generally covers natural persons and small/medium-sized enterprises. The rules on eligibility can be found in the PRA Compensation sourcebook.

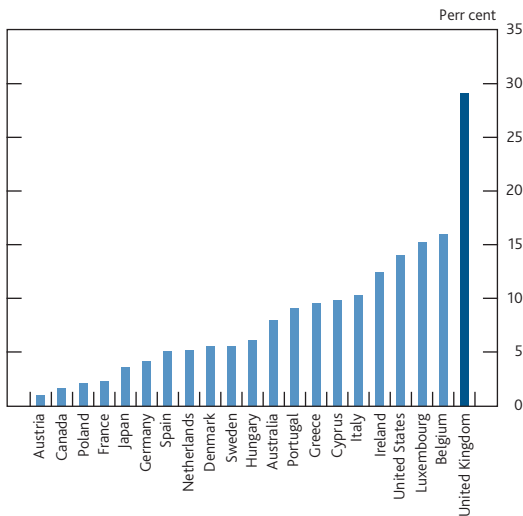
Box 2

FCA requirements

The FCA is the conduct regulator for all banks operating in the United Kingdom. Branches from the European Economic Area (EEA) have a right to passport into the United Kingdom and once established they are subject to the FCA's conduct of business rules. For non-EEA subsidiaries and branches, both

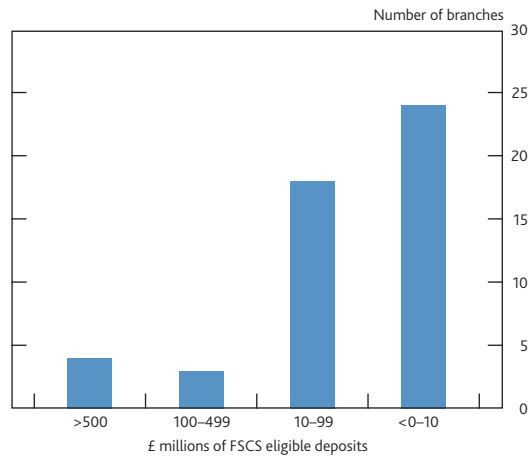
new and existing, the FCA's Threshold Conditions and conduct of business rules apply, including in areas such as anti money laundering (AML). For new applicants, authorisation can be granted only where both the FCA and the PRA are satisfied their respective requirements have been met. The FCA will independently assess applicants from a conduct perspective against its own requirements (FCA Threshold Conditions) and FCA objectives. Applicants should therefore discuss their proposals with the FCA at an early stage.

Chart 1 Branch assets to total resident banking assets (per cent) 2012



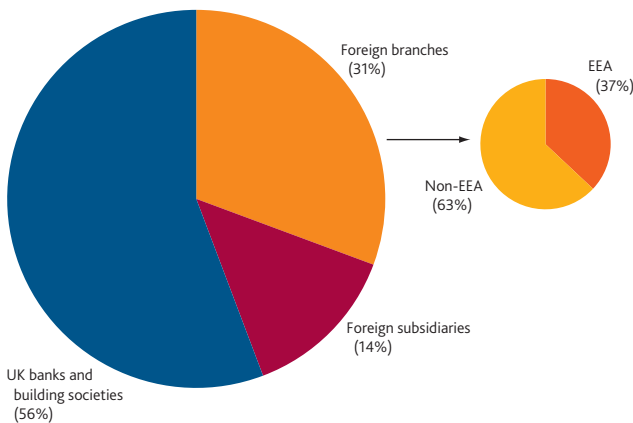
Sources: National central banks and Bank of England calculations.

Chart 4 Dispersion of FSCS eligible deposits in non-EEA branches (December 2012)



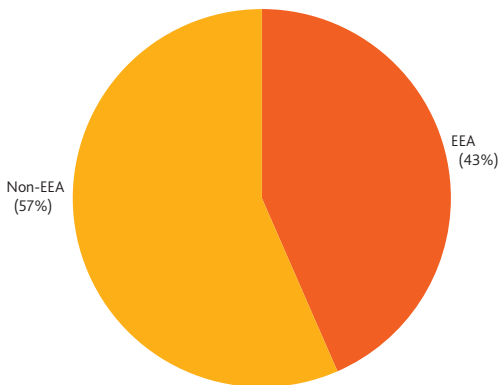
Source: Financial Services Compensation Scheme (FSCS) data.

Chart 2 UK resident bank system assets (September 2013): by firm authorisation type



Source: Bank of England.

Chart 3 Number of foreign branches (September 2013): split between EEA and non-EEA



Source: Bank of England.

Summary of approach to branch supervision

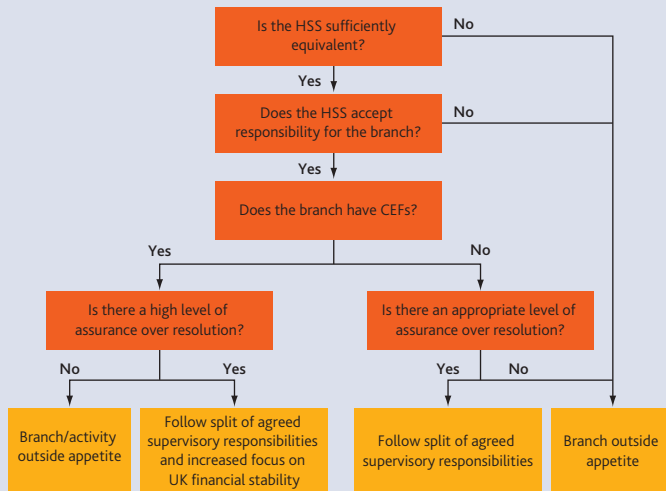
25. For non-EEA branches the PRA’s authorisation applies to the whole firm. The approach, which applies to both new and existing branches, is centred on an assessment of the equivalence of the home state’s supervision of the whole firm, the branch’s UK activities and the level of assurance the PRA gains from the HSS over resolution. Where the PRA is satisfied on these matters it will also need to have a clear and agreed split of prudential supervisory responsibilities with the HSS (full details are set out in the section on ‘Supervising non-EEA branches’). Where the PRA is not content it will consider the most appropriate course of action, which could include refusing authorisation of a new branch or cancelling an authorisation of an existing branch.

26. In addition, the PRA will be content for non-EEA branches undertaking retail banking activities beyond *de minimis* levels only if there is a very high level of assurance from the HSS over resolution. The PRA also expects new non-EEA branches to focus on wholesale banking and to do so at a level that is not critical to the UK economy, ie an interruption to the provision of service would not cause financial instability in the United Kingdom. This position is driven by two factors:

- continuity of access to transactional accounts (eg current accounts) is important for depositors. In resolution, where there is uncertainty over the financial position of a firm, such continuity cannot necessarily be provided which could potentially lead to uncertainty and financial instability; and
- non-EEA branches’ eligible deposits are covered by the United Kingdom’s Financial Services Compensation Scheme (FSCS) (up to £85,000 per eligible depositor per authorised deposit-taker). In the event of failure, if the FSCS was unable to recoup the amount it paid out via the bank insolvency procedure from recoveries from the failed

Box 3 PRA non-EEA branch risk appetite

Figure A Non-EEA branch framework



Due to the links between the different considerations, the decision tree is intended to be taken in its totality and is not intended to be assessed on a solely step-by-step basis, for example, whilst there is an acceptable level of assurance for a non-EEA branch, the criticality of the branch to the UK financial system will drive the level of assurance the PRA

deposit-taker, there would be a liability to the UK financial system. Given this, the PRA expects to exercise a greater level of supervisory oversight over those firms which potentially cause a liability to the FSCS.⁽¹⁾

27. While these risks are the same for UK subsidiaries the PRA has a greater ability to mitigate them as it has access to a full suite of supervisory tools and legal powers.

28. For existing non-EEA branches the PRA will focus its supervision on understanding if the branch undertakes CEFs, and working with the HSS to gain adequate assurance over how, if things were to go wrong, these functions would be resolved in line with the PRA's objectives. Where the PRA identifies concerns it will first raise these with the home state authorities. Where it is not content with their response, the PRA will consider using its powers over the branch to address concerns. Where serious concerns exist, the PRA may exercise the power to revoke the branch's authorisation to operate in the United Kingdom. In this circumstance a firm may choose to apply to operate a subsidiary in the United Kingdom which would need separate authorisation by both the PRA and FCA.

29. For EEA branches, the PRA's approach is consistent with CRD IV. When CRD IV is fully implemented, there will be a

would require on resolution or home state equivalence. The decision tree leads to four broad outcomes which will drive the supervisory approach:

Branch outside appetite: where the PRA would not be content with a firm operating as a branch in the United Kingdom in view of its lack of home state equivalence and/or the level of assurance over resolution.

Branch/activity outside appetite: where the PRA would not be content with a firm undertaking particular activities (CEFs) whilst operating as a branch in the United Kingdom.

Follow agreed split of supervisory responsibilities: where the PRA is content for the firm to operate in the United Kingdom as a branch and where the PRA will follow the agreed split of supervisory responsibilities, liaising closely with the home state.

Follow agreed split of supervisory responsibilities and increased focus on UK financial stability: where the PRA requires a high level of assurance on resolution to be content for a bank to operate in the United Kingdom as a branch. Where this is received, the PRA will supervise based on a split of supervisory responsibilities with the home state regulator. The PRA will focus specifically on any CEFs carried out by the branch and interconnectivity to United Kingdom financial stability.

clear division of prudential responsibilities, with the home supervisor of the branch fully responsible for the prudential supervision of the whole firm (including the branch). The PRA's approach is therefore to understand if the branch undertakes any CEFs in the United Kingdom. If it does, the PRA will seek to work with the home state to ensure that its resolution strategy takes account of the branch's potential impact on UK financial stability and to agree with it how the PRA can support prudential supervision. Where the PRA has material concerns about the firm's viability or branch's activities which the home state is not addressing, the normal recourse will be to refer the issue to the European Banking Authority (EBA). In emergency situations, and in accordance with articles 43 and 44 of the Capital Requirements Directive, where the home state has not taken appropriate action, the PRA will take the precautionary measures necessary to protect against financial instability that would seriously threaten the collective interests of depositors, investors and clients in the United Kingdom.

(1) The scope of cover the FSCS will provide is expected to expand due to changes to the Deposit Guarantee Schemes Directive (DGSD) potentially coming into force in 2015. Changes include the potential extension of protection to large corporates. The PRA is considering the implications of the changes to the DGSD and will consult on the DGSD as appropriate in due course.

Subsidiaries

30. For a **subsidiary** of an international bank, the PRA has the same legal powers and follows broadly the same supervisory framework as for a UK headquartered firm. This model focuses on three key elements:

- the potential impact that a firm could have on financial stability, both by the way it carries on its business and in the event of failure;
- how the external context in which a firm operates and the business risks it faces (together, its risk context) might affect the viability of the firm; and
- mitigating factors including: a firm's management and governance and its risk management and control (operational mitigation); its financial strength, specifically capital and liquidity (financial mitigation); and its resolvability (structural mitigation).

31. The PRA will work closely with the HSS to assess the linkages between the UK subsidiary and the wider consolidated group as well as the group's recovery and resolution plan. Consistent with its objective, where necessary the PRA will limit these linkages between the UK subsidiary and the group. Where the subsidiary is of a significant size, the PRA will be part of the supervisory college and attend the Crisis Management Group (CMG) for the consolidated group.

32. Where firms operate in the United Kingdom with both a subsidiary and a branch, the PRA expects appropriate governance to oversee and manage the links between the two entities. In supervising these firms the PRA will clearly delineate its supervision between the entities and expect the firm to have a clear booking model in place setting out what it will book in each entity and how they will verify its application.

Non-EEA branches

There are three criteria which will determine the PRA's stance towards non-EEA branches:

1 HSS equivalence

33. For a non-EEA branch, the PRA's Threshold Conditions, which are the minimum conditions for authorisation, apply to the non-EEA bank as a whole and not just the UK branch. Within this, there is a general provision that allows us to take account of the supervisory work carried out by the HSS. Although this stops short of full 'mutual recognition' or 'home country control' it does give the PRA scope to rely on others when it can satisfy itself that there are reasonable grounds for such reliance.⁽¹⁾

34. Where the PRA assesses the HSS to be sufficiently equivalent in relation to supervision and resolution, and it has an appropriate degree of assurance that its actions will be aligned to delivering PRA objectives, the PRA will support the HSS's supervision of the UK branch. Where a home state is determined not to be equivalent, either in general or in relation to the specific activities undertaken in the individual firm, the firm will need to operate in the United Kingdom as a subsidiary.

35. The PRA's equivalence assessment will focus on: the HSS's rules, powers, consolidated supervision, information sharing, confidentiality, and the competence and independence of supervision (this is not an exhaustive list). Understanding the capital, liquidity and resolution regimes will also be important factors in assessing the equivalence of the HSS, where the PRA will assess if the regime in question is consistent with international standards.⁽²⁾

36. In determining whether a HSS is considered to be of sufficient equivalence, the PRA will consider the nature of a firm's activities in the United Kingdom. The PRA will require a broad level of equivalence where, for example, the branch has or proposes to have CEFs. Where in the PRA's view the home supervisor is sufficiently equivalent but with weaknesses in areas where the firm operates, the PRA may propose to add limitations to the nature and scale of activities performed by the branch. Where the home regime is considered not to be equivalent the PRA will either:

- focus its supervisory work at mitigating the risks of non-equivalence if this is feasible for the relevant areas; or
- review the appropriateness of branches operating from that home state in close discussion with the home state and the relevant firm(s).

37. In forming its assessments of the HSS the PRA will base its analysis on the International Monetary Fund's (IMF) Financial Sector Assessment Programme reviews⁽³⁾ and Financial Stability Board (FSB) peer reviews,⁽⁴⁾ supplemented by other sources as necessary.⁽⁵⁾ The PRA will also take account of its own experiences in its interactions with the HSS. It will be important for the PRA to factor in any conduct concerns the FCA raises concerning a jurisdiction.

(1) FSMA, section 55D.

(2) Our expectation is that as global resolution standards increase, via bodies such as the Financial Stability Board, the PRA's requirements will, in turn, increase.

(3) www.imf.org/external/NP/fsap/fsap.aspx.

(4) https://www.financialstabilityboard.org/activities/peer_reviews.htm.

(5) The adoption of future European Union agreements with third countries relating to prudential supervision and resolution may also have implications for the PRA approach. The PRA will carefully consider the implications of these agreements as they are developed.

2 CEFs

38. The PRA will be content for non-EEA branches to undertake retail banking activities beyond *de minimis* levels only if there is a very high level of assurance over resolution. The PRA also expects new non-EEA branches to focus on wholesale banking and to do so at a level that is not critical to the UK economy, ie an interruption to the provision of the services does not cause financial instability in the United Kingdom. This position is driven by two factors:

- continuity of access to transactional accounts (eg current accounts) is important for depositors. In resolution, where there is uncertainty over the financial position of a firm, such continuity cannot necessarily be provided which could potentially lead to uncertainty and financial instability; and
- non-EEA branches' eligible deposits are covered by the United Kingdom's Financial Services Compensation Scheme (FSCS) (up to £85,000 per eligible depositor per authorised deposit-taker). In the event of failure, if the FSCS was unable to recoup the amount it paid out via the bank insolvency procedure from recoveries from the failed deposit-taker, there would be a liability to the UK financial system. Given this, the PRA expects to exercise a greater level of supervisory oversight over those firms which potentially cause a liability to the FSCS.

39. These risks are the same for UK subsidiaries but the PRA has a greater ability to mitigate them as it has the ability to use its full suite of supervisory tools and legal powers.

Box 4

Critical economic functions (CEFs)

The materiality of a firm's activities in the categories below will determine whether we regard it to be a CEF:

- retail banking;
- corporate banking;
- payments, clearing, settlement ;
- custody;
- intra-financial system borrowing and lending; and/or
- investment banking.

For all UK branches it is important that the PRA understands the main areas of business undertaken, or to be undertaken in the case of new authorisations. For wholesale banks CEFs are likely to be global in nature and should therefore also be considered in such terms.

3 Resolution

40. Resolution will be a key deciding factor in the PRA's judgements and is ultimately where it will place most emphasis when forming a view on its risk appetite towards branches operating in the United Kingdom. The PRA, in consultation with the Special Resolution Unit of the Bank of England, will assess both the equivalence of the HSS's resolution regime and the credibility of individual banks' resolution plans, including whether the plan adequately covers the operations within the UK branch.

41. In forming its views the PRA will take into account international standards (ie FSB). This assessment will be on a case-by-case basis and will range from receiving the appropriate home state assurances to seeking to understand the bank's group resolution plan in detail. For branches with small UK activities the PRA would seek to gain a level of assurance that is relative to the scale of their UK activities. As international standards come into force the PRA expects the level of assurance it will require from HSS over resolution plans to increase over time.

42. In terms of risk, CEFs that require continuity of service or require a significant time to wind down pose the highest level of risk to UK financial stability ie retail deposits, transaction accounts and payment systems. In line with its overall philosophy the PRA will focus on the greatest risks to financial stability. In practice, where there are or are proposed to be CEFs in the branch, the PRA will seek a higher level of assurance on the resolution plans from the HSS, including:

- a clear rationale why the activity is part of the business model for the firm, and why it is appropriate for it to be carried out in a branch;
- an understanding, to a significant degree, of the resolution plan for the whole firm and a clear understanding of how the branch links to the plan;
- a clear plan for continuity of service for the CEF, both functional and operational, including relevant details on how the activity would be wound down (and funded) in an orderly manner during a resolution to reduce the impact on UK financial stability; and
- understanding how access to critical systems and data managed in the home state will be maintained.

43. Where the activity is part of a global CEF, there will be an expectation that the home state will share the global resolution plan for this CEF and how this accounts for the activity in the UK branch.

44. While the PRA can gain assurance over resolution plans and the stated intentions of the home state, doubts may

remain over the certainty that the home state will not put national interests ahead of international objectives. The minimum outcome the PRA would seek to achieve is to ensure that the branch's UK creditors and depositors are treated equally with their domestic equivalents.

45. If there is a legally clear form of domestic depositor preference, then this is a known risk that can be assessed.⁽¹⁾ However, there are two related risks that are harder to assess: (i) the risk of short-notice legislative change in the home jurisdiction during a crisis that is intended to favour domestic depositors/creditors; and (ii) the risk that *de facto* administrative discrimination against foreign depositors/creditors takes place during the post-failure liquidation or resolution process. The PRA is reviewing its policy towards domestic depositor preference in the context of non-EEA branches, and will publish more information towards the end of 2014.

46. The BRRD was agreed in December 2013 and will be implemented in the United Kingdom from 1 January 2015. The Directive requires all Member States to ensure that their resolution authorities have wide-ranging resolution powers over non-EEA branches, including the power to resolve non-EEA branches on a stand alone basis. Together with the approach set out above, the PRA will give full consideration to the circumstances in which it will, or will not, seek to make use of such powers in each individual case.

Supervision of non-EEA branches

47. When the PRA has assessed that the HSS is equivalent and has sufficient assurance on resolution, the PRA will seek to establish a clear acceptance from the HSS of its prudential responsibilities for branches in the United Kingdom. As part of this the PRA will require there to be a firm-specific agreement on the responsibilities for prudential supervision of the branch and an appropriate level of information sharing. Where there are common interests and mutual benefits, the PRA encourages joint working with the HSS.

48. Although these agreements will vary depending on the branch's activities and the home jurisdiction, the PRA will typically focus its supervision on understanding the UK branch's activities as well as the financial strength and resolvability of the whole firm. More specifically:

- **Business risks:** where the PRA identifies risks to the whole firm from its work to understand the branch's activities, the PRA will raise these with the HSS to address these issues. Where the PRA identifies that the branch's business activities pose undue risk to the UK financial system it will assess and address these issues, and will expect to do so in consultation with the HSS.

- **Liquidity:** UK liquidity requirements enable a branch to: (i) operate self-sufficiently; or (ii) apply to waive local liquidity rules and rely on the whole firm's liquidity in exchange for regular information submitted to the PRA on the whole firm's liquidity position. The latter option is the PRA's current preferred approach for non-EEA branches. The PRA will review its approach to branch liquidity as part of the implementation of the CRD IV liquidity provisions and the BRRD.
- **Capital:** ensuring capital is sufficient to cover the risks in the branch is the responsibility of the HSS as part of its consolidated capital assessment.
- **Risk management, systems and controls:** the PRA will expect there to be a senior individual responsible for annually attesting compliance with Senior Management Arrangements, Systems and Controls (SYSC). This individual should be part of the UK management team.
- **Management and governance:** the overarching management and governance of the branch is the primary responsibility of the HSS. The PRA will be responsible for ensuring that branches have individuals responsible for the oversight of the branch and ensuring compliance with UK regulatory standards. Any senior individuals will require approval by the PRA.⁽²⁾

49. When implementing this approach the PRA will consider both the potential impact the branch may have on UK financial stability and the size and importance of the branch to the overall bank and the home state. The PRA will be proportionate in its expectations of the HSS's oversight of the UK branch and will expect greater oversight where there is a higher impact on UK financial stability.

EEA branches

50. Under European law, the home supervisor of an EEA bank that operates as a branch in another EEA country is responsible for the prudential supervision of the whole firm (including the branch). As a result, the PRA, where it is the host supervisor of such branches, is not responsible for their prudential supervision: this is the role of the home supervisor. The exception to this is that the PRA is responsible for liquidity supervision until 2015 at which point this is transferred to the home supervisor as part of the implementation of the Capital Requirements Regulation (CRR). In addition, if a branch supervisor considers that the branch is important to domestic financial stability, they are able to designate it as significant under European law. Where this occurs, the home supervisor

(1) See Financial Services Authority CP12/23, 'Addressing the implications of non-EEA national depositor preference regimes'.

(2) The rules on Senior Management accountability and how it relates to branches will be reviewed over the coming months in accordance with the Banking Reform Act.

must provide more information about the firm to the branch supervisor and to consult them on certain issues, such as planning for emergency situations. The data which the PRA proposes to collect to form a judgement as to whether a branch is significant is detailed in the Annex.

51. Notwithstanding its lack of direct prudential supervisory powers, the PRA still needs to ensure that these branches do not impact UK financial stability. The PRA will therefore identify and maintain an up to date assessment of which branches have CEFs in the United Kingdom and are therefore potentially important to UK financial stability. For those branches that are important to UK financial stability, the PRA will:

- designate the branch as 'significant' to the home supervisor;
- maintain an up-to-date view on the whole bank's proximity to failure;
- support the home supervisor in its prudential supervision of the branch, in particular through participating in the firm-wide joint risk assessment undertaken in line with European requirements; and
- work with the home authorities to ensure their resolution plan minimises the potential impact on UK financial stability.

52. For those branches that are not important to UK financial stability, the PRA will use information provided by the HSS to branch supervisors under the provisions of CRD IV (including the proposed new branch return) and public information to identify any banks that appear to be at a higher risk of failure. Where the PRA determines a bank is at a higher risk of failure, only then will it undertake more in-depth work to determine the specific risk of failure, establish stronger contact with the home authorities on their resolution plan and check for any changes in the branch's UK strategy.

53. Where the PRA has concerns with the approach to the supervision of the branch, it will formally notify the home supervisor. If the PRA considers the firm is at risk of breaching CRD IV requirements, the PRA will formally ask the home supervisor to address the problem and, in line with the CRR, ask the EBA to intervene if we consider that the home supervisor is not doing so.

54. In emergency situations, and in accordance with articles 43 and 44 of the Capital Requirements Directive, where the home state has not taken appropriate action, the PRA will take the precautionary measures necessary to protect against financial instability that would seriously threaten the collective interests of depositors, investors and clients in the United Kingdom.

55. Any precautionary measures the PRA takes will be proportionate to its purpose to protect against financial instability that would seriously threaten collective interests of depositors, investors and clients in the host Member State.

Costs and benefits

56. Section 138J of FSMA 2012 requires the PRA to perform a cost benefit analysis (CBA) when proposing draft rules. The PRA is required to publish an analysis of the costs and benefits and an estimate of those costs and benefits. The PRA is not required to perform a CBA if it considers that the impact on costs and benefits is of minimal significance.

57. The main proposals in this CP will apply to non-EEA branches operating in the United Kingdom. Currently there are 145 branches in the United Kingdom of which 82 are non-EEA branches offering retail and wholesale banking services. Whilst the majority of existing non-EEA branches will not need to change their UK legal entity to a subsidiary, the PRA expects that some existing branches will be impacted by this policy. In particular non-EEA branches undertaking a CEF in the form of retail banking may be significantly impacted, as the PRA does not wish to see retail banking in non-EEA branches beyond *de minimis* levels, unless there is a very high level of assurance over resolution. Currently there are 49 non-EEA branches that accept FSCS eligible deposits in the United Kingdom. The proposed data rules will apply to all 145 branches.

58. The PRA believes that the approach set out in this CP generates incremental benefits by ensuring that the activities undertaken in branches are compatible with the PRA's objective of promoting safety and soundness in the firms it supervises. The additional data received from branches will enable the PRA to understand better the UK activities of branches.

59. The incremental costs for the PRA in implementing this supervisory approach are expected to be minor, as the proposed rules codify the PRA's existing approach on non-EEA branches. These costs will arise in designing and implementing a new regulatory return.

60. The PRA estimates that some branches will incur a cost for complying with the proposed approach. This cost is expected to arise from the new supervisory approach and not from the additional data requirements, as the data are already collected by the PRA on an *ad-hoc* basis. The new supervisory approach is expected to require some branches to either exit the market or become a subsidiary. Subsidiarisation is expected to create both one-off and ongoing costs to firms. One-off costs consist of costs such as the legal costs to incorporate a firm in the United Kingdom and application fees. Ongoing costs cover the additional cost of day-to-day business of a subsidiary, such as

holding capital, maintaining a Board, tax, and compliance with the regulation.

61. For those firms that will need to operate in the United Kingdom as subsidiary rather than a non-EEA branch the costs of subsidiarisation varies depending on the size and nature of the bank's UK operations, the bank's activities in the United Kingdom and the home jurisdiction where it is headquartered. For instance, firms that operate both a branch and a subsidiary in the United Kingdom might incur less cost in transforming their branch to a subsidiary than other firms.

62. Given the number of factors that affect compliance costs, the PRA is unable to provide an estimate of costs for all the possible cases of subsidiarisation. Therefore this CBA provides only an indicative figure of the average cost of subsidiarisation to be. From previous supervisory experience of branches changing to subsidiaries the PRA estimates that a branch with total assets of less than £2 billion and with no-complex activities will incur a one-off cost of about £525,000 and ongoing cost of about £150,000 per annum to become a subsidiary.

63. Also there are additional indirect costs that the PRA are not able to quantify. For example, there are opportunity costs of holding capital in a UK subsidiary, whereas for a branch any capital requirements would be more fungible as part of the overall entity's capital. These costs would be higher for banks with larger and/or more complex UK activities.

64. In the analysis the PRA has also considered the effect on competition. The PRA expects that the rules might have a marginal impact on competition both in retail and wholesale banking. In retail banking, the costs of subsidiarisation may lead some firms to exit the market and will potentially increase the costs of non-EEA firms wishing to undertake retail deposit-taking in the United Kingdom. The PRA does not expect a profound impact on retail competition as it envisages that most of the current non-EEA retail branches will remain and will undertake these activities in a subsidiary and, at most, only a handful will exit. Similarly, in wholesale banking, the

PRA envisages that a clarification of its rules on branch supervision might bring new wholesale non-EEA branches in the United Kingdom, causing some minor effects on competition.

65. In conclusion, the proposed approach is expected to generate an additional cost to firms that operate non-EEA branches in the United Kingdom, accompanied with some possible effects on competition; however the PRA expects that these will be outweighed by the benefits of safety and soundness articulated above.

Statutory obligations

66. The PRA has a statutory requirement to state whether the impact of proposed rules on mutuals will be significantly different from the impact on other firms. The PRA does not expect the proposed rules and the supervisory statement to impact mutuals.

67. The PRA has had regard to the Regulatory Principles⁽¹⁾ and believes that the proposed policy is consistent with the Principles. The PRA considers that the benefits of these proposals are proportionate to the costs, as analysed above. Setting out the PRA's proposed approach to branch supervision in a supervisory statement and data collection in a rule helps all firms to understand the PRA's expectations, and so uses the resources of the PRA efficiently. In addition, the benefits as set out above in relation to advancing the PRA's objectives of safety and soundness contribute to the desirability of sustainable growth in the United Kingdom in the medium term.

68. The PRA has considered the equality and diversity issues that may arise from the proposals in this CP. The conclusion reached is that when looking at the range of products provided by UK incorporated firms, compared to non-EEA branches, the PRA sees no material impact based on product, diversity, or overall market size.

69. The PRA has consulted the FCA in relation to the draft rules contained in this CP.

(1) Section 3B of FSMA 2000.

PRA RULEBOOK: BRANCH RULES INSTRUMENT 2014

Powers exercised

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

Pre-conditions to making

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

PRA Rulebook: Branch Rules Instrument 2014

- D. The PRA makes the rules in Annex A, Annex B and Annex C to this instrument.

Commencement

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

Citation

- F. This instrument may be cited as the PRA Rulebook: Branch Rules Instrument [2014].

By order of the Board of the Prudential Regulation Authority

[DATE]

Annex A

PRA RULEBOOK - GLOSSARY

In this Annex, new text is shown underlined and deleted text is shown strikethrough.

...

bank

means:

- (1) a firm with a Part 4A Permission to carry on the regulated activity of accepting deposits and is a credit institution, but is not a credit union, friendly society or a building society, or
- (2) an EEA bank.

...

CRD credit institution

means a credit institution that has its registered office (or, if it has no registered office, its head office) in an EEA State, excluding an institution to which the CRD does not apply under Article 2 of the CRD.

...

designated investment firm

means an investment firm that has been designated by the PRA under Article 3 of Financial Services and Markets Act 2000 (PRA-regulated Activities) Order (S.I. 2013/556).

...

EEA bank

means an incoming EEA firm that is a CRD credit institution.

...

incoming EEA firm

means an EEA firm which is exercising, or has exercised, its right to carry on a regulated activity in the UK in accordance with Schedule 3 of FSMA.

...

third country firm

means an overseas firm that is not an incoming firm.

...

UK designated investment firm

means a *UK undertaking* that is ~~an investment firm that has been designated by the PRA under Article 3 of Financial Services and Markets Act 2000 (PRA-regulated Activities) Order (S.I. 2013/556)~~ a *designated investment firm*.

Annex B

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

Part

INCOMING FIRMS AND THIRD COUNTRY FIRMS

Chapter content

1. APPLICATION AND DEFINITION
2. BRANCH RETURN
3. ADEQUACY OF RESOLUTION PLAN
4. BRANCH RETURN FORM

Links

1 APPLICATION AND DEFINITION

1.1 Unless otherwise stated, this Part applies only to:

- (1) an *incoming firm*; or
- (2) a *third country firm*,

that is:

- (3) a *bank*; or
- (4) a *designated investment firm*.

1.2 In this Part the following definition shall apply:

resolution plan

means, in relation to a *firm*, the plan for the resolution of the *firm* prepared by the authority in the jurisdiction of the *firm's* head office responsible for the *firm's* resolution.

2 BRANCH RETURN

2.1 A *firm* must provide the *PRA*, every six months and no later than 30 days after 1 January and 1 June each year, with information as set out in the *Branch Return Form*.

3 ADEQUACY OF RESOLUTION PLAN

3.1 This chapter applies only to a *third country firm* that is:

- (1) a *bank*; or
- (2) a *designated investment firm*.

3.2 A *firm* must take all steps within its control to ensure that its *resolution plan* provides adequately for the resolution of the *firm's* *UK* branch.

4 BRANCH RETURN FORM

4.1 The *Branch Return Form* can be found here.

Annex C

Branch Return Form

Any reference in the *PRA* Rulebook to the Branch Return Form is a reference to this form:



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

This data is submitted in good faith on a 'best efforts' basis but does not constitute a regulatory return and will not necessarily have been subject to the normal sign-off and verification process to which regulatory returns are subject.

Main Details - Incoming EEA & Non-EEA Bank Branches

FRN	
Reporting Date (DD/MM/YYYY)	

What is the name of the firm	
-------------------------------------	--

GBP '000

Total Assets as at reporting date	
Functional currency of the firm	

In the event of a query, the Bank of England may contact:

Name: _____

Email: _____ Tel: _____

Deposit Taking

Item no

1 Retail Current (Transactional) Accounts

- a Amount covered by a recognised deposit insurance scheme
- b Amount uncovered by a recognised deposit insurance scheme
- c Total value of retail current accounts (a+b)
- d Total number of accounts fully covered by a recognised deposit insurance scheme
- e Total number of accounts partially covered by a recognised deposit insurance scheme
- f Total number of accounts uncovered by a recognised deposit insurance scheme
- g Total number of accounts (d+e+f)

£000s		
Sterling	Euro	Other

2 SME Current (Transactional) Accounts

- a Amount covered by a recognised deposit insurance scheme
- b Amount uncovered by a recognised deposit insurance scheme
- c Total value of SME current accounts (a+b)
- d Total number of accounts fully covered by a recognised deposit insurance scheme
- e Total number of accounts partially covered by a recognised deposit insurance scheme
- f Total number of accounts uncovered by a recognised deposit insurance scheme
- g Total number of accounts (d+e+f)

£000s		
Sterling	Euro	Other

3 Retail Savings (Non-transactional) Accounts

- a Amount covered by a recognised deposit insurance scheme
- b Amount uncovered by a recognised deposit insurance scheme
- c Total value of retail savings accounts (a+b)
- d Total number of accounts fully covered by a recognised deposit insurance scheme
- e Total number of accounts partially covered by a recognised deposit insurance scheme
- f Total number of accounts uncovered by a recognised deposit insurance scheme
- g Total number of accounts (d+e+f)

£000s		
Sterling	Euro	Other

4 SME Savings (Non-transactional) Accounts

- a Amount covered by a recognised deposit insurance scheme
- b Amount uncovered by a recognised deposit insurance scheme
- c Total value of SME savings accounts (a+b)
- d Total number of accounts fully covered by a recognised deposit insurance scheme
- e Total number of accounts partially covered by a recognised deposit insurance scheme
- f Total number of accounts uncovered by a recognised deposit insurance scheme
- g Total number of accounts (d+e+f)

£000s		
Sterling	Euro	Other

5 (Non-financial) Corporate Deposits

- a Total value of (non-financial) corporate deposits
- b of which: deposits from charities and UK local authorities
- c Total number of accounts (all non-financial deposits)
- d Total number of accounts (deposits from UK charities and local authorities)

£000s		
Sterling	Euro	Other

Lending

Item no

1 Retail Secured

£000s

- a Total value of outstanding retail mortgage loans
 b Total value of other retail secured loans
 c Total value of secured loans to retail customers (a+b)

	Sterling	Euro	Other
a			
b			
c			

- d Total number of outstanding mortgage loans
 e Total number of other retail secured loans
 f Total number of secured loans to retail customers (d+e)

d	
e	
f	

2 Retail Unsecured Personal Lending (Other Than Credit Cards)

£000s

- a Total value of outstanding unsecured retail loans

	Sterling	Euro	Other
a			

- b Total number of unsecured retail loans

b	
---	--

3 Retail Credit Cards

£000s

- a Total drawn value of credit cards outstanding
 b Total undrawn value of credit cards outstanding
 c Total notional value of credit card lending (a+b)

	Sterling	Euro	Other
a			
b			
c			

- d Total number of credit card accounts

d	
---	--

4 SME Lending

£000s

- a Total value of outstanding loans to SME's (secured)
 b Total value of outstanding loans to SME's (unsecured)
 c Total value of outstanding loans to SME's (a+b)

	Sterling	Euro	Other
a			
b			
c			

- d Total number of outstanding loans to SME's (secured)
 e Total number of outstanding loans to SME's (unsecured)
 f Total number of outstanding loans to SME's (d+e)

d	
e	
f	

5 (Non-financial) Corporate Lending

£000s

- a Total drawn value of bilateral loans to non-financial corporates
 b Total undrawn value of bilateral loans to non-financial corporates
 c Total value of drawn syndicate loans/facilities to non-financial corporates
 d Total value of undrawn syndicate loans/facilities to non-financial corporates
 e Total value of syndicate loans/facilities for which acting as agent

	Sterling	Euro	Other
a			
b			
c			
d			
e			

- f Total number of bilateral loans to non-financial corporates
 g Total number of syndicate loans/facilities to non-financial corporates
 h Total number of syndicate loans/facilities for which acting as agent

f	
g	
h	

6 Total Non-financial Lending

£000s

- a Total gross (non-financial) loans and advances
 b of which: Commercial real estate
 c of which: Infrastructure

	Sterling	Euro	Other
a			
b			
c			

Trade Finance

Item no

1 Documentary Credit & Collection

£000s		
Sterling	Euro	Other

a Total notional value of client facilities

b Total number of client accounts

--

2 Guarantees

£000s		
Sterling	Euro	Other

a Total notional value of client facilities

c Total number of client accounts

--

3 Import & Export Loans

£000s		
Sterling	Euro	Other

a Total outstanding value of client loans

c Total number of client accounts

--

4 Factoring/forfaiting & Invoice Finance

£000s		
Sterling	Euro	Other

a Total outstanding value of client loans

b Total number of client accounts

--

Credit Card Merchant Services

Item no

1 Credit Card Merchant Services

£000s

Sterling

Euro

Other

a Total average daily transaction value

--	--	--

b Total average daily transaction volume

--

c Total number of client accounts

Capital Markets & Investment

Item no

1 Derivatives - On Balance Sheet

£000s

- a Counterparty exposure of derivatives contracts
- b of which: Exchange traded
- c of which: Cleared by a CCP
- d of which: Bilateral OTC

	£000s		
	Sterling	Euro	Other
a			
b			
c			
d			

2 Derivatives - Off Balance Sheet

£000s

- a Potential future exposure of derivatives contracts
- b of which: Exchange traded
- c of which: Cleared by a CCP
- d of which: Bilateral OTC

	£000s		
	Sterling	Euro	Other
a			
b			
c			
d			

3 Derivatives - Total On & Off Balance Exposure Sheet By Product

£000s

- a Equities
- b Sovereign credit
- c Non-sovereign credit
- d Rates
- e Foreign exchange
- f Commodities

	£000s		
	Sterling	Euro	Other
a			
b			
c			
d			
e			
f			

4 Trading (AFS & HTM) Portfolio By Product

£000s

- a Equities
- b Sovereign credit
- c Non-sovereign credit
- d Other

	£000s		
	Sterling	Euro	Other
a			
b			
c			
d			

Payments, Settlements, Custody & Clearing (1/2)

Item no

1 Payment Services

UK Payment Systems
CHAPS CREST etc

- a (List) Legal entity holding direct membership of system
- b (List) Legal entity holding indirect membership of system
- c Total monthly average transaction volume (direct & indirect)
- d Total monthly average flow volume (direct & indirect)
- e Total monthly average transaction value (GBP '000 equivalent)
- f Number of agents

2 Settlement Services

UK Settlement Systems

- a (List) Legal entity holding direct membership of system
- b (List) Legal entity holding indirect membership of system
- c Total monthly average transaction volume (direct & indirect)
- d Total monthly average flow volume (direct & indirect)
- e Total monthly average transaction value (GBP '000 equivalent)
- f Number of agents

3 Cash Services

- a Number of (physical) branches
- b Number of ATMs

4 Custody Services

£000s

- a Assets under custody (direct)
- b Assets under custody (with sub-custodian)

	Sterling	Euro	Other

c Total number of custody clients

Payments, Settlements, Custody & Clearing (2/2)

	£000s		
	Sterling	Euro	Other
d Assets under administration			
e Total number of fund administration clients			
f Total number of underlying funds			
	£000s		
	Sterling	Euro	Other
e Assets under management			
f Securities Lending			
	£000s		
	Sterling	Euro	Other
g Total value of lendable assets			
h Total value of assets on loan			
i Number of clients <u>providing</u> lendable assets			

3rd Party Services Provided & Received

Item no	Service Description
1 3rd Party Services Provided	
a	Please provide details of any services provided <u>by</u> the firm to 3rd parties, such as branch counter, cheque processing, credit card payments, back office etc
	1
	2
	3
	4
	5
	6
	7
	8
	9
	10
2 3rd Party Services Received	
a	Please provide details of any services provided to the firm by 3rd parties, such as branch counter, cheque processing, credit card payments, back office etc
	1
	2
	3
	4
	5
	6
	7
	8
	9
	10