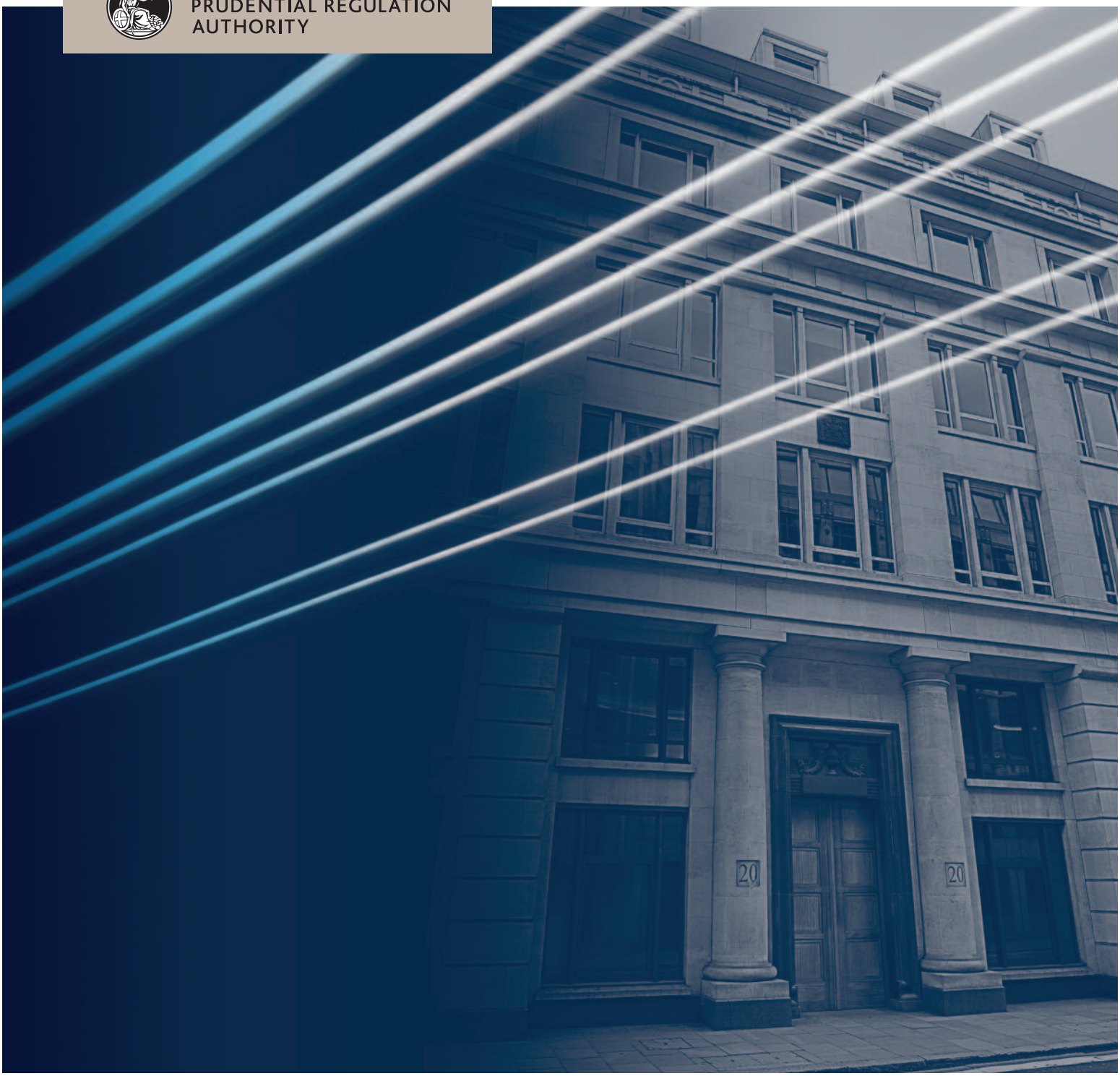
Supervisory Statement | SS10/14

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

September 2014

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Introduction

1.1 This supervisory statement expands on the Prudential Regulation Authority's (PRA's) approach to banking supervision[1] as it summarises the PRA's approach to international bank supervision, and clarifies how the PRA will supervise branches. This supervisory statement is relevant to all PRA-supervised firms operating in the United Kingdom which are not UK-headquartered firms, as well as to any firm looking to operate in the United Kingdom in the future.

1.2 At consultation, the PRA considered the way in which the policy advances its objectives, impact on mutuals, consistency with the Regulatory Principles,[2] the impact on equality and diversity, and costs and benefits of the proposed policy. The PRA's findings on these issues are unchanged following consultation and consideration of the feedback received.

1.3 Setting out the PRA's proposed approach to branch supervision in a supervisory statement, and the requirement for adequacy of resolution plans 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 set out at consultation 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.

Background

1.4 The approach to the supervision of deposit-takers and significant investment firms that operate in the United Kingdom was set out in the PRA's approach to banking supervision. In that document, the PRA also 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.

1.5 The PRA's approach document outlined the PRA's approach to the supervision of international banks in the United Kingdom, and noted that a fuller statement would be published in due course.

1.6 This statement sets out the PRA's approach to international bank supervision and clarifies how the PRA will supervise branches. A draft of this supervisory statement was consulted on in February 2014.[3] This final Supervisory Statement is published alongside Policy Statement 8/14[4] and provides responses to the feedback received in consultation.

International banks in the United Kingdom

1.7 Internationally headquartered banks can operate in the United Kingdom either as subsidiaries or as 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 it does need to meet local regulatory requirements.

1.8 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.[5] However, responsibilities for the prudential supervision of branches are split between the supervisor where the bank is headquartered — the home state supervisor (HSS) — and the PRA. This supervisory statement is therefore primarily focussed on the PRA's approach to branches. In terms of establishing a branch in the United Kingdom, non-European Economic Area (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 European Union (EU) treaty rights to passport into other Member States.

1.9 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 Critical Economic Functions (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.

1.10 Many international banks operate in the United Kingdom and are significant providers of financial services to the UK economy. The United Kingdom's supervision of branches (where the PRA is the host supervisor) and co-operation with HSS's have always gone hand in hand.

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

1.12 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; this is not affected by this supervisory statement.

(1) The Prudential Regulation Authority's approach to banking supervision, June 2014; www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1406.pdf.
(2) Section 3B of the Financial Services and Markets Act (FSMA) 2000.
(3) *PRA Consultation Paper CP4/14*, 'Supervising international banks: the Prudential Regulation Authority's approach to branch supervision', February 2014; www.bankofengland.co.uk/pra/Documents/publications/cp/2014/cp414.pdf.
(4) *PRA Supervisory Statement PS8/14*, 'Supervising international banks: the Prudential Regulation Authority's approach to branch supervision', September 2014; www.bankofengland.co.uk/pra/Documents/publications/ps/2014/ps814.pdf.
(5) See footnote (1) above.

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. 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 non-EEA branches are can be covered by the UK deposit guarantee scheme.(3) 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 United Kingdom's deposit guarantee scheme.

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

- 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.

- The regulatory and taxation arrangements applied to branches and subsidiaries can also differ across host authorities. These differences are likely to be important in determining the structure of a bank's foreign operation.

- 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 across the bank. There are occasionally exceptions, particularly where there are restrictions in place eg exchange controls.

- In contrast to the bullet point above 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 Financial Services Compensation Scheme (FSCS), see www.fscs.org.uk/industry/eea-top-ups/.
(2) Eligible deposits refer to those deposits which are covered by the FSCS. Covered deposits refer to eligible deposits up to the compensation limit of £85,000 per eligible depositor per authorised deposit-taker. The rules on eligibility can be found in the Compensation sourcebook of the PRA Handbook.
(3) If the home state's deposit guarantee protection is not equivalent, Member States may, subject to Article 47(1) of Directive 2013/36/EU, stipulate that branches established by a credit institution which has its head office outside the European Union must join a deposit guarantee scheme in operation within their territories. At present all non-EEA branch's eligible deposits are covered by the FSCS.

Summary of approach to branch supervision

1.13 **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 HSS'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 Section 4). 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.

1.14 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:

(i) **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 disruption and uncertainty for individuals and to wider financial instability. For this factor the PRA will determine its risk-appetite based on the value and type of accounts, the number of customers, substitutability and any planned growth.

Box 2
FCA requirements

The FCA is the conduct regulator for all banks operating in the United Kingdom. Branches from the 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. 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 and objectives. Applicants should, therefore, discuss their proposals with the FCA at an early stage.

(ii) **Eligible deposits of non-EEA branches covered by the 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, there would be a liability to the UK financial system. Given this, the PRA expects to have a very high level of assurance about resolution for those firms which could potentially cause a material liability to the FSCS, including an understanding of where the FSCS would rank in the creditor hierarchy in a home state insolvency. Where this is not the case these non-EEA branches will fall outside of the PRA's risk-appetite. In terms of setting a threshold for this factor, the PRA will collect better data on corporate deposits in non-EEA branches in the Branch Return.

1.15 These factors will be assessed in the round so the PRA's judgements on an acceptable threshold may vary on a firm-by-firm basis.

1.16 For existing non-EEA branches the PRA will focus its supervision on understanding whether 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 the 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 approval for authorisation by both the PRA and FCA.

1.17 For EEA branches, the PRA's approach is consistent with the package of EU legislation known as CRD IV, consisting of the Capital Requirements Regulation (CRR)[1] and the Capital Requirements Directive (CRD).[2]

1.18 Under CRD IV there is a clear division of prudential responsibilities, with the branch's HSS fully responsible for the prudential supervision of the whole firm (including the branch). The PRA's approach is, therefore, to understand whether the branch undertakes any CEFs in the United Kingdom. If it does, the PRA will seek to work with the HSS to ensure that the resolution strategy for the whole firm takes account of the branch's potential impact on UK financial stability and to agree how the PRA can support the HSS's prudential supervision. Where the PRA has material concerns about the firm's viability or branch's activities which the HSS 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 CRD, where the HSS 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.

Feedback to consultation responses

1.19 The PRA received a number of responses to CP4/14. Overall, respondents were supportive of the PRA's approach. A number sought clarification on different aspects of the approach. The PRA considered the responses and made minor changes to the final supervisory statement. The responses focused on five areas which are discussed in more detail below.

'De minimis retail deposits'

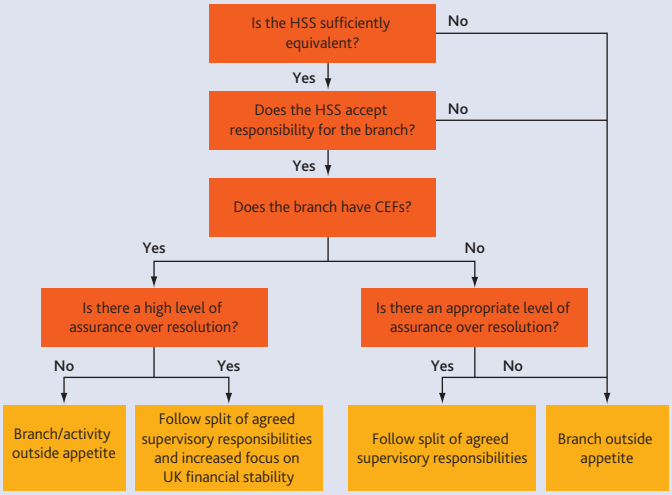
1.20 Respondents sought clarification of '*de minimis*' in the following statement 'the PRA will be content for non-EEA branches to undertake retail banking activities beyond *de minimis* levels only if there is a very high level of assurance from the HSS over resolution'.

1.21 When determining what is '*de minimis*' the PRA will take into account overall level of FSCS deposits, the value and type of account, the number of customers, substitutability of services and planned growth. The supervisory statement now includes more clarification on what the PRA would view as '*de minimis*'. These levels have been determined based on historical experiences of where retail deposits have caused financial stability concerns, as even a relatively small value of deposits can have a disproportionate impact on confidence in

(1) Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms.
(2) Directive 2013/36/EU of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

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 (**Figure A**). For example, while there may be 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 would require on resolution or home state equivalence. The decision tree leads to four broad outcomes that will influence 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 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 HSS.

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 HSS. The PRA will focus specifically on any CEFs carried out by the branch and interconnectivity to UK financial stability.

the financial system. These factors will be assessed in the round so the PRA's judgements on an acceptable threshold may vary on a firm-by-firm basis.

Home state equivalence

1.22 Respondents asked for clarification of the criteria used to determine whether a HSS is equivalent. Comments reflected a concern that as this process is outside the control of the firms, there is little transparency as to how the process would be conducted and also little transparency while it is being undertaken, and that this would impact on the ability of firms to plan future business strategy.

1.23 The process of determining whether an HSS is equivalent is an internal PRA process and involves the exercise of supervisory judgement, the approach to which will develop over time as the global regulatory environment changes. This is not a new process, and one that has been in place for a number of years; however, the aim has been to make the process more transparent. The supervisory statement now includes a clarification that it is the HSS and not the firm that is being evaluated, and that the frequency of determination of HSS equivalence will be based on the combined impact branches from one country have on the PRA's objectives.

Critical economic functions

1.24 Respondents requested further clarification of CEFs, metrics for determining a CEF and *de minimis* levels to avoid being a CEF. The requests were predominantly directed so that firms can obtain sufficient clarification as to how a CEF is determined so that they can make an evaluation as to whether their own activities would be classified as a CEF.

1.25 As noted in other areas, the PRA makes its judgements on a firm-by-firm basis. The PRA, therefore, does not believe it appropriate to provide exact details on when an activity becomes critical, however, the PRA has provided a more detailed definition of what constitutes a CEF.

SYSC attestation

1.26 Respondents raised concerns about the requirement in a non-EEA branch for a senior individual to be responsible for annually attesting compliance with the Senior Management Arrangements, Systems and Controls (SYSC) sourcebook of the PRA Handbook.

1.27 The attestation should cover areas of SYSC that relate to branches. While the PRA recognises a number of individuals may be responsible for ensuring compliance with various parts of SYSC, in line with the Senior Managers Regime the PRA

views it as important to have one individual responsible for providing an overall attestation. The PRA recommends that this attestation states: 'I confirm that [insert branch name] is in compliance with the relevant rules in the Senior Management Arrangements, Systems and Controls (SYSC) sourcebook of the PRA Handbook as at [insert date] and has been for the last twelve months'. The PRA will review if there is a continued need for this attestation once it is clear if, and how the Senior Managers Regime will apply to non-EEA branches.

1.28 Separate to this attestation, the PRA will continue to expect firms to notify if any SYSC breaches in a timely manner.

Implementation

1.29 Respondents asked for more information on how the PRA will implement this policy.

1.30 For non-EEA branches, this policy will be implemented immediately for all new branches. For existing branches the PRA envisages that it will implement this policy over time. The PRA will engage HSS's and branches on a priority basis, focusing on those branches and countries that have the highest impact on the PRA's objectives.

1.31 For EEA branches this is already how we supervise branches. The PRA will amend its approach as the final elements of CRD IV are implemented.

Branch Return

1.32 A number of respondents wanted assurance that when the Branch Return had been developed it had been assessed against existing PRA data requirements to avoid duplication. This has been completed, and has been assessed as not duplicating requirements given the low volume of data the PRA currently receives from branches.

1.33 A number of respondents requested accompanying notes for the Branch Return, as well as a number of detailed questions about what to include in certain fields.

1.34 The PRA is in the process of producing accompanying notes for the Branch Return. The PRA has undertaken a pilot of the Branch Return with 25 branches. Based on both the feedback and the pilot, the PRA has decided it is appropriate to complete a second pilot before publishing the final rule relating to the Branch Return. All branches will be requested to complete a slightly revised Branch Return as part of the second pilot. The Branch Return, and accompanying notes, will be sent to all branches by 30 September 2014, to be returned by 14 November 2014. The 25 branches that have already completed the initial Branch Return as part of the first pilot, with the exception of a few new fields, will be able to use the original submission as long as this has been correctly populated as per the accompanying notes. Following a review and analysis of the second pilot, the PRA will then publish the Branch Return rule, an accompanying policy statement, and the final Branch Return.

2 Subsidiaries

2.1 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:

(i) 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;

(ii) 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

(iii) mitigating factors including a firm's: management, governance and risk management and control (operational mitigation); financial strength, specifically capital and liquidity (financial mitigation); and resolvability (structural mitigation).

2.2 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 plans. 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 for the consolidated group.

2.3 Where firms operate in the United Kingdom with both a subsidiary and a branch, the PRA expects appropriate governance to oversee and manage the linkages 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 its application will be verified.

3 Non-EEA branches

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

(1) HSS equivalence;
(2) CEFs; and
(3) resolvability.

(1) HSS equivalence

3.1 For a non-EEA branch, the Threshold Conditions of the FSMA 2000 (which are the minimum conditions for authorisation) apply to the non-EEA bank as a whole and not just the UK branch. The PRA can take account of the supervisory work carried out by the HSS and of any opinion of the HSS about the firm's compliance with the United Kingdom's Threshold Conditions. 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)

3.2 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 an HSS 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.

3.3 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 is consistent with international standards.(2)

3.4 In determining whether an 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 HSS 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 HSS's 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 HSS and the relevant firms.

3.5 Equivalence assessments are reviewed periodically with the frequency determined by the number and size of the firms from a home state. In forming its assessments of the HSS the PRA will base its analysis on the International Monetary Fund's Financial Sector Assessment Programme reviews(3) and 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.

3.6 The existence of another branch from the same home state will not automatically mean that other firms from that jurisdiction can operate as branches in the United Kingdom. The PRA will conduct an equivalence assessment to ensure the HSS is equivalent in the specific activities, alongside the business model and rationale for all new branches. For example, if an existing branch undertakes wholesale banking activities, it does not necessarily follow that the PRA would be content for a new branch to open which undertakes retail banking activities.

(2) Critical Economic Functions

3.7 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:

(i) **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 disruption and uncertainty for individuals and wider financial instability. For this factor the PRA will determine its risk-appetite based on the following:

(a) The value and type of account; whilst not a hard threshold, the PRA expects non-EEA branches to have under £100 million of retail/small and medium-sized enterprises (SME)(6) covered transactional or instant access account balances.

(b) The number of customers; in addition to the value of deposits, the PRA will also take into account the number of customers. Where non-EEA branches have more than 5,000 retail and SME customers this may also be of concern.

(1) Section 55D of FSMA.
(2) The PRA expects that as global resolution standards increase, via bodies such as the Financial Stability Board (FSB), its expectations will, in turn, increase.
(3) www.imf.org/external/NP/fsap/fsap.aspx.
(4) www.financialstabilityboard.org/activities/peer_reviews.htm.
(5) The adoption of future EU agreements with third countries relating to prudential supervision and resolution may also have implications for the PRA approach. The PRA will consider the implications of these agreements as they are developed.
(6) An SME must meet at least two of the following criteria: (i) turnover is not more than £6.5 million per annum: (ii) balance sheet total of not more than £3.26 million; and/or (iii) number of employees is not more than 50.

Box 4
CEFs

A CEF can be defined as a function whose disruption or withdrawal could have an adverse material impact on financial stability in the United Kingdom. Therefore, the materiality of a bank's activities in the categories below will determine whether the PRA regard it as a CEF:

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

(c) Substitutability; in general the PRA's view is that transactional accounts are homogenous. In addition, there are numerous examples of firms providing these accounts via a UK subsidiary. However, in line with its statutory obligations, the PRA will also take into account the diversity, substitutability of the range of products provided and the market share in niche markets when forming a view on both the criticality of the function and if this is within the risk-appetite.

(d) Planned growth; whilst a non-EEA branch's existing retail deposits could be within the PRA's appetite, the PRA may conclude that the branch's plans to grow retail deposits are outside the risk-appetite.

(ii) **Eligible deposits of non-EEA branches are covered by the FSCS**. In the event of failure, if the FSCS was unable to recoup the amount it paid out via the bank insolvency procedure from recoveries, there would be a liability to the UK financial system. Given this, the PRA expects a very high level of assurance over resolution for those firms which could potentially cause a material liability to the FSCS, including an understanding of where the FSCS would rank in the creditor hierarchy in a home state's insolvency. Where this is not the case these non-EEA branches will fall outside of the PRA's risk-appetite.

The level of corporate deposits (which after the implementation of the Deposit Guarantee Scheme Directive will be covered by the FSCS) will be included in determining if a firm's deposits could create a material liability for the FSCS. In terms of setting a threshold for this factor, the PRA will collect better data on corporate deposits in non-EEA branches in the Branch Return. However, the PRA notes that even if a non-EEA branch has only a small proportion of the overall level of FSCS covered deposits, this could still cause an unacceptable increase in fees for the remaining fee payers if the FSCS were not to be repaid through a home state insolvency.

3.8 These factors will be assessed in the round so the PRA's judgements on an acceptable threshold may vary on a firm-by-firm basis.(1)

3.9 While these risks are the same for UK subsidiaries, the PRA has a greater ability to mitigate risks in these cases as it has access to a more potent suite of supervisory tools and legal powers.

(3) Resolvability

3.10 Arrangements for 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 Bank of England acting in its capacity as the United Kingdom's resolution authority, 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.

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

3.12 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, transactional 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:

(1) Any non-EEA branch will also need to factor into its proposals the costs and resources of initial and ongoing compliance with applicable FCA conduct of business requirements.

- 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.

3.13 Where the activity is part of a global CEF, the PRA expects the HSS to share the global resolution plan for this CEF, and explain how this accounts for the activity in the UK branch.

3.14 While the PRA can gain assurance over resolution plans and the stated intentions of the HSS, doubts may remain over the certainty that the HSS will not put national interests ahead of international objectives. The minimum outcome the PRA seeks is to ensure that the branch's UK creditors and depositors are treated equally with their home state equivalents.

3.15 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:

- the risk of short-notice legislative change in the home jurisdiction during a crisis that is intended to favour domestic depositors and/or creditors; and

- the risk that *de facto* administrative discrimination against foreign depositors and/or 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 in 2014 Q4.

3.16 The Bank Recovery and Resolution Directive (BRRD) was agreed by European authorities in December 2013 and will be implemented in the United Kingdom from 1 January 2015. The BRRD 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 in certain circumstances. While the PRA's preferred approach is to gain assurance that the home state's resolution regime will deliver the appropriate outcomes for the PRA's objectives, if this cannot be achieved, the PRA will give full consideration to the circumstances in which it will seek to make use of such powers in the BRRD.(2)

4 Supervision of non-EEA branches

4.1 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. This will also include confirmation from the HSS that the whole firm meets the Threshold Conditions needed for PRA authorisation. The PRA will also require the existence of a firm-specific agreement on the split of responsibilities for prudential supervision of the branch and an appropriate level of information sharing. Where there are common interests and mutual benefits, the PRA will seek to work closely with the HSS.

4.2 Although these agreements will vary depending on the branch's activities and the home jurisdiction, the PRA will typically focus its approach to 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, in its supervision of the branch, the PRA identifies risks to the whole firm, it will raise these identified risks with the HSS so that the HSS can address them. 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:

  - operate self-sufficiently; or

  - apply to waive UK 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.

  While self-sufficiency is the default position, the latter option is the PRA's current preferred approach for non-EEA branches. The PRA will consult separately on its approach to non-EEA branch liquidity as part of the implementation of the CRD IV liquidity provisions. In that consultation the PRA will propose that its requirements are better aligned with its preference, in that providing whole firm liquidity information will be the default option for non-EEA branches.

(1) *FSA Consultation Paper CP12/23*, 'Addressing the implications of non-EEA national depositor preference regimes', September 2012; www.fsa.gov.uk/static/pubs/cp/cp12-23.pdf.
(2) *PRA Consultation Paper CP13/14*, 'Implementing the Bank Recovery and Resolution Directive', July 2014; www.bankofengland.co.uk/pra/Documents/publications/cp/2014/cp1314.pdf.

- 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 expects a senior individual to be responsible for annually attesting compliance with SYSC. This individual should be part of the UK management team. The first attestations should be sent to the relevant supervisory team by 31 March 2015 and then by 31 March in subsequent years. The attestation should state:

  'I confirm that [insert branch name] is in compliance with the relevant rules in the Senior Management Arrangements, Systems and Controls (SYSC) sourcebook of the PRA Handbook as at [insert date] and has been for the last twelve months'.

  Once it is clear if, and how, the Senior Managers Regime will apply to non-EEA branches, the PRA will consider whether there is still need for this attestation.

  Separate to this attestation, the PRA will continue to expect firms to notify the PRA of any SYSC breaches in a timely manner.

- Management and governance; the overarching management and governance of the branch is the primary responsibility of the HSS. Contingent on the outcome of HM Treasury's proposed consultation on extending the new accountability regimes in the Financial Services (Banking Reform) Act 2013 to incoming branches and any resulting Final Order, the PRA will consult on rules to apply the proposed Senior Managers, Certification and Conduct Rules regimes to branches.

  Full details of the PRA's proposals will be set out in a future Consultation Paper. In the meantime, Chapter 6 of CP14/14[1] sets out (but does not formally consult on) the PRA's proposed initial approach to applying the Senior Managers Regime to incoming non-EEA branches, which will be to require at least one individual per incoming non-EEA branch to be approved as an Overseas Branch Senior Executive Manager. The PRA propose that this Senior Management Function is defined as 'the function of having responsibility, alone or jointly with others, for the conduct of all activities of the UK branch of an overseas firm which are subject to the UK regulatory system'. The individual(s) approved will typically be performing activities akin to those of a Chief Executive Officer in relation to the branch. In some situations, the PRA may require a branch to put more than one individual forward for approval, for instance where the individual originally put forward by the firm is not the most senior individual exercising influence in relation to the branch.

4.3 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.

5 EEA branches

5.1 Under European law, the HSS 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 the prudential supervision of those branches, this is the role of the home supervisor. The exception to this is that the PRA is responsible for liquidity supervision until the liquidity requirements in the CRR are implemented. At this point the supervision of branch liquidity will be the responsibility of the HSS. In addition, in line with Article 51 of CRD, if a branch supervisor considers that the branch is important to domestic financial stability, this supervisor is able to designate the branch as 'significant'. Where this occurs, the HSS must provide more information about the firm to the branch supervisor and to consult it on certain issues, such as planning for emergency situations. The PRA proposes that, once implemented, the Branch Return will provide the data the PRA will use to form a judgement as to whether a branch is 'significant'.[2] The rule on the collection of this data for EEA branches will come into effect for EEA branches when the liquidity requirements in CRD IV are implemented.

5.2 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 HSS;

- maintain an up-to-date view on the whole bank's proximity to failure;

(1) *PRA Consultation Paper CP14/14*, 'Strengthening accountability in banking: a new regulatory framework for individuals', July 2014; www.bankofengland.co.uk/pra/Documents/publications/cp/2014/cp1414.pdf.

(2) The Branch Return will also include a requirement for EEA branches to specify whether they undertake lending collateralised by immovable property in the United Kingdom. If the branch does undertake such lending, this will trigger a separate requirement within the Gabriel system for the branch to report information semi-annually on losses stemming from this lending. The requirement for EEA branches to provide information on these losses is set out in the CRR and the information that will need to be provided is set out in Annex VI of the Implementing Technical Standards on supervisory reporting under Regulation (EU) No 575/2013.

- support the HSS 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 HSS to ensure the whole firm resolution plan minimises the potential impact on UK financial stability.

5.3 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 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 HSS on the whole firm resolution plan and check for any changes in the branch's UK strategy.

5.4 Where the PRA has concerns about the HSS's approach to the supervision of the branch, it will formally notify the HSS. 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 the PRA considers that the home supervisor is not doing so.

5.5 In emergency situations, and in accordance with Articles 43 and 44 of the CRD, 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.