



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

# Annual Report and Accounts **2014**



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# **Prudential Regulation Authority**

## **Annual Report and Accounts**

### **for the year ended 28 February 2014**

Presented to Parliament pursuant to paragraphs 19(4) and 23(3)  
of Schedule 1ZB of the Financial Services and Markets Act 2000,  
as amended by the Financial Services Act 2012.

Ordered by the House of Commons to be printed on 17 June 2014.

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**This report is made by the Prudential Regulation Authority (PRA) under the Financial Services and Markets Act 2000 (FSMA). It is made to HM Treasury and covers year ended 28 February 2014.**

The report covers the requirements of paragraph 19 of Schedule 1ZB of FSMA.

HM Treasury has issued an accounts direction, disclosures relating to this are made on page 39.

The PRA's audited accounts for the reporting year ending 28 February 2014 are on pages 46-63.

Additional material can be found on the Bank of England (the Bank) website at [www.bankofengland.co.uk/pr](http://www.bankofengland.co.uk/pr)

## Consultation

Members of the public are invited to make representations to the PRA on the:

- Annual Report;
- way in which the PRA has discharged, or failed to discharge, its functions during the period to which the report relates; and
- extent to which, in their opinion, the PRA's objectives have been advanced and the PRA has considered the regulatory principles to which it must have regard when carrying out certain of its functions (contained in section 3B of FSMA) and the need to minimise any adverse effect on competition in the relevant markets that may result from the manner in which the PRA discharges those functions.

Please address any comments or enquiries to:

Strategy, Planning and Performance  
Prudential Regulation Authority  
20 Moorgate  
London EC2R 6DA  
[praannualreport@bankofengland.co.uk](mailto:praannualreport@bankofengland.co.uk)  
020 3461 8860

The consultation finishes on 17 September 2014.



The PRA makes an important contribution to the Bank of England's financial stability objective of protecting and enhancing the stability of the UK financial system



# Interactive contents

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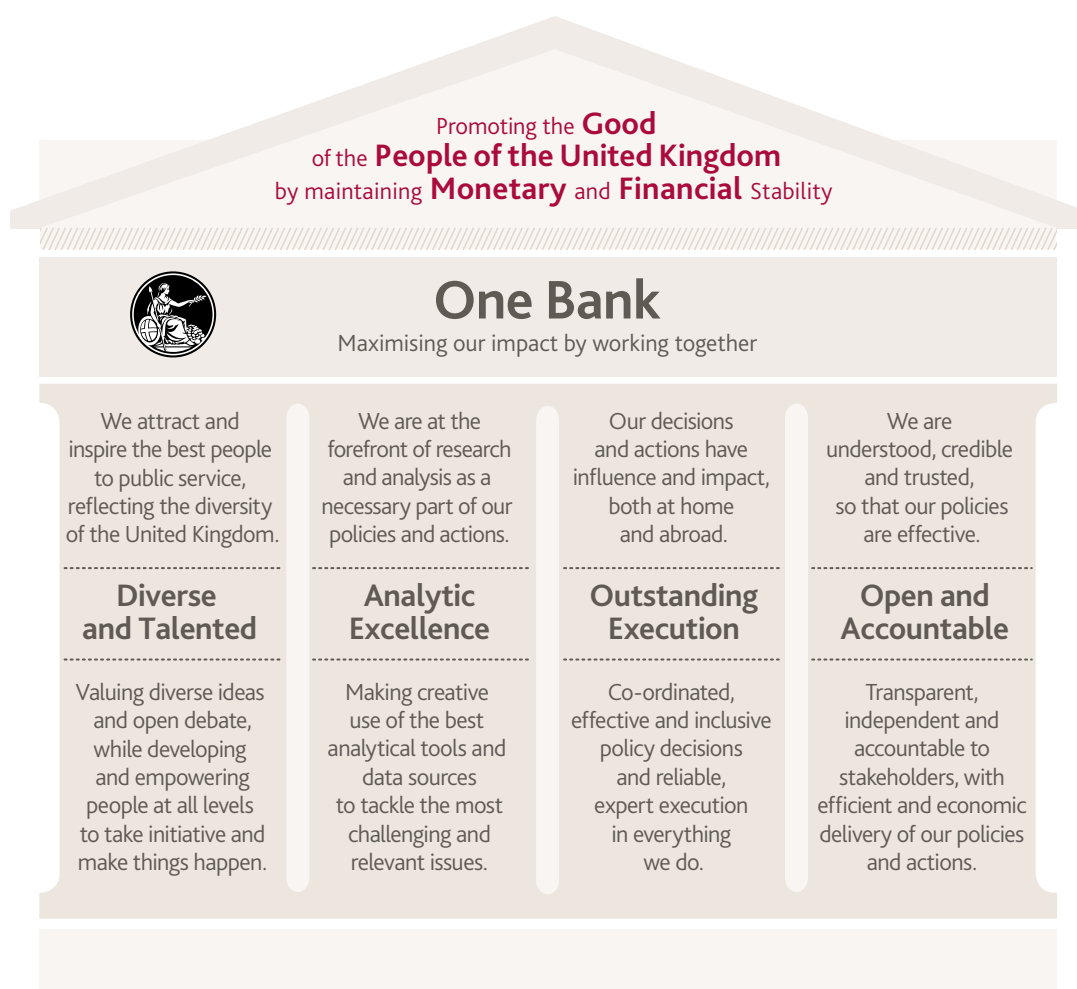
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Elycke Maat Danquere Leonard Exyne Habberdasher Edward Exry Gentleman Thomas Exmlins  
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ard Verbury Saller Rob. Ward Esquire John Young Ironmonger William Waldeu Dr John Wavell Francis Vates Gold-  
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tow Robert Bristol jun James de Batts Henry Butt John Borrett Samuel Brewster Charles Blau-  
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ual Bishop Henry Baldwin George Baupier Benjamin Brownsmith &c &c Haar Veringure &c

'Now know ye, that we being desirous to promote the publick Good and Benefit of our People...'  
Charter of the Bank of England, 1694



# One Mission, One Bank

The Bank of England's mission is to promote the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability.



# Foreword by the Chair



**Mark Carney**  
Chair of the  
PRA Board

**In April 2013 the Bank of England (the Bank) took on enormous new powers and responsibilities, including the responsibility for prudential regulation of banks and insurers and the design and operation of macroprudential policy.**

Our task has been to make the new enlarged Bank of England fulfill its potential by creating a single, unified institution – One Bank – that fully exploits the synergies from co-ordinating across our policy functions. The Prudential Regulation Authority (PRA) has been central to that task.

Andrew Bailey and his team have successfully delivered the transition of prudential regulation to the PRA. I am delighted that the PRA and its more than one thousand staff already form a major part of the Bank's fabric and culture. The integration of the PRA with the Bank now means that prudential regulation benefits from, and indeed adds to, the diverse range of expertise across the Bank; it draws on, and contributes to, the Bank's assessment of monetary and macrofinancial stability; and actions taken at the level of individual institutions can now be co-ordinated with actions at the level of the financial system as a whole.

All of those benefits have been on display in the PRA's first year, during which a great deal has been achieved. The work of supervisors, risk specialists and policy analysts has reinforced the resilience and effectiveness of the UK's banks and insurers, influenced domestic, European and global prudential standards, and played a role in ensuring the recovery of the UK economy after a long period of stagnation.

The PRA has an approach to supervision that embodies the lessons of the global financial crisis. The core of that approach is that our supervisors must use judgement to pursue our statutory objectives and that we must be forward looking. Although we will always be proportionate, our supervisors will not wait until a specific rule is broken or requirement breached before taking action.

The strength of that approach has already been demonstrated. Actions were taken by the PRA, in concert with the Bank's Financial Policy Committee (FPC), to strengthen the balance sheets of major banks and building societies, putting them in a position to support the nascent economic recovery. Liquidity requirements were adjusted to reinforce that recovery and in a way that, through co-ordination with the design of the Bank's liquidity facilities, did not compromise resilience.

The forward-looking approach is now being developed through the introduction, by the PRA and FPC, of a new annual stress-testing regime for banks. That process brings together expertise from across the Bank to ensure the resilience of the banking system and support a sustainable economic expansion.



The PRA has also contributed to the design and implementation of vital European and international reforms to supervisory standards. The PRA has been active, for example, in ensuring that Solvency II remains a prudent but proportionate Directive for insurance. Recognising the importance of these and other international initiatives, the Bank has consolidated our international operations, aligned our negotiating strategies, and further deepened our working relationship with HM Treasury.

The PRA, in concert with the Bank's Resolution Directorate, has also engaged in the development of an international framework for the resolution of failing systemic banks without adverse effects on the real economy or cost to the taxpayer. Comprehensive and effective plans to resolve major UK banks are being drawn up.

Such plans are necessary to give life to the PRA's commitment that firms should face the discipline of the market and consequences of their actions. We do not operate a zero failure regime. This will not only encourage the safety and soundness of individual firms, but also the competitiveness of the UK financial sector.

By ensuring that firms are able to fail without threatening the stability of the system as a whole, we have been able to amend the prudential requirements on new entrants into the banking market and reduce the barriers to entry into the market. The processing of new banking licenses has also been streamlined. As a result, we are seeing new banks enter the UK market and expect to see more during 2014.

The reform of domestic requirements has also been a focus for the PRA, in part reflecting the completion of the impressive work of the Parliamentary Commission on Banking Standards. A new framework is being established for approval and regulation of senior managers in banks. That will also be accompanied by new rules on remuneration. These developments will create the right incentives for those working in regulated institutions and, in doing so, further the PRA's objective of ensuring the safety and soundness of those institutions. These considerable achievements are the result of a heavy workload for the team at the PRA and the members of the new PRA Board. They have carried this burden with enthusiasm and determination, and should be proud of what they have achieved.

The new regime has been launched effectively, but we will not now stand still. The challenge is to develop it to maturity. We will complete the job of putting in place robust, internationally-consistent standards; of evolving our supervisory approach to developments in the economy, markets and the firms we regulate; and we will integrate prudential supervision fully into the wider Bank. By meeting that challenge we will maximise our contribution to stability and, through that, the good of the people of the United Kingdom.



6 June 2014

# Foreword by the Chief Executive



**Andrew Bailey**  
Chief Executive

**Work to create the new system of financial regulation in the UK began four years ago at a time when the worst period of the global financial crisis was still a very vivid memory.**

It is our firm intention that the new approach we take to prudential regulation will learn from the very bad experiences of the crisis. Chief among these lessons is that we must be prepared as prudential supervisors to use our judgement to achieve our objectives, and in doing so, create the right incentives for behaviour in the firms we supervise. Likewise, we must be forward looking in the application of judgement to the risks that lie ahead. We should be proportionate in our actions and consistent with our overall objective of maintaining the stability of the financial system. Thus, we recognise some firms pose greater risks than others because of their size, interconnectedness, complexity or business type. Above all, we need to be engaged with and close to developments in the industries whose firms we supervise and thereby understand the emerging risks.

The PRA has clear statutory objectives, primarily to promote the safety and soundness of banks, insurers and major investment firms in the UK and to seek to secure an appropriate degree of protection for insurance policyholders. These were supplemented with a new secondary objective to facilitate effective competition in the markets for services provided by PRA- authorised firms from 1 March 2014. I welcome this change to our objectives.

A crucial lesson from the financial crisis has been the importance of effective policy co-ordination, which is why it is so much at the heart of the new role of the Bank. The PRA has worked in concert with the Financial Policy Committee and firms to better understand the principal risks to the UK banking system.

The past twelve months have included risks from potential sharp upward movements in long-term interest rates and credit spreads, current and potential stress in the euro area and the threat of cyber attack. The PRA has also looked to bolster firm governance in light of the Parliamentary Commission on Banking Standards' final Recommendations, ensuring key activities undertaken by firms, or key risks to which they are potentially exposed, are assigned to senior individuals.

Close co-ordination with the Financial Conduct Authority (FCA) and international partners on a range of issues has also been essential to the successful achievement of the PRA's objectives this year. Of particular note is the influence the PRA has had in shaping new capital requirements (CRD IV) that came into effect on 1 January 2014. These requirements, which implement the international Basel III agreement in the European Union (EU), will help to increase and improve the capital held by banks, enhance risk coverage, reduce pro-cyclicality, and improve firm disclosure. Over the past year, the major UK banks raised in excess of £10bn of new, higher-quality capital to ensure they meet these new requirements. Additionally, leverage ratios have been raised significantly. These changes will help to ensure firms are better protected against potential future losses, but have been achieved without compromising resilience. For smaller firms, we have used thematic supervision to identify and address specific areas of concern. And we have set out how we intend to supervise firms from within and outside the European Economic Area.




For insurance companies, the PRA has focused on building two new directorates for General and Life Insurance. Our supervisors have engaged closely with firms to better understand the range of risks posed to these firms' business models, including future changes in interest rates, annuities and the introduction of new European capital rules in 2016, in the form of Solvency II.

Across banking and insurance the PRA has progressed the design and use of stress testing and announced the introduction of annual concurrent tests for the eight largest UK banks and building societies. And we have introduced new recovery and resolution rules to increase preparedness for those occasions when firms do unfortunately fail. The PRA worked with the Cypriot authorities in their resolution of the Cypriot banks, Bank of Cyprus and Cyprus Popular Bank. Deposits held with the London branch of Cyprus Popular Bank (known as Laiki Bank) were transferred to the Bank of Cyprus UK Ltd, on 2 April 2013. This high pressure work was an early, successful test for our staff, processes and statutory objectives.

I was proud to see that in its recent report on the new approach to financial regulation the National Audit Office pointed to the skills of PRA staff.<sup>1</sup> This praise is well deserved. However, resourcing was a significant challenge for us during 2013/14 with delays in recruitment and a higher than expected turnover rate at the PRA. Ensuring that we can retain and continue to recruit high-calibre staff to deliver forward-looking, judgement-based supervision remains a priority.

Much has been achieved during the PRA's inaugural year, and I would like to extend thanks on behalf of the Board of the PRA to all our staff for their dedication and contribution. But there remains much still to do, not least ending 'too big to fail' and ensuring the resolvability of large and complex firms. Those are challenges on which we will seek to make progress over the next twelve months, supported by the Bank's new Strategic Plan and organisational structure.



6 June 2014

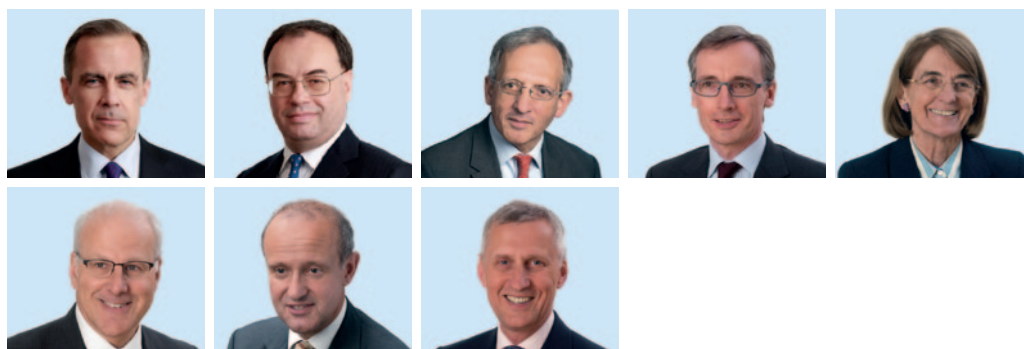
**We must be prepared as prudential supervisors to use our judgement to achieve our objectives, and in doing so, create the right incentives for behaviour in the firms we supervise**

1 The NAO completed its *Regulating Financial Services* report in March 2014. It included a number of recommendations for the PRA and FCA. [www.bankofengland.co.uk/pra-ar2014/links](http://www.bankofengland.co.uk/pra-ar2014/links)





# Board of the Prudential Regulation Authority



**Members of the Board  
as of 28 February 2014**  
Top row, left to right

**Mark Carney**

Governor,  
Chair of the PRA Board

**Andrew Bailey**

Deputy Governor, Prudential  
Regulation and Chief Executive  
of the PRA

**Sir Jon Cunliffe**

Deputy Governor,  
Financial Stability

**Iain Cornish**

Appointed Member  
Term: 20 February 2013  
– 19 February 2016

**Rosalind Gilmore**

Appointed Member  
Term: 20 February 2013  
– 19 February 2015

**Bottom row, left to right**

**Charles Randell**

Appointed Member  
Term: 20 February 2013  
– 19 February 2017

**Nick Prettejohn**

Appointed Member  
Resigned wef 5 March 2014

**Martin Wheatley**

Chief Executive,  
Financial Conduct Authority  
(*ex officio*)

**The PRA is a subsidiary of the Bank of England. In April 2013, it became the UK's prudential regulator for banks, building societies and credit unions (collectively known as deposit-takers), insurers and major investment firms.**

The PRA's objectives are set out in statute, in the Financial Services and Markets Act 2000 (FSMA).

The PRA has three statutory objectives:

- a general objective to promote the safety and soundness of the firms it regulates;
- an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders; and
- in addition to the primary statutory objectives above, the final report of the Parliamentary Commission on Banking Standards recommended a new secondary competition objective for the PRA, which was accepted by the Government in July 2013.

The new competition objective was introduced in the Financial Services (Banking Reform) Act 2013, amending FSMA, as follows: 'When discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities.' The competition objective came into force on 1 March 2014.

The PRA's most significant supervisory decisions are taken by the governing body of the PRA, the PRA Board, which the Governor of the Bank chairs. Three members of the Board are Bank staff – the Governor, the Deputy Governor for Financial Stability and the Deputy Governor for Prudential Regulation. Appointed members are appointed by the Bank's Court of Directors (Court) with HM Treasury's approval. A majority of the Board must be non-executive members. The PRA's strategy is set by its Board, in consultation with Court, and can be found in the Strategic Report on page 25.

# Organisational structure as at 1 June 2014



**Andrew Bailey**  
Deputy Governor,  
Prudential Regulation  
and CEO of the PRA  
(FPC, PRA Board)



**David Rule**  
Exec Director  
Prudential Policy\*



**Paul Fisher**  
Exec Director  
Supervisory Risk  
Specialists and  
Regulatory  
Operations \*\*  
(PRA Board)



**Julian Adams**  
Exec Director  
Insurance Supervision



**Vicky Saporta**  
Director  
Financial Prudential  
Policy



**Sasha Mills**  
Director  
Cross-Cutting  
Prudential Policy



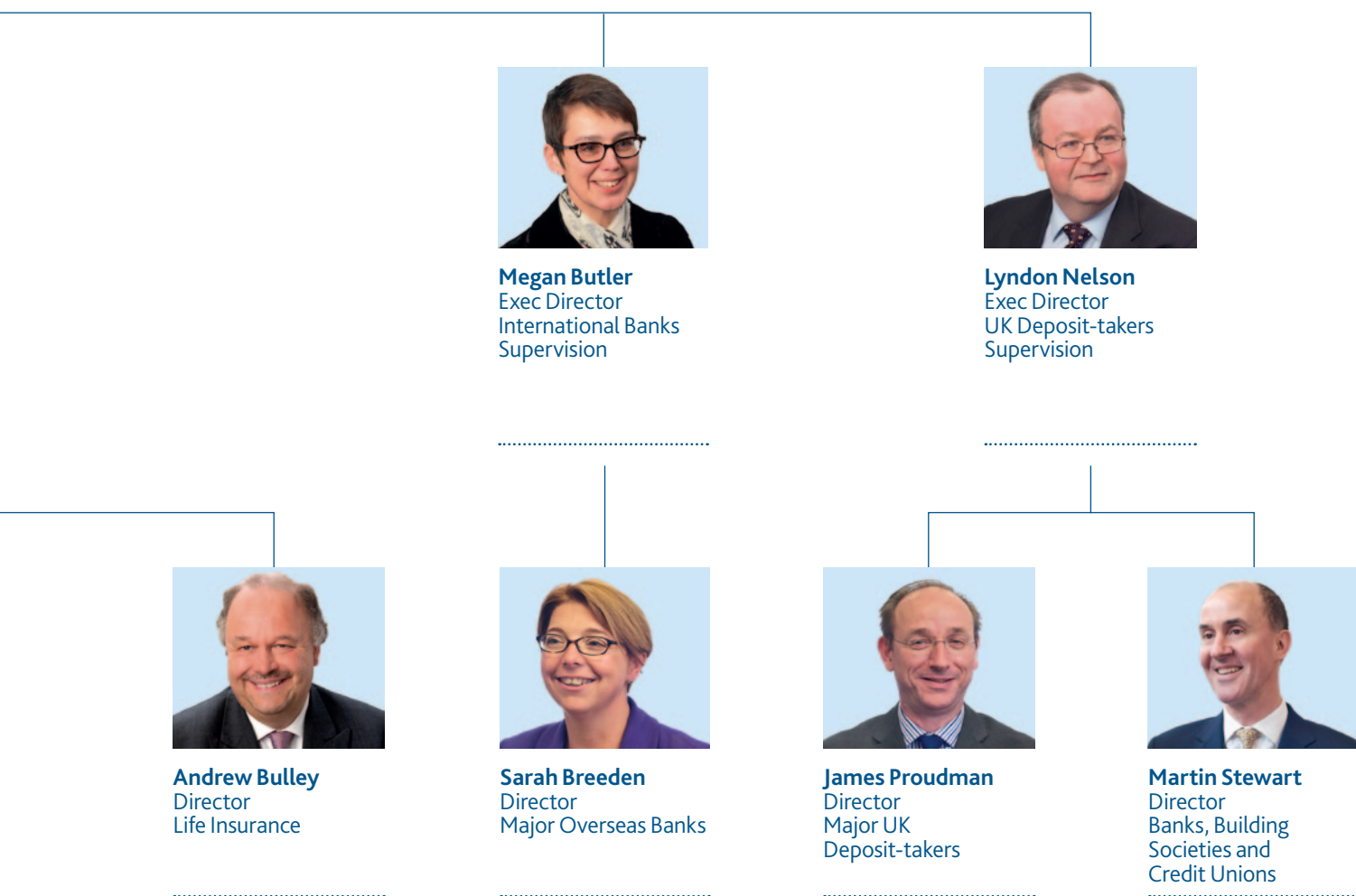
**Jo Paisley**  
Director  
Supervisory Risk  
Specialists



**Chris Moulder**  
Director  
General Insurance

\* Also reports to Deputy Governor,  
Financial Stability.

\*\* Includes PRA Chief Operating Officer.





# PRA Strategic Report: Summary

## The PRA was established as a wholly-owned subsidiary of the Bank of England on 21 November 2011, anticipating planned legislation to reform the UK regulatory framework.

The PRA became the UK's prudential regulator for banks, building societies and credit unions (collectively known as deposit-takers), insurers and major investment firms, with statutory responsibilities under FSMA, on 1 April 2013. Prior to 1 April 2013, the only activity was the setting up and preparing the PRA for its responsibilities.

The PRA is responsible for supervising around 1,700 firms and groups.

The PRA's objectives are set out in statute, in the Financial Services and Markets Act 2000 (FSMA), and include a general objective to promote the safety and soundness of the firms it regulates; and an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders. These are complementary to the Bank's financial stability objective, which is to protect and enhance the stability of the financial system of the UK.

The PRA focuses primarily on the harm firms can cause to the stability of the UK financial system. A stable financial system is one in which firms continue to provide critical financial services – a precondition for a healthy and successful economy. A key principle underlying the PRA's approach is that it does not seek to operate a 'zero failure' regime. Rather, the PRA, working with the Bank's Resolution Directorate, seeks to ensure any firms that fail do so in a way that avoids significant disruption to the supply of critical financial services.<sup>2</sup>

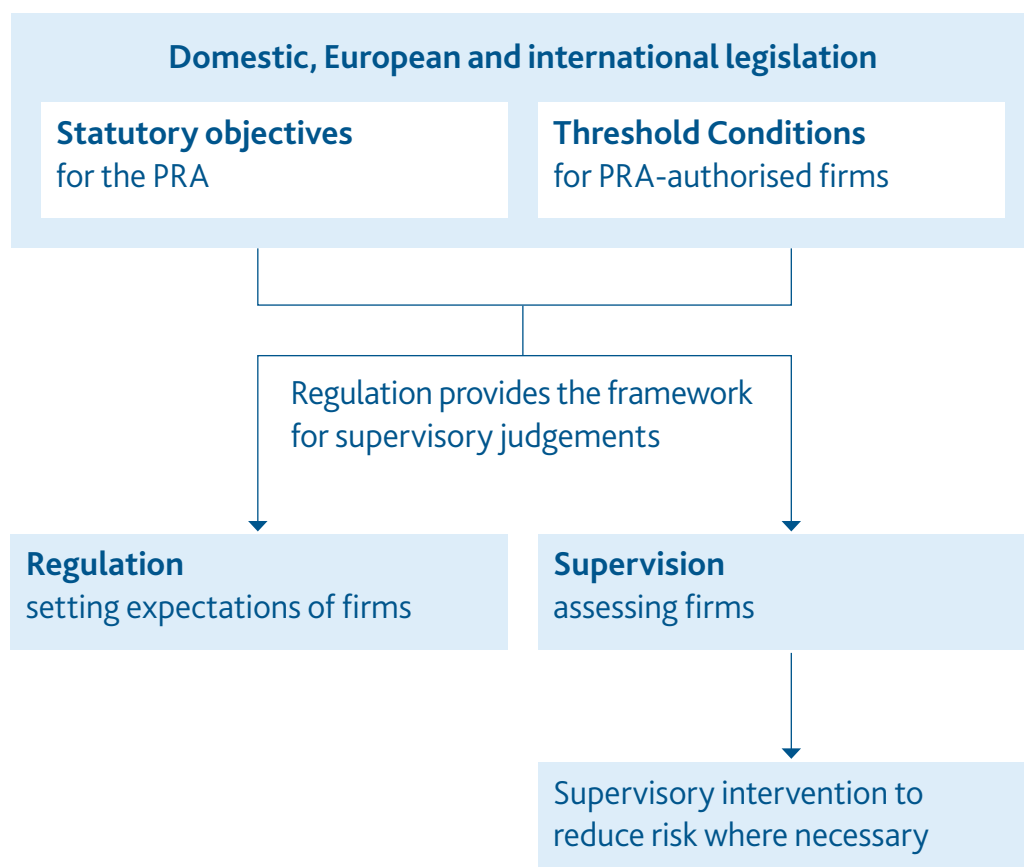
On 1 March 2014, the PRA acquired a new secondary competition objective in response to the final report of the Parliamentary Commission on Banking Standards (PCBS). As a secondary objective, the PRA's requirement to facilitate competition is subordinate to its general objective to promote the safety and soundness of the firms it regulates (and to its insurance objective). The PRA is making changes as necessary to the prudential regime to further its competition objective without undermining the primary objectives.

In addition to the statutory objectives, the Threshold Conditions for authorisation (Schedule 6 of FSMA) set out the minimum requirements that firms must meet in order to be permitted to carry on the regulated activities in which they engage. They are designed to promote safety and soundness and, in broad terms, require firms to have an appropriate amount and quality of capital and liquidity, to have appropriate resources to measure, monitor and manage risk, to be fit and proper, and to conduct their business prudently.

The PRA advances its objectives and promotes adherence to the Threshold Conditions by two means. First, through regulation, by setting standards, including detailed rules and higher-level expectations that firms should meet. And second, through supervision, by assessing the risks firms pose to the PRA's objectives in the context of these standards and taking action where necessary to reduce them. This framework is illustrated in Figure 1.

**A stable financial system is one in which firms continue to provide critical financial services – a precondition for a healthy and successful economy**

2 The PRA's judgement about a firm's proximity to failure is captured in a firm's position within the Proactive Intervention Framework (PIF). Aggregate PIF statistics are published annually on the PRA website [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)

Figure 1: Stylised diagram of PRA approach<sup>3</sup>

A review of the PRA's first year is set out on pages 13–24. The PRA's strategy 2014/15 is set out on page 25. The way in which the PRA intends to implement its strategy in 2014/15 is set out in the Business Plan summary on pages 27–33. The plan seeks to build on the progress in establishing the PRA and covers three broad areas.

First, delivering effective supervision as set out in the PRA approach documents for banking and insurance supervision. Second, continuing to embed its operating model. Third, reflecting new domestic and European regulatory reforms in the PRA's approach to supervision.



The key business aim of the PRA is to deliver effective banking and insurance supervision and work with other supervisory authorities in the UK and overseas



# PRA Strategic Report: Review of 2013/14

**The PRA's focus this year has been on delivering its 2013/14 business aims (Box 1), mitigating the key risks identified by the PRA Executive and Board, and integrating with the Bank.**

## Box 1: 2013/14 Business aims

- Deliver effective banking supervision and work with other supervisory authorities in the UK and overseas.
- Deliver effective insurance supervision and work with other supervisory authorities to advance the PRA's fulfilment of the PRA's general objective and policyholder protection objective.
- Influence and implement policy to advance the fulfilment of the PRA regulatory agenda.
- Equip the PRA better to anticipate risks in the firms it regulates and in the environment in which they operate, to enable the PRA to deliver its objectives and contribute to the FPC's macroprudential objectives.
- Establish the PRA with the desired culture and the right people, supported by appropriate and effective processes.

FSMA sets out a variety of matters to which the PRA must have regard when carrying out certain of its functions (contained in section 3B of FSMA). The PRA considers these issues in a variety of contexts, including when making policy. As an example, the PRA considered 'have regards' in each chapter when setting out the CRD IV consultation paper in August 2013.<sup>4</sup>

Further, in carrying out its functions during the reporting period, the PRA was required to have regard to the need to minimise any adverse effect on competition in the relevant markets that may result from the manner in which the PRA discharges those functions (as mentioned in s2H(1) (b) of FSMA).<sup>5</sup> For example, the provisions

of CRD IV (see page 15 for more on implementation of CRD IV) had the potential to affect competition in markets in which PRA-supervised firms operate. In particular, CRD IV raised capital requirements for certain activities, raising entry and expansion barriers in the markets for these activities. While the PRA had little discretion over how it implemented CRD IV (in particular the Capital Requirements Regulation (CRR)), it considered that the steps taken to reduce barriers with respect to authorisation and prudential requirements more widely for new firms helped mitigate any additional hurdles.<sup>6</sup> Further authorisations work can be found on page 22.

## Supervisory approach

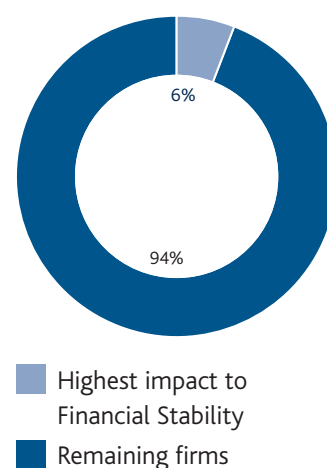
Supervision is weighted to the issues and firms that, in the PRA's judgement, pose the greatest risk to the stability of the system. The PRA published its approaches to supervising banks and insurers in April 2013. The approach documents are updated as PRA supervisory practices evolve and will be updated in Summer 2014.<sup>7</sup>

## Risk-based view of firms

The PRA focuses on the largest firms and greatest risks posed to the financial stability of the UK (see Figure 2). These firms are subject to continuous assessment by dedicated teams of supervisors.

A key part of the continuous assessment process for these larger firms is an annual stock take, referred to as a Periodic Summary Meeting. The findings are presented to the firm's board of directors with the PRA's expectation that the firm will act to resolve any concerns. In the first year of operation, the main focus of the reviews were capital, governance and resolvability for banks and governance, credit risk and reserving for insurers. The PRA supplements Periodic Summary Meetings with additional supervisory tools, including business model analysis, stress testing, asset quality reviews and Section 166 reports (see Box 2 on page 14) to look at particular issues in greater detail.

**Figure 2:** Proportion of PRA-regulated firms with the highest impact to Financial Stability



Source: PRA Data.  
Circa 1,700 firms in total.

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4 [www.bankofengland.co.uk/pr-ar2014/links](http://www.bankofengland.co.uk/pr-ar2014/links)  
5 S2H of FSMA has since been amended with effect from 1 March 2014.  
6, 7 [www.bankofengland.co.uk/pr-ar2014/links](http://www.bankofengland.co.uk/pr-ar2014/links)

**Box 2: Section 166 reports by skilled persons**

Section 166 (s166) of FSMA provides a regulatory tool which gives the PRA the powers to obtain an outside expert view of aspects of a firm’s activities that, for example, cause concern or where further analysis is required.

In 2013/14, s166 was used by the PRA in 33 cases (2012/13: 27 cases),<sup>8</sup> of which four were commissioned using new powers, introduced in the Financial Services Act 2012, to contract directly with the skilled person. The reviews focused on: governance, controls and risk management frameworks; prudential issues; data and IT infrastructure.

**Table 1: s166 reports by area of focus (2013/14)**

| Area of focus  | Number of s166s |
|--|-----------------|
| Governance, controls and risk management framework         | 16              |
| Data and IT infrastructure                                 | 2               |
| Prudential – deposit-takers and recognised clearing houses | 7               |
| Prudential – insurance                                     | 8               |
| Total  | 33              |

The total cost to the firms concerned was £11.4m (2012/13: £14.7m) and the cost per report ranged from £14,602 to £1.3m (2012/13: £33,795 to £3.0m). The costs disclosed include actual costs incurred by the firms or an estimate where actual costs are not yet available; and are disclosed for transparency (additional information can be found online).<sup>9</sup>

**Smaller firms**

The 1,200 or so smaller firms (smaller banks and building societies, credit unions, smaller domestic insurers and some overseas banks) are supervised by the PRA on a portfolio basis. This proportionate approach uses peer analysis to assess risks that might be arising in segments of the banking and insurance sectors.

In addition, engagement with relevant trade bodies and overseas counterparts gives a vital insight into the PRA’s understanding of prevalent issues and the implications of regulatory policy and supervision.

**Firm feedback**

The PRA is keen to receive input from firms on the effectiveness and quality of its supervisory framework and approach. This has been managed in four ways: individual feedback, through firms to their usual supervisory contact; via industry events and forums; stakeholder engagement with key trade and professional bodies; and through the PRA’s consultation process.

The Financial Services Act 2012 requires the Bank, PRA and FCA to have arrangements for the investigation of complaints against them, known as the Complaints Scheme. There have been 123 complaints received by the PRA since April 2013. The majority (99%) relate to a single issue and, in accordance with the Scheme, the PRA has taken the decision to defer any investigations into complaints while there is ongoing complex regulatory action by the PRA. The Complaints Commissioner received five complaints about the PRA during the period 1 April 2013 to 28 February 2014. The Complaints Commissioner deferred his investigation into those complaints until such time as the PRA has completed its ongoing complex regulatory action.

**This proportionate approach uses peer analysis to assess risks that might be arising in segments of the banking and insurance sectors**

**→ Find out more online**  
[www.bankofengland.co.uk/pr](http://www.bankofengland.co.uk/pr)

<sup>8</sup> 2013/14 figures cover the 11-month period since the PRA was created. These have been compared to the proportion of the s166s reported in the 2012/13 Financial Services Authority *Annual Report* that cover prudential issues, and the complete 12-month period.

<sup>9</sup> [www.bankofengland.co.uk/pr](http://www.bankofengland.co.uk/pr)-ar2014/links

As at the end of February 2014 there were no complaints that were upheld by the PRA. Data on complaints received during 2013/14 can be found online.<sup>10</sup>

### Promoting safety and soundness

The PRA, FPC and other parts of the Bank have worked together to increase the quality and quantity of capital held by UK banks and building societies over the past year. The PRA has also been revising aspects of its current liquidity regime. For insurers, work has been focused on preparing for the introduction of new European rules in 2016.

#### Building resilience – capital

One of the main considerations of the FPC over the year has been the capital adequacy of the major UK banks. The FPC published a set of Recommendations aimed at improving the quality and quantity of capital in March 2013 following analysis conducted by the FSA and the Bank.<sup>11</sup> The PRA considers that a well-capitalised banking system promotes the sustainable flow of credit to the real economy. Following the Committee's recommendation, the PRA oversaw actions taken by the major UK banks to strengthen their capital positions through a combination of new capital issuance, earnings retention and, in some cases, continued deleveraging of non-core portfolios. At the end of 2013, most firms had achieved the targets recommended by the FPC and adopted by the PRA.

The PRA also implemented CRD IV, which came into effect on 1 January 2014, through the publication of rules and supervisory statements. CRD IV and the accompanying directly applicable CRR are intended to implement the Basel III agreement in the EU. This package aims, in addition to increasing and improving capital held by banks, to enhance risk coverage, reduce pro-cyclicality, improve disclosure and introduce leverage disclosure requirements. As part of this, the PRA oversaw actions by investment banks to increase capital levels and quality in preparation.

The Bank participated in over 35 working groups and task forces, in addition to the Board of Supervisors and Management Board of the European Banking Authority (EBA), to help develop the technical standards and guidelines to support Basel III, including the standards relating to Supervisory Reporting and Own Funds. The PRA provided advice to HM Treasury on the design of the Help to Buy scheme in order to ensure participating firms were able to hold appropriate capital and comply with the relevant eligibility conditions and prudential requirements set out in the CRR.

#### Building resilience – liquidity

Over the past year, much of the PRA's work on liquidity has been concerned with the development of the new liquidity regime that will be introduced in 2015. This embeds the Basel EU-wide Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio.

The PRA has also been active in maintaining and revising aspects of its current liquidity regime, including responding to FPC Recommendations.<sup>12</sup> For those major UK banks and building societies that meet the capital threshold set by the FPC and PRA Board, the PRA has reduced the level of required liquid asset holdings so that it is broadly equivalent to 80% of the LCR (as defined in the CRR). The effect will be to lower total required holdings by £90bn, which has the potential to support lending to the real economy since funds held in liquidity buffers are not otherwise available for this purpose. The PRA's liquidity regime is closely linked to other Bank responsibilities, notably its role in providing liquidity insurance to the banking system and providing payment, clearing and settlement services across its accounts.

**The PRA considers that a well-capitalised banking system promotes the sustainable flow of credit to the real economy**

10, 11, 12 [www.bankofengland.co.uk/prarar2014/links](http://www.bankofengland.co.uk/prarar2014/links)



### Preparing for Solvency II

Substantial progress has been made over the year in preparation for the introduction of EU-wide capital requirements and risk management standards for insurers, Solvency II, on 1 January 2016.<sup>13</sup> The PRA worked to negotiate the EU policy and with firms to ensure appropriate preparations are being made ahead of implementation. In particular, the PRA has influenced drafting of the technical standards through the European Insurance and Occupational Pensions Authority.

Transparency of approach and effective preparation with firms has been central to the PRA's preparatory work. The PRA has held regular briefings with the insurance industry and set out its expectations of firms during the preparatory phase following consultation.<sup>14</sup> Further work was conducted with firms to encourage the development, submission and approval of high-quality internal models. The PRA also clarified for firms its intention to monitor the continuing appropriateness of Solvency II internal models after their approval through the use of early warning indicators.

### Stress testing

In the first instance, firms (and their boards) are responsible for assessing their risks and the adequacy of the capital they hold. Stress tests are an important tool to enable both firms and supervisors to judge the adequacy of capital and capital plans. The PRA progressed the use of stress testing across banks, building societies and insurers this year, carrying out firm-specific and sector-wide stress tests; both qualitative and quantitative. In particular, the PRA completed its standardised stress-testing exercise for life insurance firms, which helped to assess capital adequacy and identify industry-wide risks and trends which may pose a threat to financial stability. The key finding from the exercise was that the life insurance industry is increasingly vulnerable to credit risk events, primarily driven by an increasing proportion of annuity business on the industry's balance sheet. The results have been used in the supervision of individual firms to assess and

challenge preparedness for adverse market movements and make forward-looking judgements on risk profile, capital adequacy and corporate structure.

In October 2013, the PRA Board and FPC published proposals for concurrent stress tests of the UK banking system alongside those being conducted by the EBA. The tests will begin in 2014, and will aim to provide a quantitative, forward-looking assessment of the capital adequacy of the UK banking system and individual firms in it (see Business Plan section, page 27). The tests will play a critical role in supporting both the PRA and FPC in meeting their statutory objectives.

The PRA has invested in new infrastructure to perform supervisory stress tests. For example, tools resulting from an Analytics and Risk Technology project, completed in 2013, will be used in forthcoming tests.

### Business model analysis

The PRA uses business model analysis to help identify and assess emerging areas of risk. Over the year, business model analysis has been particularly important in helping insurance supervisors assess so-called 'alternative capital' and annuities. It has also been used extensively across the different types of deposit-takers.

'Alternative capital' is a general term used to describe the flow of additional capital into insurance markets from non-traditional investors. While this is not a new phenomenon, the increase of this flow is putting pressure on the traditional reinsurance markets to loosen terms and reduce premiums. During the year, the PRA used business model analysis to understand how reinsurers are managing pressure on margins and potential changes in their risk profile. The PRA expects firms to adopt robust risk management processes to ensure that key risks (including collateral risk, basis risk, legal risk, multiple peril risk and reputational risk) are understood, monitored and appropriately managed.

**The PRA uses business model analysis to help identify and assess emerging areas of risk**

<sup>13</sup> Solvency II is a European directive that sets out new, stronger EU-wide requirements on capital adequacy and risk management for insurers.

<sup>14</sup> [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)

The annuity market grew, by over 13%,<sup>15</sup> from £15.8bn in 2011 to £17.9bn in 2012, driven by factors such as the ending of defined benefit schemes, workplace enrolment and the baby-boom generation nearing retirement. This created an unavoidable increase in the credit risk faced by the life insurance market and to longevity risk. The PRA recognises the low interest rate environment and associated search for yield has driven some annuity writers to seek out higher yielding asset classes to back their liabilities, such as equity release mortgages, infrastructure, commercial property and commodities. Annuity writers' business models have been subjected to stress testing for this risk over the year and this has been shared with the FPC. Subsequent to the end of the PRA's financial year, the Government made an announcement in the Budget which is expected to have important implications for the business models of annuity providers.

The PRA has continued to analyse the business models of UK and international banks and building societies with a focus on understanding performance and risks on a forward-looking basis. This work has been used to develop and refine the PRA's banking supervisory strategy and identify areas of further work. The PRA has also undertaken market and cross-firm analysis in the retail, corporate and investment banking sectors to identify the growth, key trends and developments which have an impact on financial performance. Some of the main areas of focus have been the Funding for Lending scheme and the impact on volumes and pricing of mortgages and savings products, developments in the housing market, (including the buy-to-let segment), developments in corporate real estate and leveraged loans markets, and performance of fixed income in the investment banking sector. The PRA has also continued to monitor firms' exposures to emerging markets, through both credit exposures and trading strategies.

### Branch supervision

In the banking supervision approach document, the PRA provided a high-level overview of its powers and responsibilities with regards to supervision of overseas branches. The PRA committed to providing a fuller statement and in February 2014 published CP4/14: Supervising international banks: the PRA's approach to branch supervision.<sup>16</sup> This document set out proposals on how the PRA will supervise UK branches of banks based outside the European Economic Area (EEA) and explains the PRA's approach to EEA branches and subsidiaries.

### Audit and disclosure

Enhancing the effectiveness of supervisory and external auditor engagement continued to be a focus of work for the PRA over the year. On 1 April 2013, the PRA published a Code of Practice on the relationship between the external auditor and the supervisor. It describes expectations of the nature of the relationship and mandates a minimum number of meetings between auditors and supervisors for firms that could have a material impact on the UK financial system.

The PRA has also undertaken policy work on data disclosed to the market. As recommended by the FPC, the PRA encouraged major UK banks to strive further, in certain aspects of their 2013 annual reports, towards meeting European (Basel Pillar III) standards and internationally the Financial Stability Board's Enhanced Disclosure Task Force's 2012 recommendations. For the EBA's annual review of Pillar III disclosures, the PRA reviewed a sample of UK banks against EU peers and found that UK banks set best practice in several respects.

Enhancing the effectiveness of supervisory and external auditor engagement continued to be a focus of work for the PRA over the year

15 Source: FSA Annual returns  
16 [www.bankofengland.co.uk/pr-ar2014/links](http://www.bankofengland.co.uk/pr-ar2014/links)

### Data and infrastructure

The PRA uses a wide range of information and data in forming supervisory judgements about the risks that firms face and pose. The PRA Data Board oversees the development and execution of the PRA's data strategy, governing all PRA data-related activities. A central element in the development of the strategy has been a detailed analysis of the PRA's data requirements against existing data collections. Over the past year analysis has focused on balance sheet, profit and loss, capital, and market risk data from banks, building societies and investment firms.

In addition to providing tools and data for PRA risk analysis, the Firm Data Submission Framework within the Analytics and Risk Technology infrastructure has increased substantially the speed of data translation, validation and reconciliation between the PRA and the major UK banks, thereby improving efficiency. The PRA has worked closely with the US Federal Reserve and EBA in this area. Further work will continue in 2014/15 as set out in the Business Plan section on page 27.

### Supporting domestic and international regulation

The UK is home to one of the world's largest financial centres. The PRA makes a significant contribution to the development of international standards for the regulation of banks and insurers. Additionally, the PRA's effective collaboration with domestic, European and international counterparts is essential to the PRA's fulfilment of its statutory objectives.

Whether negotiating internationally developed policy or domestic initiatives, the PRA has undertaken economic analysis of policy proposals; including, for example, the microeconomic and macroeconomic effects of CRDIV/CRR. The PRA also made commitments in its approach documents to implement policy that is clear, concise and straightforward to understand, so firms and supervisors can make sound, forward-looking judgements. The PRA has started to replace legacy PRA Handbook material with a PRA Rulebook and associated supervisory statements in order to meet this commitment. This has been achieved with the implementation of CRD IV and a further consultation paper dedicated to rewriting sections of the current Handbook.

### Systemically important institutions

The PRA has worked with the International Association of Insurance Supervisors (IAIS) to develop a methodology to identify global systemically important insurers and a policy framework to mitigate the risks they pose. This work culminated in July 2013 with the Financial Stability Board's publication of a list of systemically important firms, including two UK firms (Aviva and Prudential), and the IAIS' publication of a new policy framework.

The PRA has worked closely with the Basel Committee for Banking Supervision to identify global systemically important banks, contributing to the international efforts of addressing 'too big to fail'. The UK has also been involved in the EBA's work in implementing this framework into EU legislation, including the setting of higher capital buffers for these firms in order to reduce their probability of failure. In November 2013, four UK banks were designated as globally systemic (HSBC, Barclays, RBS and Standard Chartered).

**The PRA Data Board oversees the development and execution of the PRA's data strategy, governing all PRA data-related activities**



## Recovery and resolution

The PRA has worked with the Bank's Resolution Directorate and internationally with the Financial Stability Board to pursue the development of credible resolution strategies for the global systemically important banks. The PRA hosted a number of cross-border crisis management groups during the year as part of the development process for these strategies.

In December 2013, the PRA published recovery and resolution rules and associated supervisory statements aimed at increasing preparedness in the event of the possibility of a firm failing.<sup>17</sup> In the same month, European agreement was reached on the Bank Recovery and Resolution Directive, which sets the European framework for consistent bank recovery and resolution requirements. While the UK will not be part of the EU Banking Union, the PRA has engaged with HM Treasury and other countries on the proposals for a Single Supervisory Mechanism and a Single Resolution Mechanism to ensure an effective approach to the supervision and resolution of cross-border banks in Europe.

Meanwhile, the PRA has been working on two fronts to reduce the potential impact of an insurance failure. Firstly, through contributing to the Financial Stability Board and IAIS developments concerning an adequate resolution framework for insurers. Secondly, through assessment of individual insurers' resolvability. The PRA has participated in discussions at the European level to share experiences in developing recovery and resolution plans and co-operated with other authorities who would be involved in the resolution of systemically important insurers.

In the event of a firm failing, effective redress mechanisms for depositors and insurance policyholders are key to maintaining confidence in the financial system. The insurance protection provided by the Financial Services Compensation Scheme (FSCS) helps to achieve this and deliver the PRA's insurance objective of securing an appropriate degree of policyholder protection (see Box 3 on page 20).

On banking, the PRA has started work to review the single customer view requirements, which support faster pay-outs to depositors in the event of a firm failure. Work has also progressed to explore how continuity of access to deposits can be provided in the event of a failure as an alternative to pay out. Over the past year, seven credit unions failed with all depositors paid out and no adverse impact on financial stability.

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**In December 2013, the PRA published recovery and resolution rules and associated supervisory statements aimed at increasing preparedness in the event of the possibility of a firm failing**

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**Box 3: Insurance objective**

In addition to the safety and soundness objective, the PRA has a separate insurance objective of 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'.

All policyholders of UK authorised and regulated firms are given a degree of protection. The overall PRA supervisory approach applies to all insurers so all insurers need to meet the Threshold Conditions in FSMA and, inter alia, have to show they have appropriate financial and non-financial resources, meet the fit and proper requirements and can be effectively supervised. In addition, there will be a level of solvency regulation – as a minimum this means that all insurers will need to meet the solvency requirements set out in the PRA rules. These requirements will deliver a substantial measure of policyholder protection at all times in respect of all UK-authorised firms.

To date the PRA has focused on ensuring that its categorisation of insurers (and hence the intensity of supervision) properly reflects the potential impact of the failure of the firm on policyholders. The PRA is considering how it could adapt the overall supervisory approach to give particular focus to certain types of policies or policyholders. This could be because certain types of insurance or policyholders require a higher degree of protection. It will also take into account the impact of the cover being withdrawn and the ability of and cost to the policyholder to transfer to another provider. Such a framework would suggest greater focus on compulsory insurance, any disruption to which would have an impact on

the real economy, and long-term life insurance products which are difficult to transfer. The PRA will also consider the extent to which the level of protection provided by FSCS coverage should affect the supervisory approach.

The PRA will also need to clarify the extent to which the PRA insurance objective applies to policyholders who are UK policyholders of incoming EEA branches and non-UK policyholders of UK groups. In normal conditions the PRA's general objective (safety and soundness) goes hand in hand with the insurance objective (policyholder protection) – ensuring the firm remains solvent is the main protection for policyholders. While in most instances the compatibility of the two objectives will be obvious, tension between them may occur when a firm is stressed. In the past this has particularly been the case in relation to with-profits business where management actions to protect solvency could be justified on safety and soundness grounds but might cause with-profits policies to underperform relative to what policyholders expected; this is also an area where the PRA has been working closely with the FCA (see page 21). When this type of situation arises, the PRA will need to consider whether policyholders are best protected by: the continuation of the firm if possible, closure to new business and a move into solvent run-off; or its orderly failure which will require complex supervisory judgements and potential trade-offs between the objectives. Responsibility for such judgements will rest with the appropriate decision makers within the PRA taking account of relevant information and analysis and, for the largest firms, the decision will ultimately fall to the PRA Board.

**The PRA has a separate insurance objective of 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'**

### Domestic banking reform

The PRA assisted HM Treasury in the development of the Financial Services (Banking Reform) Act 2013 (the Banking Reform Act) in relation to the ring-fencing of retail banking activities from wholesale and investment banking activities. These provisions are aimed at reducing the risk of disruption to services, such as deposit-taking and payment services to consumers and small and medium enterprises, as a result of firm failure. Implementation of ring-fencing work towards this is required by 2019 and work towards this is a key deliverable in 2014/15.

The Parliamentary Commission on Banking Standards published its final report in June 2013, making Recommendations to the Government, regulators and above all industry itself, aimed at remedying the shortcomings in standards that it had identified. A number of Recommendations were addressed to the PRA and taken forward by the Government through the Banking Reform Act.

Part of the Commission's report focused on reforming governance within banks and recommended the adoption of a new Remuneration Code, building on existing provisions. In March 2014, the PRA issued a consultation paper on extending the Remuneration Code to require all PRA-authorized firms to amend employment contracts to be able to clawback certain forms of remuneration for six years. The proposed new rules would come into effect on 1 January 2015.

### Effective regulatory co-ordination with Financial Conduct Authority

The PRA has worked closely with the FCA over the past year on a range of issues. A Memorandum of Understanding was agreed ahead of 1 April 2013 setting out the expectations for co-ordination and is supported by more detailed working-level documents. Performance against the memorandum is reported on a quarterly basis and reviewed regularly by the Chief Executives of both organisations. Lessons have been learnt

through this process and changes made to PRA working practices as issues have been addressed. However, the PRA and FCA recognise that with differing objectives and responsibilities, it may sometimes be appropriate to take divergent approaches.

Authorisation is one regulatory process which underwent significant change when the two regulators were created. The two authorities have their own objectives against which they assess an application (see Box 4 on page 22). However, an agreed single administrative process means that a joint approach is taken whenever possible, for example when conducting Significant Influence Function interviews. The regulators also liaise regularly in relation to enforcement, including potential referrals that are of interest to both authorities, and in situations where either regulator is proposing to take action against firms or individuals.

The PRA and FCA have worked together on the FCA's development of a policy for with-profits funds following publication of an FSA consultation paper in December 2012.<sup>18</sup> The PRA has an interest in any impact the outcome of FCA policy might have on its statutory objectives and any changes to jointly designated rules or definitions.

Both the PRA and FCA are represented on the FPC and this is another way in which the two authorities have co-operated. For example, one of the biggest challenges facing the financial system is the threat from cyber attack. Following an FPC recommendation in June 2013 – and in co-ordination with HM Treasury – work has been undertaken between the Bank, FCA, relevant government agencies and industry to evaluate and improve firm resilience to cyber attack. A survey to assess current levels of resilience against cyber attack and identify areas of weakness was launched in December 2013.<sup>19</sup> Further information can be found in the Bank's *Annual Report*.

**The PRA has worked closely with the FCA over the past year on a range of issues**

18, 19 [www.bankofengland.co.uk/pra-ar2014/links](http://www.bankofengland.co.uk/pra-ar2014/links)

The PRA has continued work initiated by the FSA to review IT risk governance across the eight largest retail banks, following significant outages in 2012. The authorities have been following up the findings of the reviews with individual firms and will run the exercise again in 2014 to measure progress and identify new risks.

Under FSMA, the PRA has the power to require the FCA to refrain from taking certain actions specified under FSMA (s3I of FSMA) or to give a direction to the FCA in relation to with-profits policies (s3J of FSMA). The PRA has not exercised these powers during the period.

#### Box 4: Authorisations and enforcement Authorisations

Five firms were authorised as banks between 1 April 2013 and 28 February 2014.<sup>20</sup> These authorisations arose either as a new application or via a Variation of Permission to add deposit-taking. Four of these five banks were authorised within the statutory timeframe, with the fifth needing longer to meet its capital requirements. The average time to authorisation from application receipt was just over 40 weeks. The PRA also authorised two new insurance firms and three credit unions, all within the statutory timeframe.

Over the past year, the PRA has sought to improve the authorisation process for banks in two ways. First, by giving firms the option to be authorised as a bank having met key essential elements (such as capital, liquidity and governance requirements), but with restrictions on their activities due to some areas needing to be completed.<sup>21</sup> Three of the banks were authorised through this new route. Second, by providing greater support and a clearer pre-application process. The PRA and FCA had 45 pre-application meetings with firms seeking authorisation between 1 April 2013 and 28 February 2014, of which 29 applicants had more than one meeting. These have been important steps in removing one of the barriers to entry in the banking sector and

## People

A key pillar of the Bank's Strategic Plan 2014–17 is the attraction, development and retention of the best people into public service and building a talent base reflective of the diversity of the UK. The PRA has worked with the wider Bank to develop its people and skills, with this year's emphasis on ensuring PRA staff have the required knowledge and skills to deliver the judgement-led supervisory approach. Staff recruitment and retention is a key operational risk and is at the forefront of the PRA's Strategic Plan and Business Plan.

one of the ways in which the PRA will deliver its competition objective. The National Audit Office in its *Regulating Financial Services* report indicated some slowing of processing across the various regulatory transactions, due to the new dual regulated approach (not including new firm authorisations).<sup>22</sup> However, there has been no significant deterioration in the number of statutory service standards breaches. Details of the PRA's performance against these standards are available online.<sup>23</sup>

## Enforcement

A small number of enforcement investigations were initiated over the past year. While the PRA would not normally publicise details of its investigations until there has been a regulatory outcome, it has made two ongoing investigations public: the 2012 IT outage at RBS; and the financial difficulties experienced by the Co-operative Bank.

The Regulatory Action Division is responsible for carrying out enforcement investigations for the PRA. However, where appropriate, the PRA seeks to outsource the investigative process to third parties or, where there is overlap with the FCA, the FCA's Enforcement Division. This arrangement minimises costs and duplication, and ensures that the subject of the investigation deals with only one set of investigators wherever possible.

**The Bank, including the PRA, is committed to promoting equality and diversity. Policies covering equality, diversity and inclusion, flexible working, career development and wellbeing are implemented across all areas of the Bank**

- 20 Of the five firms authorised, three offer deposit taking to retail customers and four offer deposit taking to wholesale depositors; one is a UK institution and four are non-EEA subsidiaries. Four offer easy-access and fixed-terms accounts and one offers corporate-only accounts.
- 21 This alternative route to authorisation is referred to as Mobilisation (Option B). It enables a firm to be authorised as a bank having met key essential elements (such as capital and liquidity requirements) but with a restriction on their activities due to some areas needing to be completed. The firm then enters a period where outstanding requirements are met (such as IT systems) which enables the restriction to be removed and the firm to operate as a fully authorised bank with no restrictions on its activities. Please see Chapter 5 of the report for a fuller description [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)
- 22 The NAO completed its 'Regulating Financial Services' report in March 2014. It included a number of recommendations for the PRA and FCA. [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)
- 23 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)



### Developing and retaining PRA staff

Ensuring the PRA can retain and develop talented individuals is essential to achieving its objectives. Emphasis has been placed on talent management, including the delivery of a career development week, talent planning for senior roles, and greater emphasis on diversity and inclusion initiatives in recruitment and career advancement.

Performance management has received particular attention with the introduction of technical competencies that identify the knowledge and skills needed for roles across the PRA. This has provided a consistent and comprehensive framework against which staff can be objectively and fairly assessed for learning and development requirements.

The Bank, including the PRA, is committed to promoting equality and diversity. Policies covering equality, diversity and inclusion, flexible working, career development and wellbeing are implemented across all areas of the Bank.

Internal promotions and mobility are key to the PRA's talent management. In 2013, 6% of PRA staff received a promotion, and 8% moved role within the organisation. Secondment opportunities are also a key way for the PRA to gain industry and wider experience. Over the year, 62 PRA staff were out on external secondment.

An operational issue is the high, relative to the rest of the Bank, staff turnover rate at the PRA. The Bank, including the PRA, has a turnover rate of 8.1% while the PRA alone has a turnover rate of 11.6%. The effectiveness of recruiting replacements is being monitored closely.

### Recruitment

At the end of February 2014, 1,045 staff worked in the PRA, of which 94 were part time and 25 were employed on temporary contracts. Of the 1,045, 40% were female and 21% were Black, Asian and Minority Ethnic (BAME). There has been a beneficial flow of staff between the PRA

and other parts of the Bank during the year, with 48 staff moving from other parts of the Bank to the PRA and 32 moving from the PRA to other parts of the organisation. A further 164 PRA staff were recruited externally, helping to deliver the required skills mix and industry experience.

During the financial year, the PRA hired 45 supervisors into the banking and insurance supervision teams from the external market. This represented 27% of all the PRA's hires over the year.

The PRA made eight senior appointments, all of which were internal promotions. 18 of the graduates recruited by the Bank within the financial year were appointed to the PRA. More details on the Bank's graduate recruitment are available on page 33 of the Bank's *Annual Report*.

### Employee involvement

The Bank's recruitment, talent management and career development programmes have been extended across the PRA, with the objective being to ensure the staff have the opportunity to develop to their full potential. These programmes will be further developed in 2014 in order to support the Strategic Plan. The Bank maintains its arrangements for consulting staff on matters affecting their interests, including with representatives of the recognised trade union, Unite.

### Employment of people with disabilities

The Bank is a 'Two Ticks' employer. This is an accreditation that is given to organisations that are committed to employing people with disabilities. The Bank works with partners who specialise in supporting people with disabilities both for existing staff at the Bank and for candidates (for example, Blind in Business, The Disability Café and the National Autistic Society). The Bank also actively advertises roles through sites such as Diversity Jobs (who target diversity strands including disability). The Bank has a Disability Forum employee network.

# 1,045

Staff at the end of  
February 2014



For the coming year the main focus for the PRA is to deliver effective supervision reflecting new domestic and European regulatory reforms

# PRA Strategic Report:

## The PRA strategy

### **Under FSMA, the PRA was required to determine its strategy in relation to its objectives by 31 March 2014 and from time to time review, and if necessary revise, its strategy.**

The PRA is required to consult Court before determining or revising its strategy. The PRA agreed (in consultation with Court) and published a strategy on 10 March 2014.<sup>24</sup>

The revised strategy for the PRA comprises:

- continuing to apply a forward-looking, judgement-based supervision approach to firms that pose the greatest risk to the PRA's objectives, whilst also ensuring an appropriate supervisory regime for smaller firms;
- developing its approach to overseas supervision, following publication of a statement on the PRA's approach to supervision of overseas banks;
- finalising implementation of the Basel III framework;
- promoting orderly resolution of firms through structural reform such as ring-fencing of core retail banking services from wholesale and investment banking services;
- implementing the Senior Manager Regime for banks, building societies and insurers; and
- advancing its new competition objective, by increasing specialist capability in competition, providing guidance and training to staff and beginning periodic reviews of existing rules to identify areas where changes would facilitate greater competition without compromising the safety and soundness and policyholder protection objectives.

The strategy builds on what the PRA published in March 2014 and is expanded on in the updated PRA approach documents, which are to be published in Summer 2014.<sup>25</sup> The PRA will play a key role in advancing the Bank's Strategic Plan initiatives over the next three years. This will provide further opportunities to build on the opportunities that have already been realised from having microprudential supervision, macroprudential policy and monetary policy in the same organisation, and the synergies that come from close cooperation between them.

The way in which the PRA intends to implement its strategy in 2014/15 is set out in the Business Plan summary on pages 27–33.

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24, 25 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)





The PRA uses a wide range of information and data in forming supervisory judgements about the risks that firms face and pose



# PRA Strategic Report: Business Plan 2014/15

**The PRA's Business Plan is driven by its statutory objectives, the wider Bank's strategy and objectives, and regulatory requirements from domestic, European and international policy fora.**

For the coming year, the main focus for the PRA is to:

- deliver effective supervision as set out in the PRA's approach documents for banking and insurance supervision;<sup>26</sup>
- reflect new domestic and European regulatory reforms in the PRA's approach to supervision; and
- continue to embed the operating model.

The business aims set out below support the PRA in achieving these objectives.

During the coming year, the PRA is also required to undertake a number of new activities, which have contributed to the increased budgeted cost of regulation (see Financial review on page 42):

- delivery of structural reform;<sup>27</sup>
- delivery of concurrent stress testing of the eight largest UK banks;<sup>28</sup> and
- implementation of the Recommendations in the final report of the PCBS,<sup>29</sup> which includes the addition of a secondary competition objective.

## 2014/15 Business aims

### Business aim 1

**Continue to implement the forward-looking, judgement-based regulatory regime**

The PRA will continue to implement the forward-looking, judgement-based supervisory approach to firms that pose the greatest risk to the PRA's objectives, while also ensuring an appropriate supervisory regime for smaller firms.

A key part of the PRA's approach to supervising systemically important financial institutions will be realised through the delivery of a stress-testing framework, which will inform FPC and PRA decision making about the capital resilience of individual banks and the banking system overall.

The PRA will further develop its approach to overseas supervision, following publication of a consultation paper on the PRA's approach to supervision of overseas banks in February 2014.

In line with the Bank's Strategic Plan, the PRA will work with the wider Bank to develop a data strategy to inform the collection of valid, accurate and meaningful information; enabling appropriate use of data to aid early intervention and escalation of key prudential risks.

**A key part of the PRA's approach to supervising systemically important financial institutions will be realised through the delivery of a stress-testing framework**

26 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)

27 In the UK, the implementation of the structural reform project will achieve separation of core retail banking services from wholesale and investment banking activities through a ring-fence, which will improve loss absorbency. Ring-fencing will be required for the big six UK banks.

28, 29 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)

## Business aim 2

### Continue to implement changes to domestic, European and international regulation, including the Financial Services (Banking Reform) Act 2013

The international and European dimension to financial regulation is central to the PRA regulatory agenda. Continued engagement with the European regulatory process is very important to delivering effective financial regulation for the UK. The PRA will continue to make a significant contribution to prudential measures agreed internationally or at a European level and the subsequent implementation of these agreements within the PRA's policy framework. This includes: preparation for the implementation of Solvency II; implementation of the Deposit Guarantee Scheme Directive;<sup>30</sup> implementation of liquidity coverage ratios; finalising the Basel III framework; influencing the development of enhanced global insurance supervision to reduce the risks posed by globally systemic insurers; and actively contributing to European and international agreements on resolution of banks and insurers.

The PRA will also continue to support the wider framework for macroeconomic and financial stability in the UK and internationally through actively participating in a number of different forums and frameworks, including:

- the Financial Stability Board and other global standard setters; and
- the EU framework, including European Supervisory Authorities, governing financial regulation and setting out technical standards.

## Business aim 3

### Influence, devise and implement policy to advance structural reform in banking, resolution policy, the secondary competition objective, and other elements of post-crisis standard setting

The PRA will implement policy that ensures the impact of failure for the big six UK banks is reduced by promoting orderly resolution of firms through structural reform, via consultation on the implementation of ring-fencing of core retail banking services from wholesale and investment banking services. The PRA will review the Pillar 2 framework for banks in order to align it with the new CRD IV capital regime and the new PRA supervisory approach.<sup>31</sup>

The PRA will continue to focus on implementing policy that ensures firms have adequate resources to reduce the probability of failure. Over the next year, the PRA will also continue to mitigate the impact to financial stability that arises when firms do fail, including provision of appropriate resolution tools, depositor protection and continued access to essential services.

Under FSMA, as amended by the Banking Reform Act 2013, the PRA has received a new secondary competition objective. To advance this objective, the PRA is taking the following actions:

- increasing its specialist capability in competition;
- providing guidance and training to staff; and
- conducting analysis of rules, both existing and as new policy is developed, to identify options that will facilitate effective competition without compromising its safety and soundness and policyholder protection objectives.

The PRA will continue to focus on implementing policy that ensures that firms have adequate resources to reduce the probability of failure

30 [www.bankofengland.co.uk/prarar2014/links](http://www.bankofengland.co.uk/prarar2014/links)

31 Pillar 2 proposes procedures for supervisory review of an institution's capital adequacy and internal risk assessment process.

Implementing recommendations in the final PCBS report, *Changing Banking for Good*, is one of the new activities for 2014/15. As part of this, the PRA will develop a new Senior Manager and Certification Regime that will help to support a change in culture at all levels in firms. It will also consult on enhancements to the Remuneration Code, in addition to consultation on clawback in early 2014, to further align individual incentives with safety and soundness.

In addition to the above, the PRA, together with the FCA, will review the effect of its revised approach to authorising new banks over the period 1 April 2013 to 31 March 2014. It will publish its findings at the beginning of July 2014.

## Business aim 4

### Contribute towards delivering the FPC's macroprudential objectives

An effective regulatory framework needs to combine firm-specific supervision with work to enhance the resilience of the financial system as a whole. The PRA will therefore continue to work closely with the FPC and actively contribute to the delivery of the FPC's macroprudential objectives.

This effort is supported by a frequent two-way flow of information and exchange of views between the PRA and the FPC. The PRA will continue to provide a supervisory view to FPC to inform its assessment of systemic risks, and the FPC's assessment of systemic risks will continue to influence the PRA's judgements in pursuit of its own objectives.

The PRA will also continue to work with the other parts of the Bank and FCA to support the FPC in delivering its agenda in its three priority areas: the medium-term capital framework; shadow banking and diverse and resilient sources of market-based finance; and ending 'too big to fail'. A further key area of focus for the PRA will be delivering a framework for annual, concurrent stress testing of the UK banking system.

## Business aim 5

### Ensure the PRA has the right people to meet its statutory objectives

The PRA is committed to ensuring that it has the right staff in place to deliver its statutory objectives. Attracting and retaining talented individuals will continue to be a priority as it is key to the PRA being able to deliver a more judgement-based approach. Priorities in this area include: defining and delivering a secondment strategy; ensuring staff development plans are in place for identified high-potential staff; ongoing assessment of the PRA's resource profile; and regular assessment of specific recruitment and training requirements.

Over the next year, the Bank's Strategic Plan will introduce a framework for performance management which will support the identification and development of talent.

The PRA is committed to ensuring that it has the right staff in place to deliver its statutory objectives

## Business aim 6

### Ensure the right infrastructure and governance to meet the PRA's statutory objectives

Strong governance is essential to ensuring the Executive Committee and Board are able to make decisions in an efficient and effective manner, and that the PRA continues to meet its regulatory and reporting responsibilities. Through effective governance, the PRA sets its strategy, delivers against its Business Plan and regularly reviews its performance.

The PRA's activities need to be supported by an infrastructure of effective processes, tools and systems. One aspect of this is the Supervisory Oversight Function which provides assurance to the PRA Board and Executive Committee about the quality and effectiveness of supervision. This is delivered through firm-specific and thematic supervisory effectiveness reviews, management information and analysis, and, where appropriate, initial assessments of potential regulatory failure. To support PRA activities, a portfolio of projects are underway to build new processes, tools and systems covering key areas such as whistleblowing, money laundering and intelligence.

As part of the Complaints Scheme (of which the PRA, Bank and FCA are a part), the PRA will continue to ensure formal complaints against the PRA are dealt with in an efficient and effective manner, including working with the FCA and the Office of the Complaints Commissioner as appropriate.

## 2014/15 Key initiatives, deliverables and policy consultations

In line with these business aims, the initiatives listed below are key activities ongoing throughout 2014/15, with some carrying on into the following financial year.

### Initiatives

- Delivery of clear expectations on key elements of the capital standards applicable to banks.
- Further development of the Recovery and Resolution Directive policy initiative.
- Supporting and influencing the IAIS' work on the development of enhanced global insurance supervision standards, including the Insurance Capital Standard and the Common Supervisory Framework.
- Development of a Bank-wide data strategy.
- Conducting reverse stress testing exercises with clear articulation of 'break points' of insurance firms' solvency.
- Review of the PRA's approach to setting Pillar 2A requirements for banks.<sup>32</sup>
- Transition to CRD IV regulatory and reporting regime.<sup>33</sup>
- Implementation of the approach to assessing resolvability across banks.<sup>34</sup>
- Consultation on a revised credit union sourcebook, written to reflect the PRA's objectives, making its regulation of the sector more flexible and responsive to the increasing significance of non-traditional credit union business models.

Specific policy consultations and key 2014/15 deliverables are included in the table on the following page.

Through effective governance, the PRA sets its strategy, delivers against its Business Plan and regularly reviews its performance

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32 Pillar 2A refers to the component of Pillar 2 that looks at risks not captured, or only partially captured, under the Pillar 1 framework.

33, 34 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)



| Upcoming policy consultations   | Q1<br>Mar – May | Q2<br>Jun – Aug | Q3<br>Sep – Nov | Q4<br>Dec – Feb |
|---|-----------------|-----------------|-----------------|-----------------|
| <b>Business aim 2</b><br>Continue to implement changes to domestic, European and international regulation, including the Financial Services (Banking Reform) Act 2013   |                 |                 |                 |                 |
| Transposition of Solvency II  |                 |                 |                 |                 |
| Banking Recovery and Resolution Directive   |                 |                 |                 |                 |
| Liquidity Coverage Requirement  |                 |                 |                 |                 |
| Depositor Protection and Implementation of the Deposit Guarantee Scheme Directive   |                 |                 |                 |                 |
| <b>Business aim 3</b><br>Influence, devise and implement policy to advance structural reform in banking, resolution policy, the secondary competition objective, and other elements of post-crisis standard setting |                 |                 |                 |                 |
| Remuneration  |                 |                 |                 |                 |
| Senior Manager Regime   |                 |                 |                 |                 |
| Insurance Policyholder Protection   |                 |                 |                 |                 |
| Publication of Prudential Reports   |                 |                 |                 |                 |
| Structural Reform of Banks  |                 |                 |                 |                 |
| Pillar 2 Capital for Banks  |                 |                 |                 |                 |
| External Auditor's Contribution to Prudential Supervision   |                 |                 |                 |                 |
| <b>Other</b><br>Transposition of Handbook to PRA Rulebook   |                 |                 |                 |                 |
| PRA Rulebook  |                 |                 |                 |                 |
| Key deliverables  | Q1<br>Mar – May | Q2<br>Jun – Aug | Q3<br>Sep – Nov | Q4<br>Dec – Feb |
| Completion of the transition of the largest firms to the Periodic Summary Meeting supervisory cycle   |                 |                 |                 |                 |
| Publication of a statement on the PRA's approach to supervision of overseas entities, following a consultation process launched at the end of February 2014   |                 |                 |                 |                 |
| Delivery of a smooth, effective transition from the UK's current prudential liquidity regime to the Liquidity Coverage Ratio  |                 |                 |                 |                 |
| Implementation of the Deposit Guarantee Scheme and Banking Recovery and Resolution Directive  |                 |                 |                 |                 |
| Implementation of the stress testing initiative – stress testing the resilience of the largest eight UK banking groups to a common stress scenario  |                 |                 |                 |                 |
| Support and influence IAIS work on the development of the Basic Capital Requirement for global systemically important insurers (GSIIIs)   |                 |                 |                 |                 |
| Transposition of Solvency II – feedback and final rules   |                 |                 |                 |                 |

## Measuring success

Performance against the PRA's statutory objectives is difficult to measure for a number of reasons including:

- defining a baseline against which to measure is not straightforward and there are a number of factors which limit the PRA's ability to estimate counterfactuals;
- the PRA's successes are generally market sensitive and therefore often not in the public domain; and
- external factors affect the PRA's ability to exert direct influence over outcomes.

Indicators used for measuring financial stability and protection of policyholders includes:

- quantity and quality of capital and liquidity held by PRA firms;
- strength of firms' arrangements for effective management and governance;
- quality of the PRA's supervisory tools; and
- the ability of insurance firms to meet claims from and material obligations to policyholders.

The PRA will be working to include more outcome-focused measures in its performance measurement framework in line with the National Audit Office's recommendations.<sup>35</sup>

Key ways in which the PRA will measure the success of its new judgement-based, forward-looking supervisory model are:

- self and peer reviews – this will entail staff assessing their own performance and receiving independent challenge at regular intervals;
- regular review of how firm-specific risks are being managed – these measures will cover both the core judgements (for example, business model analysis, key risks, proactive intervention framework rating (PIF), the approval of the supervision strategy) and the core execution (that is assurance the supervision strategy is 'on track'); and
- assessment of the capability of staff to make the right judgement about the course of action to reduce the probability of risks to the statutory objectives through a supervisory competence framework.

In order to assess the effectiveness of key policy initiatives the PRA will:

- continue to monitor the outcomes for the UK of successful negotiation of European/international policy; and
- in line with National Audit Office recommendations, put in place formal evaluation approaches such as post implementation reviews.

The PRA needs high-quality staff with relevant experience and a blend of market and regulatory skills to deliver judgement-based supervision. This is measured through:

- length of service of staff;
- staff turnover;
- successful progression of staff through the Training and Competence schemes; and
- diversity of experience in the PRA, ie the blend of experienced hires vs graduates, the range of industry sectors the PRA attract talent from, and the mix of backgrounds in the management team.

**The PRA needs high-quality staff with relevant experience and a blend of market and regulatory skills to deliver judgement-based supervision**

## Key risks to achieving the PRA business aims

### Resourcing

Insufficient resources in terms of both capacity and skills/experience may lead to staff stretch, a need to re-prioritise planned PRA deliverables or failure to execute the Business Plan.

The PRA needs to be able to recruit and retain high-quality people in a range of disciplines and with the right technical expertise and generate sufficient development opportunities to retain staff. The PRA will face an increased market demand for expertise and retention of employees may become more difficult.

### Internal factors

The PRA is in the early stages of development and is not yet at steady state. The volume of change is significant and there exists material delivery risk in embedding and enhancing its new approach as well as establishing the new organisation. The Bank has launched a new Strategic Plan which will lead to further change as the PRA takes its full part in delivering the wider Bank's agenda.

### External factors

As a public body and a prudential regulator, the PRA is exposed to external factors such as changes in the regulatory and economic environment. These fall into three main areas:

- legislative uncertainty and policy delay: uncertainty or delay with the delivery of domestic, European and international standards for legislation could hinder delivery for the Business Plan, and make it harder for the PRA to deliver its supervisory approach;
- change in focus of PRA activities: examples here might be legislative scope change such as the competition objective, but they will also arise in business as usual activities from bodies such as the FPC, Financial Stability Board or Monetary Policy Committee, which require the PRA to provide assistance. These requirements may cause the PRA to reprioritise its planned activities; and
- economic context: any adverse change in the economic environment or change in the use of macroeconomic policy tools, within or outside the UK, may impact on the safety or soundness of deposit-takers and insurers. While recovery and resolution planning will reduce the impact of firm failure on financial stability, a large and wide ranging shock that impacts financial stability remains a clear risk.

**The Bank has launched a new Strategic Plan which will lead to further change as the PRA takes its full part in delivering the wider Bank's agenda**

By order of the Board

Mr M Carney  
Chairman

6 June 2014

# Directors' Report

The Directors present their report and the audited financial statements of the Prudential Regulation Authority for the year to 28 February 2014.

The Directors' Report, the Strategic Report and the financial statements have been reviewed by the Audit and Risk Committee of the Bank.

The Directors of the PRA who served during the period were:

| Name                  | Appointment date   | Expiry of term   | Attendance at Board meetings |
|-----------------------|--|------------------|------------------------------|
| Lord King of Lothbury | 20 February 2013   | 30 June 2013     | 14/14                        |
| Mark Carney (a)       | 1 July 2013  | 30 June 2021     | 14/16                        |
| Andrew Bailey (b)     | 20 February 2013   | 31 March 2018    | 29/30                        |
| Sir Paul Tucker       | 20 February 2013   | 18 October 2013  | 20/22                        |
| Sir Jon Cunliffe      | 1 November 2013  | 31 October 2018  | 6/7                          |
| Martin Wheatley (c)   | 20 February 2013   | –                | 18/30                        |
| Iain Cornish (d)*     | 20 February 2013   | 19 February 2016 | 27/30                        |
| Rosalind Gilmore*     | 20 February 2013   | 19 February 2015 | 25/30                        |
| Charles Randell (e)*  | 20 February 2013<br>and reappointed on<br>20 February 2014 | 19 February 2017 | 29/30                        |
| Nick Prettejohn*      | 10 June 2013   | 5 March 2014     | 15/19                        |

(a) Mr Carney has indicated that he will serve until 30 June 2018.

(b) In addition to Board meetings, attended 6/6 meetings of the Audit and Risk Committee of the Bank.

(c) Ex officio member. Under FSMA Mr Wheatley must not take part in discussions by or decisions of the PRA which relate to the PRA's supervisory functions and decisions; as such he does not attend all Board meetings.

(d) In addition to Board meetings, attended 3/3 meetings of the Audit and Risk Committee of the Bank, commencing in July 2013.

(e) In addition to Board meetings, attended 1/1 meetings of the Remuneration Committee of the Bank.

\* Appointed members

None of the Directors had a beneficial interest at any time during the financial period in the shares of the PRA.



## Principal activity

The PRA was established as a wholly-owned subsidiary of the Bank of England on 21 November 2011, anticipating planned legislation to reform the UK regulatory framework. The PRA became the UK's prudential regulator for banks, building societies and credit unions (collectively known as deposit-takers), insurers and major investment firms, with statutory responsibilities under FSMA, on 1 April 2013. On the same date the PRA's name was changed from the Prudential Regulation Authority Limited to the Prudential Regulation Authority.<sup>36</sup> The PRA's regulatory activities during the year are described in the Strategic Report on pages 13–24.

## Review of the year

Prior to 1 April 2013, the only activity was the setting up and preparing the PRA for its responsibilities. Any set up costs incurred by the Bank were recharged to the PRA (see Financial review on page 42).

## Future developments in the business of the PRA

Details of proposed future developments can be found within the Strategic Report section on pages 25–33.

## Financial results

The PRA's financial statements for the period to 28 February 2014 are presented on pages 46–63.

## Governance

As a private limited company the PRA is not obliged to comply with the UK Corporate Governance Code (the Code). However, the PRA is required under FSMA to 'have regard to such generally-accepted principles of good corporate governance as it is reasonable to regard as applicable to it'.<sup>37</sup> The Board considers that the PRA complies with the Code as far as it is appropriate to the PRA. The PRA's governance arrangements are described below.

## The Board

The PRA is led by its governing body, the Board. In accordance with FSMA<sup>38</sup> the Governor of the Bank is Chair of the PRA; the Bank's Deputy Governor for Prudential Regulation is the Chief Executive of the PRA; the Deputy Governor for Financial Stability and the Chief Executive of the Financial Conduct Authority are members of the Board; and there are additional 'appointed members' of the Board. Appointed members are appointed by the Bank's Court of Directors, with the approval of HM Treasury<sup>39</sup> and must not be subject to direction from the Bank.<sup>40</sup> As at 28 February 2014, Court had appointed four members (see table on page 34). A majority of the Board must be made up of non-executive members who are not employed by the PRA or the Bank.<sup>41</sup>

To guide the process of appointing Board members, Court has adopted a policy on conflicts of interest. This is published on the Bank's website.<sup>42</sup> The key requirement is that, other than in exceptional circumstances, Board members should have no continuing association with PRA-regulated firms. Appointed members are appointed for renewable terms of three years, though some initial appointments have been for shorter periods to stagger rotation (see the table on page 34).

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- 36 Section 2A(1) of FSMA.
- 37 Section 3C of FSMA.
- 38 Paragraphs 2 and 3 of Schedule 1ZB of FSMA. [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)
- 39 Paragraph 6 of Schedule 1ZB of FSMA.
- 40 Paragraph 11(2) of Schedule 1ZB of FSMA.
- 41 Paragraphs 8 and 9 of Schedule 1ZB of FSMA.
- 42 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)

During the year the Board met 24 times (with an additional six teleconferences), and has adopted a normal schedule of two meetings each month. Attendance at Board meetings is set out in the table on page 34. The Board has not exercised its power to create sub-committees. Court's Audit and Risk and Remuneration Committees perform the relevant functions on behalf of the PRA and further details can be found in the Risk management, Audit and Management sections of this Directors' Report.

An exercise to review and evaluate the Board's performance is planned in the second half of 2014.

### Regulatory functions and decision-taking

The Board is independently responsible for delivering the PRA's statutory objectives. The PRA pursues its objectives by making policies and rules, supervising authorised firms, giving directions, issuing guidance and other legislative functions and in doing so acts through its Board.<sup>43</sup> The Board (in consultation with Court) also sets the PRA's strategy.<sup>44</sup> The Board has delegated some other matters to the PRA's Chief Executive, but has reserved to itself key regulatory decisions relating to the most significant firms.<sup>45</sup>

The strategy adopted by the Board and the actions the PRA proposes to take during the year to implement the strategy are set out in the Strategic Report and Business Plan on pages 25–33.

### Management

The PRA's management, personnel, budgetary and financial infrastructure is integrated with the Bank's: the PRA's staff are Bank employees; and common services are provided centrally by the Bank. The PRA's budget is subject to the approval of the Bank<sup>46</sup>, and the Bank, has reserved to itself the right to determine remuneration policies, significant changes in the management structure, the most senior appointments, and codes of conduct for staff and Directors.<sup>47</sup> The Bank's Remuneration Committee advises, and the Oversight Committee determines, the remuneration of the appointed directors of the PRA. The PRA Board receives regular information from the Bank functions on which it relies, including in particular Finance, Internal Audit and HR.

### Risk management

The PRA participates in the Bank's risk management framework. The Bank's Court is responsible for the risk management and internal control systems across the Bank and its subsidiaries. These take account of the materiality of the risks. The Bank's risk framework includes risk standards to define the organisation's tolerance of risk and an incident monitoring system. It is an overarching framework to achieve consistency and transparency in risk management across the Bank and its subsidiaries; it identifies key parties and their roles and responsibilities and risk management policies; it considers strategic risks, financial risks to the Bank's balance sheet and operational risks caused by weaknesses in processes, systems, or through staff and third-party activities. For further information on the Bank's risk management framework and risk governance, see page 56 of the Bank's *Annual Report*.

43

Paragraph 16(2) and (3) of Schedule 1ZB of FSMA.

44

Section 2E of FSMA.

45

www.bankofengland.co.uk/pr-ar2014/links

46

Paragraph 18(1) of Schedule 1ZB of FSMA.

47

Article 10 of the Articles of Association of the PRA.

Risk management and internal control forms part of Court's responsibility for the overall governance framework of the Bank and its subsidiaries. The responsibility for day-to-day operations is delegated to executive management.

The PRA Board has put in place reporting systems and controls to identify, evaluate and manage risks to the PRA's objectives. The PRA's specific reporting systems and controls include identifying:

- external developments affecting the resilience of regulated institutions as a whole, including the economic environment, competitive pressures and legislative developments in the UK and internationally;
- risks arising from interaction with other macroprudential and microprudential regulators, including the FPC, the FCA and European agencies; and
- risks to the Board's regulatory strategy arising from the regulatory process, the quality of supervision, resource constraints and other operational factors.

These risks are described in more detail in the Strategic Report. The Board's appetite for risk is ultimately determined by the statutory objectives of the PRA and is set out in the PRA's strategy and approach documents.<sup>48</sup>

The PRA has developed a structured process for monitoring risks to these objectives, and the assessment is approved by the Board before being shared with the Bank's risk committees, including Court's Audit and Risk Committee, which Board members attend.

The PRA's proactive intervention framework captures the PRA's judgement about the risk of failure of each individual firm and the Board routinely considers the supervisory strategies (including resolution plans) for those judged to be most at risk.

The Board is supported by a Supervisory Oversight Function, the aim of which is to: assure senior management on the quality and effectiveness of supervision; promote continuous improvement through the findings and recommendations from its Supervisory Effectiveness Reviews; support supervision and respond to ad hoc requests to conduct reviews; and provide a portfolio-wide view on supervision risk.

The Supervisory Oversight Function fulfils this role in a number of ways: by conducting a rolling programme of Supervisory Effectiveness Reviews; high-level analysis of supervisory risk management information; and conducting initial assessment of any potential regulatory failures.

## Audit

The Bank's Audit and Risk Committee (ARCo) assists Court in meeting Court's responsibilities for an effective system of financial reporting, internal control and risk management. It is responsible for reviewing the findings of internal and external auditors. It is supported by the Bank's internal audit function.

The Board participates in ARCo, which is attended by Board members (see table on page 34), and in which the PRA's performance and risk profile can be reviewed alongside other parts of the Bank. ARCo also acts as an interface with the National Audit Office, as statutory auditor of the PRA. For further information on the Audit and Risk Committee, see page 56 of the Bank's *Annual Report*.

The PRA is within the scope of the Bank's internal audit function. The Board is consulted on the annual internal audit plan before it is finalised, receives copies of internal audit reports relating to the PRA and meets with the Head of Internal Audit on a quarterly basis.

## Oversight Committee

The Bank has reserved to itself (as shareholder of the PRA) the function of keeping under review the PRA's performance in relation to its objectives and strategy. The Court subsequently delegated that function to the Oversight Committee of Court. Details of Court's relationship with the PRA Board can be found online.<sup>49</sup> The Report of the Oversight Committee, including its review of the performance of the PRA, can be found on pages 60–66 of the Bank's *Annual Report*.

## Accountability

The PRA is required under FSMA to be accountable to stakeholders including the public and practitioners. The PRA consults the public before making rules. Consultation with PRA-authorized persons on general policies and practices is carried out through a panel of persons established and maintained by the PRA (the PRA Practitioner Panel) to represent the interests of practitioners. Details of the panel can be found online.<sup>50</sup>

## Indemnities

Members of the PRA Board have been indemnified by the Bank against any personal civil liability arising from the carrying out or purported carrying out of their functions, provided they have acted honestly and in good faith and have not acted recklessly.

## Immunity

In addition to the indemnity referred to above, under FSMA the PRA and persons acting as members, officers and members of staff of the PRA have immunity from liability in damages.<sup>51</sup>

**Table 1: PRA Board remuneration (audited)**

|                                     | Mr A J Bailey |         | Mr Cornish |         | Mr Prettejohn |         | Mrs Gilmore |         | Mr Randell |         |
|-------------------------------------|---------------|---------|------------|---------|---------------|---------|-------------|---------|------------|---------|
|                                     | 2013/14       | 2012/13 | 2013/14    | 2012/13 | 2013/14       | 2012/13 | 2013/14     | 2012/13 | 2013/14    | 2012/13 |
| Base salary                         | 253,127       | –       | 77,520     | 2,087   | 56,152        | –       | 77,520      | 2,087   | 77,520     | 2,087   |
| Salary and fees                     | 253,127       | –       | 77,520     | 2,087   | 56,152        | –       | 77,520      | 2,087   | 77,520     | 2,087   |
| Taxable benefits                    | 11,356        | –       | –          | –       | –             | –       | –           | –       | –          | –       |
| Payment in lieu of pension          | 75,938        | –       | –          | –       | –             | –       | –           | –       | –          | –       |
| Pension benefits                    | 75,938        | –       | –          | –       | –             | –       | –           | –       | –          | –       |
| Total single figure of remuneration | 340,421       | –       | 77,520     | 2,087   | 56,152        | –       | 77,520      | 2,087   | 77,520     | 2,087   |

49, 50 [www.bankofengland.co.uk/prar2014/links](http://www.bankofengland.co.uk/prar2014/links)

51 Paragraph 33 of Schedule 1ZB of FSMA.



## Board remuneration

The remuneration of the Board is reported here. The PRA Board is appointed under statute and is the governing body of the PRA.

Remuneration of appointed members of the Board is determined by the Bank's Remuneration Committee. During the year they were paid at the rate of £77,520p.a. Mr Cornish, Mrs Gilmore and Mr Randell were paid salary in 2013 as they were appointed members of the Board on 20 February 2013. They received no other benefits. Mr Bailey was appointed Deputy Governor of the Bank of England as of 1 April 2013 and is remunerated at a rate of £258,809p.a.

Mr Bailey and the appointed members are remunerated by the Bank. The PRA pays consideration to the Bank for the directors' services received. The Bank recharged as consideration Mr Bailey's remuneration in full for the year from 1 March 2013 to 28 February 2014. In addition, the Bank received consideration of £295,000 for the services provided by the Governor, Lord King, Sir Paul Tucker and Sir Jon Cunliffe to the PRA. Their full remuneration is reported in the Bank's *Annual Report*.<sup>52</sup>

Mr Wheatley receives no remuneration from the PRA.

## Pension arrangements

Mr Bailey is a member of the Bank of England pension fund but receives no further pension contributions from the Bank. Included in Mr Bailey's benefits is 30% salary supplement in lieu of pension contributions of £75,938. Appointed members of the Board are not eligible for the Bank of England pension fund.

## Other disclosures (audited)

HM Treasury has made a direction under paragraph 22 of Schedule 1ZB of FSMA to disclose the following:

### Fair pay

The banded remuneration of the highest-paid Director (base salary plus benefits excluding payment in lieu of pension) in the financial year 2014 was £270,165 (salary of £258,809 as at 28 February 2014 plus non-pension related benefits of £11,356). This was 3.68 times the median remuneration of the workforce, which was £73,448.

In 2014, no employees received remuneration in excess of the highest paid Director. Remuneration ranged from £16,900 to £270,165.

Total remuneration includes salary, non-consolidated performance-related pay and benefits-in-kind. It does not include severance payments, employer pension contributions and the cash equivalent transfer value of pensions.

#### Exit packages

There have been no compulsory redundancies during the year. There were two other exit packages agreed during the year, one in the range £30,000–£40,000 and the other in the range £40,000–£50,000.

#### Employee involvement

Details of employee involvement can be found in the Strategic Report on page 23.

#### Employment of people with disabilities

Details of employment of people with disabilities can be found on page 23.

#### Health and safety

The Bank manages health, safety and risk as a priority. Through its safety management system the Bank delivers a safe working environment, promotes and maintains a positive health and safety culture. Health and safety issues and incidents are monitored by the Bank's Safety Health and Environment (SHE) committee.

#### The environment

In addition to health and safety, the SHE committee monitors the impact of the Bank's operations on the environment. By managing waste production/disposal and reducing energy usage through better power efficiency, the Bank is able to minimise its impact on the environment. Recent replacement of engineering plant at the Bank's premises saw an improvement in efficiency and a reduction in consumption. This reduction is reflected in the displayed energy certificate.

More than 98%, or 1,439 tonnes, of waste generated by the Bank is recycled or reused. One third of this waste is utilised in the production of power through the burning of the waste material at an award winning 'Energy from Waste' facility. The Bank's main publications, including this *Annual Report*, are printed on paper which contains at least 50% recovered waste and 50% virgin fibre and is certified as a Forest Stewardship Council mixed sources product.

#### Disclosure of information to the Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the PRA's Auditor is unaware; and each Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the PRA's Auditor is aware of that information.

## Statement of Directors' responsibilities in respect of the Directors' Report and the financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations and in accordance with accounts direction given by HM Treasury. Company law requires the Directors to prepare financial statements for each financial period. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the EU and applicable law. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the PRA and of the profit or loss of the PRA for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with International Financial Reporting Standards as adopted by the EU
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the PRA will continue in business; and
- observe the accounts direction issued by HM Treasury including the relevant accounts and disclosure requirements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the PRA's transactions and disclose with reasonable accuracy at any time the financial position of the PRA and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the PRA and to prevent and detect fraud and other irregularities.

## Auditor

The Comptroller and Auditor General is responsible for auditing the PRA's accounts, under the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012. This is effective from 24 January 2013.

## Financial review of 2013/14

### The financial framework of the PRA is defined by paragraph 31 of schedule 1ZB of the FSMA, as amended by the Financial Services Act 2012.

The PRA may make rules for the recovery of costs from fee-payers:

- to meet expenses incurred in carrying out its functions or for any incidental purpose;
- to repay the principal of, and pay any interest on, any relevant borrowing and to meet relevant commencement expenses; and
- to maintain adequate reserves.

The Prudential Regulation Authority came into being on 21 November 2011 and assumed its supervisory functions on 1 April 2013 following legal cutover. Operating costs for the eleven month period to end February 2014 were £193m. A further £9m of costs associated with the transition and set up of the PRA were incurred in 2014 (2013: £65m). All transition costs are recovered via the levy on regulated firms.

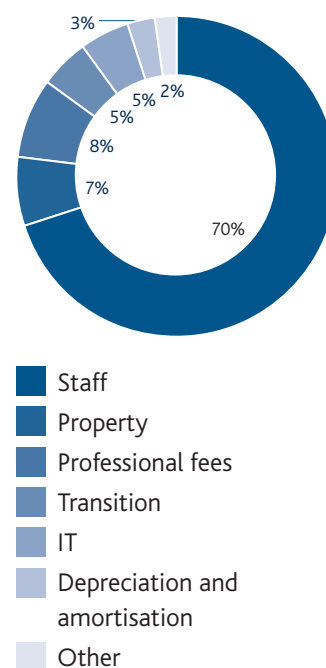
The budget is subject to internal review and challenge before approval by the PRA Board and the Court of the Bank. The fees from individual firms are based on the size of their business. Consequently, those firms that present the greatest risk to the stability of the UK financial system will be the main contributors to the PRA's funding needs.

**Table 2: PRA expenditure by function<sup>53</sup>**

| £m                                      | 2014 Actual | 2013 Actual |
|---|-------------|-------------|
| Banking supervision                     | 32          | –           |
| Insurance supervision                   | 30          | –           |
| Policy                                  | 14          | –           |
| Regulatory operations                   | 42          | –           |
| Bank of England management fee          | 59          | –           |
| Depreciation, amortisation and property | 16          | –           |
| Transition costs                        | 9           | 65          |
| <b>Total expenditure</b>                | <b>202</b>  | <b>65</b>   |

53 PRA expenditure by function table: The 2014 actuals represents an 11 month operating period. The total budget for 2014 on a full year equivalent basis was £230m.

**Figure 3: PRA expenditure analysis**



Source: PRA Data.

Total operating costs of £202m for the PRA are primarily comprised of staff related costs (70%; £142m)

The 2014 budget was £212m for the eleven month operating period, including transition costs and special project fees totalling £12m. Actual expenditure for 2014 of £202m was £10m below budget, due primarily to recruitment delays and higher attrition rates.

The PRA's budget for 2015 is £238m, which includes £6m for special project expenditure.

The 2015 budgeted cost increase reflects the inclusion of a full year of operations, closure of prior year resourcing gaps, and remit expansion, including:

- i. Concurrent stress testing of the UK banking system, to assess capital adequacy in line with FPC recommendations;
- ii. Structural reform of financial service firms, with ring-fencing and loss-absorbing capacity proposals, and implementing a new secondary competition objective; and
- iii. Parliamentary Commission on Banking Standards, highlighting four main areas where it is believed reform is needed: individual responsibility, governance, competition and the responsibilities of regulators.

## Annual Funding Requirement (AFR)

The AFR fee income recognised for 2013/14 was £182m. Of the AFR actually levied and collected in the year, £20m will be refunded to fee payers, representing the amount in excess of expenses incurred.

£9m of transition cost recoveries were recognised in the year. Total transition costs of £74m are being recovered over a five-year period commencing 2014.

## Balance sheet

The balance sheet total at 28 February 2014 was £102m.

Assets include current and non-current transition costs receivable from fee payers of £59m. Cash of £18m and fixed and intangible assets of £25m make up the balance.

Liabilities include levy income to be refunded of £20m. The PRA intends to return surplus annual fees to fee payers in the 2015 financial year. An amount of £78m is due to the Bank, of which £59m is in relation to transition costs and £19m in management recharges.

By order of the Board

Mr M Carney  
Chairman

6 June 2014



## The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the Prudential Regulation Authority for the year ended 28 February 2014 under the Financial Services and Markets Act 2000. The financial statements comprise the Statement of Comprehensive Income, Balance Sheet, Statement of Cash Flows, Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

### Respective responsibilities of the directors and the auditor

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Financial Services and Markets Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

### Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

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### Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Prudential Regulation Authority's affairs as at 28 February 2014 and of its surplus for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- the financial statements have been prepared in accordance with the Companies Act 2006 and HM Treasury directions issued under the Financial Services and Markets Act 2000.

### Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006 and HM Treasury directions issued under the Financial Services and Markets Act 2000; and
- the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit.

### Report

I have no observations to make on these financial statements.

**Amyas C E Morse**  
**Comptroller and Auditor General**

11 June 2014

National Audit Office  
157–197 Buckingham Palace Road  
Victoria  
London SW1W 9SP

# Statement of comprehensive income for the year to 28 February 2014

|                                | Note | 2014<br>£000   | 2013<br>£000  |
|--------------------------------|------|----------------|---------------|
| <b>Income</b>                  |      |                |               |
| Fee income                     | 4    | 189,998        | 64,722        |
| Income on bank deposits        |      | 339            | –             |
| Other income                   | 5    | 12,205         | –             |
| <b>Total income</b>            |      | <b>202,542</b> | <b>64,722</b> |
| <b>Expenses</b>                |      |                |               |
| Administrative costs           | 6    | 193,249        | –             |
| Other expenses                 | 8    | 9,215          | 64,722        |
| <b>Total expenses</b>          |      | <b>202,464</b> | <b>64,722</b> |
| <b>Surplus before taxation</b> |      | <b>78</b>      | <b>–</b>      |
| Taxation                       | 11   | (78)           | –             |
| <b>Surplus after taxation</b>  |      | <b>–</b>       | <b>–</b>      |

The statement of comprehensive income has been prepared for a 12 month period, Operational costs and fee income were only incurred over an 11 month period following legal cutover on 1 April 2013.

# Statement of changes in equity for the year to 28 February 2014

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There were no changes in equity during the period. The entire capital comprising 1 ordinary share of £1 was issued, fully paid to the Governor and Company of the Bank of England on 21 November 2011.

# Balance sheet

## as at 28 February 2014

|                                     | Note | 2014<br>£000   | 2013<br>£000  |
|-------------------------------------|------|----------------|---------------|
| <b>Assets</b>                       |      |                |               |
| <b>Current assets</b>               |      |                |               |
| Cash and cash equivalents           | 12   | 17,864         | –             |
| Trade and other receivables         | 13   | 15,293         | 14,820        |
|                                     |      | 33,157         | 14,820        |
| <b>Non-current assets</b>           |      |                |               |
| Property, plant and equipment       | 15   | 8,617          | –             |
| Intangibles                         | 16   | 15,948         | –             |
| Trade and other receivables         | 14   | 44,253         | 49,902        |
|                                     |      | 68,818         | 49,902        |
| <b>Total assets</b>                 |      | <b>101,975</b> | <b>64,722</b> |
| <b>Liabilities</b>                  |      |                |               |
| <b>Current liabilities</b>          |      |                |               |
| Trade and other payables            | 17   | 57,718         | 14,820        |
|                                     |      | 57,718         | 14,820        |
| <b>Non-current liabilities</b>      |      |                |               |
| Trade and other payables            | 18   | 44,257         | 49,902        |
|                                     |      | 44,257         | 49,902        |
| <b>Total liabilities</b>            |      | <b>101,975</b> | <b>64,722</b> |
| <b>Equity</b>                       | 19   | –              | –             |
| <b>Total liabilities and equity</b> |      | <b>101,975</b> | <b>64,722</b> |

The financial statements were approved by the Board on 6 June 2014 and signed on its behalf by:

Mr M Carney Chairman

Sir J Cunliffe Director

Company Number: 07854923

Except as provided by section 22 (1) of Schedule 1ZB of FSMA, as amended by the Financial Services Act 2012, the PRA is exempt from the requirements of Part 16 of the Companies Act 2006.



# Statement of cash flows

## for the year to 28 February 2014

|  | Note      | 2014<br>£000    | 2013<br>£000 |
|--|-----------|-----------------|--------------|
| <b>Surplus for the year from operations</b>      |           | –               | –            |
| <b>Adjustments for:</b>                          |           |                 |              |
| Interest received on bank deposits               |           | (339)           |              |
| Amortisation of other intangible assets          | 16        | 2,741           |              |
| Impairment loss on intangible assets             | 16        | 685             |              |
| Depreciation of property, plant and equipment    | 15        | 2,329           |              |
| Decrease/(increase) in receivables               | 13, 14    | 5,176           | (64,722)     |
| Increase in payables                             | 17, 18    | 37,253          | 64,722       |
| Corporation tax paid                             | 11        | –               | –            |
| Other non cash items                             | 15, 16    | (538)           | –            |
| <b>Net cash from operating activities</b>        |           | <b>47,307</b>   | <b>–</b>     |
| <b>Investing activities</b>                      |           |                 |              |
| Interest received on bank deposits               |           | 339             | –            |
| Expenditure on software development              | 16        | (18,865)        | –            |
| Purchases of property, plant and equipment       | 15        | (10,917)        | –            |
| <b>Net cash used in investing activities</b>     |           | <b>(29,443)</b> | <b>–</b>     |
| <b>Net increase in cash and cash equivalents</b> | <b>12</b> | <b>17,864</b>   | <b>–</b>     |
| Cash and cash equivalents at 1 March             |           | –               | –            |
| <b>Cash and cash equivalents at 28 February</b>  | <b>12</b> | <b>17,864</b>   | <b>–</b>     |

The cash flow statement has been prepared for a 12 month period. Operational costs and fee income were only incurred over an 11 month period following legal cutover on 1 April 2013.

# Notes to the financial statements

## 1 Basis of preparation

### Form of presentation of the financial statements

The financial statements comprise the statement of comprehensive income, the balance sheet, the statement of cash flows, statement of changes in equity and related notes.

The Prudential Regulation Authority's (PRA) financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards and interpretations of International Financial Reporting Interpretations Committee as adopted by the EU (together, 'adopted IFRS'). The financial statements have been prepared on a going-concern basis, under the historical cost convention and in accordance with Companies Act 2006, with the exception of the requirements of paragraph 16, applicable accounting standards and in accordance with Accounts Direction given by HM Treasury under paragraph 22(1) of schedule 1ZB to the Financial Services and Markets Act 2000.

The principal accounting policies applied in the preparation of the financial statements are set out below. These policies have been applied consistently to all the years presented unless otherwise stated.

## 2 Accounting policies

### a Functional and presentation currency

The financial statements are presented in sterling, which is the PRA's functional and presentation currency.

### b New and amended standards

The PRA has considered the potential effect of forthcoming EU endorsed standards which have not been adopted in the financial statements; none of these are expected to materially impact the PRA.

### c Property, plant and equipment

#### i Initial recognition

Expenditure on property, plant and equipment is capitalised if the asset is expected to have a useful economic life of three years or more and an invoice value greater than a stated threshold of £5,000. The amount capitalised at initial recognition is the purchase price of the asset along with any further costs incurred in bringing the asset to its present condition and location.

Assets transferred from the FSA and the Bank of England have been transferred at the carrying value at 1 April 2013 (legal cutover). Transferring assets include fixtures and fittings and hardware relating to projects.

#### ii Subsequent valuation

Subsequent costs are added to an asset's carrying amount or are recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the PRA and the cost of the item can be reliably measured.

All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

#### iii Depreciation

Depreciation on leasehold improvements, plant and equipment is charged on a straight-line basis:

IT equipment      over periods ranging from three to seven years

Other equipment    over periods ranging from three to twenty years

#### iv Impairment

The assets' residual values and useful lives are reviewed and adjusted if appropriate at each reporting date. Assets that have a net book value of £nil or are greater than five years old are assessed for any indication of impairment. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

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**v Gains or losses on the disposal of property, plant and equipment**

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the statement of comprehensive income.

**d Intangible assets**

Intangible assets primarily consist of computer software and the costs associated with the development of software for internal use. Costs associated with maintaining software programs are recognised as an expense when incurred. Intangible assets are tested for impairment at each reporting date.

Assets transferred from the FSA have been transferred at the carrying value at 1 April 2013 (legal cutover).

**i Initial recognition**

Costs directly associated with the internal production of unique and separately identifiable software products, which are controlled by the PRA and which will probably generate economic benefits exceeding those costs; and externally purchased software which is controlled by the PRA are recognised as intangible assets.

**ii Subsequent valuation**

Subsequent costs are added to an asset's carrying amount or are recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the PRA and the cost of the item can be reliably measured.

All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

**iii Amortisation**

Intangible assets are amortised over the expected useful lives of the software, ranging from three to five years, determined on a case by case basis.

**iv Impairment**

Intangible assets are tested for impairment at each balance sheet date. Intangible assets are also subject to an impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

**e Financial assets**

Financial assets are recognised initially at fair value and are subsequently measured at amortised cost using the effective interest method. Due to the short maturity and low value of these assets, the receivables have been reported at fair value at the reporting date.

**Transition costs**

In the two years prior to legal cutover the Bank of England incurred costs in relation to setting up and preparing the PRA for its responsibilities, these were charged to the PRA in the year ending 28 February 2013. During the current year the PRA has been charged further costs by the Bank of England for the same purpose. The Board agreed to recover these costs from fee-payers over five years from 2013. An amount receivable from fee-payers and a corresponding amount payable to the Bank of England have been recognised on the balance sheet.

**f Financial liabilities**

Financial liabilities are recognised initially at fair value and are subsequently measured at amortised cost using the effective interest method. Due to the short maturity and low value of these liabilities, the payables have been reported at fair value at the reporting date.

## Notes to the financial statements

### continued

#### g Revenue recognition

Most revenue is receivable under the Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, and is measured at fair value and represents fees to which the PRA deemed it was entitled to in respect of the financial year.

##### Fee income

Fee income comprises levy fees collected from regulated firms through the Annual Funding Requirement (AFR) consultation process. This fee income is then recognised net of any surplus against expenditure in the year in the statement of comprehensive income.

Any surplus or deficit against levy income in the year will be held as a payable or receivable on the balance sheet as the intention is to refund any surplus or claim any deficit in the following financial year.

##### Special project fees

Special project fees are recognised as a receivable and fee income in the year. The income is recognised as expenses are incurred against the special project and categorised as 'special project fee income'.

Solvency II special project fees were collected in advance from fee payers and are recognised on the balance sheet as fees received in advance. Income is recognised with consideration to expenditure incurred in the year.

##### Enforcement fine income

Enforcement fines are recognised as revenue where they have been levied in the financial year. Where enforcement fines specific to a single case exceed its costs, the excess fines received can be used to cover expenditure on other cases in the current period. Any income received in excess of total enforcement expenditure in the current period is paid over to HM Treasury.

##### Interest income

Interest income is recognised on a straight line basis which approximates the effective interest method.

#### h Reserves

The PRA will not hold any accumulated reserves as the intention is to return any surplus to fee payers or collect any deficit from fee payers in the following year.

#### i Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition.

#### j Provisions

Provisions are recognised when the PRA has a present obligation, legal or constructive, as a result of a past event, where it is probable that an outflow of resources will be required to settle that obligation and the amount can be reliably estimated.

#### k Equity capital

The entire equity capital comprising one £1 ordinary share is held by the Governor and Company of the Bank of England.

#### l Taxation

Under the agreement with HM Revenue and Customs (HMRC), the fees paid by regulated institutions for regulatory purposes are not within the charge to corporation tax, but net interest income on deposits and any other investment income are subject to corporation tax as non-trade credits.



### m Retirement benefit costs

Employees are members of either the FSA defined contribution scheme or the Bank of England defined benefit scheme. Company contributions to the defined contribution scheme are recognised in the period incurred.

The PRA is a participating employer in the Bank of England pension fund. Within the recharge of staff costs the Bank of England charges an agreed rate for pension contributions of 33%. This rate of contribution has been estimated by the Bank of England to be the average cost of pensions in the medium term. These are disclosed with the pension contributions charge for the year. There is no policy for the Bank of England charging the PRA a portion of the net defined benefit cost of the Bank of England pension fund. Further details of the Bank of England pension fund are reported in the *Bank of England Annual Report and Accounts*.

### n Property costs

The lease for the 20 Moorgate property is held by the Bank of England. Floor-space recharges and building management charges are charged to the PRA by the Bank of England.

## 3 Significant accounting estimates and judgements in applying accounting policies

The PRA makes estimates and assumptions that affect the reported amounts of assets within the financial statements. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### a Intangible assets

Management has made judgements when capitalising intangible assets. Various costs incurred in the production of an internal project are capitalised if a number of criteria are met. Management has made judgements and assumptions when assessing whether a project meets these criteria and when measuring the costs and economic life attributable to such projects.

### b Staff costs

Staff working within the PRA are employed by the Bank of England and the PRA is recharged the costs monthly. In substance this arrangement is that employees are PRA staff members and as such full staff cost and number disclosures have been made.

### c Deferred income

Any surplus or deficit of expenditure against levy income will be recognised on the balance sheet. It is the intention of the PRA to refund or recoup any such surplus or deficit in future years.

## 4 Fee income

|  | 2014<br>£000   | 2013<br>£000  |
|--|----------------|---------------|
| Fee income                                 | 180,783        | –             |
| Transition cost recoveries from fee payers | 9,215          | 64,722        |
| <b>Total</b>                               | <b>189,998</b> | <b>64,722</b> |

Costs related to the transition to the new regulatory framework were incurred by the Bank of England and charged to the PRA. These are recoverable from fee-payers over a five year period commencing 2014. During 2014 transition costs were incurred both pre and post legal cutover (1 April 2013) as the transition continued during the year. These have been charged to the PRA by the Bank of England.

## Notes to the financial statements

### continued

#### 5 Other income

|                            | 2014<br>£000  | 2013<br>£000 |
|----------------------------|---------------|--------------|
| Solvency II income         | 9,539         | –            |
| Special project fee income | 1,528         | –            |
| Other sundry income        | 1,138         | –            |
| <b>Total</b>               | <b>12,205</b> | <b>–</b>     |

Solvency II income is recognised in so far as to match the costs incurred during the year on non-recurrent Solvency II activity.

Special project fee income is recognised to match the costs incurred on activity that has been designated as a special project, for which fees will be raised separately.

Other sundry income comprises fees for firms and individuals applying to become authorised in PRA-regulated activities, training services and any late payment fees charged in the year.

#### 6 Administrative expenses

|   | Note | 2014<br>£000   | 2013<br>£000 |
|---|------|----------------|--------------|
| Staff costs                                   | 9    | 97,889         | –            |
| Bank of England management fee                |      | 59,374         | –            |
| Property costs                                |      | 10,610         | –            |
| Professional and membership fees              |      | 11,892         | –            |
| Information technology costs                  |      | 5,076          | –            |
| Amortisation of intangible assets             |      | 2,741          | –            |
| Depreciation of property, plant and equipment |      | 2,329          | –            |
| Travel and accommodation                      |      | 1,964          | –            |
| Other administration and general expenses     |      | 1,374          | –            |
| <b>Total</b>                                  |      | <b>193,249</b> | <b>–</b>     |

The components of the Bank of England management fee are disclosed in the table below:

|                              | £000          |
|------------------------------|---------------|
| Staff costs                  | 44,594        |
| Depreciation                 | 1,311         |
| Administration expenditure   | 1,128         |
| Information technology costs | 4,309         |
| Professional fees            | 3,719         |
| Property costs               | 1,174         |
| Overhead allocation          | 3,139         |
| <b>Total</b>                 | <b>59,374</b> |

## 7 Enforcement expenditure

During the year no enforcement fines were raised. Enforcement expenditure in the year was £529,000.

## 8 Other expenses

|   | 2014<br>£000 | 2013<br>£000  |
|---|--------------|---------------|
| Transition costs charged by the Bank of England | 9,215        | 64,722        |
| <b>Total</b>                                    | <b>9,215</b> | <b>64,722</b> |

Costs related to the transition to the new regulatory framework have been incurred by the Bank of England and charged to the PRA, these are recoverable from fee-payers.

## Notes to the financial statements

### continued

#### 9 Staff costs

|   | 2014<br>£000  | 2013<br>£000 |
|---|---------------|--------------|
| Wages and salaries                      | 80,466        | –            |
| Social security costs                   | 9,890         | –            |
| Pension and other post-retirement costs | 8,052         | –            |
| Seconded staff recoveries               | (519)         | –            |
| <b>Total</b>                            | <b>97,889</b> | <b>–</b>     |

All staff are employed by the Bank of England. Staff costs are recharged to the PRA on a monthly basis by the Bank of England.

Pension costs include £6,265,000 of contributions to the FSA defined contribution scheme, at 28 February 2014 £nil was outstanding.

Contributions to the Bank of England pension fund are made at 33% of salary. The contribution made in the year to 28 February 2014 was £1,787,000. Full details about the Bank of England pension fund can be found in the *Bank of England Annual Report and Accounts 2014*.

During 2014, bonus payments relating to 2013 for ex-FSA staff who moved to the Bank of England were paid by the PRA. These costs were subsequently reimbursed by the FCA (£12,827,000). These costs have not been included within staff costs.

#### Average staff numbers

|  | 2014         | 2013     |
|--|--------------|----------|
| Chief Executive and other members of the Executive Committee | 13           | –        |
| Managers and analysts  | 895          | –        |
| Other staff  | 130          | –        |
| <b>Total</b>   | <b>1,038</b> | <b>–</b> |

Average staff numbers have been calculated over the 11 month period since legal cutover on 1 April 2013.

The number of staff employed by the Bank and working for the PRA at 28 February 2014 was 1,045, of which 951 were full-time staff and 94 were part-time (2013: none).

#### Directors' emoluments

The Directors' remuneration is disclosed in the Remuneration Report.

## 10 Audit fees

|  | 2014<br>£000 | 2013<br>£000 |
|--|--------------|--------------|
| Audit fees relating to the PRA's audit | 65           | 20           |
| <b>Total</b>                           | <b>65</b>    | <b>20</b>    |

No non-audit work was undertaken by the auditor.

## 11 Taxation

|   | 2014<br>£000 | 2013<br>£000 |
|---|--------------|--------------|
| Interest on cash deposits                       | 339          | –            |
| Tax calculated at rate of 23.08% (2013: 24.17%) | 78           | –            |
| Non-deductible expenses                         | –            | –            |
| Prior year items                                | –            | –            |
| <b>Total tax charge for period</b>              | <b>78</b>    | <b>–</b>     |

Under the agreement with HM Revenue and Customs (HMRC), the fee paid by regulated institutions for regulatory purposes are not within the charge to corporation tax, but net interest income on deposits and any other investment income are subject to corporation tax as non-trade credits.



## Notes to the financial statements

### continued

#### 12 Cash and cash equivalents

|  | 2014<br>£000  | 2013<br>£000 |
|--|---------------|--------------|
| Cash balance held at the Bank of England | 17,864        | –            |
| <b>Total</b>                             | <b>17,864</b> | <b>–</b>     |

#### 13 Current trade and other receivables

|  | 2014<br>£000  | 2013<br>£000  |
|--|---------------|---------------|
| Fees receivables                             | 542           | –             |
| Transition costs recoverable from fee payers | 14,751        | 14,820        |
| <b>Total</b>                                 | <b>15,293</b> | <b>14,820</b> |

Transition costs are being recovered from fee payers over a five year period commencing 2013/14. The transition fees recognised here are recoverable within one year.

#### 14 Non-current trade and other receivables

|  | 2014<br>£000  | 2013<br>£000  |
|--|---------------|---------------|
| Transition costs recoverable from fee payers | 44,253        | 49,902        |
| <b>Total</b>                                 | <b>44,253</b> | <b>49,902</b> |

## 15 Property, plant and equipment

|   | Computer<br>equipment<br>£000 | Furniture and<br>equipment<br>£000 | Total<br>£000 |
|---|-------------------------------|------------------------------------|---------------|
| <b>For the period to 28 February 2014</b> |                               |                                    |               |
| <b>Cost or valuation</b>                  |                               |                                    |               |
| At 1 March 2013                           | –                             | –                                  | –             |
| Additions                                 | 189                           | 121                                | 310           |
| Transfers in from Bank of England         | 6,769                         | 861                                | 7,630         |
| Transfers in from FSA                     | 2,299                         | 707                                | 3,006         |
| <b>At 28 February 2014</b>                | <b>9,257</b>                  | <b>1,689</b>                       | <b>10,946</b> |
| <b>Accumulated depreciation</b>           |                               |                                    |               |
| At 1 March 2013                           | –                             | –                                  | –             |
| Charge for the year                       | 2,059                         | 270                                | 2,329         |
| <b>At 28 February 2014</b>                | <b>2,059</b>                  | <b>270</b>                         | <b>2,329</b>  |
| Net book value at 1 March 2013            | –                             | –                                  | –             |
| <b>Net book value at 28 February 2014</b> | <b>7,198</b>                  | <b>1,419</b>                       | <b>8,617</b>  |

There are no assets held under finance leases. The fair value of assets is not materially different to the carrying value.

Included within additions is £29,000 of furniture and equipment purchased but not paid for at the balance sheet date.

## Notes to the financial statements

### continued

#### 16 Intangible assets

|   | Intangibles<br>£000 | Intangibles<br>work in<br>progress<br>£000 | Total<br>£000 |
|---|---------------------|--|---------------|
| <b>Cost</b>                               |                     |  |               |
| At 1 March 2013                           | –                   | –  | –             |
| Additions                                 | –                   | 4,345                                      | 4,345         |
| Transfers in from FSA                     | 15,029              | –  | 15,029        |
| Impairments                               | (685)               | –  | (685)         |
| <b>At 28 February 2014</b>                | <b>14,344</b>       | <b>4,345</b>                               | <b>18,689</b> |
| <b>Accumulated amortisation</b>           |                     |  |               |
| At 1 March 2013                           | –                   | –  | –             |
| Charge for the year                       | 2,741               | –  | 2,741         |
| <b>At 28 February 2014</b>                | <b>2,741</b>        | <b>–</b>                                   | <b>2,741</b>  |
| <b>Net book value at 1 March 2013</b>     | <b>–</b>            | <b>–</b>                                   | <b>–</b>      |
| <b>Net book value at 28 February 2014</b> | <b>11,603</b>       | <b>4,345</b>                               | <b>15,948</b> |

Intangible assets comprise software development for Analytical Risk Technology and Solvency II requirements.

Included within additions is £509,000 of intangible assets purchased but not paid for at the balance sheet date.

## 17 Current trade and other payables

|  | 2014<br>£000  | 2013<br>£000  |
|--|---------------|---------------|
| Fees received in advance                                 | 20,260        | –             |
| Fees received in advance – Solvency II                   | 3,516         | –             |
| Amounts due to the Bank of England – transition costs    | 14,781        | 14,820        |
| Amounts due to the Bank of England – management recharge | 19,079        | –             |
| Other payables   | 82            | –             |
| <b>Total</b>   | <b>57,718</b> | <b>14,820</b> |

Fees received in advance comprise fees in relation to the annual funding requirement surplus in the year. This surplus will be refunded in financial year 2014/15.

Amounts due to the Bank of England comprise transition cost recoveries payable within one year and recharged expenditure, staff costs and the management fee.

## Notes to the financial statements

### continued

#### 18 Non-current trade and other payables

|   | 2014<br>£000  | 2013<br>£000  |
|---|---------------|---------------|
| Amounts due to the Bank of England – transition costs | 44,257        | 49,902        |
| <b>Total</b>  | <b>44,257</b> | <b>49,902</b> |

#### 19 Capital

The entire capital comprising of one authorised, issued and fully paid ordinary share of £1 is held by the Governor and Company of the Bank of England.

#### 20 Financial risk

The PRA's principal financial assets are cash, together with fee and other receivables.

##### Credit risk

Credit risk is the risk of loss arising from the failure of a counterparty to meet its financial obligations to the PRA. The credit risk that the PRA faces arises when the PRA invoices counterparties for the collection of regulatory fees from the financial services industry.

The Bank of England monitors the credit risk exposures on behalf of the PRA and the collection of fees from counterparties. The PRA has a strong record of collecting fees with bad debts accounting for less than 0.02% of fees receivable in the year.

##### Liquidity risk

Liquidity risk is the risk of encountering difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The PRA manages its liquidity risk by monitoring and forecasting the projected income and expenditure related to its day to day business. The PRA also has an overdraft facility in place with the Bank of England should the need for additional liquidity arise.

##### Interest rate risk

Interest rate risk is the risk of loss as a result of changes in the absolute level of interest rates. The PRA is only exposed to interest rate risk on its cash deposits held with the Bank of England which are sensitive to variations in interest rates.



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## 21 Related party transactions

### The Bank of England

The Bank of England is the parent company of the PRA and provides central services and support functions to the PRA, for which it charges a management fee on a monthly basis, during the year these fees totalled £59,374,000.

All PRA staff are employed by the Bank of England, during the year staff cost recoveries of £97,889,000 were charged by the Bank to the PRA.

The lease for 20 Moorgate is held by the Bank of England who charge the PRA property management costs, these were £10,610,000 in the year.

The Bank of England meets the cost of direct expenditure for the PRA and recharges the cost, in the year this totalled £20,021,000.

At the period ended 28 February 2014 £59,038,000 of transition costs are due to the Bank of England, a further £19,079,000 is due to the Bank of England in respect of the management fee and other recharged costs.

During the year the Bank of England incurred £9,215,000 of costs in relation to the transition from the FSA to the PRA. These have been charged to the PRA in the year. Additionally a transfer of property, plant and equipment purchased as part of the transition programme was made at legal cutover of £7,630,000.

The PRA made contributions to the Bank of England pension fund of £1,787,000 on behalf of employees.

### HM Treasury

As part of the HM Treasury group the PRA is a related party to Royal Bank of Scotland and Lloyds Banking Group. The PRA received levy income from both Royal Bank of Scotland and Lloyds Banking Group in the year.

### Financial Conduct Authority

The Financial Conduct Authority (FCA) is a related party as one PRA director and another Board member are also appointed members of the Board of the FCA. Martin Wheatley as Chief Executive and Andrew Bailey as a Non-executive Director. The FCA charges the PRA an administration fee relating to the invoicing and collection of fee and other income from levy payers. Charges for this service totalled £83,000 in the year. The PRA is also charged for the shared use of some FCA software applications to support regulation. The total charge for this service was £6,875,000. During the year, as part of the set-up of the PRA, there was a transfer of assets (£18,320,000) and liabilities (£15,567,000) from the FSA representing a net cost of £2,753,000, this was paid in full to the FCA in the year. The PRA had an amount payable to the FCA of £3,000 at the balance sheet date.

### Key management

The Directors of PRA are considered to be the only key personnel as defined by IAS 24. The Directors' remuneration is disclosed in the Remuneration Report. There were no transactions that would be required to be shown under the provision of the Companies Act 2006. None of the key management personnel had a material interest, directly or indirectly, in any other significant transaction or arrangement with the PRA at any time during the year.

All transactions with related parties are entered into on an arm's length basis.

## 22 Ultimate parent company

The ultimate parent company of the PRA is HM Treasury.

## 23 Events after the balance sheet date

The accounts were approved for distribution on 11 June 2014.

Prudential Regulation Authority  
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Company Number: 07854923

# Contacting the Bank of England and the PRA

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