



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Annual Report and Accounts

1 March 2016–1 March 2017



Prudential Regulation Authority

Annual Report and Accounts

The financial year 1 March 2016–1 March 2017

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 and the Bank of England and Financial Services Act 2016.

Ordered by the House of Commons to be printed on 6 July 2017.

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This report is made by the Prudential Regulation Authority (PRA) under the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016. It is made to the Chancellor of the Exchequer and covers the year ended 1 March 2017.

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

HM Treasury has issued an accounts direction; disclosures relating to this can be found on page 61.

The PRA's audited accounts for the reporting year ending 1 March 2017 are set out on pages 69–85.

The Bank of England *Annual Report and Accounts* for year ending 28 February 2017 are available on the Bank's website at www.bankofengland.co.uk/publications/Pages/annualreport/default.aspx

Additional material can be found on the Bank's website at 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 facilitated effective competition in the markets for services provided by PRA-authorised firms in carrying on regulated activities in accordance with section 2H of FSMA.

Please address any comments or enquiries to:
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London
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The consultation closes on 6 October 2017.

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Promoting the **Good**
of the **People of the United Kingdom**
by maintaining **Monetary** and **Financial** Stability



One Bank

Maximising our impact by working together

We attract and inspire the best people to public service, reflecting the diversity of the United Kingdom.

Diverse and Talented

Valuing diverse ideas and open debate, while developing and empowering people at all levels to take initiative and make things happen.

We are at the forefront of research and analysis as a necessary part of our policies and actions.

Analytic Excellence

Making creative use of the best analytical tools and data sources to tackle the most challenging and relevant issues.

Our decisions and actions have influence and impact, both at home and abroad.

Outstanding Execution

Co-ordinated, effective and inclusive policy decisions and reliable, expert execution in everything we do.

We are understood, credible and trusted, so that our policies are effective.

Open and Accountable

Transparent, independent and accountable to stakeholders, with efficient and economic delivery of our policies and actions.

Foreword by the Chair



Mark Carney
Governor,
Chair of the Prudential
Regulation Committee

The United Kingdom hosts the world's leading international financial centre. Its defining characteristics include the talents of its people, the rule of its laws, the reach of its language and the good fortune of its time zone. Just as important are its enduring commitments to markets, openness and innovation. Together these factors have driven the growth of the UK financial system to almost ten times the size of UK GDP as it serves the economies of the United Kingdom, Europe and the world. The UK financial system can continue to be a partner in prosperity for the real economy at home and abroad — provided we maintain its resilience through the highest standards of supervision and regulation, and the most effective co-operation with other regulators.

The United Kingdom continues to be at the forefront of an international effort to fix the fault lines revealed by the financial crisis — creating a system that is safer, simpler and fairer. Capital requirements for the largest global banks are now ten times higher than before the crisis. Banks are lending more to the real economy and less to each other. And the 'too big to fail' public subsidy enjoyed by private systemic banks is estimated to have fallen by around 90% in the United Kingdom. The 2016 stress test showed once again that our banking system is resilient and capitalised to support the real economy even under a broad, severe and synchronised stress scenario.

Authorities across the globe are working together to manage the cross-border challenges to financial stability. This starts with the consistent, fair and transparent implementation of international standards, to which the PRA is committed. As the home country regulator for four G-SIBs and the host for all 30 G-SIBs, the PRA also participates actively in supervisory colleges which promote information sharing. And crucially, the Bank of England continues to lead the way in embedding an effective 'gone concern' regime for when things go wrong. For example, last year we published requirements which will make it possible to resolve failing banks by ensuring that they hold sufficient equity and debt to absorb losses.

The progress of the past decade has been exemplified by how the financial system helped cushion events of the summer of last year. It absorbed, not amplified, the uncertainty and volatility in market prices around the referendum

on the United Kingdom's membership of the European Union. The cost of borrowing stayed low and the availability of credit was maintained. More resilient, better prepared banks and insurers were part of the solution. The PRA made sure firms were ready going into the referendum and, coming out of it, worked closely with the wider Bank which reinforced stability with a package of stimulus measures. Sam Woods, who became Deputy Governor for Prudential Regulation and CEO of the PRA in July, was instrumental to this work and his leadership will be vital for the challenges ahead.

The effectiveness of preparations for the referendum was testament to our 2014 strategic plan, by which the PRA has been woven into the fabric of One Bank. This work was completed by the Bank of England and Financial Services Act 2016, which recast the PRA Board into the Prudential Regulation Committee. The PRC is able now to focus squarely on taking the most important supervisory and microprudential policy decisions, on the same legal footing as — and working in concert with — the MPC and FPC.

We will not rest on these laurels. More effective decision-making, enabling stronger collaboration, doing what matters most for our statutory objectives — these are all hallmarks of our strategic plan, Vision 2020, which will transform how the entire Bank works and communicates.

The focus of our work in the year ahead will inevitably be dominated by the issues relating to the United Kingdom's withdrawal from the European Union. The PRA will be working closely



with Her Majesty's Government to make sure that as relevant EU requirements are converted into the UK framework, they remain operable and coherent. And irrespective of the particular form of the United Kingdom's future relationship with the EU, and consistent with our statutory responsibilities, we will remain committed to the implementation of robust prudential standards in the UK financial system. We will help firms plan for the full range of potential scenarios around the United Kingdom's withdrawal from the European Union, so that they can take decisions at the right time in their own best interest while risks to the financial stability of the wider system are mitigated. The PRA will play a vital role in ensuring that firms are ready to execute contingency plans should the need arise.

More broadly, our task now is to complete the journey from fragility to resilience. Not resilience as an end in itself, but efficient resilience which promotes wider economic stability.

Take stress testing. Last year's test was the first under our new annual cyclical scenario framework. The 2017 test will be complemented by a new biennial exploratory scenario with a longer time horizon. Its focus will not be on whether, but how banks would meet regulatory requirements and build sustainable business models in an environment of headwinds to profitability, such as persistently low interest rates. The PRA is also working with firms to prepare for the inclusion of the new accounting standard, IFRS 9, in the 2018 stress test.

Structural reform — a programme which has moved firmly from requirements into implementation — is another epitome of efficient resilience. Last year, we confirmed the higher prudential requirements which will apply to ring-fenced banks. Structurally separating them from the rest of their groups helps ensure the continuity of retail banking in the event of external shocks while preserving the free flow of capital provided by wholesale and investment banking activities across borders.

Efficient resilience is also about adjusting prudential measures if there are unnecessary duplications,

inconsistencies or material unintended consequences. For example — working with international colleagues as appropriate — the PRA will look to refine our approach to implementing Solvency II requirements which are too sensitive or countercyclical, notably the risk margin. It is also taking forward the recommendations of the Bank's Independent Evaluation Office (IEO) in its approach to its objective of contributing to policyholder protection.

The PRA's secondary objective to facilitate effective competition is another vital lens through which to consider the effectiveness of post-crisis reforms. Last year saw the PRA complete the implementation of the IEO report on the approach to this objective. Moreover, the PRA is levelling the playing field for smaller banks and building societies using the standardised approach to credit risk rather than internal models and is reforming the process for firms who wish to move from the former to the latter. This complements the important ongoing international work to finalise the Basel reforms, which should reduce the excessive variability in risk-weighted capital requirements.

Efficient resilience is not just financial. Working with other authorities and firms, the PRA is increasing its focus on testing and reinforcing the operational continuity of those critical services which support the UK economy. At the same time the PRA is working with the wider Bank to encourage new and innovative financial technologies and understand their potential impact on business models.

This is how the PRA helps to realise the promise of our leading international financial sector. Fixing the fault lines of the past and building efficient resilience for the future — all for the good of the people of the United Kingdom.

26 June 2017

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Report by the Chief Executive



Sam Woods
Deputy Governor,
Prudential Regulation
and Chief Executive of
the PRA

Later this year we will mark a decade since the failure of Northern Rock. This was soon followed by the taxpayer bailouts of RBS and Lloyds Banking Group. While memories of the financial crisis fade, we at the PRA remain strongly focused on delivering the objectives given to us by Parliament.

These are to: promote the safety and soundness of banks and insurers; contribute to the protection of insurance policyholders; and — subject to both — facilitate effective competition. These objectives fit together to provide a clear and simple mandate for the PRA, working as part of the Bank for the good of the people of the United Kingdom. Our objectives are unchanged by the Bank of England and Financial Services Act 2016, which turned the PRA Board into the Prudential Regulation Committee (PRC). This most senior of our decision-making bodies is now on the same legal footing as the other policy committees in the Bank, simplifying and clarifying our governance structure.

I've now been at the helm of the PRA for a year. My approach to delivering our objectives is simply expressed: more of the same. While the landscape changes around us, and we need constantly to update our view of the risks we face, the approach we adopted for the PRA at its inception in 2013 is the right one and we will stick with it: forward-looking, judgement-based supervision focused on the key risks.

In forewords of this kind one inevitably highlights a few major events and initiatives from the year in question. These are important, and I comment on them below. But the real backbone of the PRA is the day-in day-out business of regulation and supervision including: risk assessments, stocktakes, asset quality reviews, governance reviews, setting capital and liquidity requirements, scrutiny of models, examinations of underwriting practices, reserves deep dives, setting and delivering supervisory strategies, consulting on and making rules, engaging with colleagues across Europe and the globe on regulatory and supervisory issues, and of course running the PRA itself. It is hard to bring all this activity to life in an annual report, but this is

what our job is really about — and I would like to thank all my colleagues who work diligently and tirelessly on these tasks in the public interest, including Paul Fisher who retired this year.

Turning to events of the year, it would be odd not to start with our approach to the referendum on the United Kingdom's membership of the European Union.

The PRA has engaged closely with firms' contingency planning. Prior to the vote we made sure, for example, that firms were carefully managing funding and liquidity risks in sterling and foreign currency. Since the referendum we have worked closely with firms to ensure they are making, and stand ready to execute in good time should the need arise, contingency plans for the full range of possible scenarios around the United Kingdom's withdrawal. This is second nature for forward-looking supervisors who are in the business of precautions — the more orderly the transition, the lower the risks to our objectives.

While most contingency planning is by its nature specific to each firm, the PRA has also played an important role in broader referendum-related policy work across the Bank. For example, in the days and weeks following the vote we co-ordinated with the Financial Policy Committee to ensure that banks could make effective use of their capital buffers, and that insurers could maximise the flexibility in Solvency II regulations to recalculate transitional measures. We also provided input to the Monetary Policy Committee before it decided to reduce Bank Rate to 0.25%; thanks to the accompanying Term Funding Scheme, this had a broadly neutral impact on lenders' net interest margins, helping them to pass on the cut to households and firms. And we are now firmly



engaged in work to prepare for the on-shoring of EU rules.

The referendum came hard on the heels of the introduction of Solvency II for insurance companies on 1 January 2016. So we and insurance companies have this year been getting used to the new regime. The core philosophy of Solvency II builds very much on the previous UK regime — but there are some important new features. One of these in particular is not working well — the risk margin, a new liability for insurance companies, is far too sensitive to risk-free rates and as a result is currently too big. We are engaged with colleagues in Europe to fix this problem, and in the meantime are giving firms the full benefit of transitional measures to offset it. We have also had a busy year updating our tools to fit the new regime — for instance in our approach to recalculating transitional measures, monitoring model drift and assessing the ‘matching adjustment’ benefit insurers are able to claim in respect of assets they can hold to maturity. All of this was the subject of a lively debate at the Treasury Committee (TC) as part of its inquiry into Solvency II.

Meanwhile we will continue to implement the final two major elements of the post-crisis reforms for banks. First, ring-fencing. The structural separation of retail banking from other activities such as investment and international banking takes legal effect on 1 January 2019. The necessary changes are complex but preparations are well advanced. These will become more prominent in the year ahead as — for example — the sort codes of some customers will be changed. Second, we are supporting colleagues in the Bank in completing the resolution framework. Key to this is ensuring that firms have sufficient equity and liabilities in place to allow failing firms to be resolved without recourse to the taxpayer, because we do not operate a zero-failure regime. Interim requirements for so-called ‘bail-in debt’ will take effect by 2020, and we continue to work with the Resolution Directorate to ensure that resolution plans for orderly failure are in place for all UK banks.

The passage of time since the financial crisis does not mean it is fully behind us. While the system was first brought to its knees by the prudential phase of the crisis, the misconduct phase casts a longer shadow. Banks continue to bear significant costs of fines, compensation and redress for outstanding cases of past misconduct. This illustrates the crucial role that robust governance and accountability plays in fostering effective cultures within firms, and with this in mind we will continue to embed our new Senior Managers and Certification Regime.

A stressed view of misconduct costs is one of the risks we look at in stress testing. Last year’s scenario also incorporated a synchronised UK and global recession, with associated shocks to financial market prices. This was the most severe stress we had tested banks against, and held them to a higher standard reflecting the phasing-in of capital buffers. While the system as a whole came through strongly, some capital inadequacies among individual firms were revealed so plans were put in place to build further resilience. At the same time, it is clear from the profitability of the UK banks that they have not fully adjusted to the new post-crisis world. So this year’s test will apply a second stress to the big incumbent banks, an exploratory scenario to understand how their business models — upon which their resilience ultimately is founded — might evolve in the future.

Turning to our secondary objective, which is another topic in which the TC takes a keen interest, we have this year taken some significant steps forward. On the banking side, our efforts fall into two broad categories. First, we continue to invest to make sure that we encourage new entrants, through our New Banks Start-up Unit and the tools it uses, such as the ‘mobilisation phase’ which allows new banks to get up and running with limited permissions before the full weight of our authorisation process is brought to bear. I know for a fact that this simple innovation has been decisive in allowing some new entrants to get off the ground. Results speak louder than any words I can put in an

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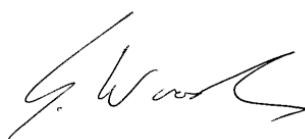
annual report — since the PRA opened its doors four years ago we have authorised 25 banks.

The second category of issues on the banking side relates to the complaint of banks using the standardised approach to credit risk as opposed to models (typically smaller banks) that there is an unlevel playing field in capital requirements, particularly for low loan to value (LTV) mortgages. I have long been troubled by this and we are determined to make progress, which we have this year by: taking further steps to make sure firms are able to apply for model approval; making a major change to how we set 'Pillar 2A' requirements for banks without models; arguing in Basel for a large reduction in the standardised risk-weight for low LTV mortgages; and delivering ground-breaking research to the Competition and Markets Authority about the possible impact of this issue on mortgage pricing. All of this, and the actions we are taking to facilitate competition in insurance, are set out in our Competition Report published today.

Looking ahead, we are undertaking a review into the credit quality of new consumer credit lending by all PRA-regulated lenders, focusing on credit cards, motor and unsecured personal loans. On

the insurance side, persistently low market interest rates internationally continue to pose a number of challenges, which we will continue to monitor. Another essential plank of our supervisory priorities is operational resilience. Our work to ensure that firms are effectively tested against the risk of cyber attack, are addressing their vulnerabilities and have plans in place should an attack prove successful, is all fully co-ordinated with authorities across the sector. But it is work that has little precedent — cyber is a risk that evolves and our framework for tackling it will also therefore need to develop.

To come back to where I started, we will remain strongly focused on our statutory objectives in the period ahead. We will finish the job of repairing the financial system following the financial crisis and we will then hold the line.



26 June 2017



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Prudential Regulation Committee



On 1 March 2017, the PRA Board was replaced by the Prudential Regulation Committee (PRC), and the PRA was brought within the single legal entity of the Bank of England. These changes were required by the Bank of England and Financial Services Act 2016 (the Act).

The PRC is the body within the Bank responsible for exercising the Bank's functions as the Prudential Regulation Authority as set out in the Bank of England Act 1998 and the FSMA 2000.¹ The PRC is on the same legal footing as the Monetary Policy Committee (MPC) and the Financial Policy Committee (FPC).

The PRC has twelve members,² consisting of five Bank Governors and officials, the Chief Executive of the FCA, and at least six members appointed by the Chancellor of the Exchequer.

Following the commencement of the relevant provisions of the Act:

- The PRC continues to be independent in all its decision-making functions, including making rules and the PRA's most important supervisory and policy decisions.
- The PRA functions continue to be exercised by the Bank and will continue to be funded by the PRA levy, with the PRC responsible for consulting on and setting the level.
- The PRA's legal status as a subsidiary company has been ended.
- The PRC will report annually to the Chancellor on the adequacy of the resources allocated to the PRA functions and the extent to which the exercise of those

Members as at 26 June 2017*

Top row, left to right

Mark Carney
Governor, Chair of the PRC

Ben Broadbent**
Deputy Governor,
Monetary Policy

Sir Jon Cunliffe
Deputy Governor,
Financial Stability

Sam Woods
Deputy Governor, Prudential
Regulation and Chief Executive of
the PRA

Middle row, left to right

Andrew Bailey
Chief Executive of the
Financial Conduct Authority
1 March 2017 –

David Belsham
External member
Term: 1 March 2017 –
30 April 2018

Sandy Boss
External member
Term: 1 March 2017 –
31 August 2017

Norval Bryson
External member
Term: 1 March 2017 –
31 August 2018

Bottom row, left to right

Charles Randell
External member
Term: 1 March 2017 –
28 February 2019

David Thorburn
External member
Term: 1 March 2017 –
31 August 2018

Mark Yallop
External member
Term: 1 March 2017 –
30 November 2017

* For details of date of first appointment and terms on the PRA Board, please refer to Table 3 on page 58.

** The Act provides for one member to be appointed by the Governor with the approval of the Chancellor. The Governor has appointed Ben Broadbent.

1 In this report, references to the 'PRA' should be construed as references to either: (i) the Company, acting via its Board, in the period to 1 March 2017; or (ii) the Bank, acting through the PRC, post-1 March 2017, as the context requires.

2 Following the departure of Charlotte Hogg on 28 April 2017, the PRC had eleven members on 26 June as shown here.



functions is independent of the exercise of the Bank's other functions.

- HM Treasury can make recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance its objectives, and when considering the application of the regulatory principles in FSMA.

These changes will maintain the PRA's operational independence, while at the same time promoting the sharing of knowledge, expertise, and analysis throughout the Bank. The statutory objectives of the PRA, which underpin its forward-looking, judgement-based approach to supervision, remain unchanged:

- a general objective to promote the safety and soundness of the firms it regulates;

- specifically for insurers, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders; and

- a secondary objective to, so far as is reasonably possible, act in a way which facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.

Under FSMA, the PRA is required to review, and if necessary revise, and publish annually its strategy in relation to how it will deliver its statutory objectives. The PRA's strategy will be set by the PRC, in consultation with the Bank's Court of Directors (Court). The strategy for 2017/18 can be found in the Strategic Report section on page 19.

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Sam Woods
Deputy Governor,
Prudential Regulation
and CEO of the PRA
(FPC, PRC)



Vicky Saporta*
Executive Director
Prudential Policy



Lyndon Nelson
Deputy CEO and
Executive Director
Supervisory Risk
Specialists and
Regulatory
Operations



David Rule
Executive Director
Insurance Supervision



Phil Evans
Director
Financial Prudential
Policy



Sasha Mills
Director
Cross-Cutting
Prudential Policy



Charlotte Gerken
Director
Supervisory Risk
Specialists



Anna Sweeney
Director
General Insurance

* Also reports to Deputy Governor, Financial Stability.

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Sarah Breeden
Executive Director
International Banks
Supervision



James Proudman
Executive Director
UK Deposit-takers
Supervision



Mike Mitchell
Director
International Banks
Supervision



Martin Stewart
Director
Banks, Building
Societies and
Credit Unions



[Find out more online](#)
www.bankofengland.co.uk



**BANK OF ENGLAND
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PRA Strategic Report:

Overview of responsibilities and approach

On 1 March 2017, the PRA ceased to be a subsidiary and became part of the legal entity of the Bank. There has been no change to the PRA's objectives or functions, and the day-to-day business of the PRA is unaffected.

The PRA is responsible for the prudential regulation of deposit-takers,¹ insurers and the largest investment firms in the United Kingdom. The PRA supervises around 1,500 firms² and groups (see **Charts 1 and 2**). This includes nearly 900 banks, building societies and credit unions and over 600 insurers of all types (general insurers, life insurers, friendly societies, mutuals and the London market).

In discharging its powers the PRA seeks to assess and address risks that the firms it supervises can pose to the stability of the financial system.

The United Kingdom has one of the world's largest centres for financial services. Over half of the total UK banking sector assets belong to branches and subsidiaries of foreign banks, totalling around £4.1 trillion. Reflecting this role in international finance, the PRA supervises around 170 branches and subsidiaries of foreign banks from over 50 jurisdictions.

The UK insurance sector is the largest in Europe and the fourth largest in the world.

Among the population of PRA regulated firms, the PRA is the home state regulator of four UK global systemically important banks (G-SIBs) and two UK global systemically important insurers (G-SIIs). The United Kingdom acts as host regulator to all internationally headquartered G-SIBs and several G-SIIs.

The PRA's approach to supervision

The PRA's supervisory approach, as published on the PRA's website,³ is forward-looking and judgement-based and key to enabling the PRA to meet its strategy. The PRA adopts a proportional approach which focuses on the harm that firms can cause to the stability of the UK financial system. A stable financial system is one in which firms continue to provide critical financial services, and is essential for a healthy economy.

Threshold Conditions set out the minimum requirements firms must meet in order to be permitted to carry on regulated activities.

For authorised firms the PRA prioritises its supervisory efforts across a wide and diverse population of institutions, reflecting a number of different factors. These include the PRA's judgement of a firm's potential impact on the stability of the financial system, and therefore its systemic importance; its proximity to failure and its resolvability; and for insurers, the impact on policyholders if the firm were to fail.

Firms judged by the PRA as unlikely, individually, to create disruption to the wider financial system are subject to a baseline level of supervisory activity to ensure that they meet key prudential standards. The PRA makes use of a fuller selection of its supervisory tools for higher impact firms — these firms are subject to continuous assessment by dedicated teams of supervisors.

The PRA advances its objectives and promotes safety and soundness by setting standards, including detailed rules that firms must meet, and through supervision, where the PRA assesses the risks posed to its objectives and takes action to mitigate them.

The areas of focus in assessing risks posed by firms include: the risk context, or how the

The PRA seeks to assess and address risks that the firms it supervises can pose to the stability of the financial system

Chart 1: PRA supervised deposit-takers, as at 1 March 2017

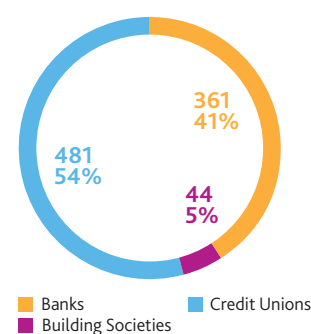
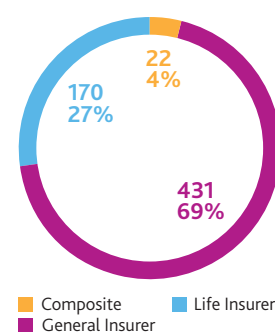


Chart 2: PRA supervised insurers as at 1 March 2017



1 Banks, building societies and credit unions are the only UK financial institutions that are authorised and regulated to collect deposits from the general public.

2 Over the course of the year the exact number of PRA-authorised firms and groups changes as new firms enter, other firms close or change their permissions, and entities within groups restructure. This total also includes all designated investment firms.

3 www.bankofengland.co.uk/publications/Pages/other/prasupervisoryapproach.aspx.



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environment and the business risks a firm faces affects the viability of the firm, and the extent of mitigating factors that may exist such as the governance and management oversight; financial strength; and resolvability of the firm.

The PRA uses quantitative and qualitative analysis to allocate firms to five categories of potential impact. Category 1 represents the most significant firms with a capacity to cause major disruption to the UK financial system, and Category 5 represents firms with a capacity to cause almost no disruption (see **Charts 3 and 4**).

The PRA assesses the potential impact that firms could have on financial stability or policyholders by failing, or coming under stress, or through the way they carry on their business. The intensity of supervision applied to firms will vary in proportion to this assessment.

An effective framework for financial stability needs to combine firm-specific supervision with work to protect and enhance the resilience of the financial system as a whole. As part of the Bank, the PRA works closely with the FPC to contribute to the identification and assessment of macroprudential risks that could negatively affect the safety and soundness of PRA-regulated firms.

The PRA works with other parts of the Bank on areas such as market intelligence and oversight of the critical financial infrastructure. The PRA also works closely with the Resolution Directorate on resolution planning, contingency planning for firm failure and operational resilience — see page 16 for more information on the PRA’s role in resolution.

International engagement

The UK banking and insurance industries are highly internationalised. The decision in June 2016 for the United Kingdom to leave the

European Union, and the potential implications of changes in the international arena, have put a spotlight on the future of international engagement. The PRA will continue its international engagement to ensure the financial stability of the UK system and the continued availability of critical economic functions.¹ The following section sets out the PRA’s current approach to the supervision of overseas firms operating in the United Kingdom.

For banks, the supervision of overseas firms operating in the United Kingdom is an important part of the PRA’s work. However, the PRA’s legal powers and responsibilities vary depending on the location of the parent and the legal form of its operations in the United Kingdom. As a result, prudential standards for overseas firms in the United Kingdom are set by a combination of home and host state supervisory powers.

The types of risks which the PRA will assess in respect of overseas firms are: those arising from the parent entity; risks from exposures to overseas jurisdictions; the firm’s legal status (branch or subsidiary); the nature of the home country regulatory regime(s) (supervisory and resolution) for non-European Economic Area (EEA) entities; and the nature and scale of the firm’s operations in the United Kingdom, including whether the firm undertakes critical economic functions.

For **subsidiaries of overseas firms** the PRA has full powers and responsibilities and treats such firms as equivalent to UK-owned firms, applying the same prudential requirements.

For **UK branches of EEA firms**, the PRA’s powers and responsibilities are limited under European law, and prudential requirements are set by the home supervisor. To assure itself that risks to the UK financial system from EEA branches, particularly those considered significant, are adequately managed, the PRA

Chart 3: Distribution of potential impact categories across PRA-regulated firms, Category 1 being the highest impact to financial stability

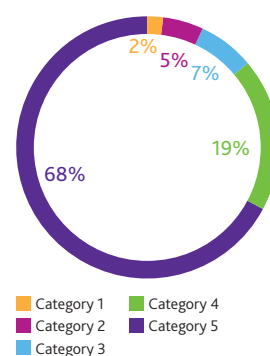
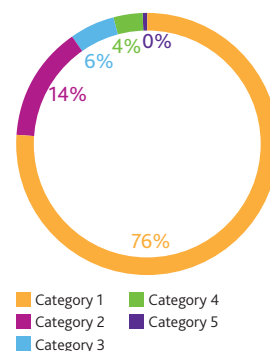


Chart 4: Total potential impact of each category of PRA-regulated firm



¹ In March 2017 the FPC noted that over a longer horizon, it is alert to the potential for greater complexity in firms’ business structures to reduce the resilience of the UK financial system and is examining appropriate mitigants.



focuses on recovery and resolution planning (along with the Resolution Directorate) and on ensuring that it has access to relevant information on the safety and soundness of the parent firm through collaboration with home authorities.

For **UK branches of non-EEA firms**, the power to set capital and liquidity requirements sits with the home supervisor. The PRA's authorisation applies to the whole firm. The approach, as set out in Supervisory Statement 10/14¹ which applies to both new and existing branches, reflects an assessment of the UK branch's activities, and is centred on the equivalence of the home authority's supervision of the whole firm, including its ability and willingness to share confidential information and the degree of supervisory co-operation, and the level of assurance the PRA gains from the home authority over resolution. Where the PRA is satisfied on these matters it will also need to have a clear and agreed split of prudential supervisory responsibilities with the home authority. Alternatively, the PRA may consider authorising such a firm as a subsidiary instead, which can help address supervisory concerns or allow the application of UK resolution powers in the event of firm failure.

The PRA maintains co-operation agreements, including memorandums of understanding (MoU), with overseas counterparts to enable the sharing of confidential information on cross-border firms. The PRA currently has over 60 MoUs with non-EEA counterparts. For its largest firms with large international operations, the PRA engages closely with overseas regulators including through participation in supervisory colleges. Colleges of supervisors for EEA banks with subsidiaries or significant branches in other EEA countries occur on a regular basis and include supervisors from non-EEA countries where relevant.

Many insurers regulated by the PRA have overseas subsidiaries, or parents that are regulated by overseas regulators, and thus the PRA's legal powers and responsibilities will necessarily vary depending on the legal structure of its operations in the United Kingdom. Co-ordination with the relevant overseas regulators is an important part of the PRA's role, and involves regulators from both the developed and the emerging markets. The PRA has been hosting and supporting regulatory colleges for its larger firms and groups for several years. In addition to these international colleges, the PRA works directly with international regulators on issues such as the approval of group-wide models, or specific concerns as they arise.

PRA approach to policy

The Bank and PRA make prudential policy within a legal framework, which is set out in **Figure 1**. It means that the PRA is required under law to make policy in pursuit of its objectives and in line with legal obligations. Prudential supervision is based on policies which ensure that judgements on risks to the PRA's objectives are made within the legal framework. The legislation to desubsidarise the PRA introduced a new mechanism for HM Treasury to make recommendations to the PRC about aspects of the government's economic policy to which the PRC should have regard when considering how to advance its objectives, and when considering the application of the regulatory principles in FSMA. The PRA aims to establish and maintain published policy material that is consistent with its objectives, clear in intent, straightforward in its presentation, as concise as possible, and usable by the senior management of firms.

At a global level, the PRA is actively involved in the work of the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the International Association of

The PRA maintains co-operation agreements, with overseas counterparts to enable the sharing of confidential information on cross-border firms

¹ www.bankofengland.co.uk/pr/Pages/publications/ss/2014/ss1014.aspx.

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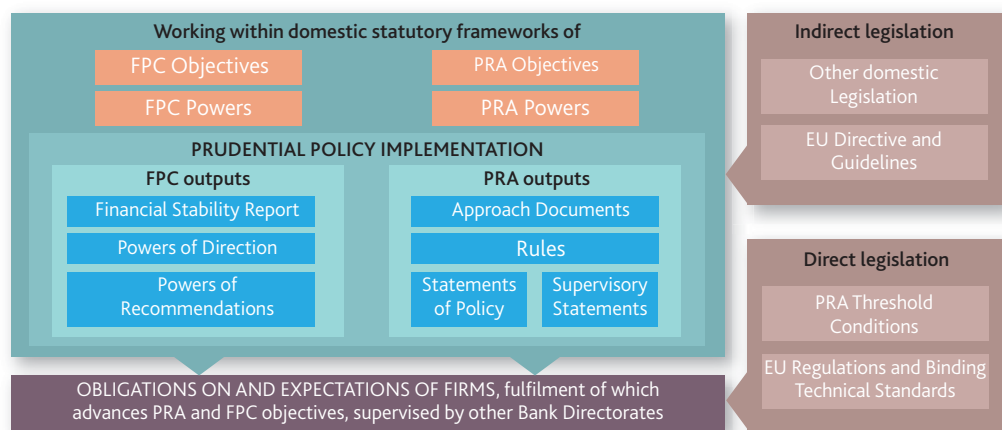
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Figure 1: Prudential policy legal framework



Insurance Supervisors (IAIS), and the Joint Forum.¹ In Europe, the PRA and other areas of the Bank are active participants in the work of the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Systemic Risk Board (ESRB).

The PRA’s role in resolution

A key principle underlying the PRA’s approach to supervision is that it does not seek to operate a ‘zero failure’ regime. Rather, the PRA, working with the Resolution Directorate, seeks to ensure any firms that fail do so in an orderly way that avoids significant disruption to the financial system or to the supply of critical financial services and does not expose public funds to loss. A firm that is judged to be capable of doing so is considered ‘resolvable’. Both the PRA, as prudential regulator, and the Bank, as resolution authority, have statutory objectives that require action to be taken to ensure that institutions are resolvable. The PRA’s approach to banking supervision explicitly states that the PRA may use its powers to require institutions to take action, including restructuring, to improve the feasibility of orderly resolution. The Bank, as the resolution authority, develops resolution plans, carries out the resolvability assessments and has its own powers to direct

institutions to address impediments to resolvability.

Each authority will consult the other and co-operate closely in exercising these complementary responsibilities and powers.

Working with the FCA

The FCA is responsible for the regulation of conduct of business, with the mandate and tools to protect consumers and market participants including through the promotion of competition. An MoU between the FCA and the PRA describes how the two regulators co-ordinate their duties in a way that supports each regulator’s ability to advance its own objectives. A key principle for this co-operation, given the regulators’ separate mandates for prudential and conduct regulation of PRA-authorized firms, is that each authority should focus on the key risks to its own objectives, while being aware of the potential for concerns of the other. The relationship is explained in more detail in the ‘Review of 2016/17’ section on page 36.

¹ The Joint Forum deals with issues common to the banking, securities, and insurance sector including the regulation of financial conglomerates.



The PRA's relationship with the Financial Policy Committee (FPC)

The FPC is the Bank's macroprudential policy making body. It contributes to the Bank of England's financial stability objective by monitoring, identifying and taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system as a whole. It also has a secondary objective to support the economic policy of the UK Government.

The PRA works closely with the FPC to ensure that both bodies can meet their objectives. To meet its objectives the FPC can issue directions and recommendations to the PRA which the PRA implements with reference to its own objectives. There is also a two-way flow of information between the FPC and PRA. The PRA provides the FPC with its assessment of supervisory risks, to assist its macroprudential oversight, while the FPC's assessment of systemic risks influences the PRA's judgements in pursuit of its own objectives.

In March 2017, the FPC stated that it will assess the financial stability implications of firms' plans to adapt to the United Kingdom's withdrawal from the European Union. The FPC supports the work of the PRA and FCA to ensure regulated firms have comprehensive plans in place to operate in a range of possible outcomes. The FPC also supported a review launched by the PRA into the credit quality of new lending relating to consumer credit by PRA-regulated lenders, and a review by the FCA into its rules and guidance on creditworthiness assessments used in the consumer credit market. The FPC will review these findings in 2017.

The FPC supported the position of the PRA to allow insurance companies to use the flexibility in Solvency II regulations to recalculate transitional measures. These measures smooth the impact of those regulations. Without them, the regulations,

which came into force in January 2016 would have tightened regulatory constraints on insurance companies following sharp falls in market interest rates. At the margin, the recalculation of transitional measures is likely to reduce immediate pressure on insurance companies to sell corporate securities and other risky assets.

A collaborative relationship is embedded into the Bank's governance since the Governor, Deputy Governor for Financial Stability, Deputy Governor for Monetary Policy, and Deputy Governor for Prudential Regulation are members of both the PRC and FPC. In addition, the CEO of the FCA sits on both the PRC and FPC as an *ex-officio* member.

The PRA's relationship with the Monetary Policy Committee (MPC)

The MPC is the Bank's monetary policy setting body. It has a primary objective to deliver price stability (defined as a 2% target for the 12-month increase in CPI inflation) and, subject to that, to support the Government's economic policy, including its objectives for growth and employment. The PRA supports the MPC in achieving its objectives in two principal respects.

In order to set monetary policy, the MPC needs to assess the outlook for the macroeconomy. This outlook will depend, in part, on the cost and availability of credit which UK households and companies can access from banks and building societies. The first respect in which the PRA supports the MPC is by contributing advice and intelligence regarding developments in the UK banking system, in order to help colleagues in the Monetary Analysis area of the Bank to draw together an overall assessment of credit conditions facing the UK economy, which the MPC can then consider and take account of when assessing the macroeconomic outlook.

To meet its objectives the FPC can issue directions and recommendations to the PRA which the PRA implements with reference to its own objectives

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Issues the PRA would typically advise on include developments in the nature and intensity of competition in different credit markets and how lenders might, in aggregate, respond to anticipated events and developments. This information is then combined with intelligence collected from a variety of other sources, including directly from lenders themselves, via the Bank's *Credit Conditions Survey*, and from the Bank's network of Agents around the United Kingdom, in order to help the MPC form an overall assessment of credit conditions.

The second respect in which the PRA works closely with colleagues in the Monetary Analysis area of the Bank in order to support the MPC is to assess the prospective impact that different possible settings for its monetary policy tools might have on institutions regulated by the PRA, which could affect how monetary policy actions feed through into economic growth and inflation. For example, the PRA considered the impact that lowering Bank Rate from 0.5% to 0.25% could have on the UK banking sector prior to the MPC taking the decision to make this reduction in August 2016.

PRA Strategic Report: The PRA Strategy

The PRA's strategy is to deliver a resilient financial sector by seeking: an appropriate quantity and quality of capital and liquidity; effective risk management; robust business models; and sound governance including clear accountability of firms' management. This supports the PRA's pursuit of its primary safety and soundness, policyholder protection, and secondary competition statutory objectives.

The PRA does not seek to operate a regime in which firms can never fail. When failure does occur, this should be with limited disruption to the provision of core financial services, without spillovers to the wider financial sector, and should not expose the public sector to loss.

This strategy will be achieved in close co-operation with other parts of the Bank, the FCA, and European and international counterparts. In delivering this strategy, the PRA will be forward-looking and judgement-based, proportionate in its actions, and efficient in its allocation of resources.

The PRA's statutory objectives :

- a general objective to promote the safety and soundness of PRA-authorized firms;
- specifically for insurers, to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders; and
- a secondary objective to, so far as is reasonably possible, act in a way which facilitates effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities.

Shaping the PRA Strategy

Each year the PRA is required by law to determine and publish its strategy setting out how it will advance its statutory objectives. In addition to its statutory objectives, the PRA's strategy is shaped by its other responsibilities such as the requirement to implement domestic, European and international legislation. Furthermore, as part of the Bank, the PRA contributes to the delivery of the Bank's wider financial stability and monetary policy objectives.

The strategy ensures that the PRA is able to maintain the flexibility to respond to changes in markets, developments in the economy and other risks which can impact the PRA's statutory objectives and priorities, and reprioritise its activities as needed.

It is expected that activity in relation to the United Kingdom's withdrawal from the

European Union will require a significant amount of work to be undertaken by the PRA over a number of years. This will include: ensuring regulated firms have comprehensive plans in place to operate in a range of possible outcomes; preparing the regulatory and supervisory framework in light of EU withdrawal; and ensuring that the process and approach for any regulatory transactions are in place.

The PRA Strategy

Under FSMA, the PRA is required to review, and if necessary revise, and publish annually its strategy in relation to how it will deliver its statutory objectives. The PRA's strategy was set by the PRC, in consultation with Court.



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Priorities for 2017/18

The strategy outlines the PRA's intentions over the medium to long term. The Business Plan 2017/18, sets out how the PRA will work towards achieving this strategy. Within the Business Plan, which is detailed later in this *Annual Report* (page 38), the priorities are to:

- Continue to implement structural reform (ring-fencing) for UK banks.
- Ensure that the approach to insurance supervision aligns with the requirements of Solvency II, transactions are executed as BAU activity, and risks arising are identified as firms adapt to Solvency II.
- Prepare to implement the UK financial regulatory framework following the United Kingdom's exit from the European Union.
- Maintain a strong voice and contribute to international standards for banks and insurers: delivering requirements for international insurance standards and finalising the Basel banking reforms.
- Progress work to facilitate competition, including reforms to Pillar 2A and standardised risk-weights for low loan to value (LTV) mortgages.
- Establish operational resilience in the supervisory framework in 2017.
- Ensure PRA policy and supervision effectively support the Bank's resolution objectives.
- Understand the risks and vulnerabilities posed by credit risk and asset quality.
- Understand the impact of 'low for long' on banks and insurers.
- Deliver and embed the governance regime for banks and insurers including the principle of proportionality.
- Deliver a strong and efficient operational platform — the right resources, technology, data analytics and tools, people and governance — to deliver the PRA's objectives effectively.

The strategy outlines the PRA's intentions over the medium to long term

PRA Strategic Report: Review of 2016/17



The PRA's activities in 2016/17 were directed by the Bank's Strategic Plan and the PRA's Business Plan (as set out in the 2015/16 PRA Annual Report).¹

This section of the *Annual Report* outlines the work completed in pursuit of the PRA's 2016/17 business aims and in support of its

statutory objectives. The United Kingdom's decision to leave the European Union in the referendum on 23 June 2016 has played, and will continue to play, a significant role in the PRA's activities. The PRA Board remained focused on activities that continued to advance the PRA's objectives.

Box 1 provides some examples of how the PRA has delivered its business aims.

Box 1: Examples of how the PRA delivered its 2016/17 business aims

1. Continue to develop and implement the forward-looking, judgement-based supervisory regime:

- delivered the Bank of England's annual concurrent stress test to the largest UK banks, the first to be conducted under the annual cyclical scenario framework;
- participated in the EIOPA EU-wide stress test, conducted for a second time on a Solvency II basis;
- worked with the Resolution Directorate on the development and implementation of minimum requirement for own funds and eligible liabilities (MREL);
- continued to embed Solvency II within the PRA's approach to insurance supervision;
- introduced electronic reporting for credit unions aligned to the new prudential framework; and
- published the second *PRA Annual Competition Report*.²

2. Support the Bank in delivering its financial stability and monetary policy objectives:

- finalised its approach to the implementation of the FPC's framework for the systemic risk buffer and set out a policy to implement the Recommendation issued to it by the FPC;
- consulted on a set of proposals to reduce the variability in firms' modelling approaches for residential mortgage risk weights;
- published a policy statement changing the loan to income (LTI) flow limit from a quarterly limit to a four quarter rolling limit;
- issued policy introducing underwriting standards for buy-to-let contracts;

- responded to the FPC's Recommendation to exclude central bank reserves from the exposure measure in the current UK leverage ratio framework, with immediate effect; and
- contributed towards the FPC's assessment of risks to financial stability arising from the investment activities of UK insurers.

3. Implement changes to domestic, European and international regulation:

- began the phase-in of CRD IV capital buffers as part of the transition to full implementation of the framework of capital requirements and buffers in 2019;
- implemented a leverage ratio for major UK banks and building societies with global deposits over £50 billion following a Direction and Recommendation from the FPC made to the PRA in 2015;
- finalised the policy on prudential requirements, intragroup arrangements and the use of financial market infrastructures, and reporting requirements to establish ring-fencing arrangements within structural reform;
- developed policy and implemented the new Senior Managers and Certification Regime (SM&CR) and Senior Insurance Managers Regime (SIMR);
- undertook a broad range of activities to ensure firms are taking prudent and consistent approaches to the implementation of International Financial Reporting Standard (IFRS) 9; and
- restoring the deposit protection limit to £85,000 as a consequence of the structural shift in the exchange rate that had occurred after the UK referendum result.

¹ www.bankofengland.co.uk/pr/Pages/publications/prannualreport/2016.aspx.

² www.bankofengland.co.uk/publications/Documents/annualreport/2017/compreport.pdf.

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4. Continue to devise and influence the domestic and international policy agenda:

- supported the BCBS in developing a package of measures designed to reduce risk weighted asset variability;
- supported the IAIS in the development of the Insurance Capital Standard (ICS) for international insurance groups; and
- provided continued support on EU legislation to implement simple, transparent and standardised (STS) securitisation.

5. Ensure the PRA has the right people, infrastructure and governance to deliver its strategy:

- established the PRC;
- progressed the development of IT and data capabilities as part of the Bank's operational architecture;
- established a Performance Account for the PRA which encompasses strategic and operational planning. This is underpinned by a comprehensive governance and assurance framework; and
- continued to co-ordinate with the FCA across a range of supervisory and policy matters.

Business aim 1: Continue to develop and implement a forward-looking, judgement-based supervisory regime

Appropriate quantity and quality of capital in the banking sector

i) Enhancing the PRA medium-term stress-testing framework

The annual concurrent stress test continues to be a vital component of capital setting for systemically important banks and building societies. In 2016 seven firms participated in the Bank's test which was the first to be conducted under the annual cyclical scenario framework set out in 'The Bank of England's approach to stress testing the UK banking system'.¹

The 2016 stress test incorporated a synchronised UK and global recession with associated shocks to financial market prices, and an independent stress of misconduct costs. It examined the resilience of the system to a more severe stress than in 2014 and 2015. It also judged banks against the Bank's new hurdle rate framework, which held systemic banks to a higher standard reflecting the phasing-in of capital buffers for G-SIBs.

The PRA Board judged that some capital inadequacies were revealed for three of the seven banks, these banks now have plans in place to build further resilience.

Stress testing is a key example of the PRA's work in support of its statutory objective to promote the safety and soundness of the firms it regulates, and is also used as a tool to assess capital adequacy and vulnerabilities across banks, building societies, investment firms, and groups of firms.

ii) The EBA 2016 stress-testing exercise

Following the launch of the EBA's stress-test methodology and macroeconomic scenarios in February 2016 four UK banks (the same four as for the 2014 test) were among the 51 European banks that participated in the test. The results, published in July 2016, were consistent with those of previous Bank stress tests (given methodological differences) and provided further evidence that major UK banks have the resilience necessary to maintain lending to the real economy, even in a macroeconomic stress scenario.

¹ www.bankofengland.co.uk/financialstability/Documents/stresstesting/2015/approach.pdf



Appropriate quantity and quality of capital in the insurance sector — the EIOPA 2016 stress-testing exercise

The PRA participated in the EIOPA EU-wide stress test, conducted on a Solvency II basis for the second time. The exercise focused on the overall impact of an adverse market scenario and a low-yield scenario. UK insurers' capital positions were most affected by the market stress scenario, while the low-yield scenario had a very limited impact on UK-regulated solo insurance entities due to stronger asset and liability matching practices, and limited guarantee return products relative to other parts of Europe.

The results were published by EIOPA on 15 December 2016¹ and the PRA is taking forward those recommendations which apply to PRA-regulated firms.

Recovery and Resolution — further implementation of the Bank Recovery and Resolution Directive (BRRD) and continued development of solvent wind down plans for international banks

The PRA worked with the Resolution Directorate on the development of the Bank's approach to implementing the BRRD's MREL for firms. To ensure sufficient equity and liabilities are in place to allow failing firms to be resolved the PRA published its final policy on the relationships between MREL and regulatory buffers, and MREL and Threshold Conditions in November 2016.²

The PRA also continued work to ensure that firms can continue to operate and support customers in stress or resolution, including the finalising and implementation of policy for ensuring operational continuity in resolution in July 2016.³ The policy focuses on the continuity of critical services like IT and payroll, including when these are outsourced to services companies within a banking group or to external third parties.

Further, to support the effectiveness of the bail-in tool in a cross-border resolution and promote equal treatment between EU and third-country liability holders, the PRA continued work on the implementation of the contractual recognition of bail-in (Article 55 of the BRRD). The PRA consulted on, and set out its final policy in June 2016.⁴

Solvent wind down plans

In 2016, the largest international investment banks submitted their second iteration of solvent wind down plans for their UK trading book activities. These plans detail the costs firms are likely to incur in the wind down of their balance sheets, in this case in normal market conditions following an idiosyncratic event. They also allow firms and the 'Authorities' (PRA, FCA and HM Treasury) to test the adequacy of current financial resources to support a wind down, and inform the Authorities' thinking on how best to support the wind down of an international bank with a large trading book, and to help identify operational dependencies that may impede an orderly wind down. The PRA will continue to work with firms over the next few years to improve their methodologies for calculating exit and operational costs in a wind down under various scenarios. The next iteration of the work will also introduce a systemic stress as the PRA continues to target the attainment of increasingly feasible and executable plans.

Resolution arrangements for insurers

The PRA has continued to work with international bodies to review, assess and enhance the resolution arrangements. The International Monetary Fund (IMF) recommended in its Financial Sector Assessment Program (FSAP) report of June 2016⁵ that the 'UK authorities should work with international partners to develop an integrated regime of resolution powers for insurance with due regard to the business model'. Work continues with European and

The PRA continued work to ensure that firms can continue to operate and support customers in stress or resolution

- 1 <https://eiopa.europa.eu/pages/financial-stability-and-crisis-prevention/stress-test-2016.aspx>.
- 2 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3016.aspx.
- 3 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps2116.aspx.
- 4 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps1716.aspx.
- 5 www.imf.org/external/pubs/cat/longres.aspx?sk=43969.0.

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other international partners to further this recommendation.

The PRA engaged closely with the FSB in 2016 to finalise guidance on 'Developing effective resolution strategies and plans for systemically important insurers'¹ and will be working with systemically important insurers to implement the guidance.

On 2 December 2016, EIOPA published for consultation a discussion paper on 'Potential harmonisation of recovery and resolution frameworks for insurers'.² The consultation closed on 28 February 2016 and the PRA will work closely with EIOPA to assess the feedback received from stakeholders.

Implementation of the PRA's approach to branches and subsidiaries of international banks

Internationally headquartered banks can operate in the United Kingdom either as subsidiaries or as branches, and the PRA has a clear framework that takes into account the different legal requirements for the types of firm it supervises.

The PRA continued to implement its branch strategy, as set out in Supervisory Statement 10/14.³ Discussions with firms, and relevant home state supervisors, took place where branches undertake activities that are outside the PRA's risk appetite. The PRA also started a cross-firm review of the major trading firms' booking practices.

The PRA will take forward its approach to the supervision of UK subsidiaries of overseas banking groups once arrangements following the United Kingdom's withdrawal from the European Union are clear.

Embedding Solvency II within the PRA's approach to insurance supervision

The PRA continued to embed Solvency II into its supervisory approach.

Box 2: The Bank's EU Withdrawal Unit

In September 2016, following the UK referendum result, a new unit was set up in Financial Prudential Policy to co-ordinate all the EU withdrawal related work across the Bank and the PRA. The EU Withdrawal Unit (the Unit) comprised of policy and legal experts, sits at the centre of the Bank's EU withdrawal work. The Unit has overall responsibility for co-ordinating the information flow to Governors and the relevant Bank committees. The Unit also supports the Bank's Governors and its committees by providing technical advice on EU withdrawal matters in accordance with the Bank and PRA statutory objectives.

- **Consolidating policy** — the PRA issued its expectations as policy⁴ on areas including internal model assessment, the own risk and solvency assessment (ORSA), and the treatment of pension scheme risk, that were contained in statements and letters between April 2013 and February 2016.
- **Clarifying the use and monitoring of internal models** — the PRA set out its approach to monitor model drift in response to the risk that, as models evolve over time, capital levels drift downward and fail to reflect adequately the level of risk in the system.⁵ PRA policy was also updated to provide further clarity on the output information to be reported by firms using an internal model to calculate the solvency capital requirement (SCR).⁶ Further, the PRA published its policy and approach to firms' application for a major change to their approved internal model.⁷
- **Reporting and disclosure** — during the year, the PRA set out its policy, issued templates and instructions in relation to reporting, including how it collects data from

The PRA has a clear framework that takes into account the different legal requirements for the types of firm it supervises

1 www.fsb.org/wp-content/uploads/Final-guidance-on-insurance-resolution-strategies.pdf.

2 <https://eiopa.europa.eu/Publications/Consultations/EIOPA-CP-16-009%20Discussion%20paper%20recovery%20and%20resolution%20for%20insurers.pdf>.

3 www.bankofengland.co.uk/pr/Pages/publications/ss/2014/ss1014.aspx.

4 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3316.aspx.

5 www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss1516.aspx.

6 www.bankofengland.co.uk/pr/Pages/publications/ss/2017/ss2515update.aspx.

7 www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss1716.aspx.



Solvency II firms that is considered to be specific to the UK market and supervisory approach in what are known as 'national specific templates'. On disclosure, it has outlined policy and expectations on the ongoing appropriateness of the information disclosed, the level of assurance with respect to the external audit requirement on the publicly disclosed Solvency and Financial Condition Report (SFCR), and the audit guidance for auditors to follow in auditing a firm's SFCR.¹

- **Ongoing developments** — as the Solvency II regime embeds further, the PRA has issued policy on areas such as: how firms should comply with the remuneration requirements contained within Article 275 of the Delegated Regulation;² to provide clarity with respect to the PRA's expectations, and proposed process, for recalculations by firms of the transitional measure on technical provisions (TMTP);³ group supervision; and matching adjustment — illiquid unrated assets and equity release mortgages.⁴

The PRA continued to maintain a dedicated Solvency II webpage⁵ to provide information on its activities specifically for the UK insurance industry.

Clear management accountability

As part of its work on improving standards of governance and management of PRA-supervised firms, the PRA implemented the new SM&CR which came into force on 7 March 2016. More information is set out on page 30.

Operational resilience within the financial sector

Operational resilience of systems supporting critical functions has become ever more important in the financial sector with ever greater reliance on technology. Together with other directorates of the Bank, the PRA continues to focus on the identification of

operational risk issues as part of its developing microprudential supervisory approach to operational resilience. The Bank works closely with the FCA to review the progress of major UK retail banks, international banks, and financial market infrastructure providers towards improving their management of critical infrastructure, technology and outsourcer risk. Examples of this include the PRA's high level of focus on the operational resilience of those banks providing custody services: the PRA is working with these firms to ensure they have robust frameworks and processes to deliver critical services supporting UK economic functions.

The PRA has continued to conduct firm-specific reviews of IT strategy, strategic change implementation capability and outsourcing risk management across a subset of PRA regulated firms, to help inform it about the scale of key IT risks faced by PRA-regulated firms. These reviews have supported the PRA's assessment of IT change risk within the five firms in scope of structural reform and of restructuring capability in general. This work will continue through 2017 and into 2018.

The Bank also started a programme of targeted cross-firm IT assessments, covering systemic banks and a sample of larger banks and building societies, focusing on key IT risks: IT privileged access management; vendor risk management; and IT change management. This programme is continuing through 2017, with further reviews planned.

In addition, 31 of the 34 'core firms' (ie firms and financial market infrastructures considered by the UK financial authorities as being core to the UK financial system) completed CBEST. CBEST is a framework to deliver a controlled, intelligence-led penetration test. The test mimics behaviours of cyber attackers who are assessed by Government and commercial intelligence providers as posing a genuine threat to systemically important financial

Operational resilience of systems supporting critical functions has become ever more important in the financial sector

- 1 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps2416.aspx.
- 2 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps2216.aspx.
- 3 www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps1117.aspx.
- 4 www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4816.aspx.
- 5 www.bankofengland.co.uk/pr/Pages/solvency2/updates.aspx.

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institutions. Plans have also been agreed for the future of CBEST testing including:

- for the core firms, regulator-led testing will be undertaken within normal supervisory cycles unless there is a material change in the threat environment or vulnerabilities are identified;
- firms will be expected to conduct their own regular testing of cyber resilience; and
- this firm-led testing will be subject to spot checks from regulators.

Authorisations

Firms wishing to carry out PRA-regulated activities, or make changes to the activities they undertake, must apply for authorisation to ensure they meet the standards expected of the regulatory system and are fit to operate in the United Kingdom.

The average time to authorisation was 275 days. The PRA also held 37 pre-application meetings with over 25 prospective banks and nine meetings with other types of applicant firms.

Number of new authorisations:

8
Banks

4
Insurers

Competition

The PRA's second *Annual Competition Report* (ACR) has been published alongside this *Annual Report*.¹ The ACR sets out further detail about the specific actions the PRA has taken to fully embed its secondary competition objective to facilitate effective competition in its processes, governance and know-how, with clear results in policy and supervisory decisions. Key examples during the past twelve months include:

- i) the completion of the review of the PRA's approach to internal ratings based (IRB) model applications from smaller firms; and
- ii) the consultation on proposed refinements to the PRA's Pillar 2A capital framework.²

The PRA assisted the Competition and Markets Authority (CMA) with its retail banking market investigation, in particular in relation to the work on the impact of the capital requirements regime. The CMA

published conclusions on its retail banking market inquiry in August 2016³ and confirmed the provisional finding that prudential rules do not give rise to an adverse effect on competition. The CMA also called on both HM Treasury and the PRA to give due consideration to competition aspects.

In line with the recommendation made by the CMA, the PRA has also considered competition with respect to international negotiations. Consequently, the PRA argued for a significant lowering of the standardised risk-weight for low LTV mortgages when negotiating revisions to the standardised approach for credit risk being considered by the BCBS.

1 www.bankofengland.co.uk/publications/Documents/annualreport/2017/compreport.pdf.

2 www.bankofengland.co.uk/pr/Pages/publications/cp/2017/cp317.aspx.

3 <https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf>.



Business aim 2: Support the Bank in delivering its financial stability and monetary policy objectives

Appropriate quantity and quality of capital in the banking sector

In 2016, the FPC set out its intention to keep three major judgements underlying its assessment of the overall level of capital for UK banks under review.¹ Those judgements included: the international work to address shortcomings in the measures of risk-weighted assets; the effectiveness of arrangements for resolving banks that fail; and the economic costs of higher capital requirements. Separately, the Treasury Committee announced an inquiry into bank capital requirements in the United Kingdom.² The PRA has provided economic and technical analysis and research to support the FPC's initial review of its judgements, and together with the FPC and other areas of the Bank, set out a response to the questions raised in the terms of reference for the first phase of the Treasury Committee's Inquiry.³ The PRA has also finalised its approach to the implementation of the FPC's framework for the systemic risk buffer and set out a policy to implement the Recommendation issued to it by the FPC.⁴

Following the 2014 stress-test scenario, the FPC was concerned that the risk weights generated by some mortgage credit risk internal models were highly procyclical. In July 2016, the PRA consulted on a set of proposals on firms' approaches to calculating mortgage risk weights, designed to lead to more consistent modelling approaches across firms and to reduce cyclicity in capital requirements. The PRA issued its final policy in June 2017.⁵

Housing market risks

The PRA continues to support the FPC in its review of risks in the housing market. As part of the annual review of the FPC Recommendation for owner-occupied lending, which concluded

in 2016 Q4; the PRA changed the LTI flow limit from a quarterly limit to a four-quarter rolling limit.⁶ The FPC and PRA Board considered risks arising from the buy-to-let market. In support of this, the PRA issued policy introducing underwriting standards for buy-to-let contracts.⁷ Furthermore, HM Treasury gave powers of direction to the FPC on buy-to-let lending and the PRA will support the FPC in its consideration of the use of such powers.

FPC review of market liquidity

The PRA supported the FPC in its review of developments in the liquidity of dealer-intermediated markets, which was published in the July 2016 *Financial Stability Report*.⁸ Resilient, liquid dealer-intermediated markets support the safety and soundness of PRA regulated firms in a range of ways, for example, by providing a source of funding via securities financing markets and ensuring risks can be rapidly hedged in stressed periods. The PRA provided expertise on the requirements of post-crisis regulations and how individual firms have adjusted their activities in response to them.

The review noted that there had been a reduction in the liquidity of some government and corporate bond markets in recent years, with the most marked changes having been in securities financing markets. The FPC judged that post-crisis regulations, including the leverage ratio, have probably been one driver of these developments, although some of their impact is likely to be transitory as firms adjust to new regulations. The FPC judged that the net economic effect of post-crisis regulations has been positive, but that it could be appropriate to adjust regulatory measures, where opportunities exist to mitigate their impact on liquidity without compromising their positive effects. This principle was adopted in the FPC's 2016 review of its Direction on the leverage ratio requirement where it judged that there would be merit in a small number of amendments to the internationally agreed

The FPC and PRA Board considered risks arising from the buy-to-let market.

1 www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2016/record1605.pdf.

2 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries/parliament-2015/capital-inquiry-16-17/.

3 <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/capital-and-resolution/written/69208.pdf>.

4 www.bankofengland.co.uk/pr/Pages/publications/sop/2016/srbapproach.aspx.

5 www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps1317.aspx.

6 www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps517.aspx.

7 www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps2816.aspx.

8 www.bankofengland.co.uk/publications/Pages/fsr/2016/jul.aspx.

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leverage exposure measure to support market liquidity and avoid discouraging central clearing of derivatives.

Insurance risks

The PRA contributed towards the FPC's assessment of risks to financial stability arising from the investment activities of UK insurers. The assessment focused on:

- i) the extent to which the introduction of Solvency II might have a procyclical effect on the propensity of UK life insurers to invest; and
- ii) whether the risks to market liquidity emanating from unit-linked insurance products are comparable to the risks from open-ended investment funds.

The conclusions of the FPC's assessment were included in the November 2016 *Financial Stability Report*.¹

Business aim 3: Implement changes to domestic, European and international regulation

Appropriate quantity and quality of capital and liquidity in the banking sector

As part of the transition to full implementation in 2019 of the framework of capital requirements and buffers, the PRA has started the phase in of the CRD IV capital buffers. The capital conservation buffer is being phased in for all firms. Additional buffers for G-SIBs are being introduced in stages to 2019. Firms may also be subject to countercyclical capital buffers (CCyB) both in the United Kingdom and in other countries in which they operate. PRA supervisors can apply an additional buffer (the 'PRA buffer') to cover firm-specific risks. When setting this, the PRA considers the extent to which the capital conservation buffer and CCyB already capture the risks identified in the PRA buffer assessment.

As part of its capital framework, the PRA sets Pillar 2A capital for risks which are either not captured, or not fully captured, under the Capital Requirements Regulation (CRR). It assesses those risks as part of the supervisory review and evaluation process, in light of both the calculations included in a firm's Internal Capital Adequacy Assessment Process (ICAAP) document and the PRA's Pillar 2A methodologies.² In February 2017, the PRA published its proposals on refinements to the Pillar 2A capital framework to make the PRA's Pillar 2A capital assessment both more robust and proportionate by addressing some of the concerns over the differences between standardised approach (SA) and IRB model risk weights and by strengthening and updating the calibration of the IRB benchmark. They are aimed at promoting the safety and soundness of PRA-regulated firms, as well as facilitating more effective competition in the banking sector (see also the PRA *Annual Competition Report*). The consultation closed in May 2017, and the proposed implementation date is 1 January 2018.

Leverage ratio

From 1 January 2016, the PRA implemented a leverage ratio for major UK banks and building societies with global retail deposits over £50 billion, following a Direction and Recommendation from the FPC. In August 2016, the PRA responded to the FPC's Recommendation to exclude central bank reserves from the exposure measure in the current UK leverage ratio framework, with immediate effect. The aim was to ensure that the leverage ratio does not act as a barrier to the effective implementation of actions taken to maintain monetary and financial stability: including the package of actions announced by the MPC in August 2016.

The PRA delivered the change in leverage ratio definition by inviting firms to apply for a waiver from the existing rule.³

The PRA published its proposals on refinements to make the PRA's Pillar 2A capital assessment both more robust and proportionate

1 www.bankofengland.co.uk/publications/Pages/fsr/2016/nov.aspx.

2 www.bankofengland.co.uk/pr/Pages/publications/sop/2017/p2methodologiesupdate.aspx.

3 www.bankofengland.co.uk/pr/Pages/authorisations/waivers/waiversbyconsent.aspx.



Excluding central bank claims from the exposure measure mechanically reduces the nominal amount of capital required to meet the leverage ratio standard, if no offsetting action is taken. As this is not the intention, the FPC will consult and decide on the appropriate recalibration of the UK leverage ratio standard in the 2017 review.

Liquidity

The PRA is considering what liquidity requirements it should set to complement the EU Liquidity Coverage Requirement (LCR) as part of a Pillar 2 framework for liquidity: for example to address risks not captured, or not fully captured, in the Pillar 1 standard. A first consultation on Pillar 2 liquidity was published in May 2016.¹ This was followed with a statement in October² which summarised the feedback received on the draft policy, but did not provide final policy proposals. The PRA is planning to publish a second consultation paper in 2017 covering a range of risks outlined in the first consultation.

Structural reform — ring-fencing of core financial services and activities

Large UK banks are due to ring-fence their core UK services and activities by 2019, as required by amendments to FSMA under the Financial Services (Banking Reform) Act 2013. The changes brought about by structural reform are intended to insulate ring-fenced banks from shocks that originate in the rest of their banking group or the financial system, to minimise the risk of disruption to the provision of core services, and to facilitate orderly resolution.

During the year, the PRA finalised the policy on prudential requirements, intragroup arrangements and the use of financial market infrastructures, and reporting requirements to establish ring-fencing arrangements within structural reform.³ In parallel, the PRA has reviewed and provided feedback on the implementation plans submitted by the firms in scope.

Expected loan loss provisioning

The introduction of IFRS 9 in 2018 will bring a change from provisioning for incurred losses to provisioning for expected credit losses (ECL), with firms required to make provisions against twelve months expected losses moving to lifetime expected losses if exposures have experienced a significant increase in credit risk.

The PRA continued a broad range of activities, involving firms, auditors and global bodies, and accounting and auditing standard setters as well as consideration of PRA supervisory activities, in order to help ensure an orderly transition. This included monitoring whether firms are taking prudent and consistent approaches to implementation. For example, the PRA engaged with colleagues at the EBA on 'Guidelines on credit risk and accounting for expected credit losses'.⁴

The PRA also continued to engage with the BCBS and EU to ensure that the approaches to calculating regulatory bank capital are adjusted as necessary in response to the different approach to provisioning. As noted on page 26, the PRA published a consultation paper on refining the Pillar 2A capital framework for firms using the SA for credit risk.

The PRA published guidance on how firms should incorporate IFRS 9 into 2017 ICAAPs, stress testing (including the concurrent stress test), and capital planning⁵ and has published a consultation paper on changes to regulatory reporting requirements.⁶

Large UK banks are due to ring-fence their core UK services and activities by 2019

- 1 www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp2116.aspx.
- 2 www.bankofengland.co.uk/pr/Documents/publications/reports/prastatement181016.pdf.
- 3 www.bankofengland.co.uk/pr/Pages/supervision/structuralreform/default.aspx.
- 4 www.eba.europa.eu/documents/10180/1842525/Final+Guidelines+on+Accounting+for+Expected+Credit+Losses+%28EBA-GL-2017-06%29.pdf.
- 5 www.bankofengland.co.uk/pr/Pages/supervision/activities/stresstestscenario.aspx.
- 6 www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4616.aspx.

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Box 3: Clear management accountability in banking and insurance¹

The PRA has continued to develop its supervisory approach to governance to ensure it is consistent with and complements the SM&CR and SIMR, which took effect from 7 March 2016. The five key areas of activity are set out below.

1) **Individual accountability** — in its work on the SM&CR, SIMR, and regulatory references, including the changes and extension of the regime to all firms approved under FSMA in the Bank of England and Financial Services Act 2016 (the Act), the PRA issued:

- consultations on amendments and optimisations to the SM&CR and SIMR as a result of the Act, including setting out the PRA's expectations around the 'duty of responsibility' and applying certain conduct rules and standards to non-executive directors who are not approved persons under the SM&CR and SIMR. Proposals also covered areas identified through the experience of implementing the new regime, including: a new Senior Management Function and Prescribed Responsibility for operational continuity; a revised definition of the Head of Key Business Area function; and clarifications of the PRA's expectations of Statements of Responsibilities and Management Responsibilities Maps; and
- final rules on regulatory references which came into force in March 2017, aimed at allowing firms to receive better information about individuals they hire and reduce the scope for 'rolling bad apples' where individuals had potentially moved between roles and avoided responsibility for regulatory breaches.

2) **Corporate governance** — the PRA published '*Corporate governance: Board responsibilities*' in March 2016. This policy identifies aspects of governance to which the PRA attaches special importance and to which the PRA may devote particular attention in the course of its supervision. It includes information on the skills and experience and roles and responsibilities of board members, independence and culture as well as board time and resources, subsidiary boards, management information and succession planning. In August 2016, the PRA published a letter to the chairs of

banks' boards reminding them of the PRA's expectations regarding diversity to promote good governance.

3) **Remuneration** — to ensure that, by moving firms, employees could not avoid the consequences of their actions, the PRA published policy and rules to enable buy-outs awarded by banks to material risk-takers to be subject to malus (withholding unvested awards) and clawback (reclaiming vested awards). For insurers, the PRA published its expectations of firms in implementing the Solvency II remuneration requirements. The PRA also continued to engage closely in the work of the FSB's Compensation Monitoring Contact Group in addressing misconduct risk including through co-chairing a working group to draft guidance on the use of compensation tools to address misconduct.

4) **Supervisory reviews** — to promote an agenda of effective implementation, the PRA continued to undertake governance reviews of regulated firms, including their governance processes and culture. Feedback was provided to firms and, where necessary, action plans for improvements in governance arrangements set out.

5) **Enforcement: tackling threats to safety and soundness and strengthening accountability in PRA-licensed firms** — while the PRA's approach to supervision is forward looking and seeks to prevent prudential risks from crystallising, it recognises the importance of taking robust and decisive action where firms and individuals fall short of its expectations.

The PRA took enforcement action against three firms (a UK-incorporated subsidiary bank of an overseas bank, a London branch of an international bank and a UK-incorporated designated investment firm subsidiary of an overseas securities firm) during the past financial year for a series of failings that potentially put those firms' safety and soundness at risk, or are crucial to the PRA's ability to supervise firms effectively and to meet its statutory objectives.

¹ All materials are available on the dedicated 'Strengthening accountability' webpage; www.bankofengland.co.uk/pr/Pages/supervision/strengtheningacc/default.aspx.



- On 8 April 2016, the PRA imposed a £1.38 million fine on QIB (UK) Plc for significant failings in capital adequacy and regulatory reporting during 2011 and 2012. From 30 June 2011 to 31 December 2012, QIB (UK) Plc (a UK subsidiary of an overseas firm) failed to recognise that it had to comply with regulatory requirements relating to the assessment and maintenance of financial resources and capital. As a result, the firm did not undertake a regular assessment of its capital as it was required to by rules in force at the time.
- On 9 February 2017, the PRA imposed a £17.85 million fine on the Bank of Tokyo-Mitsubishi UFJ Limited (BTMU) and a £8.925 million fine on MUFG Securities EMEA plc (MUS(EMEA)) for failing to be open and co-operative with the PRA in relation to an enforcement action into BTMU by the New York Department of Financial Services (DFS). BTMU and MUS(EMEA) did not inform the PRA of the DFS enforcement action until after the DFS' public announcement. BTMU's inadequate systems and controls for the communication of relevant information contributed to this failure to be open with the PRA.

Other activity

During the year, the PRA delivered the following activity pertaining to business aim 3.

For the banking sector, the PRA:

- restored the deposit protection limit to £85,000 as a consequence of the structural shift in the exchange rate that had occurred after the UK referendum result;
- revised its expectations for building societies in December 2016,¹ focusing on treasury and lending activities;
- executed key elements of its data strategy with the collection of valid, accurate and meaningful information to support the PRA's objectives. This included a consultation on reporting requirements for IFRS 9 and formalising previously voluntary collection of forecast capital data (Capital +); and introduced mandatory electronic reporting for credit unions aligned to the new prudential framework for those firms; and
- worked with the FCA to align policy on MiFID II.²

For the insurance sector, the PRA:

- published proposals on its expectations of how general insurance firms, particularly those operating in the global speciality insurance and reinsurance market (known as the London market), might plan for and respond to a market turning event,³ such as a significant general insurance loss event which might affect firms' solvency and future business plans;
- issued its expectations of reporting requirements for non-Solvency II firms and firms that are not friendly societies in October 2016;⁴ and
- published proposals setting out its expectations for the prudent management of cyber underwriting risk,⁵ such as the set of prudential risks emanating from underwriting insurance contracts that are exposed to losses resulting from a cyber attack. This consultation closed in February 2017, with final policy to follow.

¹ www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3416.aspx.

² www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4316.aspx.

³ www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp3216.aspx.

⁴ www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4016.aspx.

⁵ www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp3916.aspx.

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Business aim 4: Continue to devise and influence the domestic and international policy agenda

International capital standards for banks

The BCBS announced in March 2017 that it is making progress toward the finalisation of its post-crisis reforms to bank capital standards.¹ These reforms mainly concern the measurement of risk for the purpose of setting risk-weighted capital requirements. They are considering: the role of internal models for credit risk measurement; revisions to the standardised approach for credit risk measurement; floors for capital requirements based on standardised approaches; a new credit valuation adjustment treatment; and the approach to the measurement of operational risk. In addition, the BCBS is seeking to finalise a leverage ratio framework, including additional buffers for G-SIBs. The PRA has supported the BCBS in developing a package of measures designed to reduce risk-weighted asset variability while delivering on the commitment by the Governors and Heads of Supervision not to raise overall capital requirements significantly. Data was collected from UK and international banks during 2016 to estimate the impact of these proposals. The PRA has worked with other members of the BCBS to assess and analyse the outcome of those impact assessments to advance the package of reforms.

International insurance capital standards

A continuing priority for the PRA in 2016/17 was the development of global prudential standards for insurers, led by the IAIS. The IAIS has continued to lead the development of the ICS at the request of the FSB. The ICS is intended to provide a global solvency standard for international insurance groups, enabling enhanced supervisory co-operation between countries, and supporting decision-making by investors and policyholders.

The PRA has been actively involved in shaping the open technical issues in the development of ICS for international insurance groups as part of the ongoing field-testing process, as well as the IAIS's work on the identification of G-SIIs.

The second field-testing exercise of the ICS took place in 2016 and focused on testing options for liability valuation and refinements to the 2015 ICS design. The field tests allow the IAIS to address the impact of different options on firms, markets and supervisors and propose refinements to address any issues that are identified.

In 2016 the IAIS undertook its annual identification of G-SIIs based on the revised G-SII Assessment Methodology published in June 2016. Nine insurers including two from the United Kingdom were designated again as G-SIIs in 2016. The IAIS has further committed to a fundamental review of its systemic risk framework for insurers by considering the merits of introducing an activities-based assessment (ABA). This could be incorporated as part of the common framework for supervision of internationally active insurance groups (ComFrame) alongside ICS version 2.0, and may be applied as complementary to a more proportionate G-SII framework, which will be reviewed in parallel.

Vicky Saporta, the PRA's Executive Director of Prudential Policy, was reappointed as Chair of the IAIS's Executive Committee in November 2016.

EU legislation on securitisation

The PRA will continue to support the EU legislation to implement simple, transparent and standardised (STS) securitisation, including reforms to capital requirements for banks and insurers. The legislative proposal is at an advanced stage and is due to complete in 2017.

A continuing priority for the PRA in 2016/17 was the development of global prudential standards for insurers, led by the IAIS

¹ <http://www.bis.org/press/p170302.htm>.



Future EU banking and insurance legislation

The Bank continued to engage actively to influence EU legislation, including through participation in the EBA and EIOPA.

In November 2016 the European Commission published proposals to amend prudential requirements for banks and investment firms. Within these proposals, full, consistent and timely implementation of post-crisis reforms is a priority, including rules for capitalisation of market risk and eligibility criteria for MREL. In addition, the Bank supports the introduction of transitional provisions to smooth the impact on firms' capital of the higher levels of provisions that will be required under IFRS 9. In line with the Bank's response to the Commission's Call for Evidence on the EU Regulatory Framework for Financial Services,¹ the PRA supports measures to introduce greater proportionality

in prudential requirements for smaller, less complex firms in areas such as remuneration, reporting and disclosure. The Bank stresses the importance of maintaining the existing micro and macroprudential flexibility in the use of Pillar 2. The importance of macroprudential flexibility more broadly was set out in the Bank's response to the separate consultation on the review of the EU macroprudential framework.²

In addition, the Bank is reviewing closely the potential impact of the EU Intermediate Parent Undertaking (IPU) proposal on UK firms, including those subject to UK ring-fencing requirements, after the United Kingdom has left the European Union. It is not immediately clear that the proposals would enhance the effectiveness of resolution as intended.

The Bank continued to engage actively to influence EU legislation, including through participation in the EBA and EIOPA

Parliamentary accountability

Throughout 2016/17, Sam Woods and other members of the PRA Board gave evidence to the Treasury Committee on the work of the PRA.

The topics covered included:

- Sam Woods' appointment hearing as Deputy Governor for Prudential Regulation;¹
- a general inquiry into the work of the PRA — Sam Woods, Dr Norval Bryson and David Thorburn;² and
- European insurance regulation — Sam Woods, David Belsham and Vicky Saporta.³

As well as appearing to give oral evidence to the Treasury Committee, Sam Woods wrote

to the Chair of the Committee regarding a variety of supervisory and regulatory issues.⁴

Alongside the PRA's formal accountability to the Treasury Committee, Sam Woods corresponded with numerous Parliamentarians to assist their constituents on enquiries regarding PRA-regulated firms.

1 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/deputy-governor-for-prudential-regulation-16-17/.

2 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/prudential-regulation-authority-16-17/.

3 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/eu-insurance-regulation-16-17/.

4 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/publications/.

1 www.bankofengland.co.uk/financialstability/Pages/regframework/response.aspx.

2 <https://ec.europa.eu/eusurvey/files/49f8e999-1ee6-427f-9dbf-2652f40daa48>.

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Business aim 5: Ensure the PRA has the right people, infrastructure and governance to deliver its strategy

Establish the Prudential Regulation Committee (PRC)

On 1 March 2017, the PRA ceased to be a subsidiary and became part of the legal entity of the Bank. Policy making and supervisory decisions that were previously made by the PRA Board are now made by the PRC. There has been no change to the PRA's objectives or functions and the day-to-day business of the PRA is unaffected. The transition is mostly complete, with the residual PRA Limited company to be wound down.

Establish an independent enforcement decision-making committee (EDMC)

In April 2016, the PRA and the FCA jointly issued a consultation paper which made a number of proposals to improve the transparency of regulatory enforcement processes. In response to the comments on the consultation paper, the PRA and FCA jointly published a policy statement on 1 February 2017 explaining what changes would be made to enforcement policies and processes.¹

In July 2016, the PRA and the Bank of England published a short consultation paper proposing the establishment of a functionally independent EDMC which will act as the final stage of the administrative decision-making process in contested disciplinary cases arising out of several of the Bank's functions. The Bank's approach to its use of disciplinary powers is set out in existing policy statements² and the creation of a functionally independent EDMC is not designed to change that.

Developing and implementing the plan for PRA IT, specifically: improving management information on the PRA's assessment of firms; use of outsourced services; and improved data analytical tools

The PRA has continued to work with other areas of the Bank to ensure it has robust IT and data systems, as part of the Bank's overall operational architecture. This year, the PRA has focused on improving its use of data analytic tools and management information (MI) on its assessment of firms.

Develop and implement an improved control and assurance framework

The PRA's control framework seeks to support and increase the likelihood that the PRA will advance its statutory objectives, strategy and business aims. It does so by providing a structure of governance and assurance, the functioning of which the PRA Board and management are informed of through a Performance Account (of which this *Annual Report* is part). The PRA Board approved a revised governance structure, assurance framework and Performance Account in 2016 and received its first reporting under that framework in 2016 Q4.

The PRA Board also approved the PRA's approach to risk in 2016. This approach is compatible with the Bank's risk framework and provides additional granularity to risks and issues most relevant to the PRA.

The PRA also formally extended the internal planning horizon to a three-year cycle. This not only matched the supervisory cycle of firms regulated by PRA, but allowed management and the PRA Board to take a more strategic view of resource needs and availability.

On 1 March 2017, the PRA ceased to be a subsidiary and became part of the legal entity of the Bank

1 www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps217.aspx.

2 www.bankofengland.co.uk/pr/Documents/publications/sop/2016/approachenforcementupdate.pdf.



Communications: supporting the PRA's objectives

A vital part of the delivery of its statutory objectives and supervisory approach is the PRA's industry-wide communications. This includes publications, briefings, speeches, and letters to firms and industry participants on both policy and supervisory activity.

In the 2016/17 financial year the PRA has:

- provided communications to industry to support the implementation and/or embedding of the PRA's key initiatives, including the SM&CR and SIMR, structural reform and Solvency II, as well as new reporting requirements for firms as part of the PRA's data strategy;
- following the launch of the New Bank Start-up Unit in February 2016, held two joint PRA/FCA seminars providing a forum for over 300 representatives from prospective banks, recently authorised banks and those giving advice and support to firms, to gain insight into becoming a bank in the United Kingdom;
- continued to provide updates on dedicated webpages for the PRA's key initiatives: strengthening accountability, structural reform, Solvency II and CRD IV.¹ These webpages aim to provide all relevant

information in one place on policy and implementation;

- published a number of documents across the range of its regulatory and supervisory activities — including policy aligned with other areas of the Bank and the FCA. It has also published eight letters and twelve other publications, including the inaugural PRA *Annual Competition Report* in June 2016;
- the monthly PRA *Regulatory Digest* continues to be one of the most downloaded publications;² and
- in addition to the written word, continued its engagement with firms and other industry participants. It has hosted briefings on a range of topics, and provided speakers and panellists for a number of events hosted by others, including the FCA, overseas counterparts, trade and professional bodies. This has provided a valuable insight, and enhanced the PRA's understanding of prevalent issues and the implications of regulatory policy and supervision.

¹ www.bankofengland.co.uk/pr/Pages/default.aspx.


² www.bankofengland.co.uk/pr/Pages/publications/default.aspx.

A vital part of the delivery of its statutory objectives and supervisory approach is the PRA's industry-wide communications

2016/2017 policy publications¹

45 
Consultation Papers

35 
Policy Statements

41 
Supervisory Statements

5 
Statements of Policy

¹ www.bankofengland.co.uk/pr/Pages/policy/default.aspx.

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Firm feedback

This year the PRA extended the sample of firms invited to complete an annual feedback survey to include Categories 3–5. 125 firms completed the survey (up from 69 in 2015/16) with 32 follow-up meetings. While the majority of respondents expressed positive views about the PRA, there were suggestions for a number of areas for improvement such as improving supervisory handovers, and continued streamlining of information requests.

Figure 2 shows a selection of the survey results reflecting the type of issues on which the PRA sought opinion. The full quantitative results are available on the PRA’s website.¹

FCA: effective regular co-ordination

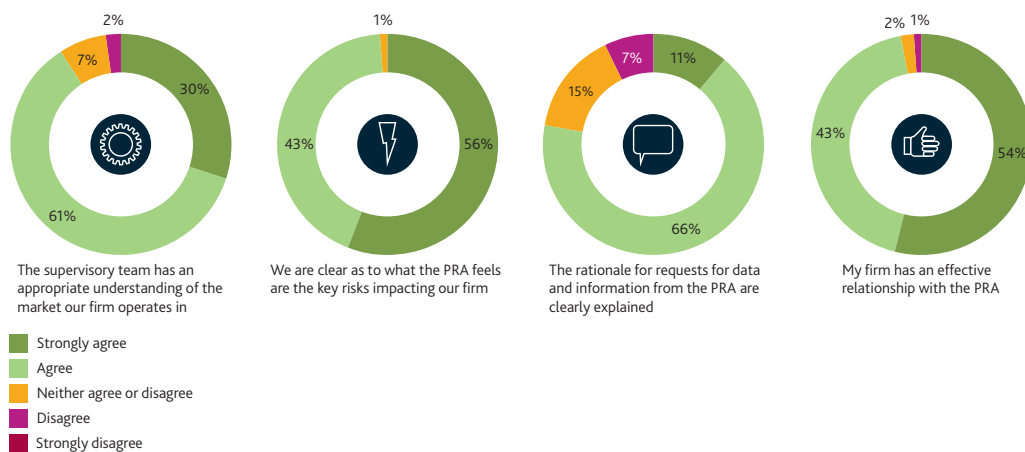
The PRA continued to co-ordinate, where appropriate, with the FCA across a range of supervisory and policy matters. The PRA and FCA assess their performance against the statutory PRA-FCA MoU on a quarterly basis. Over the reporting period co-ordination remained strong and continued to improve with any material failures of co-ordination being remediated at the earliest opportunity. In addition, the FCA and PRA continued to

recognise that with differing objectives and responsibilities, it may sometimes be appropriate to take divergent approaches.

The regulators have co-ordinated effectively on policy issues such as the SMR, remuneration, and structural reform. In April and July 2016, the PRA and the FCA jointly issued two consultation papers which made a number of proposals to improve the transparency of regulatory enforcement processes, following recommendations by HM Treasury.

Co-ordination between supervisory, authorisation and specialist teams in both the FCA and PRA has seen an improvement over the reporting period and no material breaches of the MoU have been reported. The regulators worked closely together to respond effectively to specific incidents through the Authorities’ Response Framework (ARF) which allows for a co-ordinated response required by the FCA, Bank and HM Treasury to an event that results in major disruption to the financial sector and/or to the Authorities.

Figure 2: Selection of firm feedback survey results 2016/17



¹ www.bankofengland.co.uk/pradocuments/supervision/firmfeedback201617.pdf.



Both regulators continue to review the shared FSA IT legacy systems to ensure both organisations have systems which meet their individual needs while supporting a collaborative approach to sharing information. The strength of this approach enabled the regulators to minimise disruption to normal operations during a brief outage which affected certain shared systems in September 2016.

Progress was made to update the wording of the PRA-FCA MoU to reflect a number of changes, including those required as a result of the Bank of England and Financial Services Act 2016. With the completion of desubsidiarisation of the PRA into the Bank on 1 March 2017, it is anticipated that over the coming reporting year the revised text will be discussed and agreed by the FCA Board and PRC, communicated to HM Treasury, and put before Parliament before being published.

PRA people: our staff

The ability to recruit and retain high-quality people in a range of disciplines and with the

right technical expertise was identified as a risk in last year's *Annual Report*. To address this, the PRA ran a strategic recruitment campaign to attract diverse and talented individuals.

Once at the PRA, internal and external training ensures people are appropriately skilled for their roles. The Bank offers a range of training frameworks and courses to meet the needs of staff at all stages of their career. These include frameworks to support development of core business, IT and management skills, supervisory development training, and technical skills on central banking and financial regulation. There is also flexibility in the framework to provide training to support staff to deliver initiatives such as the introduction of SM&CR and SIMR, and structural reform.

The PRA, as part of the Bank, holds itself to the highest standards of ethics and conduct. Details of the Bank's approach to Corporate Social Responsibility, including detailed work on diversity and inclusion, can be found in the Bank's *Annual Report*.¹

PRA Staff 2016/17

1,363
Total staff (increase of 95)

254
Recruited from the external market (136 into supervision teams)

21.2%
moved roles across the organisation

2
Senior appointments made

9.2%
turnover (up from 8.9%)

43%
Female

20%
BAME

¹ www.bankofengland.co.uk/publications/Documents/annualreport/2017/boereport.pdf.

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PRA Strategic Report: Business Plan 2017/18

This section sets out the key initiatives the PRA is planning on taking forward over the coming year to advance its statutory objectives, and pursue its strategy, and meet the strategic priorities outlined earlier in the *Annual Report* (page 20).

The majority of the PRA's activity will focus on delivering its strategic priorities, including the implementation of structural reform, the extension of the Senior Managers and Certification Regime to insurers, the development of a microprudential framework for operational resilience, and measures to facilitate competition.

The PRA will also continue to undertake all necessary work to pursue its statutory objectives in the context of EU withdrawal.

The PRA will continue to monitor and adapt its priorities as circumstances dictate.

Business aim 1: Continue to develop and implement a forward-looking, judgement-based supervisory regime

Solvency II — ensuring the approach to insurance supervision aligns with the requirements of the Solvency II Directive and identifying risks arising as firms adapt to the regime.

The PRA will continue to implement forward-looking, judgement-based supervision of UK insurers within the framework of Solvency II to deliver its statutory objectives. Where appropriate and possible, the PRA will adjust its supervisory approach in the light of experience and taking into account any recommendations from the Treasury Committee Inquiry into Solvency II.¹ Some of these changes will need amendment to Solvency II, for example the excessive sensitivity of the risk margin to the level of interest rates, which the FPC in 2016 identified as having a procyclical effect; such amendments will in the first instance be pursued through the forthcoming review of

Solvency II by the European Commission, following advice from EIOPA.

Since the implementation of the regime, the PRA has continued to observe an increase in illiquid, unrated assets held by insurance companies particularly backing annuity liabilities. The PRA also understands many firms intend to increase their exposures to these types of assets. The PRA recognises these assets can be a good match for long-term annuity liabilities and increasing investment in real assets may have wider economic benefits. However, these can be complex assets that may lack observable market prices as well as external credit ratings, making it difficult to assess the credit risk firms are exposed to.

In December 2016 the PRA published a consultation setting out its proposed approach to assessing the appropriateness of the matching adjustment benefit claimed by firms in respect of illiquid, unrated assets.² In addition the consultation set out proposals in respect of equity release mortgages (ERMs) that follow on from a discussion paper

The PRA will continue to implement forward-looking, judgement-based supervision of UK insurers within the framework of Solvency II

1 <https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/eu-insurance-regulation-16-17/>.

2 www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4816.aspx.



published in March 2016. The consultation closed in March 2017 and the PRA plans to finalise the supervisory statement in the summer of 2017.

In addition to considering the appropriateness of the matching adjustment the PRA plans to carry out a number of firm specific deep dive reviews of firms' credit models and risk management and governance in respect of illiquid unrated assets. These reviews will be targeted at those firms with the highest and most complex exposures.

In the coming year, the PRA will also undertake work to streamline its Solvency II major model change and other applications processes, without compromising the need for firms to continue to meet the test and standards of the regime. Supervisors will spend more time on intensive reviews of reinsurance and risk transfer, pricing, reserving, and asset quality, including the credit risk management capabilities of those insurers investing in illiquid assets.

Alongside this, Solvency II regulatory reporting is being introduced with the data used to inform the PRA's supervisory activities and a proportionate approach taken for smaller firms. In May 2017, insurers with a December financial year-end published the first Solvency Financial Condition Reports (SFCR), the first submissions of the full annual Quantitative Reporting Templates (QRTs), and National Specific Templates (NSTs).

Authorisation and supervision of insurance special purpose vehicles

As part of HM Treasury's work with the London insurance market to design a new framework to facilitate the issuance of Insurance Linked Securities (ILS) in the United Kingdom, the PRA published a consultation¹ on the proposed authorisation and supervisory approach. The PRA expects to finalise the rules and applicable guidance (in the form of a supervisory

statement) required to shape the regime by which ILS business in the United Kingdom will be regulated. The final regime will be consistent with relevant legislation, including the requirements set out in the Solvency II Directive.

Market turning event in the general insurance sector

Last year the PRA published a consultation paper setting out the PRA's expectations of how general insurers should prepare for, and deal with, a market turning event, and how the PRA would expect firms to interact with it to enable the PRA to act as necessary.² The PRA has also worked to help explain to firms how the PRA would expect to manage its response to such a scenario, working in conjunction with other relevant authorities. Following consideration of the feedback to the CP the PRA intends to finalise the supervisory statement. Over the next year the PRA will continue to build on its work to help improve firms' ability to manage and respond to a so-called market turning event in the general insurance sector, particularly in the specialist London market. The PRA will also continue to work with the industry in following up on the recommendations to its own market simulation exercise, to which the PRA was an observer.

Credit risk and asset quality: understanding the risks and/or vulnerabilities posed by credit risk and asset quality

In addition to the elements included in other sections, the PRA will, through its supervisory activities, seek to understand and where necessary increase resilience through regulatory action against the risks of excessive credit risk (now and in a stressed environment). For instance, this may mean that the PRA ensures insurers are taking proper account of all factors in their assessment of credit risk and that firms have credit risk management capability appropriate for the assets they are holding.

The PRA will undertake work to streamline its Solvency II major model change and other applications processes

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1 www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4216.aspx.

2 www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp3216.aspx.

Work continues on how banks are implementing IFRS 9. Supervisors are working closely with firms to monitor implementation and the impact on capital under IFRS 9. The BCBS published on 29 March 2017 rules for transitional arrangements applicable to jurisdiction which choose to implement transitionals. The European Commission has published a consultation on changes to the CRR that would provide firms with transitional relief on the impact of IFRS 9 on common equity Tier 1 (CET1) capital.

The PRA has also issued its proposals on refinements to the PRA's Pillar 2A capital framework (see page 29), with a view to publishing final policy in 2017 with implementation proposed from 1 January 2018.

The PRA will continue working with firms, auditors and global accounting and auditing standards setters to identify any guidance needed for an orderly, prudent and consistent approach to implementation.

Resolvability: delivering PRA policy and supervision to support the Bank's resolution objectives.

The PRA will continue its work with the Resolution Directorate to support the Bank in meeting its obligation under the BRRD to set minimum requirement for MREL for all firms, including internal MREL where needed. It will also work with the Bank to ensure implementation of operational continuity in resolution policy by 2019.

The PRA also continues its work with the Resolution Directive to establish orderly wind down plans for Category 1 investment banking subsidiaries as described on page 23. Submissions of the wind down plans saw notable progress in firms' approach to exit and operational cost, following the introduction of more granular and prescriptive guidance. The next iteration of the exercise will continue to

introduce further stress elements to continue making the exercise more realistic and improve firm's capabilities to wind down their activities in an orderly manner. Future work will consider capturing UK Category 1 firms with material trading activities and continue the PRA's ongoing collaboration with international regulators to ensure a co-ordinated and effective approach.

For insurers, the PRA will continue to work at a domestic and international level to review, assess and enhance resolution arrangements. This includes the work with: UK authorities, European and international partners to further the recommendation of the FSAP report of June 2016; systemically important insurers to implement the FSB's 2016 guidance; and EIOPA to assess the feedback to its consultation on 'Potential harmonisation of recovery and resolution frameworks for insurers'.¹

In addition, in March 2017 the IAIS published for consultation a revised version of ICP 12 (Exit from the Market and Resolution),² which is relevant to all insurers. ICP 12 also includes the ComFrame material on resolution, which is relevant to Internationally Active Insurance Groups (IAIGs). The consultation closed on 1 June 2017 and the PRA will continue to work with the IAIS to finalise guidance in this area.

Supervisors are working closely with firms to monitor implementation and the impact on capital under IFRS 9

1 <https://eiopa.europa.eu/Publications/Consultations/EIOPA-CP-16-009%20Discussion%20paper%20recovery%20and%20resolution%20for%20insurers.pdf>.

2 <https://www.iaisweb.org/index.cfm?event=survey:-showIntroduction&action=intro&s=BD2B0E340ECB8E60B-C2A6EF96C758221>.



Business aim 2: Support the Bank in delivering its financial stability and monetary policy objectives

Prepare to implement the UK financial regulatory framework following the United Kingdom's exit from the European Union

From its work with firms and other industry participants, the PRA will seek to understand different options in the post EU regulatory landscape for all types of firm, whether UK headquartered, a branch or a subsidiary, so that it can maintain current levels of safety and soundness in face of any additional risks posed. As part of this analysis, the PRA will identify any risks to firms, including any potential barriers to entry that might arise from EU withdrawal. It will also analyse the impact and implications of the post referendum policy options.

A major piece of work in relation to EU withdrawal includes ensuring that there is a fully functioning legal and regulatory framework for financial services, so there is minimal legal uncertainty.

EU law is deeply embedded within the United Kingdom's domestic regulatory regime as a large proportion of financial services regulation has been legislated at an EU level. The current body of EU law (the Acquis) will be converted into UK law. This process will also involve reviewing and amending the UK regulatory regime, including the PRA's Rulebook that applies to PRA-authorised firms, to ensure it remains operable and coherent in light of EU withdrawal.

As it did in the *Financial Stability Report* of July 2016,¹ the Bank will continue to monitor the pressures on firms that may restrict the provision of financial services, including the supply of credit and support for market functioning. As the outlook evolves, the FPC stands ready to take any further actions that

promote a financial system that dampens, rather than amplifies, the impact of uncertainty and adjustment on the real economy. As noted on page 17 the FPC supports the work of the PRA and FCA to ensure regulated firms have comprehensive plans in place to operate in a range of possible outcomes. On 7 April 2017, the PRA published a letter to firms from Sam Woods, PRA Chief Executive, on contingency planning for the United Kingdom's withdrawal from the European Union.²

Contribution to financial stability

The PRA will contribute to financial stability through its policy development and implementation. This will include: undertaking a review into the credit quality of new consumer credit lending by PRA-regulated lenders focusing on credit cards, motor and unsecured personal loans; monitoring the implementation of underwriting standards of buy-to-let mortgages through data collection (first of which is October for 2017 Q3 data); consulting on second charge mortgages and the LTI limit; understanding better the quality of assets and how they are valued and underwritten (for instance unrated illiquid assets and equity release mortgages in the insurance sector); and how the valuations compare between countries.

As noted in business aim 1 (page 28), in 2016 the FPC assessed procyclicality in insurers' investment activities and noted that the current design of the risk margin element of Solvency II rules could, in future, encourage procyclical investment behaviour, and should be addressed, including through the forthcoming review of Solvency II by the European Commission. Such incentives should also be avoided in the International Capital Standards for insurers, which are being developed by the IAIS (see also page 32).

The PRA will seek to understand different options in the post EU regulatory landscape for all types of firm

1 www.bankofengland.co.uk/publications/Pages/fsr/2016/jul.aspx.

2 www.bankofengland.co.uk/pradocuments/about/letter070417.pdf.

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Firms' operational resilience — developing a microprudential supervisory approach to operational resilience

The interconnectedness of major financial institutions and recent high-profile service outages and cyber attacks support the recognition of operational resilience as a high priority initiative for the PRA and other areas of the Bank. For instance, the Bank's financial stability objectives may be undermined by the failure of firms to provide 'essential and systemically important' functions, ie critical economic functions and critical shared services.

The PRA's microprudential supervisory approach is a key element of the Bank's wider operational resilience programme, which aims to ensure that critical economic functions are delivered to the levels expected. The PRA's approach is co-ordinated with the FCA and underpinned by work to build the evidence base by which the PRA prioritises supervisory interventions. Supervisors will assess firms' anticipation, protection, response, and recovery capabilities to understand and ensure firms have adequate resilience to withstand, or at least quickly identify and minimise, the potential prudential impact on the firm from operational events and systems unavailability. For the smaller PRA-regulated firms, supervisors will assess operational risk and resilience to understand and ensure firms have adequate systems, controls and response processes to withstand, or at least quickly identify and minimise, the potential prudential impact on the firm from operational events and systems unavailability.

Stress testing

Stress testing of firms is one of the key tools to support the Bank's financial stability objective. The PRA has embedded the medium-term stress-testing framework into its supervisory cycle and will continue activity in this area so that it becomes more engrained.

For the banking sector, the Bank's 2017 concurrent stress test published on 27 March 2017¹ included two stress scenarios. In addition to the annual cyclical scenario, which is intended to assess the risks to the banking system emanating from the financial cycle, the Bank is, for the first time, running an exploratory scenario. The aim of the Bank's 2017 exploratory scenario is to consider how the UK banking system might evolve if recent headwinds to bank profitability persist or intensify. The test has a seven-year horizon to capture these long-term trends. This will allow the Bank to assess banks' resilience to a wider range of potential threats and represents an important step towards achieving the vision set out in 'The Bank of England's approach to stress testing the UK banking system'.²

For general insurers, the 2017 General Insurance Stress Test (GIST2017) has been developed to assess the impact of severe but conceivable events both at a macro level, across the UK non-life insurance sector, and at a micro, firm-specific, level. At a macro level, it will allow the PRA to assess market resilience, to be better prepared in the event similar scenarios were to occur, to quantify the key reinsurer counterparties and jurisdictions to which the UK non-life sector would be exposed in those events, and to develop the PRA's understanding of the exposures assumed by the UK non-life sector to various sectors of the UK economy. At a micro level, GIST2017 will not be used to set capital requirements for non-life insurers but will inform the PRA's review of internal models, will provide the PRA with a consistent perspective of firms' stress testing, and will give the PRA an insight into how well firms manage their potential exposures to various liability shocks. The largest non-life insurers were asked to complete this exercise in 2017 Q2 with aggregated industry-level results reported back after the PRA's analysis later this year.

The PRA's microprudential supervisory approach is a key element of the Bank's wider operational resilience programme

1 www.bankofengland.co.uk/financialstability/Pages/fpc/stresstest.aspx.

2 www.bankofengland.co.uk/financialstability/Documents/stresstesting/2015/approach.pdf.



The PRA will also continue analyses of market sensitivity data to determine how a firm's solvency position may move under key market stresses. The PRA's proposals for the reporting of sensitivities by firms with material exposure to market risk are set out in CP7/17.¹

The PRA will take forward the recommendations following the EBA and EIOPA 2016 stress tests, and will continue to work with the EBA, EIOPA and firms to participate in the next tests planned for 2018.

Low for long — understanding the impact on insurers of low market interest rates for an extended period

Persistently low market interest rates internationally continue to pose a number of challenges for the insurance sector. The PRA has observed a number of firms continuing to increase their exposures to illiquid assets, including lower-rated fixed-income securities and often unrated real economy assets such as equity release mortgages,² commercial real estate and infrastructure. It is important that the risks associated with, and cashflows generated by, firms' investments remain well suited to the liabilities that they back, including those held within matching adjustment portfolios. Further details about the PRA's work regarding insurers' illiquid investments can be found on page 38.

Alongside these developments, a number of life insurers have sought to mitigate their exposure to interest rates on new annuities business by hedging offshore the associated longevity risks using swaps and reinsurance contracts.

The PRA will continue to monitor adjustments in insurers' business models and the effects that they may have on firms' safety and soundness, product availability and pricing for policyholders. The PRA will also continue to develop its understanding of the ways in which Solvency II could be enhanced and will seek

changes as appropriate — including to the design of the risk margin, which the PRA views as a helpful concept but unduly sensitive to low market interest rates.³

Business aim 3: Implement changes to domestic, European and international regulation

Structural reform — delivering the policy and implementation of the Independent Commission on Banking's recommendations that retail banking be separated from wholesale and investment banking activities.

Large UK banks are due to ring-fence their core UK retail services and activities by 2019, as required by amendments to FSMA under the Financial Services (Banking Reform) Act 2013 (the 2013 Act), see Box 4 for the background to structural reform, also referred to as ring-fencing. The 2013 Act requires the PRA and FCA to develop rules to set out how banks should implement ring-fencing: these rules have now been finalised.

The coming year will see activity on key regulatory transactions to support banks' implementation of ring-fencing, such as the authorisation of new banking entities. Banks will also start the legal processes by which they transfer assets and liabilities around their groups in order to comply with the requirements of the 2013 Act. The implementation of ring-fencing is being closely managed by the banks, and monitored by the PRA and FCA.

The coming year will see activity on key regulatory transactions to support banks' implementation of ring-fencing

- 1 www.bankofengland.co.uk/pr/Pages/publications/cp/2017/cp717.aspx.
- 2 The FPC has taken action to mitigate systemic risks associated with high LTI and LTV lending in the housing market.
- 3 See also the speech given by Sam Woods, Deputy Governor of Prudential Regulation and CEO of the PRA on 20 March 2017 at London Business School, www.bankofengland.co.uk/publications/Documents/speeches/2017/speech967.pdf.

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Box 4: Structural reform

The global financial crisis revealed the need for fundamental changes to how banks are run. In response, the Government developed legislation to require UK banks to separate within their groups the provision of core retail services from other activities such as investment and international banking. These requirements are known as ring-fencing or structural reform. The aim is to protect UK retail banking from shocks originating elsewhere in the group and in global financial markets. Ring-fencing is a key part of the Government's package of banking reforms designed to increase the stability of the UK financial system and prevent the costs of banks failing falling on taxpayers.

Today, many banking groups provide a mix of services, for example, taking deposits from households and small businesses, mortgage lending, payments processing, corporate lending and trading in financial markets. The risks associated with these activities are very different, but often they are provided alongside each other within a banking group.

One implication of this is that problems in one type of activity can disrupt a bank's ability to provide services in other areas. Ring-fencing will result in the separation of core banking services — taking deposits, making payments and providing overdrafts for UK retail customers and small businesses — from other activities that banks undertake. This will help protect core services from problems which may arise elsewhere within a banking group. Banks which have been separated from the rest of their groups in this way are known as ring-fenced bodies.

Ring-fencing requirements will apply to banks with more than £25 billion of retail deposits from 2019. Large UK banking groups must ensure that the structure of their businesses is consistent with ring-fencing requirements. This means that most will need to adopt new legal structures and ways of operating, through large and complex restructuring programmes in 2017 and 2018. These changes will also affect some of the banks' customers, counterparties and suppliers. For example, the sort codes of some customers will change.

The aim is to protect UK retail banking from shocks originating elsewhere in the group and in global financial markets

Accountability — delivering and embedding the governance regime for banks and insurers including the principle of proportionality

The PRA will continue to develop its supervisory approach to accountability within firms, including monitoring governance in areas such as remuneration practices, dividend distributions, and corporate governance at board level. In the coming year, the PRA will also develop and finalise policy on the extension of the SM&CR and SIMR to FSMA regulated firms aligning its activity with the FCA where appropriate. At the international level, through the FSB's Working Group on Governance Frameworks, the PRA will support

efforts by the official and private sectors to strengthen governance to mitigate misconduct risks, and continue proactively to support the work of the FSB's Compensation Monitoring Contact Group, including further work on the role incentives and compensation tools can play in addressing misconduct risk.

Upcoming policy publications 2017/18	Q1 Mar–May	Q2 June–Aug	Q3 Sep–Nov	Q4 Dec–Feb
IRB approach: clarifying PRA expectations				
The PRA's expectations on remuneration				
Solvency II: recalculation of the 'transitional measure on technical provisions'				
Whistleblowing in UK branches				
Delivering accountability: amendments and optimisations to the SMR and SIMR; extension of the SM&CR to insurers; and diversity rules for insurers				
Recovery planning				
Cyber insurance underwriting risk				
Residential mortgage risk weights				
Delivering accountability: governance policy updates and FCA accountability update				

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Business aim 4: Continue to devise and influence the domestic and international policy agenda

Maintaining a strong voice and contributing to international standards for banks and insurers

International capital standards for banks

The PRA continues to work with other members of the BCBS to finalise the Basel III package of reforms. These mainly concern measurement of risk for the purpose of setting risk-weighted capital requirements and the finalisation of the international framework for leverage ratio requirements and buffers. The package seeks to reduce unwarranted variability in risk weights and level the playing field for capital requirements internationally. Domestically, the PRA also expects the Basel III package to help narrow the gap between standardised and model-based approaches, which would support more effective competition.

In November 2016 the European Commission issued proposals for consultation on CRR II and CRD V. The PRA will be negotiating on areas including market risk, the leverage ratio, net stable funding ratio, and remuneration with a view to implementation, on current timelines, in 2017. Alongside this, the PRA will be negotiating in the policy development of CRR III over the coming year.

International capital standards for insurers

The investigation by the IAIS into an ABA will take a cross sectoral view, recognising the ability of insurers to undertake both asset management and deposit-like business, similar to that done by banks. This will in particular involve an assessment of the extent to which systemic risks are already mitigated by the ICS for international insurance groups that the IAIS is developing, or whether any amendments to the ICS or ComFrame may be needed.

The PRA will continue to be actively involved in the development of the ICS and the systemic risk framework for insurance in the coming years. ICS version 1.0 for extended field-testing is to be released in 2017 ahead of version 2.0 which is due to be adopted by the IAIS in 2019 and implemented as of 2020. The Higher Loss-Absorbency requirements applicable to G-SIIs will be reviewed ahead of implementation as of 2022.

The IAIS will continue to run its annual G-SII identification process. The next three-year review of the G-SII Assessment Methodology will take place in 2018–19 and will take into account the outcome of the ABA and cross sectoral work.

The PRA expects the Basel III package to help narrow the gap between standardised and model-based approaches

Figure 3: Key policy initiatives, by intended date of policy finalisation

This diagram highlights some of the major policy work streams that will support the delivery of the PRA’s strategy by the intended publication date of the main policy proposals. This includes international, EU and domestic initiatives. Dates may be subject to revision.



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Box 5: The PRA policy pipeline beyond the next twelve months

The PRA continues to make significant progress in steadily finalising and implementing the post-crisis regulatory framework. The PRA is also focusing on making policy more responsive to risks. The ongoing implementation process coincides with a period of heightened uncertainty before the United Kingdom — and therefore the financial system — adjusts to a new relationship with the European Union. In the meantime, the PRA will continue to implement the current regulatory framework and pursue its objectives (including competition) until any new arrangements with the European Union take effect, further develop the supervisory framework, and test firms' operational resilience.

Over the coming years, banks will need to continue to meet capital and liquidity requirements, and the standards on the calculation of risk-weighted assets. Insurers will also be required to maintain robust balance sheets and manage risks effectively. Across both banking and insurance, firms are subject to a robust accountability framework for senior managers, reduced scope for dangerous pay structures, and more effective board governance.

Banking

Work continues on finalising the Basel III standards. The PRA's aim remains to focus on reducing unwarranted variability in risk weights, while arguing that there should not be a significant increase in global capital requirements. On ring-fencing, the domestic legislative and regulatory requirements are largely in place, and firms have provided their plans to implement them in time for the Government's 2019 deadline. The PRA is working closely with firms as firms change their structures and transfer business activity, assets and liabilities between entities. However, firms must manage the impacts on customers, employees and other stakeholders.

Insurance

For insurance, the PRA continues to engage with industry and Parliament on aspects of Solvency II that can be improved, for example around the sensitivity of the risk margin. The PRA also continues to contribute to international work to develop a Common Supervisory Framework and within it an ICS for IAIGs.

Horizon scanning

As the PRA moves into the implementation phase for post-crisis prudential reforms, it needs to monitor whether policy is implemented effectively, and to evaluate whether they are having the intended consequences. The PRA is proactively looking ahead to identify and manage emerging risks not captured by our current prudential framework, or which may warrant more attention in its supervision of firms.

Financial technology

As set out in the Bank's *Annual Report*, Financial Technology (FinTech) presents both opportunities and risks for the way the Bank sets monetary policy, the safety and soundness of firms it supervises, the resilience of the financial system and the nature of the shocks it might face. Aligned to the Bank's approach, the PRA is engaging in discussions to assess new technology to determine its impact on business models.

Prudential regulatory framework

One element of this horizon scanning work will be for the PRA to remain vigilant in defending the regulatory framework. In order to remain fit for purpose, the prudential regulatory framework must be responsive to changes in the behaviour and structure of the financial system and identify any gaps, faults, or incoherence that can lead to perverse behaviour.

The PRA will also continue to work to support the FPC, including its reviews on capital, leverage and housing, as well as its assessment of risks arising from the levels of consumer credit, and its work on the systemic risk buffer.



Business aim 5: Ensure the PRA has the right people, infrastructure and governance to deliver its strategy

Establish an independent enforcement decision-making committee

Following the PRA and Bank of England consultation in July 2016¹ proposing the establishment of a functionally independent Enforcement Decision Making Committee (EDMC), work is focused on producing more detailed operating procedures for publication in 2017.

Embedding the plan for PRA IT, specifically: improving management information on the PRA's assessment of firms; and improved data analytical tools

The PRA will continue to develop its capability to provide improved management information to support the assessment of firms. Over the coming year the PRA will focus on making the best use of data, including through wider usage of analytical tools, and sharing expert knowledge and best practice to improve support for supervisors and policymakers in their analysis and decision-making.

Develop and implement an improved control and assurance framework

In 2017 the PRA will continue its work to improve frontline controls and management information. This will include a full review of internal guidance to supervisors, the rollout of real-time management information dashboards, and increased functionality in supporting IT systems. The PRC will keep the framework under review.

Risks to delivering the Business Plan

As for the previous year, there continue to be risks to the delivery of the Business Plan. These risks are monitored, actively mitigated against (where possible), managed, and reported to the PRC and Executive Committee on a regular basis.

Unforeseen events

The nature of the PRA's environment means it deals with unforeseen events that may arise internationally and domestically and which require a swift regulatory response. Depending on the scale and nature of these events, they can lead to significant re-prioritisation of Business Plan deliverables.

The crystallisation of risks within firms can place additional constraints on the delivery of day-to-day supervisory activity, possibly impacting on the safety and soundness of firms, and may lead to re-prioritisation of deliverables.

Any adverse change in the economic environment, or other changes within or outside the United Kingdom, may impact the safety or soundness of firms. While recovery and resolution planning and stress testing 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's *Financial Stability Report* provides the FPC's and wider Bank view of the current stability of the UK financial system and areas of risk.

Execution risk

The PRA continues to manage an extensive landscape of regulatory and legislative change and this will place additional constraint on resource which may compromise its ability to carry out its obligations as planned. The most significant execution risks include structural reform, stress testing, and implementing the BRRD.

As the United Kingdom progresses towards EU withdrawal, there may be increased activity by regulated firms, including some which may choose to restructure existing businesses or seek new authorisations. This could lead to the re-prioritisation of business plan deliverables.

The nature of the PRA's environment means it deals with unforeseen events which require a swift regulatory response

¹ www.bankofengland.co.uk/publications/Pages/other/edmc/cpedmc2016.aspx.

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Dependencies

The PRA is reliant on the FCA for the provision of certain IT systems and any degradation of service will impact on the PRA's ability to deliver its obligations. The FCA provides upgrades and fixes to ensure a maintained service.

PRA policymaking is often dependent on overseas authorities who lead on timings and requirements for delivery of legislative and regulatory change. The outcome of international policy negotiation could also differ from current PRA and Bank objectives which, in certain circumstances, could weaken the PRA's current approach. Maintaining external policy relationships is key in ensuring that new policy requirements are in the best interest of providing safety, soundness and financial stability to the United Kingdom and ultimately meet the PRA's statutory objectives.

Internal factors

Staff stretch caused by insufficient resources in terms of skills, experience and capacity continues to be a concern. This may result in work set out in the Business Plan being delivered to a lower standard, delayed, or reprioritised.

The PRA needs to continue to attract, recruit and retain high-quality people in a range of disciplines and with the right technical expertise to undertake its 'business as usual' activities and strategic priorities. The PRA also needs to be able to retain staff through appropriate terms and conditions, training, and development opportunities.

Measuring progress

The PRA draws on a variety of information to monitor the progress of its delivery against its statutory objectives, strategy and business plan on an ongoing basis.

The PRC and the Executive Committee receive information on a regular basis, both quantitative and qualitative measures and indicators (see **Table 1**) to enable an assessment of delivery against the Business Plan, statutory objectives and strategy. This will enable the PRC to report to the Chancellor on the adequacy of resources and provide sufficient information on supervisory processes and outcomes. The PRA's progress reports against these objectives are generally market sensitive, and not public.

The PRC and the Executive Committee receive information on a regular basis, to enable an assessment of delivery against the Business Plan



Table 1: Sample of measures and indicators used to monitor the PRA's performance against its statutory objectives, strategy and business plan

Objective to be assessed	Sources of assurance
Financial stability and protection of policyholders	<ul style="list-style-type: none"> the quantity and quality of capital and liquidity held by PRA-regulated firms; the strength of firms' arrangements for effective risk management and governance as reflected in supervisory assessments; the ability of insurance firms to meet claims from and material obligations to policyholders; and the quality of the PRA's supervisory tools as measured by, for example, the quality of supervisory outputs and internal audit reviews.
The success of the PRA's forward-looking judgement-based supervisory model	<ul style="list-style-type: none"> self and peer reviews — this entails staff assessing their own performance and receiving independent challenge at regular intervals, as well as reviews carried out by other bodies (such as the IMF); regular review of how firm-specific risks are being managed — these measures cover both the core supervisory judgements (for example, business model analysis, and key risks), the approval of the supervision strategy and execution (that is assurance the supervision strategy is 'on track'); 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; and firm feedback and external reviews (for example, IMF's FSAP).
The effectiveness of prudential policy initiatives	<ul style="list-style-type: none"> the outcomes from negotiation of European and international policy; macroprudential policy outcomes; and feedback on influence in key committees and with overseas regulators and central banks.
Operational performance	<ul style="list-style-type: none"> people-related indicators such as length of service of staff, staff turnover and diversity; quarterly review of operational risks including operational resilience; quality and performance of information technology systems; and quarterly review of any breaches of the MoU between the PRA and FCA.

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PRA Strategic Report: Complying with FSMA

This section covers a number of issues that the PRA takes into account when carrying out its duties or has an obligation to report on.

These include:

- complying with FSMA;
- complying with the regulators' code and principles;
- the PRA's complaints scheme;
- details of how the PRA has used the provisions of section 166 of FSMA; and
- sections 339A and 339B of FSMA relating to firms' auditors.

Complying with FSMA

In carrying out its functions during the reporting period, the PRA was required to, so far as is reasonably possible: (i) act in a way which advances its general objective to promote the safety and soundness of PRA-authorised persons; and (ii) specifically for insurers, act in a way which contributes to the securing of an appropriate degree of protection for those who are or may become policyholders (sections 2B and 2C of FSMA). The Strategic Report sets out how the PRA has discharged its functions and the extent to which, in its opinion, its objectives have been advanced. Section 3B of FSMA sets out a number of regulatory principles to which the PRA must have regard (under section 2H(2) of FSMA) in discharging its general functions. These are:

- a) the need to use its resources in discharging its general functions in the most efficient and economic way;
- b) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

- c) the desirability of sustainable growth in the economy of the United Kingdom in the medium or long term;
- d) the general principle that consumers should take responsibility for their decisions;
- e) the responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements;
- f) the desirability where appropriate of exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of persons such as mutual societies and other kinds of business organisations) subject to requirements imposed by or under FSMA;
- g) the desirability in appropriate cases of publishing information relating to persons on whom requirements are imposed by or under FSMA, or requiring such persons to publish information, as a means of contributing to the advancement by the PRA of its objectives; and
- h) the principle that it should exercise its functions as transparently as possible.

The PRA takes these principles into consideration when carrying out its functions, including when making policy.

Further, in carrying out its functions during the reporting period, the PRA was required to, so far as is reasonably possible, act in a way which facilitated effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities (section 2H(1) of FSMA). There are several examples of how meeting this requirement is achieved on page 26. The *Annual Competition Report*, published in July 2017, provides further examples of how meeting this requirement has been achieved.



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Details of how the PRA has met its general duty to consult (under section 2L of FSMA) and consider any representations made (under section 2N of FSMA) can be found on page 35, which also explains how the PRA engages with firms more generally. These arrangements include the establishment and maintenance of the PRA Practitioner Panel (the Panel) (under section 2M of FSMA).¹ The Panel is an independent body representing the interests of practitioners in the financial services industry. It plays an important role in PRA policymaking by providing appropriate challenge and scrutiny. As well as PRA policies, the Panel also considers items from other directorates within the Bank of England whose policies have a potential prudential impact.

In 2016/17 the Panel met six times and provided the PRA Board and senior management from across the PRA and Bank with feedback on topics including the Senior Managers Regime, Structural Reform, IFRS 9 and increasing competition in the banking sector.

The PRA and FCA have a duty to ensure a co-ordinated exercise of functions (under section 3D of FSMA) and details of how this has been managed effectively is covered on pages 16 and 36–37.

The PRA has the power to require the FCA to refrain from taking certain actions, specified under section 3I of FSMA, or to give a direction to the FCA in relation to with-profits policies (section 3J of FSMA). The PRA did not exercise this power during the period.

The PRA is considering how it will meet its new requirement in paragraph 19(1A) of Schedule 1ZB of FSMA to report on ring-fenced bodies.

Section 354B of FSMA outlines the PRA's duty to co-operate with other persons (whether in the United Kingdom or elsewhere) who have functions similar to the PRA or have functions

relevant to financial stability. Details of how the PRA has complied with this duty is set out on pages 16 and 36–37.

Regulators' Principles and Code²

In accordance with sections 21 and 22 of the Legislative and Regulatory Reform Act 2006 and the Legislative and Regulatory Reform (Regulatory Functions) Order 2007, the PRA, when exercising its functions, is required to have regard to the following Regulators' Principles and Code.

Regulators' Principles

- Regulatory activities should be carried out in a way which is transparent, accountable, proportionate and consistent.
- Regulatory activities should be targeted only at cases in which action is needed.

Regulators' Code

- Regulators should carry out their activities in a way that supports those they regulate to comply and grow.
- Regulators should provide simple and straightforward ways to engage with those they regulate and hear their views.
- Regulators should base their regulatory activities on risk.
- Regulators should share information about compliance and risk.
- Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply.
- Regulators should ensure that their approach to their regulatory activities is transparent.

PRA's complaints scheme

As part of the statutory Complaints Scheme (under Part 6 of the Financial Services Act 2012), the PRA is responsible for ensuring formal complaints against it are dealt with in an efficient and effective manner. During 2016/17 the PRA received five complaints.

¹ www.bankofengland.co.uk/practitionerpanel.aspx.

² www.gov.uk/government/publications/regulators-code.



Investigations were in progress at the end of the reporting period into three of the complaints received. There were no complaints upheld during the year.

One complaint (a joint complaint about the PRA and FCA) was referred to the Commissioner during the year, and this is being considered by the Commissioner. During the reporting period the Complaints Commissioner concluded an investigation into a PRA complaint referred from 2015/16. This complaint related to dissatisfaction with the PRA's policy not to disclose buffers/capital requirements for individual firms. The Commissioner did not uphold this complaint. The Complaints Commissioner's reports can be found on the Office of the Complaints Commissioner website.¹

Section 166 reports by skilled persons

Section 166 (s166) of FSMA provides a regulatory tool which gives the PRA powers to obtain an independent expert review of aspects of a regulated firm's activities. Such reviews can be undertaken where the PRA seeks additional information, further analysis, expert advice and recommendations, or assurance around a particular subject.

In 2016/17 s166 was used by the PRA eleven times (2015/16: 20 cases). Four (2015/16: eight) were commissioned by the PRA contracting directly with the skilled person.

The reviews mainly covered risk management, governance and controls. The reviews fell within the areas shown in **Table 2**.

The total estimated cost of commissioned s166 reviews was £3 million (2015/16: £5.1 million)² and the cost per review ranged from £50,000 to £1.1 million (2015/16: £65,000 to £0.6 million). Of this total, the cost of the four reviews where the PRA contracted directly with the skilled persons is estimated to be £1.1 million (2015/16: eight at a cost of £2.1 million).³ The costs disclosed include actual costs incurred by the firms or an estimate where actual costs are not yet available.

New Skilled Persons Framework

Working with the FCA, the Bank and PRA have for the first time conducted a procurement process for a new Skilled Persons Framework in accordance with the Public Contract Regulations 2015. This was necessary as the framework set up by the FSA in 2013 expired on 31 March 2017. The new framework commenced on 1 April 2017 and will be used by the regulatory authorities for appointing skilled persons to provide reviews under section 166 of FSMA.

The framework is composed of ten areas of supervisory interest, referred to as lots. A list of the skilled persons by lot and a description of each lot is available on the Bank's website.⁴ The framework will be effective for four years.

Table 2: Section 166 reviews by areas of focus

Lot	Total for 2015/16	Total for 2016/17
Governance, controls and risk frameworks	10	7
Data and IT infrastructure	1	1
Prudential — insurance	9	3
Total	20	11

¹ <http://fsc.gov.uk/>.

² The figure provided in the 2015/16 *Annual Report* has been revised and includes VAT for directly commissioned reviews. This remains an estimate as two s166 reviews commissioned in 2015/16 are still ongoing.

³ £0.6 million of this total estimated cost has been incurred in 2016/17, with the remaining £0.5 million expected to be incurred in 2017/18. Costs include VAT.

⁴ www.bankofengland.co.uk/pradocuments/supervision/activities/skilledpersonpanel.pdf.

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In total, 36 out of 91 skilled persons who applied have been selected to be part of the 2017 Skilled Person Panel. The panel is diverse and includes small specialist consultancies, large consulting practices, accounting firms and legal firms among others. Eleven of the suppliers are new entrants who were not on the 2013 panel.

Meeting with auditors

Pursuant to section 339A(2) of FSMA the PRA must issue and maintain a code of practice which includes arrangements on: (i) the sharing with auditors of PRA-authorized persons of information that the PRA is not prevented from disclosing; and (ii) the exchange of opinions with auditors of PRA-authorized persons. The PRA published the code of practice in April 2013. Pursuant to section 339B of FSMA the PRA must make arrangements for meetings to take place at least once a year between the PRA and the auditor of any PRA-authorized person to which section 339C of FSMA applies. 39 firms (2015/16: 39) fell within the scope of section 339B FSMA during the reporting period and the PRA conducted 51 meetings (2015/16: 54) with the auditors of these firms.

At least one meeting with the auditor of each such firm was held during the reporting period.

The PRA looks to auditors to contribute to effective supervision by directly engaging with the PRA in a proactive and constructive way.

The PRA has reported to its Board, and will report to the PRC, annually on the quality of the relationship between auditors and supervisors. In October 2016, the PRA reported to the PRA Board that the majority of supervisory respondents to a PRA-commissioned survey reported no change in the quality of the relationship since the last reporting period while a quarter recorded an improvement in the quality of the relationship. Only 3% reported a decline in the quality. While there are areas where the relationship could be improved, the PRA notes that nearly all supervisors surveyed felt that they met auditors with an appropriate frequency and that auditors expressed their views proactively and frankly.

By order of the Board

Mr M Carney
Chair
26 June 2017

Directors' Report

The Directors present their report and the audited financial statements of the Prudential Regulation Authority for the year to 1 March 2017.

Principal activity and future developments

The PRA has, since 1 April 2013, been the United Kingdom's prudential regulator for deposit-takers, insurers and major investment firms, with statutory responsibilities under FSMA. Until 1 March 2017, the functions of the PRA were exercised by the Company, which is a subsidiary company of the Bank.

On 1 March 2017, the PRA functions and powers, and the assets and liabilities held by the Company, were transferred to the Bank, and the Company's name changed with effect from the same date to Prudential Regulation Authority Limited. The Company is therefore now not trading and will be wound up in due course. The functions of the PRA are now exercised through the Bank's Prudential Regulation Committee (PRC).

In this report, references to the 'PRA' should be construed as references to either: (i) the Company, acting via its Board, in the period prior to 1 March 2017; or (ii) the Bank, acting through the PRC, post-1 March 2017, as the context requires.

The PRA's regulatory activities during the year are described in the Review of 2016/17 on pages 21–37.

Financial results

The PRA's financial statements for the period to 1 March 2017 are presented on pages 69–85.

Governance

Until 1 March 2017, the PRA was 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'.¹ Although not required to comply with the UK Corporate Governance Code (the Code), the Board considers that the PRA complied with the Code as far as was appropriate to its functions. The PRA's governance arrangements for the period ended 1 March 2017 are described below.

The Board

During the year the PRA was led by its governing body, the Board. Under the provisions of FSMA then applying, the Governor of the Bank was Chair of the PRA; the Bank's Deputy Governor for Prudential Regulation was the Chief Executive; the Deputy Governor for Financial Stability and the Chief Executive of the Financial Conduct Authority were members of the Board; and additional members were appointed by the Bank's Court of Directors, with the approval of HM Treasury.² Appointed members could be executive or non-executive, but a majority of the Board had to be members not employed by the PRA or the Bank. Membership of the Board during the year is shown in **Table 3**. The current membership of the PRC is shown on page 8.

During the year the Board met 21 times. There were also three joint meetings with the Financial Policy Committee. Attendance at Board meetings is set out in **Table 3**.

¹ Section 3C of FSMA as amended by the Bank of England and Financial Services Act 2016.

² Paragraph 6 of Schedule 1ZB of FSMA repealed with effect from 1 March 2017.



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Table 3: PRA Directors 2016/17

		Date of first appointment	Expiry of current term	Attendance at Board meetings (21)
Mark Carney	<i>Ex officio</i>	1 July 2013	30 June 2021 ^a	16
Andrew Bailey ^{b, c}	<i>Ex officio</i>	20 February 2013	–	18
Sir Jon Cunliffe	<i>Ex officio</i>	1 November 2013	31 October 2018	16
Sam Woods	<i>Ex officio</i>	1 July 2016	30 June 2021	18 of 19 ^d
Tracey McDermott ^c	<i>Ex officio</i>	12 September 2015	30 June 2016	4 of 6
David Belsham	Appointed NED	1 May 2015	31 April 2018 (as PRC member)	21
Sandy Boss	Appointed NED	1 September 2014	31 August 2017 (as PRC member)	19
Norval Bryson	Appointed NED	1 September 2015	31 August 2018 (as PRC member)	19
Charles Randell	Appointed NED	20 February 2013	28 February 2019 (as PRC member)	21
David Thorburn	Appointed NED	1 September 2015	31 August 2018 (as PRC member)	21
Mark Yallop	Appointed NED	1 December 2014	30 November 2017 (as PRC member)	20
Dame Minouche Shafik	Appointed Bank	1 September 2014	Resigned 28 February 2017	17
Paul Fisher	Appointed Bank	1 September 2015	Resigned 1 March 2016	n.a.

Board members have declared the following interests, and where these may involve potential conflicts these have been noted and approved by the Board, subject in some cases to conditions:

Mr Belsham

Director of David Belsham Consulting Ltd
Director of Oakmead Residents Association Limited

Ms Boss

Non-executive director, member of Compensation Committee and Nominating and Governance Committee, Enstar Group
Non-executive director of Elementis plc and a member of the Audit, Nominating and Remuneration committees of Elementis plc

Mr Bryson

Chair of St Columba's Hospice in Edinburgh

Mr Randell

Non-executive director and Chair of Audit and Risk Assurance Committee, Department for Business, Energy and Industrial Strategy

Mr Thorburn

Director of DJT Limited (dormant)
Independent non-executive on the Global Governance Council of Ernst & Young Global Limited
Chair of the 2025 Foundation of The Chartered Banker Institute

Mr Yallop

Director of Baltic Wharf Limited
Director of Dartmouth Ventures Ltd
Partner of TQ9 Partnership LLP
General Partner, Illuminate Financial Management LLP
Chair of Fixed Income, Currency and Commodities Markets Standards Board (from July 2016)

^a The Governor has indicated that he will leave office on 30 June 2019.

^b As CEO of the PRA until 30 June 2016 and then as CEO of the Financial Conduct Authority from 1 July 2016.

^c In line with paragraph 5 of Schedule 1ZB of FSMA (repealed with effect from 1 March 2017), Ms McDermott and Mr Bailey (from 1 July 2016) did not attend meetings convened solely to discuss or take decisions about a particular institution or person.

^d Includes four additional PRA Board meetings before becoming Deputy Governor for Prudential Regulation on 1 July 2016.



In addition to statutory functions such as rulemaking, the Board reserved to itself the making of key decisions in relation to the most significant regulated firms. Matters reserved to the Board included: regulatory policy, strategy and management, recommending the PRA budget to Court and risk management. Other decisions were delegated to the Executive and its committee structure. Similar arrangements have been made by the PRC and are set out on the Bank's website.¹

Board effectiveness

During the previous year the Chair of the Bank's Court reviewed the operation of the PRA Board, based on a targeted survey and discussions with individual members. His findings were discussed at an extended board meeting in July 2016, and reflected in the operating procedures of the PRC.

Regulatory functions and decision-taking

The Board was 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 carrying out other legislative functions. The Board (consulting Court) set the PRA's Strategy, delegated some other matters to the PRA's Chief Executive, but reserved to itself key regulatory decisions relating to the most significant firms.

The Board (and now the PRC) was supported by a Supervisory Oversight Function which aims to assure management and the PRC on the quality and effectiveness of supervision, by conducting reviews of supervision and making recommendations where appropriate. The PRA has recently refocused the function to make it more forward-looking, promoting continuous improvement, learning lessons, and sharing good practice.

The Bank's Independent Evaluation Office (IEO), although reporting directly to the Bank's Court, also provided support to the PRA. During the year the IEO conducted, and published, an analysis of the PRA's approach to its insurance objective.²

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 and takes account of the views expressed. Consultation with PRA-authorised persons on general policies and practices is carried out in part 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 on the Bank's website.³

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, on the basis of which it sets a levy on regulated firms, is subject to the approval of the Bank's Court, 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. The Bank's Remuneration Committee and Court determined the remuneration of the *ex officio* and the appointed directors of the PRA. The PRA Board received an assurance report, and regular information including data on IT, finance, internal audit, and HR.

¹ www.bankofengland.co.uk/pradocuments/about/prc-terms-of-reference.pdf.

² www.bankofengland.co.uk/about/pages/ieo/default.aspx.

³ www.bankofengland.co.uk/pradocuments/practitionerpanel.aspx.

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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. 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.¹

The PRA 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 United Kingdom and internationally; risks arising from interaction with other macroprudential and microprudential regulators, including the FPC, the FCA and international agencies; and risks to the Board's regulatory strategy arising from the regulatory process, including risks of failing to comply with legal requirements, the quality of supervision, resource constraints and other operational factors. The PRA is part of the Bank's risk management framework and its approach to risk is entirely consistent with that framework.

The PRA's approach to risk is ultimately determined by its statutory objectives and is set out in the PRA's Strategy (on page 19 of this *Annual Report*) and approach documents.²

Systems and controls

Court's Audit and Risk Committee (ARCo) oversees the Bank's 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 PRA participates in ARCo, which during the year was attended by Board members, so that the PRA's performance and risk profile could be reviewed alongside other parts of the Bank. ARCo also acts as an interface with the National Audit Office, in their role of conducting the audit of the PRA on behalf of the Comptroller and Auditor General.³

ARCo makes an annual report on its activities, which is reported in the Bank's *Annual Report*. The PRA is within the scope of the Bank's internal audit function. The Board was consulted on the annual internal audit plan before it was finalised, received copies of internal audit reports relating to the PRA and met with the Head of Internal Audit on a quarterly basis.

Board remuneration

The PRA Board was appointed under statute and was the governing body of the PRA during the period under review. Remuneration of appointed members of the Board was determined by the Bank's Remuneration Committee. Board members were paid by the Bank and the PRA paid consideration to the Bank for the directors' services received. The Bank re-charged Mr Bailey's remuneration in full for the period he was employed during the 2016 financial year, subsequently Mr Woods' remuneration was re-charged in full for the year to 1 March 2017 from the date of his appointment. In addition, the Bank received consideration of £442,660 (2015/16: £442,000) for the services provided to the PRA by the Governor, Sir Jon Cunliffe and Dame Minouche Shafik. Their full

1 For further information on the Bank's risk management framework and risk governance, see the Bank's *Annual Report*.

2 www.bankofengland.co.uk/publications/Pages/other/prasupervisoryapproach.aspx.

3 The audit of the PRA will, in future, be part of the Bank's own audit.



remuneration is reported in the Bank's *Annual Report*. Ms McDermott received no remuneration from the PRA.

Mr Woods is a member of the Bank's career average defined benefit pension fund and his benefits are based on an accrued rate of 1/65th of salary. Upon his appointment, Mr Woods is no longer eligible to receive a performance award.

Board members leaving the PRA were bound by the terms of their contract to accept no new employment that would conflict with their PRA responsibilities for a period of three months, and their fee continued to be paid for that period. As there was not deemed to be a conflict with Mr Bailey's appointment at the FCA, he was not subject to such a period of restricted duties.

Indemnities

Members of the PRA Board have been indemnified against personal civil liability arising from the carrying out or purported carrying out of their functions, provided they have not acted in bad faith. In addition, under FSMA the PRA and persons acting as members, officers and employees of the PRA have immunity from liability in damages.

Other disclosures

HM Treasury

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

Fair pay (audited)

The banded remuneration of the highest paid director (full-time equivalent base salary plus benefits and excluding pension) in the financial year 2016/17 was £272,380 (2015/16: £269,926). This comprises a salary of £270,626 (2015/16: £267,946) as at 1 March 2017, plus non-pension related benefits of £1,754 (2015/16: £1,980). This was

4.19 (2015/16: 4.08) times the median remuneration of the workforce, which was £64,521 (2015/16: £66,139). During 2016/17, no employees received remuneration in excess of the highest paid director. Remuneration ranged from £20,330 to £272,380 (2015/16: £18,578 to £269,926).

Exit packages (audited)

There were two compulsory redundancies during the year, in the ranges set out below:

£30,000–39,999 — 1
£70,000–79,999 — 1

There were eleven exit packages agreed during the year, in the ranges set out below:

£0–10,000 — 8
£10,001–20,000 — 3

Sickness absence

The level of sickness absence in the organisation, calculated as average working days lost per financial year based on the number of full-time equivalent employees was six days (six in 2016).

The environment, recycling and reusing

The Bank approach to minimising its impact on the environment is set out in its *Annual Report*.

Employee involvement

Details of employee involvement can be found in the Bank's *Annual Report*.

Employment of people with disabilities

Details of employment of people with disabilities can be found in the Bank's *Annual Report*.

Health and Safety

Details of health and safety arrangements can be found in the Bank's *Annual Report*.

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Table 4: PRA Board remuneration (audited)^a

	Mr A J Bailey		Mr S Woods		Mr P Fisher ^b	
	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16
Base salary	90,209	267,946	180,417	–	75,870	103,794
Taxable benefits	628	578	2,254	–	5,629	6,664
Pension benefits	–	–	60,305	–	–	–
Payment in lieu of pension	27,063	80,384	–	–	40,439	42,336
Total pension benefits	27,063	80,384	60,305	–	40,439	42,336
Other remuneration	764	1,402	607	–	377	328
Total single figure of remuneration	118,664	351,310	243,583	–	122,315	153,122

Non-executive directors

	Mr D Belsham		Ms S Boss		Mr N Bryson		Mr C Randell	
	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16
Base salary	104,900	86,551	104,900	103,861	104,900	51,931	104,900	103,861
Taxable benefits ^c	–	–	–	–	32,091	32,546	–	–
Total single figure of remuneration	104,900	86,551	104,900	103,861	136,991	84,477	104,900	103,861

	Mr D Thorburn		Mr M Yallop	
	2016/17	2015/16	2016/17	2015/16
Base salary	104,900	51,931	104,900	103,861
Taxable benefits	30,587	22,973	–	–
Total single figure of remuneration	135,487	74,904	104,900	103,861

a Figures reported in Table 4 are the actual remunerations received by individuals while in post as PRA Board members.

b Mr P Fisher resigned from the PRA Board on 1 March 2016.

c Taxable benefits are principally the costs incurred in attending meetings at the PRA.



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 they ought to have taken as a Director to make themselves 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 with any accounts direction given by HM Treasury. Company law requires the Directors to prepare financial statements for each financial period, and they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and applicable 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 the relevant 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 European Union and applicable law;
- 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.

Assessment of going concern

The Bank of England and Financial Services Act 2016 transferred the prudential regulatory activities of the company, along with its assets and liabilities, to the Bank of England. The financial statements have therefore been prepared on the break up basis because the Directors have assessed that the company is no longer a going concern.

Auditor

Under provisions of FSMA, the Comptroller and Auditor General is responsible for auditing the Company's accounts.

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Operating costs for 2017 of £254 million (2016: £253 million) were slightly higher than the budget of £253 million, predominantly due to additional expenditure in relation to EU withdrawal activity and acceleration of system costs for supervisory risk management.

The increase from 2016 across all areas is primarily attributable to closure of prior year resourcing gaps and expansion of the PRA's responsibilities, most notably in relation to EU withdrawal.

Specific initiatives that drove year-on-year operating cost movements include:

- increased activity in relation to banking structural reform implementation (also known as ring-fencing) in UK Deposit-Takers Supervision;
- completion of Solvency II implementation activity impacting Insurance Supervision;
- acceleration of system development costs; and
- a change in the way stress-testing costs are allocated across business areas resulting in a decrease in Supervisory Risk Specialists costs and an increase across all other areas.

The PRA's budget for 2017/18 is £288 million, including special project and implementation fees of £27 million, which is an increase of £34 million on 2016/17 expenditure with the increase primarily attributable to:

- further increases to banking structural reform implementation activity reflecting the additional activity associated with the collection of regulatory data and increasing work on firms' implementation of ring-fencing plans;
- incremental expenditure in relation to EU withdrawal activity;
- additional cost pressures arising from rent and rates increases and expanded remit, eg carrying out additional stress-testing activity; and
- incremental pensions service costs arising due to declining gilt and corporate bond rates.

This budget includes two amendments approved after the start of the financial year: the first in relation to the emerging EU withdrawal implementation costs (£3 million); and the second to accommodate the impact of market conditions on pension costs and further costs in relation to EU withdrawal (£10 million).

These are offset by cost saving initiatives planned to optimise operational efficiencies across the PRA.

Table 5: PRA expenditure by function

	2017 £m	2016 £m
UK Deposit-Takers Supervision	52	44
International Banks Supervision	21	19
Insurance Supervision	55	63
Prudential Policy	34	33
Supervisory Risk Specialists	37	41
Regulatory Operations	55	53
Total expenditure*	254	253

*Of total operating costs, £8 million (2016: £13 million) related to special projects.



Income

Total income for the year, reflecting the level of expenditure incurred, was £254 million (2016: £253 million), and comprised:

- fee income for 2017 of £243 million (2016: £238 million) representing the Annual Funding Requirement (AFR)¹ levied to regulated firms of £242 million (2016: £243 million) plus an additional £1 million of levy to be invoiced to fee payers in 2017/18; in respect of under-collection of fees due to some significant changes in tariff data submitted within the fee year (2016: £5 million levy in excess of expenditure to be refunded to fee payers);
- ring-fencing implementation fee income of £7 million (2016: £3 million);
- Solvency II income of £2 million (2016: £9 million) representing the Solvency II Special Project Fees;
- special project fee income of less than £1 million predominantly relating to firm restructuring activity;
- other income of less than £1 million (2016: £1 million) which is made up of other smaller special project fees, interest on deposits and authorisation fees; and
- financial enforcement fee income of £1 million (2016: £1 million).

Balance sheet

Following the enactment of the Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision), agreement with HM Treasury was reached to extend the PRA accounting period by one day, and the assets and liabilities of the PRA transferred to the Bank of England on 1 March 2017, at book value.

Total assets at 1 March 2017 were £1 (2016: £71 million). Assets comprise a deposit at the Bank of England.

The assets transferring to the Bank included cash of £48 million (2016: £21 million), receivables from fee payers of £2 million (2016: £30 million), and intangible assets of £9 million (2016: £16 million).

Liabilities include enforcement fines collected in the year of £1 million (2016: £1 million), which is payable to fee payers and £27 million (2016: £nil) payable to HM Treasury. Fees received in advance of £0.4 million (2016: £5 million) in relation to the 2017/18 AFR and less than £1 million (2016: £nil) in relation to Ring-fencing Implementation Fee levies. An amount of £37 million (2016: £56 million) was due to the Bank, of which £15 million (2016: £30 million) relates to transition costs and £22 million (2016: £26 million) to corporate services recharges, which settled on transfer.

By order of the Board

Mr M Carney
Chair
26 June 2017

¹ Excludes the element of the AFR which recovers transition costs, as these were incurred in previous periods.

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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 1 March 2017 under the Financial Services and Markets Act 2000. The financial statements comprise the Statement of Comprehensive Income, Statement of Changes in Equity, Statement of Financial Position, Statement of Cash Flows 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 Directors' Report that is described as having been audited.

Respective responsibilities of the directors and the auditor

As explained more fully in the Statement of Directors' Responsibilities in respect of the Directors' Report and the financial statements, 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 of 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 Company's affairs as at 1 March 2017 and of its result for the period then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by 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.

Emphasis of Matter

Without qualifying my opinion, I draw attention to the disclosures made in Note 1 to the financial statements concerning the management's decision to apply a basis other than going concern in the preparation of the financial statements. This was made following the enactment of the Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision) Regulations 2017 on 1 March 2017, at which point the prudential regulatory activities of the company, along with its assets and liabilities, transferred to the Bank of England.

Opinion on other matters

In my opinion:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and these reports have been prepared in accordance with the applicable legal requirements; and
- in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic Report or the Directors' Report.

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 Directors' 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 further observations to make on these financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General

28 June 2017

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



Statement of comprehensive income

for the period 1 March 2016 to 1 March 2017

	Note	1 March 2017 £000	29 February 2016 £000
Income			
Fee income	4	242,619	237,583
Enforcement fine income	7	972	1,336
Income on bank deposits		315	386
Other income	5	10,573	13,911
Total income		254,479	253,216
Expenses			
Administrative expenses	6	(254,416)	(253,138)
Total expenses		(254,416)	(253,138)
Surplus before taxation		63	78
Taxation	10	(63)	(78)
Surplus after taxation		-	-

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The notes on pages 73 to 85 are an integral part of these financial statements.

Statement of changes in equity for the year to 1 March 2017

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

The notes on pages 73 to 85 are an integral part of these financial statements.

Statement of financial position as at 1 March 2017

	Note	1 March 2017 £000	29 February 2016 £000
Assets			
Current assets			
Cash and cash equivalents	11	–	21,359
Trade and other receivables	12	–	34,080
Intangibles	13	–	15,872
Total current assets		–	71,311
Total assets		–	71,311
Liabilities			
Current liabilities			
Trade and other payables	14	–	71,311
Total liabilities		–	71,311
Equity	15	–	–
Total liabilities and equity		–	71,311

On 1 March 2017, the prudential regulatory activities of the PRA, along with its assets and liabilities transferred to the Bank of England. The statement of financial position immediately before transfer is included in the notes to the financial statements.

Mr M Carney Chair

Sir Jon Cunliffe Director

Company Number: 07854923

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

The notes on pages 73 to 85 are an integral part of these financial statements.



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Statement of cash flows

for the year to 1 March 2017

	Note	1 March 2017 £000	29 February 2016 £000
Surplus for the year from operations		–	–
Adjustments for:			
Interest received on bank deposits		(315)	(386)
Amortisation of other intangible assets	13	5,501	4,550
Impairment loss on intangible assets	13	1,865	294
Decrease/(increase) in receivables	12	17,538	11,112
(Decrease)/Increase in payables	14	2,171	(12,451)
Net cash from operating activities		26,760	3,119
Investing activities			
Interest received on bank deposits		315	386
Expenditure on software development	13	(644)	(4,777)
Cash transferred to Bank of England		(47,790)	–
Net cash used in investing activities		(48,119)	(4,391)
Net increase/(decrease) in cash and cash equivalents		(21,359)	(1,272)
Cash and cash equivalents at 1 March 2016	11	21,359	22,631
Cash and cash equivalents at 1 March 2017	11	–	21,359

The notes on pages 73 to 85 are an integral part of these financial statements.



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 statement of financial position, the statement of cash flows, statement of changes in equity and related notes.

The Prudential Regulatory Authority's (PRA) financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards and interpretations of the International Financial Reporting Interpretations Committee as adopted by the EU (together, 'adopted IFRS').

The Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision) Regulations 2016 came into force on 1 March 2017, at which point the prudential regulatory activities of the company, along with its assets and liabilities, transferred to the Bank of England. Following agreement with HM Treasury, the reporting period was extended by one day to 1 March 2017, in order that the financial statements could be prepared after the transfer took place. The financial statements have therefore been prepared on a wind-up basis because the Directors have assessed that the company is no longer a going concern.

The assets and liabilities prior to transfer to the Bank of England is set out below.

	Note	£000
Assets		
Current assets		
Cash and cash equivalents	11	47,790
Trade and other receivables	12	16,542
Intangibles	13	9,150
Total assets		73,482
Liabilities		
Current liabilities		
Trade and other payables	14	73,482
Total liabilities		73,482
Equity		–
Total liabilities and equity		73,482

The assets and liabilities transferred at the carrying value at the point of transfer. This is deemed appropriate as the regulatory activity of the PRA continues within the Bank, and as such it inherits the assets and liabilities to perform these functions.

2 Accounting policies

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.

a Functional and presentational currency

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

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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; as the PRA is no longer active none of these are expected to materially impact the PRA.

c 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 valued at the lower of cost and net realisable value.

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.

d Financial assets

Financial assets are receivables from counterparties. They are recognised initially at fair value, which is deemed to be not materially different to amortised cost due to the low value and short maturity. Fair value is therefore used at the reporting date. Appropriate allowances for estimated irrecoverable amounts are recognised in the statement of comprehensive income when there is objective evidence that the asset is impaired. The amount of loss is measured as the difference between the asset's carrying value and the present value of the estimated future cash flows.

e 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 years ending 28 February 2013 and 28 February 2014, and recognised in those years. The Board agreed to recover the costs from fee-payers over a five year period commencing 2013. An amount receivable from fee-payers, and a corresponding amount payable to the Bank of England, were recognised on the balance sheet at 28 February 2017. Following the enactment of the Bank of England Act 2016, these amounts were settled on transfer of the assets and liabilities of the PRA to the Bank of England on 1 March 2017.

f Financial liabilities

Financial liabilities are recognised initially at fair value, which is deemed to be not materially different to amortised cost due to the low value and short maturity. Fair value is therefore used at the reporting date.

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 recognised net of any surplus against expenditure, 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 return any surplus or claim any deficit in the following financial year.

Special project fees

Special project fee income is recognised to the value of relevant expenditure.

Ring-fencing special project fees

Ring-fencing special project fees are collected from fee payers in anticipation of the total spending requirements in the year. Income is recognised through the income statement against cost incurred. Any surplus or deficit is returned or recovered in subsequent financial years.

Solvency II special project fees

Fees collected which relate to capital and not revenue expenditure are deferred to the balance sheet and recognised as income in subsequent periods. This is applicable to both tangible assets which are held on the Bank of England balance sheet, and intangible assets held on the PRA balance sheet.

Enforcement fine income

Enforcement fines are recognised as revenue where they have been levied and received 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, this is returned to fee payers (excluding those fined) in the following financial year. 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.

Sundry income

Sundry income comprises fees for firms and individuals applying to become authorised on PRA regulated activities, and are recognised as incurred. It also includes late payment charges and other miscellaneous items.

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 subsequent financial 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.

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l Taxation

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

m Retirement benefit costs

The PRA is a participating employer in the Bank of England pension fund, of which all staff are members unless they have opted-out. Within the recharge of staff costs from the Bank of England is a charge for pension costs, to the fund for each individual at a rate equivalent to the service cost. No allowance is made for any interest income or expense on the net pension asset/liability held by the Bank.

Further details of the Bank of England pension fund are reported in the Bank of England *Annual Report and Accounts*.

n Property costs

Office space is provided to the PRA by the Bank of England. Floor space recharges are based on occupancy and building management charges and are transferred to the PRA by the Bank of England.

o Cost recoveries

Costs in relation to section 166, of FSMA, reports are fully recovered directly from the specific entities under review. The recovery of these costs is matched directly to the costs incurred in the income statement within expenditure.

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

Ahead of the enactment of the Bank of England Act 2016, staff working in the PRA were employed by the Bank of England and the PRA recharged these costs monthly. In substance this arrangement reflects that employees were PRA staff members, and as such full staff cost and number disclosures have been made.

c Levy 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 return any such surplus or deficit to fee payers in the subsequent financial year, and therefore management have determined that these amounts should be recognised on the balance sheet and not through reserves.

d Deferred income — capital

Special project fees collected in respect of capital expenditure are recognised as deferred income on the balance sheet, and have been transferred to the Bank of England. Income is subsequently recognised in the income statement as the assets are depreciated or amortised.

Where assets linked to special projects are tangible, they are held on the Bank of England balance sheet. Management have determined it appropriate to hold this deferred income and recognise revenue as the PRA is charged for the use of these assets through the corporate services fee.



4 Fee income

	1 March 2017 £000	29 February 2016 £000
Fee income	242,619	237,583
Total	242,619	237,583

5 Other income

	1 March 2017 £000	29 February 2016 £000
Solvency II income	2,206	8,659
Ring-fencing income	7,469	–
Special project fee income	559	4,604
Other sundry income	339	648
Total	10,573	13,911

Solvency II income is recognised to the extent of costs incurred during the year on Solvency II activity.

Ring-fencing income is recognised to match expenditure incurred on activity that has been designated as being related to the ring-fencing implementation project, for which fees are raised separately.

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

Other sundry income includes authorisation fees paid by firms and individuals, which is recognised in the income statement as incurred.

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6 Administrative expenses

	Note	21 March 2017 £000	29 February 2016 £000
Staff costs	8	135,237	128,287
Corporate services fee		98,031	95,554
Property costs		–	18
Professional and membership fees		10,397	20,462
Impairment of assets		1,865	312
Information technology costs		–	219
Amortisation of intangible assets		5,501	4,536
Travel and accommodation		2,330	2,083
Other administration and general expenses		3,154	2,778
Cost recoveries		(2,099)	(1,111)
Total		254,416	253,138

Included within administrative expenses is a Corporate Services fee charged by the Bank of England for provision of IT, Finance, Property and Procurement and Human Resource services. This fee totalled £98.5m, (2016; £97.0m) for the year of which £0.5m (2016: £1.4m), relating to software development which was capitalised.

The components of the corporate services fee are disclosed in the table below;

	1 March 2017 £000	29 February 2016 £000
Staff costs	56,932	49,551
Depreciation	5,513	4,718
Administration expenditure	3,932	3,782
Information technology costs	13,934	13,518
Professional fees	7,620	13,402
Property costs	10,100	10,583
Total	98,031	95,554



7 Enforcement fine income

	Note	1 March 2017 £000	29 February 2016 £000
Fines raised in the year		28,160	4,429
Fine receivables brought forward		230	–
Financial penalties due to HMT	14	(27,360)	–
Fine receipts due in future years	14	(58)	(230)
Fines written off/down in the year		–	(2,863)
Fine income recognised		972	1,336

8 Staff costs

	1 March 2017 £000	29 February 2016 £000
Wages and salaries	102,930	96,330
Social security costs	12,887	11,299
Pension and other post-retirement costs	19,420	20,716
Seconded staff recoveries	–	(58)
Total	135,237	128,287

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. Staff costs exclude contingent workers costs which are recognised in Administrative expenses.

Contributions to the Bank of England pension fund are made based on the cost of provision of the pension benefit to employees. The contribution made in the year to the point of transfer was £18.6m (2016: £20.3m, £0.5m FSA defined contribution scheme), the current year representing the full charge for all employees on the same terms and conditions, following the 'One Bank' realignment. Full details regarding the Bank of England pension fund can be found in the Bank of England *Annual Report and Accounts*.

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Average staff numbers

The average number of persons employed by the PRA during the year was made up as follows:

	1 March 2017	29 February 2016
Chief Executive and other members of the Executive Committee	23	23
Managers and Analysts	1,115	1,019
Other staff	178	172
Total	1,316	1,214

The number of staff employed by the Bank and working for the PRA (excluding contingent workers) at 1 March 2017 was 1,363, of which 1,193 were full-time staff and 170 were part-time.

Directors' emoluments

The Directors' remuneration is disclosed in the Directors' Report and in the Remuneration Report.

9 Audit fees

	1 March 2017 £000	29 February 2016 £000
Audit fees for the PRA's audit		
Fees relating to current year	80	90
Total	80	90

No non-audit work was undertaken by the auditor.

10 Taxation

	1 March 2017 £000	29 February 2016 £000
Tax charge on investment income	63	78
Total tax charge on investment income	63	78

	1 March 2017 £000	29 February 2016 £000
Interest on cash deposits	315	386
Tax calculated at rate of 20.08% (2016: 20.08%)	63	78
Total tax charge for the period	63	78

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



11 Cash and cash equivalents

	1 March 2017 £000	29 February 2016 £000
Cash balance held at the Bank of England	–	21,359
Total	–	21,359

Following the enactment of The Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision) on 1 March 2017, a cash balance of £47.8m was transferred to the Bank of England.

12 Current trade and other receivables

	1 March 2017 £000	29 February 2016 £000
Fees receivable	–	4,625
Transition costs recoverable from fee payers	–	29,455
Total	–	34,080

Following the enactment of The Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision) on 1 March 2017, the following balances were transferred to the Bank of England:

	£000
Fees receivable	1,861
Transition costs recoverable from fee payers	14,681
Total	16,542

Transition costs are being recovered from fee payers over a five-year period commencing 2013.

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13 Intangible assets

	Intangibles £000	Intangibles work in progress £000	Total £000
Cost			
At 1 March 2016	26,446	–	26,446
Additions	421	223	644
Impairments	(3,734)	–	(3,734)
Transferred to Bank of England	(23,133)	(223)	(23,356)
At 1 March 2017	–	–	–
Accumulated amortisation			
At 1 March 2016	10,574	–	10,574
Charge for the year	5,501	–	5,501
Impairments	(1,869)	–	(1,869)
Transferred to Bank of England	(14,206)	–	(14,206)
At 1 March 2017	–	–	–
Net book value at 1 March 2016	15,872	–	15,872
At 1 March 2017	–	–	–

	Intangibles £000	Intangibles work in progress £000	Total £000
Cost			
At 1 March 2015	18,777	3,204	21,981
Transfers from WIP	3,204	(3,204)	–
Additions	4,777	–	4,777
Impairments	(312)	–	(312)
At 29 February 2016	26,446	–	26,446
Accumulated amortisation			
At 1 March 2015	6,042	–	6,042
Charge for the year	4,550	–	4,550
Impairments	(18)	–	(18)
At 29 February 2016	10,574	–	10,574
Net book value at 1 March 2015	12,735	3,204	15,939
At 29 February 2016	15,872	–	15,872



Intangible assets comprise software development to enable the PRA to fulfil its regulatory duties. Following the enactment of The Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision) on 1 March 2017, a balance of £9,150k was transferred to the Bank of England.

There were no additions of intangible assets purchased but not paid for at the balance sheet date (2016: £nil).

14 Current trade and other payables

	1 March 2017 £000	29 February 2016 £000
Fees received in advance	–	4,788
Fees received in advance — Solvency II	–	44
Deferred income — Solvency II	–	9,626
Financial penalties due	7	230
Financial penalties received — payable to fee payers	7	1,336
Amounts due to the Bank of England — transition costs	–	29,516
Amounts due to the Bank of England — management recharge	–	25,730
Other payables	–	41
Total	–	71,311

Following the enactment of The Bank of England and Financial Services Act 2016 (Commencement No. 4 and Saving Provision) on 1 March 2017, the following balances were transferred to the Bank of England:

	£000
Fees received in advance	364
Fees received in advance — ringfencing	418
Solvency II deferred income	7,332
Financial penalties due	58
Financial penalties due — payable to HM Treasury	27,360
Financial penalties due — payable to fee payers	972
Total	36,504

Amounts due to the Bank of England comprise transition cost recoveries payable within one year and recharged expenditure, staff costs and the corporate services fee. On the 1 March 2017 these balances, totalling £37.0m, were settled on transfer against the receivables held by the Bank of England.

Fees received in advance comprise fees collected in relation to the annual funding requirement and Ring-fencing, in excess of related expenditure.

In accordance with the PRA Financial Penalty Scheme, financial penalty monies received are payable to HM Treasury where they are in excess of costs incurred during the year, with the remainder due to fee payers.

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15 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.

16 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 PRA faces arises when the PRA invoices counterparties from the financial services industry for the collection of regulatory fees.

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 outstanding amounts at the year-end almost negligible.

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 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.

17 Losses and Special payments

There were no reportable losses or special payments in the year.

18 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 Corporate Services Fee on a monthly basis, during the period these fees totalled £98.5m (2016: £97.0m).

All PRA staff are employed by the Bank of England. During the period staff cost recoveries of £135.2m (2016: £128.3m) were charged by the Bank to the PRA. Included in the staff cost recoveries are PRA contributions to the Bank of England pension fund of £18.6m (2016: £20.3m) on behalf of employees.

The Bank of England meets the cost of direct expenditure for the PRA and recharges the cost. In 2016 this totalled £28.0m (2016: £27.5m).

As at 28 February 2017 £14.7m (2016: £29.5m) of transition costs were due to the Bank of England. A further £22.3m (2016: £25.7m) was due to the Bank of England in respect of the management fee and other recharged costs. Following the enactment of the Bank of England and Financial Services Act 2016 on 1 March 2017, these amounts were settled on transfer of the assets and liabilities of the PRA to the Bank of England.

HM Treasury

As part of the HM Treasury group the PRA is a related party to Royal Bank of Scotland, Lloyds Banking Group and the Financial Conduct Authority. 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 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 £90,000 (2016: £90,000) 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 £7.5m (2016: £7.5m). The PRA had no amounts payable to the FCA (2015: £nil) at the balance sheet date.



Key management

The Directors of the PRA are considered to be the only key personnel as defined by IAS 24. The Directors' remuneration is disclosed in the Directors' Report and in the Bank of England's *Annual Report*.

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

19 Ultimate parent company

The ultimate parent company of the PRA is HM Treasury.

20 Events after the balance sheet date

There were no events that had a material effect on the accounts after the reporting date.

21 Preparation of accounts

The accounts were approved for distribution on 28 June 2017.

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Company Number: 07854923

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BAME	Black, Asian and Minority Ethnic individuals	IAIG	International Active Insurance Groups
Bank	Bank of England	IAIS	International Association of Insurance Supervisors
BCBS	Basel Committee on Banking Supervision	ICS	Insurance Capital Standard
BRRD	Bank Recovery and Resolution Directive	IEO	Bank's Independent Evaluation Office
CEO	Chief Executive Officer	IFRS 9	International Financial Reporting Standard 9
Court	Bank's Court of Directors	IMF	International Monetary Fund
CP	Consultation Paper	IRB	Internal ratings based
CRD	Capital Requirements Directive	LCR	Liquidity Coverage Requirement
CRD IV	CRR and CRD collectively	LTI	Loan to income
CRR	Capital Requirements Regulation	LTV	Loan to value
EBA	European Banking Authority	MPC	Monetary Policy Committee
ECB	European Central Bank	MoU	Memorandum of understanding
EEA	European Economic Area	MREL	Minimum requirement for own funds and eligible liabilities
EIOPA	European Insurance and Occupational Pensions Authority	NED	Non-executive Director
ESRB	European Systemic Risk Board	PRA	Prudential Regulation Authority
EU	European Union	PRC	Prudential Regulation Committee
FCA	Financial Conduct Authority	SIMR	Senior Insurance Managers Regime
FPC	Financial Policy Committee	SMR	Senior Managers Regime
FSAP	Financial Sector Assessment Program	SM&CR	Senior Managers and Certification Regime
FSB	Financial Stability Board		
FSCS	Financial Services Compensation Scheme		
FSMA	Financial Services and Markets Act 2000 (as amended)		
G-SIB	Global systemically important bank		



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	2	<i>PRA Annual Competition Report 2017</i>
22	1	The Bank of England's approach to stress testing the UK banking system
23	1	EIOPA Stress Test 2016
	2	Policy Statement 30/16 'The minimum requirement for own funds and eligible liabilities (MREL) — buffers and Threshold Conditions'
	3	Policy Statement 21/16 'Ensuring operational continuity in resolution'
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	5	United Kingdom: Financial Sector Assessment Program-Insurance Sector-Technical Note
24	1	Developing effective resolution strategies and plans for systemically important insurers
	2	Discussion paper on potential harmonisation of recovery and resolution frameworks for insurers
	3	Supervisory Statement 10/14 'Supervising international banks: the PRA's approach to branch supervision'
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	5	Supervisory Statement 15/16 'Solvency II: Monitoring model drift and standard formula SCR reporting for firms with an approved internal model'
	6	Supervisory Statement 25/15 update 'Solvency II: regulatory reporting, internal model outputs'
	7	Supervisory Statement 17/16 'Solvency II: internal models — assessment, model change and the role of non-executive directors'
25	1	Policy Statement 24/16 'Solvency II: external audit of the public disclosure requirement'
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	8	<i>Financial Stability Report, July 2016</i>
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43	1	Consultation Paper 7/17 'Solvency II: Data collection of market risk sensitivities'
	3	See also 'Insurance supervision at the PRA', a speech given by Sam Woods, Deputy Governor of Prudential Regulation and PRA CEO, on 20 March 2017 at the London Business School
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BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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