



BANK OF ENGLAND



# Designation of investment firms for prudential supervision by the PRA: consultation on a draft policy statement

October 2012



## Introduction

This paper is being issued by the Bank of England (the Bank) and the Financial Services Authority (FSA) in advance of legal cutover — the point at which the Prudential Regulation Authority (PRA) assumes its responsibilities for prudential regulation — to provide greater clarity on which firms (in addition to deposit-takers and insurers) will be regulated by the PRA.

This paper is being issued for public consultation. Comments are invited and should be sent by 4 January 2013 to:

[DesignationofInvestmentFirmsCP@bankofengland.co.uk](mailto:DesignationofInvestmentFirmsCP@bankofengland.co.uk) or  
[DesignationofInvestmentFirmsCP@fsa.gov.uk](mailto:DesignationofInvestmentFirmsCP@fsa.gov.uk).

## Overview of the statutory framework

1. The Financial Services Bill (clause 8) adds a new section 22A to the Financial Services and Markets Act 2000 (FSMA), providing that HM Treasury may, by order, specify which regulated activities are 'PRA-regulated activities'. In October 2012, HM Treasury published a draft of the Financial Services and Markets Act 2000 (PRA-Regulated Activities) Order 201\* (the PRA-Regulated Activities Order) for consultation.<sup>(1)</sup>

2. The draft Order provides that the regulated activity of 'accepting deposits' and certain insurance-related regulated activities<sup>(2)</sup> are PRA-regulated activities. Any firm holding a permission to carry out one of these regulated activities will be automatically subject to prudential supervision by the PRA.

3. The draft Order gives the PRA the power to designate certain investment firms (that is, certain firms with permission to 'deal in investments as principal') for prudential supervision by the PRA. The legal context is set out further in the draft statement of policy in Annex 1.

4. The draft Order requires the PRA to keep designations under review and makes provision for withdrawing designation from investment firms. It also makes provision as to the procedure to be followed on designation (and withdrawal of designation). Appeals from such decisions will go to the Upper Tribunal.

## Draft PRA statement of policy

5. The draft Order requires the PRA to issue a statement of policy on designation. A draft statement of policy is included as Annex 1 to this paper, setting out the current views of the Bank and the FSA on how the PRA will approach designation of investment firms.<sup>(3)</sup> The draft policy statement sets out proposed factors to which the PRA will have regard when deciding whether to designate an investment firm and explains

the rationale for these factors. The statement also sets out the procedural arrangements for making these decisions, including how it will communicate these to firms in line with the requirements of the draft Order.

6. The procedural arrangements set out in the main body of the draft statement of policy would take effect following legal cutover. As noted in the draft statement of policy, procedural arrangements for the designation decisions that will take effect at legal cutover need to differ from the procedural arrangements the Bank and the FSA are consulting on in this paper. The FSA expects to engage with relevant firms in the period before legal cutover to discuss these procedural matters in more detail. The FSA has sought to ensure that the firms that it considers are most likely to be designated by the PRA are supervised by the Prudential Business Unit within the FSA, under the internal 'twin peaks' model. The PRA will, however, make the formal designation decision.

## Request for comments

7. The Bank and the FSA would welcome any general comments on the proposals, both the criteria for designation and the proposed procedural arrangements. The Bank and the FSA are particularly interested to hear any comments in relation to the communication of designation decisions and the proposed three-month period during which a firm would prepare for a change in its regulator as a result of a designation decision. The Bank and the FSA may make responses for formal consultation publicly available unless the respondent requests otherwise.<sup>(4)</sup>

---

(1) See s22A order:

[www.hm-treasury.gov.uk/consult\\_fin\\_regulation\\_draft\\_secondary\\_leg.htm](http://www.hm-treasury.gov.uk/consult_fin_regulation_draft_secondary_leg.htm).

(2) The activity of effecting a contract of insurance as principal; the activity of carrying out a contract of insurance as principal; the activity of managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's; the activity of arranging, by the society incorporated by the Lloyd's Act 1871 by the name of Lloyd's, of deals in contracts of insurance written at Lloyd's or any other regulated activity carried on by that society in connection with, or for the purposes of, that activity.

(3) The material set out in this draft policy statement builds on the paper published by the Bank of England and the FSA in May 2012.

See: [www.fsa.gov.uk/static/pubs/other/designation.pdf](http://www.fsa.gov.uk/static/pubs/other/designation.pdf).

(4) A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. A confidential response may be requested from the Bank and the FSA under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

## Annex 1: Draft statement of policy

1. This statement of policy is issued under article 8 of the Financial Services and Markets Act 2000 (PRA-Regulated Activities) Order 201\* (the PRA-Regulated Activities Order).<sup>(1)</sup>

### Legal context

2. Under the PRA-Regulated Activities Order, the PRA is able to designate certain persons for prudential supervision by the PRA. Before the PRA may do so, the conditions set out in article 3(2) and (3) of the PRA-Regulated Activities Order must be satisfied. These are, broadly speaking, that the person:

- (a) has, or has applied for, permission to deal in investments as principal; and
- (b) has, or would have if it were authorised, a minimum capital of EUR 730,000, or is a broadly analogous European Economic Area (EEA) passporting firm or non-EEA firm.

In this statement of policy, a person meeting the conditions in article 3(2) and (3) is referred to as an 'Eligible Investment Firm'.

3. Provided these conditions are met, the PRA may designate an Eligible Investment Firm if the PRA 'considers that it is desirable that the activity of dealing in investments as principal, when carried on by [the Eligible Investment Firm], should be a PRA-regulated activity' (article 3(1)(c)). In taking designation decisions the PRA is to have regard to its statutory objectives and the matters set out in article 3(4) of the PRA-Regulated Activities Order, which are:

- (a) the assets of the Eligible Investment Firm; and
- (b) where the Eligible Investment Firm is a member of a group:
  - i. the assets of other Eligible Investment Firms within the group;
  - ii. whether any other members of the Eligible Investment Firm's group have been designated; and
  - iii. whether the Eligible Investment Firm's activities have, or might have, a material impact on the ability of the PRA to advance any of its objectives in relation to PRA-authorised persons in its group.

4. The PRA-Regulated Activities Order also:

- (a) requires the PRA to keep under review all designations (article 5); and
- (b) provides for the PRA to withdraw a designation if the PRA considers it 'appropriate to do so' (article 6).

5. In taking designation decisions the PRA-Regulated Activities Order requires the PRA to have regard to the factors set out in paragraph 3. It also requires the PRA to have regard to this statement of policy in taking decisions to designate or withdraw designation or in reviewing designations. But these factors are not exhaustive. The PRA may also have regard to other considerations in deciding whether it is desirable for an Eligible Investment Firm to be designated or appropriate for a designation to be withdrawn.

6. In principle, HM Treasury may add other PRA-regulated activities to the PRA-Regulated Activities Order or make other changes to it in due course.

### Designation policy

7. The PRA will have regard to each of the following factors in determining whether an Eligible Investment Firm should be designated:

- whether the firm's balance sheet exceeds an average of £15 billion total gross assets over four quarters, as reported on regulatory returns; and/or
- whether the sum of the balance sheets of all Eligible Investment Firms in a group exceeds an average of £15 billion total gross assets over four quarters; and/or
- where the firm is part of a PRA group, whether the firm's revenues, balance sheet and risk-taking is significant relative to the group's revenues, balance sheet and risk-taking.

8. The first factor — that a firm is designated where it has **total gross assets over four quarters averaging more than £15 billion** — relates to the assets consideration in the PRA-Regulated Activities Order. While an individual firm's impact on the financial system is not only a function of its size, but also the complexity of its operations, the substitutability of the services it provides and its connectedness with the rest of the system, the use of a size threshold provides an objective reference point to indicate which firms are likely to be systemically relevant in this context. This does not mean that all firms above this threshold will be systemically relevant, nor that any firm below the threshold cannot be systemically relevant; it is simply indicative as to likely systemic relevance in this context.

9. Analysing the size of a firm's balance sheet over four quarters prevents any large temporary movements in the balance sheet from distorting the view of a firm's likely

---

<sup>(1)</sup> As noted previously, HM Treasury are consulting on the draft PRA-Regulated Activities Order.

importance. In addition to looking at balance sheet size, the PRA will also consider a firm's business model and booking practices to ensure that assets booked to the firm do not give a distorted view of the firm's business and risk profile. Other assessments of asset values beyond those regularly submitted on a firm's regulatory returns (both end-of-day and intraday) may also be considered in order to identify whether a firm's assets, as disclosed in regulatory returns, provide an accurate representation of its risk-taking.

10. The second factor — **that the sum of the total gross assets of all investment firms in a group potentially subject to designation averages more than £15 billion over four quarters** — relates to the requirement in the PRA-Regulated Activities Order to take into account, where the firm is a member of a group, the assets of the group members. This ensures that groups do not structure themselves in such a way as to avoid designation of a firm by spreading business across several investment firms within the same group which individually fall below the total assets threshold.

11. The third factor — **that the PRA analyses whether the share of a firm's revenues, balance sheet and risk-taking is significant relative to the group's revenues, balance sheet and risk-taking** — relates to the provision in the PRA-Regulated Activities Order to have regard to the impact of an investment firm on any PRA-authorised person within the group. In some cases, an Eligible Investment Firm may pose risks to other PRA-authorised persons within the group even where the investment firm does not meet the total assets threshold. A firm's 'significance' to the rest of a group would be determined, amongst other things, through supervisory judgement gained through knowledge of the group and dialogue with the Financial Conduct Authority (FCA). The PRA would typically consider the materiality of a legal entity to its group with reference to its share of the group's revenues, balance sheet or risk-taking. Given that group structures vary significantly, the materiality of an individual entity requires specific knowledge of the group in question and will be a matter of judgement for the PRA.

## Withdrawal of designation

12. In determining whether it is appropriate to withdraw a designation, the PRA will have regard to the same factors as it does when deciding to designate an Eligible Investment Firm. The PRA would not normally be minded to withdraw a designation, however, unless the firm had been subject to prudential supervision by the PRA for at least one year after designation (except where there is a de-merger or a sale). This is also designed to guard against 'volatility in designation', where a firm switches between prudential supervisors on a frequent basis.

## Periodic review of firms subject to designation

13. The PRA-Regulated Activities Order requires the PRA to keep all designations under review. In establishing the arrangements to review designations, it will be important to guard against volatility in designation. That is why the value of total assets is averaged over four quarters.

14. PRA staff will review the eligible population of firms against the designation criteria on a periodic basis to consider whether any additional firms should be designated, or their designation withdrawn. A summary of this analysis, plus any designation recommendations, will be put to the appropriate decision-making body of the PRA.

## Procedural arrangements for designation decisions

15. The PRA-Regulated Activities Order requires the PRA to give firms notice of its intention to designate a firm and also confers rights on firms to make representations to the PRA and to refer designation decisions to the Upper Tribunal.

16. If the PRA decides to designate an investment firm, it will issue the firm with a notice stating the reasons for designation. The PRA will normally give the firm 28 days to make representations. The notice will also make clear the firm's right to refer matters to the Upper Tribunal. The notice will state the date that the designation decision would take effect which will usually be three months from the date of the notice being issued. The PRA-Regulated Activities Order does provide for designation decisions to take immediate effect, in appropriate circumstances, but this will not normally be the case.

17. Where the PRA decides that a firm should no longer be designated, article 6 requires the PRA to follow the procedure for warning notices and decision notices. Should designation be withdrawn, the prudential supervision of the firm would pass to the FCA.

## Designation decisions taking effect from legal cutover

18. The procedural arrangements will be modified for the first designation decisions which will take effect at legal cutover (the point at which the PRA assumes its responsibilities for prudential regulation). The PRA will still give firms the opportunity to make representations on proposed designation decisions; this is, however, likely to be subject to an accelerated timetable. In practice, firms will be well aware of their likely regulator as the FSA will discuss designation arrangements with relevant firms.