

Bank of England PRA

Appendices to CP20/23 – Ring-fenced bodies: managing risks from third-country subsidiaries and branches

Consultation paper | CP20/23

September 2023

Draft for consultation



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Draft for consultation

1: Draft amendments to PRA Rulebook

Draft new rule instrument, to amend the PRA Rulebook: Ring-fenced bodies

PRA RULEBOOK: CRR FIRMS AND NON-AUTHORISED PERSONS: RING-FENCED BODIES INSTRUMENT 2023

Powers exercised

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules);
 - (2) section 137T (General supplementary powers);
 - (3) section 192JA (Rules applying to parent undertakings of ring-fenced bodies); and
 - (4) section 142H (Ring-fencing rules).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

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

PRA Rulebook: CRR Firms and Non-Authorised Persons: Ring-fenced Bodies Instrument 2023

- D. The PRA makes the rules in the Annex to this instrument.

Commencement

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

Citation

- F. This instrument may be cited as the PRA Rulebook: CRR Firms and Non-Authorised Persons: Ring-fenced Bodies Instrument 2023.

By order of the Prudential Regulation Committee

[DATE]

Annex

Amendments to the Ring-fenced Bodies Part

In this Annex new text is underlined and deleted text is struck through.

Part

Ring-fenced Bodies

Chapter content

1. APPLICATION AND DEFINITIONS
2. APPLICATION OF RULES WITHIN A SUB-CONSOLIDATION GROUP
3. GENERAL RULES
4. BOARD COMPOSITION AND MEMBERSHIP
5. RISK MANAGEMENT
6. INTERNAL AUDIT POLICY
7. HUMAN RESOURCES POLICY
8. REMUNERATION POLICY
9. CONTINUITY OF PROVISION OF SERVICES
10. INTRAGROUP CREDIT VALUATION ADJUSTMENT RISK
11. DISTRIBUTIONS
12. ARM'S LENGTH TRANSACTIONS
13. INCOME DEPENDENCE
14. NETTING ARRANGEMENTS
15. AVAILABILITY OF SHARED COLLATERAL
16. ACCESS TO CENTRAL COUNTERPARTIES AND CENTRAL SECURITIES DEPOSITORIES
17. POLICIES REGARDING USE OF EXCEPTIONS TO EXCLUDED ACTIVITIES AND PROHIBITIONS
18. APPLICATION OF CERTAIN PRA RULES TO RING-FENCED BODIES ON A SUBCONSOLIDATED BASIS
19. APPLICATION FOR PERMISSION FOR INDIRECT ACCESS TO INTER-BANK PAYMENT SYSTEMS
20. THIRD COUNTRY BRANCHES AND SUBSIDIARIES

...

2 APPLICATION OF RULES WITHIN A SUB-CONSOLIDATION GROUP

2.1 In this Chapter, “relevant rule” refers to each of the rules in:

- (1) 3.5;
- (2) 9.1; and
- (3) 11, 12, 13, 14, 15, ~~and 16~~ and 20.

...

20 THIRD COUNTRY BRANCHES AND SUBSIDIARIES

A ring-fenced body must ensure that:

- (a) any subsidiary undertaking of the ring-fenced body incorporated or formed under the law of a third country; and
- (b) any branch established or maintained by the ring-fenced body in a third country,

does not present a material risk to the continuity of the provision in the United Kingdom of core services by the ring-fenced body.

PART-SPECIFIC EXTERNALLY DEFINED TERMS

Term	Definition Source
subsidiary undertaking	s.420 FSMA
ring-fenced body	s.417 FSMA
core services	s.417 FSMA

2: Draft amendments to supervisory statement 8/16 – Ring-fenced bodies (RFBs)

In this appendix, new text is underlined and deleted text is struck through.

1 Introduction

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1.2 This statement should be read alongside the PRA Rulebook, the Capital Requirements Regulation (CRR)¹ and ring-fencing legislation set out in the Act and statutory instruments.²

...

2 Legal structure and holdings of capital

...

2.8 The PRA will adopt this approach in a manner it considers to be proportionate to achieve the outcomes set out by the group ring-fencing purposes in the Act. In doing so, the PRA would assess, on a case-by-case basis, the risks that such ownership stakes might pose to the RFB's resilience and resolvability and to the PRA's general safety and soundness objective in relation to ring-fencing. The PRA expects that the owner of an RFB, where it is not a ring-fenced affiliate, may:

- ~~maintain or establish a non-European Economic Area (EEA) branch;~~
- ~~have an ownership interest or hold capital instruments in a non-EEA undertaking;~~
- have an ownership interest or hold capital instruments in an excluded activity entity; or
- have an ownership interest or hold capital instruments in an entity where the holding does not qualify as a participating interest.

...

¹ ~~Regulation (EU) No 575/2013~~ Onshored and amended UK version of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, referred to as the 'CRR' in this SS.

² SI 2014/1960 The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014;
SI 2014/2080 The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014;
and SI 2015/547 The Financial Services and Markets Act 2000 (Banking Reform) (Pensions) Regulations 2015.

3 Establishment of an RFB sub-group and application of requirements on a sub-consolidated basis

...

3.1 This chapter sets out the PRA's approach to requiring an RFB to meet prudential requirements on a sub-consolidated basis, including the circumstances in which it will constitute an RFB sub-group and how it decides the composition of an RFB sub-group. An RFB sub-group is a sub-set of related group entities within a consolidated group, consisting of one or more RFBs and other legal entities, which is established when the PRA gives effect to Article ~~44(5)~~ 11(6) of the CRR.

...

3.3 Article ~~44(5)~~ 11(6) of the CRR permits competent authorities to require firms to comply with prudential requirements on a sub-consolidated basis in certain circumstances, in addition to the application of requirements to firms on an individual and consolidated basis. These circumstances include where the Member State has adopted national laws requiring structural separation of activities within a banking group.

3.4 The PRA expects that, in general, it will exercise the discretion in Article ~~44(5)~~ 11(6) of the CRR to require an RFB to meet prudential requirements on a sub-consolidated basis, in respect of its RFB sub-group. Further detail on the membership of an RFB sub-group and the boundary for sub-consolidation is set out in paragraphs 3.10 to 3.18.

...

3.19 Provision for the application of prudential requirements on a sub-consolidated basis is set out in Article ~~44(5)~~ 11(6) of the CRR. To give effect to Article ~~44(5)~~ 11(6) of the CRR, the PRA constitutes an RFB sub-group, and mandates sub-consolidation, by use of a requirement under section 55M of the Act. The PRA anticipates that the structure and content of RFB sub-groups are likely to vary between different groups and the approach to implementation enables the PRA to adopt a tailored approach to each group based on its circumstances.

...

3.20 There may be circumstances in which it would be inappropriate to apply prudential requirements on a sub-consolidated basis, in which case the PRA would not use Article ~~44(5)~~ 11(6) to constitute an RFB sub-group. For example, if an RFB has no subsidiaries or only has very small subsidiaries whose activities are judged to present immaterial risk to the RFB, then it may be disproportionate to apply prudential requirements on a sub-consolidated basis. Similarly, if the UK banking group has no excluded activity entities, it may not be appropriate to ring-fence a sub-group of entities.

...

3.24 The PRA sets out below its expectations with regard to RFBs and ring-fenced affiliates wishing to establish a subsidiary or branch in a third country.

3.25 Ring-fenced bodies are required by Rule 20 of the Ring-fenced Bodies Part of the PRA Rulebook to ensure that any subsidiary or branch they wish to establish in a third country does not create material risks to the continuity of the RFB's provision of core services in the UK. In this SS, the PRA sets out examples of the factors it will consider when determining whether an overseas branch or subsidiary may pose a material risk and therefore whether the RFB is compliant with Rule 20 of the Ring-Fenced Bodies Part. This is a non-exhaustive set of examples around which the PRA has supervisory expectations; the PRA will consider any activity which may cause non-compliance with Rule 20 on a case-by-case basis.

3.26 Substantial foreign subsidiaries or branches may pose material risks to an RFB. Accordingly, RFBs with non-UK subsidiaries or branches which individually or in aggregate contribute over 5% of the RFB consolidation sub-group's risk-weighted assets (RWAs) are expected to disclose this in their Internal Capital Adequacy Assessment Process (ICAAP). Here, they should also explain the steps taken to assess the materiality of risks posed to the continuity of the provision of core services from the RFB, and how they are mitigated.

3.27 The PRA expects that firms will ensure that any third-country subsidiary does not create a material risk to the RFB through the nature of supervision in the third country. This may include arrangements for resolution. When assessing if a firm is compliant and therefore whether action is needed to limit these activities, the PRA will consider the following factors, among others:

- a. whether the host jurisdiction's prudential supervision regime is sufficiently equivalent to the UK regime; and
- b. whether there is sufficient scope for supervisory cooperation between the PRA and the supervisor of the host state.

3.28 Accordingly, if considering overseas expansion, RFBs are advised to consider the regulatory regime of the country in question, for instance using public information sources on the jurisdiction's prudential standards, such as those published by the Basel Committee on Banking Supervision, including via its Regulatory Consistency Assessment Programme. The PRA expects that RFBs will not establish operations in jurisdictions where the prudential regime is not sufficiently aligned to the UK, or where the nature of relations with the host country makes effective supervisory cooperation between financial authorities unlikely. For cases which appear marginal, firms are advised to engage with the PRA early in the process, and seek views from the PRA.

3.29 This expectation, on the nature of host country supervision, only applies to subsidiaries and not to branches. This is because the PRA would retain oversight of branches through its day-to-day supervision of the RFB.

3.30 The PRA expects that firms that have or are seeking to establish non-UK subsidiaries or branches will identify, assess, and mitigate any issues related to the resolvability of the firm, or the resolution group of which it is a part, that may arise from establishing the subsidiary or branch. The PRA will, in consultation with the Bank of England (the Bank) as the UK resolution authority have regard to the firm's own assessment, and the requirements of Fundamental Rule 8³, to determine whether or not there is a material risk to the continuity of core services in the UK.

9 Use of financial market infrastructures

9.14 Ring-fenced Bodies 16 of the PRA Rulebook imposes a requirement on the manner by which an RFB should access CCPs and CSDs. For CCPs based in the EEA UK, an RFB that is not a direct participant may meet this requirement by using an individually segregated account or an omnibus account where the margin requirement for the account is calculated as the sum of the margin required to cover separately the positions of each client within the omnibus account. For CSDs based in the EEA UK, an RFB that is not a direct participant may meet this requirement by using an individually segregated account. For CCPs and CSDs based outside of the EEA UK, Ring-fenced Bodies 16 requires an RFB to take necessary steps to ensure its positions, if applicable, and assets are separately identifiable from those of other entities by measures that deliver comparable outcomes to those specified for EEA UK-based CCPs and CSDs.

³ Fundamental Rules, Rule 2.8 of the PRA Rulebook: 'a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services'.