



**David Bailey**  
Executive Director

**Rebecca Jackson**  
Director

International Banks Supervision  
Prudential Regulation Authority

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Dear Chief Executive Officer,

### **Prudential Regulation Authority (PRA) International Banks Supervision: 2021 Priorities**

We are writing to update you on our 2021 priorities for international banks active in the UK. These priorities are intended to complement our ongoing supervision and the feedback you will have received following the most recent Periodic Summary Meeting (PSM) for your firm. These priorities are sent to the wide and diverse range of international banks that we supervise and so this list is not exhaustive, but this letter is intended to provide a helpful overview of our priorities for 2021.

Covid-19 and the measures taken to contain it are having a significant and ongoing impact on the UK and around the world. The PRA took a number of actions to help PRA-regulated firms deal with Covid-19 and firms have acted quickly to respond to a new operating environment. Further adjustments may be needed as the pandemic continues, and as such, Covid-19 represents an over-arching issue with implications across the 2021 priorities set out in this letter.

#### **1. Financial resilience**

It is important that the financial sector is resilient so that the banking system can carry on supporting businesses and households through the economic disruption caused by Covid-19. We will continue to monitor our regulatory regime to ensure it does not act in a procyclical way, including ensuring firms can draw down on capital and liquidity buffers where necessary.<sup>1</sup>

Temporary government support schemes and supervisory measures have provided a cushion, but the economic consequences of Covid-19 are expected to continue and will cause additional future impacts on banks. Reflecting this, a focus of our supervisory engagement through 2021 will be to assess how firms are ensuring robust credit risk management practices that are appropriate for the current situation, including in determining provisioning levels, and maintaining an appropriate risk appetite for trading businesses.

We will also remain focussed on the challenges some firms have in establishing or maintaining sustainable business models in the continued low rate environment, with wider global economic headwinds, coupled with adjustment to the post-Brexit world.

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<sup>1</sup> 'Q&A on the usability of liquidity and capital buffers', April 2020:  
<https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda>.

## 2. Operational risk and resilience

Enhancing the operational resilience of the financial sector remains a strategic priority for the PRA. Covid-19 has reinforced its importance. Although firms responded to the pandemic to ensure operations could continue, in some instances they have adjusted risk appetites to accommodate deficiencies in controls as a result of temporary changes to their operating environment. We will continue to challenge how firms are ensuring that risk and control frameworks are operating effectively under the current working environment. This includes the capabilities of the three lines of defence, and the monitoring of material residual risks against risk appetites. Firms should not become complacent in their preparations for other operational disruptions or from the ongoing impact of Covid-19.

Following our policy consultations<sup>2</sup>, we intend to set standards for operational resilience and outsourcing during 2021 and we expect firms to consider the steps they will need to take to meet these standards.<sup>3</sup> We encourage firms to address the lessons learned from the pandemic, and review how these experiences might impact the development of operational resilience as a continuing discipline. As part of our supervisory approach, we will be following up with firms to understand how they will be taking this forward.

## 3. Transition from LIBOR to alternative Risk Free Rates

The continued reliance of global financial markets on LIBOR poses a risk to financial stability that can only be reduced through a transition to alternative risk-free rates. While progress was made in certain areas during 2020, Covid-19 made others areas such as client engagement more challenging. The time available for action is reducing so the PRA will expect to see intensive efforts and early progress in 2021.

We will be monitoring firms' progress against the targets of the Working Group on Sterling Risk Free Reference Rates (RFRWG) and targets for non-GBP exposures where relevant, as we expect all firms to play their part in meeting these milestones.<sup>4</sup> We will also be closely monitoring how firms are managing the risks associated with transition through regular review meetings with a range of firms and by reviewing the data we collect on firms' exposures. We will keep a range of supervisory tools under review for use where we see insufficient progress, or incidents of poor risk management or governance of transition.

## 4. Financial risks arising from climate change

Climate change represents a material financial risk to firms and to the financial system and remains a key PRA priority. It is also an area of increasing focus in the UK, as evidenced in the Chancellor's November 2020 announcement of a roadmap towards mandatory disclosures, through the creation of a joint regulator and government taskforce on climate-related financial disclosures. Minimising the future risks from climate change requires action now.

This increased focus builds on the PRA's 2019 supervisory statement<sup>5</sup> and 2020 letter to CEOs, which set expectations for banks and insurers to enhance their approaches to managing climate-related financial risks and fully embed these by the end of 2021.<sup>6</sup> The use of scenario analysis is key to understanding the risks and the Bank of England has announced that it will be undertaking a system-wide climate scenario exercise

<sup>2</sup> 'Operational Resilience: impact tolerances for important business services', December 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper>.

<sup>3</sup> 'Operational Resilience: impact tolerances for important business services', December 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper>.

<sup>4</sup> 'Transition to sterling risk-free rates from LIBOR': <https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor>.

<sup>5</sup> 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'. April 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss>.

<sup>6</sup> 'Letter from Sam Woods 'Managing climate-related financial risk – thematic feedback from the PRA's review of firms' SS3/19 plans and clarifications of expectations'. July 2020: <https://www.bankofengland.co.uk/prudential-regulation/letter/2020/managing-the-financial-risks-from-climate-change>.

in 2021.<sup>7</sup> Firms should continue to take a proportionate approach that reflects their exposure to climate-related financial risk and the complexity of their operations.

Although our expectations apply to UK-incorporated firms, it is important that branches of international banks also focus on climate change, which we see as a vital element of sound risk management. We will be increasing our engagement with Home State Supervisors on this issue over the coming year.

In addition to the four priorities set out in this letter, we continue to see strong governance at firms as being key to underpinning progress in meeting our expectations, and to view diversity as important for improving decision-making and providing effective challenge. We will continue to make full use of the Senior Managers Regime to support our objectives in 2021.

We are grateful for the efforts made by firms in providing additional data in response to Covid-19, which has been helpful in shaping the PRA's response to the pandemic. The submission of complete, timely and accurate regulatory returns continues to be the foundation of effective supervision, and so the PRA expects all firms to continue to take action to ensure the integrity of their returns. The PRA has been running a pilot project to assess the standard of regulatory returns, which will continue in 2021.<sup>8</sup>

This letter in conjunction with the PSM letter should convey a sense of our planned work for next year. We will continue to work closely with our international supervisory colleagues on these workstreams.

We look forward to working with you over the coming year.

Yours sincerely



**David Bailey**  
Executive Director  
International Banks Supervision



**Rebecca Jackson**  
Director  
International Banks Supervision

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<sup>7</sup> 'The 2021 biennial exploratory scenario on the financial risks from climate change'. December 2019:  
<https://www.bankofengland.co.uk/paper/2019/biennial-exploratory-scenario-climate-change-discussion-paper>.

<sup>8</sup> Letter from Sarah Breeden and David Bailey 'Reliability of regulatory returns' October 2019:  
<https://www.bankofengland.co.uk/prudential-regulation/letter/2019/reliability-of-regulatory-returns>.