Bank of England

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Prudential Regulation Authority

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[Dear Chief Executive Officer]

Banks active in the UK: 2023 priorities

We are writing to update you on the Prudential Regulation Authority's (PRA) 2023 priorities for international banks ('firms') 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 are sent to the wide and diverse range of international banks that we supervise; therefore, this list is not exhaustive, but is intended to provide a helpful overview of our priorities for 2023.

Financial Resilience

Driven by volatility in financial markets and the weak global economic outlook, the operating environment for all firms is expected to remain challenging in 2023. It is paramount that firms manage their financial resources to ensure that the financial sector can continue to support businesses and households. Firms should take proactive steps to assess the implications of the changing economic outlook. We will maintain focus on financial resilience through ongoing assessments of individual firms' capital and liquidity positions, as well as how these may evolve in light of potential headwinds.

Risk management and governance

A common thread through each of our priorities is the paramount importance to all firms of effective governance and oversight, reflective of both the nature and scale of firms' business activities, and any changes driven by internal or external factors. Individuals within the senior managers regime will be accountable for their firm's addressing of the priorities set out in this letter.

Last year, we highlighted the deficiencies in banks' risk management and governance frameworks brought to light by the default of Archegos Capital Management.[1] We specifically asked firms to consider concentrated and leveraged exposures and to improve counterparty risk management. During 2022, the market reaction to Russia's invasion of Ukraine, and volatility in the nickel and long-dated Gilt markets, reinforced the importance of a robust risk culture and sound risk management practices at firms. However, despite regular messaging from the PRA on the subject, these events demonstrated that firms continue to unintentionally accrue large and concentrated exposures to single counterparties, without fully understanding the risks that could arise. In 2023, firms must ensure that those lessons from past crises are definitively learned in full, and thoroughly embedded across the first and second lines of defence.

We expect firms to reflect on their risk management, governance, and control frameworks accordingly. This should include a comprehensive review of onboarding and due diligence practices, as well as counterparty pricing and margining frameworks. Firms should undertake a thorough review of their counterparties and stress test counterparty exposures in a way that takes into account how these frameworks operate in practice, to better understand ex ante risks across a wide range of situations and ensure appropriate (sufficient and not unduly pro-cyclical) risk mitigation in a crisis while continuing to support the broader economy.

We will continue to assess firms' risk management and control frameworks through individual and cross-firm thematic reviews. We will focus on firms' ability to monitor and manage counterparty exposures, particularly to non-bank financial institutions. Given the global nature of market events, we will continue to work closely with our regulatory counterparts on these topics.

Operational risk and resilience

We continue to maintain our focus on operational risk and resilience, including through the assessment of firms against the PRA's operational resilience rules as set out in Supervisory Statement (SS) 1/21 – 'Operational resilience: Impact tolerances for

1 https://www.bankofengland.co.uk/prudential-regulation/publication/2021/december/supervisory-review-global-equity-finance-businesses.

important business services'.[2] By now, firms are expected to have identified and mapped their Important Business Services (IBS), set impact tolerances for these, and commenced a programme of scenario testing. We have been reviewing firm self-assessments and engaging with individual firms and the sector more generally on our findings.[3]

Our focus for the coming year will be on using this framework, and the testing that firms are conducting, to assess whether they can remain within their impact tolerance for each IBS in the event of a severe but plausible disruption to their operations.

More broadly, in response to increasing digitisation, changes in payment systems, and the need to address legacy IT systems, many firms are executing large and complex programmes of IT change. We expect these changes to be well managed with the associated transition and execution risks appropriately mitigated.

We have also observed a material increase in services being outsourced, particularly to cloud providers, and we expect firms to manage the risk arising from this accordingly. In doing so, firms should meet the expectations on outsourcing and third-party risk management set out in SS2/21 – 'Outsourcing and third party risk management'.[4] Firms should ensure IBS can remain within impact tolerances even when they rely on outsourcing or third-party providers. We welcome the feedback provided to Discussion Paper (DP) 3/22 – 'Operational resilience: Critical third parties to the UK financial sector'[5] and we encourage your continued engagement as we work with other UK authorities to develop our thinking and policy further in this area.

The number of firms offering crypto products continues to grow, presenting new challenges for risk management. We will continue to monitor firms' use of new technologies, and advancements in asset tokenisation. We expect firms to have fully understood the impact of offering crypto products on their operational resilience, and to have met our supervisory expectations as set out in SS1/21 before engaging with these opportunities in any material way.

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2 https://www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-impact-tolerances-for-important-business-services-ss.

3 https://www.bankofengland.co.uk/speech/2022/april/david-bailey-speaker-at-uk-finance-event-operational-resilience-beyond-2022.

4 https://www.bankofengland.co.uk/prudential-regulation/publication/2021/march/outsourcing-and-third-party-risk-management-ss.

5 https://www.bankofengland.co.uk/prudential-regulation/publication/2022/july/operational-resilience-critical-third-parties-uk-financial-sector.

Real Time Gross Settlement (RTGS)

The Bank of England is introducing the delivery of ISO 20022 messaging[6] in CHAPS on Monday 19 June 2023 as part of the RTGS Renewal programme. We expect firms to be ready for this change, ensuring cut-over to the new messaging standard without interruption to customer payments or liquidity management. This includes completing all necessary testing and participating in dress rehearsals and go-live events in full.

A number of similar ISO migrations are happening in parallel, and firms should be clear on the dependencies between them in their own systems, including in the event of further changes to the timelines for one or more of these events. As preparations for the move to the renewed RTGS system in 2024 continue, firms should be ready to complete testing and training during 2023, adapting systems and processes as needed to be able to access and use the new system.

Data

Data remains an area of focus for the PRA as the submission of complete, timely, and accurate regulatory returns remains the foundation of effective supervision.[7] We continue to invest in delivering our own Regulatory Technology (RegTech) and data strategy, for which accurate firm submissions of data and information are critical. Over recent years, we have commissioned a programme of skilled persons reviews which have repeatedly identified deficiencies in the controls over data, governance, systems, and production controls related to regulatory reporting. We expect firms to consider the thematic findings set out in our communications on regulatory reporting[8] to inform how best to improve their submissions going forward. We will continue to use skilled persons reviews in this area in 2023.

Additionally, we will be engaging with firms in 2023 on which data we collect as part of the Banking Data Review,[9] and will continue to consult firms on the long-term reforms to the way we collect data as part of the Transforming Data Collection Programme.[10]

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6 **https://www.bankofengland.co.uk/payment-and-settlement/rtgs-renewal-programme/consultation-on-a-new-messaging-standard-for-uk-payments-iso20022**.

7 **https://www.bankofengland.co.uk/prudential-regulation/letter/2019/reliability-of-regulatory-returns**.

8 **https://www.bankofengland.co.uk/prudential-regulation/letter/2021/september/thematic-findings-on-the-reliability-of-regulatory-returns**.

9 **https://www.bankofengland.co.uk/paper/2020/transforming-data-collection-from-the-uk-financial-sector**.

10 **https://www.bankofengland.co.uk/paper/2021/transforming-data-collection-from-the-uk-financial-sector-a-plan-for-2021-and-beyond**.

Financial risks arising from climate change

Climate change presents an increasingly material risk to firms and the financial system.[11] In 2022, we started actively supervising firms against our supervisory expectations.[12] Our recently published letter to Chief Executives[13] highlighted the progress made by firms since the publication of SS3/19 - 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'. and provided feedback on the Bank of England's Climate Biennial Exploratory Scenario exercise (CBES) which was run in 2021.[14] Overall, we have observed that firms have taken tangible and positive steps to implement our expectations. However, the level of embeddedness varies from firm to firm and further progress is needed by all firms within scope of SS3/19. We expect firms to take a proactive approach to addressing risks in this area, with the letter providing some specific examples of areas where, by now, firms would be expected to demonstrate capabilities in meeting supervisory expectations.

The letter also reiterates that firms' approaches should be proportionate to the nature, scale, and complexity of the risks they face. Last year's volatility in commodities markets provides an illustrative example of the types of risk that could crystallise for some firms with commodities exposures, in the context of the energy transition.

Other areas of supervisory focus

Diversity, Equity, and Inclusion

Diversity, Equity, and Inclusion (DEI) remains an important focus and a topic we expect firms to continue to embed in their cultures. Building upon our joint Discussion Paper (DP) 2/21 – 'Diversity and inclusion in the financial sector – working together to drive change' published in July 2021[15] and the voluntary pilot survey,[16] we plan to issue a consultation paper in 2023 setting out proposals to introduce a new regulatory framework on DEI in the financial sector.

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[11] https://www.bankofengland.co.uk/speech/2022/july/nathanael-benjamin-speech-at-uk-finance-new-tides.

[12] https://www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss.

[13] https://www.bankofengland.co.uk/prudential-regulation/letter/2022/october/managing-climate-related-financial-risks.

[14] https://www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario.

[15] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/diversity-and-inclusion-in-the-financial-sector.

[16] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/diversity-and-inclusion-in-the-financial-sector.

Supervisory Approach

As set out in the PRA's 2022/23 Business Plan,[17] we continue to strengthen our supervisory approach. As part of this, and with effect from January 2023, we have updated our approach to categorising the 'potential impact'[18] of firms, reducing the number of categories from five to four. We have also refined our risk assessment framework and our core assurance work. Where this results in any changes to the supervisory workplan for any individual firm, we will communicate this directly to the firm in due course. Until they are informed otherwise, firms should continue to work with the workplan communicated to them following their last PSM. We will also update our published supervisory approach documents[19] during the first half of 2023.

The Financial Services and Markets Bill, which is currently being considered by Parliament, will – if passed into law – introduce a new secondary competitiveness and growth objective for the PRA. The new objective would require the PRA to act in a way which, subject to aligning with relevant international standards, facilitates the international competitiveness of the UK economy and its growth in the medium to long-term. If appropriate, the PRA's supervisory approach will be updated to reflect changes that are made to its statutory objectives.

This letter in conjunction with your firm's PSM letter should convey a sense of our planned work for 2023.

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

Yours sincerely,

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Executive Director	Director
Authorisations, Regulatory Technology and International Supervision	Authorisations, Regulatory Technology and International Supervision

17 https://www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pra-business-plan-2022-23.

18 A core part of the risk assessment framework is the potential impact assessment. We assess the significance of a firm to the stability of the UK financial system. This 'potential impact' reflects a firm's potential to affect adversely the stability of the system by failing, coming under operational or financial stress, or because of the way in which it carries out its business.

19 https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.