

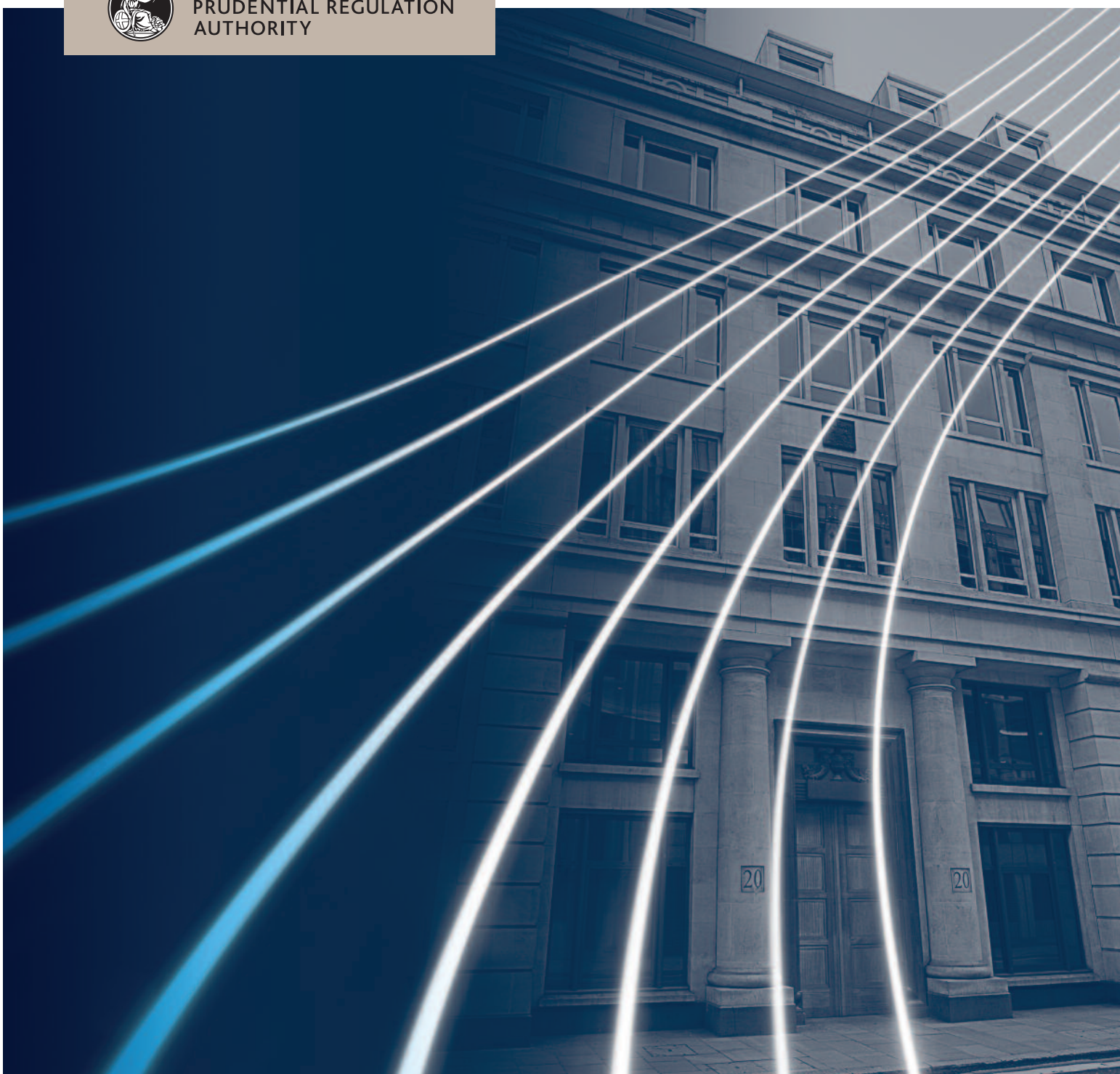
Policy Statement | PS10/15

The implementation of ring-fencing: legal structure, governance and the continuity of services and facilities

May 2015



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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This policy statement contains near-final rules and supervisory statements covering legal structure, governance and the continuity of services and facilities.

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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback on the responses received on the first consultation paper on the implementation of ring-fencing (CP19/14).⁽¹⁾ CP19/14 covered legal structure, governance and the continuity of services and facilities.

1.2 The PRA is required by the Financial Services and Markets Act 2000 (the Act) to have regard to any representations made to the proposals in a consultation, and to publish an account, in general terms, of those representations and its response to them. This PS will be of interest to banks which will be required by the Act, as amended by the Financial Services (Banking Reform) Act 2013, to ring-fence their activities. It will also be of interest to other financial institutions and customers who have dealings with ring-fenced bodies (RFBs).

1.3 The PRA does not consider that the responses to the consultation necessitate major changes to the proposed overall approach to implementing ring-fencing. But the PRA has made a number of amendments to the draft rules and supervisory statements published within CP19/14, mainly to add clarity and certainty, as requested by a number of respondents. Each section of this PS describes the most significant issues raised by respondents and notes the main areas where the PRA is making amendments to the proposals in CP19/14. Updated versions of the rules and supervisory statements, including versions where all changes have been highlighted, are included in the appendices.

1.4 The rules and supervisory statements included in this PS should be considered as 'near-final'. It is possible that, following forthcoming ring-fencing-related consultation, the PRA will need to make further changes.

1.5 A number of responses to the consultation requested further detail on the PRA's approach to waivers and modifications in relation to ring-fencing. As described in CP19/14, the PRA will take a proportionate approach in meeting its responsibilities for ring-fencing, in particular given the heterogeneous nature of the firms to which ring-fencing requirements will apply. The PRA has a discretionary power to waive or modify rules under section 138A of the Act where the application of rules would be unduly burdensome or would not achieve the purposes for which the rules were made, and as long as the waiver or modification would not adversely affect the advancement of any of the PRA's objectives. Further description of the PRA's approach, in particular in respect of the governance rules, is included in Section 3.

1.6 The PRA intends to publish a further consultation in 2015, and to publish final versions of the rules and supervisory statements consulted on in the first and second ring-fencing consultations during the first half of 2016.

1.7 The PRA encourages firms to continue discussing their plans for their legal and operating structures with their supervisors. This will help the PRA and the Financial Conduct Authority (FCA) to develop policy ahead of the forthcoming consultation later this year. Firms should also highlight any changes to their plans as a result of this PS to their supervisors.

2 Legal structure

2.1 In CP19/14, the PRA consulted on a supervisory statement on the PRA's expectations for the legal ownership of RFBs and the entities that RFBs can own. Most responses supported the principles underpinning the proposals and no issues were raised that necessitate substantive changes.

2.2 Respondents raised a number of specific questions on the detail of the supervisory statement. These are discussed below.

Entities that an RFB may own

2.3 CP19/14 stated that *'in principle, the PRA does not necessarily object to an RFB owning entities undertaking activities that are not excluded or prohibited under the Act. This would be considered on a case-by-case basis'*.⁽²⁾ A number of respondents requested more clarity on the types of subsidiaries that the PRA would and would not object to being owned by an RFB.

2.4 The PRA does not intend to set out the types of subsidiaries which can and cannot be owned by an RFB. This should be discussed on a case-by-case basis by firms and their supervisors. Such discussion should be framed by a consideration of the risks that a particular subsidiary might pose to the PRA's objectives. These objectives include ensuring that the business of RFBs is protected from risks (arising in the United Kingdom or elsewhere) that could adversely affect the continuity of the provision in the United Kingdom of core services, that the RFB does not depend on resources provided by other group members that would cease to be available in the event of the insolvency of the other member, and minimising the risk that the failure of a member of an RFB's group could affect the continuity of core services. As a result, the PRA will generally seek to ensure that the RFB is not materially exposed to risks from its subsidiaries which are largely unrelated to its own business. This expectation will be applied proportionately.

2.5 One respondent asked whether non-bank subsidiaries of the RFB would be subject to the Act's requirements on access to inter-bank payment systems. This is not required under the Act itself, but the PRA will, where relevant, consider to what

(1) PRA Consultation Paper CP19/14, 'The implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities', October 2014;

www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp1914.aspx.

(2) CP19/14, page 26, paragraph 3.3.

extent it expects entities within an RFB's sub-group to meet the same requirements as the RFB. This will be discussed in forthcoming consultation.

Entities that can own an RFB

2.6 CP19/14 stated that '*the PRA does not expect an entity that undertakes excluded or prohibited activities to have ownership rights in an RFB*'.⁽¹⁾ Two main concerns were highlighted in the responses.

2.7 First, a number of respondents suggested that this expectation would prevent the owner of an RFB from also owning entities that, for example, undertake investment banking activity, because exposures to such entities would be prohibited under the Excluded Activities and Prohibitions Order 2014 (the Order).⁽²⁾ The PRA does not expect to prevent the owner of an RFB having ownership stakes in entities that are not ring-fenced. The supervisory statement has been amended to clarify this.

2.8 The Order permits an RFB to incur financial institution exposures to other group members, as long as these are not prohibited under rules made by the PRA or the FCA under the Act and the exposures arise as a result of a commercial transaction conducted on arm's-length terms or a holding of shares or other securities issued by a subsidiary undertaking of the RFB. The PRA considers that applying this approach to the owners of RFBs should be sufficient to ensure that they are not unduly constrained from lending to other group entities. As stated in the supervisory statement, the PRA would apply this expectation in a proportionate way.

2.9 Second, respondents also highlighted that the proposed supervisory statement would prohibit the owners of RFBs from undertaking the prohibited activity of having branches or subsidiaries located outside the EEA. This was not the intention, and the supervisory statement has been amended to clarify this.

3 Governance

3.1 The governance chapter of CP19/14 proposed general rules applicable to RFBs and rules specifically relating to the board membership, risk management and internal audit arrangements, human resources policies and remuneration policies of RFBs. This section sets out the PRA's responses to the most significant issues raised in the feedback to the proposals.

3.2 The governance proposals are to meet the group ring-fencing purposes set out in the Act.⁽³⁾ These include the purpose to *ensure as far as reasonably practicable that in carrying on its business a ring-fenced body is able to take decisions independently of other members of its group*.

3.3 It is important to emphasise that where an RFB forms part of a wider group it will remain a subsidiary, and therefore the

parent company will still be expected to exercise adequate oversight of the RFB in an appropriate manner consistent with governance good practice. However, parent company actions should not cause an RFB to act in a way that is inconsistent with the ring-fencing obligations.

3.4 CP19/14 proposed an additional prescribed responsibility for senior managers of RFBs, to be included as part of the Senior Managers Regime (SMR). The PRA has responded to feedback on the proposed ring-fencing SMR rule in PS3/15 alongside the other elements of the SMR.⁽⁴⁾ The PRA plans to respond to feedback on the draft supervisory statement on the SMR separately as part of a further publication planned for later in 2015.

PRA and FRC commentary on corporate governance and financial reporting

3.5 The former members of the Parliamentary Commission on Banking Standards (PCBS) made a statement in their November 2014 report highlighting potential tensions between the required independence of an RFB and its accountability and transparency to group shareholders in respect of corporate governance and financial reporting.⁽⁵⁾

3.6 The PRA and the Financial Reporting Council (FRC) acknowledge that tensions could occur in an RFB's relationship with its parent. These could occur were an RFB to be required to act in a way inconsistent with its legal and governance responsibilities including the ring-fencing obligations. The outcome that an RFB is able to take decisions independently is prescribed by the Act and enforceable by the PRA. An RFB's ability to take such decisions is also consistent with the Companies Act duty on a director to promote the success of the company. This duty applies to directors of all group entities.

3.7 The PRA was mindful of the potential challenges in this area when developing the proposed governance rules for RFBs. Therefore, as part of its approach, the PRA has sought to avoid disrupting the usual mechanisms of accountability more than is necessary to achieve the statutory ring-fencing objectives. For example, an RFB's shareholders will appoint RFB directors.

3.8 The requirement for an RFB to be able to take decisions independently does not mean that an RFB's policies are required to be at odds with those of the wider group. The PRA

(1) CP19/14, page 26, paragraph 4.1.

(2) The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014; www.legislation.gov.uk/uksi/2014/2080/pdfs/ukxi_20142080_en.pdf.

(3) The 'group ring-fencing purposes' are set out in section 142H of the Act, as amended by the Financial Services (Banking Reform) Act 2013.

(4) PRA Policy Statement PS3/15, 'Strengthening individual accountability in banking and insurance — responses to CP14/14 and CP26/14', March 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps315.aspx. The near-final instrument in Appendix 1 of this PS introduces a new defined term 'ring-fencing obligation'. The PRA proposes to make a consequential amendment to the Allocation of Responsibilities Part of the Rulebook in order to reflect this definition.

(5) Statement by former Members of the Parliamentary Commission on Banking Standards, 4 November 2014; www.parliament.uk/documents/commons-committees/treasury/Statement_by_former_Members_of_PCBS.pdf.

would typically expect to see RFBs adopt group policies, with the RFB board and management reviewing these against the ring-fencing obligations and objectives, and making additions or adopting more restrictive policies in line with those obligations and objectives only where necessary. Co-ordination of business planning and strategy across the group, including the RFB, is to be expected given the need of the parent board to retain consolidated oversight and the need of the RFB to be confident of shareholder support for its business plan and strategy.

3.9 The proposed rules accept that, to the extent consistent with the Act, groups will have different mixes of business, and therefore the rules seek to allow a wide degree of flexibility in the structures firms choose to adopt in order to meet the statutory requirements. Where rules are more prescriptive, firms may apply for a waiver or modification. This is discussed in more depth below.

3.10 It is for firms to establish appropriate financial reporting policies, including decisions around the consolidation of entities. Consolidation for financial reporting purposes is based on a control relationship existing. Such a relationship exists only if there is both an ability to direct and an ability to benefit from that direction. It is the PRA's view that the rules proposed to date do not in themselves necessitate arrangements that would prohibit a parent having those abilities over an RFB.

Application of governance rules where an RFB sub-group is formed

3.11 A number of respondents asked the PRA to clarify in the rules text the intended application of the governance proposals in instances where an RFB sub-group is formed. The PRA's approach to the formation of sub-groups will be covered in a forthcoming PRA consultation. However, to provide additional clarity, the PRA has included amendments to the near-final rules stating where individual proposals are not intended to apply between entities within the RFB sub-group.⁽¹⁾ These include amendments providing that the board cross-membership restrictions will not apply between entities in an RFB sub-group. There will be opportunity to comment on these proposed amendments as part of the subsequent consultation.

Board membership and senior managers for risk management and internal audit

3.12 The PRA has not made substantive changes to the board membership rules or the rules for senior managers responsible for the risk management function and internal audit function of RFBs proposed in CP19/14.

3.13 Some responses to the consultation stated a preference for greater flexibility and supervisory discretion to be built into the proposals. However, the PRA considers that these

proposals are appropriate to support the advancement of the group ring-fencing purposes while also meeting the PRA's other specific rule-making obligations under the Act.

3.14 Flexibility is already available under section 138A of the Act whereby firms can request waivers or modifications of individual rules to allow for different outcomes on a case-by-case basis where the statutory tests are met, as detailed below.

PRA policy on consideration of waivers and modifications of ring-fencing rules

3.15 CP19/14 stated that the PRA recognises that the position of each RFB in the context of its wider group, such as the size of an RFB's business relative to that of the wider group, may have a bearing on how often it finds its interests are not aligned with those of the wider group, as well as the degree to which an RFB's decision-making could be unduly influenced by other members of the group. The PRA is also mindful of the need to ensure that an RFB has sufficient representation at the parent's board to support oversight of the RFB and appropriate alignment of objectives, policies and practices. Such considerations would be considered in any modification or waiver applications.

3.16 Some responses to the consultation also requested greater clarity around proportionality and when the PRA would consider waivers and modifications. The statutory tests determine whether the PRA may grant a waiver or modification. These set out that rules may be waived or modified if the firm's compliance with the rules would be unduly burdensome or would not achieve the purposes for which the rules were made, and where the granting of a waiver or modification would not adversely affect the advancement of any of the PRA's objectives. A proper process must be followed for each decision to ensure the outcome does not undermine the robustness of the ring-fence or the PRA's wider objectives, and to ensure consistency between similar cases.

3.17 The PRA will require firms to demonstrate in their applications how the arrangements they plan to have in place, if the waiver or modification is granted, will ensure that neither the advancement of the group ring-fencing purposes, set out in section 142H of the Act, nor the PRA's wider objectives are adversely affected. An applicant will be required to demonstrate to the PRA how its proposed governance arrangements will compensate for any potential weakening of the regime and how they will ensure the purposes of the regime are still being advanced.

3.18 The governance proposals are interrelated and should therefore be considered as a package. The PRA will consider waiver and modification applications in this context as well as

(1) The PRA has introduced the term 'ring-fenced affiliate' into the near-final rules to identify any member of the RFBs sub-consolidation group.

in the wider context of firms' restructuring plans and how firms intend to ensure compliance with the regime as a whole.

3.19 Some respondents were concerned about the transparency of waivers or modifications. Where waivers or modifications are granted, decision notices will normally be published on the Financial Services Register.⁽¹⁾ This is general practice for waiver or modification decisions.

3.20 The PRA does not have the power to waive or modify rules if so doing would contravene European law. Such requirements include establishing risk and nomination committees comprising non-executive members of the management body of the firm.⁽²⁾

Personnel dependency

3.21 Some respondents expressed concern that the requirement for an RFB not to depend on personnel that would cease to be available in the event of the insolvency of another member of its group may restrict an RFB from relying on employees from elsewhere in the group. Other respondents specifically requested a clarification to be provided in the rule to exempt group services entities from this requirement.

3.22 The PRA is of the view that the draft rule does not prohibit firms from relying on staff from group services entities or any other group entities. Therefore, the PRA is not proposing an amendment to this rule. The rule does require a firm to ensure that if it relies on certain personnel in carrying on its business, as far as reasonably practicable, those employees should not cease to be available to the RFB in the event of the insolvency of a member of the RFB's group. Factors to be taken into consideration when making this judgement could include if there are appropriate contingency arrangements in place in the event of there being a disruption to the entity, or if the RFB does not depend on these personnel in the carrying on of its business because, for example, the services being provided by these personnel to the RFB are substitutable.

3.23 It is also relevant to note that 'employee' used in the draft rules and the PRA Rulebook Glossary has a wider meaning than the ordinary meaning of the word and includes individuals who provide services to the firm under an arrangement with a third party.⁽³⁾

Independence criteria

3.24 The majority of consultation responses either did not comment on the independence criteria or supported the consistency that the PRA has sought to provide with the material in the UK Corporate Governance Code (the Code).⁽⁴⁾ The PRA has diverged from the language of the Code's independence criteria only where necessary to provide increased legal certainty required for rule making. The PRA rules should not be considered as an aid to the interpretation

of the Code, whether for listed entities not subject to PRA rules or for those entities to which the PRA rules will apply.

3.25 One respondent identified a conflict between two of the proposed criteria. One sets out that a director cannot be considered independent if he or she receives, or has received, remuneration apart from their directors' fee from the RFB or another member of its group. Another states that, in effect, a former employee can be considered independent only after five years away from employment with a firm.

3.26 The remuneration criterion has been amended so that the receipt of pensions and fixed or variable remuneration (apart from a director's fee) would not be a factor disqualifying a director from being considered independent, as long as the entitlement to the remuneration in question is attributed to a period of employment that concluded five years before his or her appointment as a director.

3.27 Further drafting amendments have been made to the independence criteria to provide greater clarity. These include a more precise definition of close family ties.

Remuneration

3.28 Concerns were raised by respondents that the wording of the remuneration rules would prohibit RFB employees from being able to receive a proportion of their remuneration in a form associated with the group, for example shares of a listed parent entity. The remuneration proposals seek to ensure personnel who provide services to the RFB are remunerated in a way that supports sound and effective risk management and the long-term interests of the RFB, as distinct from the wider group. The PRA accepts that the rule should not prohibit part of this remuneration being made up of such instruments, and so the PRA has amended the rules accordingly.

3.29 Where an employee provides services to both the RFB and another group entity the wording of the rule requires only remuneration policies, practices and procedures relating to services provided to the RFB to satisfy PRA rules. The PRA expects that where employees provide services to multiple group entities such activities would be conducted on an arm's-length basis.⁽⁵⁾

Vacancies for independent NEDs on RFB boards

3.30 Some respondents were concerned with the additional cost and burden that could arise from the proposal to require the public advertisement of independent NEDs on RFB boards.

(1) See www.fsa.gov.uk/register/home.do.

(2) General Organisational Requirements 6 and Risk Controls 3, respectively, of the PRA Rulebook. See *PRA Policy Statement PS7/15*, 'The PRA Rulebook: Part 2' April 2015; www.bankofengland.co.uk/pradocuments/publications/ps/2015/ps715.pdf. These requirements were previously in SYSC 4 and 7 in the PRA Handbook.

(3) See <http://fshandbook.info/FS/html/PRA/GLSSY/-link-/PDF>.

(4) www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf.

(5) PRA policy on arm's-length requirements will form part of a subsequent consultation.

The PRA supports the view of the PCBS, expressed in its final report, that the public advertisement of independent NED vacancies is beneficial as it provides additional transparency and may encourage a more diverse pool of applicants for NED roles.⁽¹⁾ Therefore, the PRA has not amended this proposal.

Disclosure requirements for RFBs

3.31 The PRA received responses recommending it introduce further requirements for RFBs to produce additional public disclosures. Rules of this nature fall outside the scope of the topics covered by CP19/14. The PRA intends to consider how the disclosure requirements in Part 8 of the Capital Requirements Regulation should be applied to RFBs as part of a subsequent consultation but at this juncture does not consider it necessary to introduce additional rules on disclosures by RFBs.⁽²⁾ Following the implementation of ring-fencing, the PRA Annual Report will cover, in general terms, the extent to which RFBs are complying with the ring-fencing provisions.

Rules on RFB board audit committees

3.32 The transposition of the 8th EU Audit Directive (8th Directive) is anticipated to be complete before the ring-fencing regime commences.⁽³⁾ Many of the requirements introduced by the 8th Directive are likely to supersede the requirements on RFB audit committees in CP19/14. To pre-empt these changes, the PRA has chosen to delete the elements of these rules that will duplicate or overlap with the 8th Directive requirements.

Compliance with the ring-fencing obligations

3.33 CP19/14 included a proposal that an RFB must be able to demonstrate to the PRA its compliance with the ring-fencing rules.

3.34 The PRA is of the view that the proposal should be widened, to require demonstration of compliance with all ring-fencing obligations, including those which come directly from legislation.⁽⁴⁾ This is consistent with the PRA's duty to report to Parliament on compliance with all aspects of the ring-fence.

3.35 Although not required by the Act to do so, the PRA will consult on this change as part of subsequent consultation because the proposed amendment seeks to widen the scope of the draft rule.

4 Continuity of services and facilities

4.1 In CP19/14, the PRA consulted on rules and a supervisory statement to ensure that RFBs have appropriate arrangements in respect of the services and facilities they need to provide core services.⁽⁵⁾

4.2 The proposals in CP19/14 were to be read in conjunction with the discussion paper on ensuring operational continuity

in resolution (DP1/14) that set out the PRA's proposals for the principles that all deposit-takers (excluding credit unions) and PRA-designated investment firms should follow to demonstrate operational continuity in resolution and facilitate recovery and post-resolution restructuring.⁽⁶⁾ Respondents to DP1/14 were broadly supportive of these proposals. The PRA plans to consult on a set of rules and a supervisory statement on operational continuity in resolution, in line with the proposals set out in DP1/14, later this year.

4.3 Respondents raised a limited number of issues in relation to the proposals in CP19/14. These issues and the PRA's response are discussed below.

Group services arrangements

4.4 Respondents argued that the definition of 'dedicated intragroup services entity' was too restrictive:

- one respondent suggested that qualifying parent undertakings should be allowed to provide services to RFBs provided they are not the 'resolution entity' for the group. The PRA considered this but decided against it on the grounds that a qualifying parent undertaking is not itself insulated from the failure of other group entities and could cause disruption to the RFB as a result; and
- some respondents also asked that the definition of a 'dedicated intragroup services entity' be broadened to allow for the provision of services to third parties. The PRA has decided to broaden the definition in this manner on the basis that it would facilitate the ability of smaller banks to access services and facilities provided by larger banks' services entities, thereby supporting competition in banking markets. The PRA has amended the defined term to 'group services entity' to reflect that services are no longer exclusively intragroup but can be provided by a group entity to third parties.

4.5 A number of respondents found the draft supervisory statement too restrictive by allowing RFBs to receive shared services only from group services entities.⁽⁷⁾ In response to this feedback, the PRA has amended the supervisory

(1) Parliamentary Commission on Banking Standards, *Changing banking for good*, June 2013; www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/.

(2) Capital Requirements Regulation, Regulation 575/2013/EU; <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0575>.

(3) EU Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts; <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0056>.

(4) As set out in Appendix 1, a ring-fencing obligation means 'any obligation, prohibition or other requirement imposed on a ring-fenced body by or under FSMA by virtue of it being a ring-fenced body, including any statutory instrument made under FSMA and any ring-fencing rule but not including any rule made by the FCA'.

(5) See Appendix 5 for examples of types of 'services and facilities'.

(6) PRA Discussion Paper DP1/14, 'Ensuring operational continuity in resolution', October 2014;

www.bankofengland.co.uk/pr/Pages/publications/cp/2014/dp114.aspx.

(7) CP19/14 defined shared services as those services and facilities which are needed to support the business of the RFB and other group entities.

statement to allow the provision of all transactional services by group services entities, ie those services that can be fully represented in contractual terms. The PRA expects that RFBs will appropriately manage their outsourcing arrangements and associated operational risk, in accordance with the Senior Management Arrangements, Systems and Controls (SYSC) Rulebook requirements. The PRA also expects RFBs to be able to demonstrate compliance with the restructuring principles set out in DP1/14, to be consulted on later this year. Based on the existing SYSC requirements and the proposals set out in DP1/14, the PRA would not expect the risk management functions of the RFB to be outsourced in their totality; for example, only those services that are transactional in nature and can be fully represented in contractual terms would be expected to sit in a group services entity.

Group and third party service arrangements

4.6 The PRA expects that RFBs make arrangements to ensure that the provision of services and facilities from group entities to an RFB cannot be disrupted through the acts, omissions or insolvency of other group members. One respondent was concerned that the proposed rule would prevent RFBs from receiving services or accessing facilities from a group services entity that has a dependency on another group services entity in order to provide services or facilities to the RFB. The PRA recognises that there could be dependencies between group services entities. The PRA does not intend to prevent RFBs from having a services framework in which multiple group services entities are involved and has amended the rule and supervisory statement to reflect this.

4.7 The PRA has therefore introduced the defined term 'permitted supplier' to describe those entities within the group from which the RFB is allowed to receive services or access facilities, ie group services entities and entities within the RFB sub-group.⁽¹⁾ The rule has been amended to specify that where there is a dependency between permitted suppliers the RFB must have sufficient safeguards in place to reduce the probability and impact of a disruption to the provision of services or access to facilities which would affect the RFB's ability to provide core services. The rule has also been amended to clarify that any group entity which is a sub-contractor to the permitted supplier is subject to the same restrictions as the permitted supplier itself. These changes help remove indirect channels of contagion from other group entities to the RFB which may adversely affect the ability of the RFB to perform its core activities.

4.8 Another respondent was concerned with the drafting of rule 8.2 and proposed that it should be amended to explicitly exclude the provision of services and facilities from financial market infrastructures (FMIs) as otherwise this would interfere with an FMI's ability to exercise default procedures against an RFB due to the actions of other members of the group. The PRA has considered the drafting of the rule and has decided it is appropriate given the Act requires the PRA to make rules to ensure that the carrying on of core activities by RFBs is not adversely affected by the acts or omissions of other group members. The access arrangements an RFB and other group members will employ when using an FMI should not prevent the FMI from exercising its default arrangements under the proposed rules.

(1) The PRA has introduced the term 'ring-fenced affiliate' into the near-final rules to identify any member of the RFBs sub-consolidation group.

Appendices

1	Near-final ring-fenced bodies rules instrument
2	Near-final ring-fenced bodies rules instrument (tracked change version)
3	Near-final supervisory statement on ring-fenced bodies: legal structure
4	Near-final supervisory statement on ring-fenced bodies: legal structure (tracked change version)
5	Near-final supervisory statement on ring-fenced bodies: continuity of services and facilities
6	Near-final supervisory statement on ring-fenced bodies: continuity of services and facilities (tracked change version)

PRA RULEBOOK: CRR FIRMS: RING-FENCED BODIES INSTRUMENT [YEAR]

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); and
 - (3) 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: Ring-fenced Bodies Instrument [YEAR]

- 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: Ring-fenced Bodies Instrument [YEAR].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex

In this Annex, the text is all new and is not underlined.

Part

Ring-fenced Bodies

Chapter content

- 1. APPLICATION AND DEFINITIONS**
- 2. GENERAL RULES APPLICABLE TO RING-FENCED BODIES**
- 3. BOARD COMPOSITION AND MEMBERSHIP OF RING-FENCED BODIES**
- 4. RISK MANAGEMENT OF RING-FENCED BODIES**
- 5. INTERNAL AUDIT POLICY OF RING-FENCED BODIES**
- 6. HUMAN RESOURCES POLICY OF RING-FENCED BODIES**
- 7. REMUNERATION POLICY OF RING-FENCED BODIES**
- 8. CONTINUITY OF PROVISION OF SERVICES TO RING-FENCED BODIES**

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *ring-fenced body*.

1.2 In this Part, the following definitions shall apply:

Chairman function

has the meaning given in Senior Management Functions 4.2.

Chairman of Audit Committee function

has the meaning given in Senior Management Functions 4.4.

Chairman of Remuneration Committee function

has the meaning given in Senior Management Functions 4.5.

Chairman of Risk Committee function

has the meaning given in Senior Management Functions 4.3.

Head of Internal Audit function

has the meaning given in Senior Management Functions 3.5.

Chief Risk function

has the meaning given in Senior Management Functions 3.4.

close family tie

means a relationship:

- (a) of marriage or civil partnership; or
- (b) which has the characteristic of a relationship of marriage or of civil partnership; or
- (c) between a *person* referred to in 1.3(2)(d) and his or her parent, sibling, child (including a step-child), grandparent or grandchild.

extraordinary vacancy

means a vacancy on the *governing body* of a *ring-fenced body* arising from the resignation, dismissal or death of an independent *non-executive director* before the expiry of his or her term of appointment as a *director*.

group services entity

in relation to a *ring-fenced body*, means an entity within the same *group* as the *ring-fenced body*, whose only business is to provide services or facilities to any other *person*.

permitted supplier

means a *person* that provides services or facilities to any other *person* and that is:

- (1) a *group services entity*; or
- (2) a *ring-fenced affiliate*.

ring-fenced affiliate

in relation to a *ring-fenced body*, means any member of the [sub-consolidated group]¹ of which the *ring-fenced body* is a member, other than the *ring-fenced body* itself.

ring-fencing obligation

means any obligation, prohibition or other requirement imposed on a *ring-fenced body* by or under *FSMA* by virtue of it being a *ring-fenced body*, including any statutory instrument made under *FSMA* and any *ring-fencing rule*, but not including any *rule* made by the *FCA*.

1.3 For the purposes of this Part:

- (1) a *director* is regarded as independent if he or she is not disqualified by virtue of falling within any of 1.3(2)(a) to (h).
- (2) a *director* is not regarded as independent if he or she:
 - (a) has been an *employee* of the *ring-fenced body* or of any other member of its *group* within the period of five years before his or her appointment as a *director* (but a non-executive *director* is not to be regarded as an *employee* for this purpose);
 - (b) has, or has had, within the period of three years before appointment, a material business relationship with the *ring-fenced body* or any other member of its *group* either directly, or as a partner, shareholder, *director* or as a member of *senior management* or equivalent of an *undertaking* that has such a relationship with the *ring-fenced body* or other member of its *group*, as the case may be;
 - (c) has received or receives fixed or variable *remuneration* from the *ring-fenced body* or any other member of its *group*, other than a *director's* fee or *remuneration* attributable to a period of service that concluded five years before his or her appointment as a *director*;
 - (d) has a *close family tie* with any of the following:
 - (i) an individual who provides or has provided professional or business advice (whether in his or her individual capacity or otherwise) to the *ring-fenced body* or any other member of its *group*;
 - (ii) a *director* of the *ring-fenced body* or of any other member of its *group*; or
 - (iii) a member of *senior management* or equivalent of the *ring-fenced body* or of any other member of its *group*;

¹ The definition of sub-consolidated group will be finalised after consideration of responses to a subsequent consultation paper. While the policy intent conveyed by this draft rule is accurate as regards its application within a sub-consolidated group, the way it is expressed in the final version of the rules is subject to change. The expression 'sub-consolidated group' has not been finally settled and may yet change.

- (e) holds a directorship in any other *undertaking* that is not a member of the *ring-fenced body's group* of which any other *director* of the *ring-fenced body* is also a *director*;
- (f) has a link, of a nature that might reasonably be expected to give rise to a conflict that is to be identified under 2.2, with any other *director* of the *ring-fenced body* through involvement in any other *undertaking* that is not a member of the *ring-fenced body's group*;
- (g) can reasonably be identified as representing or otherwise associated with the interests of a particular shareholder or shareholders of a *parent undertaking* of the *ring-fenced body* where that shareholder is or those shareholders are able to exercise significant influence over the management of the *parent undertaking*; or
- (h) has served on the *governing body* of the *ring-fenced body* or of any other member of its *group* for more than nine years from the date of first election.

2 GENERAL RULES APPLICABLE TO RING-FENCED BODIES

- 2.1 A *ring-fenced body* must, in carrying on its business, ensure that it is able to take decisions independently of other members of its *group*.
- 2.2 A *ring-fenced body* must establish and maintain arrangements to identify and manage any conflict between:
 - (1) any duty a *director* or a member of *senior management* owes to the *ring-fenced body*; and
 - (2) any interest of the *director* or member of *senior management*.
- 2.3 A *ring-fenced body* must take all reasonable steps to identify and manage any conflict between its interests and those of one or more members of its *group*.
- 2.4 A *ring-fenced body* must be able to demonstrate to the *PRA* its compliance with every *ring-fencing obligation*.

3 BOARD COMPOSITION AND MEMBERSHIP OF RING-FENCED BODIES

- 3.1 A *ring-fenced body* must ensure that at least half of the members for the time being of its *governing body* are independent *non-executive directors*.
- 3.2 For the purposes of 3.1:
 - (1) the chairperson of a *ring-fenced body's governing body* is not to be counted as one of the number of independent *non-executive directors* or as one of the total number of members for the time being of the *governing body*; and

- (2) where an *extraordinary vacancy* arises which, if not filled, would cause the *ring-fenced body* to fail to comply with 3.1, the *ring-fenced body* must fill the vacancy as soon as reasonably possible after the vacancy has arisen, and will not be in breach of 3.1 while it is in the course of so doing.
- 3.3 A *ring-fenced body* must ensure that the *person* performing the *Chairman function*:
 - (1) is an independent *non-executive director*; and
 - (2) does not chair the *governing body* of any other member of the *ring-fenced body's group*, other than a *ring-fenced affiliate*.
- 3.4 A *ring-fenced body* must ensure that no more than one-third of the members of its *governing body* are *employees* of or *directors* of any other member of the *ring-fenced body's group*, other than of a *ring-fenced affiliate*.
- 3.5 A *ring-fenced body* must ensure that it publicly advertises every vacancy for an independent *non-executive director* so as to bring the existence of the vacancy to the notice of those members of the public who might reasonably be expected to seek nomination.
- 3.6 3.5 does not apply if an *extraordinary vacancy* arises in the office held by the *person* performing the *Chairman function* of a *ring-fenced body*.
- 3.7 A *ring-fenced body* must ensure that none of its *senior management* who is a member of its *governing body* is an *executive member* of the *governing body* of any other member of the *ring-fenced body's group*, other than a member that is:
 - (1) a body corporate falling within section 192JA(2) of FSMA; or
 - (2) a *ring-fenced affiliate*.
- 3.8 For the purpose of 3.7, '*executive member*' means a *person* who performs any executive function in relation to the relevant member of the *ring-fenced body's group*.

4 RISK MANAGEMENT OF RING-FENCED BODIES

- 4.1 A *ring-fenced body* must ensure that its risk committee includes a person performing the *Chairman of the Risk Committee function*.
- 4.2 A *ring-fenced body* must ensure that the person performing the *Chairman of the Risk Committee function* does not chair any committee whose functions include oversight of the risk function of any other member of the *ring-fenced body's group*, other than a *ring-fenced affiliate*.
- 4.3 A *ring-fenced body* must ensure that:
 - (1) its risk management function has sufficient resources to perform its role;
 - (2) those resources are at all times identifiable as performing the risk management function for the *ring-fenced body*; and
 - (3) its risk management function supports the ability of the *ring-fenced body* to comply with 2.1.

- 4.4 A *ring-fenced body* must ensure that a *person* performing the *Chief Risk function* for the *ring-fenced body* is not also a *person* performing the *Chief Risk function* or function equivalent to the *Chief Risk function* (howsoever designated) for any other member of the *ring-fenced body's group* or for the *group*, other than for a *ring-fenced affiliate* or for the [sub-consolidated group].

5 INTERNAL AUDIT POLICY OF RING-FENCED BODIES

- 5.1 A *ring-fenced body* must ensure that its audit committee includes a *person* performing the *Chairman of Audit Committee function*.
- 5.2 A *ring-fenced body* must ensure that the *person* performing the *Chairman of Audit Committee function* does not chair any committee whose functions include oversight of the audit function of any other member of the *ring-fenced body's group*, other than a *ring-fenced affiliate*.
- 5.3 A *ring-fenced body* must ensure that:
- (1) its internal audit function has sufficient resources to perform its role;
 - (2) those resources are at all times identifiable as performing the internal audit function for the *ring-fenced body*; and
 - (3) its internal audit function supports the ability of the *ring-fenced body* to comply with 2.1.
- 5.4 A *ring-fenced body* must ensure that a *person* performing the *Head of Internal Audit function* for the *ring-fenced body*:
- (1) is not also a *person* performing the *Head of Internal Audit function* or function equivalent to the *Head of Internal Audit function* (howsoever designated) for any other member of *ring-fenced body's group* or for the *group*, other than for a *ring-fenced affiliate* or for the [sub-consolidated group]; and
 - (2) is able to have direct access to the *management body* of the *ring-fenced body* where he or she considers it necessary.

6 HUMAN RESOURCES POLICY OF RING-FENCED BODIES

- 6.1 A *ring-fenced body* must ensure that its nomination committee includes a chairperson.
- 6.2 A *ring-fenced body* must ensure that the chairperson of its nomination committee does not chair any committee whose functions include nomination for any other member of the *ring-fenced body's group*, other than a *ring-fenced affiliate*.
- 6.3 A *ring-fenced body* must ensure as far as reasonably practicable that, in carrying on its business, it does not depend on any *employee* who may cease to be available to undertake work for the *ring-fenced body* in the event of the insolvency of any other member of its *group*.

7 REMUNERATION POLICY OF RING-FENCED BODIES

- 7.1 A *ring-fenced body* must establish a *remuneration* committee that comprises only members of its *management body* who do not perform any executive function in relation to the *ring-fenced body*.
- 7.2 A *ring-fenced body* must ensure that its *remuneration* committee includes a *person* performing the *Chairman of Remuneration Committee function*.
- 7.3 A *ring-fenced body* must ensure that the *person* performing the *Chairman of Remuneration Committee function* does not chair any committee whose functions include *remuneration* for any other member of the *ring-fenced body's group*, other than for a *ring-fenced affiliate*.
- 7.4 When establishing, implementing and maintaining *remuneration* policies, practices and procedures for its *employees*, a *ring-fenced body* must ensure that these *remuneration* policies, practices and procedures:
- (1) are consistent with and promote the sound and effective risk management of the *ring-fenced body*;
 - (2) do not encourage risk-taking that exceeds the level of tolerated risk of the *ring-fenced body*;
 - (3) are in line with the business strategy, objectives, values and long-term interests of the *ring-fenced body*; and
 - (4) do not encourage a *ring-fenced body* to bear any risk that would undermine its ability to comply with any *ring-fencing obligation*.
- 7.5 Nothing in 7.4 restricts a *ring-fenced body* from enabling the receipt by its *employees* of *remuneration* in the form of shares or other instruments of another member of the *ring-fenced body's group*, provided that the receipt of such *remuneration* is in accordance with 7.4.

8 CONTINUITY OF PROVISION OF SERVICES TO RING-FENCED BODIES

- 8.1 Where a *ring-fenced body* receives services and accesses facilities that it requires on a regular basis from an entity in its *group*, it may do so, whether directly or indirectly, only where that entity is a *permitted supplier*.
- 8.2 A *ring-fenced body* must ensure the agreement and any related arrangement under which it receives services or accesses facilities it requires in relation to the carrying on of *core activities* does not permit any other party to terminate, suspend or materially alter the services or facilities or the agreement or arrangement as a result of an act, omission or deterioration in the financial circumstances of another entity within the same *group* as the *ring-fenced body*.
- 8.3 (1) 8.3 applies if the ability of a *permitted supplier* (PS1) that provides services or facilities referred to in 8.2 to a *ring-fenced body* is dependent upon the provision of services or facilities to PS1 by another *permitted supplier* (PS2), whether the provision of services or facilities to PS1 by PS2 is direct or indirect.

(2) 8.2 does not prevent the *ring-fenced body* agreeing PS1 may suspend or alter the provision of those services or facilities to the extent it is prevented from providing those services or facilities as a result of a deterioration in the financial circumstances of PS2, provided:

- (a) the *ring-fenced body* takes all reasonable steps before and after entering into that agreement to reduce the probability and likely impact of such an alteration to the provision of those services or facilities; and
- (b) the agreement requires PS1 to use its best efforts to eliminate or reduce the effect of any such suspension or alteration.

PRA RULEBOOK: CRR FIRMS: RING-FENCED BODIES INSTRUMENT [YEAR]

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); and
 - (3) 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: Ring-fenced Bodies Instrument [YEAR]

- D. The PRA makes the rules in the Annex A and Annex B 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: Ring-fenced Bodies Instrument [YEAR].

By order of the Board of the Prudential Regulation Authority
[DATE]

Annex-A

In this Annex, the text is all new and is not underlined.

Part

Ring-fenced Bodies¹

Chapter content

1. APPLICATION AND DEFINITIONS
2. GENERAL RULES APPLICABLE TO RING-FENCED BODIES
3. BOARD COMPOSITION AND MEMBERSHIP OF RING-FENCED BODIES
4. RISK MANAGEMENT OF RING-FENCED BODIES
5. INTERNAL AUDIT POLICY OF RING-FENCED BODIES
6. HUMAN RESOURCES POLICY OF RING-FENCED BODIES
7. REMUNERATION POLICY OF RING-FENCED BODIES
8. CONTINUITY OF PROVISION OF SERVICES TO RING-FENCED BODIES

¹ These draft rules impose requirements upon each ring-fenced body in a group at an individual level. The policy intent is for some of these rules to not apply within a sub-group of ring-fenced bodies and certain undertakings related to ring-fenced bodies, or to apply at the level of such a sub-group. The approach to creating a ring-fenced body sub-group is to be consulted upon in a subsequent consultation paper. The application of these draft rules is subject to the finalisation and implementation of the policy on ring-fenced body sub-groups.

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *ring-fenced body*.

1.2 In this Part, the following definitions shall apply:

Chairman function

has the meaning given in Senior Management Functions 4.2.

Chairman of Audit Committee function

~~is the function of having responsibility for chairing, and overseeing the performance of the role of, the audit committee of a ring-fenced body.~~

has the meaning given in Senior Management Functions 4.4.

Chairman of Remuneration Committee function

~~is the function of having responsibility for chairing, and overseeing the performance of the role of, the remuneration committee of a ring-fenced body.~~

has the meaning given in Senior Management Functions 4.5.

Chairman of Risk Committee function

~~is the function of having responsibility for chairing, and overseeing the performance of the role of, the risk committee of a ring-fenced body.~~

~~Chief~~ has the meaning given in Senior Management Functions 4.3.

Head of Internal Audit function

~~is the function of having responsibility for management of the internal audit function of a ring-fenced body and for reporting directly to the management body of the ring-fenced body on the internal audit function.~~

has the meaning given in Senior Management Functions 3.5.

Chief Risk function

~~is the function of having responsibility for overall management of the risk controls of a ring-fenced body, including the setting and managing of its risk exposures, and reporting directly to the management body of the ring-fenced body in relation to its risk management arrangements.~~

~~dedicated intragroup services entity~~

~~means an entity within the same group as the ring-fenced body, whose only business is to provide services or facilities to other entities within its group.~~

has the meaning given in Senior Management Functions 3.4.

close family tie

means a relationship:

- (a) of marriage or civil partnership; or
- (b) which has the characteristic of a relationship of marriage or of civil partnership; or
- (c) between a *person* referred to in 1.3(2)(d) and his or her parent, sibling, child (including a step-child), grandparent or grandchild.

extraordinary vacancy

means a vacancy on the *governing body* of a *ring-fenced body* arising from the resignation, dismissal or death of an independent *non-executive director* before the expiry of his or her term of appointment as a *director*.

~~*remuneration*~~

~~means any form of remuneration, including salaries, discretionary pension benefits and benefits of any kind.~~

~~*statutory audit*~~

~~means any audit required by or under the Companies Act 2006 or any other legislation.~~

group services entity

in relation to a *ring-fenced body*, means an entity within the same *group* as the *ring-fenced body*, whose only business is to provide services or facilities to any other *person*.

permitted supplier

means a *person* that provides services or facilities to any other *person* and that is:

- (1) a *group services entity*; or
- (2) a *ring-fenced affiliate*.

ring-fenced affiliate

in relation to a *ring-fenced body*, means any member of the [sub-consolidated group]² of which the *ring-fenced body* is a member, other than the *ring-fenced body* itself.

ring-fencing obligation

means any obligation, prohibition or other requirement imposed on a *ring-fenced body* by or under *FSMA* by virtue of it being a *ring-fenced body*, including any statutory instrument made under *FSMA* and any *ring-fencing rule*, but not including any rule made by the *FCA*.

1.3 For the purposes of this Part:

² The definition of sub-consolidated group will be finalised after consideration of responses to a subsequent consultation paper. While the policy intent conveyed by this draft rule is accurate as regards its application within a sub-consolidated group, the way it is expressed in the final version of the rules is subject to change. The expression 'sub-consolidated group' has not been finally settled and may yet change.

(1) a director is regarded as independent if he or she is not disqualified by virtue of falling within any of 1.3(2)(a) to (h).

(2) a director is not regarded as independent if he or she:

- (a) has been an employee (other than holding an appointment as a non-executive director) of the ring-fenced body or of any other member of its group within the period of five years before his or her appointment as a director; (but a non-executive director is not to be regarded as an employee for this purpose);
- (b) has, or has had, within the period of three years before appointment, a material business relationship with the ring-fenced body or any other member of its group either directly, or as a partner, shareholder, director or as a member of senior management or equivalent of an undertaking that has such a relationship with the ring-fenced body or other member of its group, as the case may be;
- (c) has received or receives additional fixed or variable remuneration from the ring-fenced body or any other member of its group apart from, other than a director's fee, participates in the ring-fenced body's share option or performance-related pay scheme, or is remuneration attributable to a member period of the ring-fenced body's pension scheme service that concluded five years before his or her appointment as a director;
- (d) has a close family tie with any of the advisers, directors or following:
 - (i) an individual who provides or has provided professional or business advice (whether in his or her individual capacity or otherwise) to the ring-fenced body or any other member of its group;
 - (ii) a director of the ring-fenced body or of any other member of its group; or
 - (iii) a member of senior management or equivalent of the ring-fenced body or of any other member of its group;
- (e) holds directorships in common with other directors of the ring-fenced body a directorship in any other undertaking that is not a member of the ring-fenced body's group of which any other director of the ring-fenced body is also a director;
- (f) has significant links a link, of a nature that might reasonably be expected to give rise to a conflict of a sort that is to be identified and managed under 2.2, with any other directors director of the ring-fenced body through involvement in any other undertaking that is not a member of the ring-fenced body's group;
- (g) represents a significant can reasonably be identified as representing or otherwise associated with the interests of a particular shareholder or shareholders of a parent undertaking (whether an authorised person or not) of the ring-fenced body where that shareholder is or those shareholders are able to exercise significant influence over the management of the parent undertaking; or
- (h) has served on the governing body of the ring-fenced body or of any other member of its group for more than nine years from the date of first election; and.

a director is non-executive if he or she does not hold a senior management position in the ring-fenced body.

2 GENERAL RULES APPLICABLE TO RING-FENCED BODIES

- 2.1 A *ring-fenced body* must, in carrying on its business, ensure that it is able to take decisions independently of other members of its *group*.
- 2.2 A *ring-fenced body* must establish and maintain arrangements to identify and manage any ~~conflicts~~conflict between:
- (1) ~~the duties~~any duty a *director* or a member of *senior management* owes to the *ring-fenced body*; and
 - (2) any ~~interests~~interest of the *director* or member of *senior management*.
- 2.3 A *ring-fenced body* must take all reasonable steps to identify and manage any conflict between its interests and those of one or more members of its *group*.
- 2.4 A *ring-fenced body* must be able to demonstrate to the *PRA* its compliance with every ring-fencing rule~~obligation~~.

3 BOARD COMPOSITION AND MEMBERSHIP OF RING-FENCED BODIES

- 3.1 A *ring-fenced body* must ensure that at least half of the ~~positions or members for the time being of its governing body~~ are filled by independent non-executive directors.
- 3.2 For the purposes of 3.1:
- (1) the chairperson of a *ring-fenced body's governing body* is not to be counted as one of the number of independent *non-executive directors* or as one of the total number of ~~positions or members for the time being of the governing body~~; and
 - (2) where an *extraordinary vacancy* arises which, if not filled, would cause the *ring-fenced body* to fail to comply with 3.1, ~~that position is to be treated as filled by an independent non-executive director provided the ring-fenced body meets~~ must fill the test in 3.1 without relying on this provision ~~vacancy as soon as reasonably possible after the extraordinary vacancy has arisen, and will not be in breach of 3.1 while it is in the course of so doing.~~
- 3.3 A *ring-fenced body* must ensure that the person performing the *Chairman function* ~~of its governing body~~:
- (1) is an independent and non-executive director; and
 - (2) does not chair the *governing body* of any other member of the *ring-fenced body's group*, other than a ring-fenced affiliate.
- 3.4 A *ring-fenced body* must ensure that no more than one-third of the members of its *governing body* are *employees* of or *directors* of any other member of the *ring-fenced body's group*, unless that other member is ~~than of a ring-fenced body~~ affiliate.
- 3.5 A *ring-fenced body* must ensure that it publicly advertises every vacancy for an independent *non-executive director* so as to bring the existence of the vacancy to the notice of those members of the public who might reasonably be expected to seek nomination.

- 3.6 3.5 does not apply if an *extraordinary vacancy* arises in the office held by the ~~chairperson~~ person performing the governing body Chairman function of a *ring-fenced body*.
- 3.7 A *ring-fenced body* must ensure that none of its *senior management* who is a member of its *governing body* is an *executive member* of the *governing body* of any other member of the *ring-fenced body's group* ~~carrying out any activity, other than a member that is:~~
- (1) ~~excluded by or under~~ a body corporate falling within section 142D192JA(2) of FSMA;
or
 - (2) ~~prohibited by any order made under section 142E of FSMA.~~
 - (2) a *ring-fenced affiliate*.
- 3.8 For the purpose of 3.7, 'executive member' means a *person* who performs any executive function in relation to the relevant member of the *ring-fenced body's group*.

4 RISK MANAGEMENT OF RING-FENCED BODIES

- 4.1 A *ring-fenced body* must ensure that its risk committee ~~is chaired by a chairperson~~ includes a person performing the *Chairman of the Risk Committee function*.
- 4.2 A *ring-fenced body* must ensure that the ~~chairperson of its risk committee~~ person performing the *Chairman of the Risk Committee function* does not chair any committee whose functions include oversight of the risk function of any other member of the *ring-fenced body's group*, other than a *ring-fenced affiliate*.
- 4.3 A *ring-fenced body* must ensure that:
- (1) its risk management function has sufficient resources ~~and that they~~ to perform its role;
 - (2) those resources are at all times identifiable as performing the risk management function for the *ring-fenced body*; and
 - (2) ~~these resources enable~~ (3) its risk management function supports the ability of the *ring-fenced body* to take decisions independently of other members of its group comply with 2.1.
- 4.4 A *ring-fenced body* must ensure that a *person* performing the *Chief Risk function* for the *ring-fenced body* is not also a *person* performing the *Chief Risk function* or function equivalent to the *Chief Risk function* (howsoever designated) for any other member or members of the *ring-fenced body's group* or for the *group* as, other than for a *whole ring-fenced affiliate* or for the *[sub-consolidated group]*.

5 INTERNAL AUDIT POLICY OF RING-FENCED BODIES

- 5.1 A *ring-fenced body* must ~~establish an audit committee and~~ ensure that ~~the~~ its audit committee:
- (1) ~~is chaired by~~ includes a chairperson person performing the *Chairman of the Audit Committee function*;

- (2) ~~is composed of members of the management body who do not perform any executive function in the ring-fenced body; and~~
- (3) ~~has appropriate knowledge, skills and expertise in relation to audit, controls, control frameworks and reporting matters.~~
- 5.2 ~~A ring-fenced body must ensure that the chairperson of its audit committee~~person performing the Chairman of Audit Committee function does not chair any committee whose functions include oversight of the audit function of any other member of ~~the ring-fenced body's group,~~other than a ring-fenced affiliate.
- 5.3 ~~A ring-fenced body must ensure that the responsibilities of its audit committee include:~~
- (1) ~~monitoring the financial reporting process;~~
- (2) ~~monitoring the effectiveness of the ring-fenced body's:~~
- (a) ~~internal controls;~~
- (b) ~~internal audit function; and~~
- (c) ~~risk management systems;~~
- (3) ~~monitoring the statutory audit of the accounts of the ring-fenced body; and~~
- (4) ~~reviewing and monitoring the independence of persons conducting the statutory audit.~~
- 5.4 ~~A ring-fenced body must ensure its audit committee develops and maintains formal terms of reference.~~
- 5.5 ~~A ring-fenced body must ensure that:~~
- (1) ~~its internal audit function has sufficient resources and that they are to perform its role;~~
- (2) ~~those resources are at all times identifiable as performing the internal audit function for the ring-fenced body; and~~
- (2) ~~these resources enable~~³its internal audit function supports the ability of the ring-fenced body to take decisions independently of other members of its group comply with 2.1.
- 5.6⁴ ~~A ring-fenced body must ensure that a person performing the~~Chief Head of Internal Audit function for the ring-fenced body:
- (1) ~~is not also a person performing the Head of Internal Audit function or function equivalent to the Chief Head of Internal Audit function (howsoever designated) for any other member or members of ring-fenced body's group or for the group as, other than for a whole, ring-fenced affiliate or for the [sub-consolidated group]; and~~
- (2) ~~is able to have direct access to the management body of the ring-fenced body where he or she considers it necessary.~~
- 5.7 ~~A ring-fenced body must ensure that its management body and its audit committee have adequate access to the internal audit function and to external expert advice.~~

6 HUMAN RESOURCES POLICY OF RING-FENCED BODIES

- 6.1 A *ring-fenced body* must ensure that its nomination committee ~~is chaired by~~includes a chairperson.
- 6.2 A *ring-fenced body* must ensure that the chairperson of its nomination committee does not chair any committee whose functions include nomination for any other member of *the ring-fenced body's group*, other than a ring-fenced affiliate.
- 6.3 A *ring-fenced body* must ensure as far as reasonably practicable that, in carrying on its business, it does not depend on any *employee* who may cease to be available to undertake work for the *ring-fenced body* in the event of the insolvency of any other member of its *group*.

7 REMUNERATION POLICY OF RING-FENCED BODIES

- 7.1 A *ring-fenced body* must establish a *remuneration* committee that comprises only members of its *management body* who do not perform any executive function in relation to the ring-fenced body.
- 7.2 A *ring-fenced body* must ensure that its *remuneration* committee ~~is chaired by~~includes a ~~chairperson~~person performing the *Chairman of the Remuneration Committee* function.
- 7.3 A *ring-fenced body* must ensure that the ~~chairperson~~person performing the *Chairman of its remuneration committee*Remuneration Committee function does not chair any committee whose functions include *remuneration* for any other member of the *ring-fenced body's group*, other than for a ring-fenced affiliate.
- 7.4 When establishing, implementing and maintaining *remuneration* policies, practices and procedures for its *employees*, a *ring-fenced body* must ensure that these *remuneration* policies, practices and procedures:
- (1) are consistent with and promote the sound and effective risk management of the *ring-fenced body*;
 - (2) do not encourage risk-taking that exceeds the level of tolerated risk of the *ring-fenced body*;
 - (3) are in line with the business strategy, objectives, values and long-term interests of the *ring-fenced body*; and
 - (4) ~~are~~do not influenced by encourage a *ring-fenced body* to bear any factors relating to risk that would undermine its ability to comply with any ring-fencing obligation.
- 7.5 Nothing in 7.4 restricts a ring-fenced body from enabling the receipt by its employees of remuneration in the form of shares or other instruments of another member of its the ring-fenced body's group or of the group taken as a whole where their levels of tolerated risk, business strategy, objectives, values or long term interests are different, provided that the receipt of such remuneration is in accordance with 7.4.

8 CONTINUITY OF PROVISION OF SERVICES TO RING-FENCED BODIES

8.1 ~~A~~Where a *ring-fenced body* ~~may receive~~ receives services and accesses facilities that it requires on a regular basis ~~in relation to the carrying on of the business of a *ring-fenced body*~~ from an entity in its *group*, it may do so, whether directly or indirectly, only where that entity is one of the following:

(1) ~~— a *dedicated intragroup services entity*; or *permitted supplier*.~~

(2) ~~— an entity within the same [*ring-fenced body sub-group*]³ as the *ring-fenced body*.~~

8.2 A *ring-fenced body* must ensure ~~that the agreement or~~ and any related arrangement under which it receives services or accesses facilities ~~that it requires in relation to the carrying on of *core activities*~~ does not permit any other party to terminate, suspend or materially alter the services or facilities or the agreement or arrangement ~~solely~~ as a result of an act, omission or deterioration in the financial circumstances of another entity within the same *group* as the *ring-fenced body*.

8.3 (1) 8.3 applies if the ability of a *permitted supplier* (PS1) that provides services or facilities referred to in 8.2 to a *ring-fenced body* is dependent upon the provision of services or facilities to PS1 by another *permitted supplier* (PS2), whether the provision of services or facilities to PS1 by PS2 is direct or indirect.

(2) 8.2 does not prevent the *ring-fenced body* agreeing PS1 may suspend or alter the provision of those services or facilities to the extent it is prevented from providing those services or facilities as a result of a deterioration in the financial circumstances of PS2, provided:

(a) the *ring-fenced body* takes all reasonable steps before and after entering into that agreement to reduce the probability and likely impact of such an alteration to the provision of those services or facilities; and

(b) the agreement requires PS1 to use its best efforts to eliminate or reduce the effect of any such suspension or alteration.

³ ~~The exact scope of entities that will form a *ring-fenced body sub-group* has not yet been determined and will be the subject of further consultation.~~

Near-final supervisory statement on ring-fenced bodies: legal structure

1 Introduction

1.1 This supervisory statement is aimed at ring-fenced bodies (RFBs) as defined in the Financial Services and Markets Act 2000, section 142A.

1.2 The purpose of this supervisory statement is to set out the expectations that the PRA has in relation to the ownership structure of banking groups containing one or more RFBs. The content of this supervisory statement sets out some of the factors that the PRA will take into consideration when deciding whether or not to impose requirements in relation to the group ownership structure of such banking groups.

2 Expectations of banking group structures containing an RFB

2.1 The PRA will seek to ensure the continuity of the provision of core services by an RFB.

2.2 Where an RFB's group structure could adversely affect the safety and soundness of the RFB and therefore pose risks to the continuity of provision of core services, the PRA may use its powers under section 55M or section 192C of the Act to impose requirements on such an RFB.

3 Expectations of the types of entity that an RFB may own

3.1 The PRA's expectation is that an RFB must not have ownership rights in an entity that undertakes activities that, if it were an RFB, would amount to activities that contravene a prohibition or be excluded activities under the Act (for the purpose of this statement: an 'excluded activity entity'). Ownership rights may include voting rights and other rights to participate in the capital or profits of the relevant entity. This reduces the risk of losses associated with, for example, international or investment banking activity weakening the RFB. As a result, this approach helps to ensure the continuity of the provision of core services by implementing ring-fencing with regard to improving the resilience of RFBs. It may also reduce the complications associated with the possible resolution and/or failure of a subsidiary if it undertook activities that would be prohibited or excluded activities if it were an RFB.

3.2 The PRA will adopt this approach proportionately to achieve the outcomes set out by the group ring-fencing purposes of the Act.

3.3 In principle, the PRA does not necessarily object to an RFB owning entities which are not excluded activity entities. Such ownership would be considered on a case-by-case basis, based on the risks that it might pose to the RFB's resilience and resolvability and the PRA's objectives. In particular, such an assessment would consider whether the entity — if it were owned by the RFB — would represent a material threat to:

- ensuring that the RFB does not depend on resources provided by other members of its group that would cease to be available in the event of the insolvency of the other member;
- ensuring, as far as reasonably practicable, that the RFB would be able to continue to carry on core activities in the event of the insolvency of other group members; or
- ensuring that the business of RFBs is protected from risks (arising in the United Kingdom or elsewhere) that could adversely affect the continuity of the provision in the United Kingdom of core services.

4 Expectations of the types of entity that may own an RFB

4.1 Within a UK group (that is, the group headed by the ultimate UK parent), the PRA does not expect an excluded activity entity to have ownership rights in an RFB. This policy supports the RFB's ability to make independent decisions in accordance with the group ring-fencing purposes. The PRA would adopt this approach proportionately to achieve the outcomes set out in the group ring-fencing purposes. The PRA expects that the owner of an RFB may maintain or establish a non-EEA branch, have a participating interest in a non-EEA undertaking or have ownership stakes in an excluded activity entity.

4.2 In assessing whether an entity that is not an excluded activity entity should be restricted from owning an RFB within the UK group, the PRA will consider, as part of the assessment required under the Act, the resilience and resolvability of the RFB and risks posed to the continuity of provision of core activities. This assessment will include the extent to which:

- the RFB is able to make decisions independently of group entities;
- the RFB is not reliant on resources in group entities (for example capital resources) which may cease to be available in the event of insolvency of that group entity; and
- the RFB is sufficiently insulated from risks in the rest of the group, so as to ensure it is not adversely affected by the acts or omissions of group entities.

Near-final supervisory statement on ring-fenced bodies: legal structure (tracked change version)

1 Introduction

1.1 This supervisory statement is aimed at ring-fenced bodies (RFBs) as defined in the Financial Services and Markets Act 2000, section 142A.

1.2 The purpose of this supervisory statement is to set out the expectations that the PRA has in relation to the ownership structure of banking groups containing one or more RFBs. The content of this supervisory statement sets out some of the factors that the PRA will take into consideration when deciding whether or not to impose requirements in relation to the group ownership structure of such banking groups.

2 Expectations of banking group structures containing an RFB

2.1 The PRA will seek to ensure the continuity of the provision of core services by an RFB.

2.2 Where an RFB's group structure could adversely affect the safety and soundness of the RFB and therefore pose risks to the continuity of provision of core services, the PRA may use its powers under section 55M or section 192C of the Act to impose requirements on such an RFB.

3 Expectations of the types of entity that an RFB may own

3.1 The PRA's expectation is that an RFB must not have ownership rights in an entity that undertakes activities that, if it were an RFB, would amount to activities that contravene a prohibition or be excluded activities under the Act (for the purpose of this statement: an 'excluded activity entity') carries out prohibited or excluded activities. Ownership rights may include, but are not limited to, voting rights and other rights to participate in the capital or profits of the relevant entity. This reduces the risk of losses associated with, for example, international or investment banking activity weakening the RFB. As a result, this approach helps to ensure the continuity of the provision of core services by implementing ring-fencing with regard to improving the resilience of RFBs. It may also reduce the complications associated with the possible resolution and/or failure of a subsidiary if it undertook excluded or prohibited activities that would be prohibited or excluded activities if it were an RFB.

3.2 The PRA will adopt this approach proportionately to achieve the outcomes set out by the group ring-fencing purposes of the Act.

3.3 In principle, the PRA does not necessarily object to an RFB owning entities which are not excluded activity entities undertaking activities that are not excluded or prohibited under the Act. Such ownership This would be considered on a case-by-case basis, based on the risks that it might pose to the RFB's resilience and resolvability and the PRA's objectives. In particular, such an assessment would consider whether the entity — if it were owned by the RFB — would represent a material threat to:

- ensuring that the RFB does not depend on resources provided by other members of its group that would cease to be available in the event of the insolvency of the other member;
- ensuring, as far as reasonably practicable, that the RFB would be able to continue to carry on core activities in the event of the insolvency of other group members; or
- ensuring that the business of RFBs is protected from risks (arising in the United Kingdom or elsewhere) that could adversely affect the continuity of the provision in the United Kingdom of core services.

4 Expectations of the types of entity that may own an RFB

4.1 Within a UK group (that is, the group headed by the ultimate UK parent), the PRA does not expect an excluded activity entity that undertakes excluded or prohibited activities to have ownership rights in an RFB. This policy supports the RFB's ability to make independent decisions in accordance with the group ring-fencing purposes. The PRA would adopt this approach proportionately to achieve the outcomes set out in the group ring-fencing purposes. The PRA expects that the owner of an RFB may maintain or establish a non-EEA branch, have a participating interest in a non-EEA undertaking or have ownership stakes in an excluded activity entity.

4.2 In assessing whether an entity that is not an excluded activity entity in the same UK group as an RFB that does not carry out excluded or prohibited activities should be restricted from owning an RFB within the UK group, the PRA will consider, as part of the assessment required under the Act, the resilience and resolvability of the RFB and risks posed to the continuity of provision of core activities. This assessment will include the extent to which:

- the RFB is able to make decisions independently of group entities;

- the RFB is not reliant on resources in group entities (for example capital resources) which may cease to be available in the event of insolvency of that group entity; and
- the RFB is sufficiently insulated from risks in the rest of the group, so as to ensure it is not adversely affected by the acts or omissions of group entities.

Near-final supervisory statement on ring-fenced bodies: continuity of services and facilities

1 Introduction

1.1 This supervisory statement is aimed at ring-fenced bodies (RFBs) as defined in the Financial Services and Markets Act 2000, section 142A.

1.2 The purpose of this supervisory statement is to set out the PRA's expectations on the arrangements that RFBs may make where they receive services and facilities from other group entities or third parties outside of their group.

2 Group service arrangements

2.1 An RFB may receive services and facilities only from other group entities where such entities are group services entities or are ring-fenced affiliates.⁽¹⁾⁽²⁾

2.2 'Services and facilities' includes the following types of services and facilities that support the business of the RFB: data-processing services; property management services; information technology; data centres; and back office functions. Note that this is not an exhaustive list.

2.3 RFBs should be aware that the rules and guidance on outsourcing requirements in the Senior Management Arrangements, Systems and Control sourcebook of the PRA's Rulebook (SYSC 8) apply to RFBs.

2.4 The PRA expects RFBs to demonstrate that they are appropriately managing the operational risk associated with any services and facilities they outsource. Factors supporting this could include:

- group services entities are financially and operationally resilient to an insolvency or resolution event involving the group entities they provide services to;
- there are appropriate contingency arrangements in the event of there being disruption to the RFB's outsourcing arrangement; and/or
- the services and facilities being provided to the RFB are substitutable.

3 Group and third-party service arrangements

3.1 The provision of services and facilities from other group entities and third parties to an RFB that is required for the RFB to carry on its core activities should not be capable of being disrupted through the acts, omissions, or insolvency of other group members.

3.2 It is expected that this could be achieved through RFBs ensuring:

- that their contractual arrangements do not contain clauses such as set off rights, security interest, netting arrangements, and material adverse event provisions which could be triggered as a result of the acts or omissions of other group members. Note that this is not an exhaustive list of relevant contractual provisions; and
- that a material deterioration in the financial circumstances of another group entity, or an insolvency or resolution event, does not disrupt any arrangements the RFB has with relevant parties which are necessary for the RFB to conduct its core activities.

(1) A 'group services entity' means an entity within the same group as the ring-fenced body whose only business is to provide services or facilities.

(2) The PRA has introduced the term 'ring-fenced affiliate' into the near-final rules to identify any member of the RFB's sub-consolidation group. The definition of sub-consolidated group will be finalised after consideration of responses to a subsequent consultation paper. While the policy intent conveyed by this draft rule is accurate with regard to its application within a sub-consolidated group, the way it is expressed in the final version of the rules is subject to change.

Near-final supervisory statement on ring-fenced bodies: continuity of services and facilities (tracked change version)

1 Introduction

1.1 This supervisory statement is aimed at ring-fenced bodies (RFBs) as defined in the Financial Services and Markets Act 2000, section 142A.

1.2 The purpose of this supervisory statement is to set out the PRA's expectations on the arrangements that RFBs may make where they receive services and facilities from other intragroup entities or third parties outside of their group.

2 ~~Intragroup~~ Group service arrangements

2.1 An RFB may receive ~~shared~~ services and facilities only from other group entities where such entities are ~~part of the RFB's subgroup or are dedicated intragroup services entities or are~~ ring-fenced affiliates.⁽¹⁾⁽²⁾

~~2.2 'Shared services and facilities' refers to those services and facilities which are needed to support the business of the RFB and other group entities. 'Services and facilities' includes the following types of services and facilities that support the business of the RFB: For example: data-processing services; property management services; information technology; data centres; and back office functions. Note that this is not an exhaustive list.~~

2.3 RFBs should be aware that the rules and guidance on outsourcing requirements in the Senior Management Arrangements, Systems and Control sourcebook of the PRA's Rulebook (SYSC 8) apply to RFBs.

2.4 The PRA expects RFBs to demonstrate that they are appropriately managing the operational risk associated with any services and facilities they outsource. Factors supporting this could include:

- group services entities are financially and operationally resilient to an insolvency or resolution event involving the group entities they provide services to;
- there are appropriate contingency arrangements in the event of there being disruption to the RFB's outsourcing arrangement; and/or
- the services and facilities being provided to the RFB are substitutable.

~~2.5 Where an RFB relies on services and facilities that are not shared with other group entities then it is expected that these should be owned and managed by the RFB itself or the RFB should contract directly with third parties for the provision of them.~~

3 ~~Intragroup~~ Group and third party service arrangements

3.1 The provision of services and facilities from other group entities and third parties to an RFB that is required for the RFB to carry on its core activities should not be capable of being disrupted through the acts, omissions, or insolvency of other group members.

3.2 It is expected that this could be achieved through RFBs ensuring:

- that their contractual arrangements do not contain clauses such as set off rights, security interest liens, netting arrangements, and material adverse event provisions which could be triggered as a result of the acts or omissions of other group members. Note that this is not an exhaustive list of relevant contractual provisions; and
- that a material deterioration in the financial circumstances of another group entity, or an insolvency or resolution event, does not disrupt any arrangements the RFB has with relevant parties which are necessary for the RFB to conduct its core activities.

(1) A ~~'dedicated intragroup services entity'~~ means an entity within the same group as the ring-fenced body whose only business is to provide services or facilities ~~to other entities within its group.~~

(2) The PRA has introduced the term 'ring-fenced affiliate' into the near-final rules to identify any member of the RFB's sub-consolidation group. The definition of sub-consolidated group will be finalised after consideration of responses to a subsequent consultation paper. While the policy intent conveyed by this draft rule is accurate with regard to its application within a sub-consolidated group, the way it is expressed in the final version of the rules is subject to change.