

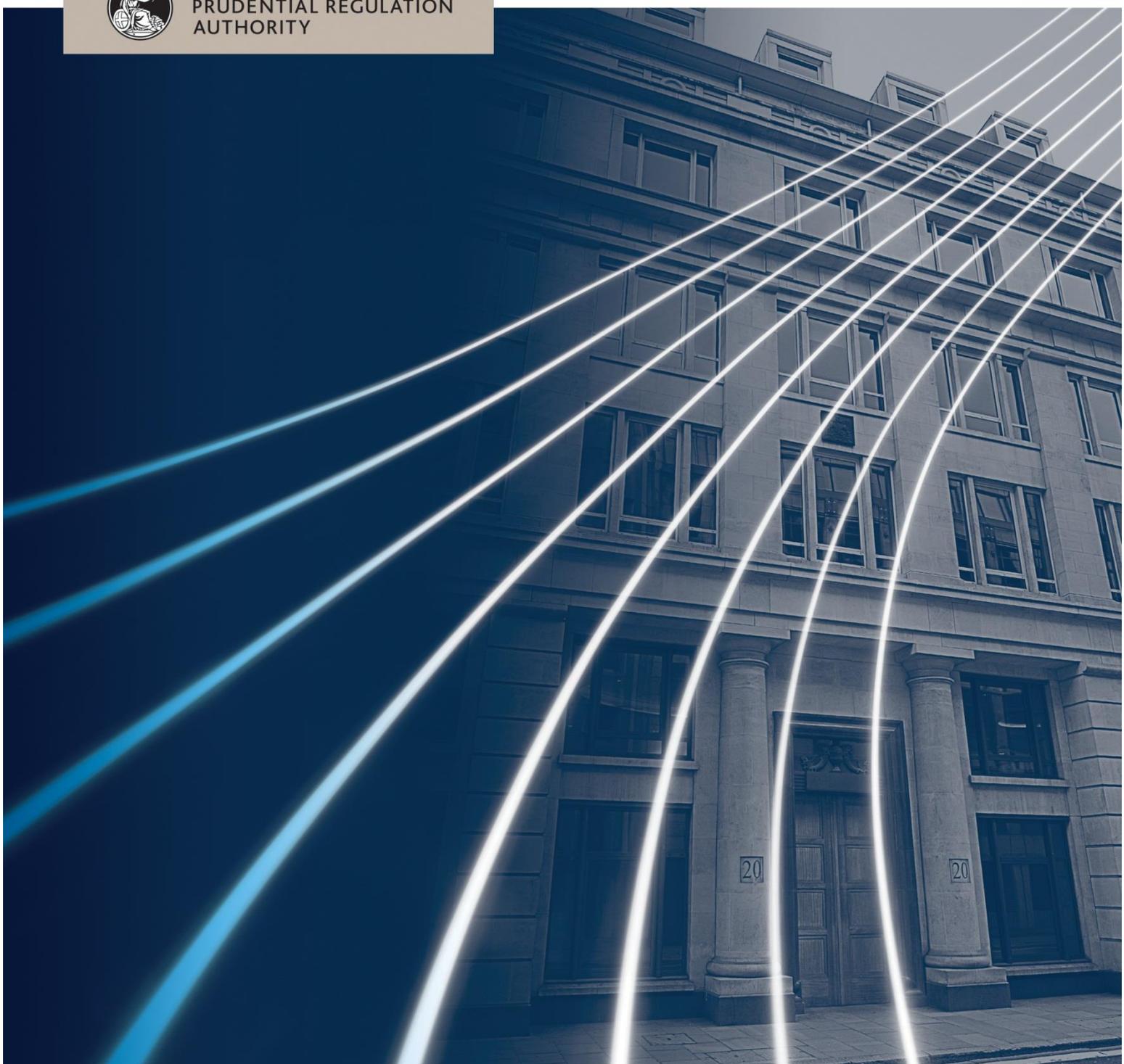
Policy Statement | PS3/17

# The implementation of ring-fencing: reporting and residual matters – responses to CP25/16 and Chapter 5 of CP36/16

February 2017



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This policy statement (PS) provides feedback on responses received to Consultation Paper (CP) 25/16 'The implementation of ring-fencing: reporting and residual matters' and Chapter 5 of CP36/16 'Occasional Consultation Paper' and contains the final rules and supervisory statements.



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## 1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback on responses received to Consultation Paper (CP) 25/16 ‘The implementation of ring-fencing: reporting and residual matters’.<sup>1</sup> It also provides feedback on responses received to Chapter 5 ‘Ring-fencing – consequential and reporting amendments’ of CP36/16 ‘Occasional Consultation Paper’.<sup>2</sup>

1.2 This PS is relevant to those banking groups that will be required by the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services (Banking Reform) Act 2013 (the Banking Reform Act) to ring-fence their ‘core activities’. This includes both those groups which currently have ‘core’ deposits – broadly those deposits from individuals and small businesses – in excess of £25 billion and those groups which expect to exceed this threshold by 1 January 2019. This PS will also be relevant to banks and banking groups which may approach this threshold over time. This PS will be of interest to financial and other institutions, and customers who have dealings with these banking groups.<sup>3</sup> It should be read alongside the Ring-fenced Bodies Part and the Regulatory Reporting Part of the PRA Rulebook.

1.3 The appendices to this PS set out the final rules (see Appendix 1) and supporting policy documents (see Appendices 2-6) to implement the proposals consulted on in CP25/16. The relevant appendices items include links to final reporting templates and instructions.<sup>4</sup>

1.4 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made. The PRA received seven responses to CP25/16. Overall, the PRA does not consider that the responses received necessitate significant changes to its proposals. The PRA has, however, made minor amendments to the proposed rules and supervisory statements consulted on in CP25/16 in light of the feedback received and to add further clarity. As the changes are not significant, the PRA has not updated the assessment of impact on mutuals or cost benefit analysis (CBA) from CP25/16. Each chapter of this PS describes the most important issues raised by respondents and notes the main areas where the PRA has made amendments in the rules and supporting policy documents.

1.5 The PRA has developed the policy in this PS in the context of the existing UK and European Union (EU) regulatory framework. The PRA will keep the policy under review to assess whether any changes may be required in connection with the UK’s withdrawal from the EU.

### Consequential changes

1.6 In July 2016 HM Treasury made a number of amendments to the ring-fencing secondary legislation.<sup>5</sup> As a result of these amendments, the PRA identified a need for consequential

1 July 2016: [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp2516.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp2516.aspx).

2 October 2016: [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp3616.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp3616.aspx).

3 The PRA has a dedicated webpage on ring-fencing and structural reform, which includes background, key changes, a table summarising policy development and updates on implementation: [www.bankofengland.co.uk/pr/Pages/supervision/structuralreform/default.aspx](http://www.bankofengland.co.uk/pr/Pages/supervision/structuralreform/default.aspx).

4 In CP25/16, the PRA consulted on new templates and instructions RFB001-008 (previously PRA109-116) which are contained in Appendix 1 and 2. The PRA also consulted on changes to the data item and instructions for FSA071, ‘Firm information and Pillar 2A summary’, and ‘Guidance on terms used in data items FSA071 to FSA082’, which are contained in SS32/15, ‘Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082’. The updated SS32/15 is included as Appendix 6.

5 The Financial Services and Markets Act 2000 (Ring-fenced Bodies, Core Activities, Excluded Activities and Prohibitions) (Amendment) Order 2016: [www.legislation.gov.uk/uksi/2016/1032/contents/made](http://www.legislation.gov.uk/uksi/2016/1032/contents/made).

changes to the PRA’s ring-fencing regime, including to the reporting requirements proposed in CP25/16. The PRA consulted on these changes in Chapter 5 of CP36/16.<sup>1</sup>

1.7 CP36/16 closed on 12 December 2016 and the PRA received three responses. These responses are discussed in Chapters 4 and 5 of this PS. The PRA has incorporated the amendments proposed in Chapter 5 of CP36/16 into the final rules and reporting templates published in the appendices to this PS.

1.8 Firms should also note that, following the publication of CP25/16, the PRA has made changes to the Regulatory Reporting Part in the following instruments as a result of other PRA publications:

- (i) PRA Rulebook: Non-CRR Firms: Credit Unions Instrument (No. 2) 2016 (PRA 2016/40), moving credit unions’ reporting requirements from the Regulatory Reporting Part to the Credit Unions Part of the PRA Rulebook;<sup>2</sup>
- (ii) PRA Rulebook: CRR Firms: Regulatory Reporting Amendment Instrument 2016 (PRA 2016/43), introducing requirements in relation to forecast capital data reporting;<sup>3</sup>
- (iii) PRA Rulebook: CRR Firms: Regulatory Reporting (Amendment) (No. 2) Instrument 2016 (PRA 2016/44), making changes to formatting and footnotes including in relation to annual reporting and accounts under the Companies Act 2006;<sup>4</sup> and
- (iv) PRA Rulebook: CRR Firms: Regulatory Reporting (Amendment) (No. 3) Instrument 2016 (PRA 2016/48), making changes in relation to reporting financial statement data.<sup>5</sup>

1.9 Each of these final rule instruments have been published and will be in force prior to 1 January 2019. Consequently, the rules in Appendix 1 of this PS incorporate the changes made to the Regulatory Reporting Part as a result of the changes above.

### Reporting template references

1.10 The PRA has amended the references of the templates proposed in CP25/16 to help distinguish these from other PRA reporting templates. Table 1 below shows the template references proposed in CP25/16 and the names used in the final rules. The final references, as set out in Table 1, are used throughout this PS.

**Table 1: Original and final template names**

Data item	Original name	Final name
Intragroup exposures	PRA109	RFB001
Intragroup funding	PRA110	RFB002
Intragroup financial reporting (core)	PRA111	RFB003
Intragroup financial reporting (detailed)	PRA112	RFB004

1 See footnote 2, page 1.

2 PRA Policy Statement 31/16 ‘Credit union regulatory reporting’, November 2016: [www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3116.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3116.aspx).

3 PRA Policy Statement 32/16 ‘Responses to Chapter 3 of CP17/16 - forecast capital data’, November 2016: [www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3216.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3216.aspx).

4 PRA Policy Statement 35/16 ‘Responses to CP26/16’, December 2016: [www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3516.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3516.aspx).

5 PRA Policy Statement 36/16 ‘Financial statements - responses to Chapter 3 of CP17/16’, December 2016: [www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3616.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3616.aspx).

Joint and several liability arising from taxes	PRA113	RFB005
Excluded activity entities	PRA114	RFB006
Use of financial market infrastructures	PRA115	RFB007
Excluded activities and prohibitions	PRA116	RFB008

## 2 Supervision of prudential requirements at RFB sub-group level

2.1 The PRA has set out in SS8/16 ‘Ring-fenced bodies (RFBs)’<sup>1</sup> that it expects to exercise the discretion in Article 11(5) of the Capital Requirements Regulation (CRR)<sup>2,3</sup> to require a ring-fenced body (RFB) to meet prudential requirements on a sub-consolidated basis, in respect of its RFB sub-group.<sup>4</sup> CP25/16 sets out the consequences for reporting and disclosure requirements under the CRR.<sup>5</sup>

2.2 In CP25/16, the PRA proposed that other reporting requirements outside the CRR, but within the PRA’s reporting regime that apply on a consolidated basis to banking groups affected by ring-fencing, should also be applied to an RFB sub-group. These data will enable the PRA to monitor an RFB sub-group’s financial resources.

2.3 The PRA also proposed:

- (i) an expectation that it will require an RFB sub-group to report CRR Financial Reporting (FINREP) and audited financial statements if it would not otherwise be required to do so;
- (ii) an expectation that an RFB will provide certain remuneration data on a sub-consolidated basis as part of existing annual group review procedures; and
- (iii) that an RFB would be required to submit the reporting requirements proposed in CP17/16 ‘Regulatory reporting of financial statements, forecast capital data and IFRS 9 requirements’,<sup>6</sup> on a sub-consolidated basis, if those proposals were adopted.

2.4 In general, respondents supported the overarching principle set out in CP25/15, that an RFB sub-group should be required to submit all data that are currently provided on a consolidated basis by banking groups affected by ring-fencing. Respondents did, however, raise concerns with, or seek clarity on, certain aspects of the proposals. These are set out below along with the PRA’s response.

### Waiving of requirements on an individual basis

2.5 Several respondents stated that, where reporting requirements are applied on a sub-consolidated basis, the continued application of reporting requirements on an individual

1 PRA Supervisory Statement 8/16 ‘Ring-fenced bodies (RFBs)’, July 2016: [www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss816.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss816.aspx).

2 Regulation (EU) No 575/2013.

3 On 23 November 2016, the European Commission published proposals to amend the CRR and the Capital Requirements Directive IV: [www.ec.europa.eu/finance/bank/regcapital/crr-crd-review/index\\_en.htm](http://www.ec.europa.eu/finance/bank/regcapital/crr-crd-review/index_en.htm).

4 An RFB sub-group is a sub-set of related group entities within a consolidated group, consisting of one or more RFBs and other legal entities, which is established when the PRA gives effect to Article 11(5) of the CRR.

5 Where prudential requirements are applied on a sub-consolidated basis, a credit institution is required to meet the reporting and disclosure requirements contained within Parts Two to Four and Six to Eight of the CRR on a sub-consolidated basis.

6 April 2016: [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp1716.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp1716.aspx). Final policy following CP17/16 was published in PRA Policy Statement 36/16 ‘Financial statements - responses to Chapter 3 of CP17/16’ December 2016: [www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3616.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3616.aspx) and Policy Statement 32/16 ‘Responses to Chapter 3 of CP17/16 - forecast capital data’ November 2016: [www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3216.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps3216.aspx).

basis could be burdensome. One respondent suggested that the PRA should waive individual reporting requirements under Article 7 of the CRR in cases where a high proportion of the RFB sub-group is comprised principally from one or more RFBs.<sup>1</sup>

2.6 The PRA has already stated, in SS8/16, that it does not expect to grant a waiver of financial resources requirements to an RFB or any other PRA-authorized person that is a member of its RFB sub-group. Accordingly, it does not expect to waive individual reporting requirements, as Article 7 of the CRR does not permit the PRA to waive some prudential requirements but not others.

### **Pillar 3 disclosures**

2.7 Under the CRR, ‘significant subsidiaries’ within consolidated banking groups are required to publish individual Pillar 3 disclosure requirements. As described in paragraph 2.1 above, an RFB will be required to meet Pillar 3 disclosure requirements on a sub-consolidated basis. Several respondents expressed concern that there could be considerable overlap between the sub-consolidated disclosures of an RFB sub-group and the individual disclosures of significant subsidiaries within banking groups containing an RFB. Respondents stated that this could be duplicative and confusing for the market.

2.8 One respondent suggested that the PRA should require a reduced set of disclosures for significant group subsidiaries within an RFB sub-group. Another suggested that the PRA should waive the requirement for an RFB to meet Pillar 3 disclosure requirements on a sub-consolidated basis.

2.9 The scope of Pillar 3 disclosure requirements is set by the CRR, and there are no discretions available to the PRA to change these. However, the PRA notes that, under the CRR, significant subsidiaries of consolidated groups are required to meet Pillar 3 disclosure requirements on a sub-consolidated or an individual basis, not both. This means that significant subsidiaries which meet Pillar 3 disclosure requirements on a sub-consolidated basis as a consequence of their membership of an RFB sub-group will not be required to separately meet Pillar 3 disclosure requirements on an individual basis.

### **PRA Rulebook reporting requirements**

2.10 In CP17/16, the PRA set out proposals for future reporting of balance sheet, statement of profit or loss (P&L) and forecast capital data.<sup>2</sup> As stated in paragraph 2.2 above, the PRA proposed in CP25/16 that, if the proposals in CP17/16 were adopted, an RFB would be required to meet those reporting requirements on a sub-consolidated basis.

2.11 The PRA has now published its response to CP17/16 in PS32/16<sup>3</sup> and PS36/16<sup>4</sup> which confirms the proposed reporting requirements relating to financial statements, forecast capital data and International Financial Reporting Standard 9 (IFRS 9). As proposed in CP25/16, an RFB will therefore be required to comply with these requirements on a sub-consolidated basis.

2.12 In addition to the requirements proposed in CP25/16, firms should note that a subsequent PRA consultation paper, CP46/16 ‘IFRS 9: changes to reporting requirements’,<sup>5</sup> has proposed further changes to reporting requirements in 2018, in light of the implementation of

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1 Article 7 CRR permits, but does not require, a competent authority to waive the application of certain prudential requirements on an individual basis provided the specified conditions are met.

2 See footnote 6, page 7.

3 See footnote 6, page 7.

4 See footnote 6, page 7.

5 December 2016: [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4616.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4616.aspx).

IFRS 9. CP46/16 also proposes that these new reporting requirements should apply to an RFB on a sub-consolidated basis. The consultation on these proposals is ongoing and a further consultation is expected to follow at a later date on the exact rule changes required to apply the reporting requirements proposed in CP46/16 to an RFB on a sub-consolidated basis.

### Prudential valuation returns

2.13 The final rules appended to this PS (Appendix 1) require an RFB to submit Prudent Valuation Returns on a sub-consolidated basis. Firms should note that, in March 2016, the European Banking Authority (EBA) consulted on adding templates relating to prudent valuation information to Common Reporting (COREP).<sup>1</sup> When these templates are finalised and adopted, the PRA will consider whether any changes are needed to its own prudent valuation reporting requirements.

## 3 Intragroup transactions

3.1 In CP25/16, the PRA proposed new reporting templates to collect data on transactions between an RFB sub-group and group entities that are not members of the RFB sub-group. These templates will provide the PRA with data to monitor risks to an RFB sub-group from, and any dependencies of an RFB sub-group on, group entities that are not members of the RFB sub-group.

3.2 The proposed reporting requirements will also meet the PRA's legal obligation under Section 142H(5)(c) of FSMA to make rules requiring the disclosure to the PRA of information relating to transactions between an RFB and other members of its group.

3.3 CP25/16 proposed the following intragroup reporting templates:

- (i) RFB001 (previously PRA109) - Intragroup exposures and credit risk mitigation (CRM), based on the COREP large exposure templates (C28.00 and C29.00), where these would not otherwise be reported due to reporting thresholds;
- (ii) RFB002 (previously PRA110) - Intragroup funding transactions, based on the COREP concentration of funding by counterparty template (C67.00);
- (iii) RFB003 (previously PRA111) - Intragroup FINREP - core intragroup balance sheet and profit or loss (P&L) items, based on FINREP templates and definitions; and
- (iv) RFB004 (previously PRA112) - Intragroup FINREP - detailed breakdowns of intragroup balance sheet and P&L items, based on FINREP templates and definitions.<sup>2</sup>

3.4 In general, respondents supported the PRA's approach of using existing COREP and FINREP templates and definitions as a basis for the new intragroup reporting templates. One respondent stated that the proposed reporting requirements were a logical extension of the existing reporting regime to ring-fencing.

3.5 Another respondent stated that the PRA should clarify that reporting due dates for the new intragroup data templates will not be set in advance of equivalent RFB sub-group COREP and FINREP returns. This is because the PRA has defined due dates expressed in terms of

<sup>1</sup> [www.eba.europa.eu/-/eba-seeks-comments-on-reporting-of-prudent-valuation-information](http://www.eba.europa.eu/-/eba-seeks-comments-on-reporting-of-prudent-valuation-information).

<sup>2</sup> On 30 November, the European Banking Authority published the updated version of FINREP for application from Q1 2018: [www.eba.europa.eu/-/eba-amends-supervisory-reporting-standards-due-to-the-new-ifs-9](http://www.eba.europa.eu/-/eba-amends-supervisory-reporting-standards-due-to-the-new-ifs-9). The PRA has therefore updated data items RFB003 and RFB004 accordingly.

numbers of business days after the end of the quarter, while COREP and FINREP due dates are set on fixed calendar days. The PRA can confirm that the due dates for the new intragroup data templates are on the same day or later than the due dates for the equivalent COREP and FINREP returns.

### **Intragroup exposures – RFB001 (previously PRA109)**

3.6 One respondent stated that the PRA should include a reporting threshold to avoid reporting of exposures that were de minimis. The PRA does not agree that a reporting threshold is necessary. The proposed template was no more granular than the existing large exposure templates C28.00 and C29.00, which require a full breakdown of exposures to all entities in a group of connected clients (GCC), regardless of size, if the gross exposure to the GCC is above a certain threshold. RFB001 simply extends this to require the full breakdown of exposures even in cases where the gross exposure is below the existing threshold.

3.7 Another respondent stated that the PRA should clarify that exposures between entities that are members of an RFB's core UK group (CUG) or non-core large exposure group (NCLEG) would not be included in the template.

3.8 The proposed template would only capture exposures of members of an RFB sub-group to group entities that are not members of the RFB sub-group. In SS8/16,<sup>1</sup> the PRA set out its expectation not to grant an intragroup large exposure permission to an RFB, or to a PRA-authorized person that is a ring-fenced affiliate,<sup>2</sup> in respect of transactions with or exposures to group entities that are not part of the RFB sub-group. Accordingly, the PRA expects that all members of an RFB's CUG or NCLEG will be members of the RFB's sub-group. In these circumstances, exposures between those entities would not be included in the template.

3.9 Another respondent suggested that the PRA amend the reporting instructions for RFB001 to provide further detail on the difference in scope between this template and existing large exposure templates. The PRA has made minor amendments to the reporting instructions to clarify which exposures it would expect to be reported.

3.10 Another respondent asked the PRA to clarify whether the proposed reporting of collateral used to secure intragroup exposures only applies to collateral held by the RFB in respect of obligations owed by the rest of the group to the RFB and not to client collateral. The PRA can confirm that the proposed reporting does not apply to client collateral.

### **Intragroup FINREP – RFB003 and RFB004 (previously PRA111 and PRA112)**

3.11 One respondent stated that the proposed reporting of intragroup balance sheet and P&L in RFB003 and RFB004 was burdensome and would involve significant upfront and ongoing costs. The respondent stated that these costs could not be justified by the value of such granular information and suggested that such reporting should be subject to materiality thresholds.

3.12 The PRA does not agree that materiality thresholds are necessary. The proposed templates will provide key data on intragroup assets, liabilities, income and expenses as well as on intragroup transactions eg derivatives. These data are essential to the PRA's approach to supervising ring-fencing by monitoring the RFB sub-group and its interactions with the rest of its group. The proposed reporting is also no more granular than the COREP and FINREP

<sup>1</sup> See footnote 1, page 7.

<sup>2</sup> A ring-fenced affiliate, in relation to an RFB, is an entity which is a member of an RFB sub-group which is not itself that RFB.

reporting that will be required from an RFB sub-group and which will provide a comparator for the intragroup data provided in RFB003 and RFB004.

#### Intragroup and shared customer income

3.13 The proposed intragroup reporting templates also included proposals for quarterly reporting by an RFB sub-group of data on intragroup and shared customer income. These data will help the PRA monitor any risk of dependence by the RFB sub-group on income generated from transactions or customers shared with the rest of its group.<sup>1</sup>

3.14 One respondent stated that this proposal was disproportionate given the systems costs involved. The respondent suggested that income from customers shared with certain group entities outside the RFB sub-group should be out of scope of the reporting of shared customer income and that the frequency of reporting should be reduced from quarterly to annual.

3.15 The PRA does not consider that there are any grounds for excluding income from customers shared with certain group entities outside the RFB sub-group from the scope of the reporting requirement. This is because the PRA's rules<sup>2</sup> and expectations<sup>3</sup> relating to income dependence would apply to any income generated from this business. The PRA has not reduced the frequency of these templates as it considers that the frequency of reporting should be aligned to the frequency of reporting of the intragroup balance sheet.

3.16 The PRA notes that there are incremental costs associated with reporting this information. It is important to note, however, that PRA rules require an RFB to be able to demonstrate that it is not, as far as reasonably practicable, dependent on contingent intragroup or shared customer income and the PRA expects an RFB to monitor such income.<sup>4</sup> An RFB is therefore already required to be able to identify intragroup and shared customer income.

3.17 Several respondents suggested that further detailed definitions of 'contingent income', 'intragroup income' and 'shared customer income' were needed for banks to comply with the proposed reporting requirement. Another respondent proposed that an industry discussion with the PRA would be helpful. The PRA has not expanded on the definitions provided in the reporting instructions, which are based on the definitions used in the Ring-fenced Bodies Part and in SS8/16. The PRA would expect the usual industry discussions to take place as part of implementation.

## 4 Use of exceptions to excluded activities and prohibitions

4.1 As set out in CP25/16, FSMA prohibits an RFB from carrying on excluded activities or contravening prohibitions, including from having exposures to relevant financial institutions (RFIs). The Excluded Activities and Prohibitions Order (the Order)<sup>5</sup> specifies a number of exceptions to these exclusions and prohibitions which allow an RFB to carry out certain activities it would otherwise be prevented from undertaking. FSMA also requires the PRA to include an assessment, in general terms, within its annual report to Parliament pursuant to paragraph 19 of Schedule 1ZB of FSMA, of the extent to which RFBs have used the exceptions set out in the Order.

1 Ring-fenced Bodies 2 and 13.

2 Ring-fenced Bodies 13.

3 Chapter 7 of SS8/16.

4 Paragraph 7.9 of SS8/16.

5 The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014: [www.legislation.gov.uk/ukdsi/2014/9780111117101/contents](http://www.legislation.gov.uk/ukdsi/2014/9780111117101/contents).

4.2 In CP25/16, the PRA proposed new reporting templates (RFB008, previously PRA116) to collect data to monitor an RFB's use of the majority of these exceptions. The PRA proposed that these templates be submitted by each RFB at an individual level, rather than from an RFB sub-group. CP25/16 proposed that these templates be submitted annually.<sup>1,2</sup>

### **Granularity of reporting**

4.3 One respondent stated that the PRA should consider whether the proposed template RFB008a (previously PRA116a), which requires an RFB to report data on transactions relating to risk management, could be disproportionately granular when considered against the ring-fencing purposes. The PRA has not amended the granularity of RFB008a. The proposed template was considered to provide only sufficient information to allow the PRA to identify where firms are potentially not compliant, or are taking risks that might adversely affect the continuity of provision of core services. The PRA considers this to be the most proportionate approach.

### **Reporting of RFI exposures**

4.4 One respondent highlighted that there would be practical difficulties with reporting certain permitted exposures to RFIs where these form part of an RFB's collateral arrangements.<sup>3</sup> The respondent gave the example of an RFB securing a loan with a charge over a borrower's book debts which may include a receivable owed by an RFI, or other RFI exposures that might arise from time to time under a floating charge. This respondent interpreted the reporting templates in RFB008 as not capturing these exposures.

4.5 The PRA can confirm that the proposal in CP25/16 was that all direct exposures should be reported. Direct exposures are those exposures where the immediate counterparty is an RFI. A transaction secured by an RFI exposure (eg where collateral provided by a borrower to secure a loan contains an RFI exposure) would not therefore constitute a direct exposure. The PRA has amended the reporting instructions to clarify this.

4.6 Further, the PRA acknowledges that even where a direct RFI exposure may arise (for example in the event of default of a collateralised loan) it may be difficult for an RFB to identify it. The PRA has therefore amended this section of the reporting instructions to require that an RFB report on RFI exposures that may arise through collateral arrangements on a reasonable endeavours basis. In line with Ring-Fenced Bodies 17 and Chapter 10 of SS8/16, the PRA would also expect an RFB to document where such exposures might arise in its exceptions policy.

### **Use of exceptions by ring-fenced affiliates**

4.7 In CP25/16, the PRA proposed that the reporting templates covering the use of exceptions be submitted by each RFB at an individual level.

4.8 As part of the development of its ring-fencing policy, the PRA has set out its expectation that an RFB will apply the relevant parts of its exceptions policies to the other entities in its RFB sub-group or assess their activities against its exceptions policies.<sup>4</sup> The PRA expects an RFB to do this as part of assessing whether it is meeting the PRA's expectations in relation to legal structure, in particular whether it owns entities that perform activities that would be excluded activities or contravene prohibitions under the Order if those entities were RFBs.

1 The PRA proposed reporting templates covering the majority of exceptions contained within the Order. The PRA did not propose new reporting requirements where existing reporting requirements (or other requirements proposed in CP25/16) were expected to provide sufficient information. The PRA also did not propose reporting templates where, in its view, it would lead to costs that would be disproportionate to risks involved in the activity being monitored.

2 The PRA has made a minor amendment to template RFB008f ('Customer derivatives'), to ensure this is aligned with the Order.

3 Article 14(3)(d) of the Order allows an RFB to incur an RFI exposure where it does so for the sole or main purpose of mitigating default risk.

4 Chapter 10 of SS8/16.

4.9 In light of this, the PRA will consult on a proposal that an RFB should be required to report an aggregated total for the use of exceptions by all entities in its RFB sub-group, in addition to the reporting by individual RFBs proposed in CP25/16, in due course.

#### **Notification requirements for use of exceptions**

4.10 In Chapter 5 of CP36/16, the PRA proposed that an RFB must notify the PRA when it uses certain exceptions under the Order. Two respondents stated that the wording of the notification requirement relating to RFI exposures arising due to a change in status of an RFB's counterparty (rule 12.7 in the Notifications Part of the PRA Rulebook) would be difficult to comply with. The PRA has amended Notifications 12.7 to clarify that an RFB only has to notify the PRA within 30 days of becoming aware that a counterparty has become an RFI.

#### **The PRA's Annual Report**

4.11 The reporting proposed in CP25/16 will be required annually for the calendar year to 31 December. As the PRA's first report on this matter to Parliament will be published in mid-2019, CP25/16 stated that supervisors would discuss with firms the extent and nature of data required to cover the initial period from 1 January 2019.

4.12 Several respondents asked for further clarity on what information would be collected and whether this information will be limited to exceptions data for Q1 2019 only. The PRA expects that any such information request would contain at most the information covered by template RFB008 (excluded activities and prohibitions), plus potentially extra data on the use of the transitional provision set out in Article 21 of the Order, and would cover data for January and February 2019 only.

4.13 Several respondents also asked how this information will be used and whether it will be kept confidential, given firms' own internal procedure and governance for publication of data. Any firm-specific information will be confidential information under FSMA. The PRA has to report to Parliament in general terms, so the PRA is not required to include individual firms' data in the report.

## **5 Ring-fencing rules and supervisory statements**

5.1 In CP25/16, the PRA proposed new reporting templates to monitor an RFB's compliance with certain PRA rules and the extent to which an RFB has acted in accordance with certain PRA expectations. In general, respondents were supportive of these proposals. Some respondents did raise technical issues with certain proposed templates, however. These are set out below along with the PRA's response.

#### **Sub-group entities which perform excluded activities – (RFB006 previously PRA114)**

5.2 In CP25/16, the PRA proposed a new reporting template (RFB006) which collects data on excluded activities undertaken, or prohibited exposures incurred, by ring-fenced affiliates (excluding RFBs), net of the use of exceptions. Two respondents to Chapter 5 of CP36/16 asked the PRA to reconsider the scope of RFB006, arguing that filling in this information may be burdensome for entities such as pension trustee companies. The PRA has not amended the template: its intention is to capture the extent to which excluded or prohibited activities are taking place within the RFB sub-group. An RFB should be aware of the nature and extent of any such activities within their sub-groups, irrespective of the type of entity carrying them out.

#### **Participation in financial market infrastructures – RFB007 (previously PRA115)**

5.3 In CP25/16, the PRA proposed a new reporting template (RFB007) to collect data on the volume and value of transactions by an RFB and its ring-fenced affiliates through each financial

market infrastructure (FMI) in which they participate and whether access to the FMI is direct or indirect. Where access is indirect, the PRA proposed that an RFB would be required to report on the intermediaries used. For indirect access to inter-bank payment systems, the PRA also proposed that an RFB would be required to identify the exception it is exercising under the legislation.

5.4 One respondent stated that, in cases where it was accessing a foreign payment system through an intermediary, it may not be able to identify the specific inter-bank payments system used. This is because many jurisdictions have multiple payment systems in operation, and the decision on which to use would be made by the intermediary (ie the correspondent bank).

5.5 The PRA has amended the reporting instructions to allow volumes and values to be reported on a currency basis where payment transactions are made through an intermediary and it is not possible to identify the inter-bank payments system being used.

5.6 One respondent also asked that the PRA clarify whether processing of client payments or payments on an agency basis should be reported. The PRA has amended the reporting instructions to clarify that all transactions are to be reported.

### **Information on certain taxes with joint and several liability – RFB005 (previously PRA113)**

5.7 In CP25/16, the PRA proposed a new reporting template (RFB005) to collect data on taxes where an RFB sub-group has joint and several liability. The proposed template required an RFB to report its consolidated group's annual charge for the Bank Levy and Corporation Tax Surcharge and its total VAT amount due and reclaimed for each quarter, and the amount of each of these that is attributable to the RFB sub-group.

5.8 Two respondents noted that the concept of joint and several liability does not apply to the Corporation Tax Surcharge within a group. The PRA has therefore removed the Corporation Tax Surcharge from the reporting template. One respondent also suggested that the PRA should use a better measure of liability than the consolidated group charge for reporting on the Bank Levy. The PRA has amended the reporting template and reporting instructions to reflect this by also asking for details of the year-end liability in respect of the Bank Levy in addition to details of the annual Bank Levy charge. The PRA has also amended the template and reporting instructions to clarify that data collected on amounts attributable to the RFB sub-group should reflect amounts recognised in the financial results of the RFB sub-group.

## **6 Reporting systems**

6.1 In CP27/16, the PRA stated that it expects the data in the RFB reporting templates to be collected by electronic means, as for other regulatory reporting. The PRA is aware that firms will need information on the mechanism by which that data will be collected, to assist with implementation.

6.2 For the collection from an RFB sub-group of all data that is currently provided by banking groups affected by ring-fencing (as described in Chapter 3 of CP25/16) it is anticipated that the mechanism and data format will be the same as for the corresponding group level data set.

6.3 For the intragroup reporting described in Chapter 4 of CP25/16, and reporting of data on the use of exceptions by an RFB and reporting on certain PRA rules and expectations (as set out in Chapters 5 and 6 of CP25/16), it is expected that the data format will be XBRL.

6.4 The PRA will communicate further detail on the means by which these data will be collected in due course.

## 7 Double leverage

7.1 In CP25/16, the PRA proposed to take account of ‘RFB group risk’<sup>1</sup> when assessing capital adequacy at the consolidated group level under Pillar 2. These proposals reduce the incentive for firms to use double leverage when prudential requirements are set at both the RFB sub-group and the consolidated group level.

### Sufficiency of existing capital regime

7.2 A number of respondents stated that the existing capital regime already provides for an appropriate allocation of capital across the consolidation group, and the proposals could therefore undermine the principles underpinning the existing regime. For example, the following concerns were raised:

- individual entity stress testing buffers may be based on scenarios which are specific to the entity concerned and would not be logically consistent across a group, making their aggregation at a consolidated group level inappropriate;
- each of the banking entities and the RFB sub-group within the consolidated group will continue to be subject to prudential requirements, thereby ensuring that there is an appropriate distribution of capital across the group; and
- the application of proportionally higher requirements at the level of the RFB sub-group could effectively introduce requirements at a consolidation group level for exposures which would otherwise eliminate on consolidation.

7.3 The proposals in CP25/16 are intended to deal with RFB group risk. In the absence of an assessment of this risk at the consolidated group level, where prudential requirements at the level of the RFB sub-group are higher than the corresponding requirements at the consolidated group level, the consolidated group could have insufficient capital resources (of appropriate quality and distribution across the group) to cover the risks faced by the RFB sub-group itself and, separately, group entities that are not members of the RFB sub-group.

7.4 The PRA is not therefore proposing to make any substantive changes to the proposals contained in CP25/16. However, SS31/15 and Statement of Policy ‘The PRA’s methodologies for setting Pillar 2 capital’ have been amended (see appendices 4 and 5) to make it clear that:

- the RFB group risk assessment does not cover the same risks already covered by other elements of the capital framework; and
- any minimum capital and buffers attributable to risk-weighted exposures of the RFB sub-group to group entities that are not members of the RFB sub-group need only be included in the assessment of RFB group risk to the extent that those exposures are not already captured by the assessment of other aspects of RFB group risk.

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<sup>1</sup> RFB group risk means, in relation to a consolidation group containing an RFB sub-group, the risk that the financial position of a firm on a consolidated basis may be adversely affected by the minimum capital and buffers applicable at the level of the RFB sub-group, such that there is insufficient capital within (or an inappropriate distribution of capital across) the consolidated group to cover the risks of the consolidated group.

### **Other proportionately higher capital requirements at RFB sub-group level**

7.5 One respondent asked for clarification on what other risks would drive proportionately higher capital requirements at the level of the RFB sub-group, compared to the consolidated group, over and above the examples provided in CP25/16. In particular they asked for clarification of the treatment of interest rate risk in the banking book (IRRBB).

7.6 In CP25/16, the PRA proposed that the Pillar 2A group risk assessment at the consolidated group level would be informed by ‘any other proportionately higher capital requirements at the level of the RFB sub-group compared to the consolidated group, if appropriate’. The treatment of pension obligation risks at the level of the RFB sub-group is an exception to this general principle. The Pillar 2A group risk assessment should therefore include, where relevant, proportionately higher IRRBB of the RFB sub-group compared to the consolidated group.

7.7 The PRA is not proposing to make any substantive changes to the proposals as set out in CP25/16, but SS31/15 and Statement of Policy ‘The PRA’s methodologies for setting Pillar 2 capital’ have been amended to clarify that the PRA expects the assessment of RFB group risk at consolidated group level to take into account any proportionately higher IRRBB of the RFB sub-group, and that the exception made for pension risk should not be taken as applying to other risks (see appendices 4 and 5).

### **Interaction of systemic buffers that apply at different levels of consolidation**

7.8 One respondent stated that the PRA’s proposals for implementing the Financial Policy Committee (FPC)’s recommendation in relation to the Systemic Risk Buffer (SRB) framework<sup>1</sup> did not recognise diversification between different entities in the group.

7.9 The proposals in CP25/16 are intended to address the risk, identified by the FPC, that, in the event that the SRB requires a proportionately higher share of existing group resources to be invested in the RFB sub-group compared to the rest of the group (eg where the SRB rate exceeds the global systemically important bank (G-SIB) buffer rate), group entities outside the RFB sub-group do not hold sufficient capital to reflect their global systemic importance. These proposals are therefore not driven by the same policy considerations as whether to recognise diversification; rather they are designed to ensure that there is sufficient capital within the consolidation group, and distributed appropriately across it, to address both global and domestic systemic risk. This is particularly important because the activities on which the G-SIB buffer is calibrated (predominantly focused around the group’s interaction with the rest of the financial system) would largely be located outside the RFB sub-group. The PRA is therefore maintaining its proposals for implementing the FPC’s recommendation in respect of the interaction of the G-SIB buffer and the SRB as set out in CP25/16.

### **Cost benefit analysis**

7.10 A number of respondents asked that the PRA provide an updated CBA to reflect the new proposals.

7.11 The PRA consulted on the additional capital needed as a consequence of setting requirements at the RFB sub-group level in CP37/15, ‘The implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures’<sup>2</sup> and the FPC consulted on the framework for the SRB in ‘The Financial Policy Committee’s framework for the systemic risk buffer’.<sup>3</sup> These consultations both included CBAs which were

1 The Financial Policy Committee’s framework for the systemic risk buffer, May 2016: [www.bankofengland.co.uk/financialstability/Pages/fpc/systemicrisk.aspx](http://www.bankofengland.co.uk/financialstability/Pages/fpc/systemicrisk.aspx).

2 July 2016: [www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps2016.aspx](http://www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps2016.aspx).

3 See footnote 1, page 16.

performed on the basis that double leverage would not be used to fund investments in RFB sub-groups, and as such, the PRA does not consider that a further CBA is warranted.

## 8 Reverse stress testing

8.1 In CP25/16, the PRA proposed an expectation that an RFB should assess the impact of the failure of group entities that are not members of the RFB sub-group as part of reverse stress testing. This will ensure that an RFB sub-group understands the potential impact on it of the failure of, and understands any dependencies it may have on, group entities that are not members of the RFB sub-group.

8.2 One respondent asked the PRA to clarify whether it expects an RFB to perform this assessment only in those cases where the default of those group entities may jeopardise the RFB's continuous operation. The respondent stated that it felt an RFB should focus only on those risks that are likely to adversely affect the viability of the RFB.

8.3 The PRA considers that focusing only on those cases where the default of group entities would jeopardise the provision of core services would restrict this analysis considerably. The PRA agrees, however, that an RFB should focus on those cases where the default of a group entity may have a material impact on the RFB. The PRA has therefore amended SS8/16 to state that an RFB should focus on those cases where the failure of the group entity may have a material impact on the RFB.

## 9 Recovery planning

9.1 In CP25/16, the PRA proposed an expectation that a group containing an RFB should include in its group plan recovery options for the RFB sub-group. CP25/16 also noted that, either as consolidating supervisor or as college member, the PRA intended to discuss within colleges of supervisors of groups that contain an RFB, the provision of a separate recovery plan for each RFB sub-group.

9.2 The PRA is maintaining its proposals set out in CP25/16 and clarifying further that the indicator framework, design of scenarios and governance arrangements<sup>1</sup> set out in the group recovery plan should have regard to recovery planning for the RFB as well as for the group as a whole. The PRA has also made this clarification in SS8/16.

9.3 Respondents were broadly supportive of the proposals in CP25/16. One respondent noted that separate recovery options are sufficient and that the PRA should not request a separate recovery plan, as it would be in the best interest of financial stability to maintain recovery plans at group level. The PRA at this stage only expects groups containing an RFB to include in their group recovery plan recovery options, indicators, scenarios and governance arrangements for the RFB sub-group. The PRA may, however, either as consolidating supervisor or as college member, discuss at a later stage within colleges of supervisors of groups that contain an RFB, the provision of a separate recovery plan for each RFB sub-group, if appropriate.

9.4 One respondent asked for clarity on whether there could be a case for the aggregation of non-RFB activity, for instance where a banking group with an RFB included a large investment bank and a small asset manager. The aim of the PRA's expectations in relation to recovery

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<sup>1</sup> PRA Supervisory Statement 18/13 'Recovery Planning', January 2015: [www.bankofengland.co.uk/prs/Pages/publications/ps/2015/recoveryresolutionupdate.aspx](http://www.bankofengland.co.uk/prs/Pages/publications/ps/2015/recoveryresolutionupdate.aspx).

planning is to ensure that the RFB has credible recovery arrangements it can use in a stress. Firms should come to a view with regard to how they capture non-RFB activities in the group recovery plan.

9.5 The PRA also notes that the reference to SS19/13 ‘Resolution planning’ on page 27 of CP25/16 and in paragraph 4.39 of the draft SS8/16 should in fact be a reference to SS18/13 ‘Recovery planning.’ The PRA has amended SS8/16 (Appendix 3) accordingly.

## **10 Operational continuity and financial market infrastructures (FMIs)**

10.1 In CP25/16, the PRA proposed that the continuity of services and facilities requirements set out in Ring-fenced Bodies 9 and the expectations set out in Chapter 8 of SS8/16 should apply to an RFB’s use of FMI-related back-office services and facilities.

10.2 Respondents were broadly supportive of the proposals, but some respondents sought clarity as to whether the PRA was proposing new requirements relating to the circumstances under which an RFB should directly participate in FMIs. The PRA can confirm that CP25/16 did not contain any proposals relating to the circumstances under which an RFB can access FMIs.

10.3 Firms should refer to Article 13 of the Order for the provisions relating to an RFB’s access to payment systems, and Chapter 9 of SS8/16 for the PRA’s guidance on applications to access systems indirectly in ‘exceptional circumstances’. For other FMIs (central securities depositories (CSDs) and central counterparties (CCPs)) in-scope firms should refer to Chapter 9 of SS8/16 for the PRA’s expectations on participation.

## Appendices

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- 1 PRA RULEBOOK: CRR FIRMS AND NON-AUTHORISED PERSONS: RING-FENCING INSTRUMENT 2017 available at [www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx).<sup>1</sup>**

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  - 2 Supervisory Statement 34/15 ‘Guidelines for completing regulatory reports’ UPDATE available at [www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx).<sup>2</sup>**

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  - 3 Supervisory Statement 8/16 ‘Ring-fenced bodies (RFBs)’ UPDATE available at [www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx).**

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  - 4 Supervisory Statement 31/15 ‘The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)’ UPDATE available at [www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx).**

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  - 5 Statement of Policy ‘The PRA’s methodologies for setting Pillar 2 capital’ UPDATE available at [www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx).**

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  - 6 Supervisory Statement 32/15 ‘Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082’ UPDATE available at [www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx).<sup>3</sup>**
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1 This includes links to new RFB001-008 reporting templates.

2 This includes links to new RFB001-008 reporting templates and instructions.

3 This includes links to updated FSA071 reporting template and instructions and ‘Guidance on terms used in FSA071-FSA082’.