

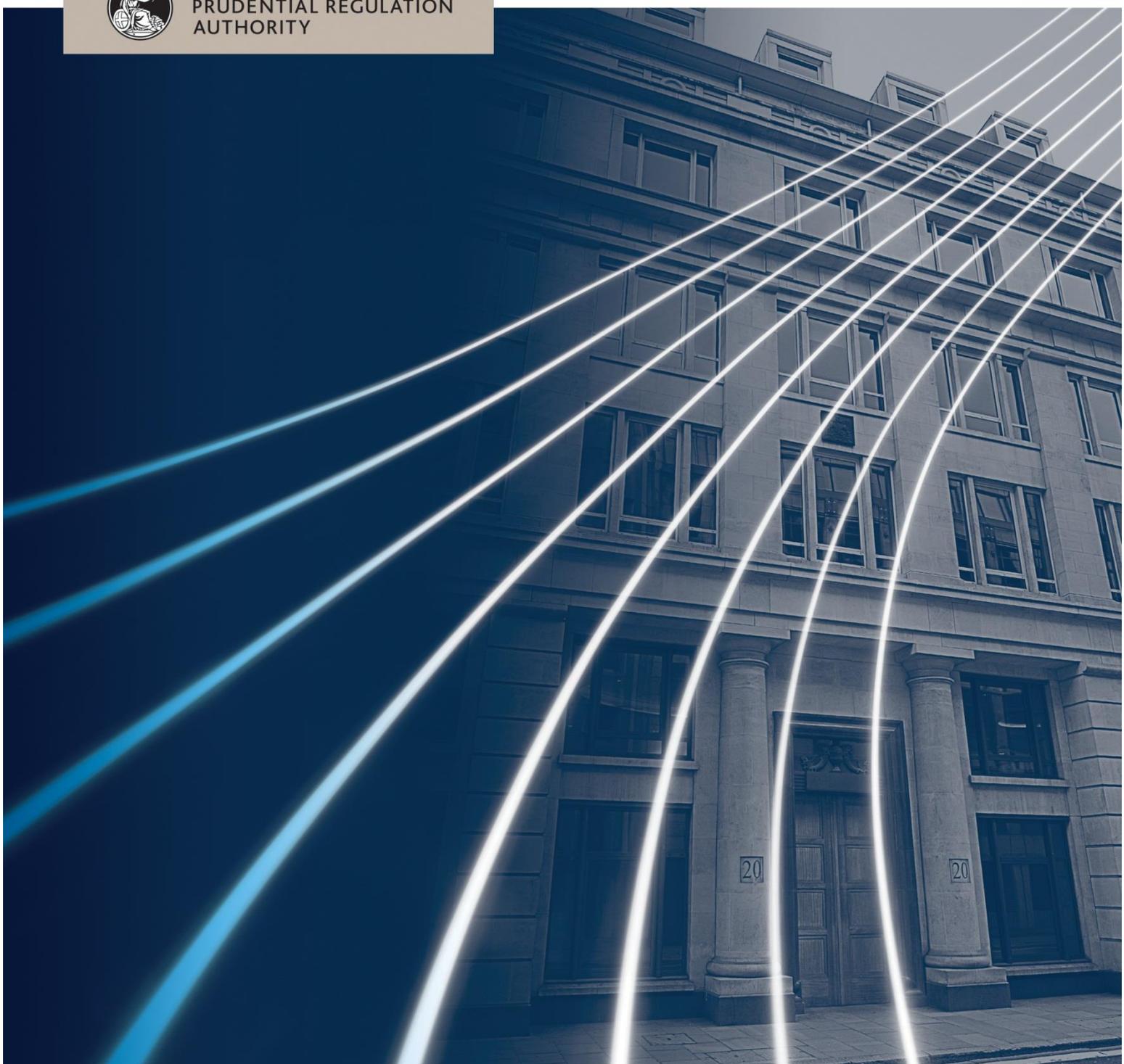
Policy Statement | PS3/18

International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision

March 2018



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY





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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback on responses to Consultation Paper (CP) 29/17 'International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision'.¹ The PRA received seven responses to the CP. The respondents supported the proposed approach set out in the CP with some requests for clarification.

1.2 The new Supervisory Statement (SS) 1/18 'International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision' is included as a link in the Appendix and replaces SS10/14 'Supervising international banks: the Prudential Regulation Authority's approach to branch supervision'.²

1.3 This statement is relevant to all PRA-authorised banks and designated investment firms³ not incorporated in the UK which form part of a non-UK headquartered group ('international banks') and which are operating in the UK through a branch, as well as any such firm looking to apply for PRA authorisation in the future.

Background

1.4 In CP29/17 the PRA set out the general approach to branch authorisation and supervision. In addition, it also proposed the PRA's approach to authorising and supervising systemic wholesale branches, building on its general approach. This is based on three key elements:

- (i) The importance of the branch to the financial stability of the UK - its systemic importance;
- (ii) The importance the PRA attaches to the supervisability of an international bank that operates in the UK in deciding whether to allow branching into the UK. The PRA would place:
 - a particular focus on the quality of supervisory cooperation with the home state supervisor, with the expectation that the degree of cooperation needs to be greater for international banks undertaking wholesale activities in the UK which are determined to be systemically important ('systemic wholesale branches'); and
 - for systemic wholesale branches, a greater emphasis on the degree of influence and visibility that the PRA has over the supervisory outcomes for the firm as a whole and the wider group, so far as relevant to the safety and soundness of the firm and necessary to achieve the PRA's objectives.
- (iii) In the event that the PRA is unable to gain sufficient assurance over the supervisability of systemic wholesale branches, the likelihood is that the PRA would impose specific regulatory requirements at the branch level. Such requirements would be imposed on a case-by-case basis, to ensure the PRA can achieve its objectives. If in a particular case imposing specific regulatory requirements proved to be ineffective in delivering the PRA's objectives, the PRA would likely be prepared to authorise the firm only as a subsidiary.

1 December 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/international-banks-pras-approach-to-branch-authorisation-and-supervision.

2 September 2014: www.bankofengland.co.uk/prudential-regulation/publication/2014/supervising-international-banks-the-pra-approach-to-branch-supervision-ss.

3 PRA designated investment firms list: www.bankofengland.co.uk/prudential-regulation/authorisations/which-firms-does-the-pra-regulate.

1.5 The CP proposed to maintain the PRA's approach that it would not, in general, allow retail and small-company deposit-taking activities¹ via a branch above *de minimis* levels.

1.6 On the basis of their existing business and structures and current degree of supervisability, including the level of supervisory cooperation already in place, the PRA does not expect the new approach to affect any of the non-EEA international banks currently authorised to operate in the UK through branches.

1.7 The new approach comes into effect from 29 March 2018. For European Economic Area (EEA) firms currently branching into the UK under 'passporting' arrangements and intending to apply for PRA authorisation in order to continue operating in the UK after the UK's withdrawal from the European Union (EU), this approach will be relevant to authorisations for this purpose.

1.8 The PRA will keep the policy under review to assess whether any changes will be required due to changes in the UK financial system or regulatory framework, including those arising once any new arrangements with the EU take effect.

Changes to the proposals

1.9 The PRA has not made any material changes to the proposals as set out in CP29/17. The PRA has made a number of minor amendments to the draft SS in light of the feedback received to add further clarity. These clarifications are explained in the following chapter, regarding the approach to retail activities, home state supervisory and regulatory equivalence, the approach to systemic wholesale branches, assurance over resolution arrangements, and other responses.

1.10 The PRA does not consider the changes to be significant and, as a result, has not updated the assessment of impact on mutuals or the cost benefit analysis from CP29/17.

2 Feedback to Responses

2.1 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) 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.

2.2 The PRA received seven responses to CP29/17. Respondents supported the overarching principle that international banks should be able to branch into the UK for wholesale purposes, given sufficient supervisory cooperation with home state supervisors (HSS) and the supervisability of the bank branch.

2.3 The following sections summarise the responses received from industry together with feedback from the PRA. This includes amendments to the text of the draft SS.

Approach to significant retail activities

2.4 Respondents asked for clarity over the PRA's definition of 'retail' banking and what kind of accounts would be relevant to that. Some respondents questioned what would count as a transactional account; specifically they questioned whether only direct client relationships are

1 Paragraph 4.2 of the SS sets out that this approach refers to retail and small-company Financial Services Compensation Scheme (FSCS) covered transactional and instant access accounts, and total covered deposit activity that could lead to a material call on the FSCS.

included or also underlying client relationships, such as accounts opened by an intermediary like an investment or a wealth manager.

2.5 The PRA reiterates that its underlying policy on retail bank branching into the UK from third countries remains substantially unchanged from SS10/14. In response to feedback, the PRA has added relevant subheadings between paragraphs 4.2 and 4.7 of the SS to improve the clarity of the document.

2.6 In relation to the number of customers, the SS now clarifies that the indicative number of customer accounts taken into consideration as a maximum level for branch retail activity is that number used for transactional purposes. The starting point for a 'transactional account' is one from which withdrawals have been made nine or more times within a three month period, but the PRA may additionally consider other factors. For clarity the PRA has removed the third bullet point of paragraph 4.2 of the draft SS regarding the substitutability of accounts, and directs attention to footnote 2 of paragraph 4.3 of the updated SS. The PRA will continue to take a pragmatic, judgement-based view as to whether the accounts are transactional in practice.

2.7 To add greater clarity, the SS separates the proposals regarding the *de minimis* threshold into those relating to the amount of retail and small-company activity, and those relating to the impact on the Financial Services Compensation Scheme (FSCS).

2.8 Respondents questioned the definition of 'Small and Medium-sized Enterprise' (SME) used in the CP, noting the reference to annual turnover criterion set out in the European Commission definition¹ used is wider than the definition for an SME given in SS10/14. According to some responses, this change in definition could cause a material impact on some firms.

2.9 Since the PRA's risk appetite for retail deposit-taking activities has not changed, the PRA has decided not to change the definition of a 'small company' from SS10/14. To clarify this point, the SS has been updated (Paragraphs 4.1 - 4.4, boxes 2 and 4) to refer to 'small companies' rather than SMEs. It follows the Companies Act 2006 definition of a small company. The key aspects of this definition require firms to meet at least two of the following criteria: (i) the turnover is not more than £10.2 million per annum; (ii) the balance sheet total is not more than £5.1 million; and/or (iii) the number of employees is not more than 50.² For the avoidance of doubt, the definition of 'micro, small and medium-sized enterprises' for the purposes of the Depositor Protection part of the PRA Rulebook remains unchanged.

2.10 Some responses sought clarification on the scope of FSCS coverage as regards the £500 million total potential liability.

2.11 The £500 million potential FSCS liability relates to covered deposits as defined in the Depositor Protection Part of the PRA Rulebook. This clarification has been added at paragraph 4.5 of the SS.

1 European Commission Recommendation 2003/361/EC, Annex 1: 'The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.'

2 www.legislation.gov.uk/ukpga/2006/46/part/15/chapter/1/crossheading/companies-subject-to-the-small-companies-regime.

Equivalence of the home state supervisor's regulatory regime / Supervisory cooperation

2.12 Respondents sought clarity on the envisaged relationship between the PRA and HSS. Some responses questioned the process of supervisory cooperation at authorisation and on an ongoing basis. Some respondents asked what the PRA intended to highlight when stating that an HSS regime would have to be consistent with the UK regulatory framework in addition to international standards. One questioned how the PRA would assess equivalence were it to introduce rules that are more stringent than those in other jurisdictions. Some respondents requested confirmation that the assessment would be outcomes-based rather than a line-by-line regulatory assessment.

2.13 The PRA sets out its approach to regulatory equivalence assessments from paragraph 3.5 onwards in the SS. The starting point for the PRA's authorisation of a branch in the UK is the equivalence of the HSS regulatory regime to the UK regulatory framework, and the level of supervisory cooperation with the HSS. These are based on international standards¹ and supplemented with other sources as necessary, as well as the PRA's own experiences of its interactions with HSS in order to deliver appropriate outcomes that meet the PRA's objectives. Paragraph 3.6 of the SS states that the PRA will consider the nature of the firm's UK activities and its systemic importance to the UK economy when determining whether the HSS regime is of sufficient equivalence. Paragraph 3.7 of the SS states that the frequency of review is determined by the number, size and systemic importance of the firms from a home state. The fact that the PRA authorises one firm from a particular home state to operate in the UK as a branch will not automatically mean that it will be prepared to authorise other firms from that home state to operate as branches in the UK.

2.14 The more systemically important a third country branch is to the UK, the stronger the supervisory cooperation will need to be. Cooperation with the HSS needs to be ongoing for supervisory purposes. Mechanisms of ongoing supervisory cooperation are set out in paragraph 3.10 and 3.11 of the SS and include, but are not limited to: a clear split of responsibilities between the supervisors; Memoranda of Understanding; structured bilateral or supervisory college meetings; clear and prompt information exchange; and supervisory support from the HSS. Paragraph 5.10 of the SS sets out the additional expectations of cooperation in respect of systemic branches.

2.15 Respondents asked about potential demands on firms during the PRA's assessment of HSS regulatory regimes. Some responses noted an apparent inconsistency between this CP and SS1/17 'Supervising international banks: the PRA's approach to branch supervision – liquidity reporting'² regarding liquidity reporting.

2.16 In general, firms should not expect additional demands during the PRA's assessment of HSS supervisory cooperation. Firms can expect the PRA to engage with HSS itself, unless the PRA communicates otherwise to the firm on a case-by-case basis. The PRA will not duplicate requests for information to the firm and HSS. To avoid giving that impression, the SS has been updated at the second bullet point of paragraph 3.11 to remove reference to liquidity reporting.

2.17 There was a question regarding the application of this approach to non-EEA firms as well as EEA firms. Some respondents queried the consistency of the PRA's statement that the

1 The International Monetary Fund's Financial Sector Assessment Programme reviews, the Basel Committee's Regulatory Consistency Assessment Programme reviews, and the Financial Stability Board's peer reviews.

2 February 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/supervising-international-banks-the-pras-approach-to-branch-supervision-liquidity-reporting-ss.

regime for current third country (non-EEA) branches will not change, and the statement in the CP at paragraph 3.7 that the PRA does not expect there to be material incremental compliance costs for the majority of non-EEA international banks' systemic wholesale branches.

2.18 The PRA stated in the CP that under current circumstances it considers all third country HSS as satisfactorily equivalent in terms of regulatory regime, and that there is sufficient supervisory cooperation given the systemic importance of their bank branches. The compliance costs for non-EEA international banks' systemic wholesale branches depend on the HSS's approach to supervisory cooperation with the PRA, and are based on the PRA's current assessment of third country supervisory cooperation. These compliance costs would only rise if the PRA's assessment of the HSS approach changes in the future.

Approach to systemic wholesale branches

2.19 There were a number of responses questioning the triggering criteria for a systemic branch. Respondents questioned how the PRA would calculate the £15 billion of total gross assets as a threshold trigger for systemic status, including how the PRA will take into account firms' booking arrangements. They questioned whether the £15 billion would take into account intragroup and intercompany assets, and precisely how cross-border booking arrangements would be treated for the calculation of this number.

2.20 In paragraph 5.4, the PRA states that the £15 billion metric is a starting point; it is not an automatic threshold. This number is an indicative guide about the PRA's approach to a firm, while the final decision will be based on the PRA's overall judgement of the firm on a case-by-case basis. The PRA will take all relevant assets into account for the purpose of the £15 billion metric, including intragroup assets and assets originated by the branch but booked outside the UK. As a starting point the PRA will assess this by looking at the information provided at the time of authorisation or reported by the firm in the Branch Return.

2.21 Some respondents asked for clarification over the scope of a group's UK footprint that will be taken into account when the PRA aggregates branch assets as part of its assessment of systemic importance.

2.22 Where a group maintains PRA-supervised branches from more than one legal entity, the PRA will aggregate the assets of the branches for the purpose of assessing the £15 billion of total gross assets. Where a group also maintains a UK branch of an investment firm, the PRA may also take into account the assets of that branch. Where the assets of a group's bank and investment firm branches in aggregate exceed £15 billion – and/or the PRA considers these branches to be systemic in aggregate - it will be relevant to the PRA's consideration of whether to designate the relevant investment firm(s) for supervision by the PRA in accordance with its Statement of Policy on the designation of investment firms.¹

2.23 Some respondents requested clarification on the timing and process for a branch becoming subject to additional requirements or being required to subsidiarise.

2.24 In paragraph 5.12 of the SS the PRA sets out how it will treat branches about which it has concerns. These concerns will be dealt with according to the specifics of the firm in question and on a case-by-case basis. Both the timing and the measures to be taken will be discussed with the firm and the HSS as appropriate given the branch's systemic importance to the UK.

¹ March 2013: <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/designation-of-investment-firms-for-prudential-supervision-by-the-pra>.

Assurance over the resolution arrangements

2.25 A minority of respondents asked for clarity as to how the SS will affect third country branch resolution. Some responses asked the PRA to clarify that it bases its resolution equivalence assessments on international standards.

2.26 The Bank of England has set out its approach to resolution in 'The Bank of England's Approach to Resolution'.¹ This approach is unaffected by this PS and SS on branching policy. The resolution equivalence assessments are judgement-based, and founded on international standards as set out in the Financial Stability Board's 'Key Attributes'.²

2.27 Some respondents asked for clarification that potential branch subsidiarisation would not automatically lead to a multiple point of entry (MPE) approach to resolution.

2.28 For systemic wholesale branches, if supervisory cooperation with an HSS deteriorates sufficiently and the PRA is unable to achieve its supervisory objectives, the PRA may require the firm to undertake activities in the UK as a subsidiary. The PRA in consultation with the Bank of England as resolution authority maintains discretion over its approach to resolution for this subsidiary (Single Point of Entry (SPE) or MPE). This will be assessed on a case-by-case basis. It may require an MPE approach to resolution, depending on cooperation with the home state resolution authority, especially given the necessary deterioration of cooperation that would have led the branch to be subsidiarised in the first place.

Other responses

2.29 Some respondents asked for clarification as to what counts as a critical function.

2.30 The PRA has not altered its approach to critical functions. Box 3 of the SS offers an indicative summary of the PRA's approach to critical functions. The PRA will consider each branch's activities on a case-by-case basis according to its systemic importance and the nature of its activities in the UK.

2.31 Some queried how the PRA would use its Threshold Conditions (TCs) on a whole-firm basis as regards a branch in the UK.

2.32 The PRA expects branches to comply with its TCs on a whole-firm basis, as set out in paragraph 3.3 of the SS. This states that TCs apply to the international bank as a whole and not just the UK branch. In determining whether its TCs are met, the PRA has scope to rely on the HSS when it can satisfy itself that there are reasonable grounds for such reliance.

2.33 The scope of firms for which the SS is relevant has been amended in paragraph 1.2 of the SS to clarify that the SS is relevant to all PRA-authorized banks and designated investment firms not incorporated in the UK which form part of a non-UK headquartered group and which are operating in the UK through a branch, as well as any such firm looking to apply for PRA authorisation in the future.

1 October 2017: www.bankofengland.co.uk/news/2017/october/the-bank-of-england-approach-to-resolution.

2 Financial Stability Board 'Key Attributes of Effective Resolution Regimes for Financial Institutions', 15 October 2014.

Appendix

**Supervisory Statement 1/18 'International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision', available at:
www.bankofengland.co.uk/prudential-regulation/publication/2018/international-banks-pras-approach-to-branch-authorisation-and-supervision-ss.**