BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Business Plan

2020/21

Prudential Regulation Authority

Business Plan 2020/21

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Contents

Impacts of Coronavirus

To manage the impact from the outbreak of Coronavirus (Covid-19), the Bank of England (Bank) and the Prudential Regulation Authority (PRA) have engaged with UK Government, HM Treasury, industry bodies, international counterparts, the firms we regulate and the Financial Conduct Authority (FCA) on measures to support PRA-regulated firms and the wider UK economy. At the same time, we have taken steps to ensure the safety and wellbeing of our staff, so that we are able to continue delivering our core services.

This has meant that we have had to reassess our plans for the coming year, and reprioritise our work and resources to ensure that we can continue to deliver our services appropriately. As a result we took measures, announced on Friday 20 March 2020, which included the cancellation of the 2020 annual cyclical scenario (ACS) stress tests and delaying the publication of the 2019 biennial exploratory scenario (BES) results.[1]

We have also looked at our supervisory work with individual firms. We postponed less critical elements where possible and delayed certain skilled person reviews so that firms can focus on their own contingency arrangements, and our supervisory teams can target key areas to support financial stability, the safety and soundness of firms, and protection of policyholders.

In terms of setting policy, we have elected to extend consultation periods where suitable – including the current consultation on operational resilience[2] – to prevent drawing resources away from immediately critical work. We are extending the implementation timescales for new policies that have recently been consulted on, including changes to internal ratings based models which will now be delayed until the beginning of 2022. To help co-ordinate the impacts of regulatory initiatives on firms and smooth the peaks of demand they may cause, we are expediting work to establish a regulatory initiatives forum, as the intended benefit of this forum is now increasingly important to the industry.

We will continue to assess the effects of Covid-19 on our capacity as an organisation and on the capabilities of the firms we regulate. We will actively revise elements of this Business Plan as may become necessary in order to keep working as effectively as possible towards the delivery of our objectives – to promote the safety and soundness of the firms we regulate, to contribute to ensuring that insurance policyholders are appropriately protected, and to facilitate effective competition in the markets for services provided by PRA-regulated firms.

The Prudential Regulation Committee

April 2020

1 https://www.bankofengland.co.uk/news/2020/march/boe-announces-supervisory-and-prudential-policy-measures-to-address-the-challenges-of-covid-19.

2 December 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper.

Foreword by Chief Executive Sam Woods

In putting together this plan, like everyone else we are having to deal with Covid-19. We have had to make some adjustments to our Business Plan as a result, in order to allow us and firms to focus our energies on dealing with the impact of the virus. Nonetheless, at this stage we think that a good portion of our more business-as-usual work will be able to continue – and I'm confident that we will continue to meet our statutory objectives.

If and when any more space opens up later in the year, as the PRA reaches its seventh birthday I would like to use some of that space to take stock and decide how we need to evolve for the next phase of the PRA's existence. I don't think we need to change our fundamental approach or objectives. We continue to ensure that banks and insurers are resilient throughout the economic cycle. And as the last financial crisis moves further behind us, we must defend the level of resilience that has built up in the financial system. To do this in a dynamic way, we will deliver a targeted approach that focusses on the key risks and higher-risk firms within each sector. This includes firms with challenged or concentrated business models, firms whose ability to manage through an economic downturn has not yet been tested and firms who are increasing their illiquid asset exposures.

This year we expect to see the shape of the UK's future relationship with the European Union (EU) develop, and there will be important implications for the PRA's policy and supervisory approach. We are committed to maintaining robust prudential standards, above those required by baseline international standards. But this may also be an opportunity to review elements of the current regimes that are sub-optimal for the UK market, such as the level and complexity in regulation for small firms.

EU withdrawal also brings with it a significant increase in the number of European branches and subsidiaries within the PRA's remit. One thing we will need to decide is how we absorb this larger supervisory task.

That's supervision as we currently know it, but the world is changing and there are a number of new and emerging risks that we need to make room for in our activities. Covid-19 is of course the most obvious and immediate one and is dominating our activity at the time of writing this. But there are others, equally important if longer-term. Climate change is one, and operational resilience another – work on these will continue even if the scheduling has to flex a bit in response to Covid-19 pressures. It is vital that we adapt to new risk areas as they emerge, but as we do this we must not lose focus on the more traditional areas of prudential supervision and regulation. We will be asking ourselves where the optimal balance lies between the two.

We wouldn't be able to do any of this without the hard work and dedication of our staff. That's why we are committed to building an increasingly talented and diverse workforce that is able to represent the UK public we're serving. This is the right thing to do but also brings great organisational benefits by introducing different skills and perspectives, as well as fostering an inclusive environment where diverse views and outlooks are encouraged. I often think that this is particularly important in an organisation like ours, which needs to guard against excessive risks – surely the easiest way to fail in this task is to have us all thinking in exactly the same way!

We also recognise some of the challenges faced by our existing staff, which can make it difficult for them to do their jobs efficiently. Part of this is addressed through developing our data and RegTech strategies so that we can maximise our resources. Another part may be streamlining our internal processes and decision-making to encourage colleagues to work in an efficient and empowered way. Of course this should be done without compromising controls, and Covid-19 is a significant, if temporary, complication which has the potential to impact the delivery of some of our Business Plan but should not prevent us from delivering our statutory objectives.

I want to thank all of the staff in the PRA for their great efforts over the last year. I am excited about the next phase of the PRA's work and I hope this Business Plan provides a clear sense of our focus for the coming year.

Sam Woods
Deputy Governor and Chief Executive Officer

Overview of responsibilities and approach

The PRA, part of the Bank of England, regulates around 1,500 deposit-takers, building societies, credit unions, insurers, and major investment firms in the UK.

The PRA has two primary objectives: a general objective to promote the safety and soundness of the firms we regulate; and an objective specific to insurance firms, to contribute to ensuring that policyholders are appropriately protected. We also have a secondary objective to facilitate effective competition in the markets for services provided by PRA-authorised firms.

We advance these objectives through regulation and supervision. Through regulation, we develop standards and policies that set out what we require and expect of firms. Through supervision, we assess whether firms are meeting our requirements and expectations, the risks that firms pose to our objectives and, where necessary, we take action – supervisory or enforcement – to reduce those risks. Our approach to regulation and supervision is forward-looking, judgement-based, and focused on the issues and firms that pose the greatest risk to the stability of the UK financial system and policyholders, and is set out in 'The PRA's approach to supervision'.[3]

We currently regulate around 1,500 firms and groups.[4] This includes nearly 900 banks, building societies, credit unions[5] and designated investment firms (DIFs), and over 600 insurers of all types (general insurers, life insurers, friendly societies, mutuals, the London market and insurance special purpose vehicles (ISPVs)). Our focus is primarily at the individual firm and sector level with the most important decisions taken by the Prudential Regulation Committee (PRC). The PRC works with other areas of the Bank and its committees, including the Financial Policy Committee (FPC) that has responsibility for the stability of the UK financial system as a whole. The PRA also works closely with the conduct regulator, the FCA.

Chart 1: PRA-supervised deposit-takers and DIFs, as at 29 January 2020

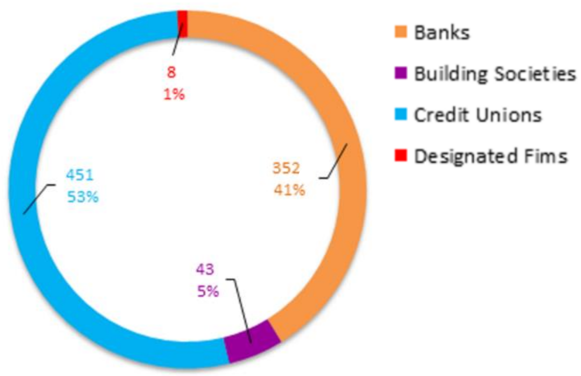
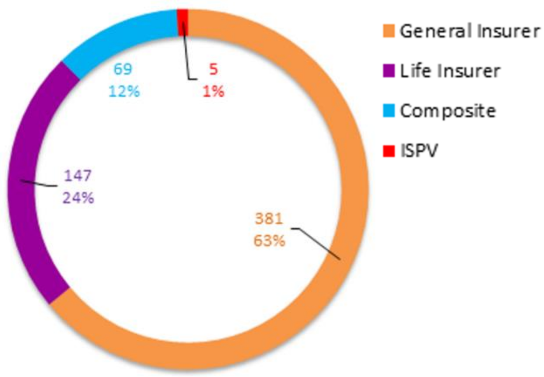


Chart 2: PRA-supervised insurers, as at 29 January 2020



3 Available on our website at https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018.
4 The exact number of PRA-authorised firms and groups changes as new firms enter, other firms close or vary their permission, and entities within groups restructure.
5 Banks, building societies and credit unions are collectively referred to as deposit-takers as they are the only UK financial institutions authorised and regulated to collect deposits from the general public.

The PRA's strategy

The PRA's strategy is to deliver a resilient financial sector by seeking: an appropriate quantity and quality of capital and liquidity; effective risk management; robust business models; and sound governance including clear accountability of firms' management. This strategy supports our primary safety and soundness, policyholder protection, and secondary competition statutory objectives.

Our regulatory regime involves both setting standards and holding firms to those standards through our supervision. We do not seek to operate a regulatory regime in which firms can never fail. When failure does occur, this should be with limited disruption to the provision of core financial services, without spillovers to the wider financial sector that could threaten financial stability, and should not expose the public sector to loss.

The strategic goals set out our work plan and priorities for the coming year. We take into account the changing regulatory environment when forming our goals.

This strategy will be achieved in close co-operation with other parts of the Bank, the FCA and international counterparts. The continued excellent engagement of our staff will be integral to ensuring the successful delivery of our goals.

Shaping the PRA's strategy

Each year the PRA is required by law to review, and if necessary revise, our strategy and to publish a revised strategy in relation to our statutory objectives:[6]

- to promote the safety and soundness of PRA-authorised firms;
- specifically for insurers, to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders; and
- a secondary objective to act, so far as is reasonably possible, in a way which facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.

In addition to the statutory objectives, our strategy is shaped by other responsibilities such as the requirement to implement domestic and international legislation. This includes ensuring we have a fully functioning legal and regulatory framework for financial services now that the UK has formally withdrawn from the EU. Furthermore, as part of the Bank, we contribute to the delivery of the Bank's wider financial stability and monetary policy objectives.

We maintain the flexibility to respond to changes in markets, developments in the economy and other risks that can affect our statutory objectives and priorities, and reprioritise activities as needed. For

[6] Section 2E of the Financial Services and Markets Act 2000 (FSMA).

2020/21 such changes relate to the UK's withdrawal from the EU and the ongoing transition period, the financial risks resulting from climate change and developments in technology.

Strategic goals for 2020/21

Our strategy outlines our intentions over the medium- to long-term. It was set by the PRC, in consultation with the Bank's Court of Directors. In order to progress the strategy, our strategic goals for 2020/21 are to:

- have in place robust prudential standards, and hold regulated firms, and those who run them, accountable for meeting these standards ('robust prudential standards and supervision');
- continue to adapt to changes in the markets in which we are involved and pre-empt and mitigate risks to our objectives ('adapt to market changes and horizon scanning');
- ensure that firms are adequately capitalised, and have sufficient liquidity, for the risks they are running or planning to take ('financial resilience');
- develop our supervision of operational resilience in order to mitigate the risk of disruption to the provision of important business services ('operational resilience');
- ensure that banks and insurers have credible plans in place to enable them to recover from stress events, and that firms work to remove barriers to their resolvability to support the management of failure – proportionate to the firm's size and systemic importance – in an orderly manner ('recovery and resolution');
- facilitate effective competition by actively considering the proportionality of our approach as it contributes to the safety and soundness of the UK financial system ('competition');
- deliver a smooth transition to a sustainable and resilient UK financial regulatory framework following the UK's exit from the European Union ('EU withdrawal'); and
- operate efficiently and effectively by ensuring that resources are allocated to work that best advances our strategy and reduces the greatest risks to the delivery of our statutory objectives, and by providing an inclusive working environment in which all staff can perform to their potential ('efficiency and effectiveness').

PRA Business Plan 2020/21

This section sets out how we will deliver our strategic goals over the coming year.

Robust prudential standards and supervision

Have in place robust prudential standards and hold regulated firms, and those who run them, accountable for meeting these standards

We maintain our commitment to effective supervision and robust prudential standards. Following the UK's withdrawal from the EU on Friday 31 January 2020, we will continue our work to ensure that we have an effective regulatory and supervisory framework at the end of the transition period. We will continue to support the FPC to ensure that the regulatory and supervisory regime is also delivering on its macroprudential objectives.

In 2020/21 we will focus on maintaining robust prudential standards and support the FPC's commitment to uphold the same level of resilience, to ensure continuity in the supply of vital financial services to the real economy throughout the cycle, including after severe shocks.[7]

Focus our supervision of banks and insurers on what matters most

With a targeted and efficient approach we will focus on key risks and prioritise higher risk firms within each sector. We will use resources flexibly and deploy them to where risks are and where they can add the most value. We will continue to improve how we document and standardise existing good practice to ensure that supervisors have ready access to this information, and will re-examine the processes and procedures currently in place to deal with any attempts to circumvent regulatory and supervisory requirements. The PRA ensures these good practices are also applied to emerging regulatory developments.

As we continue to safeguard the post-crisis gains in resilience and to hold firms accountable for meeting our standards, we will pay attention to newer firms, in particular where business models have not yet been seasoned, and of course to areas where risks may be crystallising. Across all the firms we supervise, we will continue to use our enforcement powers where it is appropriate to do so, in relation to firms and to individuals.

Structural reform came into effect on Tuesday 1 January 2019, requiring the largest UK banking groups to ring-fence their UK retail businesses from international and investment banking operations. Our focus in the post-implementation period continues to be on ensuring that the new governance structures and risk management arrangements are working effectively.

The UK's withdrawal from the EU, and the steps that firms have taken to enable them to continue to serve their clients, will require an appropriate post-EU exit model to effectively supervise new cross-border structures and governance models. For insurers we will have to accommodate a significant number of Part VII transfers[8] and third country branch applications as UK insurers evolve to maintain continuity of European Economic Area (EEA) business. As the Part VII pipeline reduces towards pre-EU exit levels, we will shift our focus to authorising a high number of third country branch applications in the UK. For banks, a number of EEA bank branches will require authorisation as third country branches

7 May 2019: https://www.bankofengland.co.uk/speech/2019/sam-woods-ubs-20th-annual-financial-institutions-conference-lausanne.
8 Part VII of the Financial Services and Markets Act 2000 (FSMA).

when passporting rights fall away. In addition, there is a growing pipeline of new UK firms coming through the New Bank and Insurance Start-up Units.

At the same time, we will continue to adapt our supervisory approach for insurers and their exposures to non-traditional and complex products and assets. A low interest rate environment can create an environment where there is increased asset risk if insurers search for yield. There is also pressure on business models from consolidation and new technology, which ultimately pose risks to PRA objectives.

2020 will be a key year for the transition away from the London interbank offered rate (LIBOR) as a valid benchmark by 2021. Orderly and timely progress requires individual firms to engage actively with the wider transition efforts in the market, both those of the authorities and those of industry. The Bank, the PRA and the FCA will continue to support market-led transition efforts through the Working Group on Sterling Risk-Free Reference Rates and each will act unilaterally to remove barriers to transition. The FPC has considered further potential supervisory tools that authorities could use to encourage the reduction on the stock of legacy LIBOR contracts to an absolute minimum before the end of 2021, and will keep the use of such tools under review in light of progress made by firms on the transition. The Bank, the PRA and the FCA will step up engagement with firms on LIBOR transition through our regular supervisory relationship, reviewing management information and collecting data from firms to assess progress.

In terms of data, we expect firms to submit complete, timely and accurate regulatory returns.[9] The integrity of regulatory reporting is the foundation of effective supervision. The Independent Review of the Prudential Supervision of The Co-operative Bank Plc (Zelmer review)[10] recommended that we should consider introducing more formal third-party reviews of key prudential information supplied by PRA-supervised firms through their regulatory data returns. Examples of errors in regulatory reporting have further underlined the need for appropriate investment in both the integrity of data and the ability to process it accurately. To address failures to meet our expectations in this area, we have written to CEOs of banks and building societies,[11] and taken enforcement action in instances where we have uncovered significant failings in regulatory reporting governance and controls.[12]

As part of our co-ordinated response to Covid-19, we will review our supervisory work plans so that non-critical data requests, on-site visits and deadlines can be postponed where appropriate. This includes pausing the skilled persons Section 166 reviews relating to the reliability of banks' regulatory returns that were announced in October 2019. In doing so we will have regard to the flexibility provided under the relevant regulatory regimes, for example in the Capital Requirements Regulation and Solvency II, and continue to closely co-ordinate our supervisory work on Covid-19, wherever possible, with the FCA and other authorities.

International co-operation

We will continue to develop jurisdictional strategies that allow us to deepen our relationships with home and host supervisors and advance our supervisory objectives. Especially in the context of the UK's withdrawal from the EU, we will ensure our supervisory approach can continue to be applied, including through adaptations to our information-sharing arrangements with other European regulators through Memoranda of Understanding.

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9 Our expectations are set out in the statement of our approach to banking supervision and in the PRA's rules. See 'The Prudential Regulation Authority's approach to banking supervision', October 2018, paragraph 112; and the PRA Rulebook, General Organisational Requirements, section 5.1(3) and PRA Notifications Rule 6.1.

10 March 2019: https://www.bankofengland.co.uk/news/2019/march/independent-review-of-the-supervision-of-the-co-op-bank-published.

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

12 https://www.bankofengland.co.uk/news/2019/november/pra-fines-citigroups-uk-operations-44-million-for-failings.

Contribution to financial stability

We will continue to contribute to financial stability through policy development, implementation and evaluation. This will include support for the FPC's review and assessment of the capital framework, housing tools and the financial stability implications that could arise from the UK's withdrawal from the EU.[13]

Adapt to market changes and horizon scanning

Continue to adapt to changes in the markets in which we are involved and pre-empt and mitigate risks to our objectives

We will seek to maintain the dynamic resilience of the regulatory framework by: scanning the horizon for emerging and evolving risks; evaluating the functioning of the framework for unintended consequences; and, where appropriate, intervening to make adjustments in response to these while ensuring that we do not weaken the level of resilience we have built so far.[14] We will continue to work closely with firms and other regulatory authorities to identify aspects of regulation that may lead to unintended outcomes, and will gather intelligence from across the Bank on how firms are responding to regulation.

Where emerging issues are identified, or where good practice can be shared, we will engage with firms individually or by sector through appropriate channels including events, direct communication, briefings, and speeches. This allows us to communicate our expectations, remind firms of their obligations, encourage prudent management, and seek input on policy proposals and our frameworks. Also, we use these mechanisms to keep the industry informed by highlighting developments and new initiatives.

Over the coming year, the following areas have been identified as of particular interest:

- climate change poses significant risks to the economy and to the financial system, and these risks are in need of action today. We will work with industry through the Climate Financial Risk Forum (CFRF) to build intellectual capacity and establish best practice in how to manage the financial risks from climate change.[15] Building on the climate scenarios in the 2019 insurance stress test, we are also preparing for the next climate biennial exploratory scenario (BES) which will test the resilience of the business models of the largest banks, insurers and the financial system as a whole to physical and transition risks from climate change;

- we will play a key role in the Bank's work on FinTech, including digital currencies and RegTech; and examine our regulatory framework to identify where we need to make changes to meet the challenges. The Bank has launched a review in discussion with banks, insurers and financial market infrastructures to reform regulatory data over the next decade.[16] The review will seek ways to decrease the burden on industry and to increase the timeliness and effectiveness of data in supporting supervisory judgements, with the outputs helping inform appropriate next steps;

- we will work to investigate how the application of artificial intelligence (AI) and machine learning within financial services is evolving, and how that affects the risks to firms' safety and soundness.[17] In June 2019, the Bank published its response to the Future of Finance review's findings: 'New economy, new finance, new Bank'.[18] The response detailed how the opportunities created by

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13 December 2019: https://www.bankofengland.co.uk/letter/2019/response-to-the-remit-letter-for-the-fpc-2019.
14 June 2019: https://www.bankofengland.co.uk/speech/2019/victoria-saporta-speech-at-risk-net-liquidity-and-funding-risk-europe.
15 April 2019: https://www.bankofengland.co.uk/speech/2019/sarah-breeden-omfif.
16 January 2020: https://www.bankofengland.co.uk/paper/2020/transforming-data-collection-from-the-uk-financial-sector.
17 June 2019: https://www.bankofengland.co.uk/speech/2019/james-proudman-speech-at-fca-conference-on-governance-in-banking-london.
18 https://www.bankofengland.co.uk/research/future-finance.

increased online interaction, AI, the move towards a carbon-neutral economy, and changes in global economic activity are accompanied by new risks (e.g. growing cyber-threats). Our strategy seeks to avoid a disorderly transition to a carbon-neutral economy as an abrupt transition could precipitate risks that are both material and unpredictable; and

- new risks, such as those posed by climate change, technological innovations, and cross-sector issues, will be identified and mitigated by engaging in thematic reviews and undertaking specialist cross-firm reviews as well as ongoing engagement with industry and external bodies. We will gather supervisory intelligence, leveraging cross-firm supervisory information to draw insights on trends and risks across the banking and insurance sectors to inform firm-specific supervisory strategies and sector-wide policy responses, and use leading-edge peer analysis to assess the risks faced by firms in international investment and wholesale banking markets.

Financial resilience

Ensure that firms are adequately capitalised, and have sufficient liquidity, for the risks they are running or planning to take

Our objective to promote the safety and soundness of PRA-regulated firms is delivered in part through ensuring that firms have adequate financial resources for the risks they are running or planning to take. We assess the financial resilience of firms through our supervision at firm and sector level, and use stress testing to examine how firms cope with extreme stress scenarios. In light of the Covid-19 outbreak, the Bank's 2020 annual stress test, the ACS, has been cancelled.

In the coming year, we will assess the adequacy of capital and liquidity resources of firms in the banking sector through a range of measures. We will continue to assess credit risk and asset quality, and to consider the level and drivers of risk-weighted assets. Technical risk reviews including firms' internal models, liquidity and capital assessments and scrutiny of regulatory returns and other data will remain core parts of our work to ensure that firms are adequately capitalised and have sufficient liquidity.

In 2020 we will finalise and implement the policy on the capital requirements for credit unions. Following the creation of the new Credit Unions Part of the PRA Rulebook in 2016, we consulted on key changes to improve the existing regime in 2019:[19]

- replacing the current regime with a 'graduated rate' approach, removing the 2% capital buffer to provide a greater degree of flexibility and removing barriers to growth for credit unions with more than £10 million of total assets;

- reducing complexity in the capital regime, by removing the association between credit union activities/membership size and capital requirements, and addressing the risks these factors pose by other means; and

- requiring credit unions with a capital to assets ratio below 5%, and those with a capital to assets ratio in the 3-5% range, to engage more fully with the PRA to help avoid firm failure where possible.

In 2020 we will clarify and publish our final approach to setting PRA buffers for new banks. In 2019 we consulted on proposals to update the Pillar 2 capital framework to reflect refinements and developments in setting the PRA buffer (also referred to as Pillar 2B).[20] The PRA buffer is an amount of capital that firms should maintain in addition to their total capital requirements to absorb losses that may arise under a severe stress scenario, while avoiding duplication with the combined buffers. It may also be increased where we assess a firm's risk management and/or governance to be significantly

19 October 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/credit-unions-review-of-the-capital-regime.
20 https://www.bankofengland.co.uk/prudential-regulation/publication/2019/pillar-2-capital-updates-to-the-framework.

weak. Since we published our approach to setting the PRA buffer, the Bank's approach to stress testing has evolved. There have been changes to the stress testing hurdle rate and the way microprudential and macroprudential buffers interact. This in turn has implications for the way that the PRA buffer is calculated. The purpose of the proposals is to bring greater clarity, consistency and transparency to our capital setting approach.

We will take forward the recommendations of the Zelmer review. We have published a consultation paper proposing enhanced expectations on how firms manage the risks associated with asset encumbrance. We are developing guidance and indicators that allow supervisors to assess the risks associated with firms' encumbrance levels and the quality of their risk management practices; and we will incorporate a review of asset encumbrance into our supervisory assessments of firms' funding stability, recovery planning, and resolvability.

With insurers focusing more on capital and balance sheet optimisation, we will expect firms to demonstrate that any activities in this area do not reduce overall levels of financial resilience or policyholder protection. We will continue our work on internal model drift and on the matching adjustment as we receive a further year of data, to ensure that firms remain adequately capitalised; and we will consider any developments on the risk margin in the context of the Solvency II 2020 review and the agreement of the Insurance Capital Standard 2.0 (ICS).

We will continue to work with HM Treasury, the Department for Work and Pensions, and other stakeholders, to develop an effective regulatory regime for defined benefit pension scheme consolidators (superfunds).[21] We have an interest in the regulatory framework for superfunds because insurance groups might operate in the consolidation market, and we might therefore become the prudential supervisor for the consolidated group.

International engagement

The PRA is committed to continuing work with international authorities to promote consistent implementation of international standards, lead the global debate on prudential standards, and encourage further openness between jurisdictions. Banking and insurance are global industries and, to a large extent, the policy framework for supervising banks and insurance companies is agreed internationally. Therefore effective cross-border co-operation is essential to our success. At the international level we will continue to be involved in negotiating policy in international fora including the Basel Committee on Banking Supervision (BCBS), the Financial Stability Board (FSB), and the International Association of Insurance Supervisors (IAIS). We will also focus on completing the implementation of post-crisis reforms, including preparations for the Basel III package for which the implementation date has now been deferred to Sunday 1 January 2023.[22] We will be co-ordinating internationally to ensure that implementation will happen alongside other major jurisdictions and will engage with the UK Government on the legislative approach.

In November 2019, the IAIS adopted the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) and the Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector; and agreed ICS. There will be a five-year monitoring period for ICS that we will take part in, beginning this year. We will also implement ComFrame and the Holistic Framework over the coming year.

Stress testing

The concurrent stress testing of firms has been one of the key tools used by the PRA and other areas of the Bank to support our microprudential and macroprudential objectives. Banking stress tests examine

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21 February 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/pra-response-to-dwp-consultation-paper-defined-benefit-pension-scheme-consolidation.

22 https://www.bis.org/press/p200327.htm.

the potential impact of a hypothetical scenario on the individual institutions that make up the banking system, and on the system as a whole. We normally run two types of banking stress test – the annual cyclical scenario (ACS) and biennial exploratory scenario (BES).

In order to accommodate the impacts of Covid-19 on the financial sector and UK economy, and to prevent causing additional stress on firms at a time when they are having to adapt to significant changes, we have decided to forgo the ACS during the coming year.

Every other year we also run the BES, which allows us to explore the resilience of the banking system to a wide range of risks that may not be linked to prevailing economic or financial conditions. These exercises inform assessments of how the financial system might respond if risks were to crystallise. In doing so, they can help the Bank and financial institutions to prepare for possible future challenges. The first BES in 2017 focused on the potential impact on banks' business models of persistently low interest rates and the increased use of FinTech. The 2019 BES explores the implications of a severe and broad-based liquidity stress affecting major UK banks simultaneously, and how the reactions of banks and authorities to the stress would shape its impact on the broader financial system and the UK economy. The Bank was due to publish the results of the 2019 BES on liquidity in mid-2020. In order to alleviate burdens on core treasury staff at banks, due to Covid-19 the Bank has paused this exercise until further notice. In 2019 the Bank published a discussion paper[23] setting out the proposal for the next BES on climate-related risks. The objective is to test the resilience of the largest banks, insurers and the financial system to different possible climate pathways and to provide a comprehensive assessment of the UK financial system's exposure to climate-related risks. The feedback received on the robustness and feasibility of the proposed framework, including whether the scenarios align with external expectations of climate-related risks and the related changes in the real economy, will form the basis of the next BES. The Bank will take stock of the responses as well as the evolving Covid-19 situation with a view to announcing the way forward for this exercise in due course.

We also run our own stress tests on a periodic basis for a number of insurance firms; regularly for specific high-impact firms, and as the need arises for others. Insurance firms use stress and scenario testing to consider the potential impact of certain adverse circumstances on their business. It is an important element in firms' planning and risk management processes, helping them identify, analyse and manage risks.

Reviews of the internal capital adequacy assessment process (ICAAP) are also a key component of how we assess the resilience of banks to stress, particularly those that do not participate in the concurrent stress test. The PRA intends to consult on enhancing the ICAAP review process for mid-sized UK banks and building societies from 2020, and to continue engaging with relevant firms to take this forward.

Asset quality

Taking a risk-based approach, we will continue to review firms' asset quality and management of investment risk. Where we find weaknesses, we will address them appropriately through supervisory action and setting regulatory expectations and/or requirements.

At the same time, we will continue to review firms' risk management and governance of illiquid and other assets, including their internal ratings. Where we have concerns about particular internal ratings, we may commission an opinion from an external credit assessment institution (ECAI) using our powers under Section 166 of FSMA. We will target our reviews at firms with large and/or complex exposures.

The Prudent Person Principle (PPP) in Solvency II is an important safeguard against concentration risk. It requires insurers to invest only in assets where they can properly identify, measure, monitor, manage,

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23 December 2019: https://www.bankofengland.co.uk/paper/2019/biennial-exploratory-scenario-climate-change-discussion-paper.

control and report risks. In 2020, we will finalise and publish a supervisory statement on our expectations of firms' implementation of the PPP.

Operational resilience

Develop our supervision of operational resilience in order to mitigate the risk of disruption to the provision of important business services

'Operational resilience' refers to the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover, and learn from operational disruptions from whatever cause, including cyber threats. Operational disruption can impact financial stability, threaten the viability of individual firms and Financial Market Intermediaries, or cause harm to consumers, policyholders and other parts of the financial system. Therefore operational resilience continues to be a strategic priority for us and other areas of the Bank, as well as the FCA.

In December 2019, we published our policy proposals for impact tolerances for important business services jointly with the FCA and the Bank.[24] Feedback from that consultation will inform a policy statement to be published in 2020/21. In recognition of the Covid-19 outbreak, the deadline for responses to the consultation will, in line with the FCA, be extended to 1 October 2020. The new aspects of the policy proposals would require firms to: identify important business services; set impact tolerances for those important business services; and take action so they are able to deliver their important business services within their impact tolerances during severe but plausible disruptions. Firms should plan and operate on this basis.

Our proposed approach to operational resilience is based on the assumption that, from time to time, disruptions will occur which may prevent firms from operating as usual, and see them unable to provide their services for a period.

During 2020/21, on a proportionate basis we will also continue:

- our international engagement, including the Basel Operational Resilience Group, the G7 Cyber Experts Group and European Systemic Cyber Group; and
- to assess firms against our existing requirements and discuss firms' preparations and capabilities to comply with the new requirements as set out in the consultation.

Recovery and resolution

Ensure that banks and insurers have credible plans in place to enable them to recover from stress events, and that firms work to remove barriers to their resolvability to support the management of failure – proportionate to the firm's size and systemic importance – in an orderly manner

We will continue to progress the work to end 'too big to fail', supporting the Bank as the UK's resolution authority. Recovery and resolution are core components of the regulatory reform agenda and help ensure that no firm is 'too big to fail', without disrupting financial stability. Firms are required to draw up recovery plans, so that they are ready to cope with stress, can stabilise their position, and recover. We expect firms to undertake recovery planning. However, if a firm does fail, the Bank as the UK's resolution authority for banks, building societies, central counterparties and some types of investment

24 December 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper.

firms must ensure that it does so in an orderly manner, reducing risks to depositors, the financial system and public finances – a process known as resolution.

The final major piece in the UK's resolution regime for banks was introduced in 2019 with the publication by the Bank (as resolution authority) and the PRA (as prudential regulator) of the Resolvability Assessment Framework (RAF), designed to ensure firms are accountable for their own resolvability. It does this by setting out how the Bank will assess the resolvability of UK banks and building societies, and by putting in place requirements for the largest UK banks and building societies to assess their preparations for resolution. Under new rules put in place by the PRA in 2019, UK banks and building societies with at least £50 billion in retail deposits will be required to submit reports of their assessments to us and to disclose a summary of that report to the public in a two-year cycle. In 2020 we will ensure that firms are accountable for their resolvability through the implementation of the RAF.

We will continue our work to ensure firms develop capabilities to wind down their trading and derivatives businesses in an orderly manner, including where relevant to their recovery and post-resolution restructuring frameworks. In the coming year we will progress this work, with a view to consulting on our approach. We will also continue the review of operational continuity in resolution, with a view to publishing a consultation paper on our revised approach to policy.

We will continue to work with international regulators and resolution authorities to ensure a coordinated and effective approach for firms that operate cross-border. For insurers, we will work closely with the FSB and IAIS so that UK internationally active insurance groups contribute to the implementation of the recently-approved Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector, a key component of which is a set of crisis management and planning tools including resolution planning. The PRA will contribute to the IAIS's development of an application paper on resolution powers and planning, which is scheduled to be published in 2021 and will provide further guidance.

Competition

Facilitate effective competition by actively considering the proportionality of our approach as it contributes to the safety and soundness of the UK financial system

Our secondary competition objective states that 'when discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which facilitates effective competition in the markets for services provided by PRA-authorised persons carrying on regulated activities'.

In November 2019, HM Treasury sent the PRC an updated recommendation letter about aspects of the UK Government's economic policy to which the PRC should have regard when considering how to advance its objectives and when considering the application of the regulatory principles set out in FSMA.[25] The letter highlighted the importance of having an open and competitive economy which allows free enterprise to flourish, and the Government's commitment to UK financial services being effectively regulated. In the coming year, we will continue to deliver against our secondary competition objective more specifically by continuing to assess the competition implications of our policies and checking for any unintended distortions to competition by:

25 Information about the PRC and HM Treasury's letter is available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

- for new and small firms:
  - continuing to support the New Bank Start-up Unit and New Insurers Start-up Unit[26] ensuring that decisions on new bank and insurer authorisation applications[27] are reached within six months of receiving a completed formal application, that we provide timely feedback to prospective applicants, and that we always apply a proportionate approach;
  - conducting further analysis on barriers to growth for smaller firms, including by assessing the extent to which the overall regulatory burden is affected as firms grow organically in size and complexity, and by considering options for harmonising and rationalising regulatory thresholds;
  - developing a tailored approach to the supervision of small and fast-growing firms, including considering how we might design and implement a regime for small, non-systemic banks and building societies. As part of that work, we will continue to pursue proportionate outcomes from implementation of Basel 3.1 and CRD V;
  - setting capital requirements in a proportionate manner reflective of the risk profile of the individual firm, and on a basis which is consistent with other firms; and reviewing capital requirements for new banks and insurers annually for the first five years of their existence, to ensure proportionality during what may be a period of rapid growth;
- for policy review and development:
  - continuing to implement policies to facilitate internal ratings based model applications from smaller banks,[28] and refining the Pillar 2A capital framework;[29]
  - developing our approach to mortgage risk weight floors;
  - developing our approach to Pillar 2 liquidity;
  - reviewing the leverage ratio;
  - further refining the framework to facilitate the issuance of Insurance Linked Securities (ILS) through ISPVs in the UK that will take account of our experience of operating the new supervisory regime since the end of 2017;[30] and
- developing in a proportionate manner our approach to operational resilience in our prudential framework.

EU withdrawal

Deliver a smooth transition to a sustainable and resilient UK financial regulatory framework following the UK's exit from the European Union

[26] The New Insurer Start-up Unit was launched in August 2018: https://www.bankofengland.co.uk/prudential-regulation/new-insurer-start-up-unit.

[27] See the dedicated web page for more information and materials: http://www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit.

[28] Policy Statement 23/17 'Internal Ratings Based (IRB) approach: clarifying PRA expectations', October 2017: https://www.bankofengland.co.uk/prudential-regulation/publication/2017/internal-ratings-based-approach-clarifying-pra-expectations.

[29] Policy Statement 22/17 'Refining the PRA's Pillar 2A capital framework', October 2017: https://www.bankofengland.co.uk/prudential-regulation/publication/2017/refining-the-pra-pillar-2a-capital-framework.

[30] Information on the framework for ISPVs is available at: https://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles.

On Friday 31 January 2020 the UK formally withdrew from the EU and agreed to a transition period until December 2020, to allow both sides to adapt to the new situation. Until the end of the transition period, UK firms can continue to operate in the EU, and EU firms will continue to operate in the UK under the EEA passporting regime.

Future regulatory framework

During the transition period, we will continue to maintain and develop the UK regulatory framework to meet our objectives and the needs of UK financial markets. As a leading global financial centre, this will need to be done in collaboration with international partners. During the transition period, a key priority will be establishing new regulatory relationships with the EU.

UK regulation post-exit

While the UK develops its relationship with the EU, we are committed to maintaining financial stability and the current level of resilience, which itself exceeds that required by international standards. We will support HM Treasury in its efforts to nationalise the acquis to ensure that at the end of the transition period we have in place an operable legal framework for financial services. We will work on equivalence assessments of the UK to the EU, and of third countries.

In the insurance sector, we will take forward work on the risk margin, regulatory data, and the appropriate calibration of the matching adjustment. Also, we will ensure a smooth transition to the risk-free rate calculation and will develop capabilities to produce independently all the various Solvency II risk-free rate components. In the banking sector, we will continue to monitor any risks presented by firms' business models and governance as a result of restructuring their activities to accommodate the UK's withdrawal from the EU.

We will continue to work closely with firms on their authorisation applications during the transition, and also remain in close contact with their home supervisor.

Finally, we will undertake analysis on transition and contingency planning to ensure that, whatever the outcome of negotiations on the future relationship, we can manage the risks to UK financial and monetary stability.

Efficiency and effectiveness

Operate effectively and efficiently by ensuring that resources are allocated to work that best advances our strategy and reduces the greatest risks to the delivery of our statutory objectives, and by providing an inclusive working environment in which all staff can perform to their potential

Despite the impacts of Covid-19, we are committed to continuing to improve the way we work. As a follow-up to the PRA strategy 2019/20, in February 2020 we started a review of our strategy and target operating model. In 2020 we will strive to maintain the level of financial resilience of the banking and insurance sectors to be at least as high as it is today, and work closely with those sectors to support their resilience while measures to prevent the spread of Covid-19 affect their business. We will also endeavour to maintain a risk-aware, post-crisis culture in the firms we regulate, while embracing new technologies to improve our efficiency and effectiveness as a regulator and delivering greater benefits to financial services firms and the real economy. We will commence work to investigate making the PRA Rulebook machine-readable, identifying opportunities for simplification and removing redundancies. We will maintain our commitment to remain a thought leader on RegTech and to deliver a world class RegTech strategy.

We will continue to focus on our resource management while taking into account the impacts of measures against Covid-19, to ensure that our resources are well-aligned to our highest priorities with a focus on value and risk mitigation, and that our projects have appropriate business and technical resources to enable timely delivery. We need to ensure that our decision-making is well informed and reflects the risk tolerance and appetite defined by the PRC.

We will continue to prioritise workloads to ensure goals and objectives can be delivered alongside reactive work. This will involve the following:

- continuing to build an increasingly talented and diverse workforce, and to attract and bring together people with different areas of expertise, skills and outlook. We will seek to recognise outstanding performance, foster an inclusive culture, and maximise use of dynamic organisational structures across the Bank;

- carrying out a discussion with firms to transform data collection from the UK financial sector over the next decade,[31] seeking ways to decrease the burden on industry and to increase the timeliness and effectiveness of data in supporting supervisory judgements. The Bank and the PRA issued a discussion paper in January 2020, setting out a range of potential options drawing on ideas explored in the Bank's response to the Future of Finance report published in June 2019 and in the pilot on digital regulatory reporting. The Bank and the PRA plan to carry out direct stakeholder engagement during 2020, where possible in light of Covid-19, including bilateral meetings, roundtable events, webinars, and industry working groups, some of which will be run jointly with the FCA as we continue to work closely together to ensure that reforms to data collection are aligned;[32]

- embedding tools and technology required for frontline supervision to improve effectiveness and efficiency through new ways of managing and using data. This includes upskilling users and supporting them to take ownership of their data and analysis; and

- ensuring our people are deployed to our priorities, equipping supervisors with the necessary skills required for uncertain and challenging times, and building capabilities so that we can deliver forward-looking, judgement-led supervision. We will do this by continually building core supervisory skills in financial resilience, business models, products and markets, operational resilience, cyber risks, and developing skills in areas such as climate change, reinsurance and illiquid assets.

Risks to the delivery of the PRA Business Plan

Operating in a complex and fast-moving environment inevitably gives rise to risks to the delivery of our Business Plan. These risks are monitored, actively mitigated (where possible), managed and reported to the PRC and Supervision, Risk and Policy Committee (SRPC) on a regular basis. One crystallised risk at the time of writing is the impact of Covid-19. We will need to review and reprioritise this Business Plan during the year as the impacts and required work for us become clearer.

We remain committed to being economical, efficient and effective with the resources provided to us. This can place operating constraints at times of extensive change or risk crystallisation. Our largest expense is on our greatest asset – our people – and we have had to make some difficult prioritisation decisions to keep our overall cost and headcount in check. This means that we are less able to accommodate unexpected tasks – particularly where they require scarce specialist or experienced resources.

Dependencies

Our policymaking is often dependent on overseas authorities that lead on timings and requirements for delivery of legislative and regulatory change. The outcome of international policy negotiation could also

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

32 January 2020: https://www.bankofengland.co.uk/news/2020/january/fca-and-boe-announce-proposals-for-data-reforms-across-the-uk-financial-sector.

differ from current PRA and Bank objectives which, in certain circumstances, could weaken our current approach. Maintaining external policy relationships is essential to ensuring that new policy requirements support our statutory objectives.

Internal factors

We ensure that our people are allocated to work that advances our strategy and reduces risk to the delivery of our statutory objectives. We will continue to ensure we meet high standards of governance alongside continually improving our people management skills through the following actions:

- facilitating working across boundaries to achieve PRA and wider Bank objectives;
- maximising the use of dynamic structures including those enabled by developments in technology;
- regularly reviewing the prioritisation of work to ensure goals and objectives can be delivered whilst maintaining a good work/life balance for our staff;
- targeting training and recruitment to ensure that our resources are used creatively and flexibly to do what matters most; and
- fostering an inclusive culture through the continued development of a diverse workforce, most notably making measureable progress on the recruitment and career progression of female employees and those from different ethnic backgrounds.

Measuring progress

We draw on a variety of information to monitor, and to provide assurance over, the progress of delivery against our statutory objectives, strategy and Business Plan on an ongoing basis. For example, we assess the success of our supervisory approach through: i) self and peer reviews where staff assess their own performance and receive independent challenge at regular intervals, as well as reviews carried out by other bodies (such as the International Monetary Fund (IMF)); ii) regular reviews of how firm-specific risks are being managed; and iii) firm feedback, and independent and/or external reviews.

We have governance in place through executive committees that receive information on a regular basis, both quantitative and qualitative measures and indicators, to enable them to assess the delivery against our strategy, Business Plan, statutory objectives, and risk tolerance. This enables the PRC to report to the Chancellor on the adequacy of resources and to provide sufficient information on supervisory processes and outcomes.[33]

[33] The annual report of the PRC to the Chancellor of the Exchequer for 2018/19 is available on pages 10 & 11 of 'The Prudential Regulation Authority Annual Report 1 March 2018 to 28 February 2019': https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2019/pra-2019.pdf.

PRA Budget 2020/21

The PRA's budget for 2020/21 is £285 million, including implementation and transaction fees of £9 million. This is an increase of £13 million (4.8%) on the 2019/20 budget.[34] Excluding an increase in pension costs, the increase is 2.2%.

The costs of the PRA have increased principally due to the increase in pension costs (£7 million), increases in investment activities, and the priorities of operational resilience, climate change and developments in technology. There has been some offset from lower budgeted costs associated with EU withdrawal related activities and continued reduction in resources to lower-risk supervisory activity. Overall headcount for the PRA in 2020/21 will reduce to 1,294, from 1,321 in 2019/20.

We explain how the PRA proposes to fund its budget in consultation paper (CP) 4/20 'Regulated fees and levies: Rates proposals 2020/21'.[35] This CP includes proposals for allocating the cost of the PRA's 2020/21 ongoing regulatory activities across PRA fee payers.

34 The PRA's budget published in the PRA Business Plan 2019/20 was stated as £273 million, but was revised to £272 million when the PRA's pension costs were available. Similarly, the PRA's budget for 2020/21 is provisional and may need to be revised when final estimates for the PRA's pension costs are available. The Bank's pension scheme is a defined benefit scheme with annual costs determined under International Accounting Standards (IAS 19). Costs are dependent on corporate bond yields as at the accounting year end date, which have deteriorated driving up pension service costs.

35 April 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/regulated-fees-and-levies-rates-proposals-2020-21.

Abbreviations

ACS	Annual cyclical scenario
AI	Artificial intelligence
Bank	Bank of England
BCBS	Basel Committee on Banking Supervision
BES	Biennial exploratory scenario
CEO	Chief executive officer
CFRF	Climate Financial Risk Forum
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
Covid-19	Novel Coronavirus disease
CRD	Capital Requirements Directive
CRD V	CRR and CRD collectively
CRR	Capital Requirements Regulation
DIF	Designated investment firm
ECAI	External credit assessment institution
EEA	European Economic Area
EU	European Union
FCA	Financial Conduct Authority
FinTech	Financial technology
FPC	Financial Policy Committee
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act 2000 (as amended)
G7	Group of Seven
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
ICAAP	Internal capital adequacy assessment process
ICS	Insurance Capital Standard
ILS	Insurance Linked Securities
IMF	International Monetary Fund
ISPV	Insurance special purpose vehicle
LIBOR	London interbank offered rate
PPP	Prudent Person Principle
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
RAF	Resolvability assessment framework
RegTech	Regulatory technology
SRPC	Supervision, Risk and Policy Committee
TPR	Temporary permissions regime
UK	United Kingdom

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