BANK OF ENGLAND

News release

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Geofinance – Speech by Sam Woods

At the Mansion House City Banquet, Deputy Governor for Prudential Regulation Sam Woods explores the impact of geography on the shape of banks, insurers and financial regulation – "a dynamic we might call *geofinance*". With the revolution in regulation following the financial crisis coming to its end, and with changes to the geopolitical landscape looming large, Sam predicts that geofinance will be "the defining challenge of the next few years".

Noting that "stability begins at home", Sam announces a new approach to ensure that UK banking groups are "at least as strong as their parts". Where a group operates across borders the PRA sets its consolidated requirements as 'home' regulator, but overseas 'hosts' might require the subsidiaries they supervise to have an outsize portion of the group's total capital. The UK parent might fund this by raising debt externally: this is known as 'double leverage'. Subject to its consultation launched today, the PRA will expect firms to demonstrate that they can manage the cash-flow and other geofinancial risks associated with double leverage, while reserving the right to take mitigating action. The PRA also plans to expand capital and liquidity reporting requirements to assess whether firms are allocating financial resources appropriately in relation to risks across jurisdictions and currencies.

Another example of "geofinance in action – in a good way" is the domestication of retail and SME banking. Ring-fencing this business from global wholesale and investment banking is a very substantial undertaking for the regulators and the UK banks, but implementation is on track.

The PRA is also responsible for the host supervision of around 170 international banks from over 50 jurisdictions. On almost any measure, Sam says, "we are the host with the most". Consistent with the logic of ring-fencing, the PRA has preferred for several years that international banks from outside the EEA with material retail and SME balances put them in a subsidiary. Local supervisors have more levers over subsidiaries than over branches, which allow funds to flow more freely across borders.
Subject to the Brexit negotiations, the PRA's current planning assumption is that EEA banks will also need to put material UK retail business in a subsidiary. This should be no surprise given the PRA's existing policy and its engagement with the handful of relevant branches following its published letter to CEOs in April about contingency planning.

Sam says that Brexit poses “material risks to the PRA’s objectives but we are well on the case in dealing with them”. Looking in particular at the ‘outbounds’ using London as a base for continental operations, he “struggle[s] to see an outcome in which banks and insurers do not get harder to supervise and harder to resolve for all involved”. These firms are a little further advanced in their planning than the ‘inbounds’ based in the EEA: the PRA has provided feedback where contingency plans needed more work. It is also engaging widely to unpick cross-sectoral problems around contract continuity and data sharing.

Most important is some form of transition or implementation period. Sam cautions that “the EU’s position on [this] is not yet clear – despite some obvious risks to EU financial stability in its absence. If we get to Christmas and the negotiations have not reached any agreement on this topic, diminishing marginal returns will kick in. Firms would start discounting the likelihood of a transition in the central case of their planning”.

Looking further ahead, Sam warns that “bringing up the borders in wholesale finance would be regrettable for all sides”. Wholesale capital markets and the banks which serve them are deeply interconnected and contribute to the efficient allocation of capital. Recently, however, the European Commission proposed that non-EU groups above a certain size or systemic importance must establish a common ‘intermediate parent undertaking’. Some see this as a response to US rules that require large foreign banking organisations to establish an ‘intermediate holding company’. Sam is “not persuaded that these developments are a good idea. We risk kidding ourselves if we think [wholesale banking] can be neatly chopped up into geographic units in which international banks can be supervised and resolved separately”.

In Sam’s view, “it is best to deepen co-operation so that between us we can properly supervise wholesale banking through branches as well as subsidiaries. This will be challenging, but progress since the crisis shows it can be done. Governments and regulators came together through the FSB in a spirit of co-operative resolve and enlightened self-interest to build a framework of global standards. Through supervisory colleges and crisis management groups, insights and expertise are exchanged across borders”.

Sam emphasises, “we must finish the job of implementing the post-crisis reforms, hold the line and stick together. Because geofinance will always complicate the supervision of international banks, the high road will never be an easy ride. But we have already seen its benefits in a financial system that can ride out shocks and surprises”.

ENDS

Notes to Editors

Link to speech: http://www.bankofengland.co.uk/publications/Documents/speeches/2017/speech1001.pdf

Links to consultation papers:

- CP19/17: *Groups policy and double leverage*
  http://www.bankofengland.co.uk/pra/Pages/publications/cp/2017/cp1917.aspx
- CP20/17: *Changes to the PRA's large exposures framework*
  http://www.bankofengland.co.uk/pra/Pages/publications/cp/2017/cp2017.aspx