BANK OF ENGLAND

News release

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The Bank of England's approach to the authorisation and supervision of international banks, insurers and central counterparties

Summary

As discussions on the UK's future relationship with the EU continue the Bank of England is announcing today that it is consulting on an updated approach to authorising and supervising international banks and insurers, and it is issuing guidance on its approach to international central counterparties (CCPs). The Bank of England is also publishing letters to relevant firms which set out the Bank of England's approach to the authorisation of those firms, so that this process can proceed in an orderly manner.

The foundation of the Bank of England's approach is the presumption that there will continue to be a high degree of supervisory cooperation between the UK and the EU. On this basis, EEA banks and insurers may (if they are not conducting material retail business) apply for authorisation to operate as a branch in the UK. There are expected to be no implications of the proposed policy for the current operations of banks and insurers from non-EEA countries such as the US, Switzerland and Japan.

This approach is rooted in the substantial evidence that openness supports economic dynamism through a range of channels, raising growth and boosting living standards.

The UK's financial system is both a national asset and global public good.

Keeping the UK's financial system open to foreign institutions is in the best interests of the UK, EU and global economies.

Having a large financial sector brings substantial benefits to the UK. A deep and liquid financial market lowers the cost of finance to households and businesses. The financial services sector accounts for 7% of output and is a source of over 1 million jobs, two thirds of which are outside London. It contributes around £70bn, or 11%, of annual tax revenues.

The UK's financial sector also brings substantial benefits to EU households and firms, allowing them to access a broad range of services efficiently and reliably. UK-located banks underwrite around half of the debt and equity issued by EU companies. UK-located banks are counterparty to over half of the over-the-counter (OTC) interest rate derivatives traded by EU companies and banks. As many as 30 million EEA policyholders are insured through a UK-based insurer. Central counterparties (CCPs) located in the United Kingdom provide services to EU clients in a range of markets. UK-located asset managers account for 37% of all assets managed in Europe.

Globally, the UK has the largest share of cross-border bank lending, foreign exchange trading and interest rate derivatives. It also has the second largest asset management industry and the fourth largest insurance industry in the world. This concentration of activity increases efficiencies in the provision of finance, which in turn support international trade and cross-border investment. Fragmentation of the UK's financial sector could increase the cost of financial intermediation, to the detriment of households, firms, and governments in the UK, EU, and elsewhere.

Two of the most important components of the UK financial system are international banking and insurance.

There are 160 branches of international banks in the UK, of which 77 are from the EEA. Their assets total £4 trillion, which is substantially larger than UK GDP. There are also 110 branches of international insurers in the UK, of which 80 are from the EEA. Other countries rely on the services these institutions provide.

International firms bring great benefits, but also bring risks.

Large and complex financial institutions are inherently risky, and if left unmanaged, these risks could spill over and damage the real economy. These risks are managed by the Bank of England through:

- Strong regulatory standards: These have been materially reinforced since the financial crisis due to the actions of the UK and its key G20 partners. Banks are now much more resilient, with capital requirements for the largest global banks ten times higher.
- Deep supervisory cooperation: The UK has actively worked since the crisis to build strong bilateral and multilateral cooperation mechanisms both through participation in supervisory colleges and crisis management groups, and via the development of agreed approaches to supervisory oversight and enforcement. Although some of this cooperation has been supported through underlying legal structures within the EU, the majority has been developed through direct interactions with regulators including in third countries.
- Transparent and effective resolution regimes: These are essential for ensuring that institutions can maintain critical functions even when they fail. For example, large banks are now required to hold significant quantities of debt that can be written down or converted to equity to recapitalise them in resolution. Firms must also work with authorities to develop resolution plans and are subject to

regular resolvability assessments to ensure continuity of critical functions without exposing taxpayers to loss.

Today the Bank of England is announcing that we are refreshing our policy to authorising and supervising such firms as the UK redefines its relationship with the EU.

As the UK withdraws from the EU, we expect the UK financial system to stay very large and it may, over time, become more complex, reducing the visibility to supervisors of overseas firms operating in the UK. This could place greater demands on supervision, and could pose challenges for effective resolution, which in turn requires deep supervisory cooperation.

To meet these challenges, the Bank of England is today announcing a proposed updated approach to authorising and supervising branches of international banks and insurers.

Our proposed policy will be out for public comment until the end of February 2018. The Bank of England would intend to finalise the policy shortly thereafter.

In expectation of the future legal framework following the negotiations between the UK and the EU, firms currently branching into the UK under 'passporting' will need to be authorised to operate in the UK.

The PRA therefore expects to undertake the authorisation of relevant firms on the basis of this proposed updated approach. The PRA is writing to relevant firms to inform them of this. That letter is being published today.

The updated policy will particularly take into account, first, what international firms do in the UK and second, where they are from.

In terms of what firms do, the PRA must take into account how "systemic" their activities are in the UK. Specifically, the types and amounts of business undertaken will determine the intensity of the PRA's approach to supervision. If the branch is important for the resilience and stability of the UK financial system as a whole, the PRA will place greater emphasis on the degree of influence and visibility that it has over the firm. For example, in making its assessment of whether a branch is systemic, the PRA will take into account a number of factors, including size (whether the firm's UK footprint is larger than £15 billion in total assets), and inter-connectedness with the UK financial system.

The PRA already expects third-country banks with material UK retail deposits to operate through subsidiaries. It proposes to extend this broad approach to insurers, based on the scale of their liabilities protected by the UK Financial Services Compensation Scheme.

In terms of where firms are from, the PRA's approach is based on an assessment of the degree of equivalence of the home state regulatory regime in meeting international standards, and, importantly, the level of cooperation with the home state supervisor. Where sufficient supervisory cooperation and assurance on resolution exists, a firm may apply to operate as a branch.

Our new approach will not affect the current operations of non-EEA firms operating in the UK.

The PRA does not expect the new approach to affect the current operations of any of the non-EEA international banks and insurers currently operating in the UK as branches. This is because we already have an appropriate level of third country supervisory cooperation with their home state supervisors in light of the systemic importance of the relevant firms.

We will take a similar approach to central counterparties (CCPs).

The Bank of England is also announcing guidance on its approach to non-UK CCPs which provide services in the UK so that they can continue doing so following the UK's withdrawal.

CCPs lie at the heart of the global and UK financial system and provide the infrastructure that allows the financial system to function in an orderly manner. Well-functioning CCPs are crucial to the resilience of the UK financial system.

The Bank of England is therefore writing to non-UK CCPs outlining the circumstances in which, if they wish to operate in the UK, they would need to be recognised to do so by the UK authorities, and the approach to recognition we expect to take. The Bank of England anticipates that, at the point of exit, the UK authorities will apply the recognition regime currently in force in the EU. Our presumption is that, subject to this process, non-UK CCPs operating here at present will be able to do so after the UK's withdrawal from the EU.

The Bank of England, consistent with our long history of cooperation with our counterparts in the EU and our commitment to an open financial system, intends to proceed on the presumption that a high degree of supervisory cooperation with the EU continues following Brexit.

EEA firms may therefore plan on the assumption that the requirements for equivalence, supervisory cooperation and adequate assurance over resolution will be met, and, provided they are not conducting material retail business in the UK, they may apply for authorisation as a branch.

In the event of a non-cooperative relationship, however, there could be implications for how we oversee some EEA firms in the UK.

If the PRA is unable to gain sufficient assurance over the degree of cooperation with the home state supervisor and its oversight of the firm, it may impose specific regulatory requirements at the branch level. If this proves to be ineffective, the PRA would likely authorise the firm only as a subsidiary.

The Bank of England will ensure that the process of introducing the updated policy is an orderly one.

The approach to authorisation and supervision of international firms will be out for consultation until February 2018 and the PRA will be open for applications from the beginning of 2018.

The Bank of England welcomes the Government's announcement today regarding its intention to provide the means for the PRA and Bank, should it be necessary, to create a temporary permissions regime for its firms and a temporary regime for CCPs. Such temporary permissions in the context of PRA and Bank regulated institutions should be viewed as a fall back option only.

Given the prudential risk associated with complex banking activities undertaken in the UK, the Bank of England is open to receiving authorisation applications from firms that would fall within the PRA regulatory perimeter and engaging with CCPs on the recognition process from the beginning of the year to ensure an orderly process and readiness.

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Notes to Editors

1. Letter from Sam Woods; *Firms' preparations for the UK's withdrawal from the European Union: planning assumptions*
2. Consultation Paper CP29/17; *International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision*
3. Consultation Paper CP30/17; *International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision*
4. Letter from Sir Jon Cunliffe; *International central counterparties; the Bank of England's planned approach to recognition following the UK's withdrawal from the European Union*