



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Consultation Paper | CP29/17

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

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Responses are requested by Tuesday 27 February 2018.

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## 1 Overview

1.1 In this consultation paper ('CP'), the Prudential Regulation Authority ('PRA') seeks views on its proposed new approach to authorising and supervising international banks, which includes a focus on those that undertake wholesale banking activities in the United Kingdom via branches.

1.2 Expanding on the PRA's general framework as set out in its banking approach document,<sup>1</sup> this CP includes a draft supervisory statement ('SS') which sets out the PRA's new approach to authorising and supervising international bank branches. When it is finalised, having taken into account consultation feedback, it will replace SS10/14 'Supervising international banks: the Prudential Regulation Authority's approach to branch supervision'.<sup>2</sup>

1.3 The proposals are relevant to all PRA-authorised deposit-takers and designated investment firms<sup>3</sup> operating in the United Kingdom that are part of non-UK headquartered groups ('international banks') and to international banks that may seek PRA authorisation in the future.

### Background

1.4 International banks can operate in the United Kingdom either as subsidiaries or branches.<sup>4</sup> At present, there are 160 branches of international banks operating in the United Kingdom, of which 77 are European Economic Area ('EEA') branches operating under the 'passporting' arrangements. In aggregate, these 160 branches account for approximately 30% (£4 trillion) of the total assets of the UK banking system in 2017.<sup>5</sup>

1.5 Branching offers less supervisory control to the PRA than a subsidiary permits. The PRA's view, however, is that the ability of international banks to branch into other countries is, if done safely, an important component of an open world economy that benefits the UK economy. This is especially true where those international banks meet the same prudential standards as the UK headquartered banks. On the other hand, there would be risks to UK financial stability if the PRA is unable to supervise international banks branching into the UK in a way that promotes safety and soundness of the firms it supervises.

1.6 A branch of an international bank is part of a legal entity established outside the UK and its operations depend on that legal entity. Therefore, the PRA authorisation framework applies to the whole legal entity ('firm'), of which the branch is part, rather than just the branch itself. A necessary part of the framework is to have an appropriate degree of supervisory cooperation with the home state supervisor<sup>6</sup> that enables the PRA to understand the nature and extent of the risks facing the firm, and provide appropriate input to the supervisory strategies of the home state supervisor, leading to outcomes which further the PRA's statutory objectives. The more important a branch is to UK financial stability, the higher would be the PRA's required standard of supervisory cooperation and standards.

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1 March 2016: [www.bankofengland.co.uk/prudential-regulation/publication/2016/pru-approach-documents-2016](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/pru-approach-documents-2016).

2 September 2014: [www.bankofengland.co.uk/prudential-regulation/publication/2014/supervising-international-banks-the-pru-approach-to-branch-supervision](http://www.bankofengland.co.uk/prudential-regulation/publication/2014/supervising-international-banks-the-pru-approach-to-branch-supervision).

3 PRA designated investment firms list: [www.bankofengland.co.uk/prudential-regulation/authorisations/which-firms-does-the-pru-regulate](http://www.bankofengland.co.uk/prudential-regulation/authorisations/which-firms-does-the-pru-regulate).

4 See Chapter 2 of the draft supervisory statement for the United Kingdom's distinction between international bank branches and subsidiaries.

5 As at 30 June 2017. Source: PRA Branch Return.

6 Home state supervisors refer to the supervisors of the international firm which the UK branch is part of. In cases where the international firm branches into the United Kingdom via an intermediate subsidiary in a third country (a 'disintermediated branch'), home state supervisors refer to the supervisors of the intermediate subsidiary and of the global consolidation group.

## Purpose

1.7 The PRA's new approach to branch authorisation and supervision is set out in the draft SS (see Appendix). This approach introduces three key elements that focus on wholesale banking:

- The importance of the branch to the financial stability of the UK - its systemic importance - as a determinant of the way in which the PRA would supervise international banks that undertake wholesale activities in the UK through a branch;
- 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');
  - 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. This requirement is especially relevant, and may be harder to satisfy, where group structures are more complex, for example where international banks are branching into the UK via an intermediate subsidiary incorporated in a different jurisdiction from the ultimate parent (a 'disintermediated branch') or where firms seek to maintain multiple branches from different entities; and
- 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 imposing specific regulatory requirements on a case-by-case basis becomes commonplace, the PRA will consider publishing further policy proposals on these requirements that would be applicable to all international banks undertaking wholesale activities in the UK through branches. 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.

1.8 In addition to the above, and consistent with its existing approach, the PRA also requires the whole firm to meet the PRA's Threshold Conditions ('TCs'); that the home state supervisor's regulatory regime is sufficiently equivalent to meet outcomes-based international standards and deliver appropriate outcomes consistent with the PRA's objectives; and for the PRA to have adequate assurances over resolution.

1.9 On the basis of their existing business 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.

1.10 This new approach reflects both the experience to date in operating the PRA's existing approach to branch supervision and the likely changes to the shape of the UK financial system given firms' desires to maintain their ability to carry out cross-border activities, eg as a result



of the UK's withdrawal from the European Union ('EU'). Other things being equal, incentives to maximise financial and operational efficiencies could lead to changes in the amount of activity, wholesale activities in particular, being undertaken in the UK through branches. Over time, there is a risk that this would lead to greater complexity and opacity in terms of structures, business models and booking arrangements of businesses operating in the UK. This is especially the case for international banks that branch into the UK as disintermediated branches, and/or seek to maintain multiple branches here from different entities. In turn, this complexity and opacity potentially increases risks to UK financial stability, should the PRA not be able to adequately assess and mitigate risks of activities being undertaken in the UK. There is considerable uncertainty about the future shape of the system, and the PRA will keep its approach to supervising international bank branches under review as developments become clearer.

1.11 It is unlikely that the PRA would be prepared to authorise (or continue to authorise) a firm to operate through a branch if there is a lack of supervisability as described above, including if the specific regulatory requirements imposed at the branch level proved to be ineffective in delivering the PRA's objectives. In such circumstances, the PRA would likely be prepared to authorise the firm only as a subsidiary. More broadly, this may in turn mean that it would be necessary for the firm to be supervised on a more standalone basis consistent with a multiple point of entry ('MPE') approach to resolution.

1.12 The PRA's proposed approach to supervising branches that undertake significant retail banking activities is, in substance, the same as the approach set out in SS10/14. In general the PRA would not be content for branches to undertake retail banking activities beyond *de minimis* levels. SS10/14 stated that the PRA would take account of the total potential call in respect of covered deposits on the Financial Services Compensation Scheme ('FSCS') in considering the extent of the deposit-taking activity that it would be content to see in a branch. In this CP, the PRA proposes to clarify that, in general, it would not be content for that potential call to exceed £500 million.

1.13 The PRA's approach to branch supervision for EEA firms that are currently branching into the UK under the 'passporting' arrangements remains unchanged (see Box 6 of the Appendix) until the UK withdraws from the EU. Subject to the outcome of the negotiations between the UK and the EU, and in particular absent some new agreement in relation to EEA firms, these firms would have to apply for authorisation in order to undertake PRA regulated activities in the UK after the UK withdraws from the EU. They would then be treated in the same way as other international bank branches.

1.14 For subsidiaries, the PRA continues to follow broadly the same supervisory framework as for a UK-headquartered firm.<sup>1</sup> This includes the PRA requiring a high degree of cooperation with the home state supervisor, where a UK subsidiary is closely interconnected with the rest of its group. This is necessary to gain an appropriate degree of influence and visibility over the regulatory outcomes of the wider group, to the extent they affect the UK subsidiary, in order to ensure that the PRA achieves its objectives.

1.15 The Financial Conduct Authority ('FCA') is the conduct regulator for all banks operating in the UK. The policy in this CP does not affect the application of the FCA's rules or requirements to international banks operating in the UK.

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<sup>1</sup> The PRA does not propose to change its current supervisory approach on subsidiaries of international banks as stated in SS10/14. However, the PRA will keep the policy under review to assess whether any changes would be required.

## Implementation

1.16 The PRA is proposing that the new approach takes effect after the completion of the consultation period and following publication of the final SS. In particular, for those EEA firms that are currently branching into the UK under the 'passporting' arrangements, and which are intending to apply for PRA authorisation in order to continue operating in the UK after the UK's withdrawal from the European Union, the PRA would apply the new approach set out in the final SS in assessing the firm's applications.<sup>1</sup> Authorisation under the new regime would come into effect after the UK withdraws from the EU.

## Responses and next steps

1.17 This consultation closes on Tuesday 27 February 2018. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP29\_17@bankofengland.co.uk.

1.18 The proposals in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the EU take effect.

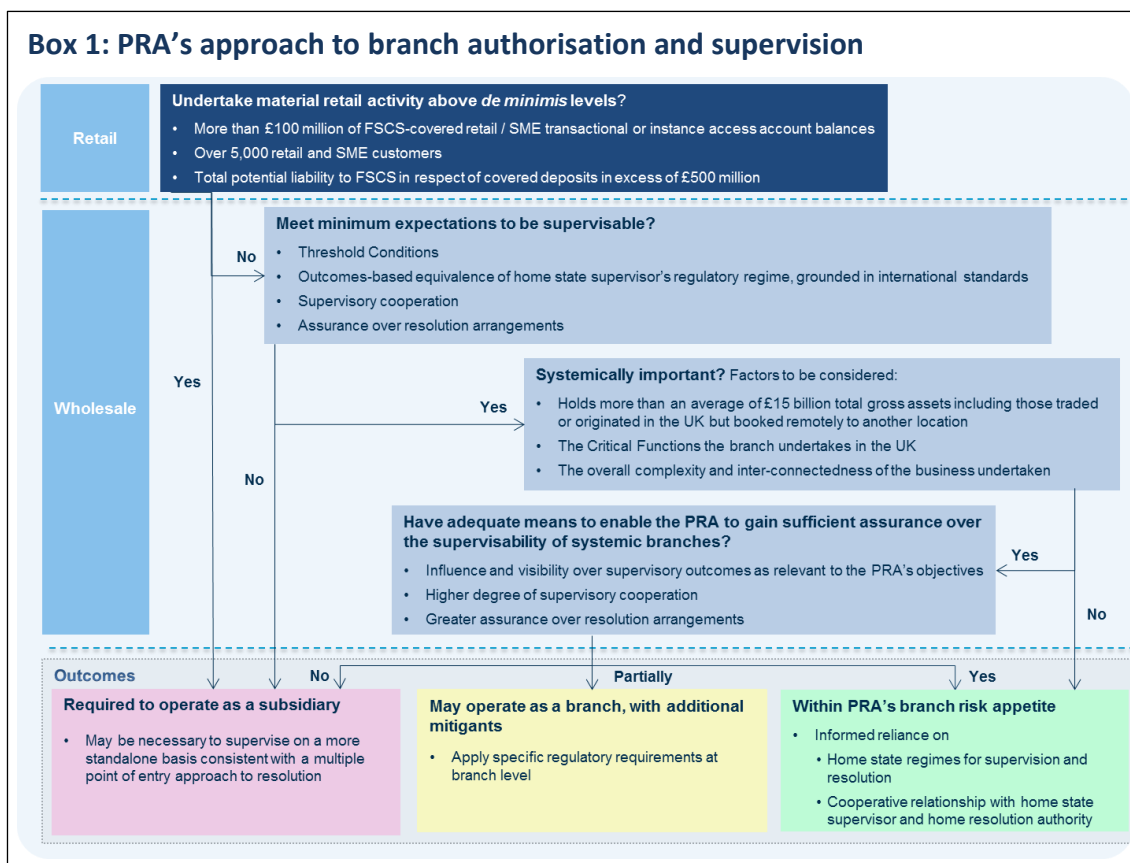
## 2 Proposals

2.1 This CP and accompanying draft SS set out the PRA's proposals for a new approach to branch authorisation and supervision. These proposals include an assessment of factors that are relevant both at the time of authorisation and on an ongoing basis during supervision. Accordingly, the factors are described below in the context of an approach to branch authorisation and supervision.

2.2 The proposals contain a general approach, applicable to all branches. The proposals also cover the PRA's additional expectations for significant retail and systemic wholesale branches. For the latter, the key additional expectations concern the PRA's requirement for a greater degree of supervisability. This focuses on ensuring the PRA has an appropriate degree of influence and visibility 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. In addition, the proposals contain the PRA's expectations on booking arrangements.

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<sup>1</sup> Under European law, the home state supervisor of an EEA bank that operates as a branch in another EEA country is responsible for the prudential supervision of the whole firm (including the branch). As a result, the PRA, where it is the host supervisor of such branches, is currently not responsible for the prudential supervision of those branches. In accordance with the Capital Requirements Directive 2013/36/EU (CRD), the PRA may take precautionary measures in relation to such branches in exceptional situations; and has greater rights of consultation and information in relation to EEA branches that are designated as 'significant'.



## The PRA's general approach to branch authorisation and supervision

2.3 The PRA's proposed general approach to branch authorisation and supervision is anchored in its statutory objectives and an assessment of a range of factors including regulatory equivalence and the supervisability of an international bank that operates in the UK through a branch, including:

- whether the whole firm meets the PRA's TCs. In determining whether these TCs are met, the PRA would consider, among other things, the nature and extent of a firm's presence in the UK, including in relation to mind and management and premises;
- the degree of equivalence of the home state supervisor's regulatory regime in meeting international standards and delivering appropriate outcomes consistent with the PRA's objectives;
- the degree of supervisory cooperation with the home state supervisor and the home resolution authority; and
- the extent to which the PRA, in consultation with the Bank of England acting in its capacity as the UK's resolution authority, has appropriate assurance over the resolution arrangements for the firm and its UK operations.

2.4 The PRA's assessment under this approach includes a focus on the overall supervisability of an international bank that operates in the UK through a branch rather than a subsidiary, and the extent and quality of cooperation with the home state supervisor and the home resolution authority in particular. In performing the assessment, the PRA would balance the overall supervisability against the nature and scale of the banking activities that the firm proposes to carry out, including those through its UK branch.

2.5 The PRA would be unlikely to be prepared to host a branch in circumstances where:

- the firm as a whole is unable to meet the PRA's TCs;
- the PRA is unable to supervise the firm effectively;
- the home state supervisor's regulatory regime is not sufficiently equivalent to meet international standards and deliver appropriate outcomes consistent with the PRA's objectives;
- there is insufficient supervisory cooperation with the home state supervisor or the home resolution authority; or
- there are inadequate assurances that the home resolution authority's resolution regime will deliver the appropriate outcomes for the PRA's objectives.

2.6 Details of the PRA's additional expectations on authorising and supervising branches that; (i) propose to undertake significant retail banking activities; and (ii) carry out wholesale banking activities that pose systemic risks to UK financial stability are set out below (and summarised in Box 1 above).

### **Approach to significant retail activities**

2.7 In general the PRA would not be content for branches to undertake retail banking activities beyond *de minimis* levels (over £100 million of retail/small and medium-sized enterprises ('SME')<sup>1</sup> transactional or instant access account balances covered by the FSCS; more than 5,000 retail and SME customers), and would also take account of the total potential call on the FSCS. The PRA would not in general be content for a branch to undertake deposit activity where the total potential liability to the FSCS in respect of covered deposits is in excess of £500 million.

2.8 The PRA would expect new branches of international banks operating in the UK to focus primarily on wholesale banking activities.

### **Approach to systemic wholesale branches**

2.9 In view of the increased risks described in paragraph 1.10, the PRA proposes to apply additional expectations in the authorisation and supervision of systemic wholesale branches.

2.10 The PRA would identify wholesale branches as systemically important where their size, complexity and/or interconnectedness indicate that the failure of the firm could have significant consequences for financial stability in the UK. In determining whether a branch is systemically important, the PRA would take as its starting point whether the overall UK footprint of the branch exceeds an average of £15 billion total gross assets. In calculating the UK footprint, the PRA would take account both of assets booked onto the balance sheet of the branch and assets traded or originated in the UK but booked remotely to another jurisdiction. The £15 billion threshold is only indicative, and the PRA's determination would also take account of the scale of provision of Critical Functions ('CFs')<sup>2</sup> the branch undertakes and links to other PRA-regulated entities. The PRA would inform the firm in cases where its wholesale branch is determined to be systemically important.

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1 An SME is defined by reference to the annual turnover criterion as set out in Article 2(1) of the Annex to Commission Recommendation 2003/361/EC, ie an annual turnover not exceeding €50 million.

2 Previously described in Supervisory Statement 10/14 as "Critical Economic Functions".

**Box 2: Significant branch activities**

The PRA's proposed approach to branch authorisation and supervision takes into account the size and nature of the activities undertaken by a branch of an international bank.

**Retail**

The PRA considers retail banking activities to be significant where a firm:

- has more than £100 million of retail/SME transactional or instant access account balances covered by FSCS; over 5,000 retail and SME customers; or
- undertakes deposit activity where the total potential liability to the FSCS in respect of covered deposits is in excess of £500 million.

In general, the PRA would expect such activities to be undertaken in a subsidiary.

**Wholesale**

In determining whether a branch that undertakes wholesale banking activities is systemically important, the PRA will consider, among other factors:

- whether it holds more than an average of £15 billion total gross assets including those traded or originated in the UK but booked remotely to another location;
- the Critical Functions it undertakes in the UK; and
- the overall complexity and inter-connectedness of the business undertaken in the branch, for example whether it provides significant operational services or is otherwise interconnected to a systemically important UK bank.

2.11 For systemic wholesale branches, the PRA would assess (in addition to the regulatory equivalence and supervisability considerations specified in paragraph 2.3 above) the degree of influence and visibility that it 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. This is designed to ensure that the home state supervisor's supervisory practices in relation to the firm and the wider group deliver an outcome that is consistent with the PRA's objectives. The importance of this factor would be greater where group structures are more complex, for example where international banks are branching into the UK as disintermediated branches, or where firms seek to maintain multiple branches here from different entities. Further details of the considerations that the PRA would take into account in assessing the degree of influence and visibility are set out in Chapter 5 of the draft SS.

2.12 Where the PRA is satisfied in relation to the degree of supervisability of a systemic wholesale branch, and has an appropriate degree of influence and visibility, the PRA would continue to rely to an appropriate degree on the home state supervisor's supervision, applying at the level of the whole firm, to ensure that the PRA's objectives are met. The intensity of the PRA's own supervisory effort would continue to be greater for branches of greater significance for UK financial stability. The PRA also expects the degree of cooperation with home state supervisor to be greater for systemic wholesale branches.

2.13 However, where the PRA is not satisfied in relation to the degree of supervisability of the systemic wholesale branch, or does not have the necessary degree of influence and visibility it needs to achieve its objectives, the PRA may exercise its powers under the Financial Services and Markets Act 2000 ('FSMA') to apply specific regulatory requirements at the level of the branch on a case-by-case basis. These would principally be intended to ensure that there are sufficient financial and operational resources, and appropriate governance, at the UK branch level where the PRA cannot gain sufficient assurance about the supervisability of the firm. In practice this is most likely where the PRA considers that the degree of influence and visibility that it has is inadequate to deliver its objectives given the systemic importance of the branch. The PRA would seek to achieve its supervisory objectives for systemic wholesale branches first through supervisory dialogue with the firm and the home state supervisor, before it considers exercising its powers to apply specific requirements.

2.14 If the PRA is still unable to achieve its objectives, the firm would be outside the PRA's risk appetite for branches. In these circumstances, the PRA would likely require the firm to undertake wholesale activities in the UK through a subsidiary. More broadly, this may in turn mean that it would be necessary for the firm to be supervised on a standalone basis consistent with a multiple point of entry ('MPE') approach to resolution.

2.15 The PRA would keep this approach under review. If imposing specific regulatory requirements on a case-by-case basis proves to be commonplace, the PRA may consider publishing further policy proposals on these requirements.

### **3 The PRA's statutory obligations**

3.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations.

3.2 Before making any rules, FSMA<sup>1</sup> requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective,<sup>2</sup> insurance objective<sup>3</sup> (if applicable), and secondary competition objective;<sup>4</sup>
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;<sup>5</sup> and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.<sup>6</sup>

3.3 The PRA should also have regard to aspects of the Government's economic policy as recommended by HM Treasury.<sup>7</sup>

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1 Section 138J of FSMA.

2 Section 2B of FSMA.

3 Section 2C of FSMA.

4 Section 2H(1) of FSMA.

5 Sections 2H(2) and 3B of FSMA.

6 Section 138K of FSMA.

7 [www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-spring-budget-2017](http://www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-spring-budget-2017).

3.4 The PRA is also required by the Equality Act 2010<sup>1</sup> to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

### **Cost benefit analysis**

3.5 The proposals in this CP would apply to international banks that are undertaking retail or wholesale banking activities via a UK branch. Currently there are 160 UK branches of international banks, of which 77 are EEA firms that branch into the UK under the 'passporting' arrangements. These proposals will primarily impact those systemic wholesale branches where the PRA is unable to obtain the appropriate degree of assurance 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 meet the PRA's objectives. Under the proposals, the firm would be outside the PRA's risk appetite for branches. In these circumstances, these firms could be subject to specific regulatory requirements at the level of the branch on a case-by-case basis. On the basis of their existing business structures and the current degree of supervisability, including the level of supervisory cooperation already in place, the PRA does not expect the proposals to affect any of the international banks currently authorised to operate in the UK through branches.

3.6 The PRA believes that the approach set out in this CP generates incremental benefits by ensuring that the activities undertaken by branches deemed to be systemically important for UK financial stability are compatible with the PRA's objective of promoting safety and soundness in the firms it supervises. The approach should also reduce the risk of fragmentation of the international financial system by facilitating international banks to branch into the UK. This would be subject to the PRA having appropriate levels of supervisory cooperation, assurance over resolution, and (for systemic wholesale branches) influence and visibility over the firm as a whole and the wider group, so far as relevant to the safety and soundness of the firm and necessary to meet the PRA's objectives, among other factors. This will result in benefits to firms by allowing them to use their resources more efficiently and to diversify risks within the groups of which they are part.

3.7 The PRA expects that, for the majority of the non-EEA international banks' systemic wholesale branches, there will not be material incremental compliance costs. However this will depend on the home state supervisor's approach to supervisory cooperation with the PRA. It may also be the case that home state supervisors will incur some incremental costs due to the requirements for enhanced coordination with the PRA, but these costs are not expected to be materially greater than those incurred today. In addition, they are considered to be outweighed by the two-way benefits of supervisory cooperation.

3.8 In the event that the PRA comes to the view that a UK branch is not compliant with its final policy following consultation, because of a lack of coordination and cooperation with the home state supervisor, inadequate assurance over resolution, and/or insufficient influence and visibility over the firm as a whole and the wider group, so far as relevant to the safety and soundness of the firm and necessary to meet the PRA's objectives, the PRA would act. This may mean that the international bank in question will likely be required to operate through a subsidiary and potentially be supervised on a more standalone basis consistent with an MPE approach to resolution. This may entail significant incremental costs stemming from the need to restructure its UK business. Nevertheless, the PRA expects that the benefits of safety and

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1 Section 149.

soundness articulated above will in these circumstances outweigh any additional costs generated by the proposals in this CP.

### **Compatibility with the PRA's objectives**

3.9 The PRA has a statutory objective to promote the safety and soundness of banks, building societies, credit unions, insurers and PRA-designated investment firms. The proposals in this CP are intended to further that objective by ensuring that the PRA has an appropriate framework to ensure that branches of systemic importance for UK financial stability are appropriately supervised and resolvable, and to improve the PRA's ability to monitor the supervisory outcomes that result from how these firms are supervised by their respective home state supervisors.

3.10 When discharging its general function in a way that advances its primary objectives, the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorised persons. Being open to international banks branching into the UK will, if done safely, facilitate competition in the UK banking sector. Furthermore, these proposals enhance effective competition by ensuring that systemically important branches are properly supervised and managed, thereby preventing branches that are not adequately supervised from gaining an undue competitive advantage as a result of a lower prudential standard that does not adequately safeguard their safety and soundness. Provided there is sufficient cooperation in practice, the PRA does not expect a significant negative impact on competition in wholesale banking. As set out above the PRA does not expect the proposals to affect any of the existing branches which are determined to be systemically important for UK financial stability, on the basis of their current business structures and the levels of cooperation.

### **Regulatory principles**

3.11 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Four of the principles are of particular relevance.

- The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction. The proposals in this CP seek to strengthen the PRA's approach towards branches undertaking wholesale banking activities deemed to be of systemic importance for UK financial stability because of their size and other relevant factors such as interconnectedness. Therefore, the impact on medium and small sized branches is not expected to be material.
- The principle that the PRA should use its resources in the most efficient and economical way. The proposals in this CP are consistent with prioritising the PRA's resources towards the supervision of those branches that pose the greatest risks to the PRA's objectives.
- The principle that the PRA should exercise its functions as transparently as possible. In this CP, the PRA sets out the key considerations relevant to its proposals, and gives respondents the opportunity to comment. The proposals outlined in this CP are intended to bring greater clarity to the PRA's approach to identifying and supervising branches deemed to be of systemic importance for UK financial stability.
- The desirability of sustainable medium or long-term growth in the economy. The proposals in this CP lay the foundations for a sustainable presence of branches undertaking wholesale banking activities so that they can contribute to medium and long-term growth in the economy.



## HM Treasury recommendation letter

3.12 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.<sup>1</sup>

3.13 The aspects of the Government's economic policy most relevant to the proposals in this CP are set out below.

### Competitiveness and trade

3.14 The Government wishes to ensure that the UK remains an attractive domicile for internationally active financial institutions, and that London retains its position as a leading international financial centre. The Government considers that achieving this aim in a manner that is consistent with robust institutions and a resilient system will support its aims for sustainable economic growth.

3.15 The Government also aims to encourage trade and inward investment to the UK that can help boost productivity and growth across our economy. This can be supported by improved competition opening the UK to new ways of doing things and being seen as a good place to do business.

3.16 The PRA believes that these proposals are consistent with robust institutions and a resilient system, and will not materially affect London's position as a leading international financial centre. This is because the proposals aim to maintain or enhance the quality of supervision applied to the UK branches of international banks in scope. The proposals in this CP strengthen the supervisory framework to secure a sustainable presence of UK branches of international banks. The PRA's view is that this contributes positively to an open world economy which in turn benefits the UK economy. The PRA would also seek to achieve its supervisory objectives for systemic wholesale branches through regular supervisory dialogues with the firm and the home state supervisor first, before it considers exercising its powers to apply additional requirements if the firm fails to meet the PRA's expectations.

### Impact on mutuals

3.17 On the basis of their existing business structures, the PRA does not expect the proposals to have a material impact on any overseas-headquartered mutual society that undertakes activities in the UK via a branch.

### Equality and diversity

3.18 The PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

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<sup>1</sup> Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at [www.bankofengland.co.uk/about/people/prudential-regulation-committee](http://www.bankofengland.co.uk/about/people/prudential-regulation-committee).

## **Appendix: Draft supervisory statement 'International banks: the Prudential Regulation Authority's approach to branch authorisation and supervision'**

### **1 Introduction**

1.1 This supervisory statement expands on the Prudential Regulation Authority's (PRA's) approach to banking supervision<sup>1</sup>. It summarises the PRA's approach to international banking supervision, and clarifies how the PRA will authorise and supervise internationally headquartered banking groups ('international banks') that branch into the United Kingdom, with a specific focus on branches undertaking wholesale banking activities in the UK.

1.2 This statement is relevant to all PRA-authorized banks and designated investment firms not incorporated in the UK and operating in the UK through a branch, as well as any such firm looking to apply for PRA authorisation. This supervisory statement replaces Supervisory Statement ('SS') 10/14 'Supervising international banks: the Prudential Regulation Authority's approach to branch supervision'.<sup>2</sup>

1.3 This supervisory statement is structured as follows:

- Chapter 2 provides an overview of international banks in the UK and the distinction between their legal forms.
- Chapter 3 sets out the PRA's general approach to branch authorisation and supervision, including how the PRA assesses the supervisability of international banks operating in the UK through branches.<sup>3</sup>
- Chapter 4 sets out the PRA's approach to authorising and supervising international banks that propose to undertake significant retail banking activities.
- Chapter 5 sets out the PRA's approach to authorising and supervising systemic wholesale branches, building on its general approach. This focuses on ensuring the PRA has an appropriate degree of influence and visibility 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 meet the PRA's objectives. It also sets out examples of specific regulatory requirements the PRA may apply to a systemic wholesale branch on a case-by-case basis to enable it to achieve its supervisory objectives. Finally, it sets out the PRA's expectations on booking arrangements.

1.4 In this statement, 'branch' means a UK branch of an international bank that does not have the right to operate through a UK branch under 'passporting' arrangements.

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1 March 2016: [www.bankofengland.co.uk/prudential-regulation/publication/2016/pru-approach-documents-2016](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/pru-approach-documents-2016).

2 September 2014: [www.bankofengland.co.uk/prudential-regulation/publication/2014/supervising-international-banks-the-pru-approach-to-branch-supervision](http://www.bankofengland.co.uk/prudential-regulation/publication/2014/supervising-international-banks-the-pru-approach-to-branch-supervision).

3 Under European law, the home state supervisor of an European Economic Area ('EEA') firm that operates as a branch in another EEA country is responsible for the prudential supervision of the whole firm (including the branch). As a result, the PRA, where it is the host supervisor of such branches, is currently not responsible for the prudential supervision of those branches, subject to certain powers to act in exceptional situations. For further information about the PRA's approach to EEA branches see Chapter 5 of SS10/14 'Supervising international banks: the Prudential Regulation Authority's approach to branch supervision'.

1.5 The PRA's approach to branch supervision for European Economic Area ('EEA') firms that are currently branching into the UK under the 'passporting' arrangements remains as set out in SS10/14 until the UK withdraws from the European Union ('EU'). Subject to the outcome of the negotiations between the UK and the EU, and in particular absent some new agreement in relation to EEA firms, these firms will have to apply for authorisation in order to carry on PRA regulated activities in the UK after the UK withdraws from the EU. They would then be treated in the same way as other international bank branches.

## 2 International banks in the United Kingdom

2.1 Banking is an international industry and the UK is a significant international financial centre. International banks can operate in the UK either as subsidiaries or branches, once authorised by the PRA. A subsidiary is a legal entity incorporated in the UK, and as such must comply with all regulatory requirements, including those relating to governance, risk management, capital and liquidity in its own right. By contrast, a branch forms part of a legal entity incorporated and authorised abroad<sup>1</sup>, and therefore in principle does not have a separate capital base, and would not necessarily have its own board. A number of factors determine whether an international bank operates abroad through a branch or a subsidiary, including its business model, and its legal, regulatory and taxation arrangements across different jurisdictions.

### Branches

2.2 UK authorities, including the PRA, are open to hosting branches of international banks where possible, recognising the efficiency benefits this brings. The PRA's view is that the ability for financial services firms to branch into other countries is, if done safely, an important component of an open world economy, which in turn benefits the UK economy. International banks operating in the UK must, however, meet the same prudential standards as domestically headquartered firms. An important element of this is that they must be capable of effective supervision by the PRA.

2.3 A branch of an international bank forms part of a legal entity incorporated outside the UK. It follows that its operations are necessarily dependent on those of the legal entity as a whole ('the firm'). PRA authorisation applies to the whole firm. More broadly, the wholesale activities that are frequently conducted in branches often involve close interconnections across locations and legal entities within the wider banking group. Accordingly, it is necessary for the PRA to have an appropriate degree of cooperation with the home state supervisor<sup>2</sup> in order to ensure that the PRA's objectives are achieved. The more important to UK financial stability an international bank is, the higher the degree of supervisory cooperation that the PRA expects. Without these, it could be necessary for the PRA to gain more supervisory control, if necessary by requiring the firm to operate as a UK subsidiary.

2.4 The prudential supervision of a bank which operates in the UK through a branch is within the remit of both the home state supervisor and the PRA.

2.5 Where firms operate in the UK with both a subsidiary and a branch (or one or more of each), the PRA expects appropriate governance to oversee and manage the linkages between

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1 An entity undertaking relevant activities such as deposit taking or dealing on own account – could be a bank (deposit-taker) or investment firm.

2 Home state supervisors refer to the supervisors of the international firm which the UK branch is part of. In cases where the international firm branches into the United Kingdom via an intermediate subsidiary in a third country (a 'disintermediated branch'), home state supervisors refer to both the supervisors of the intermediate subsidiary and of the whole group.

the entities.<sup>1</sup> In supervising these firms the PRA will delineate its supervision between the entities and expect the firm to have a clear booking arrangement in place setting out what it will book in each entity and how its application will be verified (see Chapter 5).

## Subsidiaries

2.6 For a subsidiary of an international bank, the PRA has the same legal powers and follows broadly the same supervisory framework as for a UK-headquartered firm. This model focuses on three key elements:

- (i) the potential impact that a firm could have on financial stability, both by the way it carries on its business and in the event of failure;
- (ii) how the external context in which a firm operates and the business risks it faces (together, its risk context) might affect the viability of the firm; and
- (iii) mitigating factors including a firm's: management, governance and risk management and control (operational mitigation); financial strength, specifically capital and liquidity (financial mitigation); and resolvability (structural mitigation).

2.7 The PRA will work closely with the home state supervisor to assess the linkages between the UK subsidiary and the wider consolidated group as well as the group's recovery and resolution plans. Where there are significant linkages between the UK subsidiary and the rest of the group, the PRA will expect an appropriate degree of cooperation with the home state supervisor in order that the PRA is able to understand the nature and extent of risks to the wider group to the extent they affect the UK subsidiary. Consistent with its objective, where necessary the PRA will require the firm to limit linkages between the UK subsidiary and the rest of the group to operate on a more standalone basis. More broadly in such circumstances, this may in turn mean that it would be necessary for the UK subsidiary to be supervised on a more standalone basis consistent with a multiple point of entry ('MPE') approach to resolution.

### Box 1: FCA requirements

The FCA is the conduct regulator for all banks operating in the UK. For all subsidiaries and branches,<sup>2</sup> the FCA's Threshold Conditions and conduct of business rules apply, including in areas such as anti-money laundering. Authorisation can be granted only where both the FCA and the PRA are satisfied that their respective requirements have been met. The FCA will independently assess applicants against its own requirements and objectives. Applicants should, therefore, discuss their intention to apply with the FCA at an early stage.

## 3 The PRA's general approach to branch authorisation and supervision

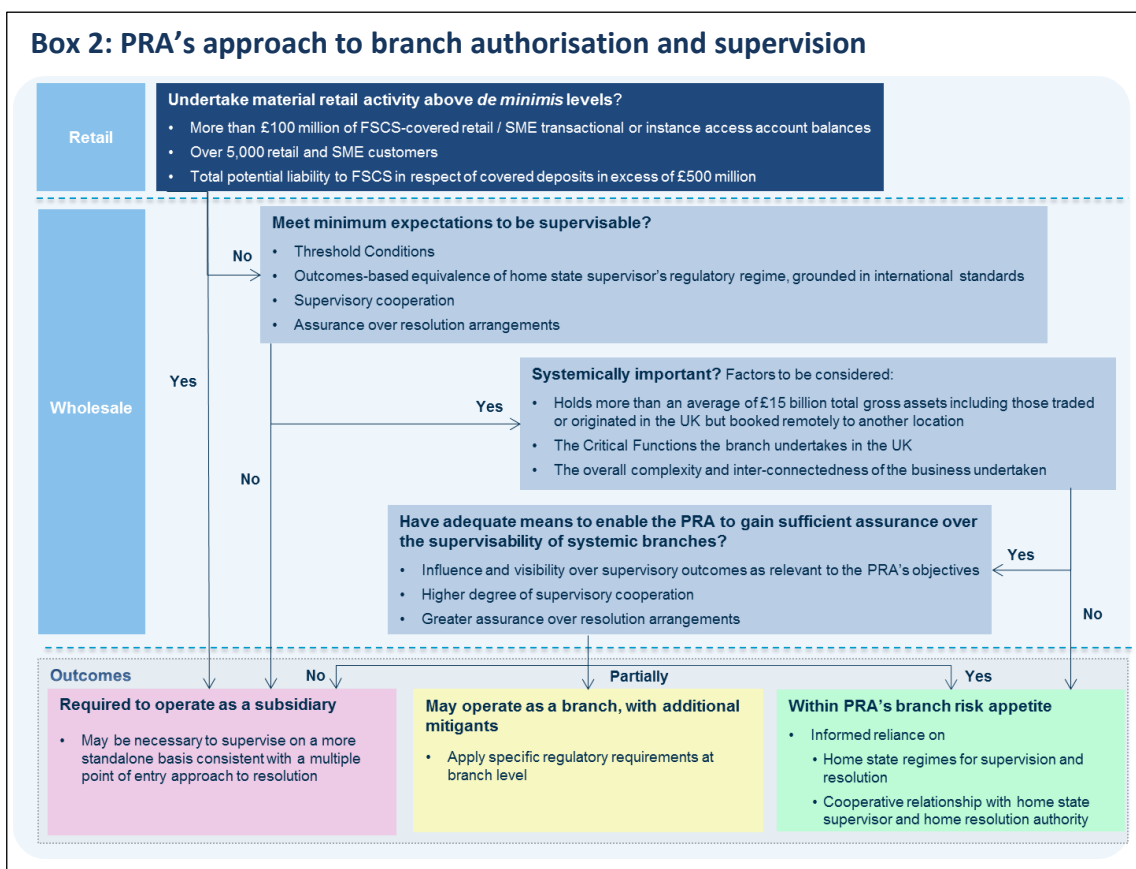
3.1 As set out in Box 2, the PRA's general approach to branch authorisation and supervision, which applies to all branches, is anchored by an assessment of a range of factors including the degree of equivalence of the home state supervisor's regulatory regime and the supervisability of an international bank that operates in the UK through a branch. These factors are relevant

<sup>1</sup> See Supervisory Statement 4/16 Internal governance of third country branches February 2016: [www.bankofengland.co.uk/prudential-regulation/publication/2016/internal-governance-of-third-country-branches-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/internal-governance-of-third-country-branches-ss).  
<sup>2</sup> Excluding EEA firms that operate in the United Kingdom as a branch.

both at the time of authorisation and on an ongoing basis during supervision. Accordingly the factors are described below in the context of an approach to branch authorisation and supervision. They include:-

- whether the whole firm meets the PRA's Threshold Conditions ('TCs');
- the degree of equivalence of the home state supervisor's regulatory regime in meeting international standards and delivering appropriate outcomes consistent with the PRA's objectives;
- the degree of supervisory cooperation with the home state supervisor and the home resolution authority; and
- the extent to which the PRA, in consultation with the Bank of England ('the Bank') acting in its capacity as the UK resolution authority, has appropriate assurance over the resolution arrangements for the firm and its UK operations.

3.2 The PRA assesses these factors in their totality, but emphasises the overall supervisability of an international bank that operates in the UK through a branch. In particular, the PRA will place considerable weight on assessing the extent and quality of cooperation with the home state supervisor and home resolution authority. In performing the assessment, the PRA will balance overall supervisability against the nature and scale of the activities that the firm proposes to carry out.



### Threshold Conditions

3.3 For a branch, the Threshold Conditions (TCs) of the Financial Services and Markets Act 2000 ('FSMA') (which are the minimum conditions for authorisation) apply to the international

bank as a whole and not just the UK branch. In broad terms, the PRA's TCs require firms to have an appropriate amount and quality of capital and liquidity, to have appropriate resources to measure, monitor and manage risk,<sup>1</sup> to be fit and proper, to conduct their business prudently and to be capable of being effectively supervised by the PRA. In determining whether these TCs are met, the PRA will consider, among other things, the nature and extent of a firm's presence in the UK, including in relation to mind and management and premises.

3.4 In determining whether its TCs are met, the PRA has scope to rely on the home state supervisor when it can satisfy itself that there are reasonable grounds for such reliance.<sup>2</sup> The PRA will accordingly take account of the opinion of the home state supervisor about the firm's compliance with the PRA's TCs when forming its own judgement.

### **Equivalence of the home state supervisor's regulatory regime**

3.5 The PRA's equivalence assessment focuses on the home state supervisor's regulatory framework, powers, approach to supervision of individual firms and consolidated groups, information sharing, confidentiality, and the competence and independence of supervisors. This is not an exhaustive list. Understanding capital and liquidity requirements, as well as other elements of the regulatory regimes will also be important factors in the PRA's assessment of the equivalence of the home state supervisor in delivering appropriate outcomes that meet the PRA's objectives. The PRA will assess if the regime is consistent with the UK regulatory framework in addition to international standards.

3.6 In determining whether the home state supervisor's regime is of sufficient equivalence, the PRA will consider the nature of a firm's activities in the UK. In the case of wholesale branches, the PRA will take account of systemic importance in considering the degree of equivalence required. Where in the PRA's view a home state supervisor is sufficiently equivalent but with weaknesses in areas where the firm operates, the PRA may propose to add limitations to the nature and scale of activities performed by the branch.

3.7 Equivalence assessments are reviewed periodically. The frequency of review is determined by the number, size and systemic importance of the firms from a home state. The assessments of the home state supervisor focus on the degree to which the home state supervisor's regime is compliant with the Basel principles in terms of supervisory approach, tools and practices. In performing the assessments, the PRA will base its analysis on the International Monetary Fund's Financial Sector Assessment Programme reviews<sup>3</sup>, the Basel Committee's Regulatory Consistency Assessment Programme reviews,<sup>4</sup> and Financial Stability Board's ('FSB') peer reviews<sup>5</sup> where appropriate, supplemented by other sources as necessary. The PRA will also take account of its own experiences in its interactions with the home state supervisors. It will be important for the PRA to factor in any conduct concerns the FCA raises concerning a jurisdiction.

3.8 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 also to operate as branches in the UK. The PRA will conduct an equivalence assessment to ensure the home state supervisor is equivalent in the specific

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1 The PRA expects branches to have appropriate risk management to support the Critical Functions they undertake (including but not limited to managing the risk stemming from booking models, operational resilience including systems to support participation in payment systems, and algorithmic trading). Readers can keep up-to-date with the PRA's supervisory expectations from the PRA section of the Bank's website: [www.bankofengland.co.uk/prudential-regulation](http://www.bankofengland.co.uk/prudential-regulation).

2 Section 55D of FSMA.

3 [www.imf.org/external/NP/fsap/fsap.aspx](http://www.imf.org/external/NP/fsap/fsap.aspx).

4 [www.bis.org/bcbs/implementation/rcap\\_jurisdictional.htm](http://www.bis.org/bcbs/implementation/rcap_jurisdictional.htm).

5 [www.financialstabilityboard.org/activities/peer\\_reviews.htm](http://www.financialstabilityboard.org/activities/peer_reviews.htm).

activities that the firm proposes to undertake, alongside its review of the business model and rationale for the new branch.

### Supervisory cooperation

3.9 In forming a view on its risk appetite towards branches operating in the UK, the PRA's judgements will be influenced by the degree of effective cooperation on supervisory matters with home state supervisors. Cooperation is necessary in order that the PRA is able to understand the nature and extent of the risks facing the firm and the wider group, and has appropriate input to the supervisory strategies of the home state supervisor, so far as relevant to the safety and soundness of the firm and necessary to meet the PRA's objectives. The degree of supervisory cooperation which the PRA expects is guided by the Basel Committee's 'Core Principles for Effective Banking Supervision'<sup>1</sup> and is founded on an open, transparent and proactive exchange of information and views with the home state supervisor and a collaborative approach including the support where necessary of the home state supervisor in the delivery of PRA's objectives. Strong supervisory cooperation supports the UK's openness to hosting branches of international banks.

3.10 First, the PRA will seek to establish a clear acceptance from the home state supervisor of its prudential responsibility for branches in the UK. This will

- include confirmation from the home state supervisor that the whole firm meets the PRA's TCs for authorisation; and
- require the existence of a specific agreement with the home state supervisor on the split of responsibilities for prudential supervision of branches from that jurisdiction, with periodic reviews to ensure each authority is meeting expectations.

3.11 Second, the PRA will expect to be able to engage with the home state supervisor in an open and transparent exchange of supervisory information and views, either with other regulators in a college format, or bilaterally as appropriate. This includes having:

- arrangements for the protection of confidential information with the home state supervisor, underpinned as necessary by a memorandum of understanding ('MoU') or equivalent document;
- documentation of the minimum amount of information required from the home state supervisor, including whole-firm liquidity information;<sup>2</sup>
- an open dialogue at an appropriate frequency with the home state supervisor on material risks facing the firm and the firm's risk management practices;
- prompt engagement by the home state supervisor in response to questions and requests from the PRA, especially in stress;
- support from the home state supervisor where necessary to assist the PRA in achieving its supervisory objectives for the firm, in particular as they relate to the branch; and

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1 Bank for International Settlement, Basel Committee on Banking Supervision: Core Principles for Effective Banking Supervision, September 2012 [www.bis.org/publ/bcbs230.pdf](http://www.bis.org/publ/bcbs230.pdf).

2 Supervisory Statement 1/17 sets out the PRA's expectations for liquidity reporting by PRA-regulated branches of third-country, and non-EEA credit institutions and designated investment firms, February 2017: [www.bankofengland.co.uk/prudential-regulation/publication/2017/supervising-international-banks-the-pras-approach-to-branch-supervision-liquidity-reporting-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2017/supervising-international-banks-the-pras-approach-to-branch-supervision-liquidity-reporting-ss).

- prompt and open notification, and discussion by the home state supervisor of significant developments affecting the firm, in particular where they could affect the firm's compliance with the PRA's TCs.

3.12 Where a home state supervisor is determined not to be equivalent or there is insufficient supervisory cooperation with the PRA given the nature and scale of the activities of the branch, the PRA will be unlikely to be prepared to host such a branch from that jurisdiction.

### **Assurance over the resolution arrangements**

3.13 Arrangements for resolution will be a factor in the PRA's judgements when forming a view on its risk-appetite towards branches operating in the UK. For branches that perform Critical Functions ('CFs')<sup>1</sup> in the UK (see Box 3), the PRA, in consultation with the Bank as UK resolution authority, will assess

- the equivalence of the home resolution authority's resolution regime (including its compliance with the FSB Key Attributes);<sup>2</sup>
- the alignment of the firm's group resolution strategy set by the home resolution authority with the PRA's objectives, including whether it ensures the continuity of the firm's CFs in the UK;
- the credibility and feasibility of the firm's group resolution strategy, including a clear process to identify and remove barriers to resolution by the home state supervisor / home resolution authority involving the host authorities including the PRA;
- the ability of the PRA, in consultation with the Bank, to rely on the home state supervisor and home resolution authority to execute the firm's resolution strategy, including the home state supervisor and/or home resolution authority's operational capability to implement a resolution and to put in place adequate coordination mechanisms between home and host authorities; and
- the willingness of the home resolution authority to share the group resolution plan with the PRA on request and to engage in a dialogue with the PRA, including the implications for the UK branch.

3.14 This assessment will be tailored to the systemic importance of the branch on a case-by-case basis. It will range from receiving the appropriate assurances from the home state supervisor and home resolution authority to seeking to understand the firm's group resolution plan in detail. Where appropriate, the PRA expects the home state supervisor and home resolution authority to explain how the plan accounts for the activities in the UK branch.

3.15 In line with its statutory objectives the PRA will focus on the greatest risks to financial stability. The level of assurance required on the resolution plans from the home state supervisor and the home resolution authority will increase, commensurate with the scale and nature of the branch's UK activities (including whether such activities are identified as CFs).

3.16 While the PRA can gain assurance over resolution plans and the stated intentions of the home state supervisor and home resolution authority, doubts may remain over the certainty

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1 Previously described in SS 10/14 as "Critical Economic Functions".

2 Financial Stability Board - Key Attributes of Effective Resolution Regimes for Financial Institutions, October 2014: [www.fsb.org/wp-content/uploads/r\\_141015.pdf](http://www.fsb.org/wp-content/uploads/r_141015.pdf).



that the home state supervisor and home resolution authority will not put national interests ahead of international objectives. The PRA's starting point is that UK creditors and depositors should be treated equally with their home state equivalents. Where that is not, or may not be, the case, the PRA will consider the impact on its objectives in deciding what action, if any, to take. As set out in paragraph 4.3 below, in any case the PRA will not in general be content for a branch to undertake deposit activity where the total potential liability to the Financial Services Compensation Scheme ('FSCS') in respect of covered deposits exceeds £500 million.

3.17 If there is a legally clear form of domestic depositor preference, then this is a known risk that can be assessed.<sup>1</sup> However, the PRA will also take account of two related risks that are harder to assess:

- the risk of short-notice legislative change in the home jurisdiction during a crisis that is intended to favour domestic depositors and/or creditors; and
- the risk that *de facto* administrative discrimination against foreign depositors and/or creditors takes place during the post-failure liquidation or resolution process.

3.18 The PRA's preferred approach is to gain assurance that the home resolution authority's resolution regime will deliver the appropriate outcomes for the PRA's and the Bank's objectives as UK resolution authority. In the absence of adequate levels of assurance, the PRA will likely not be prepared to host such a branch from that jurisdiction.<sup>2</sup> In the case of an international bank operating through an existing branch, it may be required to establish a UK subsidiary. If there is insufficient assurance over the home state resolution arrangements, this may in turn mean that it would be necessary for the firm to be supervised on a more standalone basis consistent with an MPE approach to resolution.

### Box 3: Critical Functions (CFs)<sup>3</sup>

A CF can be defined as a function whose disruption or withdrawal could have an adverse material impact on financial stability in the UK and the safety and soundness of the firms supervised by the PRA. Therefore, the materiality of a bank's activities in the categories below will determine whether the PRA regard the activity as a CF:

- retail banking;
- corporate banking;
- payments, clearing, settlement;
- custody;
- intra-financial system borrowing and lending; or
- investment banking.

For all UK branches it is important that the PRA understands the main areas of business undertaken, or to be undertaken in the case of new authorisations. For wholesale banks CFs are likely to be global in nature and should therefore also be considered in such terms.

1 FSA Consultation Paper CP12/23, 'Addressing the implications of non-EEA national depositor preference regimes', September 2012: [www.fsa.gov.uk/static/pubs/cp/cp12-23.pdf](http://www.fsa.gov.uk/static/pubs/cp/cp12-23.pdf).

2 The Bank has wide-ranging resolution powers over non-EEA branches, including the power to resolve non-EEA branches on a stand-alone basis in certain circumstances. See UK Statutory Instrument 2016 No. 1239 The Bank Recovery and Resolution Order 2016 [www.legislation.gov.uk/ukSI/2016/1239/pdfs/ukSI\\_20161239\\_en.pdf](http://www.legislation.gov.uk/ukSI/2016/1239/pdfs/ukSI_20161239_en.pdf)

3 Previously described in SS 10/14 as "Critical Economic Functions".

## 4 Approach to significant retail activities

4.1 In general the PRA will not be content for branches to undertake retail banking activities beyond *de minimis* levels described in paragraph 4.2. This ensures that the PRA is able to meet its supervisory objectives and mitigate the risks to UK financial stability.

4.2 In assessing whether the PRA will be content for an international bank to undertake retail activities in the UK through a branch, the PRA will make a determination based on the following:

- The value and type of account: while this is not a hard threshold and may vary on a firm-by-firm basis, the PRA expects branches to have under £100 million of retail/small and medium-sized enterprises ('SME')<sup>1</sup> transactional or instant access account balances covered by the FSCS.
- The number of customers: in addition to the value of deposits, the PRA will also take into account the number of customers. Where branches have more than 5,000 retail and SME customers this may be of concern, though this may differ on a firm-by-firm basis.
- Substitutability: in general the PRA's view is that transactional accounts are homogenous. In addition, there are numerous examples of firms providing these accounts via a UK subsidiary. However, in line with its statutory obligations, the PRA will also take into account the diversity, substitutability of the range of products provided and the market share in niche markets when forming a view on both the criticality of the function and whether this is within its risk appetite.
- Planned growth: while a branch's existing retail deposits could be within the PRA's appetite, the PRA may conclude that the branch's plans to grow retail deposits are outside its risk appetite.

4.3 The PRA's approach to authorising and supervising international banks that propose to undertake significant retail banking activities through branches is also driven by the fact that eligible deposits of these branches are covered by the FSCS. In the event of failure, if the FSCS were unable to recoup the amount it paid out via the bank insolvency procedure from recoveries, ultimately there would be a liability to the UK financial system. Given this, the PRA will not in general be content for a branch to undertake deposit activity where the total potential liability to the FSCS in relation to covered deposits is in excess of £500 million.

4.4 The PRA expects new branches of international banks operating in the UK to focus primarily on wholesale banking activities.

4.5 Where an international bank is required by the PRA to use a subsidiary in order to undertake retail banking activities in the UK beyond *de minimis* levels, it does not automatically mean that the Bank, as resolution authority, will also require the firm to adopt a partial transfer or bail-in resolution strategy. This reflects the fact that it may be consistent with the PRA's objectives to gain greater supervisory influence over a firm even if the test for use of stabilisation tools is higher. In line with the Bank's Statement of Policy on setting a

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<sup>1</sup> An SME is defined by reference to the annual turnover criterion as set out in Article 2(1) of the Annex to Commission Recommendation 2003/361/EC, ie an annual turnover not exceeding €50 million.

minimum requirement for own funds and eligible liabilities ('MREL'),<sup>1</sup> it considers that provision of fewer than around 40,000 to 80,000 transactional bank accounts (accounts from which withdrawals have been made nine or more times within a three-month period) is generally likely to indicate that a modified insolvency would be appropriate. The actual approach taken to resolve a firm will depend on the circumstances at the time of its failure.

## 5 Approach to systemic wholesale branches

5.1 Given the cross-border nature of many wholesale banking activities, wholesale branches tend to involve greater complexity in terms of structures, business models and booking arrangements.

5.2 For wholesale branches, the PRA will assess (in addition to the factors specified in paragraph 3.1 above):

- (i) the importance of the branch to the financial stability of the UK – its systemic importance; and
- (ii) its supervisability, including 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 meet the PRA's objectives. The assessment of this factor will focus on whether the home state supervisor's supervisory practices for the firm and the wider group deliver an outcome that is consistent with the PRA's objectives. This factor is especially relevant where international banks are branching into the UK via an intermediate subsidiary incorporated in a different jurisdiction from the ultimate parent ('disintermediated branches'), or where firms seek to maintain multiple branches in the UK from different entities.

### Systemic importance

5.3 The PRA will identify wholesale branches as systemically important where their size, complexity and interconnectedness indicate that the failure of the firm could have significant consequences for financial stability in the UK. The PRA will inform the firm in cases where its wholesale branch is determined to be systemically important.

5.4 As its starting point, the PRA will have regard to the size of a firm's UK footprint in deciding whether to determine a wholesale branch as systemically important, specifically whether it exceeds an average of £15 billion total gross assets. In calculating this figure, the PRA will take account both of assets booked onto the balance sheet of the branch and assets traded or originated in the UK but booked remotely to another jurisdiction. The PRA will use the data provided in the Branch Return to assist in determining whether the wholesale branch is systemically important.<sup>2</sup>

5.5 Where a group maintains more than one UK branch the PRA will aggregate the UK footprint of those branches to assess the overall significance of the UK branches of the group.

5.6 The PRA's assessment will also take account of the likelihood a firm will exceed the threshold in future.

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1 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities ('MREL')', November 2016: [www.bankofengland.co.uk/-/media/boe/files/financial-stability/resolution/boe-approach-to-setting-mrel-november-2016](http://www.bankofengland.co.uk/-/media/boe/files/financial-stability/resolution/boe-approach-to-setting-mrel-november-2016).

2 PRA Rulebook, Incoming Firms and Third Country Firms Part, Rule 3.1.

5.7 The £15 billion threshold is only indicative. In determining systemic importance the PRA will also focus on the overall complexity and interconnectedness of the business undertaken in the branch, including where a branch provides significant operational services or is otherwise interconnected to a systemically important UK bank. It will also take account of the level of provision of CFs the branch undertakes.

#### **Box 4: Significant branch activities**

The PRA's proposed approach to branch authorisation and supervision takes into account the size and nature of the activities undertaken by a branch of an international bank.

##### **Retail**

The PRA considers retail banking activities to be significant where a firm:

- has more than £100 million of retail/SME transactional or instant access account balances covered by FSCS; over 5,000 retail and SME customers; or
- undertakes deposit activity where the total potential liability to the FSCS in respect of covered deposits is in excess of £500 million.

In general, the PRA will expect such activities to be undertaken in a subsidiary.

##### **Wholesale**

In determining whether a branch that undertakes wholesale banking activities is systemically important, the PRA will consider, among other factors:

- whether it holds more than an average of £15 billion total gross assets including those traded or originated in the UK but booked remotely to another location;
- the Critical Functions it undertakes in the UK; and
- the overall complexity and inter-connectedness of the business undertaken in the branch, for example whether it provides significant operational services or is otherwise interconnected to a systemically important UK bank.

#### **Supervisability of systemically important branches**

5.8 Where a branch is judged to be systemically important, the PRA will assess whether the firm's UK branch is appropriately supervisable.

5.9 The critical elements of this assessment include the following, so far as relevant to the safety and soundness of the firm and necessary to meet the PRA's objectives:

- the level of influence the PRA is able to have over the regulatory outcomes for the firm as a whole and the wider group; and
- the degree of visibility the PRA has over the risks to the firm as a whole and the wider group.

**Box 5: The PRA's expectations on booking arrangements**

Having the appropriate degree of influence and visibility over 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 meet the PRA's objectives, is particularly important in the case of significant wholesale activities which may be traded or originated in one jurisdiction or legal entity and booked to the balance sheet in another jurisdiction or legal entity. The PRA has certain expectations of booking arrangements, applicable to branches as well as to UK-incorporated firms:

- Firms should set out a clear rationale for their booking arrangements, document the booking arrangements and have them approved by the appropriate governance body;
- Risk management should be appropriate for the firm's booking activities. For example, firms should specify suitable controls around the risks they are willing to accept onto their balance sheets;
- There should be a broad alignment of risk and returns at the entity level;
- Firms should have adequate systems and controls in place to ensure that intended booking arrangements are followed;
- Firms should consider whether responsibility for oversight of booking arrangements should be explicit in statements of responsibilities for individuals that are subject to the Senior Managers Regime; and
- Booking arrangements should not be an impediment to the firm's recovery and resolution.

5.10 The PRA also expects the degree of cooperation with the home state supervisor to increase in cases of systemic wholesale branches. In addition to the expectations specified in paragraphs 3.10 and 3.11 above, the PRA expects:

- regular structured engagement with the home state supervisor either via a college or bilateral meetings or both, as appropriate, that facilitates a technical discussion of the material risks and risk management practices at the firm. The PRA would expect the home state supervisor to lead that discussion and to share their views and insights proactively but would also input fully itself. Where important issues are identified there should be an ongoing dialogue at the frequency required, outside of scheduled meetings;
- through that structured engagement: (i) an ability for the PRA to contribute to the supervisory strategy for the firm as a whole, particularly where the UK branch is a material part of the group, and to have insight into the group supervisory strategy, as necessary to achieve the PRA's objectives; and (ii) agreement with the home state supervisor to coordinate supervisory work where common areas of interest are identified;
- joint supervisory work with the home state supervisor, including joint visits to the branch where both the PRA and the home state supervisor have prioritised work in particular areas;

- a regular and proactive exchange of supervisory assessments, such as the results of firm visits or analyses in areas that are of particular relevance to the UK branch and/or material to the firm as a whole;
- prompt information exchange and proactive notification of issues materially relevant to the UK branch;
- access to information on governance and financial resilience for the firm as a whole and the group of which it is part where that is relevant for the supervision of the UK branch or the PRA's objectives; and
- development by the home state supervisor of appropriate crisis management frameworks allowing for prompt and full notification and exchange of pre-agreed information in the event of a crisis. The PRA would expect the frequency of contact and depth of information exchange to increase in this event.

5.11 Where it is satisfied in relation to those factors specified in paragraph 5.9 and 5.10 above, the PRA will seek to continue to rely to an appropriate degree on the home state supervisor's regulatory regime, prudential supervision and resolution planning, applying at the level of the whole firm, to ensure its objectives are met. The intensity of the PRA's own supervisory effort will continue to be greater for branches of greater significance for UK financial stability.

5.12 Where the PRA identifies concerns, it will first raise this with the firm and the home state supervisor. However where, given its assessment of the systemic importance of a wholesale branch, it considers it necessary in order to achieve its objectives, the PRA may exercise its powers under FSMA to apply specific regulatory requirements at the level of the branch on a case-by-case basis. These would principally be intended to ensure there are sufficient financial and operational resources, and appropriate governance, at the UK branch level, where the PRA cannot gain sufficient assurance about the supervisability of the firm. In practice this is most likely where the PRA considers that the degree of influence and visibility that it 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 meet the PRA's objectives, is inadequate given the systemic importance of the branch.

5.13 These requirements may include, but would not necessarily be limited to:

- governance requirements, eg additional Senior Management Functions ('SMFs') (such as Chief Risk Officer ('CRO'), Chief Finance Officer, Chief Operating Officer, and a group executive under SMF7) or a local oversight board at the level of the branch, or the overall UK presence, to ensure appropriate governance at the UK branch level. Where an international bank has a number of different branches from different legal entities, or a combination of subsidiaries and branches, in the UK, the PRA may also consider imposing a requirement for governance across the UK presence, for example that the CRO has to review and oversee a combined risk management framework;
- additional branch liquidity requirements to ensure appropriate liquidity at the UK branch level, eg holding additional liquidity to ensure sufficient resources are held locally to allow time to respond to a stress at the branch;
- additional information relating either to the branch or to the firm as a whole to support the PRA's assessment of the risk to the UK branch;

- operational continuity in resolution ('OCIR') expectations and greater assurance on operational resilience more generally; and
- restrictions on scope and/or volume of business, to mitigate risks posed to UK financial stability.

5.14 As discussed above, the PRA will seek to achieve its supervisory objectives for systemic wholesale branches through regular supervisory dialogues with the firm and the home state supervisor first, before it considers exercising its powers to apply additional requirements if the firm fails to meet the PRA's expectations.

5.15 If the PRA is still unable to achieve its objectives afterwards, the firm will be outside the PRA's risk appetite for branches. In these circumstances, the PRA is likely to require the firm to undertake wholesale activities in the UK as a subsidiary. More broadly in such circumstances, this may in turn mean that it would be necessary for the firm to be supervised on a more standalone basis consistent with an MPE approach to resolution.

5.16 The PRA will keep this approach under review. If imposing specific regulatory requirements on a case-by-case basis proves to be commonplace, the PRA may consider publishing further policy proposals on these requirements.

#### **Box 6: EEA branches**

Under European law, the home state supervisor of an EEA bank that operates as a branch in another EEA country is responsible for the prudential supervision of the whole firm (including the branch). As a result, the PRA, where it is the host supervisor of such branches, is not responsible for the prudential supervision of those branches, this is the role of the home supervisor.

In line with Article 51 of Capital Requirements Directive (2013/36/EU) ('CRD'), if a branch supervisor considers that the branch is important to domestic financial stability, this supervisor is able to designate the branch as 'significant'. Where this occurs, the home state supervisor must provide more information about the firm to the branch supervisor and consult it on certain issues, such as planning for emergency situations. The PRA will use the data provided in the Branch Return to form a judgement as to whether a branch is 'significant'.

Notwithstanding its lack of direct prudential supervisory powers, the PRA still needs to ensure that these branches do not impact UK financial stability. The PRA will, therefore, identify and maintain an up-to-date assessment of which branches have CFs in the UK and are, therefore, potentially important to UK financial stability. For those branches that are important to UK financial stability, the PRA will:

- designate the branch as 'significant' to the home state supervisor;
- maintain an up-to-date view on the firm's proximity to failure;
- support the home state supervisor in its supervision of the branch, in particular through participating in the firm-wide joint risk assessment undertaken in line with European requirements; and
- work with the home state supervisor to ensure the whole firm resolution plan minimises the potential impact on UK financial stability.

For those branches that are not important to UK financial stability, the PRA will use information provided by the home state supervisor to branch supervisors under the provisions of CRD and public information to identify any banks that appear to be at a higher risk of failure. Where the PRA determines a bank is at a higher risk of failure, only then will it undertake more in-depth work to determine the specific risk of failure, establish stronger contact with the home state supervisor on the whole firm resolution plan and check for any changes in the branch's UK strategy.

Where the PRA has concerns about the home state supervisor's approach to the supervision of the branch, it will formally notify the home state supervisor. If the PRA considers the firm is at risk of breaching CRD requirements, the PRA will formally ask the home supervisor to address the problem and, in line with the Capital Requirements Regulation (575/2013) ('CRR'), ask the European Banking Authority ('EBA') to intervene if the PRA considers that the home supervisor is not doing so.

In emergency situations, and in accordance with Articles 43 and 44 of the CRD, where the home state has not taken appropriate action, the PRA will take the precautionary measures necessary to protect against financial instability that would seriously threaten the collective interests of depositors, investors and clients in the UK.