BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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Dear Chief Executive Officer

International banks active in the UK: 2022 priorities

We are writing to update you on the Prudential Regulation Authority's (PRA) 2022 priorities for international banks active in the United Kingdom. These priorities are intended to complement our ongoing supervision and the feedback you will have received following the most recent Periodic Summary Meeting (PSM) for your firm. These are sent to the wide and diverse range of international banks that we supervise; therefore this list is not exhaustive, but is intended to provide a helpful overview of our priorities for 2022.

1. Financial resilience

As economies continue to be impacted by Covid-19, the resilience of the financial sector remains paramount to ensure that the financial system can continue to support businesses and households. The banking sector remains resilient to outcomes for the economy that are much more severe than the Monetary Policy Committee's central forecast,[1] but risks to the recovery remain. It is important that firms take proactive steps to assess the challenges of a changing economic environment. Many firms' earnings have benefited from the accommodative macro environment and supportive government measures in the past year. As this environment evolves, firms will need to assess the implications for the sustainability of their business models. This will be particularly important for those firms that have lost market share as certain sectors have become markedly more concentrated during the pandemic.

The economic recovery is likely to be uneven across sectors, so firms will need to closely monitor credit risk and traded risk within their portfolios, particularly as official sector support schemes are withdrawn. Alongside these cyclical issues, broader structural changes – such as an acceleration of digitalisation in the banking sector – could amplify challenges faced by individual firms as they recover from the impact of Covid-19. We will continue to engage with firms to assess the challenges these changes bring to the sustainability of business models.

The default of Archegos Capital Management last year also brought to light deficiencies in banks' risk management governance and frameworks, many of which were symptoms of a broader root cause and manifestations of an inappropriate internal risk culture where lessons from the global financial crisis had not been sufficiently learnt.[2] This event further reinforced the need for firms to consider concentrated and leveraged exposures and to improve counterparty risk management. Assessing the risk culture and the incentives structures in place at firms, and the alignment of remuneration with risk management practices,

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1 December 2021: 'Financial Stability Report - December 2021'
2 December 2021: 'Joint letter to banks operating in the UK: Supervisory review of global equity finance businesses following the default of Archegos Capital Management'.

will be a key priority of our supervisory work with firms engaged in equity finance and the broader prime brokerage business. In addition, the cross-border nature of this event highlighted the importance of global regulatory cooperation, a theme that will continue into 2022.

2. Operational risk and resilience

Enhancing the operational resilience of the financial sector remains a strategic priority for the PRA. Covid-19 continues to reinforce the importance of the firms' ability to prevent, adapt, respond to, recover, and learn from operational disruptions. We will continue to assess firms' progress in developing dynamic, effective operational risk and control frameworks to manage the threat of operational disruptions. We expect firms to develop their security controls and capabilities to manage the increasing risk of cyber threats, as set out in Supervisory Statement (SS) 1/21.[3] We encourage all firms, regardless of size, to test their resilience against such threats.

By Thursday 31 March 2022, firms must have identified and mapped their important business services; set impact tolerances for these; and initiated a programme of scenario testing. Impact tolerances provide a standard which boards and senior management should use for prioritising investment, and making recovery and response arrangements. We will continue to review firms' programmes and their implementation. SS1/21 applies to subsidiaries, but we also expect third country branches in the UK to be able to demonstrate how they will deliver operationally-resilient outcomes. We will look to work with firms and with their home state supervisors to understand how they will deliver these outcomes.

We also introduced new expectations on outsourcing and third party risk management (as set out in SS2/21)[4] to strengthen our expectations on operational resilience, and to facilitate greater resilience of services provided by third parties, including the cloud and other technologies. We have observed a material increase in the services being outsourced, particularly to cloud providers, and we expect firms to manage the risk arising from this accordingly. Under SS2/21, firms should maintain an updated register of their outsourcing arrangements. Firms should also ensure their important business services can remain within impact tolerances even when they rely on outsourcing or on third party providers.

3. Financial risks arising from climate change

Climate change presents a material and increasing financial risk to firms and to the financial system. Managing the risks to firms' safety and soundness from climate change requires action now, and remains a key PRA priority. Some firms have made good progress in embedding the PRA's supervisory expectations (as set out in SS3/19)[5], but progress has not been consistent across all firms, with further work required by many to meet those expectations. We have observed that most firms are focused on the business opportunities presented by climate change, and remind firms that climate change also presents an increasing business risk that is foreseeable and requires action now.

We expect firms to take a forward-looking, strategic and ambitious approach to managing climate-related financial risks. This approach should be proportionate to the scale of the risks and the complexity of a firm's operations. From 2022, we will incorporate supervision of climate-related financial risks into our core supervisory approach. The assessment of a firm's management of climate-related financial risks will be included in all relevant elements of the supervisory cycle, as outlined in our recently published Climate Change Adaptation Report.[6] As our collective understanding of climate-related risks, data, tools, and best practice evolves, we expect firms to refine and innovate to better integrate climate-related financial risk management across their organisation. The PRA will pay particular attention to how firms quantify climate-related risks and incorporate those risks into business strategies, decision-making, and risk-taking. Furthermore, we will keep a range of supervisory tools under review for use where we deem progress to be insufficient.

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[3] March 2021: SS1/21 Operational resilience: Impact tolerances for important business services.
[4] March 2021: SS2/21 Outsourcing and third party risk management.
[5] April 2019: SS3/19 Enhancing banks' and insurers' approaches to managing the financial risks from climate change.
[6] October 2021: 'PRA Climate Change Adaptation Report'.

Although the expectations in SS3/19 apply to UK-incorporated firms, it is important that branches of international firms also focus on climate change, which we see as a vital element of sound risk management. We will continue to increase our engagement with home state supervisors on this issue.

4. Diversity & Inclusion

Discussion Paper 2/21[7] set out our ambition to support the resilience of the financial services sector by encouraging diversity within firms. We see a clear link to our objectives: diversity helps bring a mix of views, perspectives and experiences within firms. An inclusive culture where staff can freely raise concerns and participate appropriately in decision-making, can reduce the risk of groupthink, encourage debate and innovation, and support the safety and soundness of firms.

We have received positive feedback from industry on the proposals in the Discussion Paper. While we recognise that change takes time, we expect firms to consider the themes set out in the Discussion Paper and challenge themselves to understand their gaps and consider where they can make progress.

5. Risk-free rate transition

Although a major milestone in the transition to risk-free rates was reached at the end of 2021, we expect firms to continue making best efforts to actively transition LIBOR-referencing contracts wherever possible. Together with the Financial Conduct Authority, we will be closely monitoring actions to remove any remaining dependencies on LIBOR, including synthetic LIBOR. We also expect[8] firms to use the most robust alternative reference rates to LIBOR – any firm considering the use of credit-sensitive rates should assess the risks carefully and raise this with their supervisors before doing so.[9]

Other areas of supervisory focus

Data is an increasing area of focus at firms and at the PRA. We are investing to deliver a world-class regtech and data strategy, for which it is essential that we have accurate information. We recognise the efforts made by firms to improve complete, timely and accurate regulatory returns and we expect firms to maintain efforts in this regard, moving from tactical to strategic solutions, while managing supplier and project risks to achieve material benefits for data quality, flexibility, and information security. The submission of complete, timely, and accurate regulatory returns continues to be the foundation of effective supervision, so the PRA expects all firms to continue to take action to ensure the integrity of their returns. The PRA is expanding its programme of using skilled persons reviews (under Section 166 of the Financial Services and Markets Act) to verify the accuracy of regulatory returns, which will continue in 2022. In the longer term, joint industry-Bank of England work on transforming data collection creates the opportunity for better quality reporting at lower cost, and we encourage firms to engage with this initiative.[10]

This letter in conjunction with your firm's PSM letter should convey a sense of our planned work for next year. We will continue to work closely with our international supervisory colleagues on these workstreams.

We look forward to working with you over the coming year.

Yours sincerely

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7 July 2021: DP2/21 – Diversity and inclusion in the financial sector – working together to drive change; and July 2021: DP21/2: Diversity and inclusion in the financial sector - working together to drive change.
8 March 2021: Dear CEO letter 'Transition from LIBOR to Risk Free Rates'.
9 July 2021: Financial Stability Report.
10 February 2021: 'Transforming Data Collection'.