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Regulatory News Alert

UK Prudential Regulation Authority (PRA) sets out its supervisory approach for international banks

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In July 2021, the UK Prudential Regulation Authority (PRA) published its supervisory statement SS5/21 that should be of great importance for the **European banks and investment firms operating in the United Kingdom via a subsidiary or branch.**

In its supervisory statement, the PRA sets out its **supervisory approach** of these entities with the aim that international banks meet threshold conditions, particularly those concerning the firm's effective supervision and prudent conduct of business, including their systems and controls and risk management.

What about firms currently under the Temporary Permissions Regime (TPR)?

Firms operating under the TPR do not need to meet these expectations immediately, as the TPR is temporary in nature; however, firms will need to do so as soon as practicable (taking into account their individual business model and systemic impact) and, in any event, **by the time they are authorized by the PRA and exit the TPR.** As part of pre-authorization discussions, the PRA will expect these firms **to demonstrate how they intend to meet these expectations.**

Understanding the specificities of the UK supervisory regime

The United Kingdom applies a supervisory approach of **"dual-regulated firms"**, whereby both the PRA and the Financial Conduct Authority (FCA) **are** involved in the supervision of European banks and investment firms**.** For European banks, whether they operate as subsidiaries or through branches in the United Kingdom, this means the FCA's threshold conditions and conduct of business rules also apply to them, including in areas such as anti-money laundering. Therefore, these firms can only be granted authorization when **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, which are set out in the recently issued document detailing the FCA's approach to international firms.

Principle of "responsible openness"

For **UK subsidiaries** of groups based outside the United Kingdom, the PRA applies the same regulatory requirements and follows the same supervisory framework as for firms based in the United Kingdom. However, the PRA tailors its supervisory approach according to the nature,

scale and complexity of a firm's UK operations and potential impact on the United Kingdom's financial stability.

UK branches, on the other hand, will be subject to prudential regulation by their home state supervisory authority. Therefore, the PRA does not apply capital requirements to a firm that only operates through a UK branch, but the PRA looks to the home state regime to apply solo capital requirements to the firm.

The PRA must be satisfied that a firm is capable of being effectively supervised to understand what risks the UK branch or subsidiary is exposed to and how these are dependent on the business and risk profile of the rest of the firm or the group. Subject to these foundations, **the PRA is open**, in principle, to hosting subsidiaries of international groups.

"Effective supervision"

For firms that are part of international groups carrying on banking business in the United Kingdom, the PRA first assesses the **general factors** that must be in place for effective supervision to be possible, and then takes **firm-specific factors** into account.

1. **General expectations**

The general factors the PRA considers are:

a) Whether the home jurisdiction's prudential supervision regime is sufficiently **equivalent** to the UK regime;
b) Whether there is sufficient **supervisory co-operation** with the home state supervisor; and
c) The efficacy of the **arrangements for resolution.**

2. **Firm-specific expectations**

The factors that the PRA considers when assessing its ability to effectively supervise a particular international bank include:

a) Whether the PRA receives **sufficient financial and regulatory information** on the overseas risks and financial position connected with the firm, from its group or head office and relevant overseas supervisory authorities;
b) Whether any **wider group** to which the firm belongs has the capacity and willingness **to support the firm;**
c) **Governance arrangements** (e.g., it is generally undesirable for some key positions on the board of a subsidiary to be occupied by executive members of the group or parent board, due to conflicts of interest or time management availabilities)**;**
d) Transparent and effective **booking arrangements** (front-to-back lifecycle of trading, from origination, trade execution, risk capture and transfer through to back-office settlement) and that a firm appropriately manages the risks that it originates, receives and transfers out to affiliates;
e) **Operational resilience arrangements** that are in place with other group members; and
f) A credible **group resolution strategy**, or plans to support or wind up the firm in line with the bank's resolution objectives.

Retail versus wholesale business

The PRA has different expectations for businesses that engage in **retail banking activities**, since these activities tend to have a greater effect on financial stability. Therefore, additional requirements apply to firms that fall within the scope of the so-called **"ring-fencing regime"**, which requires the largest banking groups to separate core retail banking services from activities such as investment and international banking. Strategically speaking, this also means

that above certain thresholds, the PRA will consider authorizing firms in the United Kingdom as subsidiaries only. Below the ring-fencing requirement threshold, the PRA does not have any greater expectation for the separation of retail businesses.
However, regardless of these thresholds, there are three areas that European banks must consider to comply with the PRA's expectations:

- When branches or subsidiaries **outsource to parent or affiliated companies outside the United Kingdom**, they should ensure that the outsourced service complies with UK legal and regulatory requirements;
- The PRA will pay particular attention to compliance with the **UK depositor protection requirements**, including the "Single Customer View Requirements"; and
- The PRA expects to receive information on the degree of **financial, operational and other business dependencies** between the UK retail business and the wholesale business within the firm, and between the firm and the rest of the group.

Apart from ring-fencing requirements, there is no automatic or fixed expected outcome that the PRA applies, neither in terms of the degree of integration nor separation. The PRA aims to apply a proportionate set of expectations that are **tailored to each firm's circumstances.** The better these expectations on effective supervision are met, the more that the PRA is satisfied that a business in the United Kingdom is **highly integrated with the wider foreign group**, which strengthens its local position**.**

If the PRA's expectations for effective supervision are not fully met, given the degree of operational integration that an international bank currently has, then the PRA will consider taking measures to require the UK operations of the international bank **to be more independent.**

In terms of the **wholesale business**, the PRA considers size as a factor when deciding whether to designate investment firms as PRA-regulated firms. The PRA's approach is set out in the Statement of Policy (SoP) "Designation of investment firms for prudential supervision by the Prudential Regulation Authority" (the revised version is currently under consultation, with changes coming into effect 1 January 2022). Similar thresholds will apply for the assessment of whether the UK branch undertaking the wholesale business is systemically important.

Finally, UK subsidiaries are expected to be **structurally profitable** on a standalone and going-concern basis. The PRA may request that firms provide evidence that parental support will be provided and the parent has a clear strategy to do so.

How can Deloitte help you?

Deloitte has developed a systematic approach: first, a Brexit health check to assess the potential impacts Brexit may have on your structure and organization. Then, based on both business development plans and legal realities, Deloitte can help you implement operational changes for a robust post-Brexit environment strategy.

With our Regulatory Watch Kaleidoscope service, Deloitte helps you stay ahead of the regulatory curve to better manage and plan upcoming regulations.

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