



AFB

COMPLIANCE PLATFORM

COMPLIANCE EXPERT PANEL – OUTPUT PAPER

**AFB Expert Panels meet regularly and produce Output Papers on behalf of the whole membership (see Note).*

PRA AND FCA CONSULTATIONS ON SUPERVISION OF INTERNATIONAL BANKS

A. PRA CONSULTATION

In January 2021 the PRA published a [consultation paper](#) and a draft supervisory statement entitled [International banks: The PRA's approach to branch and subsidiary supervision](#), which sets out proposals regarding its approach to supervising the UK activities of PRA-authorized banks and designated investment firms headquartered outside of the UK, or that are part of a group based outside of the UK. Unlike the existing supervisory statement in this area, the draft supervisory statement applies to both branches and subsidiaries of overseas-headquartered banks.

The consultation closes on 11 April 2021, and implementation is expected in Q2 2021. The draft applies to both branches and subsidiaries, and covers the PRA's:

- expectations for receiving information concerning wider group risks and cooperation from other supervisory authorities concerned with the bank or its wider group, and
- expectations of international banks in meeting the threshold conditions on the prudent conduct of business, including their systems and controls and risk management.

Firms operating under the temporary permissions regime (TPR) do not need to meet the supervisory statement expectations immediately, but must meet them as soon as practicable, and in any event by the time they are authorized by the PRA and exit the TPR.

The guiding philosophy underpinning the PRA's approach to supervising international banks is "[responsible openness](#)". Broadly, this means that the PRA:

- should engage strongly in international standard-setting processes and implement these in a thorough way;
- will adopt practices and structures that promote strong collaboration with regulators in other jurisdictions; and
- is open to hosting cross-border business in the UK, provided that:
 - it is resilient and appropriately controlled and governed; and
 - the PRA has sufficient visibility of and influence over the necessary supervisory outcomes.

General expectations, size, and systemic importance – The PRA's general expectations for effective supervision of international banks is based on:

- whether the home jurisdiction's prudential supervision regime is sufficiently equivalent to the UK regime;
- whether there is sufficient supervisory co-operation with the home state supervisor; and
- the efficacy of the arrangements for resolution.

The supervisory statement sets out a minimum expectation that UK branches or subsidiaries of international groups must be on a path to standalone profitability, i.e. they cannot solely be cost centres, and should depend on indefinite support from the parent or head office. The PRA will require information on cross-subsidisation between retail and wholesale businesses of the bank, as well as between the bank and the wider group.

With respect to retail business, intra-group outsourcing and depositor protection must comply with the UK's requirements.

Information, co-operation, and the controls required to be effectively supervised – The draft supervisory statement sets out the factors that the PRA considers in assessing its ability to effectively supervise a particular international bank when it belongs to a group based overseas, and in particular whether:

- the PRA receives sufficient cooperation and financial/regulatory information on overseas risks from its head office and overseas supervisors;
- the group has a capacity and willingness to support the bank;
- where group individuals have governance roles, UK-specific risks are taken into account;
- where UK individuals have governance roles, they have appropriate influence within the group's management;
- booking arrangements are transparent and effective, and whether affiliate risks are appropriately managed;
- group operational resilience arrangements comply with PRA requirements; and
- there is a credible group resolution strategy that takes account of the UK operation.

The PRA will also consider whether the degree of operational integration or separation is appropriate having regard to the PRA's ability to supervise. The PRA will consider this question for each of:

- governance,
- capital and liquidity,
- booking risk management,
- operational resilience,
- resolution strategy, and
- structural profitability.

Additional considerations for the supervision and authorisation of branches – Whilst generally covering both subsidiaries and branches, the supervisory statement also notes that additional expectations arise in relation to branches operating in the UK. Accordingly, the PRA sets out additional considerations when deciding whether to grant authorisation. These relate to:

- **Threshold conditions:** although these apply to the whole bank, the PRA relies on the assessment of, and prudential supervision by, the home state supervisor.
- **Supervisory cooperation:** the PRA will require information from the home supervisor (for example in relation to liquidity).

- **Resolution:** the PRA will consider whether UK depositors will receive fair treatment under the home jurisdiction's insolvency and resolution regime.
- **Significant retail activities:** the PRA will generally not be content for an international branch to undertake retail banking activities beyond the soft limits of £100m in balances or 5000 customers in the retail or small company category. Newly established branches are expected to focus primarily on wholesale activities.
- **Systemic wholesale branches:** given the cross-border nature of many wholesale banking activities, wholesale branches tend to involve greater complexity in terms of structures and the PRA has additional expectations where they may become of systemic importance (i.e. having >£15bn total gross assets, including assets originated in UK but booked offshore, if they are risk managed in the UK). These expectations include:
 - Being part of the PRA's continuous assessment programme, including at least annual meetings with the CEO and/or CRO of the head office bank.
 - The head of branch being a senior figure within the bank, who is credible and influential at the group executive level.
 - Branches should consider whether they need additional branch-level SMFs, such as the Chief Risk, Chief Finance and Chief Operations functions.

B. FCA STATEMENT ON ITS APPROACH TO INTERNATIONAL FIRMS

The FCA has also published its own document in February 2021, [Our Approach to International Firms](#), which follows a [consultation](#) in September last year. A [feedback statement](#) accompanies the approach document. The approach document underlines the FCA's commitment to a competitive and open financial system, and acknowledges that international firms are an established part of the UK's financial services landscape.

- The document is for international firms that:
 - intend to apply for authorisation in the UK;
 - have applied for authorisation in the UK; or
 - are already authorised in the UK.

In particular, it focuses on the 1,500 firms in the TPR seeking authorisation, though it is not limited to these firms. It largely focuses on branches, though some of the document will also be relevant to subsidiaries.

Overview of the FCA's approach – The key requirements are that all firms must meet the minimum standards set out in the relevant legislation and be ready, willing and organised to comply with the regulatory system.

International firms have a degree of choice regarding the legal form of their UK presence. If a firm has appropriate risk mitigation in place, it may seek authorisation as a branch. However, the FCA will assess whether harm is more likely from a branch structure than from a subsidiary.

As part of the overall assessment of an international firm against the relevant minimum standards, the FCA will consider the firm's potential to cause harm, as well as the level of these risks.

The approach sets out three potential risks that are more relevant for branches of international firms, before addressing specific risk factors and mitigation in respect of each category:

- protection for retail customers may be less effective, especially if the firm becomes insolvent or exits the UK ('**retail harm**').

- UK client money/assets rules may not align with the home state's insolvency regime ('**client assets harm**').
- shocks or risks originating from overseas offices could be more difficult to detect or prevent and could be passed easily to the UK office ('**wholesale harm**').

The FCA will determine if the international firm can offer sufficient mitigation to address the risks of harm. The FCA may impose limitations or requirements on permissions if it has concerns.

Main FCA considerations for international firms – The approach sets out some of the FCA's general expectations which are particularly relevant to international firms operating from a UK branch (although may also be relevant for subsidiaries).

The FCA will consider the following issues:

- Does the firm have an active place of business in the UK? Authorised firms must be capable of being effectively supervised, with effective supervision including being able to
 - access relevant information;
 - monitor on an ongoing basis; and
 - make regulatory interventions.
- Are the firm's personnel adequate? In particular:
 - senior managers who manage the firm's UK activities should spend an adequate amount of time in the UK (although individuals with purely strategic responsibilities for a UK branch may not be based in the UK); and
 - individuals responsible for the day-to-day management of the UK branch activities must have independent decision-making powers and exercise independent challenge over strategic decisions that affect the wider firm.
- Are the UK operations appropriately financially resourced?
- Is the firm's business model and strategy implemented in a sound and prudent manner, and in the interests of consumers?
- Does the firm have appropriate systems, controls and human resources?
- Do outsourcing arrangements impair governance and internal controls?

Assessing an international firm's risks of harm – As part of the FCA's assessment of a firm for performing activities that require authorisation against minimum standards, the FCA will consider the firm generally for the potential for harm it may pose. In respect of retail harm, particular risk factors include:

- Poor quality of governance leading to inappropriate sales practices;
- Inadequate disclosure of product information;
- Inadequate management of conflicts of interest;
- Flaws in the design and implementation of systems and controls;
- Failure to hold adequate professional indemnity insurance and capital;
- Inadequate arrangements to maintain technology resilience and cyber security; and
- Failure to establish adequate controls to prevent financial crime.

In respect of client assets harm, the FCA has particular concerns around the interaction of the CASS regime with the home state's insolvency regime. The FCA would expect firms to consider whether, on

insolvency, clients' assets would be ring-fenced as CASS as UK law had intended. For wholesale harm, particular risk factors include:

- A lack of "substitutability" of products and services offered in the UK market.
- The firm occupying an important position in the UK market, e.g. having a significant market share in a niche market, or otherwise significant influence.
- The firm being interconnected to other firms in the industry, spreading and amplifying risks in the system rather than reducing or absorbing them.

The FCA will discuss risks arising in dual-regulated firms with the PRA, and with the firms themselves.

Mitigating identified risks – The approach also provides examples of ways international firms might be able to mitigate the three risks of harm identified.

For retail harm, mitigation may include:

- the FCA being able to rely on the home state regulator to obtain compensation for customers;
- comparable redress rules and supervisory approach in the firm's home jurisdiction;
- a degree of independence of branch management; and
- systems and controls that are suitable for UK operations, with controlled function staff having adequate UK regulatory or legal experience.

For client asset harm, mitigation may include:

- the firm providing information about how client assets would be treated in insolvency proceedings; and
- money held as deposits under the CASS banking exemption, making treatment in insolvency likely to be more certain.

For wholesale harm, mitigation may include:

- for banks subject to the Bank Recovery and Resolution Directive resolution arrangements, a pre-agreed plan being in place to minimise disruptions to wholesale markets if the bank is in financial difficulty; and
- where the risk of harm cannot be otherwise mitigated appropriately, the FCA will invite the branch to form a subsidiary and apply for authorisation on that basis.

NOTE

Meetings of AFB Expert Panels are held in compliance with AFB's Competition Law Guidance. All issues discussed are included in the relevant Output Paper. AFB holds a central record of all attendees at Expert Panel Meetings. AFB Expert Panel Output Papers are intended as general guidance and no action should be taken in reliance on them without specific legal advice.

QUERIES AND FOLLOW-UP

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Issued March 2020

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