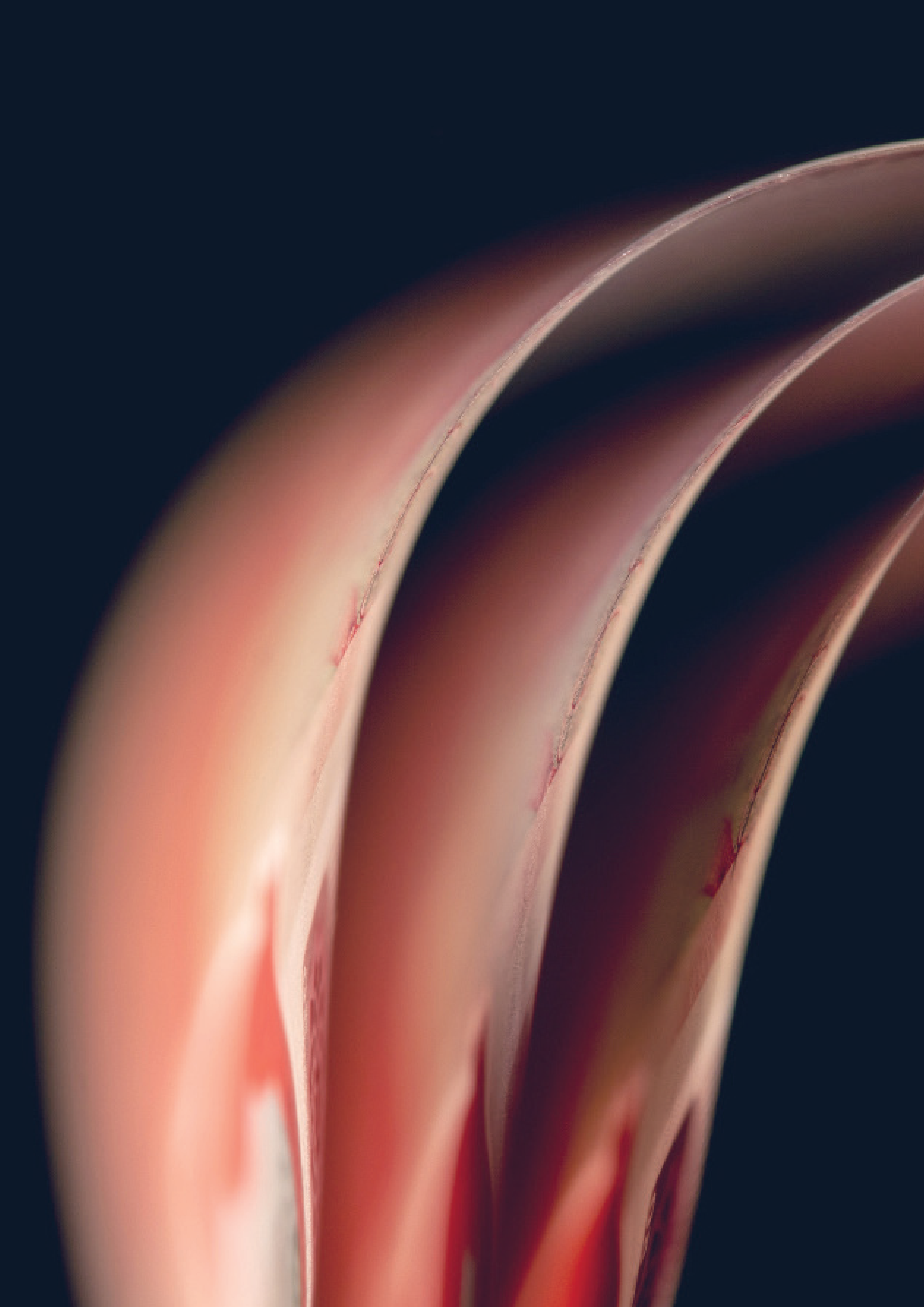
Bank of England

Prudential Regulation Authority Annual Report

1 March 2021–28 February 2022



Prudential Regulation Authority
Annual Report 2021/22[1]

1 March 2021 to 28 February 2022

Presented to Parliament pursuant to paragraph 19(4) of Schedule 1ZB of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016.

1. Including the Annual Competition Report and the Annual Report of the Prudential Regulation Committee to the Chancellor of the Exchequer on the adequacy of PRA resources and the independence of PRA functions.

ISSN 2517-1607

This Report is made by the Prudential Regulation Authority (PRA) under the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016. It is made to the Chancellor of the Exchequer and covers the year ended Monday 28 February 2022.

The report covers the requirements of paragraph 19 of schedule 1ZB of FSMA.

The Bank of England Annual Report and Accounts for the year ending Monday 28 February 2022 is available on the Bank of England's (the Bank's) website. The PRA's audited accounts for the reporting year ending Monday 28 February 2022 are set out on pages 206–215 of the Bank of England Annual Report and Accounts.[2] HM Treasury (HMT) has issued an accounts direction; disclosures relating to this can be found on pages 208–210 of the Bank's Annual Report and Accounts.

Additional material can be found on the Bank's website at **www.bankofengland.co.uk/prudential-regulation**.

Any enquiries related to this publication should be sent to us at **praannualreport@bankofengland.co.uk**.

Consultation

Members of the public are invited to make representations to the PRA on the:

- PRA Annual Report;
- way in which the PRA has discharged its functions during the period to which the report relates; and
- extent to which, in their opinion, the PRA's objectives have been advanced and the PRA has considered the regulatory principles to which it must have regard when carrying out certain of its functions (contained in section 3B of FSMA), and facilitated effective competition in the markets for services provided by PRA-authorised firms in carrying on regulated activities in accordance with section 2H of FSMA.

2. Bank's Annual Report and Accounts 2021/22: **www.bankofengland.co.uk/annual-report/2022**.

Please address any comments or enquiries to **praannualreport@bankofengland.co.uk**, or by post to:

PRA Communications
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

The consultation closes on Monday 19 September 2022.

Privacy and limitation of confidentiality notice

By providing representation to the PRA on this Annual Report, you provide personal data to the Bank of England. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the representations.

The representations will be assessed to inform our further work as a regulator. We may use your details to contact you to clarify any aspects of your response.

Your personal data will be retained in accordance with the Bank's records management schedule. To find out more about how we deal with your personal data, your rights, or to get in touch please visit **www.bankofengland.co.uk/privacy**.

Information provided in response to this report, including personal information, may be subject to publication or disclosure to other parties in accordance with access to information regimes including under the Freedom of Information Act 2000 or data protection legislation, or as otherwise required by law or in discharge of the Bank's functions.

Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England receives a request for disclosure of this information, we will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England.

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Foreword by the Chair

Andrew Bailey
Governor,
Chair of the Prudential Regulation Committee

2021/22 has again demonstrated the importance of strong standards and robust supervision, most recently in the context of the impact of Covid-19, and the conflict in Ukraine, but also the default of Archegos Capital Management earlier in the year. I am encouraged that the International Monetary Fund (IMF) has recognised in its five-yearly Financial Sector Assessment Program (FSAP) the extensive actions taken to increase resilience in the UK financial system and the effectiveness of the prudential and supervisory frameworks in helping to support the safety and soundness of the banking and insurance system. As Sam says in his foreword, we now have a key responsibility to maintain the levels of resilience built up in the financial system through the post-financial crisis reforms we, and other UK and international authorities, have spent over a decade implementing.

To do this we must also have an eye on the horizon, scanning for new and emerging risks. Events like Archegos have played out against a backdrop of major shifts happening in the financial services landscape, demonstrating the continued need for the PRA to be swift on its feet in pursuit of its objectives, and the benefit of being part of the wider Bank in doing so. As you will see in the Report, there has been a significant programme of work in the PRA.

The first Resolvability Assessment Framework (RAF) submissions were received from major UK banks and building societies in 2021. The RAF is designed to make the resolution process more transparent, better understood, and therefore successful when it is needed. Those submissions mark an important milestone in increasing confidence that firms can exit the market in an orderly way without disturbing it.

With the transformation of the role of the PRA, following the UK's exit from the European Union (EU), comes new opportunities. We now have the opportunity to tailor rules more effectively to the UK market and the firms we regulate, while maintaining strong standards. We are making good progress in this area, for instance through the joint review of the Solvency II framework for insurers with HMT, and our work to develop a 'strong and simple' regulatory framework for non-systemic banks and building societies, which aims to reduce complexity and barriers to growth for these firms.

I give my sincere thanks to PRA staff for their drive and determination during this demanding year, and to the members of the Prudential Regulation Committee for their expertise and the valuable perspective they bring to our decision-making.

Andrew Bailey

Foreword by the Chief Executive

Sam Woods
Deputy Governor, Prudential Regulation,
Chief Executive of the PRA

2021/22 was another busy year for the PRA, but we also undertook a strategic review to see what lessons could be learned from the organisation's first eight years in existence. Having moved beyond implementing the post-financial crisis reforms, we identified the need to respond to new and emerging risks resulting from technological and wider societal developments. That review resulted in recommendations to strengthen our approach in a number of areas, which we have started work on in the past year, and will continue to take forward into the coming year. These include working with the Government to ensure the UK's financial services regulatory framework is fit for the future, supporting the Bank in assessing the regulatory impacts of new forms of digital money, a particular focus on firms' operational and cyber resilience, and working to mitigate new and emerging financial risks such as climate change. Ahead of all of this, however, we have a key responsibility to maintain the levels of resilience built up through the post-financial crisis reforms.

There has been significant work around the transformation of the role of the PRA following the UK's exit from the EU, our enhanced role as a host supervisor, and the need to work out how we make policy when we have greater control of the rulebook. I have said before that we are getting on with important reforms while the wider debate around the roles of Parliament, the Government, and regulators unfolds. In April 2021, we published proposals for a new 'strong and simple' regulatory framework for non-systemic banks and building societies. This aims to tackle the complexity and barriers to growth challenges faced by these firms. We published a Policy Statement (PS) on the implementation of Basel standards in October, and are currently designing policy on the final set of Basel III standards (known as Basel 3.1). Additionally, at the end of 2021 we finalised Phase 1 changes to the Solvency II reporting requirements and expectations, as part of wider work on the Review of Solvency II being undertaken with HMT. On the ground, we are authorising growing numbers of firms as they emerge from the Temporary Permissions Regime (TPR).

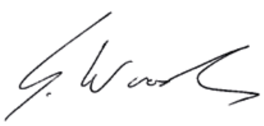
The last year has seen significant work to strengthen management practices, in particular following the default of Archegos Capital Management in March 2021. In December, we wrote to banks to outline deficiencies stemming from a flawed risk culture, in which frontline business executives failed to take accountability for risk and from independent risk functions lacking sufficient standing within firms, and senior management incentives which failed to promote sustainable longer-run outcomes. We reminded firms of the importance of investing in their risk management frameworks and controls infrastructure. There will be more on this in the coming months.

Changes to how we do our job as the prudential regulator are playing out against the backdrop of major shifts in the financial services landscape. During the Covid-19 pandemic, there have been rapid innovations in how people make payments, and the Bank and PRA need to stay ahead of these trends in order to ensure the opportunities they afford are realised in a safe way, and without compromising financial stability. We have helped the Bank with its Discussion Paper (DP) on new forms of digital money, which lays the groundwork for the regulation of systemic stablecoins. We have also written to firms setting out how they should identify, measure, and mitigate risks associated with crypto activities. Our work to integrate cryptoassets into a resilient regulatory framework continues.

A very different disruptive force we are having to contend with is climate change, and the risks it may pose to monetary and financial stability. The past year has seen us engage closely with regulated firms on their progress to embed supervisory expectations in this area, and we issued the climate biennial exploratory scenario in order to explore the resilience of major UK banks, insurers, and the financial system to climate-related risks. We also began to embed climate change into our own supervisory approach.

As we emerge from the uncertainty of Covid, we are facing new challenges that will shape our role as regulator in the years to come – from the way we make policy, to the need to ensure that the financial system remains resilient as emerging technologies make their mark on the sector and the wider economy.

I want to thank PRA staff for all their hard work over the last year, and for embracing new challenges and opportunities that will keep us regulating financial firms in a dynamic and effective way.



Prudential Regulation Committee

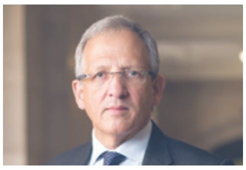
Members as at 8 June 2022[3]

Andrew Bailey
Governor, Chair of the PRC

Julia Black
External member
Term: 30 November 2018 – 29 November 2024

Ben Broadbent
Deputy Governor, Monetary Policy
Term: 1 March 2017 – 28 February 2023

Tanya Castell
External member
Term: 1 September 2021 – 31 August 2024



Sir Jon Cunliffe
Deputy Governor, Financial Stability

Antony Jenkins
External member
Term: 5 April 2021 – 4 April 2024

Jill May
External member
Term: 23 July 2018 – 22 July 2024

Sir Dave Ramsden
Deputy Governor, Markets and Banking

Nikhil Rathi
Chief Executive of the FCA
Term: 1 October 2020 – 30 September 2025

John Taylor
External member
Term: 14 January 2021 – 13 January 2024

Sam Woods
Deputy Governor, Prudential Regulation and Chief Executive of the PRA

3. The Bank of England Act 1998 provides for one member to be appointed by the Governor with the approval of the Chancellor. The Governor appointed Ben Broadbent. Ben Broadbent's PRC term differs to his Deputy Governor term. Norval Bryson was an external member of the PRC until 31 August 2021. Marjorie Ngwenya will join the PRC on 5 September 2022, commencing a three-year term, replacing Norval Bryson as an external member.

The Prudential Regulation Committee (PRC) is the body within the Bank responsible for exercising the Bank's functions as the Prudential Regulation Authority, as set out in the Bank of England Act 1998 and the Financial Services and Markets Act 2000. The PRC is on the same statutory footing as the Monetary Policy Committee and the Financial Policy Committee.

The PRC's terms of reference provide for 12 members. Five members are Bank staff: the Governor and four Deputy Governors. The Committee also includes the Chief Executive of the Financial Conduct Authority (FCA), and at least six members appointed by the Chancellor of the Exchequer.

- The PRC is independent in all its decision-making functions, including making rules and the PRA's most important supervisory and policy decisions.
- The PRA's functions are exercised by the Bank and are funded by PRA fees, with the PRC responsible for consulting on and setting the level of those fees.
- The PRC is required to report annually to the Chancellor of the Exchequer on the adequacy of resources allocated to the PRA functions and the extent to which the exercise of those functions is independent of the exercise of the Bank's other functions.[4]
- Since February 2016, the Bank has indemnified members of the PRC against personal civil liability on the same terms as the members of Court.[5]

The PRA's statutory objectives, which underpin its forward-looking, judgement-based approach to supervision are:

- a general objective to promote the safety and soundness of the firms it regulates;
- specifically for insurers, to contribute to the securing of an appropriate degree of protection for those who are, or may become insurance policyholders; and
- a secondary objective to, so far as is reasonably possible, act in a way which facilitates effective competition in the markets for services provided by PRA authorised persons in carrying on regulated activities.

4. Available on pages 14-15 in this Report.
5. See page 12 of the Bank of England's Annual Report and Accounts 2021/22.

On 23 March 2021, HMT issued ‘Recommendations for the Prudential Regulation Committee’. This was updated on 7 April 2022.[6] [7] This sets out aspects of the Government’s economic policy to which the PRC should have regard when considering how to advance its objectives, and when considering the application of the regulatory principles in FSMA.

FSMA also requires the PRA to review, if necessary revise, and publish annually its strategy in relation to how it will deliver its statutory objectives. The strategy is set by the PRC, in consultation with the Bank’s Court of Directors. The PRA’s strategy was published the PRA Business Plan 2022/23 in April 2022.[8]

6. Available at: **www.bankofengland.co.uk/-/media/boe/files/letter/2021/april/chancellor-letter-march-2021-prc.pdf**.
7. Available at: **www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-april-2022**.
8. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pra-business-plan-2022-23**.

Annual Report of the PRC to the Chancellor of the Exchequer

The adequacy of resources allocated to the performance of PRA functions and the extent to which the exercise of PRA functions is independent of other Bank functions.

This is the Annual Report by the PRC to the Chancellor of the Exchequer under paragraph 19 of Schedule 6A to the Bank of England Act 1998 (as amended). It relates to the period of 1 March 2021 to 28 February 2022. The PRA publishes this report as part of its commitment to transparency.

Background

Since 1 March 2017, the PRA has been part of the legal entity of the Bank of England. The PRC is a statutory committee of the Bank and is responsible for the exercise of the Bank's functions as the PRA. The PRC is on the same statutory footing as the Bank's Monetary Policy Committee (MPC) and the Financial Policy Committee (FPC). The PRA Annual Report summarises the PRC's responsibilities and the statutory framework under which the PRA operates. Under this statutory framework, the PRC is responsible for strategy, policy, and rulemaking, and the adoption (with the approval of the Bank's Court of Directors) of the budget for the PRA. These functions cannot be delegated.

The performance of PRA functions

The PRA has published two approach documents setting out how it advances its statutory objectives: the PRA's approach to banking supervision and the PRA's approach to insurance supervision.[9] The PRA does not seek to operate a zero-failure regime. This is a key principle underlying the PRA's approach to supervision. Each year, the PRC sets the PRA strategy and business plan, and adopts the PRA's budget. These are based on the PRA's approach to supervision, the PRA's operating model, and its risk tolerance, all agreed by the PRC.

The adequacy of resources

The PRA is fully funded by fees paid by regulated firms. The PRA consults each year on the allocation of fees among firms and has the ability, after consultation, to raise additional funds

9. PRA's approach to supervision of the banking and insurance sectors, October 2018: **www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors**.

during the year for material changes. The PRA received four responses to its fees consultation proposals in 2021/22,[10] which did not result in changes to the proposals.

The PRC seeks to ensure that the PRA's financial and non-financial resources are appropriately allocated to the work that best advances its objectives. In making judgements on the allocation of resources, the PRC takes into account a wide range of relevant considerations. These include the wider legislative and policy framework under which the PRA operates, including the duty to have regard to certain factors under FSMA, the Legislative and Regulatory Reform Act (LARA) and the Financial Services Act effective 1 March 2022. The PRC also takes into account HMT's recommendation letter,[11] updated on 7 April 2022,[12] which contains aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives, and the application of the regulatory principles set out in FSMA.

The PRC oversees the allocation of its resources to a combination of assurance work on individual firms and sectors, sectoral stress testing, policymaking, and investment in multi-year programmes that respond to changes in the external environment and risk profile of regulated firms. Work on multi-year programmes can span a range of areas, such as the operational resilience, the Future Regulatory Framework (FRF), and the review of Solvency II insurance regulation.

The PRC also receives and reviews regular updates on the PRA's performance and on how the PRA's financial and non-financial resources are allocated and monitored, as well as how any resource risks are being mitigated through performance and assurance reporting, discussions of papers prepared by staff, and PRC members' regular interaction with the PRA, including meetings with senior management and other staff. In particular, the regular reporting to PRC covers: progress against strategic aims; budget and headcount position; staff turnover; technology availability; and the PRA's risk profile. The reports and other evidence provided to the PRC during the year indicate whether the PRA has used its financial and non-financial resources to deliver its functions, in line with its business plan.

The Bank's internal control functions are also applied within the PRA. This includes the Bank's risk management framework, compliance function, internal audit function, and the Audit and Risk Committee of Court. In addition, PRC members have the benefit of their own engagement with industry through meetings and events across the year.

10. CP8/21, 'Regulated fees and levies: Rates proposals 2021/22', April 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/regulated-fees-and-levies-rates-proposals-2021-22**.
11. Available at: **www.bankofengland.co.uk/about/people/prudential-regulation-committee**.
12. Available at: **www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-april-2022**.

The PRA made substantive progress against its strategic priorities in its 2021/22 Business Plan, reprioritising as necessary in response to Covid-19. As set out in the 2022/23 Business Plan, it will aim to increase resources in the current year due to the increase in responsibilities related to rulemaking. Further investment in technology is also required to maintain and improve its operational effectiveness.

In 2021/22, the PRA underspent by £3.5 million, principally due to lower than assumed expensed project costs, reduced travel, and operating under headcount during the year. Due to additional income received in the year, the PRA will return £7.2 million to firms (2.4% of the PRA's total budget), as explained within the 2022/23 fee rates consultation.[13]

The extent to which the exercise of PRA functions is independent of other Bank functions

The PRA has a number of safeguards in place to ensure that it retains sufficient operational independence, including the independence of the PRC, and the funding and reporting arrangements set out in FSMA and the Bank of England Act 1998.

The PRC is independent in all its decision-making functions, which include making rules and the PRA's most important supervisory and policy decisions. The PRC also maintains its independence by ensuring that actual and potential conflicts of interest across its members are identified and managed on a continual basis, and by having its own internal infrastructure and processes that supplement Bank-wide arrangements. PRC members' remuneration is determined by the Bank's Remuneration Committee.

The PRA is located within the Bank, and contributes to effective policymaking on financial stability. Roles and responsibilities of the Bank and PRA are distinct, and functions are discharged in line with the Basel Core Principles. For example, the Bank has legislation-driven arrangements in place to ensure that its functions as the UK's resolution authority, and its supervisory functions (which are exercised in its capacity as the PRA) are operationally independent from one another, and has issued a statement setting out these arrangements.[14]

The PRC is structurally separated from the FPC and MPC by having different external memberships. The PRC and FPC hold all meetings separately, except those to discuss matters of mutual interest (for example, the annual concurrent stress test). The FPC has

13. CP4/22, 'Regulated fees and levies: Rates proposals 2022/23', April 2022: **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/regulated-fees-and-levies-rates-proposals-2022-23**.
14. Available at: **www.bankofengland.co.uk/-/media/boe/files/about/legislation/statement-structural-separation**.

specific powers of direction over prescribed macroprudential measures, and can make recommendations to anyone with the purpose of reducing risks to financial stability, including the PRA. This can sometimes mean that the FPC takes decisions that constrain the actions determined by the PRC.

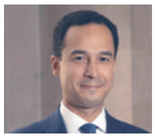
The fee income generated from regulated firms can only be used for the functions covered by the statutory framework that the PRA operates within. The PRA's budget covers its direct costs, as well as indirect costs charged by the Bank, including those for central functions such as technology, finance, and human resources. The Bank's external auditors review the allocation of indirect costs charged by the Bank, and provide external assurance that costs have been allocated appropriately.

Senior leadership team

The senior leadership team at the Prudential Regulation Authority is below.[15] [16]

David Bailey
UK Banks Supervision

Melanie Beaman
UK Deposit Takers



Nathanaël Benjamin
Authorisations, RegTech and International Supervision

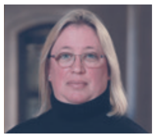
Phil Evans
Prudential Policy

Charlotte Gerken
Insurance Supervision

Rebecca Jackson
Authorisations, RegTech and International Supervision

Duncan Mackinnon
Supervisory Risk Specialists

Victoria Saporta
Prudential Policy



Alison Scott
Supervisory Risk Specialists

Anna Sweeney
Insurance Supervision, Risk and Operations

Gareth Truran
Prudential Policy

Sam Woods
Deputy Governor, Prudential Regulation and Chief Executive of the PRA

15. The following Executive Directors and Directors commenced their appointments in 2021/22: Nathanaël Benjamin (October 2021), Duncan Mackinnon (September 2021), Alison Scott (March 2022).
16. The following held Executive Director posts during 2021/22: Sarah Breeden (Executive Director, UK Deposit-Takers Supervision, until July 2021), Lyndon Nelson (Supervisory Risk Specialists and Regulatory Operations, Deputy Chief Executive, PRA, until June 2021).

Summary: Review of 2021/22

The PRA's activities in 2021/22 were directed by the PRA's Business Plan 2021/22[17]

This section of the Annual Report outlines the work completed in pursuit of our 2021/22 strategic goals, as set out in the PRA Business Plan 2021/22, and in support of the PRA's statutory objectives. Readers may also find it helpful to refer to the 'PRA Business Plan 2022/23', which sets out the PRA's strategy and workplan for the coming year,[18] and the PRA's approach to supervision documents.[19]

Examples of how the PRA delivered its 2021/22 strategic goals

1: Have in place robust prudential standards, and hold regulated firms, and those who run them, accountable for meeting these standards

- Landmark publication of the final policy for some of the remaining Basel III standards for banks, using new powers granted by Parliament.

- Work progressed on the PRA's 'strong and simple' regime for non-systemic banks and building societies.

- Emphasising to firms the importance of investing in risk management and control frameworks, following the collapse of Archegos and Greensill.

- Supported the development of international regulatory standards for insurance and the implementation of the International Association of Insurance Supervisors' (IAIS) holistic framework for managing systemic risk.

- Continued work with the Government on the review of Solvency II insurance regulation.

17. May 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/may/pra-business-plan-2021-22**.
18. May 2022: **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pra-business-plan-2022-23**.
19. 'The PRA's approach to banking supervision' and 'The PRA's approach to insurance supervision', available at: **www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors**.

- Supported the smooth transition through the cessation of GBP panel bank LIBOR.

- Reformed regulatory reporting for insurers delivering a 15% reduction in burden across the sector and significantly more for smaller firms.

- Expanded the PRA's programme of skilled persons reviews of firms' regulatory reporting and commencement of work to improve data collection, as part of the Bank's transformation programme.

- Enforcement action including significant fines for regulatory and governance failures.

2: Ensure that firms are adequately capitalised, and have sufficient liquidity, for the risks they are running or planning to take

- Thematic asset quality reviews targeted key vulnerable sectors and asset classes across banks' commercial and retail activities to assess the financial risks and impacts of Covid-19, including small and medium-sized enterprise and commercial real estate lending, unsecured personal loans, and buy-to-let portfolios.

- Worked with deposit-takers and their auditors to improve consistency and disclosure standards in expected credit loss accounting.

- Review of insurers' internal ratings of assets backing annuities.

3: Develop our supervision of operational resilience in order to mitigate the risk of disruption to the provision of important business services and critical economic functions

- Continued to complete CBEST and CQUEST intelligence-led cyber assessments, and to collaborate on cross-jurisdictional assessments of firms' cyber resilience.

- Published a co-ordinated Bank, PRA, and FCA PS on operational resilience (PS6/21); the culmination of a major workstream initiated through the 2018 operational resilience DP.

- Assessed the effectiveness of firms' operational risk management frameworks, linking this to operational resilience outcomes.

- Published a PS aimed at modernising the regulatory framework on outsourcing and third-party risk management, and engaged with firms on the implementation of third-party risk management policies.

- Assessed firms' compliance with the information and communication technology supervisory review and evaluation process (ICT SREP).

4: Ensure that banks and insurers have credible plans in place to enable them to recover from stress events, and that firms work to remove barriers to their resolvability to support the management of failure – proportionate to the firm's size and systemic importance – in an orderly manner

- The first RAF submissions were received in October 2021.

- Worked with HMT on targeted changes to insurance insolvency arrangements to reduce risk of disorderly failures.

5: Facilitate effective competition by actively considering the proportionality of our approach as it contributes to the safety and soundness of the UK financial system

- Announced the intention to develop a new 'strong and simple' framework for non-systemic and domestic banks and building societies.

- Set final policy on internal ratings based (IRB) capital requirements for UK mortgage risk weights, constraining the advantage over banks and building societies on the standardised approach.

- Made simplifications to regulatory reporting by insurers targeting a reduction of the burden on smaller firms.

- The PRA's Annual Competition Report, published alongside this Report, sets out our work over 2021/22 to support the delivery of our secondary competition objective.

6: Continue to deliver a sustainable and resilient UK financial regulatory framework (FRF) following the end of the transition period arising from the UK's exit from the European Union

- Continued work with HMT on the FRF to ensure it is fit for the future.

- Authorised a number of firms in transition from the TPR.

- Used powers under the EU Withdrawal Act, including the publishing of technical information relating to risk-free rate term structures on a monthly basis.

- Continued participation in the Financial Services Regulatory Initiatives Forum (FSRIF), established in 2020 in response to HMT's Future of Finance report, to set out the timings of regulatory initiatives and assess the cumulative operational impact on industry.

7: Continue to adapt to changes in the markets in which we are involved and pre-empt and mitigate risks to our objectives

- Worked with the Bank to lay the groundwork for the regulation of systemic stablecoins.

- Explored the resilience of major banks and insurers to climate-related financial stability risks in the Climate Biennial Exploratory Scenario (CBES) exercise.

- Contributed to the Basel Committee on Banking Supervision's (BCBS) work on the impact of digitalisation and disintermediation of finance on the retail banks.

8: Operate efficiently and effectively by ensuring that resources are allocated to work that best advances our strategy and reduces the greatest risks to the delivery of our statutory objectives, and by providing an inclusive working environment in which all staff can perform to their potential

- Undertook a strategic review to take stock of priorities and improve efficiency and effectiveness.

- Authorised seven new insurers and four new banks in 2021/22. Applications for 11 banks and 11 insurers in the TPR were also approved, with a further 35 applications from banks and 84 from insurers in progress as at end-February.

- In response to firm feedback, the PRA:

    - acknowledged the need to strengthen and transform data collection related capabilities, commencing a multi-year programme of work, starting with further investment in regulatory data collection and processing, alongside the FCA.

    - as part of the FSRIF, agreed to enhance transparency by providing examples of closely interconnected initiatives, and continues to look for ways to refine the Regulatory Initiatives Grid.

- continued to work closely with the FCA to refine the Senior Managers and Certification Regime (SM&CR) application approvals process, improve co-ordination, proactive sharing, and prioritisation of assessments to support timely processing of applications within the statutory deadline.

- started work with the FCA to create a cross-regulator view of data requests that considers firms’ business and reporting cycles.

Review of 2021/22

1: Have in place robust prudential standards, and hold regulated firms, and those who run them, accountable for meeting these standards

Contribution to financial stability

As in previous years, the PRA has contributed to the Bank's financial stability objective, at the same time as pursuing its own statutory objectives, by maintaining, and where appropriate strengthening or updating prudential standards.

October 2021 marked a historic milestone for the PRA, with the publication of PS22/21 – Implementation of Basel standards: final rules.[20] The publication introduced policy for some of the Basel III standards that had not been implemented by the EU before the end of the transition period. It was the PRA's first use of new powers[21] given by Parliament to implement outstanding Basel III standards. The PRA is currently designing policy on the Basel III standards (Basel 3.1) that remain to be implemented in the UK, and expects to consult on them in the fourth quarter of 2022. The PRA continues to support wider work at the BCBS. This includes work on assessing and understanding emerging risks that could pose a threat to financial stability, such as cyber and climate-related financial risks, as well as work to evaluate and strengthen existing standards. The PRA is a member of Basel task forces on climate and the evaluation of Basel III reforms, and works within these groups and the wider Basel structure to improve global financial stability.

The FPC and PRC also consulted and agreed on amendments to the UK leverage ratio framework, in the light of revised international standards, with some changes coming into force on 1 January 2022, and remaining changes to take effect on 1 January 2023.[22]

20. October 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/october/implementation-of-basel-standards**.
21. New powers under Financial Services and Markets Act 2000]/[FSMA] sections 144G(1); 144H(1) and (2); 192XA; and 192XC.
22. PS21/21, 'The UK leverage ratio framework', October 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework**.

The PRA announced its decision to maintain firms' O-SII buffer (previously Systemic Risk Buffer) rates at the rate set in December 2019, and confirmed that it would reassess them in December 2022.[23]

The PRA continued to support the development of international regulatory standards and the implementation of the IAIS's holistic framework for systemic risk in insurance, which included participation in the global monitoring exercise. Despite the operational challenges of 2021, the second year of the Global Insurance Capital Standard (ICS) monitoring has been effective, allowing for meaningful feedback and analysis to support discussions on ICS performance, including discussions at supervisory colleges for the UK's internationally active insurance groups (IAIGs). The ICS aims to provide a globally comparable, risk-based measure of capital adequacy of IAIGs, and a common language to facilitate effective supervisory discussions of group solvency. The PRA also engaged with a number of the IAIS committees and working groups involved in developing this framework.

International engagement and supervisory co-operation

Banking and insurance are global industries and the broad policy framework for supervising banks and insurance companies is agreed internationally. Effective cross-border engagement and co-operation is therefore essential for success. At the heart of this is the PRA's work with international authorities to play a leading role in promoting consistency in the implementation of international prudential standards, and to encourage continued openness between jurisdictions. The PRA published a Supervisory Statement (SS) on 26 July 2021,[24] setting out its approach to the supervision of international banks operating in the UK, and continues to engage internationally on the implementation of its final policy.

The PRA has continued to deepen relationships with regulatory authorities around the world to advance its supervisory and regulatory objectives. During 2021/22, the Bank and PRA have signed a number of Memorandums of Understanding (MoUs) with third-country counterparts, and have made significant progress in negotiating co-operation and information sharing agreements with others. This facilitates participation in supervisory colleges and engagement with international stakeholders. The PRA has also been participating in international forums, including the Financial Stability Board (FSB), the BCBS, and the IAIS, and has continued its efforts in implementing internationally agreed standards in banking and insurance. The PRA also worked domestically and internationally to mitigate the risks arising from the collapse of Archegos and Greensill, and is undertaking the assessment of measures

23. PRA Statement 'PRA decision on Systemic Risk Buffer Rates', December 2020: **www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-decision-on-srb-rates-december-2020**.
24. SS5/21, 'International banks: The PRA's approach to branch and subsidiary supervision', July 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pra-approach-to-branch-and-subsidiary-supervision-ss**.

that firms are implementing to address these as a matter of priority, as set out in relevant communications to firms.[25] [26]

Robust prudential standards

Work to create a simpler, but still resilient prudential framework for smaller, non-systemic banks and building societies announced in the PRA 2020/21 Business Plan, was followed by the publication of a DP in April 2021,[27] and a subsequent feedback statement. DP1/21 outlined a framework consisting of a number of layers, generating several responses. Feedback was broadly supportive of the ideas in the DP, and this has led to further work, with a planned consultation around policy options for banks and building societies that are neither systemic nor internationally active, and which provide standard lending or deposit banking products to UK customers.

Supervision of the insurance sector in 2021/22 focused on the longer-term sectoral risks, as well as heightened economic uncertainty due to the Covid-19 pandemic. A letter to CEOs of insurance firms, setting out the PRA's 2021 priorities,[28] outlined the PRA's focus on financial resilience, credit risk, the operational impact of Covid-19, the risks resulting from the ending of the EU transitional period, and climate-related financial stability risks.

The PRA undertook significant preparatory work for the 2022 insurance stress test (deferred from 2021 as part of Covid-related reprioritisation), with a particular focus on redesigning the life insurance stress test to ensure that the PRA will be in a position to publish aggregate results of the test, and a robust assessment of the resilience of the sector.

The PRA is contributing to the Government's review of the Solvency II regime in pursuit both of the objectives of the review, and of the PRA's own statutory objectives. Industry responses to HMT's call for evidence (CfE),[29] along with the PRA's own quantitative impact study (QIS)[30] data collection exercise, have helped to shape analysis of potential reform options,

25. Archegos: **www.bankofengland.co.uk/prudential-regulation/publication/2021/december/supervisory-review-global-equity-finance-businesses**.
26. Greenshill: **www.bankofengland.co.uk/prudential-regulation/letter/2021/september/trade-finance-activity-letter**.
27. FS1/21, 'Responses to DP1/21 'A strong and single prudential framework for non-systemic banks and building societies'', December 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks**.
28. Letter from Anna Sweeney and Charlotte Gerken 'Insurance Supervision: 2021 Priorities', December 2020: **www.bankofengland.co.uk/prudential-regulation/letter/2020/pra-insurance-supervision-2021-priorities**.
29. Call for Evidence response, available at: **https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/998396/Solvency_II_Call_for_Evidence_Response.pdf**.
30. QIS and Qualitative Questionnaire, available at: **www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/solvency-ii-reform-quantitative-impact-survey**.

particularly in relation to the calculation and scope of the matching adjustment, the risk margin, and the transitional measure on technical provisions (TMTP). The qualitative questionnaire published in August 2021[31] also helped with understanding the business impacts, compliance, and implementation costs of potential policy design options, as well as informing analysis of other areas for reform.

Extensive engagement with regulated firms and other stakeholders played an important part in firms' provision of high quality responses to the QIS and questionnaire, and in advancing thinking on policy reforms.

LIBOR (London interbank offered rate) transition

The transition from LIBOR to new risk-free rates represented both a systemic risk and an operational and financial risk to individual regulated firms. The PRA continued its programme of supervisory engagement on LIBOR, over the course of 2021, removing barriers to transition, and heightening its monitoring of progress against the targets of the Working Group on Sterling Risk-Free Reference Rates, and the management of associated risks. In March 2021, the PRA published a letter,[32] in conjunction with the FCA, setting out expectations of firms during the final and critical phase of transition to risk-free rates, with enhanced engagement for the highest risk firms. This included a series of industry led events in December 2021 and January 2022. Sterling markets transitioned smoothly through the cessation of GBP panel bank LIBOR at the end of 2021, with a full set of liquid Sterling Overnight Index Average (SONIA) linked markets established ahead of year end.

The PRA estimates that less than 2% of pre-2022 legacy GBP LIBOR exposures have used the synthetic GBP LIBOR rates, as a result of the successful completion of CCP conversion events, which transitioned £13 trillion of GBP LIBOR-linked derivatives to SONIA, implementation of the ISDA fallbacks, and continued active conversion through the renegotiation of contracts. In February 2022, the PRA data template used to monitor transition progress was updated, and now focuses on the outstanding LIBOR transition challenges set out in the PRA Business Plan.[33] Work also continued in supporting insurance firms in their efforts to move away from LIBOR through the production of final policy and technical information based on SONIA.

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31. Letter from Charlotte Gerken 'Gathering information for the Solvency II Review: Qualitative Questionnaire': **www.bankofengland.co.uk/prudential-regulation/letter/2021/august/gathering-information-solvency-ii-review-qualitative-questionnaire**.
32. Letter from David Bailey, Sarah Breeden and the FCA: 'Transition from LIBOR to Risk Free Rates': **www.bankofengland.co.uk/prudential-regulation/letter/2021/march/transition-from-libor-to-risk-free-rates**.
33. Prudential Regulation Authority Business Plan 2022/23: **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pra-business-plan-2022-23**.

Senior management accountability

Drawing on the 2020 evaluation of the Senior Managers and Certification Regime (SM&CR) and further stakeholder feedback, there has been significant work to develop policy and to examine the options for strengthening governance. Alongside the FCA, the PRA issued final policy,[34] which confirmed that individuals performing a senior management function (SMF) taking temporary, but extended leave, were not required to seek re-approval on return to their role, but firms would need to ensure adequate cover of SMF positions in the interim.

In response to industry feedback, an inventory of PRA expectations and guidance relating to risk topics listed in supervisory statements and letters, assigned to SMF holders, was created,[35] and the outcomes of the SM&CR evaluation[36] highlighting the importance of diverse skillsets and experience among senior management teams, were further underlined in a joint PRA/FCA/Bank DP published in July 2021.[37]

In December 2021, the PRA and FCA sent a joint letter to banks on supervisory review of global equity finance businesses following the default of Archegos Capital Management,[38] which underlined the ongoing significance of the links between governance, accountability, and risk management. The letter highlighted the many deficiencies stemming from a culture in which frontline business executives failed to take accountability for risk, from independent risk functions lacking sufficient standing within firms, and from senior management incentives not promoting sustainable longer-run outcomes. Firms were reminded of the importance of investing in their risk management frameworks and controls infrastructure.

34. PS11/21, 'Strengthening accountability: Temporary, long-term absences', June 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2020/smf-long-term-absences**.
35. Inventory of senior manager responsibilities: **www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2021/december/inventory-of-senior-manager-responsibilities.xlsx**.
36. PRA Report 'Evaluation of the Senior Managers and Certification Regime (SM&CR)', December 2020: **www.bankofengland.co.uk/prudential-regulation/publication/2020/evaluation-of-the-senior-managers-and-certification-regime**.
37. DP2/21, 'Diversity and inclusion in the financial sector – working together to drive change', July 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/diversity-and-inclusion-in-the-financial-sector**.
38. PRA Letter 'Joint letter to banks operating in the UK: Supervisory review of global equity finance businesses following the default of Archegos Capital Management', December 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/december/supervisory-review-global-equity-finance-businesses**.

Regulatory reporting

The Bank's work to transform data collection,[39] and the Bank's transformation plan[40] published in February 2021, outlined its long-term plans for modernisation. Working with industry and the FCA, the first phase of delivery work started in July 2021, focusing on redesigning commercial real estate reporting. Design work on commercial real estate data will continue into 2022/23, alongside designing a new operational resilience data collection process, and plans to refine insurance asset data collections.

Complete, timely, and reliable regulatory returns continue to provide the foundation of effective supervision. The PRA commissioned a number of reports from skilled persons that were completed during 2020/21 to assess the reliability of regulatory returns.[41] The PRA published a letter to bank, building society, and designated investment firm CEOs in September 2021,[42] setting out the thematic findings from these reviews, and wider supervisory work. The findings revealed significant deficiencies in firms' processes for delivering accurate and reliable regulatory returns, and the PRA asked firms to improve their governance, controls, and data related to regulatory reporting. The PRA has expanded its programme of skilled person's reviews, to assess the reliability of regulatory returns, with five reviews of firms' regulatory reporting commissioned in 2021/22.[43]

In the insurance sector, the PRA has delivered improvements to regulatory reporting requirements, by eliminating some reporting templates for UK insurers with effect from December 2021.[44] The granting of reporting waivers to medium-sized firms has also played a large part in making the reporting framework for insurers more proportionate. This set of reforms resulted in a 15% reduction in reporting across the insurance sector, and up to 40% for some small to medium-sized firms. Work has also continued, with close engagement with industry, to develop more ambitious reporting changes, and further improvements to existing templates, to deliver a reporting regime that is more responsive to emerging risks but less burdensome to firms.

39. Transforming data collection, available at: **www.bankofengland.co.uk/prudential-regulation/transforming-data-collection**.
40. News release 'Data Collection Transformation Plan', February 2021: **www.bankofengland.co.uk/news/2021/february/data-collection-transformation-plan**.
41. Under Section 166 of the Financial Services and Markets Act 2000.
42. PRA Letter 'Letter from David Bailey and Rebecca Jackson 'Thematic findings on the reliability of regulatory reporting', September 2021: **www.bankofengland.co.uk/prudential-regulation/letter/2021/september/thematic-findings-on-the-reliability-of-regulatory-returns**.
43. See 'Section 166 reports by skilled persons' section in this Report.
44. PS29/21, 'Review of Solvency II: Reporting (Phase 1)', December 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/review-of-solvency-ii-reporting-phase-1**.

International Monetary Fund – Financial Sector Assessment Program (FSAP)

The International Monetary Fund (IMF) delivered its five-yearly FSAP of the UK in February 2022. The assessment covered a range of sectors and responsibilities that fall under the remit of the Bank and PRA, including: banks, insurers, market-based finance, financial market infrastructures, stress testing, systemic risk oversight, crisis management and resolution, and the liquidity framework. The IMF also assessed the UK's response to structural and emerging issues such as climate change, LIBOR transition, cyber security, Fintech, and the steps taken to mitigate the financial stability risks arising from the Covid-19 pandemic and Brexit. The IMF also carried out a full assessment of the UK's adherence to the International Association of Insurance Supervisors' insurance core principles (ICPs).

The FSAP assessed four key components of financial stability:

- the soundness of banks and major financial institutions;
- the macroprudential framework and the quality of financial system oversight, for banks and systemically important non-bank financial institutions;
- the ability of policymakers and financial safety nets to withstand cases of deep financial stress and respond effectively; and
- the responsiveness of the authorities to emerging sources of risk and structural changes to the financial system.

The PRA welcomes the IMF's recognition of the strength of the current institutional framework, including the independence of the PRA and the primacy of its safety and soundness objective. The PRA is encouraged by the IMF's recognition of extensive actions taken to increase the resilience of the financial system since the last FSAP in 2016. In particular, the PRA welcomed IMF's findings that an effective prudential and supervisory structure is helping to support the safety and soundness of the UKs banking and insurance system and that these strong foundations are helping to support the UK economy and bettering the function of global finance. The FSAP team has assessed capital and liquidity levels at core banks and insurers as strong – even under some severely adverse scenarios, including the re-emergence of the pandemic. The PRA also welcomed the IMF's endorsement of UK efforts to increase the intensity of supervision on non-systemic smaller banks, and enhance firms' operational resilience, as well as the proactive stance on embedding climate-related financial risks, increased accountability of senior managers, through (SM&CR), and the strength and sophistication of the insurance supervisory framework. The PRA will assess those recommendations made by the IMF.

Enforcement: tackling threats to safety and soundness and strengthening accountability in PRA-authorised firms

As at 28 February 2022, the PRA's enforcement team, which works closely with other relevant (including criminal) authorities, was overseeing eight cases. This included investigations into eight PRA-authorised firms and 11 individuals. The issues and themes encountered span the full spectrum of the PRA's strategic priorities, including operational resilience and outsourcing, resolvability, prudential management and risk controls, regulatory reporting, and disclosure to the PRA.

In the 2021/22 financial year, the PRA's enforcement team conducted a number of investigations, expanding cases, and opening new investigations where necessary.

As a result, during the course of this year, the PRA:

- opened two new cases into PRA regulated firms;
- imposed its highest ever fine in a PRA-only enforcement case (£46.55 million) against Standard Chartered Bank (SCB), for regulatory reporting and governance failures, and for a failure to promptly notify the PRA of errors in its reporting (see further below); and
- imposed a financial penalty of £5,376,000 against Metro Bank plc (Metro Bank) for reporting and governance failures (see further below).

Cases refer to a common fact pattern, and can often encompass more than one investigation, to the extent that more than one entity or individual can be under investigation in relation to the relevant matter.

SCB[45]

On 17 December 2021, the PRA imposed a financial penalty on SCB of £46.55 million for failing to be open and co-operative with the PRA and for failings in its regulatory reporting governance and controls in relation to a tailored PRA liquidity expectation. This was the PRA's highest ever fine in a PRA-only enforcement case.

In October 2017, the PRA imposed a temporary additional liquidity expectation on SCB in response to concerns about heightened risk of USD liquidity outflows ('the liquidity metric'). This temporary expectation has now been removed. While SCB's overall liquidity position remained in surplus to its core liquidity requirements, between March 2018 and May 2019,

45. PRA News release 'PRA fines Standard Chartered Bank £46,550,000 for failing to be open and cooperative with the PRA', December 2021: **www.bankofengland.co.uk/news/2021/december/pra-final-notice-to-standard-chartered-bank-dated-20-december-2021**.

SCB made five errors reporting the liquidity metric, which meant that the PRA did not have a reliable overview of its USD liquidity position.

In relation to one of the misreporting errors, SCB only notified the PRA of the error after a four-month internal investigation into the issue. By this delay in giving due notice to the PRA, SCB failed to be open and co-operative in breach of Fundamental Rule 7.

The PRA's investigation identified that SCB's internal controls and governance arrangements underpinning its regulatory reporting in relation to the liquidity metric were not operating effectively, contributed to SCB's liquidity miscalculations and misreporting, and its failure to be open and co-operative with the PRA.

The investigation found that SCB failed to:

- promptly notify the PRA of one of the miscalculation and misreporting errors, despite having multiple opportunities to do so;
- ensure that its escalation framework for liquidity miscalculations and misreporting was properly embedded within the relevant business area;
- implement a documented policy, setting out when liquidity errors or potential liquidity errors should be notified to the PRA;
- maintain and operate adequate controls testing and checks for reporting the liquidity metric; and
- ensure that it had appropriate human resources to investigate potential misreporting of the liquidity metric.

As a result, SCB breached Fundamental Rule 6 and Fundamental Rule 7 of the PRA Rulebook. Fundamental Rule 6 requires that a firm organise and control its affairs responsibly and effectively. Fundamental Rule 7 requires that a firm be open and co-operative with the regulator.

SCB agreed to resolve this matter and therefore qualified for a 30% reduction in the fine imposed by the PRA. Without this discount, the fine imposed by the PRA would have been £66,500,000.

Metro Bank[46]

On 21 December 2021, the PRA imposed a financial penalty on Metro Bank of £5,376,000 for (i) failing to conduct its business with due skill, care and diligence, as it failed to ensure that it complied with its Common Reporting (COREP) obligations; and (ii) failing to organise and control its affairs responsibly and effectively in order to comply with its COREP reporting requirements, particularly in relation to its regulatory reporting governance, controls, and investment and data. The relevant breaches took place between 13 May 2016 to 23 January 2019.

In particular, in relation to COREP reporting, Metro Bank failed to:

- take sufficient care to ensure that it complied with its obligations to make accurate reports to the PRA;
- ensure effective oversight, challenge, and to establish effective, clear and documented escalation routes in respect of reporting;
- establish and implement effective controls in interpreting relevant regulatory rules and guidance; and
- allocate appropriate and adequate resources to enable it to comply with its reporting obligations.

As a result, Metro Bank breached Fundamental Rule 2 and Fundamental Rule 6 of the PRA Rulebook. Fundamental Rule 2 requires that a firm conducts its business with due skill, care and diligence. Fundamental Rule 6 requires that a firm organises and controls its affairs responsibly and effectively. These failings impacted the PRA's advancement of its primary objective to promote the safety and soundness of Metro Bank.

Metro Bank agreed to settle this matter during the discount stage and therefore qualified for a 30% reduction in the fine imposed by the PRA. Without this discount, the fine imposed by the PRA would have been £7,680,000.

46. PRA News release 'PRA fines Metro Bank £5,376,000 for failing in its regulatory reporting governance and controls', December 2021: **www.bankofengland.co.uk/news/2021/december/pra-fines-metro-bank-5376000-for-failing-in-its-regulatory-reporting-governance-and-controls**.

2: Ensure that firms are adequately capitalised, and have sufficient liquidity, for the risks they are running or planning to take

The PRA objective to promote the safety and soundness of firms is delivered in part through ensuring that firms have adequate financial resources for the risks they are running or planning to take. The financial resilience of firms and sectors is assessed through supervision and the use of stress testing to examine how firms would cope with severe economic scenarios. Over 2021/22, credit risk remained a key focus for both the banking and insurance sectors, and the risks from Covid-19 impacts on supply chains, energy price increases, and inflation and interest rate rises have been met with heightened sectoral monitoring. This has included reviews of firms' asset quality and their management of credit risk.

Asset quality

This year, the PRA has continued to work closely with deposit-takers and their auditors to encourage greater consistency of outcomes and high quality disclosures about expected credit loss accounting (ECL), and the implications for their capital ratios. The PRA issued statements and letters during 2020, regarding the approach to IFRS 9 taken by banks, building societies, and investment firms, to help implement existing regulatory and accounting requirements in a robust, well-balanced, and consistent way, particularly in the light of the unique challenges of Covid-19. In September 2021, following a review of written auditor reports[47] on ECL and benchmark reform, the PRA wrote to firms with thematic feedback for the 2020/2021 reporting period.[48] This built on communications in 2019, which set out the PRA's views on practices that would improve the quality and consistency of ECL implementation, and recognised the challenges faced by firms in implementing ECL, given the very high levels of uncertainty around the impact of Covid-19.

The PRA recognised efforts firms had made in adapting ECL processes for Covid-19, despite disruption. Firms now need to work on incorporating temporary changes made to strengthen ECL processes, into permanent practices, to help prepare for future stresses. Findings around the progress needed to embed quality practices were broadly similar to the previous year. Against that backdrop, the PRA set out its thematic findings on model risk, economic scenarios, and recovery strategies, and is working towards developing greater consistency among regulated firms.

47. Written auditor reporting involves the PRA developing a set of questions each year that external auditors of major UK banks answer in writing at the end of their audit. The questions give auditors insights into regulatory concerns that may be relevant to their audit work. Auditors' responses help the PRA to make more effective use of the work auditors do in areas that are of interest to supervisors.
48. Letter from Victoria Saporta 'Thematic feedback from the 2020/2021 round of written auditor reporting', September 2021: **www.bankofengland.co.uk/prudential-regulation/letter/2021/september/written-auditor-reporting-2021**.

Thematic asset quality reviews targeted key vulnerable sectors and asset classes across banks' commercial and retail activities. There has also been additional work across authorities to understand the impacts and performance of the government-backed loan schemes as they have become due for repayment, as well as work around IFRS 9 provisioning.

For corporate assets, the PRA performed specific thematic reviews on Covid-19 vulnerable sectors, and conducted reviews of major banks' problem debt management functions, and their preparedness for default volume increases. SMEs remain under close monitoring due to the large increase in lending during the pandemic, and for commercial real estate (CRE), the annual completion of the UK CRE underwriting survey, has helped to capture crucial data around loans written by major bank and insurance participants.

In the retail sector, the final exit of the loan payment deferrals and the ending of the Coronavirus Job Retention Scheme were a key focus. The PRA performed a range of thematic reviews on unsecured personal loans, and buy-to-let portfolios, given their vulnerability to changing economic conditions. Horizon scanning included an exploratory assessment of buy now pay later schemes. The PRA is also following the development of the risks associated with commercial property developers' exposures to buildings using cladding materials.

The PRA introduced new data analysis tools for non-systemic deposit-takers, including assessments of resilience and vulnerabilities using a range of stress scenarios, Internal Capital Adequacy Assessment Processes (ICAAPs), and firm-specific asset quality reviews, with a focus on commercial and unsecured activities. Conferences for non-systemic firms provided key information on the credit environment, and were used to share thematic findings and good industry practice. There has also been increased focus around the Capital Requirements Directive V (CRD V) review of mortgage risk weight floors.

The PRA continued to review insurance firms' risk management and governance of illiquid and other assets. This included the appropriateness of firms' internal ratings within their Solvency II matching adjustment (MA) portfolios and the robustness of internal rating validation processes.

Over the course of 2021/22, the PRA also continued to assess insurance firms' implementation of the Prudent Person Principle (PPP), which states that insurers should invest only in assets where they can properly identify, measure, monitor, manage, control, and report risks.

Stress testing

The Bank conducted a concurrent stress test during 2021, following the brief pause from the 2020 annual cyclical scenario (ACS) stress test, as a result of the global pandemic. The 2021 solvency stress test[49] took a different form to the ACS, and was used to cross-check the FPC's judgements made during the 2020 'reverse stress test', that banks had sufficient capital to continue to support UK households and businesses if economic outcomes were worse than expected in a severe, intensified macroeconomic shock. The test showed that major UK banks are resilient to a severe path for the economy in 2021–25, on top of the economic shock associated with the 2020 Covid-19 pandemic.

All eight participating firms remained above their reference rates for both CET1 capital and Tier 1 leverage ratios, and no individual bank was required to strengthen its capital position as a result. Consistent with the nature of the exercise, the FPC and PRC did not use the outcomes of the stress test as a direct input for setting capital buffers for UK banks.

For the insurance sector, concurrent stress testing continues to be a valuable tool for the PRA in pursuing a forward-looking, proportionate, and judgement-based approach to support insurance supervision. Insurance stress tests (ISTs) are run on a biennial basis for the largest insurance firms in both general and life sectors, and are used to test the resilience of the insurance sector to a number of hypothetical scenarios, and to assess the strength of firms' risk management frameworks. The scheduled 2021 test was deferred to 2022 in recognition of the impact of the global pandemic on the capacity of firms to undertake the exercise.

3: Develop our supervision of operational resilience in order to mitigate the risk of disruption to the provision of important business services and critical economic functions

A key priority for the Bank, PRA, and FCA is to continue building a stronger regulatory framework to improve the resilience of firms and FMIs to operational disruptions. Given firms' increased reliance on technology and third-party providers, it is vital that they prepare to recover from disruptions, and invest where needed, to ensure continued provision of important business services and critical economic functions.

In 2021, the PRA published joint policy statements on operational resilience with the Bank and the FCA,[50] setting expectations for firms to take ownership of their operational resilience

49. Available at: **www.bankofengland.co.uk/stress-testing/2021/bank-of-england-stress-testing-results**.
50. PS6/21 'Operational Resilience: Impact tolerances for important business services, March 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper**.

capabilities, and to prioritise plans and investment choices based on their operations' impacts on the public interest.

The new policy outlined requirements for firms and financial market intermediaries (FMIs) to:

- identify their important business services disruption, which could cause harm to consumers or market integrity, threaten the viability of firms, or cause instability in the financial system;
- set impact tolerance(s) for each important business service, quantifying the maximum level of disruption they could tolerate;
- identify and document the people, processes, technology, facilities, and information that support their important business services; and
- take actions to enable the services to remain within their impact tolerance through a range of severe but plausible disruption scenarios.

The PRA also published its policy for modernising the regulatory framework on outsourcing and third-party risk management[51] to facilitate adoption of the cloud and other new technologies. This followed the FPC's observations that, since the start of 2020, financial institutions have accelerated plans to scale up their reliance on cloud service providers (CSPs), and to place vital services on the cloud.

Without direct supervisory oversight, increasing reliance on a small number of CSPs and other critical third parties (CTPs) will heighten risks to financial stability. Consequently, the FPC determined that additional policy measures, potentially requiring legislative change, would be needed to mitigate these risks. This could include developing a framework for supervising CTPs designated as 'critical', including resilience standards and testing.[52] The PRA continued to engage with firms on third-party risk management throughout 2021/22. The Bank, PRA, and FCA have also announced that they intend to publish a joint discussion paper in 2022. The aims of the DP would be to inform future regulatory proposals relating to critical third parties (particularly on technically complex areas, such as resilience testing) and to provide thought leadership from the Bank, PRA, and FCA to UK cross-sectoral and international financial regulatory debates on CTPs.[53]

51. SS2/21 'Outsourcing and third party risk management', March 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/march/outsourcing-and-third-party-risk-management-ss**.
52. Financial Policy Summary and Record, July 2021: **www.bankofengland.co.uk/financial-policy-summary-and-record/2021/july-2021** and Financial Policy Summary and Record, October 2021: **www.bankofengland.co.uk/financial-policy-summary-and-record/2021/october-2021**.
53. Regulatory Initiatives Grid: **www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid-november-2021.pdf**.

The PRA has also reviewed a number of cloud outsourcing notifications from firms, and has been monitoring developments across the industry and with cloud providers, including their multi-year transformation and digitisation programs, in order to better understand idiosyncratic and collective risks.

CBEST – a joint PRA and FCA framework for assessing the cyber resilience of firms' important business services through threat intelligence-led penetration testing – has played a major role in assessing firms' cyber defence capabilities. The PRA conducted ten CBEST assessments during 2021, and initiated a further eight, as well as actively collaborating with other global financial regulators on a number of cross-jurisdictional assessments. There were also 191 cyber questionnaire thematic assessments (using the CQUEST tool) completed by firms. In addition to conducting CBEST testing for a number of insurers, the PRA also undertook horizontal reviews of the insurance sector using its CQUEST cyber questionnaire. Operational incidents affecting insurers and their service providers over the past year were heavily centred around recovery and remedial activity, and the availability of root cause analysis.

Engagement with firms has continued throughout this year, and the PRA has been assessing the approaches proposed by the most systemic firms. There has been a range of industry discussions, with significant work in developing new policy standards for incident reporting, and to incorporate operational resilience and outsourcing oversight assessments, as part of the new firm authorisations process. Supervisory work has focused on third party risk management policies, cyber and IT security, and change management frameworks, particularly in light of the greater reliance on remote working technologies.

This has included assessing the effectiveness of firms' operational risk management frameworks (ORMF) to understand how they are using operational tail risk scenarios, and for setting operational risk capital as part of Capital Supervisory Review and Evaluation Process (C-SREP). SS1/21 'Operational resilience: Impact tolerances for important business services' set expectations for firms' identification, testing, and management of operational risks.[54]

There has also been increased engagement through roundtable discussions with representatives of the financial services industry, advisory and legal firms, and industry bodies. Jointly, with the FCA, the PRA undertook an initial assessment of selected insurers' approach to the implementation of the operational resilience policy, participating in a number of seminars and events hosted by the industry. This year has also seen regular communication with senior executives in the insurance industry.

54. March 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-impact-tolerances-for-important-business-services-ss**.

The global and interconnected nature of large financial firms reinforces the importance of international co-operation on this topic. Therefore, assessing compliance with guidelines on information and communication technology supervisory review and evaluation process (ICT SREP) has formed a key consideration in supervisory assessments.

4: Ensure that banks and insurers have credible plans in place to enable them to recover from stress events, and that firms work to remove barriers to their resolvability to support the management of failure – proportionate to the firm's size and systemic importance – in an orderly manner

The UK established a framework for resolvability of deposit-takers (known as the 'resolution regime') in the Banking Act 2009. Here, the PRA works closely with the Bank as the UK's resolution authority. In September 2021, the PRA's CEO, in his Mansion House Speech,[55] informed the industry of the intention to do more in the coming years to increase confidence that firms can exit the market in an orderly way without disturbing it.

Resolvability – banks

The RAF sets out how the Bank will assess resolvability. It also requires, through the resolution assessment section of the PRA Rulebook, that the major UK banks and building societies formally assess their preparations for resolution, submit a report of that assessment, and publish a summary of their report (public disclosure). Firms have a responsibility to ensure that they are 'resolvable', that is that they have taken the steps necessary to ensure that the Bank could execute an orderly resolution in a way that would minimise disruption to depositors, businesses, and the economy. The major UK banks and building societies submitted their first RAF reports in October 2021. The mid-tier banks and building societies are required to implement the statement of policy on 'The Bank's Approach to Assessing Resolvability' and to achieve the three resolvability outcomes by January 2023.

The PRA published its final policy on operational continuity in resolution (OCIR) in May 2021,[56] which aims to improve firms' resolvability and support the Bank's approach to resolution. The Bank also finalised its statement of policy on the approach to setting a minimum requirement for own funds and eligible liabilities (MREL), in December 2021. The policy aims to ensure that all firms can be resolved in an orderly manner and incorporates changes to ensure that it is proportionate, providing new and growing firms with a clear, stepped, and flexible glide-path to meeting their end-state MRELs.

55. Prudentist – speech by Sam Woods: **www.bankofengland.co.uk/speech/2021/september/sam-woods-speech-at-mansion-house**.
56. PS9/21, 'Operational continuity in resolution: Updates to the policy', May 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2020/operational-continuity-in-resolution**.

In October 2021 the PRA published a consultation paper[57] on trading activity wind-down, in respect of firms' engagement in trading activities that may affect the financial stability of the UK. The CP contained proposed expectations that such firms be able to carry out a full or partial orderly wind-down of their trading activities in recovery and post-resolution restructuring. The proposals aim to enhance firms' ability to recover from firm-specific and/or market-wide stress. The consultation closed in January 2022.

Resolvability/ease of exit – insurers

The PRA further developed its approach to recovery and resolution for insurers by establishing and progressing a 'resolvability/ease of exit' implementation plan. Like credit institutions, the objective for insurers is to have credible recovery plans in place for stress events, and to prepare 'exit/resolution' plans to enable an orderly exit from the market in the event of firm failure – proportionate to the firm's size and systemic importance.

The UK Government has also proposed a series of targeted amendments to the current insurer insolvency arrangements, as well as the introduction of new provisions, to enable the UK authorities to better manage insurer distress in an orderly manner.[58] The Government, working with the Bank, the PRA, and the FCA, identified areas in which reform can make the UK's insolvency arrangements for insurers more robust, in order to better protect policyholders and reduce costs to industry and the wider financial sector.

5: Facilitate effective competition by actively considering the proportionality of our approach as it contributes to the safety and soundness of the UK financial system

The PRA's secondary competition objective states that 'when discharging its general functions in a way that advances its objectives, the PRA must act in a way that, as a secondary objective, facilitates effective competition in the markets, for services provided by persons carrying on regulated activities.'[59]

Three policy developments have been particularly strongly influenced by the secondary competition objective this year.

57. CP20/21, 'Trading activity wind-down', May 2022: **www.bankofengland.co.uk/prudential-regulation/publication/2021/october/trading-activity-wind-down**.
58. HMT Amendments to the Insolvency Arrangements for Insurers Consultation: **https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf** and HMT Amendments to the Insolvency Arrangements for Insurers: Response to Consultation: **https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1066045/Government_Response_Amendments_to_the_Insolvency_Arrangements_for_Insurers_April.pdf**.
59. Section 2H of FSMA.

- First, in July 2021, the PRA set out its final policy on minimum expectations for internal ratings based (IRB) UK mortgage risk weights,[60] and introduced an average IRB mortgage portfolio risk weight of 10% from 1 January 2022. This will ensure that average IRB mortgage risk weights do not fall below this level, constraining the advantage over banks and building societies on the standardised approach.

- Second, the PRA is developing the 'strong and simple' framework for non-systemic and domestic banks and building societies, and progressing work to make its rulebook more accessible, by publishing an index of prudential and resolution policies on the Bank's website.

- Third, finalised changes to the Solvency II reporting requirements and expectations[61] were also issued in December 2021, reducing ongoing costs, and facilitating better use of firm resources. Amendments to the relevant supervisory statements also aided firms' compliance with PRA reporting requirements, reducing the likelihood of erroneous reporting and associated costs of remediation, and thereby contributing positively to the facilitation of effective competition in the insurance sector.

More information on how the PRA is meeting its objective to facilitate effective competition can be found in the Annual Competition Report (see below).

6: Continue to deliver a sustainable and resilient UK financial regulatory framework following the end of the transition period arising from the UK's exit from the European Union

The Government closed the second phase of HMT's consultation[62] on the FRF review in February 2021. The review seeks to ensure that the UK's financial services regulatory framework is fit for the future, now that the UK has left the EU. The issues considered by the review include the overall policy framework, detailed regulatory standards, the transfer of rule-making powers to regulators, and an accountability framework to accompany these powers, and will result in a new Financial Services Bill.

60. CP14/20, 'Internal Ratings Based UK mortgage risk weights: Managing deficiencies in model risk capture', September 2020: **www.bankofengland.co.uk/prudential-regulation/publication/2020/internal-ratings-based-uk-mortgage-risk-weights-managing-deficiencies-in-model-risk-capture**.
61. PS29/21, 'Review of Solvency II: Reporting (Phase 1)', December 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/review-of-solvency-ii-reporting-phase-1**.
62. Consultation: **www.gov.uk/government/consultations/future-regulatory-framework-frf-review-consultation**.

Future regulatory framework

The PRA has been working with HMT on its responses to this review including:

- changes to the PRA's statutory objectives – a greater focus on international competitiveness and long-term growth through the introduction of a new secondary objective;
- accountability and scrutiny mechanisms for HMT, Parliament and other stakeholders;
- power to repeal parts of retained EU law; and
- public policy considerations the PRA must 'have regard' to when making rules.[63]

EEA authorisations

The TPR commenced on 1 January 2021, providing continuity for UK users serviced by European Economic Area (EEA) firms, while those firms seek permanent status in the UK. The PRA started the process of authorising the firms during 2021, and will continue throughout 2022/23. The 265 EU banks and insurers that entered the TPR must receive approval before the end of 2023 if they want to continue doing business in the UK. The PRA issued its statement on firm authorisation under the TPR,[64] confirming that authorisations decisions will be taken on a case-by-case basis, and the timings should not be taken as an indication of the PRA's view of risks at individual firms.

To support efficient and effective host supervision of the 130 branches of EEA insurers expected to apply for authorisation as a third country branch, the PRA is seeking to enter into agreements with relevant home supervisors in the EEA. The agreements provide a pragmatic, proportionate, and effective way of ensuring clarity around which authority will be responsible for specific supervisory tasks, on the reliance home and host may place on each other, on co-operation and information sharing, and on arriving at a shared view of the risks faced by each legal entity.

Financial Services Regulatory Initiatives Forum (FSRIF) and Grid

The PRA, together with other financial service regulators, including the Bank, continued its participation in the Financial Services Regulatory Initiatives Forum (FSRIF).[65] The FSRIF

63. Proposals for reform: **https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf**.
64. June 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/june/firm-authorisations-under-the-tpr-regime**.
65. Regulatory Initiatives Grid: **www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid**.

was first established in Spring 2020 in response to the Future of Finance report,[66] and meets twice yearly to share information on the timing of regulatory initiatives, in order to consider the cumulative operational impact on firms. Accessibility and transparency are enhanced through the publication of the FSRIF Grid, which sets out the timings of publicly announced regulatory initiatives over a two-year timeframe. The Grid gives the financial services industry and stakeholders a consolidated view of initiatives that may have a significant operational impact, and provides information on consultations in train and the timings of implementation. In 2021, building on previous enhancements, and, in response to stakeholder feedback, the FSRIF agreed to enhance transparency further by providing examples of closely interconnected initiatives.[67] The FSRIF continues to look for ways to refine and improve the Grid, and the PRA welcomes engagement and feedback on the FSRIF Grid[68] and, in particular, insights on levels of consultative and operational burden.

7: Continue to adapt to changes in the markets in which we are involved and pre-empt and mitigate risks to our objectives

The PRA maintains flexibility to adapt and respond to changes in the external environment, economic and market developments, and any other risks that may impact its statutory objectives or priorities. The PRA's risk identification process and horizon-scanning programme is at the heart of the delivery of this priority.

Horizon-scanning allows the PRA to identify emerging external risks, understand how firms' behaviour changes in response to regulation, identify practices that may generate risks to financial stability or PRA objectives, assess whether there are features of the regulatory regime that are not yet delivering the desired results, and allocate supervisory and policy resources to tackling the highest priority risks.

Outputs have been used over the course of the year to inform the prioritisation of work for the supervision of individual firms, including work to address specific risks arising from the pandemic, as well as to inform and commission thematic work, cross-firm reviews, and upcoming policy initiatives. Analysis and recommendations relating to emerging and crystallising risks, such as the increasing use of cloud outsourcing, are escalated to PRC.

66. See 'Summary table of the Bank of England's response to the van Steenis recommendations', June 2019: **www.bankofengland.co.uk/research/future-finance**.
67. 'Regulatory Initiatives Grid', May 2021: **www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid-may-2021.pdf**, page 2.
68. For details on how to provide feedback please see 'Regulatory Initiatives Grid', November 2021: **www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid-november-2021.pdf**, page 3.

The PRA has also continued its strong contributions to risk identification and horizon scanning discussions with international colleagues, eg to inform the Basel Committee on Banking Supervision's (BCBS) discussion on the impact of digitalisation.[69]

Cryptocurrencies and stablecoins

The PRA has been working with the Bank to lay the groundwork for the regulation of systemic stablecoins. In June 2021, the Bank published a DP setting out its emerging thoughts on new forms of digital money.[70] The paper set out some of the risks to financial and monetary stability emerging from deposits moving from the banking sector into new forms of digital money, including potential impacts on banks' funding costs and the availability of credit. The paper reiterated the FPC's expectations that systemic stablecoins need to offer holders protections equivalent to that of commercial bank money, and set out possible regulatory options for systemic stablecoins to achieve this, drawing on key elements of existing payments and banking regimes. The PRA is also working with international colleagues on the design of standards for banking regulation of cryptoassets.

In June 2021, the BCBS published its first of two consultations on the prudential treatment of cryptoassets (including stablecoins).[71] The future prudential framework will specify Pillar 1 requirements (including credit risk, market risk, liquidity, leverage, operational risks, and large exposures) of cryptoassets. This year's letter to CEOs[72] on identifying, measuring, and mitigating risks associated with crypto activities builds on the 2018 letter,[73] with details on specific risks, and will help firms to apply current regulations while BCBS discussions conclude and a domestic regime is developed.

FinTech, RegTech, and artificial intelligence (AI)

In October 2021, the Artificial Intelligence Public-Private Forum (AIPPF) concluded its own work in this area, publishing its final report in February 2022.[74] The forum, established by the Bank and the FCA in October 2020, was set up to advance dialogue on AI innovation

69. BCBS Press Release 'Basel Committee calls for improved cyber resilience, reviews climate-related financial risks and discusses impact of digitalisation', September 2021: **www.bis.org/press/p210920a.htm**.
70. Bank DP 'New forms of digital money', June 2021: **www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money**.
71. Consultative document – Prudential treatment of crypto-asset exposures (bis.org), available at: **www.bis.org/bcbs/publ/d519.pdf**.
72. Letter from Sam Woods 'Existing or planned exposure to cryptoassets', March 2022: **www.bankofengland.co.uk/prudential-regulation/letter/2022/march/existing-or-planned-exposure-to-cryptoassests**.
73. Letter from Sam Woods 'Existing or planned exposure to cryptoassets', June 2018: **www.bankofengland.co.uk/prudential-regulation/letter/2018/existing-or-planned-exposure-to-crypto-assets**.
74. The AI Public-Private Forum: Final report: **www.bankofengland.co.uk/research/fintech/ai-public-private-forum**.

between the public and private sectors. The AIPPF held quarterly meetings, and a number of workshops, bringing together a diverse group of experts from across financial services, the tech sector, and academia, along with public sector observers from other UK regulators and government. The AIPPF report aims to advance collective understanding, and promote further discussions among academics, practitioners, and regulators to support the safe adoption of AI in financial services. Members acted in a personal capacity, and AIPPF outputs do not reflect the views of the Bank or the FCA.

The Bank and FCA will publish a DP on AI later this year to build on the work of the AIPPF and broaden its engagement to a wider set of stakeholders. The DP will aim to provide clarity around the current regulatory framework and how it applies to AI, ask questions about how policy can best support further safe AI adoption, and give stakeholders an opportunity to share their views. The responses to the DP will help to identify what is most relevant to the PRA's remit, and in formulating any potential policy response – should it be needed.

Climate change and targets for a net-zero economy

The PRA continued its work supporting the Government's commitment to an economy-wide transition to net-zero emissions, by introducing measures for UK banks and insurers to develop effective capabilities and resilience against the financial risks to regulated firms from climate change. This priority is reflected in HMT's March 2021 recommendations letter (updated in April 2022)[75] for the PRC, which explicitly states that the PRA should 'have regard' to the Government's 2050 commitment, when considering how to advance its objectives and discharge its functions. This was also highlighted in the Financial Services Act 2021, which requires the PRA to have regard to the target for net-zero emissions when using certain rule-making powers.

The PRA held regulated firms to high standards by assessing their progress against climate-related supervisory expectations (set out in PRA supervisory statement SS3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change),[76] and their resilience to different climate scenarios in the Climate Biennial Exploratory Scenario (CBES) exercise.[77] There has been continued engagement with firms on their progress to embed supervisory expectations by 31 December 2021, and the findings were summarised in the PRA Climate Change Adaptation Report, published in

75. HMT Recommendations Letter to PRC – March 2021: **www.bankofengland.co.uk/-/media/boe/files/letter/2021/april/chancellor-letter-march-2021-prc.pdf**.
76. April 2019: **www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss**.
77. June 2021: **www.bankofengland.co.uk/stress-testing/2021/key-elements-2021-biennial-exploratory-scenario-financial-risks-climate-change**.

October 2021.[78] Industry has made good progress towards meeting expectations in some areas, particularly governance. But this has varied across firms, and there is still much to do, especially with firms' risk management and scenario analysis capabilities. Firms are also required under existing rules to identify their material exposures and demonstrate that they are holding adequate capital against them where relevant as part of their Internal Capital Adequacy Assessment Process (ICAAP) for banks, or own risk and solvency assessment (ORSA) for insurers. SS3/19 asked firms to 'be able to explain the steps taken to ensure appropriate capital levels to cover the risks.' The PRA's assessments of some ICAAPs and ORSAs over the past year suggest that firms are still exploring these issues and have some way to go in order to include underlying assessments in 2021/22 ICAAPs and ORSAs.

The CBES, issued in June 2021, sought to explore the resilience of major UK banks, insurers, and the financial system, to the risks under three climate scenarios of early, late and no action on a subset of the Network for Greening the Financial System scenarios. The objectives of this exercise were: first, to size the financial exposures of individual firms and the financial system to climate change; second, to understand how firms might respond to different climate scenarios and the impact on their business models; and third, to improve firms' management of the financial risks from climate change. However, the learnings from the exercise will be informative in forming views on the relevance of climate-related capital requirements, as well as firms' current capabilities to manage these risks.

The PRA has also continued to work collaboratively with domestic and international partners including other central banks and supervisors. The PRA continued to co-convene the climate financial risk forum (CFRF), with the FCA, to produce guidance and share best practice on how to address climate-related financial risks and opportunities.

The PRA also chairs the Sustainable Insurance Forum (SIF), which is a United Nations-convened global partnership of insurance supervisors.

Just as firms must embed supervisory expectations on climate change, the PRA started to take steps to embed climate change into its own supervisory approach at the beginning of 2022. These have been applied proportionately, based on firms' size, complexity, and exposures to climate-related financial risks.

78. Climate Change Adaptation Report: **www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2021/october/climate-change-adaptation-report-2021.pdf**.

8: Operate efficiently and effectively by ensuring that resources are allocated to work that best advances our strategy and reduces the greatest risks to the delivery of our statutory objectives, and by providing an inclusive working environment in which all staff can perform to their potential

To deliver its priorities, the PRA needs to have the right staff, technology, and processes, and an inclusive environment. The PRA Strategic Review was undertaken during the year, as the organisation headed into a new operating space, adopting new rulemaking and supervisory responsibilities, following the UK's exit from the EU. The review outcomes will strengthen the PRA's supervisory approach by making it more risk-based and flexible in the way it is resourced. The changes will allow the organisation to deploy a more confident and consistent supervisory approach, and make the governance and organisational structure more effective.

Strategic review

The strategic review, undertaken eight years after the creation of the PRA, was prompted by the need to accommodate a set of risks that were not prominent in the post-crisis regulatory framework, such as operational resilience, to adapt to its new responsibilities following the UK leaving the EU, and to seek ways to improve efficiency and effectiveness.

The outcome of the review recommended that in the near term, the PRA take action to strengthen its existing approach in three key areas. First, by undertaking work to be more risk-based and flexible in its deployment of resources, including ensuring that potential impact and risk assessment frameworks enable accurate and consistent identification of key risks to the PRA's objectives. Second, the PRA is reviewing its use of supervisory tools such as remuneration, SM&CR, skilled persons' reviews, and thematic reviews. Third, the PRA has delivered changes to its internal governance and organisational structure, to make this more effective, including streamlining reporting lines and committee structures.

In the medium term, the PRA will focus on transforming three aspects of its approach. First, making its approach to policymaking more accountable, responsive, and accessible, and later this year, publishing an outline of its vision and approach for taking on its new rulemaking responsibilities. Second, the PRA will do more to increase confidence that firms can exit the market in an orderly way, further developing the approach to wind-down and run-off planning. And third, the PRA will undertake a multi-year programme of work to improve its efficiency, effectiveness, and data culture, through phased investment in tools, technology, processes, and digital skills. Details of work planned under each of the four strategic priorities which were set by the review, can be found in the PRA Business Plan for 2022/23.

PRA diversity and inclusion

In July 2021, the Bank published an independent Court review[79] on ethnicity diversity and inclusion outlining the findings on the barriers to progression and lived experiences of minority ethnic colleagues. The PRA is committed to implementing its recommendations, to bridge barriers and support an equality of opportunities for our minority ethnic colleagues, as well as making progress towards diversity targets for gender and ethnicity for the Bank. For more details on PRA representation targets and progress made so far, please see the Diversity and Inclusion section of the Bank's Annual Report 2021/22. The PRA has embraced the Bank's strategic priority of building a diverse and inclusive Bank, taking a series of actions and measures to advance this agenda and boost further accountability for its senior leaders.

In 2021, the PRA published a DP[80] to highlight the importance of diversity and inclusion in the financial services sector as a means of bringing different views and experience to the table, encouraging debate and constructive challenge. The paper explored potential policies around data, tone from the top, firm-wide policies and practices, and potential regulatory measures to drive change. A voluntary survey to dual-regulated firms completed in November 2021 sought to understand the current position within firms, the information currently collected, and the challenges faced in doing so. Throughout the year, the PRA engaged with stakeholders in order to get feedback to the DP and data survey, which will be used to inform future policy.

Delivering the PRA's plan for RegTech and data

The PRA strategic review set priorities to strengthen and transform its data-related capabilities by 2026, building on work from the past few years, and consistent with the Bank's response to the Future of Finance report published in 2019. To support this, the PRA has now formed its RegTech strategy and completed an extensive mapping of data sources, systems, and processes used to support its core functions. The outputs were used to design a multi-year programme to bolster efficiency, effectiveness, through phased investment in tools, technology, processes, and skills. The PRA is deploying a digital skills strategy, and is recruiting additional data scientists and specialists. So far, successful proof-of-concept work has led to the deployment of flexible and resilient supervisory insight tools, better tools to produce and visualise firm data, tools for ingesting and managing ad hoc data collections from firms, and the delivery of desk-based stress testing. The programme will move to using

79. Court Review of Ethnic Diversity and Inclusion, July 2021: **www.bankofengland.co.uk/report/2021/court-review-of-ethnic-diversity-and-inclusion**.
80. DP2/21, 'Diversity and inclusion in the financial sector – working together to drive change', July 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/diversity-and-inclusion-in-the-financial-sector**.

machine learning to automate the use of quantitative data and, narrative information received from firms, allowing the PRA to deploy supervisors more effectively.

Throughout the year, the PRA has continued to play a leading role in international collaboration to underpin this work. This has included liaising closely with other leading regulators, central banks, academic institutions, and industry to share specialist knowledge and experience.

2021 saw further investment by both the FCA and the PRA in regulatory data collections with the introduction of the new, firm facing RegData system at the FCA, and significant investments in data processing systems at the PRA. At the PRA, a major new data storage platform was introduced to support more effective use of regulatory data and to reduce costs. Work is also under way to migrate a key supervisory record keeping tool to the latest versions of the underpinning technology. These investments will continue into future years, with ambitious data programmes and data collection tools, at both the Bank and FCA. It will also underpin future work to consider the continued appropriateness of the data currently collected from firms, including in the light of the UK’s exit from the EU.

Work is also under way to replace the system used to publish the PRA Rulebook.

Risks to the delivery of the PRA Business Plan, unforeseen events, and execution risk

A complex operating environment, and uncertainties in the economic environment provided a challenging backdrop to the delivery of this year’s plan, as the PRA had to make important decisions over the course of the year, to focus its limited resources on priority areas and crisis monitoring. This included the adjustment of some supervisory workplans to provide the flexibility needed to work through Covid-related impacts during the year.

The PRA’s operations and pursuit of operational effectiveness have remained under significant pressure in 2021/22, due to the continuing Covid-19 pandemic. As national restrictions eased in the second half of 2021, staff have returned to working from the office, as part of a Bank-wide pilot to adapt to hybrid working.

During the year, the PRA continued to invest in mitigating a number of significant operational risks, as noted in the Bank’s Annual Report. This has included managing a demanding project portfolio and developing the approach to attracting, retaining, and motivating staff in a highly competitive job market, in particular through investing in recruitment to maximise opportunities to attract the staff and skills the PRA needs in order to fulfil its role.

Measuring progress

In 2021/22, the PRA continued to draw on a variety of information to monitor the progress of delivery against its statutory objectives, strategy, and business plan on an ongoing basis. The PRC, Supervisory Risk and Policy Committee (SRPC) and the Operations, People and Innovation Committee (OPIC) regularly received information on both quantitative and qualitative measures and indicators, to assess delivery against the PRA's strategy, business plan, statutory objectives, and risk tolerances. This enabled the PRC to report to the Chancellor of the Exchequer on the adequacy of resources and provide sufficient information on supervisory processes and outcomes.[81]

FCA effective regular co-ordination

The PRA continues to co-ordinate well with the FCA, across a wide range of policy and supervisory matters. Performance against the statutory MoU in place is assessed each quarter, particularly in regard to rulemaking matters. The PRA and the FCA maintained good co-ordination throughout the Covid-19 crisis, and as certain related temporary prudential measures were wound down. There have also been positive interactions with the FCA on a number of other supervisory and policy matters of joint interest, notably on issues regarding Brexit and operational resilience, where information continues to be shared across respective policy and supervisory areas. The PRA and FCA have together successfully delivered the future data collections programme, which migrated all of the firms from the GABRIEL system to the new data collection platform, RegData.

Co-ordination between the PRA and FCA Enforcement areas also continues to work well, with regular meetings to discuss a variety of matters to ensure that a co-ordinated approach is taken to investigations. Similarly, respective authorisations teams have continued to work together to implement enhancements, with the aim of improving the timeliness of authorisation's decision-making.

Firm feedback

The PRA seeks input from firms on the effectiveness and quality of its supervisory framework and approach. One of the ways is through the annual firm feedback survey. The process is overseen by an independent team within the PRA.

81. Prudential Regulation Authority Business Plan 2022/23.

Through the survey, PRA-authorised firms provide feedback on a number of topics, including:

- the PRA's understanding of firms;
- the firms' understanding of PRA regulatory objectives and expectations;
- the PRA's level of challenge to firms;
- the effectiveness of the PRA's relationship with firms; and
- the PRA's co-ordination with other regulators and data requests.

Firms can make additional comments, including suggestions for improvements that the PRA can consider. In 2021, the topical question for firms covered their experience of Covid-19 supervision.

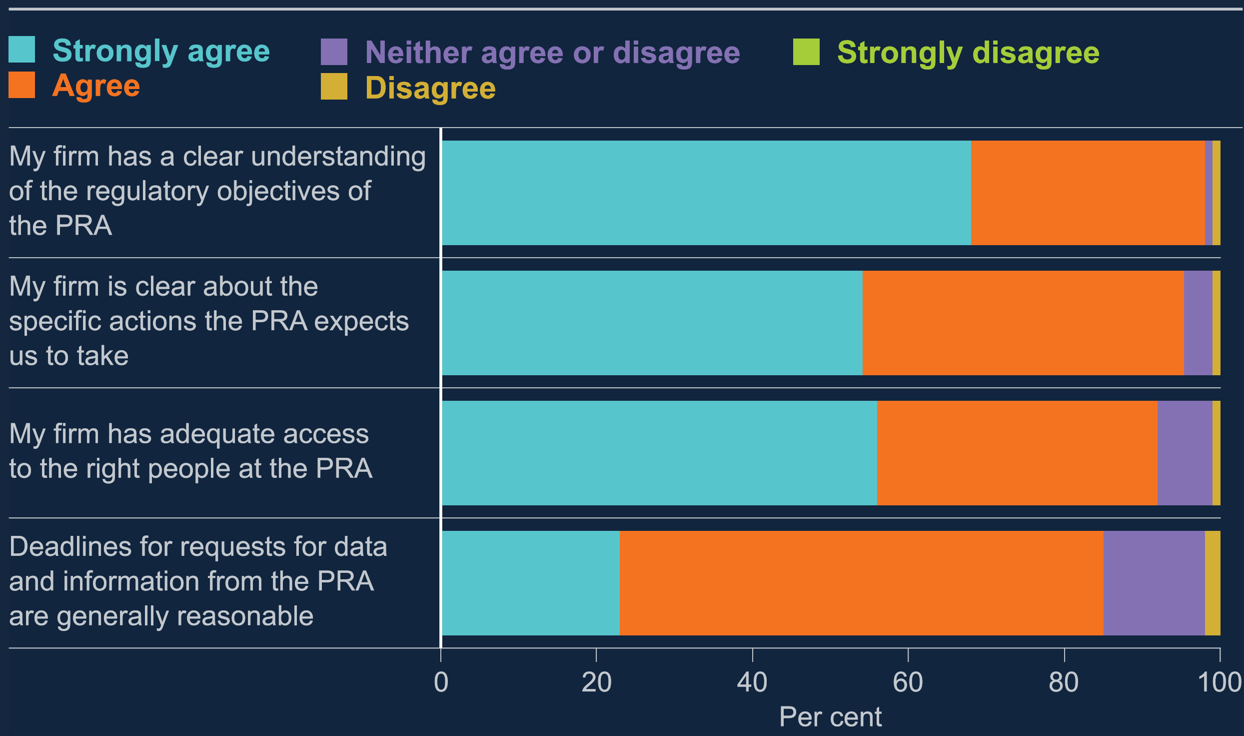
The PRA values firms' participation in the survey, and, as the regulatory landscape evolves, seeks to better understand, both what firms think works well, and what it might do differently. 2021 saw high engagement with the survey, with 196 firms completing it.

Chart 1 shows a selection of the survey results reflecting the type of issues for which the PRA sought an opinion. The full results will be available on the Bank's website.

In 2021, firms largely held positive views about the PRA. Feedback continued to show the effectiveness of supervision had improved across most questions under ongoing Covid-19 conditions. This was also the case in the 2020 survey responses, where firms gave the most positive scores for their understanding of the PRA's objectives and relationship with the PRA.

As in 2020, the least positive scores for 2021 were around co-ordination with other regulatory bodies. The question about the PRA's co-ordination with the FCA for 2021 was 76% favourable, consistent with 2020. When explored further with firms, many responses about co-ordination with the FCA acknowledged that the scores were broadly a reflection of the different functions of the two regulators.

Chart 1: Excerpt from firm feedback survey



Firms said that the PRA's co-ordination with overseas regulators was 55% favourable, a decline from 2020 when it was 67%. This feedback likely reflects the changes since the UK left the EU, together with Covid impacts. The Government's Future Regulatory Framework and the updated PRA Rulebook will help to clarify PRA expectations in future. Continued Covid-19 working conditions are a secondary contributory factor to take into account with these results. Nonetheless, as with 2020, many firms did acknowledge the PRA's co-ordination with other regulators and continued efforts over the course of the pandemic.

Firms also raised concerns about PRA data requests and senior managers regime approval timelines and information channels. Taking this feedback on board, the PRA intends to continue to improve these areas in a number of ways:

- to address firms' comments around delays in the SM&CR application approvals process, where large volumes of applications continue to be received, and for which FCA consent is required. Here, the PRA will continue to work closely with the FCA to improve co-ordination of the review process, including proactive sharing, and increased prioritisation of assessments to help streamline the review process; and

- in order to improve the data request process, the PRA will give more context on the rationale behind data requests and the deadlines for response. The PRA is closely monitoring the number of requests and the burden that they might place on firms. Additionally, the PRA is collaborating with the FCA to expand its data request management information, to create a cross-regulator view, and continue to consider firms' business and reporting cycles.

Following enhancements to the firm feedback process, the updated survey for 2022 will include two questions on accessibility and clarity of new and revised policies post-Brexit. The PRA will also resume targeted follow-up meetings with firms, which were suspended during the pandemic.

Parliamentary accountability

PRA objectives are set by Parliament. These duties to Parliament are taken very seriously, and representatives of the PRA aim to account for its decisions as transparently and clearly as possible. The senior staff of the PRA and PRC members appear in front of parliamentary committees frequently. Between 1 March 2021 and 28 February 2022:

- 26 April 2021, Vicky Saporta, Executive Director, gave evidence to the Treasury Select Committees (TSC) The Future of Financial Services Inquiry.

- 9 June 2021, Tanya Castell appeared before the Treasury Select Committee for an Appointment Hearing.

- 23 June 2021, Sam Woods, Chief Executive, appeared before the Treasury Select Committee to discuss the Work of the PRA.

- 21 February 2022, Vicky Saporta, Executive Director, appeared before the Treasury Select Committee to give evidence to The Future of Financial Services inquiry.

The PRA has also made formal submissions to parliamentary committees in writing, including:

- the Bank's submissions of evidence to the TSC, as part of its inquiry into the Future of Finance.

PRA executives have also engaged with parliamentarians outside of parliamentary committees, including through evidence to All-Party Parliamentary Group inquiries and briefings with parliamentarians on PRA policy. The PRA is committed to carrying out its policymaking role in a transparent way, which helps facilitate scrutiny by Parliament.

Communications: Supporting the PRA's objectives

Communication with industry is an essential part of delivering the PRA's statutory objectives. The PRA communications area covers a wide range of publications, including DPs, consultation papers, policy statements, speeches, and letters to firms.

In October 2021, the PRA communications team supported the PRA's landmark policy publication, using new rulemaking powers granted by Parliament, 'Implementation of Basel standards: final rules'.

Other publications for the reporting period include:

- a number of letters and statements to industry;
- Solvency II policy on the PRA's expectations for the work of external auditors on the matching adjustment;
- final policy statement on operational resilience and outsourcing and third-party risk management;
- policy statement on non-systemic UK banks: the PRA's approach to new and growing firms;
- policy outlining the new RAF;
- policy on the approval of holding companies following CRD V and CRR 2 rules;
- Occasional consultation paper (OCP) on minor policy changes and updates;
- policy statement on regulated fees and levies: rates for 2021/22;
- DP on diversity and inclusion in the financial sector;
- final policy on the internal ratings based approach for UK mortgage risk weights: managing deficiencies in model risk capture;
- policy on insurance holding company definitions and assessments;
- CRR2 final rules;
- final policy on non-performing loan securitisation;

- 2021 Climate Change Adaptation Report;
- material risk taker identification rules;
- monthly PRA Regulatory Digests – one of the PRA's most read publications; and
- further editions of the Financial Services Regulatory Initiatives Forum (FSRIF) Grid, providing industry with a cross-authority view of key regulatory publications and initiatives.

2021/22 policy publications[82] and other publications

- 18 consultation papers
- 29 policy statements
- 5 supervisory statements
- 3 statements of policy
- 15 statements
- 18 letters

Authorisations

The PRA authorised seven new insurers and four new banks in 2021/22. This brings the total number of new UK insurers authorised since the creation of the PRA to 44, and the total number of new banks to 69, of which 30 are de novo UK banks. One new authorisation application was closed outside of the statutory service standard due to the specifics of the case.

The PRA approved 989 applications for senior management functions, and 69 changes in control of authorised firms. To address delays in the SM&CR application approvals process, the PRA continued to work closely with the FCA to support timely processing of applications within the statutory deadline.

The PRA dealt with 231 variations and cancellations of Part 4A permissions, and 763 applications relating to waivers and modifications of PRA rules, and to permissions regarding models, capital exposures and other issues.

82. Available at: www.bankofengland.co.uk/prudential-regulation/policy.

The 265 EU banks and insurers that entered the TPR as a result of the UK leaving the EU must seek and receive approval before the end of 2023 if they want to continue doing business in the UK. Over the course of 2021/22, the PRA approved 11 banks and 11 insurers that were in the TPR, and as of end-February 2022 a further 35 applications from banks and 84 from insurers had been received, with this work progressing on schedule.

In accordance with the new requirements under Part 12B FSMA for UK Financial Holding Companies and Mixed Financial Holding Companies, the PRA approved 34 Financial Holding Companies, with another nine granted an exemption from the requirement to be approved.

Complying with FSMA

This section covers a number of issues that the PRA takes into account when carrying out its duties, or other areas on which it reports.

These include:

- complying with FSMA;
- complying with the regulators' code and principles;
- the PRA's complaints scheme;
- details of how the PRA has used the provisions of section 166 of FSMA; and
- sections 339A and 339B of FSMA relating to firms' auditors.

Complying with FSMA

In carrying out its functions during the reporting period, the PRA was required to, so far as was reasonably possible: (i) act in a way which advances its general objective to promote the safety and soundness of PRA-authorised persons; and (ii) specifically for insurers, act in a way which contributes to the securing of an appropriate degree of protection for those who are or may become policyholders (sections 2B and 2C of FSMA). This report sets out how the PRA has discharged its functions and the extent to which, in its opinion, the objectives have been advanced. Section 3B of FSMA sets out a number of regulatory principles to which the PRA must have regard (under section 2H(2) of FSMA) in discharging its general functions. These are the:

- need to use resources in discharging the PRA's general functions in the most efficient and economical way;
- 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;
- desirability of sustainable growth in the economy of the UK in the medium or long term;

- general principle that consumers should take responsibility for their decisions;
- responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements;
- desirability, where appropriate, of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of persons such as mutual societies and other kinds of business organisations) subject to requirements imposed by or under FSMA;
- desirability in appropriate cases of publishing information relating to persons on whom requirements are imposed by or under FSMA, or requiring such persons to publish information, as a means of contributing to the advancement by the PRA of its objectives; and
- principle that the PRA should exercise its functions as transparently as possible.

The PRA has taken these principles into consideration when carrying out its functions, including when making policy.

Furthermore, in carrying out its functions during the reporting period, the PRA was required to, so far as was reasonably possible, act in a way which facilitated effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities (section 2H(1) of FSMA). There are several examples of how meeting this requirement was achieved in the PRA Annual Competition Report on pages 66–81.

Details of how the PRA has met its duty to consult (under section 2L of FSMA) and considered any representations made (under section 2N of FSMA) can be found on pages 54–55, which also explains how the PRA engages with firms more generally. These arrangements include the establishment and maintenance of the PRA Practitioner Panel (Panel) under section 2M of FSMA. The Panel is an independent body representing the interests of practitioners in the financial services industry. It plays an important role in PRA policymaking by providing appropriate challenge and scrutiny. The Panel also considers items from other directorates within the Bank that have policies with potential prudential impact.

The Panel met six times in 2021/22, providing input into policy at different stages of development – from practical insights to implementation, to proposals under consultation, to early stage policy development. The Panel provided the PRC and senior management from across the PRA and the Bank feedback on topics such as HMT's consultation on the FRF, the PRA's 'strong and simple' project, the PRA's index of prudential and resolution policies, and diversity and inclusion in the financial sector.

The Practitioner Panel Insurance Sub-Committee met three times during the 2021/22 reporting period. It provided input to the PRA's review of Solvency II including ease of entry for the UK insurance market and resolvability and ease of exit of insurers.

The PRA and FCA have a duty to ensure a co-ordinated exercise of functions and to maintain a Memorandum of Understanding (MoU) describing how they intend to comply with that duty (under sections 3D and 3E of FSMA respectively). Details of how this has been managed effectively are covered on page 50.

The PRA has the power to require the FCA to refrain from taking certain actions, specified under section 3I of FSMA, or to give a direction to the FCA in relation to with-profits policies (section 3J of FSMA). The PRA did not exercise this power during 2021/22.

Section 354B of FSMA outlines the PRA's duty to co-operate with other persons (whether in the UK or elsewhere) who have functions similar to the PRA, or have functions relevant to financial stability. Details of how the PRA has complied with this duty are throughout this report and in particular on page 25.

Regulators' code and principles

In accordance with sections 21 and 22 of the Legislative and Regulatory Reform Act 2006 and the Legislative and Regulatory Reform (Regulatory Functions) Order 2007, the PRA, when exercising its functions, is required to have regard to the following Regulators' Principles and Code.

Regulators' principles

- Regulatory activities should be carried out in a way that is transparent, accountable, proportionate, and consistent.

- Regulatory activities should be targeted only at cases in which action is needed.

Regulators' code

- Regulators should carry out their activities in a way that supports those they regulate to comply and grow.

- Regulators should provide simple and straightforward ways to engage with those they regulate and hear their views.
- Regulators should base their regulatory activities on risk.
- Regulators should share information about compliance and risk.
- Regulators should ensure clear information, guidance, and advice is available to help those they regulate meet their responsibilities to comply.
- Regulators should ensure that their approach to their regulatory activities is transparent – including publishing, on a regular basis, details of their performance against their service standards, including feedback received from those they regulate and data relating to complaints about them. Details of firm feedback are set out below; details of complaints are set out below; and the PRA's statutory authorisations performance report is published on the Bank's website.[83]

PRA's complaints scheme

As part of the statutory Complaints Scheme (under Part 6 of the Financial Services Act 2012), the PRA is responsible for ensuring formal complaints against us are dealt with in an efficient and effective manner. During the reporting period the PRA received six formal complaints, all of which were concluded during the reporting period. Details of the Complaints Commissioner's decisions are/will be available on the Commissioner's website.[84]

During the reporting year the PRA completed a review and update of the PRA complaints website and Complaints Scheme accessibility, which included making changes to its website to make it clearer and improved signposting for users towards reasonable adjustments the PRA can make for complainants who might experience barriers to using its service.

Section 166 reports by skilled persons[85]

Section 166 (s166) of FSMA provides a regulatory tool which gives the PRA powers to obtain an independent expert review of aspects of a regulated firm's activities. Such reviews can be undertaken to seek additional information, further analysis, expert advice and recommendations, or assurance around a particular subject.

83. Available at: **www.bankofengland.co.uk/prudential-regulation/authorisations**.
84. The Financial Regulators Complaints Commissioner: **https://frccommissioner.org.uk/final-reports/pra-the-prudential-regulation-authority/**.
85. Including s166a reports by skilled persons.

In 2021/22, the PRA commissioned 27 reviews by skilled persons (2020/21: 17 reviews), including three (2020/21: 2 reviews) contracted directly with the skilled person.

The reviews fell within the areas shown in Table A. In 2021/22, there were five reviews of firms' regulatory reporting (2020/21: nil reviews), two under Lot C (controls and risk management) and three under Lot F (prudential risks for deposit-takers, clearing houses and designated investment firms). These were commissioned following a letter to CEOs, of 10 September 2021, on thematic findings on the reliability of regulatory reporting.

Table A: Section 166 reviews by areas of focus

Lot[(a)]	Total for 2020/21	Total for 2021/22
Lot B: Governance and individual accountability	4	–
Lot C: Controls and risk management frameworks	7	18
Lot F: Prudential – deposit-takers, recognised clearing houses and PRA-designated investment firms	3	7
Lot G: Prudential – insurance	3	2
Total	**17**	**27**

(a) A detailed description of the services provided under each lot can be found on the PRA's website: www.bankofengland.co.uk/prudential-regulation/supervision.

The total estimated cost[86] of s166 reviews commissioned in 2021/22 was £26.4 million (2020/21: £4.7 million), of which the cost per review ranged from £69,000 to £12 million (2020/21: £57,000 to £1.0 million).[87] Of this total, the estimated cost of the three reviews contracted directly with the skilled persons was £0.9 million[88] (2020/21: two, at a cost of £1.3 million). The estimated cost of the reviews commissioned in 2021/22 on regulatory reporting was £18.0 million (2020/21: nil).

Meeting with auditors

Under section 339A(2) of FSMA, the PRA is required to issue and maintain a code of practice that includes arrangements on the: (i) sharing of information (that the PRA is not prevented from disclosing) with auditors of PRA-authorised persons; and (ii) exchange of opinions with

86. Section 166(9) FSMA 2000 and rules 4.16 and 4.17 of the Fees Part of the PRA Rulebook.
87. The costs disclosed include actual costs incurred by the firms, or an estimate where the review is ongoing and the actual costs are not yet available. The comparative figures have been revised to reflect the actual costs incurred for reviews commissioned in 2021/22 and those completed in 2021/22. One review commissioned in 2020/21 is ongoing, and the reported costs for this review remains as an estimate.
88. Costs of directly contracted s166 reviews include VAT.

auditors of PRA-authorised persons. The PRA published SS7/13 ‘The relationship between the auditor and the supervisor: a code of practice’ (the Code) in April 2013. Section 339B(2) of FSMA states that it must make arrangements for meetings to take place at least once a year with the external auditor of any PRA-authorised person to which section 339C of FSMA applies. Thirty-five firms (2020/21: 35) fell within the scope during the reporting period, and the PRA held 61 meetings (2020/21: 62) with the auditors of these firms. At least one meeting with the auditor of each such firm was held during the reporting period. The PRA looks to auditors to contribute to effective supervision by directly engaging with the PRA in a proactive and constructive way. The PRC is updated annually on the quality of the relationship between auditors and supervisors. For the period ending 28 February 2021, the PRC was presented with the results of a survey of supervisors. A significant majority of those surveyed were satisfied with their auditor-supervisor relationship.

Structural reform – ring-fencing

Ring-fencing has been in effect since 1 January 2019. It requires UK banking groups with more than £25 billion of core deposits to ensure the provision of core services (broadly, facilities for accepting core retail deposits, and payments and overdrafts relating to core retail deposit accounts) is separate from certain other activities within their groups, such as investment and international banking.[89] As at 1 January 2022, the following UK banking groups are in scope of ring-fencing, and contain at least one ring-fenced body (RFB): Barclays, HSBC, Lloyds Banking Group, NatWest Group, Santander UK, TSB, and Virgin Money.[90]

The PRA’s activity relating to ring-fencing advances its general safety and soundness objective. The PRA is required to discharge its functions in a way that seeks (among other things) to:

- ensure that the business of RFBs is carried on in a way that avoids any adverse effect on the continuity of the provision in the UK of core services;
- ensure that the business of RFBs is protected from risks (arising in the UK or elsewhere) that could adversely affect the continuity of the provision in the UK of core services; and
- minimise the risk that the failure of an RFB or of a member of an RFB’s group could affect the continuity of the provision in the UK of core services.

89. The requirement for large UK banking groups to ring-fence their core services is set out in FSMA 2000 (as amended by the Financial Services (Banking Reform) Act 2013).
90. Key information and materials relating to ring-fencing, including the list of RFBs, is available on our dedicated webpage: **www.bankofengland.co.uk/prudential-regulation/key-initiatives/ring-fencing**.

Paragraph 19(1A) of Schedule 1ZB of FSMA requires the PRA to report in its Annual Report, in general terms, on certain aspects of ring-fencing, including: the extent to which, in the PRA's opinion, RFBs have complied with ring-fencing provisions; the steps taken by RFBs to comply with ring-fencing provisions; the steps the PRA has taken to enforce ring-fencing provisions; the extent to which RFBs are carrying on activities that would be excluded or prohibited but for an exception or exemption in the legislation; and the extent to which RFBs appear to have acted in accordance with the PRA's guidance relating to the operation of the ring-fencing provisions.

The legislation specifies the activities that must be conducted by RFBs, as well as the activities RFBs are prohibited from undertaking. Any activities falling outside those two categories – for example taking deposits from large corporates, or mortgage and credit card lending – can be carried out from either side of the ring-fence ('permitted business'). Banking groups chose to structure their groups in different ways, reflecting their current operations and preferred business strategies. As a result, some groups placed almost all permitted business within the ring-fence, while some others chose to locate significant proportions of their permitted business outside of the ring-fence. Over the previous year, the structure of most firms' RFB sub-groups remained largely the same. Firms have generally complied with the PRA's group structure policy set out in SS8/16[91] and the PRA has not identified any major concerns.

The focus for the 2021/22 reporting period has been on ensuring the ring-fencing arrangements established by firms continue to be effective and are well-embedded. The PRA has continued to assess the effectiveness of RFBs' governance structures and risk management arrangements, including in relation to ring-fencing provisions.

Ring-fencing provisions are numerous, detailed, and wide-ranging, touching on many aspects of the operations of the banks subject to them. Over the past year, firms have continued to take measures to ensure ongoing compliance with ring-fencing provisions and guidance issued by the PRA. This has included firms undertaking internal reviews, consideration of the ring-fencing implications of changes and initiatives (particularly in relation to changes in the structure of firms and interaction with other entities in their banking groups), and improvements to compliance monitoring. During this reporting period, RFBs for the most part complied with the individual ring-fencing provisions and associated guidance, but the PRA has been notified of a limited number of instances of non-compliance. These were mostly of low materiality, and none were classed as severe. In all such cases, the firms took steps to resolve breaches immediately, or took other action, including putting remediation plans in

91. 'Ring-fenced bodies (RFBs)', December 2017: **www.bankofengland.co.uk/prudential-regulation/publication/2016/ring-fenced-bodies-ss**.

place. The PRA has not taken any enforcement action in respect of the ring-fencing provisions in the past year.[92]

An important development this year was the publication of an independent report[93] reviewing ring-fencing and proprietary trading in March 2022. This review, required by the Financial Services (Banking Reform) Act 2013, focused on the operation of the legislation relating to ring-fencing regime. The review Panel concluded that ring-fencing, together with other reforms made in response to the 2008–09 global financial crisis, has contributed to the financial stability in UK retail banking sector. The Panel made a number of recommendations for authorities to consider, which aim to improve the functioning of the regime while maintaining financial stability benefits. Following the report publication, HMT established a task force, together with the Bank, to inform the Government's response to the recommendations. The PRA will work closely with HMT, to examine the recommendations, and assist the Government in implementing any changes that they and Parliament may make.

Use of exceptions

The activities of RFBs are restricted by ring-fencing legislation and PRA rules. For example, the legislation prohibits RFBs from carrying on 'excluded activities' and contains certain 'prohibitions', including:

- dealing in investments or commodities as principal;
- incurring exposures to relevant financial institutions (RFIs);
- accessing payment systems indirectly; and
- maintaining or establishing a branch or subsidiary in a country or territory which is not the UK or an EEA Member State.

The legislation also sets out certain permitted exceptions and exemptions to these 'excluded activities' and 'prohibitions' to allow RFBs to carry out activities which they would otherwise be prohibited from undertaking. These exceptions and exemptions aim to allow RFBs to undertake activities typical for a retail and commercial bank, such as 'dealing in investments as principal' for risk management purposes, collateral management, selling simple derivatives

92. For information on the use of the PRA's statutory powers see **www.bankofengland.co.uk/prudential-regulation/pra-statutory-powers**.
93. Independent Panel on Ring-fencing and Proprietary Trading – Final HMT Report: **www.gov.uk/government/publications/independent-panel-on-ring-fencing-and-proprietary-trading-final-report**.

to its account holders subject to conditions,[94] transactions with central banks, and managing pension liabilities.

PRA rules require an RFB to have policies in place that specify in detail the circumstances in which it will make use of exceptions 'exceptions policies'. The PRA assesses RFBs' use of exceptions through ongoing supervisory engagement, regulatory reports, and by undertaking reviews of RFBs' exceptions policies. This informs the PRA of the extent to which RFBs undertook activities that would be excluded or prohibited, but for an exception or exemption in the legislation.

Overall, the information reviewed suggests that firms' use of exceptions is consistent with the objectives of the ring-fencing regime, and that firms have not taken risk positions that exceed the risk limits set out in the legislation.

The legislation includes exceptions to permit RFBs to deal in investments as principal or to incur exposures to RFIs where the sole or main purpose of the associated transaction is to hedge risks. All firms used this exception. The vast majority (more than 90%) of the hedging exceptions used by RFBs were those relating to hedging changes in interest rates. The remainder of the hedging exceptions (less than 10%) were mainly used to hedge changes in exchange rates. The relatively higher use of the exception for interest rate hedging is in line with the PRA's expectations, as this type of hedging is a prominent risk management activity for many retail banks. Exposures to RFIs related to hedging were relatively small compared to firms' capital bases.

The exceptions not related to hedging, such as for customer derivatives, own securitisations and covered bonds, trade finance, conduit lending, infrastructure finance, and ancillary exposures, were used by most RFBs to varying degrees. The use of these exceptions was within any applicable limits and consistent with the RFBs' business models. For example, the exception permitting RFBs to sell simple derivatives to its account holders was used by five of the seven RFB sub-groups, with a relatively low value of related exposures, which were within the limits defined in ring-fencing legislation.

The exceptions and exemptions related to other prohibitions were mainly used to a small extent. RFBs were also generally direct participants in the main UK payment systems that they used, and where those payment systems were accessed indirectly, this was often through another RFB in the same group.

94. The conditions are set out in Article 12 of the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014/2080 (EAPO).

Annual Competition Report – June 2022

This is the seventh Annual Competition Report (ACR),[95] marking the eighth year since the secondary competition objective (SCO) came into force on 1 March 2014. The PRA produces the ACR to meet the Government's request for an annual report setting out how it is delivering against our SCO.[96] The SCO, as set out in the Financial Services and Markets Act 2000 (FSMA), states that:

'When discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities'.

The SCO applies to the exercise of the PRA's general functions. The general functions are the functions of making rules under FSMA, making technical standards under FSMA, preparing and issuing codes under FSMA, and determining the general policy and principles by reference to which the PRA performs particular functions under FSMA. As the PRA's rulemaking functions include revoking, amending, and re-making any existing rules, the SCO is engaged when the PRA revisits and reviews its existing stock of rules as well as when making new rules. The SCO is also engaged where the PRA determines and revises general policy, such as its policy on the authorisation of firms and on the setting of capital guidance.

The SCO does not require the PRA to act in a manner that is incompatible with its primary objectives. In many cases, the PRA's primary and secondary objectives will be aligned. The SCO does not mean that the PRA is a 'competition regulator'. This role falls to the concurrent competition regulators for financial services – the Competition and Markets Authority (CMA), the FCA, and the Payment Systems Regulator (PSR). The PRA's responsibility for facilitating effective competition is distinct from, but complementary to, these authorities' responsibilities to promote competition.

95. The Annual Competition Report (ACR) has been produced in response to a request from the Government included in HM Treasury's 2015 Productivity Plan 'Fixing the foundations: creating a more prosperous nation', and that the PRA should publish an annual report setting out how it is delivering against its secondary competition objective (SCO) and, in particular, 'the steps being taken to drive more competition and innovation in financial services markets and to help ensure that the right incentives exist for new banks to enter the market'. All versions of the ACR are available on the Bank's website: **www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective**.

96. The rationale for the SCO, how the PRA interprets it, and what the SCO means for the PRA's regulation of banks and insurers is set out in the Bank of England's Quarterly Bulletin article, 'The Prudential Regulation Authority's secondary competition objective', December 2015: **www.bankofengland.co.uk/quarterly-bulletin/2015/q4/the-pra-secondary-competition-objective**.

With respect to the retail banking sector, both the CMA in 2016,[97] and the FCA in 2018[98] concluded that the main competition issue lies in the fact that large deposit-takers benefit from a cost of funding advantage over smaller rivals thanks to their large personal current account (PCA) customer bases. Weak competition in PCAs and low levels of customer engagement constituted the main barrier to entry and expansion. To address this issue, the CMA and FCA have implemented a number of remedies, most notably with the launch of Open Banking by the CMA.

In January 2022,[99] the FCA concluded that some of the historical advantages of large banks may be starting to weaken through innovation, digitalisation, and changing consumer behaviour. Collectively, digital challengers now have around 8% market share for PCAs. Larger banks have adopted digital innovation in PCA banking – led by digital challengers – and this has improved service quality for many consumers.

Those digital challengers are among the cohort of 30 new UK banks authorised by the PRA since 2013. As of the end of February, there are six active applications and a similar number of firms expected to apply in the foreseeable future. Similarly, as at end-February 2022, the PRA authorised 23 new insurers and seven insurance special purpose vehicles (ISPVs, the vehicles central to the Insurance Linked Securities market) since 2013, and there is one active application and four more expected to apply in the foreseeable future, some of which with a tech-driven business model.

The PRA updated its previous research on measuring competition in the UK deposit-taking sector which is discussed in the box 'ACR1: Update on our measures of competition in the UK deposit-taking sector'.

Besides the low engagement of retail depositors, the CMA also raised concerns about the gap in capital requirements arising between the standardised approach (SA) and the internal rating based (IRB) approach for credit risk weights, in particular with respect to low loan to value (LTV) residential mortgages which are among the safest of exposures. In response, the PRA stated its commitment to continue work to narrow the gap between capital requirements based on SA and those based on IRB models.

97. Retail Banking Market Investigation Final Report, 2016, CMA: **https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf**.
98. Strategic Review of Retail Banking Business Models Final Report, 2018, FCA: **www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report.pdf**.
99. Strategic Review of Retail Banking Business Models – Final Report, 2022, FCA: **www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf**.

The PRA has sought to do this through a number of initiatives, for example, by making it easier for small firms to adopt IRB models. In this respect, the PRA approved IRB permissions for three additional firms over the last four years, increasing the total number of IRB permissions to 19. As of the end of February, there are seven firms at different stages in the IRB application pipeline, which consists of four active applications and three in the pre-engagement phase.

The PRA has also refined its methodology to the calculation of variable capital add-ons (ie P2A requirements) in order to reduce them for firms using the SA for credit risk. This is to ensure the total amount of a firm's capital does not exceed the amount necessary to ensure the sound coverage of risks. As of February, 42 firms have benefited from a reduction to their Pillar 2A add-ons, with an average adjustment of 1.55% of risk-weighted assets. Bank research suggests that this policy measure has been effective in increasing competition between SA and IRB firms in the low-risk mortgage market segment. Firms eligible for Pillar 2A capital deductions increased their propensity to lend at below 60% LTV by about 19%, which resulted in a decrease in the average LTV of mortgage originations of about 7.2 percentage points – relative to firms that are ineligible – following the publication of the policy statement. This suggests that the policy has improved non-IRB firms' ability to compete in this part of the mortgage market.

Finally, as explained in more detail later in this report, the PRA recently finalised supervisory expectations on the minimum level of IRB UK mortgage risk weights.

Looking forward, now that the UK has left the EU, the SCO will play an important role in light of the opportunity to ensure the prudential regulatory approach is appropriate for the UK market. The next section sets out key policy areas in which the PRA has delivered against its SCO by facilitating effective competition since the publication of last year's ACR.

ACR1: Update on our measures of competition in the UK deposit-taking sector

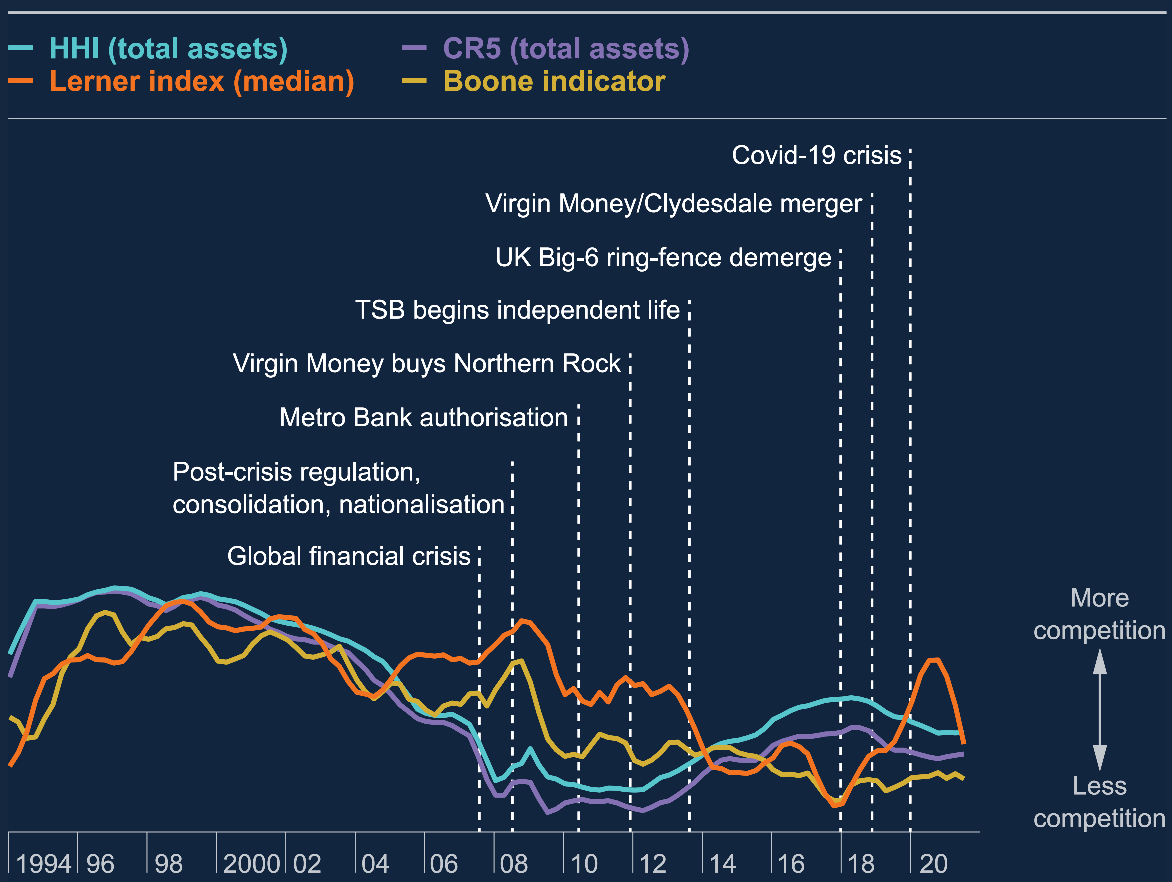
In the 2020 Annual Competition Report, the PRA set out its competition measures for markets in which UK banks and building societies (collectively ‘deposit-takers’) compete. This box provides updated measures of competition for the sector.

In Chart A, the PRA compares and contrasts four measures that provide different perspectives on competition and concentration in the deposit-taking sector: the Lerner index, a measure of price-cost margins, and hence market power; the Boone indicator, which is a measure of competition intensity; and the Herfindahl-Hirschman index (HHI) and five-firm concentration index (CR5), which are both measures of market structure/ concentration.

Competition intensity, market power and concentration all stabilised around the mid-2010s at levels generally indicating less competition than in the 1990s and early 2000s. From 2018, competition intensity improved (Boone indicator) and market power (Lerner index) declined after the separation of ring-fenced banks, followed by consolidation leading to more concentration (CR5, HHI). Deposit-takers’ margins (Lerner index) improved on average since the onset of the Covid-19 crisis, which could be the result of a reduction in the cost of funding thanks to lower rates,[100] while competition intensity (Boone indicator) and market concentration (CR5, HHI) remain broadly unchanged.

100. Specifically, the improvement in margins is driven by the fact that smaller and medium-sized lenders had more scope to reduce their cost of funding by lowering their deposit rates, in response to the reductions in the base rate, by more than the largest deposit-takers could do (as their rates were already close to the zero lower bound). This is consistent with the FCA findings on cost of retail funding: see Strategic Review of Retail Banking Business Models – Annexes to the Final Report, 2022, FCA, Figure 1.4 at page 9, **www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-annexes-final-report-2022.pdf**.

Chart A: UK bank competition indices[a]



(a) Data from Bank of England individual bank solo-consolidated Historical Banking Regulatory data set, 2022 revision. For more information on the data set, see e-Ramon, S, Francis, W and Milonas, K (2017), 'An overview of the UK banking sector since the Basel Accord: insights from a new regulatory database', Bank of England Staff Working Paper No. 652: **www.bankofengland.co.uk/working-paper/2017/an-overview-of-the-uk-banking-sector-since-the-basel-accord%20insights-from-a-new-regulatory-database**. All indices are normalised between 0 and 1 over the period for comparison, with higher values indicating more competition. Indices estimated from quarterly data are presented as annual averages. CR5 is an index of the market share from the five largest UK regulated banks. HHI is the Herfindahl-Hirschman index of market concentration of total assets. Boone indicator is a measure of competition based on an assessment of the profitability of competing banks against their efficiency. Lerner index is a measure of price competition in banking services. A detailed methodology to calculate the indices is described in de-Ramon, S and Straughan, M (2020), 'The evolution of competition in the UK deposit-taking sector, 1989–2013', European Journal of Finance, Volume 26: **www.tandfonline.com/doi/abs/10.1080/1351847X.2019.1574270**.

Application of the secondary competition objective in the PRA's work

It has been another challenging year for the PRA, with the ongoing Covid-19 pandemic in addition to implications of the UK's exit from the EU. As with the previous year, the PRA has had to delay some supervision and policy initiatives, and research outputs, to support the ongoing responses to these issues.

This section of the ACR provides an update on key policy and supervisory decisions taken to deliver against the SCO, as set out in the PRA's Business Plan 2021/22. The focus of these initiatives that deliver particularly against the SCO are:

- finalising supervisory expectations on the minimum level of internal ratings based (IRB) UK mortgage risk weights;
- reviewing the leverage ratio;
- developing the 'strong and simple' regime for non-systemic banks and building societies (see Box ACR2);
- reviewing Solvency II to tailor it better for the UK market (Phase 1), including:
  - a more proportionate approach to reporting requirements;
  - considering how the PRA might design and implement a 'mobilisation' phase for insurers.
- implementing some of the remaining Basel III standards, with enhanced proportionality for smaller firms;
- implementing a new approach to operational resilience and impact tolerances for important business services in a proportionate manner;
- modernising the framework on outsourcing and third-party risk management;
- finalising updates on operational continuity in resolution (OCIR), drawing on the experiences of small firms implementation of OCIR; and
- conducting further analysis on the complexity of the PRA Rulebook for banks and building societies, to identify aspects that could be simplified.

Finalising supervisory expectations on minimum level of IRB UK mortgage risk weights

In July 2021, the PRA set out its final policy on minimum expectations for IRB UK mortgage risk weights.[101] As explained previously, low IRB risk weights for mortgages, as well as being of prudential concern, can also be a source of competitive imbalance. Some IRB risk weights can be much lower than the equivalent SA risk weight for a similar mortgage. This means that a key funding cost for those mortgages (capital) can be considerably lower for some firms with IRB modelling permission than for SA firms. Moreover, the firms with IRB modelling permission are among the UK's largest, while those firms which use SA are typically much smaller.

The PRA decided to introduce an average IRB mortgage portfolio risk weight of 10% from 1 January 2022.[102] This will set an expectation that average IRB mortgage risk weights do not fall below this level, which will limit the competitive advantage that IRB firms have over smaller firms using the standardised approach. In addition to the implemented average portfolio risk weight, the PRA will consider carefully the calibration of probability of default (PD) and loss given default (LGD) parameter floors for mortgage exposures introduced as part of the UK's implementation of the Basel 3.1 standards, and the possible impact on competition.

Reviewing the leverage ratio

In 2021, the Bank's FPC and PRA reviewed the UK leverage ratio framework.[103] One of the outcomes of their reviews was an extension of the scope of application of the minimum leverage ratio requirement to include firms with significant non-UK assets in addition to major UK firms which were already in scope, and certain holding companies approved or designated by the PRA. The FPC and PRA considered applying the leverage ratio to a wider scope of firms, and concluded that the competition implications would be considerable. If the leverage ratio were applied as a requirement to smaller firms, it may have a negative impact on competition in the markets supplied by these firms, including because of a possible interaction with the MREL framework. If the interaction with the MREL framework were to result in a requirement to meet additional MREL for these smaller firms, it is likely that smaller

101. CP14/20, 'Internal Ratings Based UK mortgage risk weights: Managing deficiencies in model risk capture', September 2020: **www.bankofengland.co.uk/prudential-regulation/publication/2020/internal-ratings-based-uk-mortgage-risk-weights-managing-deficiencies-in-model-risk-capture**.
102. PS16/21, 'Internal Rating Based UK mortgage risk weights: Managing deficiencies in model risk capture', July 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2020/internal-ratings-based-uk-mortgage-risk-weights-managing-deficiencies-in-model-risk-capture**.
103. CP14/21, 'The UK leverage ratio framework', June 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework**.

firms would need to meet the additional MREL requirements with more costly CET1 capital due to challenges related to the type of capital or term debt instruments they can issue in markets. Larger firms are more likely to be able to issue (cheaper) Additional Tier 1 (AT1) and eligible liabilities (EL) instruments. The PRA instead implemented a leverage ratio supervisory expectation for smaller firms to mitigate any impact on them and on competition.[104]

Last year's ACR described how the PRA started considering ways the prudential framework could be changed for those banks and building societies that are neither systemically important nor internationally active, to simplify prudential regulation for those firms. The box 'ACR2: 'Strong and simple' regime' provides an update.

104. PS21/21, 'The UK leverage ratio framework', October 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework**.

ACR2: 'Strong and simple' regime

In April 2021, the PRA published a Discussion Paper (DP) on a 'strong and simple' framework for non-systemic and domestic banks and building societies (firms).[105] This explored the potential to develop a new and simpler prudential framework for those firms, consisting of a number of 'layers' tailored to firm size and business model complexity. The objective of the framework would be to maintain the resilience of those firms in scope, and of the wider UK financial sector, while using simplified prudential regulation, thereby enabling a dynamic and diverse banking sector in the UK. Simplifying the prudential regime would aim to address the adverse impact for smaller firms arising from the higher relative costs they face in assimilating and complying with complex regulation compared with their larger competitors. In designing a new prudential framework, the PRA would seek to minimise additional barriers to growth for expanding businesses.

The DP sought comments on a variety of suggestions for how a framework could be designed. The PRA also engaged in a number of stakeholder meetings after publication to understand the background to comments. In December 2021, the PRA published a feedback statement summarising the responses received from 44 respondents, and drawing out broad themes for further debate.[106] The feedback statement was subsequently discussed with the PRA Practitioner Panel.

Overall, the majority of respondents were supportive of the long-term vision for a 'strong and simple' prudential framework where prudential requirements expand and become more sophisticated as the size and/or complexity of firms increase, and accepted the idea of achieving the vision by having a small number of layered prudential regimes. There was acceptance too of the merits of starting with the 'simpler regime' layer for smaller firms, but with a desire for more information about the overall design of the 'strong and simple' framework within which it would sit.

The DP set out a spectrum of potential ways to develop new prudential requirements specifically for small firms. These ranged from a 'streamlined' approach (ie taking the existing prudential framework as a starting point and modifying those elements that appear to be over complex for smaller firms) through to a 'focused' approach (ie

105. DP1/21, 'A strong and simple framework for non-systemic banks and building societies', April 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks**.
106. FS1/21 'Responses to DP1/21 'A strong and simple prudential framework for non-systemic banks and building societies': **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks**.

adopting a narrower but more conservatively calibrated set of new prudential requirements). The preference of most respondents was for a more 'streamlined' approach, which reflected concerns that a conservatively calibrated focused regime could result in increased capital requirements, as well as create higher barriers to growth for those firms that wish to do so.

The PRA published a CP in April 2022[107] on the criteria to determine which firms should fall within scope of the first 'simpler regime' layer for smaller firms. The aim is to deliver a 'strong and simple' framework as soon as possible for those non-systemic firms whose safety and soundness can be maintained while significantly simplifying their prudential requirements. In order to maintain the simplicity and robustness of the regime, its focus will be on firms that provide mainstream retail and commercial banking services – including both deposit-taking and lending – to households and firms in the UK.

The PRA's intention is to use the 'simpler regime' criteria in determining the scope of application of forthcoming Basel 3.1 reforms, and of a set of meaningful simplifications to prudential regulations that will be the subject of consultations later in 2022 and in 2023. The PRA plans to undertake further engagement with stakeholders and remains open to further discussion with interested parties about the shape of the 'strong and simple' framework.

107. CP5/22, 'The Strong and Simple Framework: a definition of a Simpler-regime Firm', April 2022: www.bankofengland.co.uk/prudential-regulation/publication/2022/april/definition-of-a-simpler-regime-firm.

Reviewing Solvency II to tailor it better for the UK market (Phase 1) – reporting changes

In December 2021, the PRA finalised Phase 1 changes to the Solvency II reporting requirements and expectations.[108] The changes were developed in line with recommendations from HMT's review of Solvency II.[109] The removal of certain reporting requirements reduces costs and leads to better utilisation of resources for firms. The amendments to the relevant supervisory statements also aided firms in their compliance with the PRA's reporting requirements, reducing the likelihood of erroneous reporting and associated costs of remediation, and contributing positively to the facilitation of effective competition in the insurance sector.

In addition to these changes to the reporting requirements, in September 2021, the PRA proposed to update the definition of insurance holding companies.[110] The proposals will clarify the PRA's expectations on the information required from firms in order to distinguish an insurance holding company from a mixed-activity insurance holding company. Insurance holding companies are subject to a different scope of group supervision than mixed-activity insurance holding companies. In doing so, the PRA will be able to uphold consistency in its supervisory treatment of comparable holding companies, regardless of how they are structured. The reduction of regulatory costs for firms, and consistency in the PRA's supervisory treatment of comparable holding companies will help facility effective competition.

Reviewing Solvency II to tailor it better for the UK market (Phase 1) – a 'mobilisation' phase for insurers

The PRA has continued work on designing a mobilisation regime for new insurers, as part of the wider joint review of Solvency II being undertaken with HMT. Such a regime would offer eligible new insurers more time to meet certain Solvency II requirements, in exchange for a temporary restriction on the insurance activities they may conduct while in the mobilisation phase. The regime would be informed by the PRA's existing mobilisation regime for new banks, carefully modified to reflect the particularities of insurance business models and regulations. The intention is that a mobilisation regime could help address some of the

108. PS29/21, 'Review of Solvency II: Reporting (Phase 1)', December 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/review-of-solvency-ii-reporting-phase-1**.
109. HM Treasury, 'Review of Solvency II: Call for Evidence', October 2020: **www.gov.uk/government/publications/solvency-ii-review-call-for-evidence**.
110. CP17/21, 'Solvency II: Definition of an insurance holding company', September 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/september/solvency-ii-definition-of-an-insurance-holding-company**.

regulatory challenges facing entrants, while limiting risks to the PRA's objectives, including the insurance-specific objective on policyholder protection. This will help encourage entry into insurance markets and facilitate effective competition in the sector. The PRA will be consulting on the proposed regime in due course.

Implementing some of the remaining Basel III standards, with enhanced proportionality

The Basel III framework is a central element of the Basel Committee on Banking Supervision's (BCBS) response to the financial crisis.[111] In July 2021, the PRA finalised requirements to implement some of the remaining Basel III standards in the UK.[112] The requirements included: revisions to the definition of capital and standards for prudent valuation for market risk; revised standards for calculating exposures under the standardised approach, including a new standardised approach to counterparty credit risk (SA-CCR); and revised framework for exposures to central counterparties, and implementation of the Liquidity Coverage Ratio (LCR) and net stable funding ratio (NSFR)

Alongside these changes, a number of changes were made to enhance the proportionality of the PRA's framework for smaller firms, including:

- a revised counterparty credit risk requirement, including a simpler SA-CCR approach;
- a simpler, more conservative NSFR that certain smaller firms can choose to use;
- updates to the simplified calculations for credit valuation adjustment risk;
- increasing the scope of more proportionate market risk capital requirements and exemptions from new market risk reporting requirements; and
- tailored disclosure arrangements.

Smaller firms face a higher compliance burden relative to the size of their business than larger firms, which puts them at a competitive disadvantage. Enhancing the proportionality of the framework reduced the relative burden of regulation on smaller firms, enhancing their competitiveness and facilitating effective competition.

111. Basel III: international regulatory framework for banks: **www.bis.org/bcbs/basel3.htm**.
112. PS17/21, 'Implementation of Basel standards', July 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards**.

Operational resilience: impact tolerances for important business services

In March 2021, the PRA finalised its policies on operational resilience.[113] Operational disruptions to the products and services that firms provide have the potential to cause harm to consumers and market participants, threaten the viability of firms, and cause instability in the financial system. A resilient financial system is one that can absorb shocks rather than contribute to them. The PRA therefore requires firms to take an outcomes-based approach to operational risk management that includes preventative measures and capabilities to adapt and recover when things inevitably go wrong. As previous, high-profile disruptive events have shown, the speed and effectiveness of communications with the people most affected, including customers, is an important part of any firm's overall response to an operational disruption.

The PRA's operational resilience policy requires firms to identify their important business services, set impact tolerances for these services, and take action to remain within impact tolerances for these services. Business services deliver a specific outcome or service to an identifiable external end user, and are distinguished from business lines, such as mortgages, which are a collection of services and activities. Business services will vary from firm to firm, and the PRA considers the most proportionate approach is to give firms flexibility in identifying and prioritising their important business services which could impact financial stability. As such, the costs of implementing the policy will be proportionate to the size and complexity of the firm. This outcome is important for competition, as smaller firms will not face disproportionately high costs which reduce their competitiveness against larger firms who have relatively greater resources.

Modernising the framework on outsourcing and third-party risk management

Alongside PRA policy on operational resilience, the PRA modernised its framework on outsourcing and third-party risk management across both the banking and insurance sectors.[114] Firms' reliance on outsourcing arrangements is well established and subject to regulation. That said, firms are increasingly relying on technology provided by third parties, such as the Cloud, to gain entry to new markets, lower their operating costs, fuel innovation, and adapt to the digital economy. Outsourcing has the potential to reduce barriers to entry for

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113. PS6/21, 'Operational Resilience: Impact tolerances for important business services', March 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper**.
114. PS7/21, 'Outsourcing and third party risk management', March 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2019/outsourcing-and-third-party-risk-management**.

those firms who may not be able to invest in their own solutions by providing these firms with access to flexible and agile infrastructure. Clarifying regulatory expectations reduces the uncertainty for smaller regulated firms, allowing them to rely on outsourcing with greater confidence and facilitating innovation and competition.

Outsourcing of critical business services also has implications for operational resilience, which firms need to take into account. Clarifying the PRA's expectations on outsourcing generally (including any operational resilience requirements) and how smaller firms can comply proportionately, facilitates effective competition, by ensuring that smaller firms have the confidence to rely on outsourcing solutions.

Operational continuity in resolution

In May 2021, the PRA finalised updates to its operational continuity in resolution (OCIR) policy.[115] The ability to 'continue to do business through resolution and restructuring' is an outcome that the Bank considers necessary to support the resolution of a failed firm. The PRA proposed a number of updates to OCIR policy in response to its previous commitment to review its OCIR policy in light of the Bank's thinking on bail-in, and to take account of firms' experience of implementing the existing OCIR policy. The updates increased the proportion of operational arrangements for which operational continuity must be ensured, which could result in incremental costs to firms. However, the updates take into account a number of differences between types of service provision, and the PRA has reduced requirements for those that pose less risk to operational continuity in resolution. For example, from 1 January 2023, firms will no longer need to hold OCIR liquidity resources for intra-entity service providers.

The updates to the OCIR policy draws on the PRA's review of the experiences that smaller firms had when implementing the OCIR rules to ensure that they are proportionate. The updates also facilitate effective competition by lowering barriers to exit and, by reducing burdens on smaller firms, reducing barriers to entry and growth.

115. PS9/21, 'Operational continuity in resolution: Updates to the policy', May 2021: www.bankofengland.co.uk/prudential-regulation/publication/2020/operational-continuity-in-resolution.

Complexity of the PRA Rulebook

In the PRA Business Plan 2021/22, the PRA undertook further analysis on the complexity of the PRA Rulebook for banks and building societies, to identify aspects that could be simplified. This follows on from the PRA's earlier analysis of the complexity of UK banking regulation.[116] The fixed costs of implementing new requirements can be proportionally higher for small firms than for large ones when measured as a fraction of a firm's assets.[117] Consequently, there are economies of scale when it comes to compliance costs and those costs fall relatively heavier on small firms than on large firms, undermining the competitiveness of smaller firms.

In 2021, there were two workstreams that helped to simplify aspects of the PRA's rules: deleting redundant policy material; and reviewing the Rulebook website:

- the PRA proposed to delete a number of supervisory statements, and guidelines and recommendations referred to in a Statement of Policy on interpretation of EU Guidelines.[118] This material was either: redundant as the date of application had lapsed; duplicative as it had already been incorporated into or superseded by other PRA policy material; not relevant to the PRA's remit; or irrelevant as a result of the UK's exit from the EU.

- the PRA issued a DP[119] which reviewed the Rulebook website to ensure PRA rules, SSs, and SoPs are presented in a way that Rulebook users have easy access to and can understand. The PRA announced changes to be introduced in stages, including: digitised SSs and SoPs; machine-readable content; improved links to related documents; greater functionality to see past changes to rules ('time-travel' functionality). The improvement to the website functionality will help smaller, less complex firms navigate the PRA's rules.

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116. Amadxarif, Z, Brookes, J, Garbarino, N, Patel, R and Walczak, E (2019), 'The language of rules: textual complexity in banking reforms', Bank of England Staff Working Paper No. 834: **www.bankofengland.co.uk/working-paper/2019/the-language-of-rules-textual-complexity-in-banking-reforms**.
117. Building strong and simple: the first step – speech by Victoria Saporta, 29 April 2021: **www.bankofengland.co.uk/speech/2021/april/victoria-saporta-boe-webinar-on-pra-policymaking-and-the-strong-and-simple-discussion-paper**.
118. January 2022: **www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop**.
119. DP3/21, 'The PRA Rulebook website: Planned updates', November 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/november/pra-rulebook-website-updates**.

Update on competition focused research activities

In line with one of the recommendations made by the Independent Evaluation Office (IEO) in its 2016 review of the PRA's approach to the secondary competition objective, the PRA is committed to maintaining a flow of policy-oriented research projects aimed at deepening its understanding of the complex relationship between prudential regulation, financial stability, and effective competition. Since the publication of last year's ACR, the PRA has published two staff working papers. The first, entitled 'The impact of machine learning and big data on credit markets',[120] models how competition evolves when a group of bank lenders has a comparative advantage over rivals in screening perspective borrowers.[121] The second one, entitled 'Competition, profitability and financial leverage',[122] explores under what conditions a rise in profitability among non-financial US corporations is followed by an increase in financial leverage.

120. Eccles, P, Grout, P, Siciliani, P and Zalewska, A, 'The impact of machine learning and big data on credit markets', Bank of England Staff Working Paper No. 930, July 2021: **www.bankofengland.co.uk/working-paper/2021/the-impact-of-machine-learning-and-big-data-on-credit-markets**.
121. Relatedly, a policy article by Prof Paul Grout entitled 'AI, ML and competitions dynamics in Financial Markets' was published in the Oxford Review of Economic Policy (Autumn 2021): **https://doi.org/10.1093/oxrep/grab014**.
122. Banal-Estanol, A, Siciliani, P and Yoon, K, 'Competition, profitability and financial leverage', Bank of England Staff Working Paper No. 962, February 2022: **www.bankofengland.co.uk/working-paper/2022/competition-profitability-and-financial-leverage**.

Report on the use of powers delegated under the EU Withdrawal Act (EUWA)

Exercise by the Prudential Regulation Authority of sub-delegated powers under the European Union Withdrawal Act (EUWA) 2018 – report for the financial year ending 28 February 2022.

Presented to Parliament pursuant to paragraph 32(2)(a) of Schedule 7 to the European Union (Withdrawal) Act 2018.

Onshoring and temporary transitional powers

The PRA has not exercised these powers in the reporting period. The EUWA[123] requires the PRA to report to Parliament annually if relevant sub-delegated powers are exercised. This section relates to the use of the sub-delegated powers by the PRA in its annual reporting year ending 28 February 2022. HMT laid the PRA's report covering the year ending 28 February 2021 before Parliament on 21 September 2021.[124]

The main powers for the purposes of this reporting duty are the powers delegated to:

- make onshoring changes to the PRA Rulebook and Binding Technical Standards (BTS) within its remit, to ensure that they continue to work effectively in the United Kingdom (UK) at the end of the transition period, in the light of the UK's withdrawal from the European Union (EU);[125] and

- make directions to exercise the temporary transitional power (TTP) to help firms to adjust to onshoring changes made to financial services legislation, in the light of the UK's withdrawal from the EU.[126]

Detailed information on the use of these powers have been published on the PRA website.[127] [128]

123. Schedule 7, paragraph 32 of the EU (Withdrawal) Act 2018.
124. Exercise by the Bank of England and Prudential Regulation Authority of sub-delegated powers under the European Union (Withdrawal) Act 2018: **www.bankofengland.co.uk/prudential-regulation/publication/2021/september/exercise-of-sub-delegated-powers-under-eu-withdrawal-act-2018**.
125. Regulation 3 of The Financial Regulators' Powers (Technical Standards etc) (Amendment etc) (EU Exit) Regulations 2018.
126. Regulation 198 of The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019.
127. **Transitioning to post-exit rules and standards**.
128. **Temporary transitional power**.

Ongoing transferred powers

There are a number of other powers transferred under the Act that are required to be reported if exercised. The PRA has exercised its power to make Technical Standards Instruments under s138P Financial Services and Markets Act 2000.

A total of four standards instruments have been made during the reporting period:

- PRA STANDARDS INSTRUMENT: THE TECHNICAL STANDARDS (BILATERAL MARGINING) INSTRUMENT 2021 (made 29 June 2021)[129]

- PRA STANDARDS INSTRUMENT: TECHNICAL STANDARDS (ECONOMIC DOWNTURN) INSTRUMENT 2021 (made 18 October 2021)[130]

- PRA STANDARDS INSTRUMENT: THE TECHNICAL STANDARDS (REMUNERATION) INSTRUMENT 2021 (made 14 December 2021)[131]

- PRA STANDARDS INSTRUMENT: THE TECHNICAL STANDARDS (SOLVENCY II REGULAR SUPERVISORY REPORTING) INSTRUMENT 2021 (made 14 December 2021)[132]

Solvency II technical information: the PRA has exercised its power to publish technical information relating to risk-free interest rate term structures; and the symmetric adjustment of the equity capital charge (SAECC),[133] which are updated monthly. The PRA has published detailed information on its approach to publishing technical information for Solvency II firms on its website.[134]

129. Available at: www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/june/ps1421app1.pdf.
130. Available at: www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/october/ps2321app1.pdf.
131. Available at: www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/december/ps2821app2.pdf.
132. Available at: www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/december/ps2921app1.pdf.
133. Regulation 4B of the Solvency 2 Regulations 2015/575, and Article 3(5) of the Solvency II Delegated Act 2015/35.
134. Available at: www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/technical-information.

Fees: there are powers conferred on the PRA to require and set fees arising under:

- Regulation 209 of The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019; and
- Regulation 63 EEA Passport Rights (Amendment, etc, and Transitional Provisions) (EU Exit) Regulations 2018.

The use of fees powers is set out on the PRA's website.[135]

135. PS15/21, 'Regulated fees and levies: Rates proposals 2021/22', July 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/regulated-fees-and-levies-rates-proposals-2021-22**.

Financial review of 2021/22

The PRA incurred operating costs in 2021/22 of £293 million (2020/21: £278 million). Costs continued to include exceptional and non-recurring items such as special projects for firm restructuring. Where these exceptional costs are attributable to a particular segment of the authorised population, the PRA will typically raise a cost allocation, otherwise they will fall to fees in relation to regulatory activity.

Against its budget (£297 million), the PRA came in below by £3.5 million. This was predominantly due to the lower than assumed expensed project costs, lower costs in central services, and reduced travel. Due to additional income received in the year of £3.7 million, the return to firms for the next financial year is approximately £7.2 million, which will be refunded alongside collection of the 2022/23 fees.

Under section 7(2A) of the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, the Bank is required to present financial and other disclosures in respect of its activities as the PRA. These are available on pages 206–215 of the Bank's Annual Report and Accounts 2021/22.[136]

136. Bank's Annual Report and Accounts 2021/22: **www.bankofengland.co.uk/annual-report/2022**.

Abbreviations

ACR	Annual Competition Report
ACS	annual cyclical scenario
AI	artificial intelligence
AIPPF	Artificial Intelligence Public-Private Forum
AT1	Additional Tier 1
Bank	Bank of England
BCBS	Basel Committee on Banking Supervision
BTS	Binding Technical Standards
CBES	Climate Biennial Exploratory Scenario
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CfE	call for evidence
CFRF	climate financial risk forum
CMA	Competition and Markets Authority
Court	Bank's Court of Directors
COREP	Common Reporting
CP	consultation paper
CRD V	Capital Requirements Directive V
CRE	commercial real estate
CRR 2	Capital Requirements Regulation 2
CSP	cloud service provider
C-SREP	capital supervisory review and evaluation process
CTP	critical third party
DP	discussion paper
ECL	expected credit loss
EEA	European Economic Area
EL	eligible liabilities
EU	European Union
EUWA	European Union Withdrawal Act 2018
FCA	Financial Conduct Authority
FinTech	financial technology
FMI	financial market intermediary
FPC	Financial Policy Committee
FRF	Future Regulatory Framework
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board

FSMA	Financial Services and Markets Act 2000 (as amended)
FSRIF	Financial Services Regulatory Initiatives Forum
HMT	HM Treasury
IAIG	internationally active insurance groups
IAIS	International Association of Insurance Supervisors
ICAAP	Internal Capital Adequacy Assessment Process
ICP	insurance core principles
ICS	Insurance Capital Standard
ICT SREP	information and communication technology supervisory review and evaluation process
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IRB	internal ratings based
ISPV	insurance special purpose vehicle
IST	insurance stress tests
IT	information technology
LCR	Liquidity Coverage Ratio
LGD	loss given default
LIBOR	London Interbank Offered Rate
LTV	loan to value
MA	matching adjustment
MPC	Monetary Policy Committee
MoU	Memorandum of Understanding
MREL	minimum requirement for own funds and eligible liabilities
NSFR	net stable funding ratio
OCIR	operational continuity in resolution
OCP	occasional consultation paper
OPIC	Operations, People and Innovation Committee
ORMF	operational risk management frameworks
ORSA	own risk and solvency assessment
PCA	personal current account
PD	probability of default
PPP	Prudent Person Principle
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
PS	policy statement
PSR	Payment Systems Regulator
QIS	quantitative impact study
RAF	Resolvability Assessment Framework
RegTech	regulatory technology

RFB	ring-fenced body
RFI	relevant financial institutions
s166	Section 166 of the Financial Services and Markets Act
SA	standardised approach
SA-CCR	standardised approach to counterparty credit risk
SAECC	symmetric adjustment of the equity capital charge
SCB	Standard Chartered Bank
SCO	secondary competition objective
SIF	Sustainable Insurance Forum
SMF	Senior Management Function
SM&CR	senior managers and certification regime
SONIA	Sterling Overnight Index Average
SRPC	Supervisory Risk and Policy Committee
SS	supervisory statement
TMTP	transitional measure on technical provisions
TPR	Temporary Permissions Regime
TSC	Treasury Select Committee

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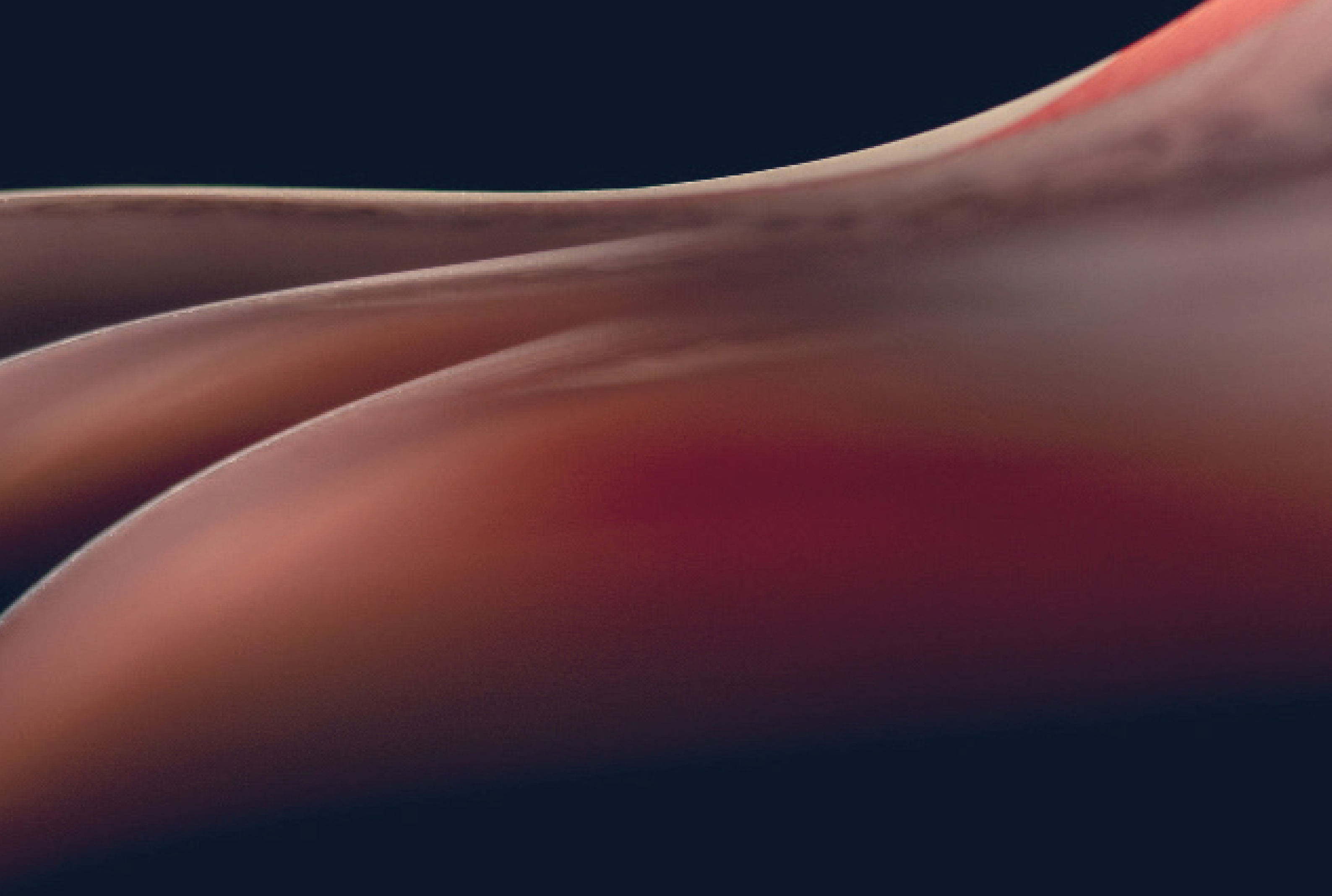

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Our mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability

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