Bank of England PRA

The Prudential Regulation Authority's approach to banking supervision

July 2023

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Foreword by the CEO

Following the global financial crisis, the Prudential Regulation Authority (PRA) was formed in April 2013 as the UK's prudential regulator of deposit-takers, insurers, and major investment firms.

The PRA has two primary objectives: a general objective to promote the safety and soundness of the firms it regulates, focusing on the adverse effects that they can have on the stability of the UK financial system; and an objective specific to insurance firms, to contribute to securing an appropriate degree of protection for policyholders. The PRA also has two secondary objectives – to act, so far as reasonably possible, in a way which (i) facilitates effective competition in the markets for services provided by PRA-authorised firms, and, (ii) under the Financial Services and Markets Act 2023 ("the 2023 Act"), facilitates, subject to alignment with relevant international standards, the international competitiveness of the UK economy, and its growth in the medium to long-term.

The resilience of the UK banking and insurance sectors is based on a strong foundation of robust regulatory standards that we have established since the PRA was founded. In order to maintain and build on this safety and soundness, we must continue to evolve our approach to account for changes in the world around us. This approach document sets out how we pursue our objectives in respect of the supervision of deposit-takers and investment firms (a second document sets out our approach for insurers). Our approach documents were originally published in 2012, and while our approach has evolved, it continues to be underpinned by three core principles established at the outset of the PRA: our supervisors rely on judgement in taking decisions; we assess firms not just against current risks, but also against those that could plausibly arise further ahead; and we focus on those issues and firms that are likely to pose the greatest risk to our objectives. Across these three principles we continue to apply proportionality to ensure that our interventions do not go beyond what is necessary in order to achieve our objectives.

Most of the changes from the original versions of these documents are evolutionary in nature, and aim to capture the ways in which our approach has developed over the last ten years in light of experience. For example, we have aimed to make our approach more risk-based and flexible, updated our potential impact and risk assessment frameworks so that they can better accommodate the risks we now face, made greater use of horizontal supervisory work to assess the risks posed across sectors, and continued to embed the use of horizon-scanning to identify areas of potential vulnerability. Each of these is underpinned by ongoing improvements in our data capabilities.

But in one important area the context for our approach as set out in these documents has changed more significantly. Under the 2023 Act, the PRA's rulemaking role has been

significantly expanded in order to replace functions which were largely carried out for the UK by European Union institutions prior to Brexit. The focus of this document is on supervision rather than policymaking but this will happen against a backdrop of changes to our approach to policymaking in response to this reform, including enhanced accountability arrangements to Parliament and how we will deliver the new competitiveness and growth objective given to the PRA under the 2023 Act.

This document is intended to provide an articulation of what we think effective supervision looks like, and how we intend to deliver it. The financial services sector and the context within which we supervise are constantly changing, and we will continue to evolve our approach in response to this. Therefore this document will, like its forbear, likely evolve over the next decade. However, we are confident that the essential ingredients, including our three core principles as established at the outset of the PRA, will endure.

Sam Woods
July 2023

Introduction

We, the Prudential Regulation Authority (PRA), as part of the Bank of England (the Bank), are the UK's prudential regulator for deposit-takers, insurance companies, and designated investment firms.

1. This document sets out how we carry out our role in respect of deposit-takers and designated investment firms (referred to collectively in this document as 'firms'); a second document relates to our supervision of insurers.[1] It is designed to help regulated firms and the market understand how we supervise these firms, and to aid accountability to the public and Parliament. The document acts as a standing reference that will be revised and reissued in response to significant legislative and other developments that result in changes to our approach.

2. This document serves three purposes. First, it aids accountability by describing what we seek to achieve and how we intend to achieve it. Second, it communicates to regulated firms what we expect of them, and what they can expect from us in the course of supervision. Third, it meets the statutory requirement for us to issue guidance on how we intend to advance our objectives. It sits alongside our requirements and expectations as published in the PRA Rulebook and our policy publications.[2]

[1] The Prudential Regulation Authority's approach to insurance supervision, July 2023. Available at: www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.

[2] The way we make policy and links to our policy publications are available at: hwww.bankofengland.co.uk/prudential-regulation/policy.

1: Our objectives

Our governing statute is the Financial Services and Markets Act 2000 (as amended) (the Act)

Our primary objectives

3. Under the Act, we have two primary objectives: (i) a general objective, to promote the safety and soundness of the firms we regulate; and (ii) an objective specific to our regulation of insurers, to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders.

4. The Act requires us to advance our general objective primarily by seeking to:

- ensure that the business of the firms we regulate is carried on in a way that avoids any adverse effect on the stability of the UK financial system; and
- minimise the adverse effect that the failure of one of the firms we regulate could be expected to have on the stability of the UK financial system.

5. The advancement of our general objective of safety and soundness of PRA-authorised persons includes the continued focus on ring-fencing to support the safeguarding of the continuity of core services (retail deposits and related payment and overdraft services). This requires us to discharge our functions in a way that seeks to:

- ensure that the business of ring-fenced bodies (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 a RFB or of a member of a RFB's group could affect the continuity of the provision in the UK of core services.

Our secondary objectives

6. We have two secondary objectives. The first is to act, so far as is reasonably possible, in a way that facilitates effective competition in the markets for services provided by the firms we regulate when they carry on regulated activities. The second requires the PRA (so far as reasonably possible) to facilitate, subject to aligning with relevant international standards, (i) the international competitiveness of the UK economy (including in particular the financial services sector through the contribution of PRA authorised persons), and (ii) its growth in the medium to long-term. Both of these

secondary objectives apply when we are making policies, codes, and rules in pursuit of our primary objectives.

Effective competition

7. Effective competition can be said to exist where suppliers offer a choice of products or services on the most attractive and sustainable terms to customers; where customers have the confidence to make informed decisions; and where firms enter, expand, and exit from the market.

8. Cases may exist where some options available to us would not deliver the maximum benefits to safety and soundness, but would deliver significantly greater benefits to competition. The secondary competition objective means that we should consider (but are not required to adopt) those options that may deliver greater benefits to competition. This approach recognises that we may have limited policy choices, for example where we are bound by other domestic or international law.

9. Regulation designed to improve financial stability can facilitate effective competition. For example, regulation can ensure that firms' and investors' decision making appropriately reflects the social cost of risk-taking, reducing incentives to compete in a way that harms others in the financial system such as taking unsustainable levels of risk only to expose others to losses through failure and loss of confidence. A robust minimum prudential regulation standard can also provide customers with greater confidence in the financial soundness of new banks, enabling entrants to gain a foothold in the market and to expand.

International competitiveness and growth

10. The introduction of our secondary objective relating to UK competitiveness and growth means that these factors will carry greater weight in our decision-making than when we were taking these considerations into account as matters to which we must 'have regard'. The formulation of the objective recognises the role that the international competitiveness of the UK financial sector can play in contributing to economic growth. The financial sector can support the international competitiveness of the UK economy and contribute to growth in the medium to long-term when: (i) UK firms successfully compete to win business around the world; (ii) the UK is a top tier global financial hub where firms from around the world choose to do business; and (iii) the financial sector supports growth by meeting the needs of the wider national economy.

11. Robust standards contribute to economic growth by reducing the frequency and severity of financial crises and by creating trust in the UK as a global financial centre, which makes the UK an attractive place to do business. The PRA is proactive in its approach to the secondary competitiveness and growth objective and looks for opportunities to advance it. PRA rule making can (i) harness the UK's strengths as a global financial centre; (ii) maintain trust in the UK as a place to do business; and (ii)

tailor regulations to UK circumstances. Competitiveness and growth can be facilitated through regulation that is not only stable, predictable, and transparent, but also proportionate and open to innovation.

Safety and soundness and the stability of the UK financial system

12. 'Safety and soundness' involves firms having resilience against failure, now and in the future, and avoiding harm resulting from disruption to the continuity of financial services.

13. We are required by statute to fulfil our primary objective to promote safety and soundness by seeking to avoid adverse effects on financial stability. Our focus is to identify risks to financial stability that can be generated by those firms and, together with the Financial Policy Committee (FPC) with its macroprudential responsibilities, where appropriate, we look to mitigate such effects.

14. We supervise a large and diverse population of deposit-takers. Some of these are large UK banking groups containing RFBs, whose contribution to, and potential impact on, the UK economy is significant.

15. In some cases, these firms are also globally systemically important institutions. Other firms we supervise are overseas firms, ranging from global investment banks to small retail operations. In addition we supervise mutuals, both building societies and many hundreds of credit unions, the majority of which operate in a particular locality.

16. Some prudential issues are common to all of these firms. They generally undertake maturity transformation and are levered (ie have debt in their capital structure), leaving them inherently vulnerable to a loss of confidence. This underlies our objective to promote their safety and soundness, so that they are financially sound, and run in a prudent manner, which we advance by setting out policies those firms should meet in spirit and to the letter. In discharging our general objective we will also focus, in particular, on the risk of disruption to the continuity of critical economic functions.[3] This is because a stable financial system, that maintains continuity of access to critical economic functions, is a necessary condition for a healthy and successful economy.

17. Reflecting these priorities, the PRA has introduced the concept of a 'Strong and Simple' prudential framework for firms that are neither systemically important nor

3 Economic functions are defined as the broad set of services the financial sector provides to the UK economy, and hence an aggregation of business services that one, or more, firms or Financial Market Infrastructure (FMI) provides. For example, the economic function of retail mortgages and secured lending would comprise a number of individual business services. If sufficiently significant in terms of both size and function, these economic functions can become critical to the UK economy.

internationally active.[4] The combined objectives of this framework are to maintain the resilience of those firms, and the stability of the UK financial sector, while using simplified prudential regulation. This could enhance effective competition, and enable a dynamic and diverse banking sector in the UK.

Firm failure

18. The Act is explicit that it is not our role to ensure that no firm fails. Therefore, a key principle underlying our approach is that we do not seek to operate a zero-failure regime. We work with the Bank as the UK's resolution authority to ensure that any firms that fail do so in an orderly manner.

19. Prudential regulation is necessary to address the risks that firms can pose more widely to the stability of the system. The failure of deposit-takers can disrupt the payment system and so depositors' ability to undertake economic activity. And some of the lending provided by banks (for example to small and medium-sized companies) may be difficult to substitute via the capital markets, meaning that bank failures or financial weakness can severely affect the supply of credit to the economy as a whole. Considering the impact of firm failure, and acting pre-emptively to ensure either recovery or orderly resolution is a core aspect of our supervisory approach, and we work to deliver this with the rest of the Bank through our supervisory strategy for individual firms. Our ability to ensure firm failure is orderly depends on both the efficacy of the UK's statutory resolution regime and ensuring firms are structured, and operate, in a way that is compatible with the Bank's preferred resolution strategy under UK resolution powers.

20. The Bank as resolution authority sets the preferred resolution strategy for all firms. The Bank works with firms to ensure that any impediments to an orderly resolution are addressed. Resolvability assessments, and the actions flowing from them, form a key part of resolution planning on a 'business–as-usual' basis before an institution actually encounters distress. This includes engagement with the Financial Services Compensation Scheme (FSCS) depositor protection scheme which protects eligible depositors, up to certain limits, in the event of firm failure where relevant.

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4 DP1/21 – A strong and simple prudential framework for non-systemic banks and building societies; available at **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks**.
CP5/22 – The Strong and Simple Framework: a definition of a Simpler-regime Firm; available at **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/definition-of-a-simpler-regime-firm**.
CP16/22 – Implementation of the Basel 3.1 Standards; available at **www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards/scope-and-levels-of-application**.
CP4/23 – The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms; available at **www.bankofengland.co.uk/prudential-regulation/publication/2023/february/strong-and-simple-framework**.

21. Firms should be allowed to fail, and we will work to ensure that any failure is orderly, that is, a continuity of access to the failed firm's critical functions[5] on which customers rely is maintained (including by transfer to another firm, by converting the instruments held by creditors, or writing down the firm's external creditors) where necessary. This reflects the view that firms should be subject to the disciplines of the market. It is important for firms to be able to fail in an orderly way without public funds being put at risk since, apart from being an unwarranted subsidy, the public provision of solvency support to a firm (or its creditors) can create an expectation of future assistance. This moral hazard in turn increases the risk of future financial instability, as it provides incentives for excessive risk taking and reduces market discipline.

22. Although firms should be allowed to fail, we do expect firms to maintain a certain level of resilience against failure. This is essential to ensuring confidence in the resilience of the firms that we supervise for us to deliver on our general objective.

Threshold Conditions

23. The Threshold Conditions are the minimum requirements that firms must meet at all times in order to be permitted to carry on the regulated activities in which they engage. They are designed to ensure that firms conduct their business in a prudent manner and are managed by persons with adequate skills, experience and propriety, which are necessary to promote safety and soundness. Threshold Conditions are crucial to the operation of our regulatory regime. We expect firms not merely to meet and continue to meet the letter of these requirements, but also to consider the overriding principle of safety and soundness. We assess firms against the Threshold Conditions on a continual basis.

Fundamental Rules

24. The Fundamental Rules are high level rules that collectively act as an expression of our general objective of promoting the safety and soundness of regulated firms. Firms must ensure they are compliant with all applicable PRA rules, including the Fundamental Rules, as set out in the PRA Rulebook.[6]

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[5] Critical functions include core services, defined by Part 9B of the Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services (Banking Reform) Act 2013. Banking groups subject to ring-fencing must ensure uninterrupted provision of such services through the ring-fenced body. More information on ring-fencing can be found in Section 5 – Tailored application of the supervisory approach. More information on the relationship between critical functions and important business services is set out in: **www.bankofengland.co.uk/prudential-regulation/publication/2020/operational-continuity-in-resolution**.

[6] PRA Rulebook: **www.prarulebook.co.uk**.

25. A failure to comply with the Fundamental Rules may be relevant to a firm's ongoing compliance with the Threshold Conditions and may result in enforcement or other actions.

Regulatory principles

26. In designing our policies, issuing codes and making rules, we have regard to a number of regulatory principles set out in the Act. These cover: using our resources efficiently; proportionality; senior management responsibility in firms; recognising differences in the nature and objectives of authorised persons; transparency; disclosure of information relating to persons on whom requirements are imposed by or under the Act; and the general principle of customers taking responsibility for their decisions. The 2023 Act requires the PRA to 'have regard' to the need to contribute towards achieving compliance by the Secretary of State with the government's 2050 net-zero emissions target and environmental targets where the exercise of our functions is relevant to the making of such a contribution.

Investigations into regulatory failure

27. The Financial Services Act 2012 requires us to investigate and report to HM Treasury (HMT) on events which indicate possible regulatory failure. We have set out, in a policy statement[7] how we will judge whether and when such failures have occurred. Consistent with our statutory objectives, we are clear that firm failures will not automatically indicate regulatory failure.

7 Conducting statutory investigations, April 2013; available at **www.bankofengland.co.uk/prudential-regulation/publication/2013/conducting-statutory-investigations**.

2: Our approach to advancing our objectives

To advance our objectives, our supervisory approach follows three key principles – it is: (i) judgement-based; (ii) forward-looking; and (iii) focused on key risks.

Judgement-based

28. Our approach relies significantly on judgement. Supervisors reach judgements on the risks that a firm is running, the risks that it poses to our objectives, whether the firm is likely to continue to meet the Threshold Conditions, and how to address any problems or shortcomings.

29. Our supervisory judgements are based on evidence and analysis. It is, however, inherent in a forward-looking system that, at times, the supervisor's judgement will be different to that of firms. Furthermore, there will be occasions when events will show that the supervisor's judgement, in hindsight, was wrong. To minimise such outcomes, our strategies and judgements are subject to regular review by those independent from supervising the firm in question, and our major judgements and decisions involve our most senior and experienced staff and directors.

30. We also engage with the boards and senior management of firms in forming our judgements, using this dialogue both to ensure that we take account of all relevant information, and to clearly communicate the rationale for our judgements. Firms should not, however, approach their relationship with us as a negotiation.

Forward looking

31. Our approach is forward-looking. Through our horizon-scanning work, we assess firms not just against current risks, but also against those that could plausibly arise further ahead. And where we judge it necessary to intervene to mitigate the risks a firm is creating; we seek to do so at an early stage. To support this, firms should be open and straightforward in their dealings with us, taking the initiative to raise issues of possible concern at an early stage. We will respond proportionately. In this way, trust can be fostered on both sides.

Focused on key risks

32. We focus our supervision on those issues and those firms that, in our judgement, pose the greatest risk to the stability of the UK financial system. Consistent with our objectives, we aim to concentrate on material issues when engaging with firms. As

outlined further in Section 3 below, our assessment of the risk that any firm poses will take into account both the gross risk derived by their relative scale, complexity and business model, and any mitigating factors and controls that have been put in place. Our assessment is based on a set of supervisory core assurance activities (the frequency and depth of which are proportionate to the potential impact assessment of any given firm). This can include both firm-specific reviews and horizontal assessment of risks across a sector or peer group.

Box 1: Engagement with other Bank of England functions

Our work is informed by, and connected to, that done by the Bank of England's other functions, including primarily the FPC – the area responsible for oversight of financial market infrastructure and resolution.

An effective regulatory framework for financial stability needs to combine deposit-taker and investment firm-specific supervision with work to protect and enhance the resilience of the financial system as a whole. We therefore work closely with the Bank's FPC, which has statutory responsibility for reducing risks to the financial system as a whole, and the areas of the Bank responsible for overseeing financial market infrastructure, given the interconnectedness of FMIs and the stability of the firms that we prudentially regulate. Our respective work is in turn informed by the Bank's broader work on market intelligence and financial sector resilience as a whole.

The PRC must report to the Chancellor of the Exchequer on an annual basis the extent to which the exercise of the PRA functions is independent of the Bank's other functions. We operate an independent decision-making framework.

The FPC

The FPC can make recommendations and give directions to us on specific actions that should be taken to achieve the FPC's objectives. We are responsible for responding to FPC recommendations which may be made on a 'comply or explain' basis, and for complying with the FPC's directions in relation to the use of macroprudential tools, specified by HM Treasury in secondary legislation.

There is a frequent two-way flow of information and exchange of views between us and the FPC. We provide firm-specific information to the FPC, to assist its macroprudential supervision and the FPC's assessment of systemic risks influences our judgements in pursuit of our own objectives.

Resolution

We work with the Bank of England as UK resolution authority to ensure that any firms that fail do so in an orderly manner. The Bank as resolution authority sets the preferred resolution strategy for all firms and works with firms to ensure that any impediments to an orderly resolution are addressed. Our approach to working with the Bank on the resolution of firms is set out in Section 1 in more detail.

Box 2: Working with other authorities

Co-ordination with other authorities is essential to our success.

Financial Conduct Authority (FCA)

The FCA is the conduct regulator for the firms prudentially regulated by the PRA. We have a statutory duty to co-ordinate with the FCA in the exercise of our statutory functions under the Act, including policymaking and supervision. A Memorandum of Understanding (MoU) between the PRA and the FCA describes how the two regulators fulfil this duty to co-ordinate in a way that supports each regulator's ability to advance its own objectives.[8]

A key principle for this co-operation, given the regulators' separate mandates for prudential and conduct regulation of PRA-authorised firms, is that each authority should focus on the key risks to its own objectives, while being aware of the potential for concerns of the other.

Conclusions and key information from supervisory activity that is materially relevant to the other regulator's objective(s) will be exchanged. In order to ensure that both the PRA's and the FCA's supervisory judgements about a firm reflect relevant information, we will share information on dual-regulated firms and firms within dual-regulated groups between us.

To support this process, domestic 'supervisory colleges' for individual firms and groups are established as appropriate, with a view to identifying which risks and mitigating actions might have a material effect on the ability of the other regulator to advance its objectives. The frequency of these colleges will reflect the importance of the firm to the other regulator's objectives.

Co-ordination between us and the FCA is assisted by the membership of the PRA CEO on the FCA Board, and reciprocal membership of the FCA CEO on PRC. This role focuses on areas of overlap and discussions of material relevance to each CEO's own organisation. Co-ordination between the organisations is also assisted by common membership of CEOs on the FPC.

Financial Services Compensation Scheme (FSCS)

The FSCS is the UK's compensation fund of last resort for customers of authorised financial services firms. It may pay compensation to depositors in relation to covered deposits if a firm is, or is likely to be, unable to pay claims against it. The MoU between the PRA and the FSCS details how the two authorities co-operate and co-ordinate.[9]

We work closely with the FSCS in order to assess and enhance the resolution framework for deposit-takers in order to discharge our primary objective. We will seek to ensure that, through the Proactive Intervention Framework (PIF) (see Section 4), the FSCS has reasonable notice of activity where we may require significant involvement of the FSCS.

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8 PRA/FCA Memorandum of Understanding; available at www.bankofengland.co.uk/about/governance-and-funding.

9 PRA/FSCS Memorandum of Understanding; available at www.bankofengland.co.uk/about/governance-and-funding.

Other UK bodies

We often need to work with other UK regulators and other UK government agencies, either to pursue our own objectives or to assist them in theirs. This may also include other enforcement agencies.

We have agreements to support the sharing of information and judgements and the co-ordination of actions. Our general approach to these arrangements and the relationships they underpin is focused on:

- enabling all parties to focus on their own objectives;
- the substantive issues of the potential co-ordination;
- avoiding where possible a detailed, prescriptive approach, to ensure that judgement and flexibility are not lost; and
- provisions for regular review, ensuring that MoUs remain current.

International co-operation

Banking is an international industry. Many UK firms have operations overseas, and many firms domiciled overseas have subsidiaries or branches in the UK. Deposit-takers and investment firms are therefore supervised on a co-operative international basis. We continue to work closely with all relevant regulatory bodies to oversee PRA regulated firms, participating in global supervisory colleges either as a home supervisor (for firms domiciled in the UK), or host supervisor (for international firms operating in the UK), where relevant. We have established MOUs with those jurisdictions with which we work most regularly – particularly those with a significant presence of PRA regulated firms within their jurisdictions, or those with firms that have a significant presence in the UK. The policy framework for this supervision is to a large extent agreed globally, including by the Basel Committee on Banking Standards (BCBS) and the Financial Stability Board (FSB), to ensure that all jurisdictions uphold appropriate standards in their collective interest.

We participate actively in global supervisory forums and seek to be an influential participant in international policy debates. In particular, we actively participate in the work of the FSB and the BCBS.

SS5/21[10] sets out our approach to supervising international banks with either branch or subsidiaries in the UK. Further detail on our approach to supervising these firms can be found in Section 5.

[10] SS5/21 - International banks: The PRA's approach to branch and subsidiary supervision; available at www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pra-approach-to-branch-and-subsidiary-supervision-ss.

3: Identifying risks to our objectives

The intensity of our supervisory activity varies across firms. The level of supervision principally reflects our judgement of a firm's potential impact on the stability of the financial system, its proximity to failure (as described in the Proactive Intervention Framework), its resolvability, and our statutory obligations. Other factors that play a part include the type of business carried out by the firm, and the complexity of the firm's business and organisation.

Our risk assessment framework

33. We take a structured approach when forming our judgements. To do this, we use a risk element framework – see Figure 1. The framework assesses the risk posed by firms to the PRA's objectives, assessing gross risk and mitigating factors. The starting point is to assess the gross risk by measuring the potential impact a firm has on the stability of the UK financial system and the external context and business model risk which a firm is exposed to. This is then overlaid with mitigating factors which are the actions a firm takes to offset the gross risk. When taken together, this helps us to make an assessment of the net risk that any given firm poses to the PRA's objectives.

Figure 1: The PRA's Risk Element Framework

<table>
<tr><th colspan="3">Gross Risk</th><th colspan="6">Mitigating Factors</th></tr>
<tr><th>Potential impact</th><th colspan="2">Risk context</th><th colspan="2">Operational mitigation</th><th colspan="2">Financial resilience</th><th>Operational resilience</th><th>Structural mitigation</th></tr>
<tr><th>Potential impact</th><th>External context</th><th>Business risk</th><th>Management and governance</th><th>Risk management and controls</th><th>Capital</th><th>Liquidity</th><th>Operational resilience</th><th>Resolvability</th></tr>
<tr><td colspan="3">We consider the potential impact a deposit-taker or designated investment firm could have on financial stability alongside how the external context and business risk it faces (together, its risk context) might affect the firm's viability. This gives us an assessment of gross risk.</td><td colspan="2">We also consider a firm's operational mitigation covering management and governance and its risk management and controls.</td><td colspan="2">Financial resilience is an important part of our assessment.</td><td>Firm's operational resilience capabilities and any areas of vulnerability that are outside of tolerance are assessed.</td><td>Structural mitigations to the potential risk that a firm poses to financial stability – namely the ease with which a firm is resolvable, and our assessment of their operational preparedness for a resolution scenario is another key element of our approach.</td></tr>
</table>

Potential impact

34. Our starting point for any firm's risk assessment is the potential impact assessment in which we assess the significance of a firm to the stability of the UK financial system. This 'potential impact' reflects a firm's potential to affect adversely the stability of the system by failing, coming under operational or financial stress, or because of the way in which it carries out its business.

35. We divide all deposit-takers and designated investment firms that we supervise into the four 'categories' of impact below:[11]

Table 1: Potential Impact Categories

Category 1	The most significant firms whose size, interconnectedness, complexity, and business type give them the capacity to cause very significant disruption to the UK financial system (and through that to economic activity more widely) by failing, or by carrying on their business in an unsafe manner.
Category 2	Significant firms whose size, interconnectedness, complexity and business type give them the capacity to cause some disruption to the UK financial system (and through that to economic activity more widely) by failing, or by carrying on their business in an unsafe manner.
Category 3	Firms whose size, interconnectedness, complexity, and business type give them the capacity to cause minor disruption to the UK financial system by failing, or by carrying on their business in an unsafe manner, but where difficulties across a whole sector or subsector have the potential to generate disruption.
Category 4	Firms whose size, interconnectedness, complexity, and business type give them almost no capacity individually to cause disruption to the UK financial system by failing, or by carrying on their business in an unsafe manner, but where difficulties across a whole sector or subsector have the potential to generate disruption.

36. We also consider the substitutability of the services that the firm provides, and the extent to which this could mitigate the impact of failure, including in stressed circumstances.

37. We use quantitative and qualitative analysis to allocate firms to categories. Numerical scoring based on firms' regulatory reporting provides an indicated categorisation which supervisors then review in light of qualitative analysis to confirm that

[11] In 2023, the PRA moved from five to four categories of potential impact.

it presents a full picture of a firm's potential impact. This categorisation process is reviewed annually.

38. Firms are told which category they have been assigned, providing a broad indication of the level of supervisory interaction to expect.

Risk framework elements

39. Following the Potential Impact Score calculation, we consider a series of further gross risk elements and mitigating factors to overlay this assessment, as set out in Figure 1 above. Each risk element is explored in further detail below.

External context

40. External context refers to any external factors that could pose a threat to the viability of a firm. Any assessment of the risks facing firms, including their financial and operational risk, requires an appreciation of the external context in which they operate. Our assessment therefore includes consideration of system-wide risks; from general economic and market conditions or the political and physical environment, to sectoral risks; for example operational risks arising from concentration of outsourcing within a sector.

41. We draw on work by other parts of the Bank, including the views of the FPC on the macroprudential environment. Sectoral analysis to understand key market developments over the medium term draws upon both market intelligence and, where appropriate, standardised information from firms. We also consider actions by other regulators, including the FCA, that might materially affect the prudential soundness of PRA-authorised firms.

Business risk

42. Business model analysis forms an important part of our supervisory approach. We examine the threats to the viability and sustainability of a firm's business model, and the ways in which a firm could create adverse effects on other participants in the system by the way it carries on its business. The analysis includes an assessment of where and how a firm makes money, the risks it takes in doing so and whether this remains within its own risk appetite, and how it funds itself. Business model analysis is conducted at the level of the firm or the sector as appropriate.

43. For those firms posing greater risk to the stability of the system, the analysis is more detailed; we include a review of the drivers of profitability, risk appetite, performance targets and underlying assumptions, and a firm's own forecasts and their plausibility. We use this analysis to form a projection of the firm's ability to achieve its business and capital plans and the associated risk and funding profile over the medium term. This projection, and the general picture supervisors form of the nature of the business, guide

our work in assessing the adequacy of the management actions the firm has available to mitigate risk. For example, our forward-looking view of the firm's prospects informs our judgement on the level of capital a firm requires, and the complexity of the firm's business informs judgements about that firm's risk management processes. If we believe that mitigating measures alone cannot adequately reduce material risks to the safety and soundness of the firm, the firm will be expected to change its plans.

44. Peer analysis forms an important part of this assessment, providing a diagnostic tool to highlight where individual firms may be outliers relative to their sector and so in need of further analysis. Such analysis also supports an understanding of common sectoral risks that have the potential to affect the stability of the system.

Management and governance

45. It is the responsibility of each firm's board and management to manage the firm prudently, thereby contributing to the continued stability of the financial system.

46. The board should articulate and maintain a culture of risk awareness and ethical behaviour for the entire organisation to follow in pursuit of its business goals. The PRA expects the culture to be embedded with the use of appropriate incentives, including but not limited to remuneration, to encourage, and where necessary require, the behaviours the board wishes to see, and for this to be actively overseen by the board. The non-executives have a key role to play in holding management to account for embedding and maintaining this culture.[12] In a ring-fenced bank, this includes maintaining the independence of the governance of the ring-fenced bank from the broader group. This includes following our policies, and any other applicable laws and regulations in line with their spirit, and embedding the principle of safety and soundness in the culture of the whole organisation.

47. We do not have any right culture in mind when making our assessment; rather we focus on whether accepted practices are challenged, and whether action is taken to address risks on a timely basis. In particular, we want to be satisfied that designated risk management and control functions carry real weight when challenging the business decisions made within firms and that consideration is given to the wide range of risks facing firms.

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12 SS5/16 – Corporate governance: Board responsibilities sets out further information for the boards of PRA-regulated firms on those aspects of governance to which we attach particular importance and may devote particular attention in the course of our supervision. Available at: www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss.

Design and effectiveness of the Board and Senior Management

48. In order to provide effective challenge across the full range of the firm's business and rigorously explore key business issues, the board must have diversity of skills, approach, and experience.[13] As a firm grows and evolves, and as the challenges it faces change (including through technology and new risk types), it may need different board members and management, including those with experience in other sectors.

49. The Senior Managers and Certification Regime (SM&CR) establishes the link between seniority and accountability by strengthening individual accountability. Accordingly, we expect firms to allocate clear responsibilities to individuals performing Senior Management Functions (SMFs) and to document them in a clear, concise and effective manner (and to hold those individuals to account against those expectations). SMFs are subject to a 'duty of responsibility' whereby they are required to take reasonable steps to prevent or stop regulatory breaches in their area of responsibility; and a requirement to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibility effectively. Moreover, senior management committees (and other similar forums) should operate in a spirit of collective responsibility, rather than simply placing the onus on the committee chair who holds the SMF responsibility.

50. We expect firms to have in place sufficient controls to minimise incentives for excessive risk-taking by management and staff. To this end, remuneration and incentive structures should reward careful and prudent management, by seeking to align better the interests of senior executives (and others who may have a material impact on a firm's risk profile) with the maintenance of safety and soundness and the long-term interests of their employers. A consequence of this is that downward adjustments to variable pay should be considered in response to financial losses, poor performance, and inadequate risk and control environments.

51. Individuals intending to hold SMF positions and their respective firms are required to apply for our approval before taking up their position. Approval is granted only if we, as prudential regulator, and the FCA, as conduct regulator, are both satisfied that an individual is fit and proper. Firms themselves should carry out appropriate checks and satisfy themselves that individuals seeking to perform an SMF are fit and proper for their intended roles before applying to us and the FCA for approval on their behalf and should continue to satisfy themselves of the fitness and propriety of their SMFs on an ongoing

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13 SS5/16 – Corporate governance: Board responsibilities sets out further information for the boards of PRA-regulated firms on those aspects of governance to which we attach particular importance and may devote particular attention in the course of our supervision. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss**.
General Organisational Requirements Part: PRA Rulebook. Available at: **www.prarulebook.co.uk**.

basis for as long as they hold those roles.[14] As above, this should include appropriate alignment of the interests of SMFs with the safety and soundness of their firm through clear linkage between their remuneration and prudent management of the firm, including through delivery of supervisory priorities.

52. Diversity and inclusion plays an important role in promoting good governance. It does so by bringing different perspectives and experiences together, which promote constructive challenge and debate, and thereby helping to guard against groupthink. There is a risk that groupthink undermines good governance in firms, leading to decisions that weaken their safety and soundness. Firms should consider diversity when recruiting members to the management body, and more broadly in their employment practices. They should also cultivate an inclusive firm culture that allows concerns to be raised and decisions to be challenged effectively.

Structures

53. We expect firms to have in place clear structures of accountability and delegation of responsibilities for individuals and committees, including checks and balances to prevent dominance by an individual. Senior individuals remain accountable for the actions of those to whom they delegate responsibilities, including where firms use third parties in respect of outsourced functions. Firms are required to have a clear, unambiguous, and effective structure of responsibility with a clear Management Responsibilities Map that shows the responsibilities for each senior individual, as well as their lines of reporting and accountability both within the firm and the wider group, where applicable.

54. Not all legal entities within a group are necessarily directly regulated. Nonetheless, unregulated group entities can be important to the functioning of the group as a whole (for instance, by providing important support services), or can undertake activities which have the potential to create risks for the group as a whole and so for authorised firms. As a result of the responsibilities of their holding companies and their regulated entities, we expect all boards of regulated legal entities within groups to have regard to our objectives. We additionally expect the boards of parent financial holding companies and parent mixed financial holding companies that we have approved under Part 12B of FSMA to have particular regard to our objectives given their responsibility for ensuring that their groups comply with consolidated prudential requirements.

55. These requirements on the boards and executive management of legal entities within groups apply equally to overseas firms that establish separately incorporated entities within the UK. In particular, we expect boards and senior management of these firms to have proper regard to our objectives, both for the group as a whole and for

14 We set out our expectations of firms and individuals in SS28/15 – Strengthening individual accountability in banking; available at **www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss**.

individual firms (and subgroups) in the UK, since issues at the parent or group level could have an effect on the PRA-authorised entity and our objectives more generally.

56. Firms are able to operate in the UK as branches of overseas legal entities, meaning that there is no separate legal entity in the UK. We expect all UK branches, like UK subsidiaries, to act responsibly in a manner that is consistent with safety and soundness and the appropriate protection of policyholders. We expect branches to appoint a senior individual as SMF 19 – Head of an overseas branch, with authority to act as a primary contact with us in relation to their affairs. This individual should also act as a channel for communication with the head office.

Disciplinary action against individuals

57. We may prohibit any individuals, not just those who currently hold an SMF, from performing functions in relation to a regulated activity carried on by a PRA-authorised firm. We may only do this where it appears to us that an individual is not a fit and proper person to perform such functions.

58. We have specific disciplinary powers over individuals approved to perform an SMF by us or an equivalent function by the FCA (eg as a member of the governing body) and we are empowered to use these where an individual fails to comply with our Conduct Rules, or has been knowingly involved in a contravention by their firm of a requirement imposed by us. The powers enable us to, among other sanctions, impose financial penalties, censure an individual publicly, withdraw approval from individuals holding SMFs, and prohibit individuals from holding SMFs in the future.

59. We will take disciplinary action where it is appropriate to do so. In assessing whether to take disciplinary action against a senior manager or director, we consider a variety of factors, including:

- the impact the individual’s behaviour has had, is having, or could have on us advancing our objectives, including the behaviour of other persons in the firm over whom the individual should exercise control, and whether that behaviour calls into question the person’s fitness and properness (be it an isolated incident or a course of conduct);
- whether taking action will serve to deter the person who committed the breach, and others who are subject to our requirements, from committing similar or other breaches; and
- the individual’s behaviour towards us, including the level of co-operation and openness with which the individual deals with us, and the appropriateness of the individual’s actions in response to concerns raised.

Risk management and controls

60. Firms should have robust frameworks for risk management, including for financial and operational risks. A robust risk management framework enables firms to effectively identify, measure, monitor, manage and report risks. Controls should be commensurate with the nature, scale and complexity of their business, and promote the firm's safety and soundness. Competent and, where appropriate, independent control functions should oversee these frameworks. Boards should ensure they receive adequate and timely information on key risks and variances from the firm's agreed risk appetite to enable them to monitor and challenge executive management. This mechanism can be reinforced by setting appropriate responsibilities under the SM&CR.

61. We expect firms to articulate the amount of risk they are willing to take across different business lines to achieve their strategic objectives. This risk appetite should be consistent with our objectives, and the firm should pay appropriate attention to identifying, measuring and controlling risks, including those arising in unlikely but very severe scenarios and from new, and evolving risks.

62. Despite appropriate scenario planning, it is always the case that a situation may come along that tests financial or operational resilience in way that had not been anticipated. As such, we do not expect firms to be able to withstand all such events. We consider it important, however, for firms' senior management and boards to understand the circumstances in which their firm might fail and have effective processes to identify, manage, monitor, and report the risks to which it is, or might be, exposed. Moreover, boards and senior managers need to be alert to past instances of firm and compliance failure within the industry, and apply these lessons to their own circumstances to help support a sound risk culture.

63. Risks should be reported to the board and senior management on a timely basis, with risks outside the agreed risk appetite and key sensitivities highlighted. We expect key decisions, both on assuming new risks and managing existing ones, to be taken at the appropriate level, including at the level of the board where they are sufficiently important.

64. Climate change, and society's response to it, present financial risks which are relevant to the PRA's objectives. While the financial risks from climate change may crystallise in full over longer time horizons, they are also becoming apparent now. We expect firms in scope of SS3/19, which detailed our supervisory expectations for firms' management of climate-related financial risks, to be able to demonstrate how they are responding to our expectations and set out the steps being taken to address barriers to progress. The PRA is aware of the need to be proportionate, and smaller firms should determine how these capabilities might map to the nature, scale, and complexity of their business.

Control framework

65. A firm's control framework encompasses the processes, delegated authorities and limits that put into effect a firm's approach to risk management and control. We expect a firm's control framework to be comprehensive in its coverage of the whole firm and all classes of risk, commensurate with the nature, scale and complexity of the firm's business, and to deliver a properly controlled operating environment (including, for example, through segregation of duties, reconciliations, or through the process to report and act on any breaches of limits).

66. We expect firms to have available the information needed to support their control frameworks. This information should be of an appropriate quality (current and consistent), integrity (that data is correct), and completeness to provide a reliable basis for making decisions and to control the business within agreed limits and tolerances, and should be produced in a sufficiently timely manner. It should be able to be accessed and analysed in aggregate for the business as a whole, across the group, and for each business line and legal entity within it, to facilitate understanding and swift management of the operational and financial risks to which the firm is exposed.

67. Models are used by firms to drive a wide range of decisions across different areas, including risk management, risk measurement, and capital and liquidity adequacy.

68. Model risk is the potential for adverse consequences from model errors or the inappropriate use of modelled outputs to inform business decisions. Decisions based on flawed model output can lead to adverse consequences such as financial loss, reputational damage or risk the solvency of firms. The increasing reliance on models to assess future risks, the increasing complexity and interconnectedness of financial systems and new advancing technologies highlight the need for sound model risk management practices.

69. It is our expectation that firms take a strategic approach to model risk management as a discipline in its own right.[15] SS1/23 summarises overarching guidance on model risk management applicable to all model- and risk-types, and relevant to all firms in a proportionate manner. We consider the principles core to robust Model Risk Management practices.

70. The overarching guidance sets out expectations and clear accountabilities for boards and senior management. Firms should understand the extent of their reliance and use of models, senior management should ensure that the appropriate risk management

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15 SS1/23 – Model risk management principles for banks; available at **www.bankofengland.co.uk/prudential-regulation/publication/2023/may/model-risk-management-principles-for-banks-ss**.
PS6/23 – Model risk management principles for banks; available at **www.bankofengland.co.uk/prudential-regulation/publication/2023/may/model-risk-management-principles-for-banks**.

processes are in place to manage model risks adequately and boards should instil a firm-wide cultural awareness of identifying and managing model risks across the organisation.

71. In addition to having an appropriate risk culture embedded across their organisation, firms should have in place separate risk management and control functions (notably risk management, finance, and internal audit) to the extent warranted by the nature, scale, and complexity of their business. We expect these functions to support and challenge the management of risks firm wide, by expressing views within the firm on the appropriateness of the level of risk being run, and the adequacy and integrity of the associated governance, risk management, financial and other control arrangements. Given this, employees engaged in such control functions must be remunerated in accordance with the achievement of the objectives linked to their functions, independently of the performance of the business areas that they control.[16]

Capital

72. Firms should maintain appropriate capital resources, both in terms of quantity and quality, consistent with ensuring their safety and soundness and taking into account the risks to which they are exposed. Having enough capital of sufficiently high quality reduces the risk of a firm becoming unable to meet the claims of its creditors, and is therefore crucial for maintaining creditor confidence. This is particularly important for deposit-takers and investment firms given their liabilities are of shorter maturity than their assets. In addition, where a firm is owned by private shareholders, having more shareholder equity, the highest quality form of capital, gives owners a greater interest in the firm being run prudently.

73. As with all elements of our approach, we expect firms in the first instance to take responsibility for ensuring that the capital they have is adequate. However, reflecting the incentives firms have to run their business in a less prudent manner than the public interest would indicate, there is also a clear role for us as prudential regulator to specify a minimum amount of capital. This does not, however, diminish the need for firms themselves to judge the adequacy of their capital position in an appropriately prudent manner, since that is necessary to maintain the confidence of their creditors. Firms should engage honestly and prudently in assessments of capital adequacy: not least because our limited resource means that we may not identify and account for every element of the risks that firms may face.

Quality of capital

74. We expect the most significant part of a firm's capital to be ordinary shares and reserves. These are the highest-quality form of capital as they allow firms to absorb losses on a going concern basis, that is, without prompting the winding up or legal

16 Remuneration Part 8.1 (3b), PRA Rulebook. Available at: www.prarulebook.co.uk/rulebook/Content/Part/292166/07-06-2023.

reorganisation of the firm and consequent disruption and loss of value. In addition, firms may meet some of their requirement in the form of Additional Tier 1 (AT1) instruments.

75. We expect all capital to be capable of absorbing losses in the manner indicated by its place in the capital structure. To this end, all capital instruments must meet the internationally agreed criteria around the definition of capital. We expect firms to comply with these criteria in spirit as well as to the letter when structuring capital instruments. Reflecting this, we expect firms to refrain from innovations when structuring new capital instruments intended to contribute to meeting their regulatory requirements if these are ineffective, or less effective, in absorbing losses or raising capital quickly when needed. We will not permit firms to count such instruments as capital where their incentive is to minimise issuance cost and promote the attractiveness to investors at the expense of genuine loss-absorbing capacity.[17]

Location of capital

76. We are mindful that capital resources are not always freely transferable around a group when it matters most. Capital resources required on a consolidated basis should be pre-positioned close to the risk to ensure entities within the groups are capable of absorbing losses or meeting liabilities as they fall due. In order to support the integrity of individual regulated entities, we will expect firms to limit their intragroup exposures.

Level of capital

77. We expect firms to take responsibility for maintaining at all times an adequate level of capital, consistent with their safety and soundness, and taking into account the risks to which they are exposed. Capital should be sufficient to absorb unexpected losses, including those arising from uncertainties about provisions and valuations, in a wide range of severe but plausible stresses, both market-wide and firm-specific. Such an approach is designed to maintain the confidence of a firm's creditors even in stressed circumstances.

78. We form judgements about how much capital individual firms need to maintain, given the risks to which they are exposed and uncertainties about the values of assets and liabilities. Our judgements should inform firms' own assessments, but we expect firms, in the first instance, to take responsibility for determining the appropriate level of capital they should maintain. Firms should engage honestly and prudently in the process of assessing capital adequacy, and not rely on regulatory minima if these are inappropriate for the risks to which they are exposed. And they should not rely on aggressive interpretations of accounting standards, especially in calculating asset valuations and loan loss provisions.

[17] SS7/13 – Definition of capital (CRR firms) sets out the PRA expectations on the quality of capital instruments that firms hold. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2013/crdiv-and-capital-ss**.

79. We expect all firms to develop a framework for stress testing and capital management that captures the full range of risks to which they are exposed and enables these risks to be stressed against a range of plausible yet severe scenarios. In support of this, we expect all firms to ensure that assets and liabilities are appropriately valued and that provisions are adequate. Firms should also take into account the effect of asset encumbrance insofar as it may reduce loss-absorbing capacity in resolution or liquidation. We will make an assessment of whether the stresses applied are appropriately prudent.

80. Firms are expected to identify and develop, as a matter of routine, management actions they could take in response to stress scenarios. Firms undertake recovery planning so that they can stabilise their financial position and recover from financial losses following firm-specific, market-wide, or combined stress. Recovery plans should include options to address capital shortfalls through generating capital internally and externally, and taking into account possible liquidity and profitability pressures. Recovery plans are developed and owned by firms, which should put in place appropriate governance processes and triggers to ensure timely implementation in stress. Plans to generate capital internally could include restricting dividends and variable remuneration. We assess the adequacy of firms' recovery plans in terms of the range of recovery options and the amount of recovery capacity they can deliver and the triggers and governance to implement them.

The framework for determining regulatory capital

81. For all firms we determine a minimum regulatory capital level and buffers on top of this, as applicable, expressed in terms of the Basel and UK risk-weighted asset framework. The UK capital framework comprises four parts:

- Pillar 1 – requirements to provide protection against credit, market and operational risk, for which firms follow internationally agreed methods of calculation and calibration.

- Pillar 2A – requirements imposed by us reflecting estimates of risks either not addressed or only partially addressed by the international standards for Pillar 1 (e.g. interest rate risk in the banking book, or risks associated with firms' own pension schemes).

- The combined buffer – this comprises the capital conservation buffer and the countercyclical capital buffer, which are relevant to all firms. For globally systemically important institutions (G-SIIs), the G-SII buffer will also be relevant, and for domestic systemic firms the O-SII buffer will be relevant. Where a firm is subject to both a G-SII buffer and an O-SII buffer at the same consolidation level, the higher of the two requirements may apply.

- The PRA buffer, as applicable – some firms may be subject to a PRA buffer which is an amount of capital that firms should hold in addition to their minimum level of

regulatory capital (Pillar 1 plus Pillar 2A) to cover risks and elements of risk not covered elsewhere, and losses that may arise under a stress. This could include a risk management and governance scalar where the PRA assesses a firm's risk management and/or governance to be significantly weak.[18]

82. Pillars 1 and 2A together represent what we regard as the minimum level of regulatory capital a firm should maintain at all times to cover adequately the risks to which it is exposed and to comply with the overall financial adequacy rule.

83. Supervisors may exercise judgement and, where it is deemed appropriate, reduce variable capital add-ons (ie Pillar 2A requirements) for firms using the standardised approach (SA) for credit risk, therefore reducing the likelihood that capital standards are overly prudent for these firms. As of February 2022, 42 firms had seen a reduction to their Pillar 2A add-ons.[19] In assessing capital needs, supervisors will take into account the greater degree of conservatism that may apply to risk weights derived under the SA compared to those from internal ratings based (IRB) models for certain types of exposure, using so-called IRB credit risk benchmarks. These are average risk weights for different types of exposure across firms that use IRB models.

84. Regulatory buffers, which include the combined buffer and PRA Buffer, ensure that banks absorb losses in times of stress without breaching their minimum requirements and can be drawn down and used to continue the provision of financial services, including the supply of credit and support for market functioning. In periods of economic disruption the use of buffers can help reduce incentives for banks to deleverage abruptly and excessively.

85. The PRA buffer is not disclosed publicly and using it does not trigger any automatic restrictions. If a bank, instead, starts drawing down on its combined buffer which is publicly disclosed, they will face restrictions on distributions, such as dividends, coupon payments on additional Tier 1 (AT1) instruments, and discretionary bonus payments.

86. Firms that do not meet their regulatory buffers can expect enhanced supervisory action and should prepare a capital restoration plan. If the PRA is satisfied with the rationale presented, the PRA will be content for firms to rebuild their buffers over a reasonable period of time, taking into account how far the firm has run into its buffers, the expected duration of the stress, the drivers of that stress, the context of that stress (whether firm-specific or systemic) and macroeconomic and financial conditions. If the PRA is not satisfied with the capital restoration plan or with the firm's reasons for using

18 Before applying a scalar, the PRA may apply what is commonly referred to as a 'suspended scalar'. Depending on the severity of the weaknesses identified in a firm's risk management and/or governance, and the proposed remediation actions, the PRA may allow the firm time to address the identified weaknesses before applying a scalar. In these circumstances, the PRA may give the firm an indicative figure for the size of the scalar that could be applied.

19 For more information, please see the Prudential Regulation Authority Annual Report 2022. Available at: **https://www.bankofengland.co.uk/prudential-regulation/publication/2022/june/pra-annual-report-2021-22**.

the buffer, it may consider using its powers under section 55M of FSMA to require the firm to raise sufficient capital to meet the buffer within an appropriate timeframe.

Internal capital models

87. Firms that have obtained the appropriate permissions may use internal models to help to quantify their Pillar 1 capital requirements for the types of risks and exposures covered by those permissions. We are generally sceptical that this approach on its own can provide an appropriate basis to calculate capital requirements. There are inherent difficulties in measuring risk using models, including limitations from their structure and complexity, the quality and availability of data used as inputs and the underpinning assumptions.[20]

88. Our overarching principle is that we expect firms to maintain, at all times, an amount of capital that adequately reflects the risks to which they are exposed. As a consequence, if firms use internal models in calculating their regulatory capital requirements, we expect the models to be appropriately conservative. Where we judge the conservatism applied in internal models not to be sufficient, we will take appropriate action to remediate the situation, which can include: requiring methodological adjustments or recalibration; setting capital floors or imposing adjustments to modelled capital requirements; or withdrawing model approval.

89. Importantly, where internal models are used for regulatory capital purposes, they should contribute to prudent risk management and measurement. Consistent with this, firms should not select between internal model based and non-model based 'standardised' approaches to calculating capital adequacy on the basis of lower capital requirements. Where separate models are used for regulatory capital purposes and for internal purposes, the firm must be able to explain the difference between those models and show that they are reasonable.

90. A firm should use a model as the basis for its capital calculation only where model calibration, controls, and governance arrangements are adequate, with the model and its output subject to effective, ongoing, and independent validation to ensure that it is performing as anticipated. We expect firms not to use internal models for particular asset classes where we judge that it is not possible to measure risk to a sufficient degree of confidence, notably because of a lack of data.

The leverage ratio framework

91. To complement the risk-weighted asset capital regime, all firms should take into account the risk of excessive leverage when assessing the adequacy of capital levels.

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20 For more information on extending the use of the IRB approach to smaller firms see Box 1 in the PRA Annual Competition Report 2017. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-annual-competition-report-2017**.

92. For major banks and building societies subject to the UK leverage ratio framework we require a minimum leverage ratio be met at all times and expect firms in scope to have regulatory capital that is equal to or greater than any applicable leverage ratio buffers. The minimum requirement and applicable buffers also extends to UK banks, building societies and PRA-regulated investment firms with significant non-UK assets, and certain holding companies approved or designated by the PRA. They apply on a consolidated basis in respect of consolidation groups and an RFB sub-consolidated basis in respect of RFB sub-groups. Additionally, they also apply on an individual basis to firms unless they are also CRR consolidation entities subject to the minimum requirement and buffers on the basis of their consolidated situation (such as firms that are parents of consolidation groups) or are the ultimate parent undertaking within their RFB sub-group. Where firms are permitted by the PRA on a case-by-case basis, they will be able to meet the applicable requirement and buffers on a sub-consolidated basis instead of on an individual basis.

93. We expect firms that are not subject to the binding leverage ratio requirement and buffers to manage their leverage risk so that their leverage ratio, as calculated in accordance with PRA Rules, does not ordinarily fall below 3.25%. Firms are expected to meet at least 75% of this leverage ratio using the highest quality of capital, Common Equity Tier 1.

94. The UK minimum leverage ratio requirement is 3.25% on a measure of exposures that excludes qualifying central bank claims. That exclusion is intended to ensure that the leverage ratio does not act as a barrier to the effective implementation of any policy measures that lead to an increase in claims on central banks. It is specified as part of an FPC Direction and Recommendation to the PRA over the leverage ratio framework. The FPC reviews its direction to the PRA, including the exclusion of central bank claims, annually as required by legislation.

Double leverage

95. Double leverage occurs when one or more parent entities in a group funds some of the capital in its subsidiaries by raising debt or lower forms of capital externally.[21] The use of double leverage introduces payment and maturity mismatch risks for the parent companies. Excessive double leverage can threaten the safety and soundness of PRA-authorised entities in a group. We expect firms to manage carefully any risks arising from use of double leverage and to take appropriate mitigating actions where necessary.

21 PS9/18 – Groups policy and double leverage. Available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/groups-policy-and-double-leverage

Liquidity

96. We expect all firms to take responsibility for ensuring that there is no significant risk that they cannot meet their liabilities as they fall due and to have appropriate risk management strategies and systems in place for managing their liquidity.

Funding profile

97. We expect firms to have a prudent funding profile, taking into account both the expected behavioural and contractual maturities of liabilities. The net stable funding ratio (NSFR) is the starting point for the PRA's assessment for the majority of firms.[22] The NSFR is intended to help to ensure that firms maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. It seeks to limit overreliance on short-term wholesale funding, encourage better assessment of funding risk across all on- and off- balance sheet items, and to promote funding stability. A sustainable funding structure reduces the likelihood that disruptions to a firm's regular sources of funding will erode its liquidity position and increase the risk of its failure. Stability in a firm's longer-term funding enhances the safety and soundness of firms, in-line with the PRA's objectives.[23] As such, we expect firms not to be reliant on funding from a narrow set of sources, or to rely excessively on short-term wholesale funding sources that may prove difficult to secure during times of stress, taking into account that even access to secured funding can dry up if counterparties have concerns over a firm's solvency. Firms should also avoid reliance on maintaining particular credit ratings in order to secure and maintain funding. Firms should consider both contractual and behavioural maturity of finding. In considering behavioural maturity, we expect firms to take account of the risk that asset encumbrance poses to unsecured funding and therefore the risk that unsecured funding is withdrawn rapidly in the event of stress.

Liquid assets

98. We expect firms to hold a buffer of high-quality, unencumbered assets that can reliably be traded or exchanged in private markets, including in stressed circumstances. This buffer should enable a firm to withstand a wide range of severe but plausible stress scenarios covering institution-specific, market-wide, and combined stress scenarios over different time periods. This gives a firm's counterparties confidence that it will be able to repay depositors and creditors on demand and gives a firm a period of time to take action to deal with liquidity concerns without undue reliance on the Bank of England and other central banks.

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22 Liquidity (CRR). Available at: **www.prarulebook.co.uk/rulebook/Content/Part/392857/30-03-2023**. CP4/23 proposes that simpler-regime firms would not be subject to NSFR in certain circumstances. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2023/february/strong-and-simple-framework**.

23 CP5/21 – Implementation of Basel standards. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards**.

99. As with capital, we reach our own view on the appropriate size and composition of the liquidity buffer that firms should hold in normal, unstressed conditions except in the case of credit unions, which must simply abide by our minimum prudential standards for these firms.[24] The Liquidity Coverage Ratio (LCR) is the starting point for our assessment.[25] But we expect firms in the first instance to take responsibility for determining the appropriate size of that buffer, taking into consideration the risks they face. Firms should engage honestly and prudently in the process of assessing liquidity risk, and not rely on regulatory minima.

100. To support their judgements on the appropriate size and composition of liquidity buffers, we expect firms to develop a framework for managing liquidity risk that captures the full range of liquidity risks to which they are exposed and to stress test these risks. We will consider whether the stresses applied by the firm are prudent.

101. We are mindful that liquidity resources are not always freely transferable around a group when it matters most. We expect firms to take account of this in ensuring that liquidity is available without impediment to the regulated entities where it is needed, including in stressed times. We recommend that firms should regularly assess their ability to convert their buffers or liquid assets into cash in a short timeframe. Regular 'turn over' of liquid assets in size in the market can reduce the risk of firms encountering problems in trying to monetise these assets in times of stress. Beyond monetising the buffer of liquid assets, firms' recovery plans should include a wide range of credible options to raise liquidity in times of stress. We will assess the adequacy of a firm's range of liquidity recovery options and the amount of recovery capacity they can deliver and the triggers and governance to activate them. We may sometimes require firms to hold additional liquidity where we anticipate a specific stress event.

102. Firms' liquid asset buffers are intended to be used. We are clear that firms may draw down their liquid asset buffer as required in times of stress; there is no expectation that firms should hold 'buffers-on-buffers' of liquidity. When a firm uses its liquid asset buffer, we will be content for the buffer to be rebuilt over a reasonable period of time, subject to a credible plan being provided to supervisors. The plan should include actions already documented in the firm's recovery plan.

Liquidity insurance

103. Firms are encouraged to take account of the range of liquidity insurance facilities offered by the Bank. These include the regular market-wide Indexed Long-Term Repo (ILTR) auctions aimed at firms with a predictable need for sterling liquidity, the bilateral on demand Discount Window Facility designed for addressing firm-specific liquidity needs in bespoke size and, if activated by the Bank, the Contingent Term Repo Facility.

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24 SS2/16 – The Prudential Regulation of Credit Unions: **www.bankofengland.co.uk/prudential-regulation/publication/2016/the-prudential-regulation-of-credit-unions-ss**.

25 Liquidity (CRR). Available at: **www.prarulebook.co.uk/rulebook/Content/Part/392857/30-03-2023**.

104. All of the Bank's liquidity facilities are intended to support the Bank's 'open for business' approach. This means there is no presumptive order of usage. An eligible firm can choose to meet a liquidity need by using the Bank's liquidity facilities, alongside market sources of liquidity and their own liquidity buffers according to their own preference. The decision when and how to use facilities is up to each firm. We would not expect firms to rely solely on the Bank's facilities for routine day-to-day liquidity management (and it has priced those facilities accordingly). But neither are the Bank's facilities intended to be only a last resort.

105. Eligible firms that are not currently members of the Sterling Monetary Framework are encouraged to discuss whether an application would be appropriate. Firms with access should familiarise themselves with the liquidity insurance facilities available, factor the availability of these facilities into liquidity planning, ensure that sufficient collateral is pre-positioned at the Bank to be able to use the facilities, and ensure that operational capacity is maintained by conducting periodic test trades with the Bank.

Operational resilience

106. We expect firms to observe high standards in the management of operational as well as financial risks. For example, firms should have processes in place to ensure continuity of its important business services in the event of financial stress or failure. Operational resilience refers to the ability of firms and the financial sector as a whole, to prevent, adapt, respond to, recover from, and learn from, operational disruptions. The PRA's approach to operational resilience is based on the assumption that, from time to time, disruptions will occur which will prevent firms from operating as usual and see them unable to provide their services for a period.[26]

107. The PRA's primary focus for operational resilience is on firms delivering the important business services that their customers and the wider economy rely upon. As part of this, we expect firms to develop impact tolerances that acknowledge that disruptive events will happen. Firms need to be able to remain within their set impact tolerances for a wide range of severe but plausible scenarios.[27]

108. In line with our statutory obligations (see Section1), we will seek greater levels of assurance around impact tolerances from firms with a higher potential impact assessment. Firms' operational resilience is the responsibility of their boards. We require them to have clear lines of accountability for their operational resilience, through responsibility for the internal operations and technology of the firm. Boards should ensure

[26] Statement of policy: Operational Resilience, March 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-sop**.

[27] PS6/21 – Operational Resilience: Impact tolerances for important business services; available at **www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper**.

there is sufficient challenge to the executive and that they have access to people within the business with appropriate technical skills.

Resolvability

109. Interruption to the critical functions provided by firms to their customers is one of the key channels through which the failure of firms can adversely affect financial stability. To mitigate this risk, the failure of any firm should be orderly, ie it should be feasible and credible for the firm to fail without excessive disruption to the financial system, interruption to the provision of critical functions or exposing public funds to losses. Orderly failure for smaller firms can typically be achieved through an insolvency process, whereby the firm's business is wound up after covered depositors have either been paid by the FSCS, or had their account transferred by the liquidator to another institution. Where this is not possible, for example in the case of larger, more complex firms, managing the failure may require the use of statutory powers by the Bank as resolution authority. A firm's 'resolvability' refers to the level of assurance around the ability to manage its failure in an orderly manner.

110. Our objective is not to avoid all instances of failure, but to minimise the adverse effects of the failure of a firm by taking appropriate actions to promote the resolvability of the firm. Making banks more resolvable also facilitates market exit and should encourage effective competition by reducing the implicit subsidy received by banking groups and the associated funding advantages. Drawing up resolution plans and assessing resolvability for all UK firms are statutory responsibilities of the Bank as resolution authority. The Bank, therefore, sets a resolution strategy for every firm.[28] As set out in more detail in the Bank's approach document on resolution, these strategies can be grouped into three categories: bail-in of a firm's shareholders and creditors, transfer of its business to a private sector purchaser or a bridge bank, or modified insolvency.[29] The designation of the preferred resolution strategy is made on the basis of the resolution planning for each firm. This designation is made by the Bank, working with us, the FCA, and relevant overseas authorities.

Solvent exit

111. It is the PRA's preference, where appropriate, that non-systemically important firms exit before reaching the point of insolvency. Such 'solvent exits' can reduce risks to the PRA's objectives, the firm, depositors, and the wider market. The PRA continues to develop its framework for solvent exit planning for non-systemic banks and building

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28 This section does not apply to credit unions, for which no special insolvency or resolution regime currently applies. Credit unions are, however, expected to meet the requirements for a 'single customer view' (SCV).

29 The Bank of England's approach to resolution: **www.bankofengland.co.uk/paper/2017/the-bank-of-england-approach-to-resolution**.

societies, with the aim to increase firms' preparedness for such exits and decrease the risk of disorderly exit.

Recovery planning

112. The PRA expects firms to undertake recovery planning so that they are ready for periods of financial stress, can stabilise their financial position and can recover from financial losses. Firms should have a number of recovery options, and maintain and test their plans. Governance of the plan should be clearly defined, and firms should have effective processes to identify and report the risks affecting their ability to recover. Recovery planning is a prescribed responsibility under the Senior Managers Regime and firms are responsible for their own recovery plans. A firm's board of directors, or other appropriate senior governance committee or group should provide challenge on the recovery plan, review and approve it.[30]

113. As well as working with firms on an overall approach to exit, we also look to engage with firms on the feasibility of their identified recovery options. This includes conducting the wind-down of trading activities. Firms which affect the financial stability of the UK and engage in trading activities are expected to have a fully-fledged set of capabilities that will allow them to execute a wind-down of their trading activities in an orderly fashion.[31] This is intended to enhance firm's ability to recover from firm-specific and/or market-wide stress and should be ready in conjunction with the Bank of England's approach to assessing resolvability.

Resolution planning

114. Where, as in the case of smaller deposit-taking firms, the preferred resolution strategy for failure is insolvency, the Bank and PRA will need to determine whether the firm's systems are able to provide the information needed by the FSCS for a rapid pay-out or transfer of protected deposits (within a target of seven days in relation to pay-out for the majority of customers). We require relevant firms to be able to produce a single, consistent view of each depositor's funds: this 'Single Customer View' (SCV) is essential to ensure that the FSCS is able to recompense depositors rapidly in relation to covered deposits, minimising the adverse effect of firm failure on the stability of the financial system.

115. The disorderly failure of larger and more complex firms, with highly interconnected legal and operational structures, is likely to have a systemic impact and to be highly detrimental for the continuity of critical functions. As a result of this, the resolution strategy for those firms is likely to involve the use of a transfer tool or a bail-in tool.

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30 SS9/17 – Recovery planning. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss**.

31 SS1/22 – Trading activity wind-down sets out these expectations effective from 3rd March 2025 in more detail. Available at: **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/trading-activity-wind-down-ss**.

Resolvability assessments

116. As part of resolution planning for a firm, the Bank as resolution authority undertakes 'resolvability assessments', in consultation with us. These assessments involve identifying potential impediments to the effectiveness of the resolution plan.[32]

117. The Bank, in consultation with the PRA, uses the Resolvability Assessment Framework (RAF) to, in part, inform the resolution assessment of firms whom have a preferred resolution strategy of bail-in or transfer. The RAF consists of three elements:

- The first is the Bank's approach to assessing firms' resolvability, including the outcomes that firms must, as a minimum, be able to achieve to be considered resolvable. These include that firms must: a) Have adequate financial resources in the context of resolution; b) Be able to continue to do business through resolution and restructuring; and c) Be able to coordinate and communicate effectively within the firm and with the authorities and markets so that resolution and subsequent restructuring are orderly.
- The second is a requirement for certain firms to carry out an assessment of their preparations for resolution, to submit a report of that assessment to us and publish a summary of that report ('public disclosure');
- The third is the publication of a statement by the Bank concerning the resolvability of each firm which makes an assessment. The assessment and disclosure cycle takes place every two years.
- In addition, the PRA also regularly assesses and reviews whether firms are prepared for resolution, in line with the requirements under the Fundamental Rules, to support our general objective of promoting the safety and soundness of regulated firms.
- Together, these components are designed to make resolution more transparent, better understood, and more successful, helping to ensure that where firms fail, they can do so in an orderly fashion- that is without causing excessive disruption to the UK financial system or to the banking services provided to households and businesses, and without exposing taxpayers in general to loss.

Removing impediments to resolvability

118. For resolution strategies and plans to be fully effective it needs to be feasible and credible for the Bank to implement them in the event of a firm's failure. This involves the identification and removal of barriers to resolvability. We expect firms to co-operate fully with the PRA and the Bank, in particular by taking actions to remove barriers to their resolvability and by providing the information needed to facilitate resolution planning. Firms are required to allocate the 'prescribed responsibility' for developing and

[32] The Bank of England's approach to assessing resolvability: www.bankofengland.co.uk/paper/2019/the-boes-approach-to-assessing-resolvability; and the Bank of England's approach to resolution: www.bankofengland.co.uk/paper/2017/the-bank-of-england-approach-to-resolution.

maintaining the firm's recovery plan, resolution pack and, where relevant, resolution assessment, and for overseeing the internal processes regarding their governance to an individual holding a Senior Manager Function.

119. If a firm does not take steps to remove barriers to resolvability, the Bank has powers to direct the firm to take action where the existence of the barrier is considered to be a substantive impediment to the resolution of the firm.[33] The Bank will inform the firm of any identified substantive impediments to resolvability. The firm will then have four months to make a proposal to remove the identified impediments. If the Bank concludes that the firm's proposal is insufficient or no proposal is received, the Bank must use its power to require the firm to take measures to address impediments to the effective exercise of the stabilisation powers, or the winding up of that firm. The firm must propose a plan to achieve the measures required by the Bank, within one month, beginning on the date of the direction.

120. We, as competent authority, also have powers to require firms to address specific impediments to resolvability in support of our general objective, as well as the potential for using our group restructuring powers in relation to ring-fencing objectives. We will consult with the Bank and co-operate closely in exercising these complementary responsibilities and powers.

Resolution of overseas firms

121. International co-operation with other supervisory and resolution authorities is crucial in delivering credible resolution plans for cross-border groups and helps to reduce the risk of uncoordinated actions if part of a group fails. We, with the Bank, have co-operation agreements in place with overseas authorities for the largest firms, which set out roles and responsibilities in resolution planning and processes for information sharing before and during resolution.

122. Where the UK is a host of a subsidiary of an overseas firm, the Bank as resolution authority expects to co-ordinate closely with the home resolution authority in developing and implementing a group resolution plan. The Bank will engage with the home resolution authority to help ensure hosted subsidiaries with bail-in or partial transfer resolution strategies are able to deliver capabilities which can support broadly comparable resolvability outcomes to those applying to UK firms under the RAF.[34]

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[33] The Bank of England's power to direct institutions to address impediments to resolvability, December 2015: **www.bankofengland.co.uk/paper/2015/the-boes-power-to-direct-institutions-to-address-impediments-to-resolvability-sop**.

[34] SS5/21 – international banks: The PRA's approach to branch and subsidiary supervision; available at **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pra-approach-to-branch-and-subsidiary-supervision-ss**.

123. Where firms operate as branches in the UK, we expect them to have robust resolution plans in place and will ensure, in consultation with the Bank, that the resolution arrangement for the firm and its UK operations are appropriate. For all firms with substantial operations outside the UK, we retain an appropriate degree of co-operation with the relevant overseas authorities in order to ensure that our statutory objectives are achieved.

4: Supervisory activity

This section describes how we supervise firms in practice, including the tools we use and the legal and enforcement powers available. In line with our key principles, this engagement will be proportionate to the size and potential impact to financial stability of any given firm. Our supervision is focused on the most material risks that a firm has the potential to pose to financial stability.

124. As set out in Section 2, our supervisory approach follows three key principles – it is: (i) judgement-based; (ii) forward-looking; and (iii) focused on key risks. These principles require us to utilise a broad range of tools in gathering quantitative and qualitative data to inform our supervisory judgements. Box 3 below outlines our approach to authorising new applicant firms, while the remainder of Section 4 refers to our engagement with firms following Authorisation.

Box 3: Authorising new firms

Firms wishing to undertake deposit-taking activities must apply to us for authorisation to do so. The application process is a joint assessment between us and the FCA. We assess applicant firms from a prudential perspective with the focus of the FCA being on conduct. The applicant firm will only be authorised if both regulators are satisfied that the firm will meet each regulator's respective Threshold Conditions, at the point of authorisation and on an ongoing basis. This includes an assessment of whether the applicant firm could be resolved in an orderly way. As provided for in the MoU, we lead and manage a single administrative process, and, as the lead regulator, we will act as the decision maker on the application.

We set out the information that we require firms to supply to complete our assessment. We stand ready to answer questions where necessary, though this does not extend to providing consultancy on completing applications. Along with the FCA, we have committed to engaging with applicants at an early stage in pre-application meetings, which will aim to produce as complete an application as possible.

We take a proportionate approach to the assessment of applications. All applicants are subject to a minimum level of assessment, beyond which work is commensurate with the potential impact of a firm's failure on the financial system.

New banks should also consider the material on the New Banks Start-up Unit webpage at **www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit**. This is a joint initiative from the regulators aimed at helping new banks to enter the market and through the early days of authorisation.

Our aim through this proportionate approach is for barriers to entry to be kept to the minimum consistent with our objectives, so enabling us to contribute to a competitive market.

Engagement with firms

125. Central to our approach is engagement with authorised firms at all levels of seniority. At a senior level, boards as a whole and individual directors should expect regular dialogue with us, either in groups or on an individual basis. In line with the principle of proportionality, this engagement will be focused on material risks that the firm has the potential to pose to financial stability, and will be proportionate to the size, activity type and potential impact that any given firm could have to financial stability. This results in an approach to supervision which is not formulaic and will vary depending on a firm's particular circumstances.

126. All firms are required to submit data, of appropriate quality, to inform judgements about the risks that they may pose to our objectives. Given the importance of this, we periodically validate firms' data, either through onsite inspection by our supervisory and specialist risk staff, or by third parties.[35] Recognising the importance that the PRA places on this, from time to time, the PRA makes use of its powers under s166 of FSMA to commission a skilled person's report focused specifically on the accuracy of regulatory data provided by firms, where concerns have been identified.

127. We gather and analyse information on a regular basis, for example through regulatory returns, firms' annual reports and disclosures, and requiring firms to participate in meetings with supervisors at a senior and working level. Some discussions are strategic in nature, while other interactions focus on information gathering and analytical work.

128. We also conduct detailed onsite testing or inspections of a particular area as appropriate. In-depth, focused reviews, for example of a proprietary trading desk or approach to valuations or risk weightings, involve discussions with staff, reviews of internal documents and testing. In addition, we may review a firm's approach to stress testing, or undertake bespoke stress testing of our own. Alongside our supervisors we often involve our risk specialists and other technical staff in our assessments. Where we feel we can rely on their effectiveness, we may also place reliance on firms' own risk, compliance, and internal audit functions.

Box 4: Section 166 Skilled persons reports

Skilled Persons reports (under s166 of FSMA) are a supervisory tool that we routinely draw on in our supervision of firms across all potential impact categories and PIF stages. Skilled persons reports are a common feature of how the PRA supervises, and firms should be ready for the PRA to utilise these in a wide range of situations. We routinely utilise this tool more than we have done in the past as part of the regular supervisory programme, especially for our most significant firms.

35 Bank of England and FCA Dear CEO Letter on transforming data collection, July 2022. Available at: www.bankofengland.co.uk/prudential-regulation/letter/2022/july/transforming-data-collection.

A skilled person (typically a professional services company, with examples listed on the skilled person panel) could be appointed to produce a report for the PRA for a series of reasons including:

(i) diagnostic purposes: to identify, assess and measure risks;

(ii) for monitoring purposes: to track the development of identified risks, wherever these arise;

(iii) for preventative action: to limit or reduce identified risks and so prevent them from crystallising or increasing; or

(iv) for remedial action: to allow the PRA to respond to risks when they have crystallised.

The use of the tool could be prompted by:

(i) a specific requirement by the PRA for information;

(ii) an analysis of information undertaken by the PRA;

(iii) an assessment of a situation by the PRA;

(iv) expert advice or recommendations received by the PRA; or

(v) a decision by the PRA to seek assurance in relation to a regulatory return.

The PRA might choose to obtain a report in circumstances where an enforcement investigation is being contemplated or is underway. However, the tool is used to support supervisory assessments first and foremost – the use of a skilled persons report does not imply any presumption of wrongdoing or rules breaches on a firm's part in and of itself.

Proactive Intervention Framework (PIF)

129. The PRA uses a Proactive Intervention Framework (PIF) to support early identification of risks to a firm's viability. Firms are assigned a PIF score that is reflective of our judgement of their proximity to failure. Supervisors consider a firm's proximity to failure when drawing up its supervisory plan. Our judgement about proximity to failure is captured in a firm's position within the PIF and is regularly updated, informed by the supervisory activities outlined above.

130. Judgements about a firm's proximity to failure are derived from those elements of the supervisory assessment framework that reflect the risks faced by a firm and its ability to manage them, namely, external context, business risk, management and governance, risk management and controls, capital, liquidity and operational resilience. The PIF is not sensitive to a firm's potential impact or resolvability.

131. The PIF is designed to ensure that we put into effect our aim of identifying and responding to emerging risks at an early stage. There are five PIF stages, each denoting a different proximity to failure, and every firm sits in a particular stage at a given point in time (Box 5). When a firm moves to a higher PIF stage (ie as we determine the firm's viability has deteriorated), supervisors will consider and deploy an appropriate set of supervisory actions. Senior management of firms will be expected to ensure that they take appropriate remedial action to reduce the likelihood of failure. In parallel the authorities will ensure appropriate preparedness for resolution.

132. We consider it important for markets and counterparties to make their own judgements on the viability of a firm. We will not therefore routinely disclose to the market or to firms themselves our own judgement on a firm's proximity to failure, not least given the possible risk that such disclosures could act to destabilise in times of stress.

Box 5: Stages in the Proactive Intervention Framework

Stage	Possible supervisory actions
Stage 1 – Low risk to viability of firm	- Firm subject to the normal supervisory risk assessment process and actions, including recovery and resolution planning.
Stage 2 – Moderate risk to viability of firm Supervisors have identified vulnerabilities in a firm's financial position of deficiencies in its risk management and/or governance practices.	*Recovery* - The intensity of supervision will increase. We may set additional reporting requirements, and make use of information gathering and investigatory powers. - We will require the firm to act to address deficiencies identified over a set period. - The firm will be required to update its recovery plan and may need to activate it. *Resolution* - Where relevant, the Bank may intensify engagement on contingency planning for resolution and obtain the information we consider needed to carry out the task. - The FSCS may be asked to evaluate the quality of data provided to support an SCV, and any obstacles to pay out or deposit transfer.

Stage 3 – Risk to viability absent action by the firm Significant threats to a firm's safety and soundness have been identified.	*Recovery* - We may require any of the following actions: changes to management and/or the composition of the board; limits on capital distribution (including dividends and variable remuneration); restrictions on existing or planned activities; a limit on balance sheet growth and/or stricter leverage limits; and setting tighter liquidity guidelines and/or capital requirements. - The firm may be required to draw on the menu of options set out in its recovery plan as appropriate. *Resolution* - With the support of the Bank, if not already underway, we may intensify engagement on contingency planning for resolution and obtain the information we consider needed to carry out the task.
Stage 4 – Imminent risk to viability of firm The position of a firm has deteriorated such that we assess that there is a real risk that the firm will fail to meet the Threshold Conditions, but some possibility of corrective action remains.	*Recovery* - We will most likely increase the scale of the recovery actions needed (including in relation to liquidity and capital). We will set out a timetable for implementation of recovery actions. - Firm-led recovery actions will need to be executed in short order and the firm will need to demonstrate that these are credible and will produce material results. - Actions initiated following activation of the recovery plan, including on asset disposal (or sale of firm), will need to be completed. *Resolution* - With the support of the Bank, we may intensify engagement on contingency planning for resolution and obtain the information we consider needed to carry out the task. - Where relevant, the Bank and FSCS will confirm that all necessary actions to prepare for the resolution of the firm have been taken, including that relevant data were readily available.

Stage 5 – Firm in resolution or being actively wound up	*Resolution* - Where appropriate the Bank will use its resolution powers as appropriate, overseeing the resolution or winding-up the firm. - The FSCS may be required to effect depositor pay out and/or to fund deposit transfer, or resolution.

Setting Supervisory Strategies

133. We hold regular internal stocktake meetings, known as Periodic Summary Meetings (PSMs) for all firms that we supervise to discuss the major risks they face, agree the supervisory strategy, and proposed remedial actions, including guidance about the adequacy of a firm's capital and liquidity (as described in Section 3). There is senior level involvement in these assessments, such that major judgements are made by our most senior and experienced individuals. These formal assessments are also subject to rigorous review by those not directly involved in day-to-day supervision of the firm, including risk specialists and independent advisers. Depending on the Potential Impact category of the firm, the assessment may also be reviewed by the PRC. The role of the PRC is explained further in Box 6.

134. There is a clear and direct link between the risks that we identify and the actions we expect from firms in consequence. For example, if we have identified deficiencies in a firm's forecasts of earnings, or inappropriate remuneration structures, leading to risks to its financial health, we will expect the firm to take steps to tackle this. This may involve direct restrictions on payments, or requirements on the firm to improve its forecasting, systems, or governance as appropriate. Or the assessment may have revealed that senior management has an inadequate view of the firm's liquidity risk, compromising the effectiveness of the firm's governance and, in consequence, the firm's soundness. We may then expect the firm to enhance internal systems for monitoring liquidity risk, or to review the design and effectiveness of its governance and reporting lines. Similarly, our assessment may highlight that deficiencies in a firm's governance processes have resulted in the board not articulating a risk tolerance for outage times as a result of operational disruptions. We may then expect the firm to review its operational resilience governance including: enhancing management information to the board; setting an impact tolerance for operational disruption; and revising its business continuity arrangements.

135. Following the PSM, we send a letter. For most firms we send an individually tailored letter clearly outlining the risks that are of greatest concern, and against which we require action. For those firms with the lowest potential impact we send a standard letter outlining issues relevant to all firms in a peer group, unless specific issues have been identified with a particular firm.

136. In response we expect firms to formally allocate an SMF to take responsibility for addressing each key risk and action highlighted by the PRA in the PSM letter. These responsibilities should be reflected in the relevant SMFs' Statement of Responsibilities (SoR).[36] We focus on the most material issues we have identified and supervisory interventions are clearly and directly linked to reducing risks to our objectives. We will communicate to a firm's board when and how we intend to verify whether any remedial actions taken to address the key risks have been completed to our satisfaction. We actively engage with the firm's board and its subcommittees, where applicable, and its non-executive directors on progress made in addressing the most significant risks identified. Lastly, we may also engage with the relevant individuals at a firm to understand how success or failure in addressing the key risks and associated actions will affect the remuneration awards of the responsible SMFs.

137. Firms may sometimes disagree with our judgements: this is inherent given the tensions between the public and private interest. We, in general, discuss issues with firms in reaching our decisions, and carefully consider representations made, not least to ensure that our decisions are made on the basis of all the relevant evidence. However, firms should not approach their relationship with us as a negotiation.

Box 6: The Prudential Regulation Committee (PRC)

The Prudential Regulation Committee (PRC) has responsibility within the Bank for exercising the Bank's functions as the PRA, as set out in the Bank of England Act 1998 and the Financial Services and Markets Act 2000.

The PRC makes our most important decisions. It sets the PRA levy, by way of rules, and adopts the budget of the PRA, with the approval of Court. It makes key supervisory decisions in relation to the largest firms we supervise. It has a number of non-delegable responsibilities, including the PRA's high-level strategy and policy-making functions. The PRC is accountable to Parliament, in the same way as the Monetary Policy Committee (MPC) and Financial Policy Committee (FPC), the Bank's other statutory decision-making bodies.

The PRC is chaired by the Governor of the Bank of England. Other members of the PRC are: the Deputy Governors for Financial Stability, Markets, Banking and Resolution, and Prudential Regulation; the Chief Executive of the FCA; a member appointed by the Governor with the approval of the Chancellor; and at least six members appointed by the Chancellor.

36 SS28/15 – Strengthening individual accountability in banking: **www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss**.

Engagement with external auditors

138. Firms' external auditors can and should play a role in supporting prudential supervision, given their ability to identify and flag to us current and potential risks in a regulated firm. As required by FSMA, we maintain arrangements to provide a firm's external auditors with relevant data and information, as well as exchanging opinions with those auditors on the implications of such information. We expect to work with firms' external auditors in an open, co-operative and constructive manner, and have published a Code of Practice detailing the arrangements we will maintain with firms' external auditors in order to promote a mutually beneficial and constructive relationship.[37] We expect auditors to disclose to us emerging concerns within firms, where this would assist us in carrying out our functions. FSMA requires us to meet at least once a year with the auditors of each deposit-taker or investment firm that is determined to be important to the stability of the UK financial system.

Engagement with the FCA

139. We also make use of the FCA's findings on firms' key conduct risks, including money laundering, and any material prudential risks in relation to FCA-authorised subsidiaries of dual-regulated groups where they are materially relevant to our objectives. These are shared under the Memorandum of Understanding between the PRA and FCA.

140. We are not a 'fraud' regulator; this role is filled by other authorities. Our onsite inspections are not therefore designed to uncover all instances of malpractice. Rather, we aim to assess the adequacy of a firm's control framework in preventing operational risk (including serious fraud) that could threaten its safety and soundness, drawing to the attention of the relevant authorities any suspicion or information that may be of material interest to them.

International supervisory colleges

141. We continue to work closely with all relevant regulatory bodies to oversee PRA regulated firms, participating in global supervisory colleges either as a home supervisor, or host supervisor, where relevant. Where we are the home supervisor, we organise and chair the supervisory college. To be fully effective, colleges must operate in a manner that enables supervisors to be open and transparent with each other, and to address difficult issues. We seek to adopt this approach when we run colleges and expect other authorities to participate on the same basis. As the lead authority and college chair for

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[37] The relationship between the external auditor and the supervisor: a code of practice; available at **www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2013/the-relationship-between-the-external-auditor-and-the-supervisor-a-code-of-practice**.
SS7/13 – The relationship between the external auditor and the supervisor: a code of practice; available at **www.bankofengland.co.uk/prudential-regulation/publication/2013/the-relationship-between-the-external-auditor-and-the-supervisor-a-code-of-practice-ss**.

major UK firms, we are prepared to tackle instances where we believe that other authorities are not acting in a manner consistent with our objectives. And we encourage other authorities to challenge us if they have concerns.

Using powers in the course of supervision

142. To assist with our risk assessment, we may choose to use our statutory powers, in particular, our information gathering power and our powers to commission reports by Skilled Persons on specific areas of interest (under s165, 165A, 166 and 166A of the Act). Such reviews can be undertaken where we seek additional information, an assessment, further analysis, independent expert advice and recommendations, or assurance on aspects of a regulated firm's activities. We may enter into a contract with a Skilled Person directly, following a transparent and consistent approach to selecting and appointing them, or we may allow the regulated firm to contract with the Skilled Person. We are always regarded as the end user of a Skilled Person report regardless of the appointment approach taken. Further detail on our approach to using Section 166 Skilled Person powers can be found in Box 4.

143. In addition to the powers to request information from firms outlined above, we have a variety of other formal powers available to us under the Act, which we can use in the course of our supervision, if deemed necessary to reduce risks. These include powers by which we can intervene directly in a firm's business. For example, we may vary a firm's permission or impose a requirement under Part 4A of the Act to prevent or curtail a firm undertaking certain regulated activities, which may require a change to a firm's business model or future strategy. The Act also confers a number of powers on us with respect to group restructuring where we may exercise these powers to enforce a restructuring of a ring-fenced bank group, or its unregulated UK-incorporated holding company. This power can be exercised in a variety of circumstances, including where the actions of the RFB are having an adverse effect on our ability to advance our objectives.

144. We may also use our statutory powers to approve or allow certain changes requested by firms, for example its permissions to perform regulated activities. Where those changes could adversely affect the safety and soundness of the firm, we may use our powers to refuse such requests. In certain circumstances, we are also able to grant a waiver or modification to a rule, using powers under FSMA.[38]

145. While we look to firms to co-operate with us in resolving supervisory issues, we will not hesitate to use formal powers where we consider them to be an appropriate means of achieving our desired supervisory outcomes. There is substantial flexibility for us to tailor requirements specific to the circumstances of a firm and the nature of our concerns, including serious cultural failings. This means that, in certain cases, we will choose to

38 Waivers and modifications of rules; available at **www.bankofengland.co.uk/prudential-regulation/authorisations/waivers-and-modifications-of-rules**.

deploy formal powers at an early stage and not merely as a last resort. This can include addressing serious failings in the culture of firms.

146. When we impose a requirement on a firm at our own initiative, we must publish such information about the matter as the PRA considers appropriate. However, we do not have to publicise the imposition of requirements if publication would be unfair to the person concerned or prejudicial to the safety and soundness of a firm.[39]

147. We consider when and how to use our formal powers, and assess the particular facts and circumstances, on a case-by-case basis. In all cases, we are likely to consider a number of factors in connection with the possible deployment of such powers, including:

- the confidence supervisors have that firms will respond appropriately to our requests without the use of powers;
- our view of the firm's proximity to failure, as reflected in its position within the Proactive Intervention Framework; and
- the likely impact, including systemic implications, of the firm's failure.

Enforcement

148. Where a firm or individual fails to comply with requirements or rules imposed by the PRA, we can take enforcement action. We have a wide range of enforcement powers and, for example, can issue a financial penalty or public censure against a firm or individual who is found to be in breach of our rules. We can also prohibit an individual from working in the regulated financial services sector. This way we clearly set out, for the benefit of the whole regulated community, the actions we consider unacceptable.

149. In practice, not every breach of a rule or requirement will result in enforcement action. This is because, in any given situation, there may be a range of possible regulatory responses by the PRA. The appropriateness of using its enforcement tools will, therefore, need to be measured against:

- their anticipated benefits in advancing the PRA's statutory objectives;
- the alternative courses of action available to the PRA; and
- the proportionality of opening an investigation, given the level of resources it may require and the level of intrusion and cost to the subject

[39] The use of PRA powers to address serious failings in the culture of firms – June 2014. Available at:www.bankofengland.co.uk/prudential-regulation/publication/2014/the-use-of-pra-powers-to-address-serious-failings-in-the-culture-of-firms.

150. Before taking enforcement action against a firm or an individual, the Bank's enforcement and litigation team usually investigate whether (and if so, which) regulatory requirements have been breached and any concerns about an individual's fitness and propriety. The PRA has published a set of referral criteria which sets out the considerations we take into account when deciding whether or not it is appropriate for us to conduct an enforcement investigation, and to determine which of the PRA's investigation tools and powers to use.[40]

5: Proportionate application of the supervisory approach

We are responsible for supervising a diverse range of firms. This includes low impact firms, international firms and groups containing ring-fenced bodies. Even within these broad categories there is substantial diversity in firm structures and sizes as well as products, which shapes the business models and risks to which these firms are exposed. We tailor our application of the supervisory assessment framework to take account of this diversity and ensure a proportionate approach.

Low impact firms

151. At an individual level, the lowest impact firms (Category 4 firms under our Potential Impact Framework) have almost no capacity to cause disruption to the UK financial system, either through the way they carry on their business or through idiosyncratic, orderly failure. However, there is a risk that problems across a whole sector or subsector could generate some disruption to the continuity of financial services, ie several firms may fail together through a common exposure, with possible wider systemic impact (as occurred in the 1990s 'small banks' crisis for example). Our proportionate and tailored approach to supervising different types of low impact firms is set out below for non-systemic UK banks and building societies, and credit unions.

Non-systemic UK banks and building societies

152. For non-systemic UK banks and building societies, our supervisory approach and level of engagement is based on the potential impact and PIF stage of the firms, overlaid with our assessment of the key risks facing each individual firm. This is shaped by the four key principles outlined in Section 2.

40 The PRA's Statutory Powers and Enforcement; available at www.bankofengland.co.uk/prudential-regulation/pra-statutory-powers.

153. The diversity of firm structures, sizes, and business models are considered thoroughly as part of our supervisory assessment framework in order to apply the principles of proportionality, and deliver against our secondary competition objective to facilitate effective competition. The Strong and Simple prudential framework will be for firms that are neither systemically important nor internationally active. The combined objectives of this framework would be to maintain the resilience of those firms, and the stability of the UK financial sector, while using simplified prudential regulation through which requirements would expand and become more sophisticated as one or both of the size or complexity of firms increase. This approach would reflect the diversity of sizes and business models of firms that the PRA does not consider systemically important or internationally active.

Credit Unions

154. Credit unions are the major constituent of the lowest impact category; they are not subject to the Capital Requirements Directive, and they are not generally issued with individual guidance for capital or for liquidity. Instead, they are subject to a specific prudential regime, as set out in the Credit Union Part of the PRA Rulebook, including prescribed minimum capital and liquidity requirements. They are supervised, and their adherence to the prescribed financial standards is monitored, as described below, and from time-to-time they are required to engage in supervisory thematic reviews.

155. Given that credit unions are only likely to pose risks to financial stability at an aggregate level, we supervise them on a portfolio basis. Automated tools that analyse their regulatory returns issue alerts highlighting outliers and trends, and they are, in general, examined individually only when their regulatory returns trigger an alert.

156. We also examine individual credit unions when a risk crystallises (as discovered through, for example, a visit to the firm, or an approach from the firm itself), or in response to authorisation requests from the firm (for example, a request to change its permissions to undertake regulated activities, or to extend the nature or scale of its business).

157. In addition, we conduct peer group and trend analysis across the credit union sector as a whole to develop a clear understanding of the risks posed both by groups of very low-impact credit unions and by individual credit unions. We still conduct annual assessments of these credit unions, but in large peer groups. Credit unions in this category are not visited on a fixed, regular schedule but are subject to onsite work by us at any time.

158. In contrast to higher-impact credit unions, those in the lower categories contact us through a centralised firm enquiries function and do not have an individual, named supervisor.

159. We seek to ensure that all credit unions are resolvable, with a particular emphasis on meeting standards for rapid pay out of depositors by the FSCS. They are not otherwise required to have recovery and resolution plans. Those individual credit unions posing a risk of contagion to other firms, for example through having uninsured depositors, are subject to more intensive supervision.

Ring-fenced bodies (RFB)

160. The PRA's general objective of promoting the safety and soundness of PRA-authorised persons was amended in 2019 to require us to discharge our general functions in a way that ensures that RFBs are protected from risks that could affect the provision of core services, and that ring-fenced banks – whether through their activities or their failure – do not threaten the provision of these services. Ring-fencing is intended to safeguard the continuity of the provision of core services (ie deposits, payments, overdrafts) by seeking to ensure that the activities of a RFB are restricted and that the RFB has a degree of protection from shocks that originate from other parts of its group, the global financial system or the RFB itself. Ring-fencing also facilitates orderly resolution in the event that either a RFB or another member of its group fails and supports the continuity of core services thereafter.

161. RFBs are necessarily supervised for compliance with more requirements than other banks, and we have special supervisory powers (ie group restructuring powers whereby we may exercise the power to enforce a restructuring of a RFB's group or its unregulated UK holding company) in order to support this. There is also additional public scrutiny in relation to ring-fencing compliance (ie our annual report requirements to provide an opinion on RFBs' compliance with ring-fencing requirements).

162. Our forward-looking, judgement-based approach to assessing the risk posed by firms to our general objective remains appropriate for RFBs. Ultimately firms will have primary responsibility for compliance with ring-fencing legislation. While there are supervisory activities to ensure that RFBs are prudentially sound, capable of independent decisions and comply with the relevant legislative and regulatory requirements, these are accounted for within our broader supervisory framework and form one aspect of our risk-based and forward-looking approach.

Overseas headquartered international banks

163. Banking is an international industry and the UK is a significant international financial centre. Many international banks operate in the UK in order to provide financial services to the UK economy and to access the global financial markets located here. They may do so either through UK subsidiaries of groups headquartered abroad, or branches of foreign banks.[41]

164. As is the case for UK firms, our approach to the supervision of international firms operating in the UK reflects an assessment of the nature and potential impact of the firm

41 A firm authorised in Gibraltar can passport into the UK; available at www.bankofengland.co.uk/prudential-regulation/authorisations/passporting.

on UK financial stability.[42] We will assess the potential impact that international firms may have on UK financial stability, be they in the form of branches or subsidiaries, and adjust the intensity of our supervisory approach accordingly.

165. Similarly, given the nature of the risks presented by foreign banks, it is necessary for us to have assessed the equivalence of the home state regulatory and supervisory regime, and to have an appropriate degree of co-operation with the home state supervisor in order to ensure that our objectives are achieved.

166. However, our legal powers and responsibilities vary depending on the legal form of a firm's operations in the UK.

167. For firms which are subsidiaries of overseas groups, we apply the same regulatory requirements and follow the same supervisory framework as for firms which are part of UK headquartered groups. Additionally, our supervisory approach takes account of the links between the subsidiary and the rest of the group of which it forms part.

168. A branch of a foreign bank forms part of a legal entity incorporated outside the UK. A branch does not have its own capital or board of directors. It follows that its operations are necessarily dependent on those of the legal entity as a whole. We are open to hosting branches of international banks, recognising the efficiency benefits this brings.

169. Whether branch or subsidiary, all firms need to meet the same Threshold Conditions to be authorised by the PRA, but the way that they meet these conditions will vary according to structural differences between entities, and the extent to which we may need to place reliance on their home state supervisor.

170. Many branches or subsidiaries of international banks have close financial and operational inter-linkages to the wider group of which they form part. The financial strength of these entities is often reliant on the overall financial strength of the group. We will therefore work closely with the home state supervisor to assess these linkages, and the group's recovery and resolution plans. Where there are significant linkages between the UK entity and the rest of the group, and where the firm may have a significant impact on UK financial stability, we will expect an appropriate degree of co-operation with the home state supervisor in order for us to understand the nature and extent of risks to the wider group to the extent they affect the UK entity.

171. Our general approach to the authorisation and supervision of international banks, whether they are branches or subsidiaries, is anchored by an assessment of a range of factors including the degree of equivalence of the home state supervisor's regulatory regime and the effectiveness with which we can supervise an international bank that

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42 We set out our approach to international banks and our expectations of them in more detail in SS5/21 – International banks: The PRA's approach to branch and subsidiary supervision; available at **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pra-approach-to-branch-and-subsidiary-supervision-ss**.

operates in the UK through a branch. These factors are relevant both at the time of authorisation and on an ongoing basis during supervision.[43]

172. In general, we will not be content for branches to undertake deposit-taking activities from retail and small company customers in excess of certain de minimis levels. Once a firm is undertaking material deposit-taking activity (for transactional purposes), we need to have greater supervisory influence over that firm and this is only possible if that firm is operating as a subsidiary.

173. In the case of branches undertaking wholesale activity, we will undertake an assessment of their systemic importance. We will identify wholesale branches as systemically important where their size, complexity, and interconnectedness indicate that the failure of the firm could have significant consequences for financial stability in the UK.

43 SS5/21 – International banks: The PRA's approach to branch and subsidiary supervision; available at **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pra-approach-to-branch-and-subsidiary-supervision-ss**. The FCA has also set out its approach to international firms; available at **www.fca.org.uk/publications/corporate-documents/our-approach-international-firms**.

Annex

July 2023: This issue of 'The Prudential Regulation Authority's approach to banking supervision' has been updated to reflect recent developments in policies and approach. The key changes are outlined below.

- New foreword from Sam Woods, PRA CEO and Deputy Governor for Prudential Regulation at the Bank (pages 3-4).
- Removal of text regarding the UK's withdrawal from the EU following transition to a steady state relationship with the EU post-withdrawal.
- Addition of text relating to our objective in relation to focus on ring-fenced banks (page 6).
- Addition of text relating to the 2023 ACT and the PRA's secondary objective for international competitiveness and the growth of the UK economy in the medium to long-term (page 6).
- Addition of text relating to disruption to continuity of critical economic functions in relation to the PRA's general objective (page 8).
- Addition of text regarding the Strong and Simple regime (page 8).
- Addition of text relating to resolvability assessments and orderly firm failure (page 9).
- Addition of text relating to FSCS Depositor Protections (page 9).
- Addition of text relating to the 2023 Act requirement for the PRA to 'have regard' to the government's 2050-net zero target and environment targets (page 11).
- Additional text throughout Section 2 to include additional detail on the PRA's risk assessment framework and how it is used in practice (pages 12-15).
- Update to Box 1: Engagement with other Bank of England functions (page 13).
- Update to Box 2: Working with other authorities' following EU withdrawal (page 14).
- Removal of previous Figure 1: The PRA's approach to risk assessment.
- Inclusion of amended Figure 1: The PRA's Risk Element Framework (page 18).
- Updated section summarising the PRA's approach to assessing Potential Impact, following the revision of the categorisation process to include four categories of firm rather than five (page 19).
- Restructuring of 'Management and Governance' section (pages 21-24).
- Addition of climate change related risk to risk management section (page 25).
- Addition of text relating to SS1/23 – Model risk management principles for banks and PS6/23 – Model risk management principles for banks (page 26).
- Amendments to capital section references to regulatory buffers, including added reference to the combined buffer (pages 27-31).

- Added detail on the Leverage Ratio Framework (page 31).
- Update to 'Liquidity' section (page 33) to refer to the net stable funding ratio and weekly ILTR auctions. Added reference to CP5/21 – Implementation of Basel Standards.
- Addition of a separate section on 'Operational Resilience' to align with changes to the PRA's Risk Element Framework (page 35). This includes reference to: Statement of Policy: Operational Resilience (March 2021) and SS1/21 – Operational resilience: Impact tolerances for important business services
- Update to 'Resolvability' section (pages 36-40) to reflect the development of the Resolvability Assessment Framework used by the Bank's Resolution Directorate.
- Addition of section on Solvent Exit (page 36).
- Restructuring of Section 4 to include additional sub-section titles to aid clarity (pages 41-50).
- Addition of reference to Bank of England and FCA Dear CEO Letter on transforming data collection, July 2022 (page 42).
- Addition of Box 4 outlining the PRA's use of Section 166 Skilled Persons Reports (page 42).
- Updates to Proactive Intervention Framework (page 43).
- Updates to 'setting supervisory strategies' (page 46) following the PRA's updated approach to core assurance.
- 'International supervisory colleges' updated to reflect post-EU withdrawal arrangements (page 48).
- Restructuring of 'Using powers in the course of supervision' (page 48), including the addition of a specific section on enforcement.
- Section 5 renamed 'Proportionate application of the supervisory approach' to better represent the contents within the section (page 51).
- Added reference to the Strong and Simple regime in discussion of non-systemic banks and building societies (page 51).
- Update on approach to ring-fenced bodies following implementation of structural reform (page 52).
- Update to Overseas Headquartered International Banks (page 53) to reflect SS5/21 – International banks: The PRA's approach to branch and subsidiary supervision,[44] and post-EU withdrawal arrangements.

[44] Available at: **www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2021/ss521-july-2021.pdf**.