October 30, 2024

Via Electronic Submission

Banking Groups and Structural Reform Team
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Re: BPI Response to PRA CP11/24 – International firms: Updates to SS5/21 and branch reporting

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To the Banking Groups and Structural Reform Team

The Bank Policy Institute (BPI)[1] welcomes the opportunity to comment on the PRA's consultation paper on targeted updates to its approach to supervising international banks with activities in the UK, branch reporting, and clarifications to the expectations of firms' booking arrangements and extending their formal application to UK trading banks.

A major overarching concern for our members is the inherent tension between the PRA's expectations around booking models and those of the ECB. We welcome confirmation from the PRA that it works collaboratively with the ECB to reach mutually acceptable solutions where this tension arises. As we discuss further below, we would encourage the PRA to provide as much information as possible about a firm's options and potential solutions where divergent regulatory expectations have caused constraints in past case studies.

Banks also remain cautious about potential consequential impacts on these expectations as a result of other anticipated policy changes, for example in relation to revised expectations in the area of the senior manager and certification regime and revised deposit protection limits. We urge the PRA to consider the timing of all such developments and where possible engage with the industry early to enable both sides to appropriately consider the potential impacts and to collaborate on proportionate methods to redress any concerns.

[1] The Bank Policy Institute is a nonpartisan, public policy, research and advocacy group that represents universal banks. Regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

We comment further on each of the three elements of the consultation below. We welcome further discussion on any of these issues, in particular if we might assist the PRA as it finalises its policy or to the extent that we have misconstrued any points of clarification by the PRA during our call on September 9.

With respect to those clarifications, certainty of expectations is critical to the attractiveness of the UK as an international financial centre and we respectfully request that concerns that have been raised by the industry are clarified in the final policy statement.

Branch risk appetite

A pragmatic response

We welcome the PRA's openness towards international business and its recognition of the benefits that branches bring to both international competitiveness and the UK economy. We support the PRA's pragmatic and measured response to the lessons learned from the failure of Silicon Valley Bank UK in March 2023.

That said, we would challenge whether £300mn is the appropriate threshold in light of the PRA's secondary objective and the need to balance the risks to the FSCS with the risk of depositors not having access to international banks. SVB UK was reported to have had £4bn of transactional and instant access accounts which prompted the PRA to require its subsidiarisation. In light of this, a threshold of £300mn is seemingly extremely conservative and we would welcome further information relating to the basis on which this number was reached.

It is also important to take into account the implications of the threshold for access to lending, as well as deposit-taking services. An excessively low threshold would likely cause some banks currently active in retail lending to introduce additional controls to limit their lending provision, which would likely have an outsized impact on client books with lower profit margins – such as for schools, charities and religious establishments – who already struggle to secure banking facilities. The public support for financial inclusion should be considered as a factor in formulating an appropriate threshold that allows all types of institutions to access lending facilities. To ensure that charities, charitable trusts, schools & colleges, religious establishments and UK local authorities maintain as broad access and choice in relation to deposit takers and providers of financial services as they currently experience, given the important societal function provided by such entities, deposits from such entities should be excluded from the thresholds for retail and small company deposits.

Discussions with individual firms should take into account the existence of a global resolution strategy, including the extent to which the availability of high-quality loss absorbing resources at group level and the existence of appropriate mechanisms for ensuring this support will be made available to the branch in resolution limits risks to the FSCS. Any thresholds, whether indicative or not, should be calibrated at a level appropriate to the risk to the FSCS, justified by an appropriate and transparent impact assessment. As such, we would welcome clarification that subsidiarisation requirements will not be applied to branches of G-SIBs, where there is a global resolution strategy in place which the BoE considers credibly ensures the UK branch would be preserved from resolution through a single point of entry approach. Clarity from the PRA on this point would be welcome, including how the PRA will reflect resolvability in

its assessment of the thresholds and the circumstances in which the PRA envisages a branch of a G-SIB would be required to subsidiarise and the communication process it would follow with the affected firm.

Furthermore, to the extent that the depositor protection limit increases, the thresholds should also be increased commensurately and a commitment to this effect in the final policy would be much welcomed. We note that the interim regulatory initiatives grid provides that the PRA expects to publish a consultation paper in connection with the review of the FSCS deposit protection limit in Q4 2024 or Q1 2025.

Evidencing customer types

We thank the PRA for its clarification but request that the final policy expressly confirm that its expectations around corporate customers undertaking UK economic activity 'that are likely to be dependent on a particular branch' do not impose any additional information requirements on the firm. Rather, the PRA will use the information reported under the new line of the Branch Return on instant access non-financial corporate deposits to monitor a firm's activity and use this as part of its ongoing supervisory dialogue with the firm to better understand the nature of these accounts and customers. No additional KYC expectations are assumed and no additional burden is intended. We understand that the PRA considers that the nature of the customer will suggest its dependence on the firm or otherwise and expects the discussion to be straight forward. We would request further information from the PRA on likely indicators of dependence, however.

Equally, where a firm trips the threshold for retail demand deposits because of deposits it holds from high-net-worth individuals (HNWIs), any existing information which the firm holds on those customers, evidencing that they had financial assets in the last financial year of over £250,000 will be deemed sufficient by the PRA. Explicit clarification to this effect in the Supervisory Statement is urged.

High-net-worth individuals' deposits

We note the distinction between the terms 'instant access' and 'transactional' accounts yet the term 'demand deposit' encapsulates both. Whilst we acknowledge the PRA's recognition that '[HNWI] accounts are less likely to be used for day-to-day transactional banking and HNWI customers are more likely to have access to alternative transactional banking arrangements' the inclusion of all HNWI accounts in the threshold calculations is a disproportionate policy response to the regulatory objectives. We would advocate more precision in the use of these concepts as they apply to HNWI accounts, and more explicit reference in the updated Supervisory Statement to the fact that such accounts, even if instant access accounts or in the few cases they may be transactional accounts, can be assumed not to concern the PRA's branch risk appetite.

Given that the PRA has provided welcome clarification that high-net-worth individuals are not unlikely to be a relevant factor in setting branch risk appetite, this could be further reflected in the requirements for firms whose deposit base is predominantly made up of HNWI individuals. For example, the requirement to report transactional accounts for HNWIs could be waived given this information will provide limited value while imposing a regular cost on firms to assemble.

Additionally, in practice deposits held for HNWIs can often be held through 'non-individuals' such as personal investment companies, trusts, SPVs or similar vehicles. By linking the definition of HNWIs to

Article 9 of the FSMA 2000 (Ring-fenced Bodies and Core Activities) Order 2014 (which only captures individuals), it is not clear whether these deposits will be treated as HNWI deposits. We would ask the PRA to clarify in its final policy that such deposits held through non-individuals still qualify as deposits from HNWIs.

Booking models

Although the PRA states in the consultation document that the amendments to the booking expectations largely consolidate its existing approach to international banks and UK trading banks, it goes on to note that it expects firms to 'meet the expectations set out within a reasonable timeframe, taking into account the firm's current position and the scale of any change that might be required' and to 'provide their supervisors with a planned timeframe for doing so'. We would welcome clarification by the PRA in its final policy that the amendments have no retrospective application. In addition, given the revised SS5/21 will not be released until 2025, we would welcome delay to the effective date signalled by the PRA of Q2 2025 and/or clarity on the elements that the PRA expects to be implemented immediately and the elements for which it recognises firms will need more time to implement (e.g. changes to systems and controls).

Our understanding is that the proposed expectations are to be applied to material changes to the booking model from the date of application of the updated Supervisory Statement, and would not be retrospectively applied to existing booking model arrangements. Retrospective application could create situations in which firms which were subject to the ECB Desk Mapping Review (DMR) would need to revert actions taken based on decisions made by the ECB in 2023. To avoid concerns along these lines it would be helpful to explicitly state in the Supervisory Statement that these changes will be forward-looking only, and are not aimed at reconsidering DMR related decisions and associated actions.

Further, while the PRA note under paragraph 4.25C that they do not expect firms make material changes to their booking models very frequently, the ECB's annual monitoring requirement under the DMR may result in further and / or a higher frequency of amendments to the booking model. We discuss below our expectation around the prism through which the materiality of any change to the booking model should be assessed.

Additionally, the ECB and PRA may have differing views on the factors to be considered in determining the appropriate location for a desk, with the ECB focussing on currency, client location and revenues, while the PRA is focused on the location of market liquidity, client location and risk dimensions. The use of different factors could lead to different views on the appropriate location for a given desk between the two authorities, which may require an increased use of split desks between the two jurisdictions, against the PRA's stated expectation under 4.25M in the draft proposed amendments to SS5/21 that these structures not be used extensively. This points to the need to align regulatory views, as recommended below.

It was reassuring to hear from the PRA that where a firm operates split desks, the supervision of centralised risk management can, and will be performed by the home state regulator. Once more, an explicit statement to this effect in the final policy is critical to give firms and their home state regulators the certainty they need.

Fragmentation

As flagged above, a major concern for the banks we represent is how to reconcile the PRA's expectations on booking models with the expectations of supervisors in other jurisdictions, most notably though not limited to the EU.

Where possible, banks would like to avoid a potential conflict between the PRA's proposals and the ECB's expectations for their booking models which have been established as part of the DMR. Where these conflicts arise firms could be in the position being unable to comply with both the PRA's and ECB's expectations at the same time.

Key areas where such potential conflict may arise, e.g. in the context of the ECB's annual monitoring exercise, include the approach to complex and non-linear risks, the measurement of business volume, the economic rationale for change, pre-existing weaknesses, the requirements related to single business heads, the proportion and seniority of traders, as well as the consolidated independent risk management.

We understand that all cases are fact specific but we would welcome further guidance from the PRA, perhaps in the form of frequently asked questions, addressing the types of solutions or accommodations that have been found acceptable by the PRA and ECB and the areas in which the regulators have 'agreed to disagree' on policy expectations.

Additionally, to address the potential for conflicting guidance between regulatory authorities, especially those regarding split desks, we would propose that the PRA establish a trilogue between the regulatory authorities and the bank in question, such trilogue preferably underpinned by a set of pre-agreed metrics (in the case of the DMR, measuring market liquidity and desk materiality). Alternatively, the PRA could use existing or bespoke dispute resolution mechanisms as part of their MOUs with those authorities.

Scope

We would welcome additional clarity around the scope of application of the booking model expectations. Paragraph 3.1 would suggest that only derivatives are subject to the requirements ('the PRA has developed these principles which focus on the risk management and control of firms' derivatives activity'). Paragraph 3.12 then discusses the expansion of the scope of application to include those 'PRA-authorised banks and designated investment firms that are headquartered in the UK, or are part of a group based in the UK, with investment banking or sales and trading activities in both the UK and overseas'.

We understand that scope of application mentioned in 3.12 solely focuses on firms in scope, rather than all activities these firms undertake. Further, based on a reading of the text, we assume that Section 3 relates to trading desks more generally and banking book activity which poses 'similar risks' (as to which see below).

Common understanding of central concepts

Understanding the concept of 'material deposit activity originated in the UK'

We agree with the PRA's conclusion that no quantitative threshold would be appropriate for determining when activity should be deemed 'material deposit taking activity originated in the UK'.

That said, we request that the PRA expressly confirm in the policy statement that materiality should be assessed through the lens of the PRA's objectives which, for UK branches of international firms, is expected to be a relatively high threshold.

This is considered critical to support competition in UK financial markets and the societal benefits of international finance. Regulatory policy should be careful not to impair investor access to deposits with international banks unless strictly necessary to support the safety and soundness of firms and UK financial stability.

Qualitative assessment of when a change to a booking model is 'material'

Similarly, any assessment of a 'material change' to a booking model, for the purpose of this policy statement, should also be filtered through the PRA's objectives. Whilst a change may be material to the firm, it should not be considered material for the purposes of this Supervisory Statement unless it has a meaningful baring on the PRA's objectives and impacts either the UK establishment, UK customers or UK market activities. A statement to this effect is necessary to support the UK's stature as a global financial centre, international competitiveness and growth.

When banking book activity poses 'similar risks'

Whilst we appreciate that the concept of banking book activity which poses 'similar risks' is not a new concept in the context of this Supervisory Statement, we would be grateful for clarification from the PRA on what this is intended to capture. Most banking books (particularly for global custody) are expected to be out of scope

However, if, against our assumption, lending exposures and investment banking related exposures are to be included, we would suggest that this is included in a later stage given ongoing efforts of banks with operations in Europe to conduct impact assessments and complete interpretation discussions of the EU's Article 21c of CRDVI (which will become effective in January 2027), and awaiting the conclusions of the ECB's 'Banking Deep-Dive'. These evolving issues could complicate a bank's implementation efforts of the PRA's requirements, and will require further analysis by both banks and regulators.

Booking responsibilities

We would welcome clarity on the type of trading role that the PRA envisages in Paragraph 4.25J in the draft proposed amendments to SS 5/21 as being appropriate to act as the individual responsible for ensuring the correctness of bookings i.e. whether it should be the trader, the desk head, or the book owner.

Branch report

We commend the PRA on all efforts to rationalise and reduce the amount of data the PRA collects, the manual nature of such collection for firms and to provide simpler submission processes.

However, it is important to acknowledge that changes in reporting requirements generally come with new reporting and governance processes in order to ensure that firms provide the data appropriately. Such new processes always have associated up-front costs and operational build times.

With respect to the new liquidity reporting requirements, particular difficulties will arise where these are not aligned with home state requirements. We welcomed confirmation from the PRA that it would defer to home state requirements and acknowledge that the draft reporting guidance states that firms can use average data rather than spot data where they are required to report average data in their returns to their home state regulator. With respect to reporting dates, however, the guidance is less certain. Firms should be able to apply the same reporting period end dates as required by their home state regulator and cannot be expected to report such data until after it has been reported to the relevant home state regulator. We would ask that the guidance be as clear on the potential for different reporting dates as it is with respect to the ability to report average data rather than spot data.

Further clarifications requested

Measurement of business volumes

For the expectations set out under 4.25D.c in the draft proposed amendments to SS 5/21, it would be helpful to understand how the PRA intend to measure the volume of business undertaken, e.g. in terms of number of trades, measures of notional, risk factors or so forth. The quantum by which the volume is measured may have an important impact on how this criterion is assessed.

Pre-existing weaknesses

Under 4.25D.e in the draft proposed amendments to SS 5/21, the PRA expect that any relevant pre-existing systems and control weaknesses in the relevant areas impacted by the booking changes have been remediated. In the final bullet point of paragraph 3.7 of the consultation paper the PRA state that such weaknesses should be remediated before a firm proposes further changes to its booking model. While this makes sense in principle, we would recommend that this requirement is refined and note that this could cause conflict with other supervisors should they require that such a booking model change is made within a specified timeline within which the remediation is unable to be completed.

There may be instances in which a booking model change is required due to changes in markets, the firm's strategy or the commercial environment. In such instances preventing a booking model change may increase risk to the firm, or their clients.

Additionally, we would consider that minor weaknesses should not necessarily impede changes where they are necessary.

We would propose that the wording be amended to specify "relevant material pre-existing systems and controls weaknesses in the ~~relevant areas~~ desk(s) impacted by the booking changes".

Single business heads

Under 4.25N.a in the draft proposed amendments to SS 5/21, the PRA state that split desks should have "a single business head who is accountable for consolidated management of split desks across entities". The level of consolidation at which an individual may be considered single business head is not fully clear. For instance, many firms may have regional or global head for a given business line (e.g. Markets) or product (e.g. Rates) and we assume that this level remains appropriate but would welcome explicit clarification in the revised Supervisory Statement.

Consolidated independent risk management

While we agree that having the capability to conduct inter-affiliate transactions is helpful, requiring firms to enter into such transactions might put those firms in direct breach of ECB or US regulatory requirements. On the latter specifically, the requirement to have "the ability to pool collateral between entities for centralised financing and short-covering purposes" could for US banks lead to conflict with Regulation W under the sections 23A and 23B of the US Federal Reserve Act where these are conducted between the bank chain and the broker chain. We would welcome acknowledgement of this in the final policy and confirmation that such circumstances will not result in a split desk model being ruled out as unacceptable.

Equally, whilst bank structures vary, there is some concern that the requirements around consolidated risk management may not be best allocated to one function alone. For example, compliance and audit functions may have the independence required but cannot reduce positions, pool collateral etc. Operations may be able to reduce positions, pool collateral etc, but would not be regarded as 'independent'. We would welcome clarification from the PRA that this responsibility can be split across the appropriate functions within the relevant firm.

Split desk "instruments"

The PRA refers to firms trading the same "instrument" from more than one location but note that identifying specific "instruments" is a considerably more complex task than identifying "products". We would like to understand if the PRA intends firms to conduct reviews of every instrument or if this could be interpreted as referring to "products". (p26 of the Supervisory Statement)

Whole-firm liquidity data

Furthermore, where the revised Supervisory Statement and branch return refer to whole-firm liquidity data, it would be helpful to clarify that this only refers to the branch and its foreign parent (not for example, other subsidiaries in the group).

The BPI thanks the PRA for its openness and engagement on these matters. It consents to the PRA publishing its name as a respondent to this CP.

We appreciate the consideration of the points in this letter. If you have any questions, please contact me by email at sam.riley@bpi.com.

Respectfully submitted,

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