BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Annual Report

1 March 2017–28 February 2018

Prudential Regulation Authority

Annual Report[1]

1 March 2017 to 28 February 2018

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

(1) Including the PRA Annual Competition Report, and the Prudential Regulation Committee report on the adequacy of PRA resources and the independence of PRA functions.

ISSN 2517-1607

This report is made by the Prudential Regulation Authority (PRA) under the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016. It is made to the Chancellor of the Exchequer and covers the year ended 28 February 2018.

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

The Bank of England Annual Report and Accounts for year ending 28 February 2018 are available on the Bank's website at www.bankofengland.co.uk/annual-report/2018. The PRA's audited financial statements for the reporting year ending 28 February 2018 are set out on pages 133–141 of the Bank of England Annual Report and Accounts. HM Treasury has issued an accounts direction: disclosures relating to this can be found on pages 137–138 of the Bank's Annual Report and Accounts.

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

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

Consultation

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

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

Please address any comments or enquiries to:
PRA Communications
Prudential Regulation Authority
20 Moorgate
London EC2R 6DA
praannualreport@bankofengland.co.uk

The consultation closes on 28 September 2018.

Privacy and limitation of confidentiality notice

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

The representations will be assessed to inform our further work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your representation.

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

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

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

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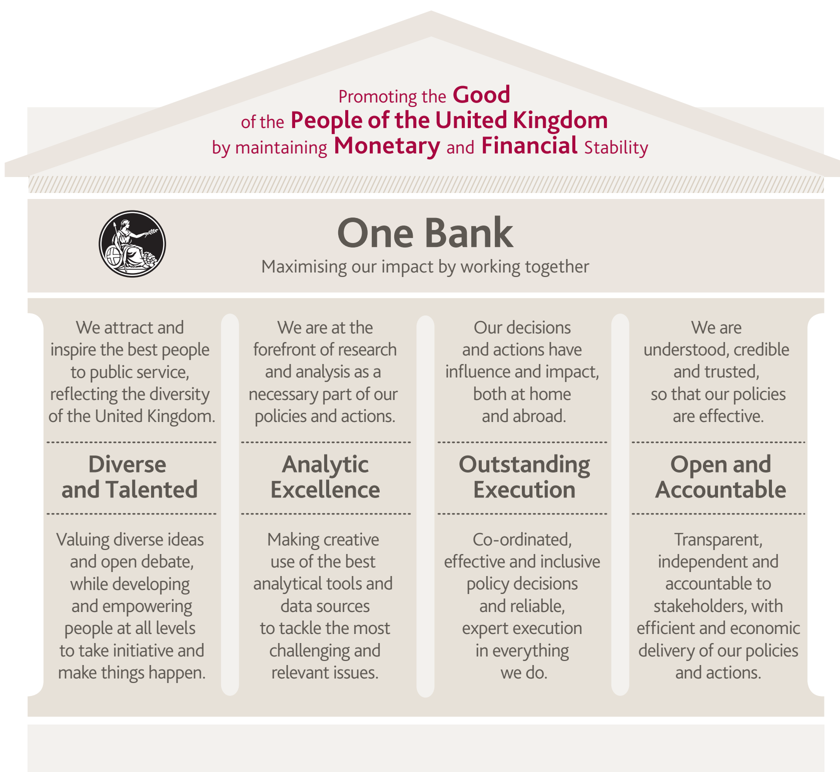

Promoting the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability
One Bank
Maximising our impact by working together
We attract and inspire the best people to public service, reflecting the diversity of the United Kingdom.
Diverse and Talented
Valuing diverse ideas and open debate, while developing and empowering people at all levels to take initiative and make things happen.
We are at the forefront of research and analysis as a necessary part of our policies and actions.
Analytic Excellence
Making creative use of the best analytical tools and data sources to tackle the most challenging and relevant issues.
Our decisions and actions have influence and impact, both at home and abroad.
Outstanding Execution
Co-ordinated, effective and inclusive policy decisions and reliable, expert execution in everything we do.
We are understood, credible and trusted, so that our policies are effective.
Open and Accountable
Transparent, independent and accountable to stakeholders, with efficient and economic delivery of our policies and actions.

Foreword by the Chair

Mark Carney
Governor,
Chair of the Prudential Regulation Committee

What will the financial system of tomorrow look like? Ten years ago, that question was met with a shudder at the sight of banks on their knees, or with scorn at the misconduct which was uncovered. More recent replies would begin with a sigh at the uncertainties around geopolitical risk. But the answer must not end there. Now is the time to lift our sights to how finance can best serve households and businesses. Whether in the emergence of new technologies or the transition to a low carbon economy, the future is arriving with a raft of opportunities and challenges. Prudential regulation will meet them with dynamism, imagination, and the highest standards.

The turning of a chapter is demonstrated by our 2017 stress test. For the first time since the Bank of England launched its stress tests four years ago, no bank needed to strengthen its capital position. The test showed that losses that would have wiped out the entire equity capital base of the banking system in 2008 could be fully absorbed within capital buffers. What a difference a decade makes.

The financial crisis showed what can go wrong when accountability is only there to be avoided and cultural norms are only honoured in the breach. As the tide of misconduct goes out, proper defences are going up. Identifying the most senior decision-makers and setting requirements of them has re-established the link between seniority and accountability. There are encouraging signs that the Senior Managers Regime — due to be extended to insurers by the end of this year — is making a difference. Senior Managers are increasingly focused on building cultures of risk awareness, openness and ethical behaviour.

As we approach the anniversary of the bail-outs of RBS and Lloyds Banking Group, we enter the final furlong of implementing structural reform. In the culmination of a giant effort by the largest UK banks and their supervisors, we are now seeing the ring-fencing of those retail services which households and businesses in the real economy rely upon every day.

This may be, however, just the end of the beginning of structural changes to UK banking. The 2017 stress test, for example, also examined UK banks' strategic responses to gradual but significant changes to business fundamentals, such as increasing competitive pressures from increased use of new financial technologies. Cost cutting alone was not found to be a sufficient response. With a longer lens, the incumbent banks will need to think more creatively about how their business models can adapt so that their resilience can endure.

For now, technological innovations are mostly forming a new front-end to the banking system. Innovative payment service providers are providing new user interfaces for domestic retail and cross-border payment services through digital wallets or prefunded eMoney. Meanwhile, aggregators are providing customers with ready access to price comparison and switching services, benefiting from the changes entailed by Open Banking. In time, these changes could reduce customer loyalty and the stability of funding of incumbent banks. If this happens, we would need to ensure prudential standards and resolution regimes for the affected banks are sufficiently robust to these risks.

As technology races forward, with the potential to transform the financial system for the benefit of consumers, we must watch out for the cyber criminals grasping at its coat-tails. In the weeks after the PRA was established in April 2013, the Bank's Systemic Risk Survey found that only 1% of firms cited cyber in their top five sources of risk to the UK financial system. That figure now stands at over 50%. With CBEST, the Bank — working in concert with other authorities — has led the way in identifying areas where the financial sector could be vulnerable to sophisticated cyber-attack. Firms must also keep on top of the risks from increased or concentrated use of third parties, and changes to business and operating models, including legacy systems. This year we will set out how we plan to embed operational resilience fully within our supervisory framework.

Consistent with our strategic plan, Vision 2020, our approach to operational resilience is being developed collaboratively by policy experts, supervisors and risk specialists. Collaboration across boundaries is the only way fully to get to grips with evolving and complex risks for which there are no precedent.

Which brings me to EU withdrawal. The UK financial system is both a national asset and a global public good, bringing shared risks as well as wide benefits. The foundation of our approach is the presumption that there will continue to be a high degree of supervisory co-operation between the UK and the EU. Given our focus on a smooth and orderly adjustment, it is welcome that the UK and EU27 agreed that there should be an implementation period until the end of 2020 as part of the UK's Withdrawal Agreement with the EU. We have been clear that in the context of their future preparations for withdrawal, EEA banks and insurers may (if they are not conducting material retail business) apply for authorisation to operate as a branch in the UK. This reflects the substantial evidence that openness supports economic dynamism, raising growth and boosting living standards.

EU withdrawal takes place against the backdrop, globally, of major progress in financial reform. New international minimum standards — including the completion of Basel III — are in place to secure the resilience of the financial system. Implementation is now assessed and reported through global bodies, levelling the playing field for cross-border activities. And the frameworks are in place for intensified co-operation between regulatory authorities. These are building blocks for deference to each other's approaches when they achieve similar outcomes, and open the way to bringing wholesale financial services more fully into bilateral trade agreements, keeping the global financial system open and resilient.

Promoting collaboration and catalysing action is also important for risks on a longer time horizon, such as climate change. The first element of the Bank's response is engaging with firms which face climate-related risks today. 2017 was the worst year on record for weather-related insurance losses, at around US$130 billion. By holding capital at a one-in-200 year risk appetite, routinely assessed against weather shocks in the PRA's general insurance stress test, UK insurers were able to support their policyholders through the horrors of the hurricanes. And there are signs that bank boards are starting to treat climate-related risks — for example, the exposure of mortgage books to flood risk — like other financial risks. This year we will publish the results of our survey of climate-related risks to the UK banking sector, following our stocktake of the insurance sector in 2015.

The second element of our response to climate change is enhancing the resilience of the financial system by supporting an orderly market transition. At the One Planet Summit in Paris in 2017, the Bank was a founding member of the Network for Greening the Financial System. And financial institutions responsible for managing US$80 trillion of assets — equivalent to annual global GDP — publicly supported the Task Force for Climate-related Disclosures (TCFD). This delivered recommendations for voluntary disclosures of material, decision-useful climate-related financial risks, helping firms explore how 2°C and other transition paths might impact their business models.

The days of tick-box, backward-looking regulation are long gone. The PRA's role is to understand and shape change so that it unfolds in the public interest. To deliver, in real time, robust and dynamic prudential standards for the good of the people of the United Kingdom.

4 June 2018

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Report by the Chief Executive

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

It is now more than a decade since the start of the global financial crisis, and we have nearly finished the regulatory reforms that it gave rise to.

One of the most important of these, and one in which I have personally been very involved, has been the implementation of ring-fencing. We have now seen three banks launch their ring-fenced subsidiaries, with the others to follow soon. Separating retail banking from global trading in this way is a sensible move for a country like ours that hosts a very large international financial centre. Another significant development this year was that, for the first time since concurrent stress testing began, not one of the large banks needed to improve their capital position as a result of the 2017 stress test. We now need to maintain and defend the post-crisis reforms, and also start to use our new tools and shine the spotlight on new areas of risk. I will touch briefly on some notable examples.

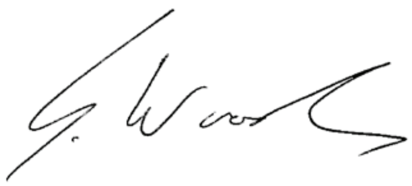
This year, we saw the first use of the newly introduced Senior Managers and Certification Regime (SM&CR) to support an enforcement case, showing that we won't shy away from holding managers individually accountable if they fail to meet our requirements. We will soon extend the SM&CR to insurers to strengthen individual accountability for all PRA-regulated firms.

It is important that we allow PRA policies to evolve in light of experience, once they have been rolled out. We have therefore announced a number of improvements to the part of the Solvency II regime over which we have discretion: we provided greater clarity on the matching adjustment (MA); we made it easier for firms to get approval for minor changes to internal models; we will soon substantially reduce the volume of reporting; and internal model firms will be able to recognise the benefit from a dynamic volatility adjustment in their capital. Finally, in line with our secondary competition objective, we are adapting our approach to authorising and supervising new insurance firms to simplify the process and provide additional support through the process.

Recent events have shown that IT disruptions can materially impact firms' ability to perform their functions and service customers. As part of our ongoing work programme on operational resilience, we have put in place extensive industry testing and exercise programmes. We are also working closely with the National Cyber Security Centre, HM Treasury and the Financial Conduct Authority (FCA) to ensure we can respond appropriately to critical incidents such as large scale cyber-attacks. Complementing these initiatives, the UK is taking a leading role globally by developing operational resilience standards for firms, with a joint PRA/Bank/FCA discussion paper due to be published by the summer.

It would be difficult to conclude this foreword without recognising the extensive work that the PRA has undertaken to prepare for and promote an orderly UK withdrawal from the European Union. As part of this, we have made clear to firms branching into the UK that they may plan on the assumption that UK authorisation or recognition will only be needed by the end of the implementation period. This is possible as a result of the Government's commitment to provide the PRA with a temporary permissions regime, if necessary, which could be used as a bridge for inbound firms. Meanwhile, we continue to work with UK and foreign firms on their plans for the periods before and after the UK has left the EU. Alongside this, we remain in close dialogue with our European peers, with whom we expect to continue to have a close and co-operative relationship, and we are progressing our work to on-shore existing EU prudential rules.

In the period ahead we will remain strongly focused on our statutory objectives. We will hold the line on the reforms put in place while adapting our activities as required to tackle new challenges.



4 June 2018

Prudential Regulation Committee

Members and responsibilities

Members as at 4 June 2018*

Top row, left to right

Mark Carney
Governor, Chair of the PRC

Ben Broadbent
Deputy Governor, Monetary Policy

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Sir Dave Ramsden
Deputy Governor, Markets and Banking

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

Bottom row, left to right

Andrew Bailey
Chief Executive of the Financial Conduct Authority
1 March 2017 –

David Belsham
External member
Term: 1 May 2018 – 30 April 2021

Sandy Boss
External member
Term: 1 September 2017 – 31 August 2020

Norval Bryson
External member
Term: 1 September 2015 – 31 August 2018

Mark Yallop
External member
Term: 1 December 2017 – 30 November 2020

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

The PRC's terms of reference provide for 12 members, consisting of five Bank Governors and officials, the Chief Executive of the Financial Conduct Authority (FCA), and at least six members appointed by the Chancellor of the Exchequer.[1]

- The PRC is independent in all its decision-making functions, including making rules and the PRA's most important supervisory and policy decisions.
- The PRA functions are exercised by the Bank and are funded by the PRA levy, with the PRC responsible for consulting on and setting the level of that levy.
- The PRC is required to report annually to the Chancellor on the adequacy of resources allocated to the PRA functions and the extent to which the exercise of those functions is independent of the exercise of the Bank's other functions.

1 The Bank of England announced on 9 March 2018 that David Thorburn had resigned from the PRC. HM Treasury announced on 5 January 2018 that Charles Randell had been appointed Chair of the FCA and the Payment Services Regulator effective 1 April 2018. He stepped down from the PRC on 31 March 2018. HM Treasury is conducting a recruitment exercise to find successors for both external members.

* Charlotte Hogg was a member of the PRC until 28 April 2017.

* The Bank of England Act 1998 provides for one member to be appointed by the Governor with the approval of the Chancellor. The Governor appointed Ben Broadbent.

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

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

On 8 March 2017, HM Treasury issued 'Recommendations for the Prudential Regulation Committee'.[1] This sets out aspects of the Government's economic policy to which the PRC should have regard when considering how to advance its objectives, and when considering the application of the regulatory principles in FSMA.

FSMA also requires the PRA to review, and if necessary revise, and publish annually its strategy in relation to how it will deliver its statutory objectives. The strategy is set by the PRC, in consultation with the Bank's Court of Directors. The PRA's strategy was published with the PRA Business Plan 2018/19 on 9 April 2018.[2]

1 www.bankofengland.co.uk/about/people/prudential-regulation-committee.

2 www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-business-plan-2018-19.

Annual report of the PRC to the Chancellor of the Exchequer

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

This is the annual report by the Prudential Regulation Committee (PRC) to the Chancellor of the Exchequer under paragraph 19 of Schedule 6A to the Bank of England Act 1998 (as amended). It relates to the period of 1 March 2017 to 28 February 2018. The Prudential Regulation Authority (PRA) publishes this report as part of its commitment to transparency.[1]

Background

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

The adequacy of resources allocated to the performance of PRA functions

The PRA has published approach documents[2] setting out how it implements its statutory objectives: the PRA's approach to banking supervision and the PRA's approach to insurance supervision. It is a key principle underlying the PRA's approach that it does not seek to operate a zero-failure regime. Informed by the approach, and the operating model and risk tolerance also agreed by the PRC, each year the PRC sets the PRA strategy, business plan and budget. The PRC seeks to ensure that its financial and non-financial resources are allocated to the work that best advances the PRA's objectives.

In making judgements on resources, the PRC takes into account a wide range of relevant considerations. These include the wider legislative and policy framework under which the PRA operates, including the duty to have regard to certain factors under the Financial Services and Markets Act 2000 (FSMA), and the Legislative and Regulatory Reform Act. Another accountability mechanism is HM Treasury's recommendation letter,[3] a check and balance to ensure the PRA has regard to the Government's economic policy when exercising its general functions. In addition, the PRA plans its resources to deliver multi-year programmes of work, (such as structural reform), and responds to changes to the external environment and risk profile of the firms regulated by the PRA.

The PRA consults each year on the allocation of fees between firms. The PRA received a small number of industry comments on its proposed fee regime[4] for this period, none of which raised substantial objections. The PRA has the ability to raise additional funds during the year by reconsulting, which has not been necessary during this period. The fee income generated from regulated firms can only be used for the functions covered by the statutory framework under which the PRA operates.

The PRC receives and reviews regular updates on the PRA's performance and on how the PRA's financial and non-financial resources are allocated and monitored, as well as how any resource risks are being mitigated, through: performance and assurance reporting; discussion of Committee papers; and Committee members' regular interaction with the PRA, including meetings with senior management and other staff. In particular, the regular reporting to PRC covers progress

1 Please note: this report was published on 9 April 2018 at www.bankofengland.co.uk/prudential-regulation/publication/2018/the-adequacy-of-pra-resources-and-the-independence-of-pra-functions. As set out in the letter from the PRC to the Chancellor, also published on 9 April 2018, this report will be published as part of the PRA's annual reporting obligations. This year, minor amendments have been made to reflect its inclusion in the PRA Annual Report.

2 www.bankofengland.co.uk/prudential-regulation/publication/2016/pra-approach-documents-2016.

3 www.bankofengland.co.uk/about/people/prudential-regulation-committee.

4 www.bankofengland.co.uk/prudential-regulation/publication/2017/regulated-fees-and-levies-rates-proposals-2017-18.

against: strategic aims; budget and headcount position; attrition rates; technology availability; and the PRA's risk profile. The Bank's internal control functions also apply equally to the PRA, including the Bank's risk management framework, Internal Audit function, and the Audit and Risk Committee of Court.

The reports and other evidence provided to the PRC during the year indicate the PRA has used its financial and non-financial resources to deliver its business plan effectively.

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

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

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

Locating the PRA within the Bank helps ensure there is effective policymaking on financial stability as the PRA needs to work closely with many other areas of the Bank. This is done in a way which maintains the respective distinct roles and responsibilities and respects the Basel Core Principles. For example, in accordance with the relevant legislation, the Bank has arrangements in place to ensure that the Bank's functions as the UK's resolution authority and its supervisory functions are operationally independent of one another and has issued a statement setting out these arrangements.[1]

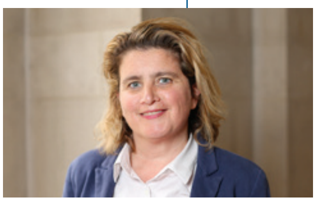
The PRC maintains separation from the FPC and MPC structurally by having different external membership. The PRC and FPC hold almost all meetings separately, but hold some joint meetings to discuss matters of mutual interest (for example, the annual concurrent stress test). The FPC sometimes takes decisions (for example, setting the countercyclical capital buffer rate), that may constrain the decisions that can subsequently be taken by the PRC. The FPC has specific powers of Direction over prescribed macroprudential measures (for example, sectoral capital requirements) and the ability to make Recommendations to the PRA, including on a 'comply or explain' basis (for example, the FPC's 2017 recommendation on the recalibration of the UK leverage ratio requirement).

The PRA's income and expenditure is managed separately from that of the rest of the Bank. As set out above, the PRA is funded by fees paid by regulated firms which can only be spent on PRA functions. As well as PRA direct costs, the PRA's budget covers indirect costs charged by the Bank, including centralised functions such as Finance and Human Resources. The PRC also looks to the Bank's external auditors, KPMG, to provide external assurance that these indirect costs have been allocated appropriately.

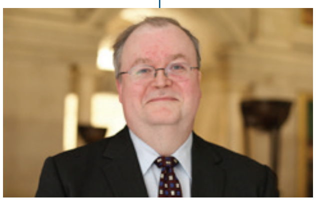
1 www.bankofengland.co.uk/-/media/boe/files/about/legislation/statement-structural-separation.

Senior leadership team
as at 4 June 2018

Sam Woods
Deputy Governor,
Prudential Regulation
and CEO of the PRA
(FPC, PRC)



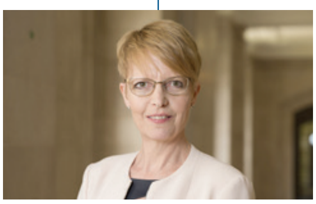
Vicky Saporta*
Executive Director
Prudential Policy



Lyndon Nelson
Deputy CEO and
Executive Director
Supervisory Risk
Specialists and
Regulatory
Operations

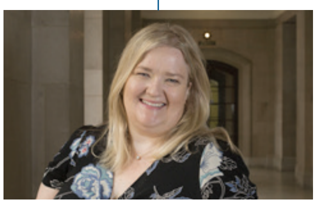
David Rule
Executive Director
Insurance Supervision

Phil Evans
Director
Financial Prudential
Policy



Sasha Mills
Director
Cross-Cutting
Prudential Policy

Charlotte Gerken
Director
Supervisory Risk
Specialists



Anna Sweeney
Director
Insurance Supervision

* Also reports to Deputy Governor, Financial Stability.

Sarah Breeden
Executive Director
International Banks
Supervision

James Proudman
Executive Director
UK Deposit-takers
Supervision

Duncan Mackinnon
Director
International Banks
Supervision

Melanie Beaman
Director
Banks, Building
Societies and
Credit Unions

Find out more online
www.bankofengland.co.uk/about/people/prudential-regulation-committee

Review of 2017–18

The PRA's activities in 2017–18 were directed by the PRA's Business Plan (as set out in the PRA Annual Report and Accounts 2016–17).[1]

This section of the PRA Annual Report outlines the work completed in pursuit of our 2017–18 business aims and in support of our statutory objectives. Readers may also find it helpful to refer to the 'PRA Business Plan 2018/19'[2] that sets out the PRA's strategy and workplan for the coming year, and the PRA approach documents.[3]

Box 1: Examples of activity we delivered against our 2017–18 business aims

1. Continue to develop and implement a forward-looking, judgement based supervisory regime:

- consulted on and effected a series of policy developments to refine our implementation of the Solvency II regime;
- developed our understanding of the risks and/or vulnerabilities posed by the current approach taken by banks to credit risk and asset quality; and
- supported the Bank's resolution objectives for banking and insurance sectors, eg a consultation on the Bank's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and continuing work to enhance resolution arrangements for insurers.

2. Support the Bank in delivering its financial stability and monetary policy objectives:

- continued to do a huge amount of work to promote an orderly UK withdrawal from the EU, including developing a fully operable and coherent prudential Rulebook, providing advice to Government, and setting out our approach for authorising the provision of financial services in the UK;
- continued to support financial stability through our policy development and implementation, eg supporting the Financial Policy Committee on assessments of the impact of EU withdrawal, and continuing to work on domestic policy including monitoring the loan to income limit, and collecting data from firms on our buy to let standards;
- worked closely with domestic and international counterparts in developing our approach to operational resilience; and
- alongside the stress test annual cyclical scenario, delivered the Bank's first exploratory scenario.

3. Implement changes to domestic, European and international regulation:

- worked with firms on delivering the implementation of ring fencing (also referred to as 'structural reform') of retail services from wholesale and investment banking; and
- continued to strengthen accountability, including embedding the Senior Managers and Certification Regime (SM&CR) for banks and consulting on extending the regime to insurance firms.

4. Continue to devise and influence the domestic and international policy agenda:

- reviewed our groups policy framework to ensure it remains coherent and fit for purpose in light of post-crisis financial reforms;
- worked intensively with other members of the Basel Committee on Banking Supervision (BCBS) to finalise the Basel III package of reforms announced in December 2017; and
- supported the International Association of Insurance Supervisors (IAIS) in the development of the Insurance Capital Standard (ICS) for international insurance groups.

5. Ensure the PRA has the right people, infrastructure and governance to deliver its strategy:

- progressed the development of IT and data capabilities as part of the Bank's operational architecture; and
- continued to co-ordinate with the FCA across a range of supervisory and policy matters.

Our activity to support the delivery of our competition objective runs through our business aims, and is also set out in the PRA Annual Competition Report on pages 31–38.

1 www.bankofengland.co.uk/prudential-regulation/publication/2017/annual-report-2017.

2 www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-business-plan-2018-19.

3 www.bankofengland.co.uk/prudential-regulation/publication/2016/pra-approach-documents-2016.

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Business aim 1: Continue to develop and implement a forward-looking, judgement-based supervisory regime

Solvency II — ensuring the approach to insurance supervision aligns with the requirements of the Solvency II Directive and identifying risks arising as firms adapt to the regime

Over the past year, we continued to implement forward-looking, judgement-based supervision of UK insurers within the framework of Solvency II, in order to meet our statutory objectives. This included consultations on a series of policy developments to refine our implementation of the Solvency II regime. Following the Treasury Committee inquiry into Solvency II,[1] and as acknowledged in our response,[2] we worked closely with firms and the Association of British Insurers (ABI) to make changes where appropriate, and where we have discretion to do so.

In October 2017, we announced the series of improvements,[3] beginning with a consultation on the application of the matching adjustment (MA). This was followed in December by proposals to update our guidance on the model change process, model change policies and the reporting of minor model changes.[4] We also set out our work to streamline the Solvency II major model change and other applications processes without compromising the need for firms to continue to meet the tests and standards of the regime.[5] In January 2018 we set out our proposals for a number of regulatory reporting changes. This required us to consider how we should strike a balance between the richer management information and metrics that speak to firm-specific and thematic risks — an opportunity that the Solvency II regulatory reporting framework gives us — and delivering a proportionate approach for firms. Our proposals are designed to reduce the burden for Solvency II insurers and mutuals while maintaining the ability to meet our statutory objectives.[6] Our work will continue into 2018–19 as set out in the PRA Business Plan.

A key area of focus has been the asset side of the balance sheet and, in particular, assessment of the risks coming from the shift in asset allocation that has occurred in recent years. This year we issued our expectations in respect of firms investing in illiquid, unrated assets within their Solvency II MA portfolios.[7] We also completed a survey of equity release mortgages in the MA portfolios of insurers. The discrepancies identified through cross-firm comparison, as well as our observations on the compliance with the effective value test (published in Supervisory Statement 3/17),[8] served as the basis of feedback to individual firms. This work was complemented by deep dive reviews on significant illiquid investments for three large insurers, and completion of valuation and liquidity risk reviews for some other insurers. We observed that the increase in insurers' exposure to illiquid assets increases their reliance upon internal ratings, and we have made progress in enhancing our supervisory toolkit to assess the capability and maturity of internal rating frameworks of insurers.

We also continued to share the observations from our supervision of firms, including:

- a speech by David Rule, Executive Director of Insurance Supervision, in July 2017 that addressed how the search for yield was changing insurer behaviour, and how we were using our approach and supervisory tools to ensure that UK insurers are adequately capitalised and managing risks appropriately;[9]
- an 'Insurance data release'[10] and 'Solvency II: Solvency and Financial Condition Report roundtables'[11] in which we set out feedback

1 https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/324/324.pdf.
2 www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-response-to-the-treasury-committees-inquiry-into-solvency-2.
3 www.bankofengland.co.uk/news/2017/october/pra-launches-series-of-improvements-to-the-implementation-of-solvency-ii.
4 www.bankofengland.co.uk/prudential-regulation/publication/2017/solvency-ii-internal-models-update.
5 www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-statement-solvency-ii-pra-review-of-model-change-related-processes-policies-and-reporting.
6 www.bankofengland.co.uk/prudential-regulation/publication/2018/changes-in-insurance-reporting-requirements.
7 www.bankofengland.co.uk/prudential-regulation/publication/2017/solvency-2-matching-adjustment-illiquid-unrated-assets-and-equity-release-mortgages-ss.
8 See footnote 7.
9 www.bankofengland.co.uk/speech/2017/changing-risk-and-the-search-for-yield-on-solvency-2-capital.
10 www.bankofengland.co.uk/prudential-regulation/publication/2017/insurance-data-release.
11 www.bankofengland.co.uk/prudential-regulation/publication/2017/solvency-2-solvency-and-financial-condition-report-roundtables.

and views on how to improve Solvency and Financial Condition Report (SFCR) disclosures; and

- a letter in February 2018 to the Chief Actuaries of general insurance firms setting out areas where we think Solvency II requirements are not always being met, sharing our findings on emerging good practice in Actuarial Function Reports, and our observations on how Chief Actuaries can be more engaged with their firm's board and risk management.

We will continue to monitor adjustments in insurers' business models and the effects that they have on firms' safety and soundness, product availability and pricing for policyholders. We have taken forward improvements to the implementation of Solvency II and we are looking at the design of the risk margin, which we consider unduly sensitive to low interest rates.

Authorisation and supervision of insurance special purpose vehicles

Working closely with HM Treasury, the FCA and industry, we designed a new, commercially viable framework for ISPVs in the UK. That framework launched in December 2017 when we issued our final policy,[1] and the first ISPV was authorised shortly afterwards. As stated in our response to the Treasury Committee's inquiry into Solvency II,[2] this was an example of both pursuing our secondary competition objective and having regard to the competitiveness of the UK in a global market.

Market turning event in the general insurance sector

Firms' ability to prepare for, and deal with, a market turning event, and how we would expect firms to interact with us, has been an area of interest which started with a consultation in 2016. We published our final expectations to firms operating in the global speciality insurance and reinsurance market, known as the London Market, whose business models are exposed to low-probability, high-severity catastrophe risks.[3] Our policy particularly focused on those firms that may breach their minimum or solvency capital requirements within three months following a market turning event.

Credit risk and asset quality: understanding the risks and/or vulnerabilities posed by credit risk and asset quality

Credit risk remains a dominant risk carried by the banking sector. Over the reporting period we assessed credit risk and asset quality in PRA-regulated banks using:

- supervisory tools such as Continuous Assessment (meetings and regulatory returns data reviews), Written Auditor Reports (WARs), and interactions with auditors;
- specialist-led reviews including assessments of firms' credit risk management, provision coverage and asset quality;
- thematic reviews, combining financial stability and risk specialist resources to provide both micro and macro impact assessments for particular asset classes and sectors;
- annual stress testing; and
- reviews of firms' Internal Capital Adequacy Assessment Process (ICAAP).

We broadened the scope of reviews to improve the systematic coverage of the full credit risk lifecycle: market conditions and strategy; asset origination and underwriting standards; asset quality; monitoring and control; problem debt management and provisions; and capital adequacy. Reviews were undertaken either by asset class (eg large corporate, owner-occupied mortgages), by risk lifecycle stage (eg underwriting standards), by firm, or

1 www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles.
2 www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-response-to-the-treasury-committees-inquiry-into-solvency-2.
3 www.bankofengland.co.uk/prudential-regulation/publication/2017/dealing-with-a-market-turning-event-in-the-general-insurance-sector-ss.

thematically. The reviews were conducted on a risk-based approach across domestic and international banks and building societies.

For retail assets, our primary focus in 2017–18 was on consumer credit lending. The consumer credit review examined PRA-regulated firms' asset quality, underwriting practices and vulnerabilities for credit cards, unsecured personal loans, and motor finance. The risks and concerns were highlighted in a PRA Statement on consumer credit in July 2017,[1] to which firms were asked to respond by September 2017. We followed this up in January 2018 with a letter sent to Chairs of relevant firms to communicate our key findings and action points following the review.[2]

From 1 January 2018, a new way of accounting for credit risk impairment losses — expected credit loss (ECL) accounting — was implemented under International Financial Reporting Standard (IFRS) 9. This caused us to look again at our supervisory approach and the wider regulatory capital regime. In the pre-implementation period we worked closely with firms to understand their approaches to ECL and the implications of those approaches for us, and to encourage greater consistency of outcomes and high-quality disclosures about ECL. Following a series of communications to firms in the run-up to implementation, we sent a letter to Chief Finance Officers of selected firms on 'Transitional disclosures for IFRS 9 'Financial Instruments''. We also published a note for non-executive directors on the impact of, and changes due to, IFRS 9.[3]

Resolvability: delivering PRA policy and supervision to support the Bank's resolution objectives

The Bank is the resolution authority in the UK. This means that the Bank is responsible for taking action to manage the failure of financial institutions (a process known as resolution). The Bank, as resolution authority, operates within a statutory framework that gives it legal powers to resolve banks in order to meet its resolution objectives. The Bank's approach to resolution is set out in its publication of October 2017.[4] This explains the key features of the UK resolution regime — including the Bank's statutory responsibilities and powers, and how the Bank would be likely to implement a resolution.

The Bank works closely with the PRA on resolution. For example, the Bank consults the PRA when it prepares resolution plans and when it produces its assessment of firms' resolvability. The Bank also works with the PRA to identify and remove impediments to resolvability.

In addition, the Bank and the PRA work closely together during planning for a resolution (referred to as contingency planning). Resolution contingency planning is a counterpart to actions taken by firms to implement their recovery plans and heightened supervision undertaken by supervisors. During this phase, the Bank will work with the PRA and the firm to ensure that the resolution strategy can be implemented in a credible and feasible manner.

For the banking sector, a significant milestone was reached on making resolution credible with the publication of the Bank's policy on MREL in 2016.[5] We are continuing our work with the Bank's Resolution Directorate towards setting internal MREL.[6] In December 2017 we published an update to clarify that the PRA's policy on the interaction between MREL and going-concern buffer requirements are not intended to create a different buffer requirement from that which is usable in the going-concern regime.[7] We also published our proposals on MREL reporting in January 2018 that will help us to monitor firms' progress towards meeting end-state MREL requirements.[8]

1 www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-statement-on-consumer-credit.
2 www.bankofengland.co.uk/prudential-regulation/letter/2017/follow-up-to-pra-statement-on-consumer-credit.
3 www.bankofengland.co.uk/prudential-regulation/letter/2017/transition-disclosures-for-ifrs9-financial-instruments.
4 www.bankofengland.co.uk/news/2017/october/the-bank-of-england-approach-to-resolution.
5 www.bankofengland.co.uk/news/2016/november/new-boe-rules-bring-uk-closer-to-ending-taxpayer-bailouts.
6 www.bankofengland.co.uk/paper/2017/internal-mrel-the-boes-approach-to-setting-mrel-within-groups-consultation.
7 www.bankofengland.co.uk/prudential-regulation/publication/2016/the-minimum-requirement-for-own-funds-and-eligible-liabilities-mrel-ss.
8 www.bankofengland.co.uk/prudential-regulation/publication/2018/resolution-planning-mrel-reporting.

The ability of group service providers to have sufficient financial resources to allow the continuation of the provision of critical services to recipient entities in the event of stress or resolution is at the heart of our operational continuity policy. In April 2017, we published our requirements for firms to report the activities and financial resources of their group provider(s)[1] ahead of implementation of the policy on 1 January 2019. Later in the year, we followed this with our updated expectations on the content of firms' and groups' recovery plans.[2]

We have also continued our work with the Bank's Resolution Directorate to establish orderly wind down plans for Category 1 investment banking subsidiaries. The analysis of this year's submissions indicated improvements in firms' wind down planning capabilities. We will continue to collaborate with international regulators to ensure a co-ordinated and effective approach.

The UK's resolution regime does not extend to insurers.

In its Financial Sector Assessment Program (FSAP) report of June 2016, the International Monetary Fund (IMF) recommended that UK authorities should develop, over the medium term, an effective resolution framework for insurance companies that could be systemically important at the point of failure.[3] The IMF recommended that we take into account international guidance.

Accordingly, our work continues with international partners to develop an integrated regime of resolution powers for insurance companies. To achieve this, we have engaged with the IAIS to update the Insurance Core Principle 12 on 'Exit from the market and resolution'.[4]

We worked closely with the European Insurance and Occupational Pensions Authority (EIOPA) on its 'Opinion on the harmonisation of the recovery and resolution framework for (re)insurers across the European Union' in July 2017,[5] which calls for a minimum harmonised recovery and resolution framework for (re)insurers to deliver increased policyholder protection and financial stability in the EU. We also engaged with the European Systemic Risk Board (ESRB) for its August 2017 report 'Recovery and resolution for the EU insurance sector: a macroprudential perspective'.[6] The ESRB report describes systemic risks in the insurance sector and makes the case, from a macroprudential perspective, for an EU recovery and resolution framework for insurers.

In addition, we have been working with systemically important insurers to implement the Financial Stability Board's (FSB) 2016 guidance 'Developing effective resolution strategies and plans for systemically important insurers'.[7] In December 2017 the FSB published for consultation the Key Attributes Assessment Methodology for the insurance sector,[8] which will eventually be used in peer reviews and IMF FSAP assessments of national resolution regimes.

We will need to consider whether, and if so how and when, to extend the resolution regime to insurers in light of these developments.

Business aim 2: Support the Bank in delivering its financial stability and monetary policy objectives

Prepare to implement the UK financial regulatory framework following the UK's exit from the EU

Over the past year, we have worked with firms and other industry participants to understand the potential impact of the UK's withdrawal from the EU on all types of firm, whether UK headquartered, a foreign firm branching into the UK, or established through a subsidiary, and any additional risks posed to

1 www.bankofengland.co.uk/prudential-regulation/publication/2016/ensuring-operational-continuity-in-resolution-reporting-requirements.

2 www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss.

3 www.imf.org/en/Publications/CR/Issues/2016/12/31/United-Kingdom-Financial-Sector-Assessment-Program-Insurance-Sector-Technical-Note-43969.

4 www.iaisweb.org/page/supervisory-material/insurance-core-principles/file/69884/draft-revised-icp-12.

5 https://eiopa.europa.eu/Publications/Opinions/EIOPA-BoS-17-148_Opinion_on_recovery_and_resolution_for_(re)insurers.pdf.

6 www.esrb.europa.eu/pub/pdf/reports/esrb.reports170817_recoveryandresolution.en.pdf.

7 www.fsb.org/wp-content/uploads/Final-guidance-on-insurance-resolution-strategies.pdf.

8 www.fsb.org/wp-content/uploads/P211217.pdf.

the current levels of safety and soundness. Through the year, we have worked with firms and HM Treasury to ensure that firms were preparing for any contingency, and communicated our approach to authorisation.

Our first industry-wide communication was in April 2017[1] requesting information from firms about their contingency plans for EU withdrawal. This was followed with a second letter in December 2017, accompanied by our proposed approach to third country branch authorisation for both banks and insurers, in which we informed firms that we would continue to assume that we will be open to firms branching into the UK after EU withdrawal.[2] At the same time as our announcements, HM Treasury also announced that it would legislate for a temporary permissions regime and a contractual continuity scheme to the extent they are needed.

We finalised both consultation papers on 28 March 2018 following the March EU Council. We welcomed the agreement at the EU Council for a transition period until the end of 2020 as part of the UK's Withdrawal Agreement with the EU. The Bank noted that the foundation of its approach to preparations for EU withdrawal remains the presumption that there will continue to be a high degree of supervisory co-operation between the UK and the EU.[3]

Consistent with the Bank's wider statutory objective of financial stability, the Financial Policy Committee (FPC) continues to identify and monitor risks associated with the UK's withdrawal from the EU so that preparations can be made and actions taken to mitigate them. We have supported the FPC in reaching their assessment that the UK banking system could continue to support the real economy through a disorderly withdrawal and we have provided analysis that underpins the FPC's checklist of actions that would mitigate risks of disruption to important financial services used by households and businesses to support their economic activity. Both the FPC and the PRC have also considered possible forms for the future relationship between the UK and EU in financial services.

Alongside work on contingency planning, authorisations, and assessing wider financial stability risks, the PRA continues to support HM Treasury in converting the current body of EU law (the Acquis) into UK law, and in particular helping to identify the technical changes that are required as a result of the UK's withdrawal from the EU. This has included reviewing over 10,000 pages of legislation and feeding into the Withdrawal Bill and statutory instrument drafting process.

Contribution to financial stability

In addition to our work with the FPC on EU withdrawal, we have continued to support financial stability through our policy development and implementation.

- Throughout the year we have continued to monitor firms' implementation of the FPC's loan to income (LTI) flow limit, now a four quarter rolling limit.
- We held a buy-to-let (BTL) roundtable with lenders and other market participants to discuss our new underwriting standards (and ahead of a second phase, which applied to portfolio landlords). The Bank has also begun to collect new data to monitor the implementation of underwriting standards of BTL mortgages. We are in the process of assessing the data and evaluating the impact of our underwriting standards.
- In September 2017, we recommended to the FPC to continue to consider reciprocation requests for other ESRB member countries as part of the FPC general policy to reciprocate appropriate foreign macroprudential capital actions. The FPC

1 www.bankofengland.co.uk/prudential-regulation/letter/2017/contingency-planning-for-the-uk-withdrawal-from-the-eu.

2 www.bankofengland.co.uk/news/2017/december/approach-to-authorisation-and-supervision-of-international-banks-insurers-central-counterparties.

3 www.bankofengland.co.uk/news/2018/march/update-on-the-regulatory-approach-to-preparations-for-eu-withdrawal.

agreed that this was of benefit to financial stability.

- In early 2018 we supported the FPC in fulfilling its biennial statutory obligation to review its framework for calibrating the systemic risk buffer (SRB). The FPC judged that there was no evidence that warranted any changes to its SRB framework at that time.

- We continue to believe that the risk margin is too sensitive to the level of interest rates and, as previously noted by the FPC, this may encourage procyclical investment behaviour. The most prominent consequence has been a sharp increase in reinsurance of the associated longevity exposure offshore. We are considering possible options to address our concerns in our supervisory implementation of Solvency II.

Firms' operational resilience — developing a microprudential supervisory approach

The operational resilience of the financial sector is a key priority for us: part of this work is about cyber security.[1] Given the nature of the risk and the interconnectedness of the financial system, our response has had to be co-ordinated. Domestically we have worked closely with the FCA, HM Treasury and the National Cyber Security Centre (NCSC). Internationally we have chaired the G7 Cyber Experts Group, which has published Fundamental Elements of Cyber Security[2] and Fundamental Elements of Effective Assessment of Cybersecurity in the Financial Sector.[3] We have been active with international standard setting bodies, such as the BCBS, the Committee on Payments and Market Infrastructures (CPMI), and the International Organisation of Securities Commissions (IOSCO), and have assisted the IMF in their Cyber Programme.

We have completed our initial CBEST testing programme. These tests subject firms that form a key part of the financial system to simulated cyber attacks, and are tailored to each firm, drawing on government, intelligence agency and private sector expertise. The tests have covered banks representing more than 80% of the outstanding stock of PRA-regulated banks' lending to the UK real economy, and deliver an average of 89% of daily payments activity in the UK. The results of testing, together with the actions taken to address weaknesses, demonstrate that firms have made significant progress in building cyber resilience.[4] CBEST will now become part of the supervisory toolkit, and we will continue to test firms' resilience to cyber attack.

Our initial tests served their intended purpose by identifying weaknesses in firms' cyber resilience. For security reasons, these results will not be published. But where shortcomings were identified, firms are implementing action plans to remedy the issues, overseen by supervisors. In some cases, controls on the integrity of systems and confidentiality of data needed to be strengthened. In others, the tests identified the need for further investment in capabilities to detect, mitigate and respond to attacks. And in general, the tests highlighted the importance of firms continuing to invest in their people, processes, and technology in order to counter the risks of cyber attack.

During the reporting period, we conducted cross-firm reviews of IT access management, IT vendor risk management and IT change management capabilities. We also supported supervisors of the banks within scope of structural reform to assess delivery risks from the IT changes required. 71 firms outside of the scope of CBEST completed cyber triage questionnaires. We also piloted a new operational resilience assessment tool, SpotCheck, with seven firms.

1 www.bankofengland.co.uk/speech/2017/the-boes-approach-to-operational-resilience.

2 www.gov.uk/government/publications/g7-fundamental-elements-for-cyber-security.

3 www.treasury.gov/press-center/press-releases/Documents/(PRA)_(BCV)_4728453_v_1_G7%20Fundamental%20Elements%20for%20Effective%20Assessment.pdf.

4 www.bankofengland.co.uk/financial-stability/financial-sector-continuity.

In addition, we conducted a range of reviews, including:

- IT resilience assessment work for custody banks, reviewing IT strategic planning for delivery of payments, clearing and settlement operations;
- assessments of firms' capability to ensure operational continuity of UK financial services in resolution;
- assessments of firms' offshoring arrangements and oversight to ensure continuity as a result of system, economic or environmental events; and
- working with colleagues on firm-specific assessments focused on the management of outsourcing arrangements for those supervised by the Financial Market Infrastructure Directorate of the Bank.

Stress testing

For the banking sector, the Bank's 2017 stress test published on 27 March included two scenarios. Alongside the annual cyclical scenario, the Bank ran an exploratory scenario for the first time. The results of the test were published on 28 November 2017.[1]

The annual cyclical scenario incorporated a severe and synchronised UK and global macroeconomic and financial market stress, as well as a separate stress of misconduct costs. For the first time since the Bank launched its stress tests in 2014, no bank needed to strengthen its capital position as a result of the test.

The exploratory scenario examined major UK banks' long-term strategic responses to an extended low growth, low interest rate environment with increasing competitive pressures in retail banking enabled in part by an increase in the use of financial technology (FinTech).

A key objective of the Bank's stress-testing framework is to contribute to an improvement in banks' risk and capital management practices. The Bank has assessed banks' practices and has provided feedback to them individually, highlighting areas where the Bank expects further improvements, as well as areas in which they have strengthened their stress-testing framework and their delivery of stress-test data and analysis.

Over the reporting period we engaged with banks and published a consultation on model risk management for stress testing in December 2017.[2] In 2018, the qualitative assessment will gauge the effectiveness of the model risk management frameworks implemented in banks.

For the insurance sector, in April 2017 we asked the largest regulated insurers to take part in our 'General Insurance Stress Test' (GIST).[3] The exercise was split into two broad areas of interest: a set of five severe but conceivable scenarios (four natural catastrophe scenarios and one economic downturn scenario consistent with the Banking Stress Test); and a capture of exposures that would allow us to better understand the impact of potential losses by various sectors of the economy.

The exercise allows us to assess market resilience, to be better prepared in the event similar scenarios were to occur, and to identify the key reinsurer counterparties and jurisdictions to which the UK general insurance sector would be exposed in those events. At a firm level, GIST 2017 was aimed at informing the internal model review process and our view of a firm's risk management systems, although it is not used to set capital requirements. The second section provides an insight into how well firms manage their potential exposures to various liability shocks.

Following our review of submissions, we published our feedback, high level results and

1 www.bankofengland.co.uk/stress-testing/2017/stress-testing-the-uk-banking-system-2017-results.

2 The final policy published in April 2018, and the consultation paper are available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/model-risk-management-principles-for-stress-testing.

3 www.bankofengland.co.uk/prudential-regulation/letter/2017/general-insurance-stress-test-2017.

observations in a letter to the CEOs of participating firms in December 2017.[1] The main findings centred on resilience and reinsurance connectedness, with a number of areas for improvement suggested by the results. These included exposure management, national catastrophe modelling, post loss planning, and accounting. The results continue to inform our supervision of firms, for instance where firms are identified as outliers or have results which appear inconsistent with their stated risk appetite or the output of their internal model.

Business aim 3: Implement changes to domestic, European and international regulation

Structural reform — delivering the implementation of ring-fencing of retail services from wholesale and investment banking

UK banks with more than £25 billion of retail deposits[2] are obliged to restructure their businesses and operations to meet ring-fencing requirements by 1 January 2019.[3] To give effect to the restructuring required, the largest firms needed to use a court approved 'ring-fencing transfer scheme' (RFTS) to move their assets and liabilities around their banking groups or to new entities authorised by the PRA. Over the past year, the firms concerned prepared their court applications which included skilled persons reports. In November 2017 we published details of how people could make written statements to the banks and the PRA if they thought they would be adversely affected by the carrying out of an RFTS.[4] Key information on the ring-fencing process is published on our dedicated webpage.[5]

The year under review also saw key regulatory transactions to support banks' implementation of ring-fencing, such as the authorisation of new banking entities and consideration of waiver applications. All of our decisions are set out on the Financial Services Register as they come into force.

Regulatory reporting by firms is an important part of our work on implementation and monitoring, and we have continued our work to ensure ring-fenced banks will be able to submit data as required.

Accountability — delivering and embedding the governance regime for banks and insurers including the principle of proportionality

Following the global financial crisis, and a number of major instances of misconduct, there was widespread international concern that few individuals responsible for running firms were held accountable for failures that occurred on their watch. Consequently, a number of jurisdictions have sought to enhance their arrangements for individual accountability.

For PRA-regulated firms, in March 2016 we introduced the SM&CR for banks, and the parallel Senior Insurance Managers Regime (SIMR) for insurers. Over the past year, we started the process of extending the SM&CR to insurance firms.[6] Once the SM&CR is fully extended, with a statutory instrument to take effect in December 2018, there will be a common, harmonised accountability framework for all PRA-regulated firms, although some minor differences will remain reflecting the respective regulatory frameworks and business models of banks and insurers.

Individual accountability is reinforced by requiring that a significant proportion of the variable remuneration of key decision-takers must now be deferred for a period of seven years to ensure that it can be clawed back over the period in which conduct issues might come to light. We published our expectations of firms, and additional guidance on how firms should comply with our

1 www.bankofengland.co.uk/prudential-regulation/letter/2017/general-insurance-stress-test-2017-feedback.

2 The requirement for large UK banks to ring-fence their UK retail services and activities by 2019 is set out in amendments to FSMA under the Financial Services (Banking Reform) Act 2013 (the 2013 Act).

3 For an overview of ring-fencing and our work to deliver it, see 'Putting up a fence' – speech by James Proudman: www.bankofengland.co.uk/speech/2017/putting-up-a-fence.

4 www.bankofengland.co.uk/prudential-regulation/authorisations/structural-reform-approvals/written-statements-to-the-pra-on-rfts.

5 www.bankofengland.co.uk/prudential-regulation/key-initiatives/structural-reform.

6 July 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-individual-accountability-in-insurance-extension-of-the-sm-cr-to-insurers, and December 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-accountability-implementing-the-extension-of-the-smcr-to-insurers-and-other-amendments.

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remuneration rules in April 2017.[1] We also continued to engage in the work of the FSB's Compensation Monitoring Contact Group. This included co-chairing a drafting group that published guidance on the use of compensation tools to address misconduct in March 2018.[2]

Enhanced individual accountability does not take away the collective responsibility of the board. The two should be complementary: boards rely on individuals to execute strategy and base their decision on information produced by various parts of the organisation for which a specific senior manager has overall responsibility (eg business lines, compliance, and risk). Consequently, we continued to review the collective responsibilities of regulated entity boards through our ongoing supervisory work, including firm-specific governance reviews. We have continued to oversee the establishment of new boards for ring-fenced firms with their specific governance features and obligations.

On 7 March 2017, the PRA's and FCA's requirements for regulatory references became effective. These requirements, which derive from the SM&CR and the recommendations of the Fair and Effective Markets Review[3] seek to address the issue of employees with poor conduct records moving within firms with their prior misconduct undetected (known as 'rolling bad apples'). Our requirements on regulatory references require banks and insurers to request and provide employment references in a standard template containing certain mandatory information on candidates' prior conduct and fitness and propriety when hiring individuals into Senior Management Functions (SMFs), Certified employee roles, Notified non-executive Director (NED) positions, and additionally for insurance firms, Key Function Holder (KFH) roles. The aim of

Box 2: Enforcement — tackling threats to safety and soundness and strengthening accountability in PRA authorised firms

In 2017 we opened eight investigations: six individual investigations and two firm investigations. This serves to demonstrate the continuing focus of our enforcement action on individual accountability. We have also progressed five ongoing investigations started before 2017.

Putting this year's figures into context, since the creation of the PRA in April 2013 we have opened a total, inclusive of this year, of 25 cases against individuals and ten against firms. Of these, 16 cases against individuals are ongoing, six have been closed with no sanction by the PRA, and three have led to sanctions being imposed.[1] In relation to firms, three investigations are ongoing and seven have led to sanctions being imposed by the PRA.

The SM&CR introduced 'Form L: Notifications of breach of conduct rules and related disciplinary action in relation to an employee performing a certification function' in March 2016. We reviewed each of the 17 Form Ls we received last year for potential enforcement action but determined, on the facts of each form, not to pursue action against any certified individuals.

The Bank has consulted on procedures for its Enforcement Decision Making Committee (EDMC) with a view to having it fully operational by mid to late 2018.[2] The EDMC will strengthen the independence and robustness of the decision-making process in PRA contested enforcement cases.

1 On 11 May 2018 the PRA announced it had concluded its investigations into Barclays and its CEO, Mr James Staley, and it had imposed a financial penalty on Mr Staley of £321,230.
2 www.bankofengland.co.uk/paper/2017/procedure-for-the-enforcement-decision-making-committee.

1 www.bankofengland.co.uk/prudential-regulation/publication/2017/remuneration-ss.
2 www.fsb.org/2018/03/supplementary-guidance-to-the-fsb-principles-and-standards-on-sound-compensation-practices-2/.
3 www.bankofengland.co.uk/report/2015/fair-and-effective-markets-review---final-report.

the regulatory reference requirements is to provide a robust and proportionate framework for firms to exchange meaningful information on the conduct and suitability of employees.

We have also sought to provide those who work at banks and insurers with information on how to raise concerns safely. We introduced requirements that UK branches of overseas banks and insurers must inform their workers of the dedicated whistleblowing arrangements run by the PRA and FCA, including how to contact them, and what constitutes a protected disclosure under the Public Interest Disclosure Act 1998. In addition, where a non-EEA banking group has both a UK branch and UK subsidiary (the latter being subject to the PRA's whistleblowing rules) employees in the branch should be informed of the subsidiary's whistleblowing arrangements.

Business aim 4: Continue to devise and influence the domestic and international policy agenda

Maintaining a strong voice and contributing to international standards for banks and insurers

International capital standards for banks

Over the past year, we worked intensively with other members of the BCBS to finalise the Basel III package of reforms announced in December 2017. This completes the reforms started in 2009, following the global financial crisis. The latest revisions mainly concern measurement of risk for the purpose of setting risk-weighted capital requirements and the finalisation of the international framework for leverage ratio requirements and buffers. The objectives of the revisions are to increase confidence in banks' capital ratios, reduce excessive risk-weighted asset (RWA) variability and increase the risk sensitivity of regulatory approaches, while not significantly increasing overall capital requirements.

Domestically, we also expect the Basel III package to help narrow the gap between standardised and model-based approaches to capital requirements, which would support more effective competition (see pages 32–33 of the PRA Annual Competition Report section of this report for information about refinements to our Pillar 2A capital framework and Internal Ratings Based (IRB) approach to credit risk). We also worked with the Bank's Resolution Directorate in developing our approach to the treatment of claims on central banks in the UK leverage ratio framework, as it is relevant to MREL for firms that are subject to UK leverage ratio requirements.

In line with our public commitment, we reviewed our groups policy framework to ensure that it remains coherent and fit for purpose in light of post-crisis financial reforms — including Basel III standards, UK ring-fencing legislation, the resolution framework and other international developments. We published two consultations in October 2017[1] containing proposals to achieve this objective. Our aim is to ensure that a group is resilient, its resources are located close to its risks, and risks of intragroup contagion are limited.

International capital standards for insurers (ICS)

A continuing priority for us in the reporting year was the development of global prudential standards for insurers, led by the IAIS. The IAIS has continued to lead the development of the ICS at the request of the FSB. The ICS is intended to provide a global solvency standard for international insurance groups, enabling enhanced supervisory co-operation between countries, and supporting decision-making by investors and policyholders. We have been actively involved in shaping the open technical issues in the development of the ICS for international insurance groups as part of the ongoing field-testing process.

In July 2017, IAIS delivered ICS version 1.0 for extended field testing, an exercise to test the standard across as wide a range of the insurance groups likely to be captured by the

1 The final policy on groups policy and double leverage was published in April 2018, see www.bankofengland.co.uk/prudential-regulation/publication/2017/groups-policy-and-double-leverage. The consultation on the PRA's large exposures framework is available at www.bankofengland.co.uk/prudential-regulation/publication/2017/changes-to-the-pras-large-exposures-framework.

ICS in the future as possible, and further refining the methodology and calibration of the ICS. In November 2017, the IAIS Executive Committee agreed and publicly announced a single unified approach for the implementation of the ICS. They agreed that implementation will be conducted in two phases: (i) a five-year monitoring period during which results will be confidentially reported to the group-wide supervisor; and (ii) following this monitoring period, the IAIS will consider whether refinements are needed ahead of hard implementation in national laws.

We took part in the IAIS annual identification of global systemically important insurers (G-SIIs) based on the revised G-SII Assessment Methodology published in June 2016. The FSB decided not to publish a new list for 2017, though the firms identified in 2016, including two groups from the UK, will continue to be subject to enhanced supervision, and

Box 3: Parliamentary accountability

Our objectives are set by Parliament. We take our accountability to Parliament very seriously and representatives of the PRA aim for the highest standard in this regard. Sam Woods, Sandy Boss, Mark Yallop, and Sarah Breeden collectively appeared at five public hearings with parliamentary committees including the Treasury Select Committee (TSC), Lords' EU Financial Affairs sub-committee and Exiting the EU Select Committee (ExEUSC) as follows:

- the progress of the UK's negotiations on EU withdrawal, 19 April 2018 (ExEUSC);[1]
- green finance, 20 March 2018 (Environmental Audit Committee);[2]
- the work of the Prudential Regulation Authority, 16 January 2018 (TSC);[3]
- Financial Stability Report, 20 December 2017 (TSC);[4] and
- financial regulation and supervision following Brexit, 1 November 2017 (Lords' EU Financial Affairs sub-committee).[5]

As well as appearing before Committees, Sam Woods wrote to parliamentary committees to answer queries or requests for information. Written submissions to parliamentary inquiries included:

- responses to the Treasury Committee inquiry on Solvency II, 27 March 2018;[6] and
- firms' contingency planning for the UK's withdrawal from the EU, 2 August 2017.[7]

1 www.parliament.uk/business/committees/committees-a-z/commons-select/exiting-the-european-union-committee/inquiries/parliament-2017/progress-uk-negotiations-eu-withdrawal-17-19/.

2 www.parliament.uk/business/committees/committees-a-z/commons-select/environmental-audit-committee/inquiries/parliament-2017/green-finance-17-19/.

3 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2017/work-prudential-regulation-authority-17-19/.

4 www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2017/boe-financial-stability-reports-17-19/.

5 www.parliament.uk/business/committees/committees-a-z/lords-select/eu-financial-affairs-subcommittee/news-parliament-2017/bank-of-england-evidence-session/.

6 https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/863/86302.htm and https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/Sam-Woods-Solvency-II-270318.pdf.

7 www.parliament.uk/documents/commons-committees/treasury/Sam-Woods-PRA-to-Chair-re-Brexit-risks.pdf.

group-wide recovery and resolution planning. The IAIS is conducting a review of its systemic risk framework for insurers and, in December 2017, released an interim consultation paper on an activities based assessment (ABA) to systemic risk. The IAIS will examine the future relationship between the ABA and the G-SII Assessment.

Business aim 5: Ensure the PRA has the right people, infrastructure and governance to deliver its strategy

Embedding the plan for PRA IT, specifically: improving management information on the PRA's assessment of firms; and improved data analytical tools

We have continued to embed our plan for IT. This year we have delivered the first stage of a 'supervisory desktop' for PRA supervisors that makes it easier for them to plan, manage and report progress against their supervisory strategies and work plans. It has allowed us to decommission several legacy systems, along with some local, tactical information systems. This has increased operational efficiency and mitigated operational risk. It has allowed us to deliver improved management information, providing the PRC and management with more reliable views of operational and regulatory performance.

Develop and implement an improved control and assurance framework

Our control framework seeks to support and increase the likelihood that we will advance our statutory objectives, strategy and strategic goals, while having regard to considerations such as the regulatory principles and the Government's economic policy. Our approach to risk management is part of the Bank's risk framework and we provide additional granularity for risks and issues most relevant to the PRA. We continue to have an internal planning horizon on a three-year cycle, which allows management and the PRC to take a more strategic view of resource needs and availability. More information about governance, accountability, management, systems and control, and risk management is available in the Bank's Annual Report and Accounts 2017–18.[1]

FCA: effective regular co-ordination

We have continued to co-ordinate, where appropriate, with the FCA across a range of supervisory and policy matters, with the PRA and FCA assessing their performance against the statutory PRA-FCA memorandum of understanding (MoU) on a quarterly basis.

Co-ordination between supervisory, authorisation and specialist teams in the FCA and PRA continued to be strong, with no material breaches of the MoU reported. The regulators also worked closely together to respond effectively to specific incidents in the past year through the Authorities' Response Framework (ARF) which allows for a co-ordinated response by the FCA, Bank and HM Treasury to an event that results in material disruption to the financial sector and/or to these bodies. EU withdrawal has also been an area of close co-ordination.

Information sharing continues to be an area of close collaboration between the regulators. The FCA's External Feedback Team and the PRA's Supervisory Oversight Function also met to compare the outcomes of their respective firm feedback surveys, to ensure both regulators have a clear understanding of how firms view the current regulatory landscape. We continue to work closely on the migration and upgrading of shared services, which were generally stable over the past year.

Firm feedback

We proactively seek input from firms on the effectiveness and quality of our supervisory framework and approach. One of the ways we do this is through the annual firm feedback

1 See pages 34–37, www.bankofengland.co.uk/-/media/boe/files/annual-report/2018/boe-2018.pdf.

survey. The survey gives PRA-authorised firms the opportunity to comment on their experience of being supervised. The survey seeks views from a range of firms on a number of topics, including the:

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

We ask some standard questions and also provide firms with the chance to make additional comments.

This year — our fifth — we increased the number of smaller firms in the sample, and introduced a simpler, more tailored set of questions for them. Partly reflecting this increased coverage, the survey was completed by 197 firms this year (up from 125 firms in 2016–17) with 27 follow-up meetings attended with the largest firms.

Overall, the results were in line with last year's survey, with an improvement in scores. The majority of respondents continued to express positive views about the PRA, citing greater clarity around our approach and expectations.

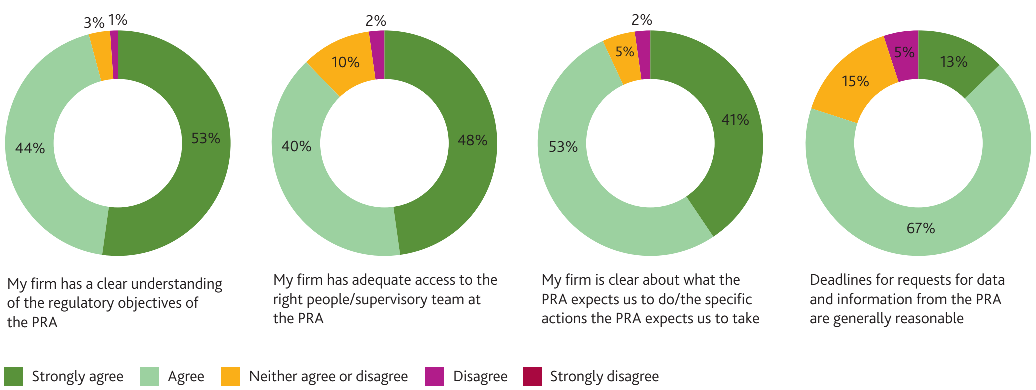
The most recent feedback did, however, suggest a number of areas for improvement such as: the level of communication on key issues as our thinking evolves; further work to streamline the feedback process following supervisory reviews; and our rationale and deadlines for information requests. We will continue to explore how we can improve our processes to address this feedback.

In response to earlier feedback, we have improved our processes and continue to focus on our activity to:

- reduce the number of information requests made and to ensure that the information requested is needed. We also seek to co-ordinate some requests to avoid duplication; and
- ensure better handovers, taking on board feedback from firms about the impact that changes in supervisory teams can have on firms. While many firms understand that we need to redeploy staff periodically, we have increased our focus on ensuring new teams are better informed when they take responsibility for firms.

Figure 1 shows a selection of the survey results reflecting the type of issues on which the PRA sought an opinion. The full quantitative results are available on the Bank's website.[1]

Figure 1: Selection of firm feedback survey results 2017–18



1 www.bankofengland.co.uk/prudential-regulation/supervision.

Box 4: Communications — supporting the PRA's objectives

A vital part of the delivery of our statutory objectives and supervisory approach is the PRA's industry-wide communications. This includes publications, briefings, speeches, and letters to firms and industry participants on both policy and supervisory activity.

In 2017–18 we:

- provided communications to industry to support the implementation and/or embedding of key initiatives, including how people can make written representations to the PRA on RFTS as banks implemented structural reform, the embedding of SM&CR and the forthcoming extension to insurers, and Solvency II;
- continued to provide updates on dedicated webpages for initiatives such as strengthening accountability, structural reform, Solvency II, CRD IV and stress testing.[1] These webpages were taken over to the Bank's new website, and continue to provide relevant information in one place on policy and implementation;
- committed to removing gendered language from our communications, including our policy where we proposed removing such references in the SM&CR as part of our proposals on the extension of the SM&CR to insurers;
- published a number of documents across the range of our regulatory and supervisory activities — including policy aligned with other areas of the Bank and the FCA. We also published 7 speeches, 11 letters, and 17 other publications. Areas covered included the implementation of IFRS 9, our work on consumer credit, our approach to policyholder protection, Solvency II-related updates and disclosures, and planning assumptions for firms on the UK's withdrawal from the EU;
- continued to issue the monthly PRA Regulatory Digest, which remains one of our most downloaded publications;[2] and
- in addition to written word, continued our engagement with firms and other industry participants in a variety of form. We have hosted briefings on a range of topics, and provided speakers and panellists for a number of events hosted by others, including the FCA, overseas counterparts, trade and professional bodies.

1 www.bankofengland.co.uk/prudential-regulation.

2 www.bankofengland.co.uk/news?NewsTypes=65d34b0d42784c6bb1dd302c1ed63653&Taxonomies=b0e4487511a44c31b3c239c3d6470f42&Direction=Latest.

2017–18 policy publications

23 Consultation Papers

26 Policy Statements

24 Supervisory Statements

3 Statements of Policy

7 Speeches

11 Letters

17 Other publications

Complying with FSMA

This section covers a number of issues that we take into account when carrying out our duties or reporting on an obligation.

These include:

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

Complying with FSMA

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

a) need to use resources in discharging our general functions in the most efficient and economic way;

b) principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

c) desirability of sustainable growth in the economy of the UK in the medium or long term;

d) general principle that consumers should take responsibility for their decisions;

e) responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements;

f) desirability where appropriate of exercising our functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of persons such as mutual societies and other kinds of business organisations) subject to requirements imposed by or under FSMA;

g) desirability in appropriate cases of publishing information relating to persons on whom requirements are imposed by or under FSMA, or requiring such persons to publish information, as a means of contributing to the advancement by the PRA of its objectives; and

h) principle that the PRA should exercise its functions as transparently as possible.

We take these principles into consideration when carrying out our functions, including when making policy.

Further, in carrying out our functions during the reporting period, we were required to, so far as was reasonably possible, act in a way which facilitated effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities (section 2H(1) of FSMA). There are several examples of how meeting this requirement was achieved in the PRA Annual Competition Report on pages 31–38.

Details of how we have met our general duty to consult (under section 2L of FSMA) and consider any representations made (under section 2N of FSMA) can be found on page iii, which also explains how the PRA engages with firms more generally. These arrangements include the establishment and maintenance of the PRA Practitioner Panel (the Panel) under section 2M of FSMA. The Panel is an independent body representing the interests of practitioners in the financial services industry. It plays an important role in PRA policymaking by providing appropriate challenge and scrutiny. As well as PRA policies, the Panel also considers items from other directorates within the Bank of England whose policies have a potential prudential impact.

In 2017–18 the Panel met six times and provided the PRC and senior management from across the PRA and Bank with feedback on topics including the SM&CR, Structural Reform and IFRS 9 implementation.

The Panel provided practical insights into the early effects of the SM&CR. The Panel continued to provide feedback on the implementation of IFRS 9. This covered engagement on possible transitional arrangements as well as different challenges for 'day one' and longer-term implementation. Details of the Panel, including its annual reports, can be found on the Bank's website.[1]

The PRA and FCA have a duty to ensure a co-ordinated exercise of functions (under section 3D of FSMA) and details of how this has been managed effectively is covered on page 24.

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

We are considering how we will meet the new requirement in paragraph 19(1A) of Schedule 1ZB of FSMA to report on ring-fenced bodies.

Section 354B of FSMA outlines the PRA's duty to co-operate with other persons (whether in the UK or elsewhere) who have functions similar to the PRA or have functions relevant to financial stability. Details of how we have complied with this duty are set out on page 24.

Regulators' Principles and Code

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

Regulators' Principles

- Regulatory activities should be carried out in a way which is transparent, accountable, proportionate and consistent.
- Regulatory activities should be targeted only at cases in which action is needed.

Regulators' Code

- Regulators should carry out their activities in a way that supports those they regulate to comply and grow.
- Regulators should provide simple and straightforward ways to engage with those they regulate and hear their views.
- Regulators should base their regulatory activities on risk.
- Regulators should share information about compliance and risk.
- Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply.

1 www.bankofengland.co.uk/prudential-regulation/pra-practitioner-panel.

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- Regulators should ensure that their approach to their regulatory activities is transparent.

PRA's complaints scheme

As part of the statutory Complaints Scheme (under Part 6 of the Financial Services Act 2012), we are responsible for ensuring formal complaints against us are dealt with in an efficient and effective manner. During the reporting period we received eight complaints. Of those complaints, two were upheld, one was partially upheld, and one was not upheld. Three complaints were outside the scope of the scheme and were therefore excluded. One complaint was still under consideration at the end of the reporting period. No complaints about the PRA were referred to the Complaints Commissioner during the reporting period. The Commissioner completed his review of one joint FCA/PRA complaint that was escalated in the previous reporting period: the complaint was not upheld.

Section 166 reports by skilled persons

Section 166 (s166) of FSMA provides a regulatory tool which gives us powers to obtain an independent expert review of aspects of a regulated firm's activities. Such reviews can be undertaken where we seek additional information, further analysis, expert advice and recommendations, or assurance around a particular subject. In 2017–18 we used s166 16 times (2016–17: 11 times). We commissioned three (2016–17: four) where we contracted directly with the skilled person.

The reviews mainly covered regulatory reporting, risk management and controls. The reviews fell within the areas shown in **Table 1**.

The total estimated cost of commissioned s166 reviews in 2017–18 was £6.3 million (2016–17: £5.6 million) and the cost per review ranged from £40,700 to £2.3 million (2016–17: £50,000 to £3.6 million).[1] Of this total, the cost of the three reviews where we contracted directly with the skilled persons is estimated to be £1.1 million[2] (2016–17: four at a cost of £1.1 million). The costs disclosed include actual costs incurred by the firms or an estimate where actual costs are not yet available.

New Skilled Persons Panel Cyber Lots

Working with the FCA, the Bank and the PRA now have four new areas of supervisory interest (lots) as part of the Skilled Person Panel, so that reviews can be directly commissioned on firms' cyber resilience

Table 1: Section 166 reviews by areas of focus[a]

Lot	Total for 2016–17 (restated)	Total for 2017–18
Prudential — Deposit-takers, recognised clearing houses and PRA-designated investment firms	0	7
Prudential — Insurance	3	6
Controls and risk management frameworks	5	3
Governance and individual accountability	2	0
Technology and information management	1	0

a Following the commencement of the new Skilled Person Panel on 1 April 2017, former lot 'Governance, controls and risk frameworks' was split into two new lots, 'Governance and individual accountability' and 'Controls and risk management frameworks'. Former lot 'Data and IT infrastructure' was replaced by lot 'Technology and information management'. For ease of comparability the reviews commissioned in 2016–17 have been restated in line with the current lots.

1 The figures provided in the PRA Annual Report 2017 have been revised to reflect actual costs incurred.

2 Costs of directly contracted revisions include VAT.

under s166. These new lots comprise skilled persons that have threat intelligence and penetration testing expertise. These skilled persons include suppliers holding the CBEST accreditation, a standard for testing cyber resilience co-developed by the Bank. The new lots commenced on 9 April 2018.

The regulatory authorities already had in place a Skilled Persons Panel composed of ten lots. The four new cyber lots increase the range of skills available to the regulatory authorities. A list of the skilled persons by lot and a description of each lot are available on the Bank's website.[1]

Meeting with auditors

Under section 339A(2) of FSMA we must issue and maintain a code of practice which includes arrangements on the: (i) sharing with auditors of PRA-authorised persons of information that we are not prevented from disclosing; and (ii) exchange of opinions with auditors of PRA-authorised persons. We published the code of practice in April 2013. Section 339B of FSMA states that we must make arrangements for meetings to take place at least once a year with the auditor of any PRA-authorised person to which section 339C of FSMA applies. 38 firms (2016–17: 39) fell within the scope of section 339B FSMA during the reporting period and we conducted 51 meetings (2016–17: 51) with the auditors of these firms.

At least one meeting with the auditor of each such firm was held during the reporting period. We look to auditors to contribute to effective supervision by directly engaging with us in a proactive and constructive way. We report to the PRC annually on the quality of the relationship between auditors and supervisors. In September 2017, we reported to the PRC that the overall quality of the relationship between auditors and supervisors remained good.

1 www.bankofengland.co.uk/prudential-regulation/supervision.

PRA Annual Competition Report — June 2018

This is the third Prudential Regulation Authority (PRA) Annual Competition Report. It has been produced in response to a request from the Government in 2015 that we should publish an annual report setting out how we are delivering against our secondary competition objective (SCO). The SCO, as set out in Financial Services and Markets Act 2000 (FSMA), came into force on 1 March 2014 and states that:

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

In March 2017, the Government sent the Prudential Regulation Committee (PRC) the first recommendation letter[1] about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance our objectives, and when considering the application of the regulatory principles set out in FSMA. Of particular relevance to this report, the letter stated that 'the government is keen to see more competition in all sectors of the industry, particularly retail banking. This includes minimising barriers to entry and ensuring a diversity of business models within the industry'. The Government also set out its views on competitiveness and innovation.

There are three parts to this report:

Parts 1 and 2 set out key policy areas in which we have delivered against the SCO by facilitating effective competition. Part 1 looks at the outcomes of multi-year efforts aimed at facilitating effective competition focusing on two themes: retail banking and insurance. On the first theme, the report sets out the outcomes of four major initiatives launched over the past four years with the aim of facilitating market entry and expansion in retail banking, specifically:

- negotiating revisions to the standardised approach (SA) for credit risk being considered by the Basel Committee on Banking Supervision (BCBS);
- reviewing the approach to internal rating based (IRB) model applications from smaller firms; and
- refining the 'Pillar 2A' capital framework of capital add-ons.

On the second theme, the report sets out how we have used our limited scope for discretion under Solvency II to facilitate effective competition in the insurance sector.

Part 2 presents what's new in terms of policy initiatives where the SCO played an important role. Examples include:

- facilitating effective competition by clarifying expectations regarding the prudent management of cyber underwriting risk;
- levelling the playing field by reviewing the use of double leverage by large international banking groups;
- preventing regulatory arbitrage when transferring credit risk in securitisations; and
- implementing reporting requirements under Solvency II in a proportionate way.

Looking forward, we (jointly with the FCA) will explore how the approach to authorising and supervising new insurance firms could be adapted, potentially to allow for a mobilisation phase as is available for new banks.

Part 3 summarises how we have continued the process of embedding the SCO into our policy

1 www.bankofengland.co.uk/about/people/prudential-regulation-committee.

and supervisory decision making. It also provides a summary of the competition-focused research activity undertaken by PRA staff, which includes organising the second annual conference on competition and financial regulation jointly with Imperial College Business School London and the Centre for Economic Policy Research (CEPR).

Part 1

1.1 Implementing the SCO: progress made so far

This part of the report sets out the key areas in which we have delivered against the SCO since its inception focusing on two themes: retail banking and insurance. On the first theme, the report sets out the outcomes of multi-year initiatives aimed at reducing entry and expansion barriers in retail banking and, on the second, it presents what has been achieved with respect to the insurance sector.

Facilitating effective competition in retail banking

The following four major initiatives launched over the past four years have helped to facilitate effective competition in retail banking by making the calculation of regulatory capital requirements fairer, levelling the playing field across the sector, and reducing entry barriers.

Narrowing the gap between IRB and standardised approaches

The PRA Annual Competition Report 2016[1] stated our commitment to continue work to narrow the gap between capital requirements based on standardised approaches (SA) to credit risk and those based on IRB models where they are unduly large. We have sought to do this by making standardised approaches more risk sensitive and by constraining internal models from producing excessively low capital requirements. Concerns about the gap between SA and IRB capital requirements were raised by the Competition and Markets Authority (CMA) in its market investigation into retail banking, in particular with respect to low loan to value (LTV) residential mortgages which are among the safest of exposures. Nevertheless, in its conclusions published in August 2016, the CMA confirmed its earlier provisional finding that prudential rules do not give rise to an adverse effect on competition. The CMA also called on both HM Treasury and the PRA to give due consideration to competition when developing and negotiating policies.

i) Negotiating substantial reforms in Basel

We argued for a significant lowering of the standardised risk weight for low LTV mortgages when negotiating revisions to the SA for credit risk being considered by the BCBS. On 7 December 2017, the BCBS Governors and Heads of Supervision (GHOS) endorsed a package of reforms to finalise Basel III. As part of this, the current gap between IRB and SA risk weights was halved through the revision of the SA by introducing greater risk sensitivity for retail mortgages, including a reduction from the current 35% to 20% risk weight for exposures with LTV values below 50%.[2]

Further, the BCBS agreed a new aggregate output floor for risk weights based on the revised SA. It will be calibrated at 72.5%, and replace the existing floor.[3] The output floor ensures that the capital requirements of banks that use internal models do not fall below 72.5% of capital requirements derived under the SA. As such, it places a limit on the regulatory capital benefit a bank can derive from internal models relative to the SA. This helps to maintain a level playing field between banks using internal models and those on the SA.

1 www.bankofengland.co.uk/prudential-regulation/publication/2016/pra-annual-competition-report.

2 For LTVs between 50% and 60% the risk weight has been reduced to 25%, and to 30% for LTVs between 60% and 80%. The standards are now final, but will not apply until 2022.

3 The output floor will be phased-in from 1 January 2022, increasing each year until it reaches its steady state level of 72.5% in January 2027.

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ii) Implementing the refinements to the Pillar 2 capital framework

In addition to international negotiations, we have also launched policy initiatives domestically aimed at supporting firms on the SA (which tend to be smaller than those using internal models). In December 2017 we finalised our refinements to the 'Pillar 2A' capital framework,[1] which allows supervisors to exercise judgement and, where it is deemed appropriate, reduce variable capital add-ons (ie Pillar 2A requirements) for firms using the SA for credit risk. The aim of this policy initiative is to apply a holistic approach to capital setting, which takes into account a firm's combined Pillar 1 and Pillar 2A capital when assessing compliance with overall capital adequacy rules. This reduces the likelihood that capital standards are overly prudent for firms using the SA for credit risk. As a result, we estimate that around a third of UK banks and building societies will have lower minimum capital requirements. On average, we anticipate these firms' minimum capital requirements will reduce by 10%–15%.

iii) Delivering on IRB model applications for smaller firms

The measures outlined above were aimed at supporting firms that use the SA. In addition, we have worked to make it easier for small firms to adopt IRB models. In October 2017 we finalised a review, launched in 2016, of our approach to IRB credit risk model applications from smaller banks and building societies.[2] As a result of the review we have clarified our expectations for firms applying for IRB model approval, focusing in particular on: how firms can demonstrate that they meet the requirements of the Capital Requirements Regulation (CRR) on 'prior experience' of using IRB approaches; and the use of external data to supplement internal data for estimating probability of default and loss given default for residential mortgages. Since 2017, three applications have been received by the PRA, with at least six more expected over the next two to three years. These new applications are being reviewed in line with the new modular approach, providing greater clarity and transparency to firms over the review process and how they are progressing.

iv) Reducing barriers to entry — the New Bank Start-up Unit

The New Bank Start-up Unit (NBSU) was established in January 2016 as a joint initiative between the PRA and FCA with the aim of giving information and support to firms thinking of becoming a bank in the UK. This includes information on an alternative route to becoming a fully operational bank or building society — 'mobilisation' — introduced in 2013 as part of 'A review of requirements for firms entering into or expanding into the banking sector: one year on'.[3] The NBSU has three principal ways of working with prospective new banks: (i) a dedicated website; (ii) the provision of periodic seminars; and (iii) a single point of contact.

Since 2016 the NBSU has hosted four seminars. Delegates heard from a variety of speakers including representatives from the PRA, FCA and the Payment Systems Regulator, as well as from a number of newly authorised firms. Feedback has been positive and suggests that the seminars are an effective mechanism for communicating relevant information, whatever business model prospective new banks are considering. The most recent seminar was held on 19 February 2018, and it is expected that seminars will continue to be hosted periodically. Since its launch, the NBSU website has had over 41,500 page views.

The NBSU has assisted several authorities from other countries that have been keen to learn more about the UK regulatory approach to the authorisation of new banks and building societies.

Since the PRA was formed in April 2013, we have authorised 31 new banks, 16 of which are

1 www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-methodologies-for-setting-pillar-2-capital.
2 www.bankofengland.co.uk/prudential-regulation/publication/2017/internal-ratings-based-approach-clarifying-pra-expectations.
3 www.bankofengland.co.uk/prudential-regulation/publication/2014/review-of-requirements-for-firms-entering-into-banking-sector.

UK banks, with the remainder being subsidiaries or branches of overseas banks. Of the 16 UK banks, four had a 'FinTech' business model based on providing retail banking services to customers entirely digitally and one was a brand new 'clearing' bank. There continues to be a healthy pipeline of potential new entrants, with interest from about 35 firms that have started the authorisation process, eight of which have formally applied to become a bank. The pipeline represents a diverse range of potential business models, a number of which will be novel in the UK.

1.2 Facilitating effective competition in insurance markets: progress made so far

As set out in the response from the PRA to the Treasury Committee's inquiry into Solvency II,[1] the SCO has had a strong, practical influence on our policy and supervisory approach for insurance. There are a number of areas where we have facilitated effective competition in the insurance sector, including:

- Issuing over 700 approvals, including waivers, under Solvency II. This has allowed firms to take a different approach to the 'default' included in Solvency II to calculating both technical provisions and setting capital requirements. It also included a number of alternative approaches that require regulatory approval — for example, using an internal model to calculate capital requirements. Small as well as large firms are able to use internal models, and of the 23 internal models approved to date, eight were for smaller firms.

- Implementing a streamlined and tailored regime for firms (including very small firms) that fall outside the scope of Solvency II, which represent 35% of the firms we supervise. This delivers on our commitment to be a proportionate regulator and supervisor of smaller firms.

- Designing and implementing the Senior Insurance Managers Regime (SIMR)[2] with the application of the SCO and the principle of proportionality. This is evident in some of the features of the SIMR including:

    - fewer responsibilities that must be allocated to a senior manager approved by us for incoming non-EEA branches, insurance special purpose vehicles (ISPVs), and smaller firms that are not in scope of the Solvency II Directive;

    - a requirement on each firm to produce a 'responsibilities map' whose length, content and level of detail should reflect its size and complexity;

    - the ability of individual directors and senior managers moving between regulated firms to submit a shortened form to the regulators, where there has been no change to the basic information already provided about the individual's fitness and propriety; and

    - a simplified and streamlined SIMR for smaller firms outside the scope of Solvency II.

A recent example of how we have had regard to competitiveness, as set out in 'Recommendations for the Prudential Regulation Committee',[3] is the recognition of the growth of the insurance-linked securities market. We have worked closely with HM Treasury, the FCA and industry to design a new, commercially viable framework for ISPVs in the UK. That framework launched in December 2017 and very shortly after we authorised the first ISPV.

Number of new authorisations:

14
Banks

7
Insurers

1 www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-response-to-the-treasury-committees-inquiry-into-solvency-2.

2 www.bankofengland.co.uk/prudential-regulation/publication/2017/strengthening-accountability-implementing-the-extension-of-the-smcr-to-insurers-and-other-amendments.

3 www.bankofengland.co.uk/about/people/prudential-regulation-committee.

Part 2 Recent application of the SCO in our work

We present what's new in terms of policy initiatives that demonstrate how we have taken the SCO into consideration in the course of reviewing existing, and developing new, policies.

2.1 Levelling the playing field

In our work to develop and implement prudential policies, we have facilitated effective competition by making sure that prudential standards are consistently applied across different business models. Risks not being assessed, mitigated or priced for can give firms an unfair competitive advantage. The initiatives below are aimed at reducing these instances.

Strengthening our supervisory framework for international banks and insurers

As part of a broader initiative to set out the Bank of England's supervisory approach for EU withdrawal,[1] on 20 December 2017 the PRA published two consultation papers on its proposed new approach to authorising and supervising international banks and insurers, which is designed to ensure that systemically important international firms for UK financial stability are appropriately supervised and resolvable. The new approach is intended to improve the PRA's ability to monitor the supervisory outcomes that result from the actions of these firms' respective home state supervisors. Accordingly, the PRA will place considerable weight on assessing the extent and quality of co-operation with the home state supervisor.[2]

Hosting international firms will, if done appropriately, facilitate effective competition in the UK financial sector. The PRA's strengthened supervisory framework enhances effective competition by ensuring that systemically important international firms are properly supervised and managed, thereby preventing firms that are not adequately supervised from gaining an undue competitive advantage as a result of a lower prudential standard that does not adequately safeguard their safety and soundness.

Clarifying expectations regarding the prudent management of cyber underwriting risk

In July 2016 we published our expectations of insurers in relation to their management of cyber insurance underwriting risk.[3] The supervisory statement (SS) covers the risks from underwriting insurance contracts that are exposed to cyber-related losses resulting from malicious acts (for example, cyber attack or infection of an IT system with malicious code) and non-malicious acts (for example, loss of data, accidental acts or omissions) involving both tangible and intangible assets. The SS followed a review we undertook in 2015 of insurers' management of cyber underwriting risk, which highlighted some material shortcomings in firms' approaches to managing the risk. We set out our expectations that firms should:

- assess and actively manage their insurance products with specific consideration to non-affirmative (or 'silent') cyber risk exposures, and introduce measures that reduce the unintended exposure to this risk;
- have clear strategies and articulated risk appetites on the management of the associated risks; and
- have sufficient expertise to monitor and manage the risks emanating from cyber risk, taking into account their level of exposure and growth aspirations in this area.

We identified a number of prudential benefits of setting these expectations and our approach was supported by respondents during consultation. In addition to these prudential

1 www.bankofengland.co.uk/news/2017/december/approach-to-authorisation-and-supervision-of-international-banks-insurers-central-counterparties.

2 See pages 16–17.

3 www.bankofengland.co.uk/prudential-regulation/publication/2017/cyber-insurance-underwriting-risk-ss.

benefits, our approach facilitated effective competition by promoting increased contract certainty for policyholders to understand the level of coverage and/or exclusions which exist within relevant insurance policies. We also made clear that decisions on pricing and the level of cover/exclusions on insurance contracts offered to policyholders remained a matter for firms to decide in the light of their own risk appetites. As such, our approach should facilitate effective competition by encouraging firms to offer products based on a clear understanding of the coverage of cyber risk, and their expertise and knowledge in managing cyber risk.

Reviewing the use of double leverage by large international banking groups

In October 2017, we published a consultation on 'groups policy', ie the framework we use to assess and mitigate risks of any adverse effects on a firm's financial position from its relationships with other entities in the same group, or risks that affect the financial position of the whole group, including reputational contagion.[1] One potential source of risk is the use of double leverage, whereby one or more parent entities in a group funds some of the equity capital in its subsidiaries by raising debt or lower forms of capital externally, so lowering their overall cost of funding.

The consultation set out a number of proposals designed to address this source of risk. In particular, where a firm's holding company uses double leverage, we proposed that a firm should assess and mitigate the risks arising from the use of double leverage as part of its consolidated capital adequacy assessment. This proposal enhances effective competition by ensuring that banking groups' use of double leverage is assessed and properly managed, thereby preventing unregulated entities within these groups that are under-resourced for the risks they face, and the groups that contain these under-resourced unregulated entities, from gaining an undue competitive advantage as a result of their funding costs being lower than those of simpler groups.

Preventing regulatory arbitrage when transferring credit risk in securitisations

We are planning to publish a consultation that will include a proposal to require banks to hold capital against the use of sophisticated securitisation arrangements as part of transactions aimed at transferring significant credit risk to investors, allowing firms to claim capital relief under the CRR.[2] Specifically, under this type of securitisation arrangement the firm agrees to use the net income earned on securitised exposures over a predetermined period to absorb losses incurred over the same period. As a result of the protection from this income buffer investors are less likely to have to absorb losses, which would reduce the credit risk exposure actually transferred to them. Our proposal aims to ensure that firms are able to understand the risks to which they are exposed. Firms will be required properly to estimate the extent to which investors are protected in the securitisation as a result of this type of arrangement in order to be able to claim capital relief. Although firms that lack modelling expertise may not be able to comply with this requirement, the approach seeks to ensure that all firms must meet our conservative modelling standards, which prevents them from gaining an unfair competitive advantage.

2.2 Increased proportionality

We have been proactive in applying the principle of proportionality to domestic regulations without compromising prudential standards.

Liquidity risk under the Pillar 2 framework

In February 2018 we finalised our approach to the assessment and mitigation of significant sources of liquidity risk under the Pillar 2 framework which covers risks not captured, or not fully captured, in Pillar 1.[3] For example, the cash-flow mismatch risk is the risk that a firm

1 www.bankofengland.co.uk/prudential-regulation/publication/2017/groups-policy-and-double-leverage.

2 www.bankofengland.co.uk/prudential-regulation/publication/2018/securitisation-the-new-eu-framework-and-significant-risk-transfer.

3 www.bankofengland.co.uk/prudential-regulation/publication/2016/pillar-2-liquidity.

has insufficient funds available from selling high-quality liquid assets and other cash inflows to cover outflows under stress on a daily basis.

The Pillar 2 liquidity approach applies in a way that is proportionate to each firm's business model and to the risk that the firm poses to our primary objective to promote the safety and soundness of firms, and the Bank's financial stability objective. In particular, if a supervisor judges the firm's Pillar 2 risks to be relatively immaterial, the supervisor may choose not to apply Pillar 2 guidance. If, having reviewed the firm's risk assessment, a supervisor judges that the risks to the PRA's primary objective are immaterial, the supervisor can also choose not to review the firm for Pillar 2 risks. A supervisor's assessment will involve consideration as to whether any Pillar 2 measures would have a disproportionate impact on a particular type of firm, including whether it results in a relatively greater burden on smaller firms.

Supervision of banks' securitisation activity

The PRA takes a proportionate approach to its supervision of banks' securitisation activity and is planning to publish a consultation on its proposed approach to: reviewing the arrangements, processes and mechanisms that firms have implemented in order to comply with the Securitisation Regulation,[1] and assessing the extent to which risk transfer to third-party investors for the standardised approach portfolios are appropriate. This approach will be aimed at allowing small firms, without it being unduly burdensome, to engage in securitisation activity — including significant risk transfer securitisations — to reduce capital requirements when legitimate.[2]

A proportionate implementation of Solvency II

As set out in the PRA Annual Competition Report 2017'[3] we committed to undertake an assessment of reporting requirements under Solvency II where the PRA has flexibility in implementation. In January 2018, we issued a consultation on 'Changes in insurance reporting requirements'[4] aimed at reducing the reporting burden faced by firms — that is within the PRA's gift — by up to a half. The proposals will reduce the number of data lines we collect in a number of the remaining templates, and fewer firms will be required to submit some others. We also proposed to maximise our use of quarterly reporting waivers by granting them automatically for smaller firms.

In addition, the PRA continues to support new firm authorisations, having authorised 26 new insurance firms since 2013. When assessing applications for authorisation of an insurer, we seek to ensure that requirements are applied in a proportionate manner. This includes the use of waivers and modifications to PRA rules where appropriate. Furthermore, we and the FCA will explore how we could adapt our existing approach to authorising and supervising new firms to simplify the process, provide additional support, and potentially to allow for a mobilisation phase as available for new banks.

Part 3
Implementing the SCO

This part of the report sets out how we have continued the process of embedding the SCO into our policy and supervisory decision-making. It also provides a summary of our competition-focused research activities.

3.1 Effective processes

In previous reports we outlined the steps we had taken to put effective processes in place so that the SCO is always considered by PRA staff responsible for developing and reviewing prudential policy. As part of our continued effort to embed the SCO, a new internal training programme is being devised for all staff in our supervisory areas. In addition, we will ensure that internal annual thematic

1 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2402&from=EN.
2 www.bankofengland.co.uk/prudential-regulation/publication/2018/securitisation-the-new-eu-framework-and-significant-risk-transfer.
3 www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-annual-competition-report-2017.
4 www.bankofengland.co.uk/prudential-regulation/publication/2018/changes-in-insurance-reporting-requirements.

reviews include an assessment on whether the SCO is being properly engaged in our supervisory decision making, for instance firm-specific decisions that may set a precedent, and consequently be perceived as defining a policy position on our delivery of the SCO.

3.2 Research agenda

We are committed to maintaining a flow of policy-oriented research projects aimed at deepening our understanding of the complex relationship between prudential regulation, financial stability and effective competition. This work supports identifying future opportunities for competition-related changes to regulation. Since the publication of last year's report, two Staff Working Papers have been published, specifically looking at the:

- use of behaviour-based price discrimination in markets with unengaged customers, such as for the provision of personal current accounts;[1] and
- competition impact of central bank digital currencies.[2]

Ongoing Bank research projects look to: understand from a theoretical perspective the optimal combination of competition and prudential regulations; evaluate the impact of the refinements to the Pillar 2 capital framework; and measure competition in the UK insurance sector.

As indicated in last year's report, we intend to hold a conference on competition and regulation in financial markets on an annual basis. Organised jointly with the Imperial College Business School and the Centre for Economic Policy Research (CEPR), this conference is part of our efforts to improve awareness and understanding of the SCO among our internal and external stakeholders. The second annual conference will be hosted by Imperial College London on 31 May 2018.

These research activities are part of a concerted effort to engage with key external stakeholders, both domestic and international. Domestically, PRA staff have presented their research outputs to both the CMA and the FCA in various seminars. Internationally, having attended our first competition conference in January 2017, the OECD invited Professor Paul Grout[3] to be a guest speaker at an event on 4 December organised by their Competition Committee on the topic '10 years on from the Financial Crisis: Co-operation between Competition Agencies and Regulators in the Financial Sector'.[4]

1 www.bankofengland.co.uk/working-paper/2017/spatial-models-of-heterogeneous-switching-costs.

2 www.bankofengland.co.uk/working-paper/2018/competition-for-retail-deposits-between-commercial-banks-and-non-bank-operators.

3 As a senior advisor at the PRA, Professor Paul Grout brings external experience from competition regulation and academia.

4 www.oecd.org/competition/cooperation-between-competition-agencies-and-regulators-in-the-financial-sector.htm.

Financial review of 2017–18

The PRA incurred operating costs in 2017–18 of £280 million (2016–17: £254 million). The increase in cost was largely due to exceptional and non-recurring items such as the Structural Reform Programme, EU withdrawal, and the provision of costs for an independent review of the prudential supervision of the Co-operative Bank. Where these exceptional costs are attributable to a particular segment of our authorised population we will typically raise a Special Project Fee, otherwise they will fall to our general levy. The other material increase over the previous year was to cover pension costs.

Against our budget (£288 million), the PRA came in below by £8 million. This was predominantly due to lower than expected resource requirements for EU withdrawal activity arising from differences in timing of work, but also from prioritisation decisions elsewhere that freed up resource to work on this priority area. In addition we achieved savings in the Structural Reform Programme.

Under the Bank of England and Financial Services Act 2016, the Bank is required to present financial and other disclosures in respect of its activities as the Prudential Regulation Authority. These are available on pages 133–141 of the Bank's Annual Report and Accounts 2017–18.[1]

1 www.bankofengland.co.uk/-/media/boe/files/annual-report/2018/boe-2018.pdf.

Abbreviations, footnotes and links

Bank	Bank of England
BCBS	Basel Committee on Banking Supervision
BTL	Buy-to-let
CEO	Chief Executive Officer
CMA	Competition and Markets Authority
Court	Bank's Court of Directors
CP	Consultation Paper
CRD	Capital Requirements Directive
CRD IV	CRR and CRD collectively
CRR	Capital Requirements Regulation
EBA	European Banking Authority
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESRB	European Systemic Risk Board
EU	European Union
FCA	Financial Conduct Authority
FPC	Financial Policy Committee
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act 2000 (as amended)
G-SII	Global systemically important insurer
IAIS	International Association of Insurance Supervisors
ICS	Insurance Capital Standard
IFRS 9	International Financial Reporting Standard 9
IMF	International Monetary Fund
IRB	Internal ratings based
ISPV	Insurance special purpose vehicle
LTI	Loan to income
LTV	Loan to value
MPC	Monetary Policy Committee
MoU	Memorandum of understanding
MREL	Minimum requirement for own funds and eligible liabilities
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
SCO	Secondary competition objective
SIMR	Senior Insurance Managers Regime
SMR	Senior Managers Regime
SM&CR	Senior Managers and Certification Regime

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	2	Prudential Regulation Authority Business Plan 2018/19
8	1	The adequacy of PRA resources and the independence of PRA functions
	2	PRA approach documents 2016
	3	Prudential Regulation Committee webpage
	4	Policy Statement 17/17 'Regulated fees and levies: rates proposals 2017/18'
9	1	Statement on structural separation between the resolution and supervision functions of the Bank of England
12	1	Prudential Regulation Authority Annual Report and Accounts 2017
	2	Prudential Regulation Authority Business Plan 2018/19
	3	PRA approach documents 2016
13	1	The Solvency II Directive and its impact on the UK Insurance Industry
	2	PRA response to the Treasury Committee's inquiry into Solvency II
	3	PRA launches series of improvements to the implementation of Solvency II
	4	Consultation Paper 27/17 'Solvency II: Internal models update'
	5	PRA statement 'Solvency II: PRA review of model change related processes, policies and reporting'
	6	Consultation Paper 2/18 'Changes in insurance reporting requirements'
	7	Supervisory Statement 3/17 'Solvency II: Matching adjustment — illiquid unrated assets and equity release mortgages'
	9	'Changing risks and the search for yield on Solvency II capital' — speech by David Rule, Executive Director of Insurance Supervision
	10	Insurance data release
	11	Solvency II: Solvency and Financial Condition Report roundtables
14	1	Policy Statement 26/17 'Authorisation and supervision of insurance special purpose vehicles'
	2	PRA response to the Treasury Committee's inquiry into Solvency II
	3	Supervisory Statement 5/17 'Dealing with a market turning event in the general insurance sector'

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	5	New Bank of England rules bring UK closer to ending taxpayer bailouts
	6	Bank of England consultation 'Internal MREL — the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and further issues'
	7	Supervisory Statement 16/16 'The minimum requirement for own funds and eligible liabilities (MREL) — buffers and Threshold Conditions'
	8	Consultation Paper 1/18 'Resolution planning: MREL reporting'
16	1	Policy Statement 10/17 'Ensuring operational continuity in resolution: reporting requirements'
	2	Supervisory Statement 9/17 'Recovery planning'
	3	IMF 'United Kingdom: Financial Sector Assessment Program — Insurance Sector — Technical Note'
	4	International Association of Insurance Supervisors 'Insurance Core Principles, Standards, Guidance and Assessment Methodology — Draft Revised ICP 12'
	5	European Insurance and Occupational Pensions Authority 'Opinion to institutions of the European Union on the harmonisation of recovery and resolution frameworks for (re)insurers across the member states'
	6	European Systemic Risk Board 'Recovery and resolution for the EU insurance sector: a macroprudential perspective'
	7	Financial Stability Board 'Developing Effective Resolution Strategies and Plans for Systemically Important Insurers'
	8	Financial Stability Board 'Key Attributes Assessment Methodology for the Insurance Sector'
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	2	Policy Statement 7/18 and Consultation Paper 26/17 'Model risk management principles for stress testing'
	3	Letter to firms 'General Insurance Stress Test 2017 (GIST 2017)'
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	3	'Putting up a fence' — speech by James Proudman, Executive Director, UK Deposit Takers
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	4	OECD 'Co-operation between Competition Agencies and Regulators in the Financial Sector: 10 years on from the Financial Crisis'
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