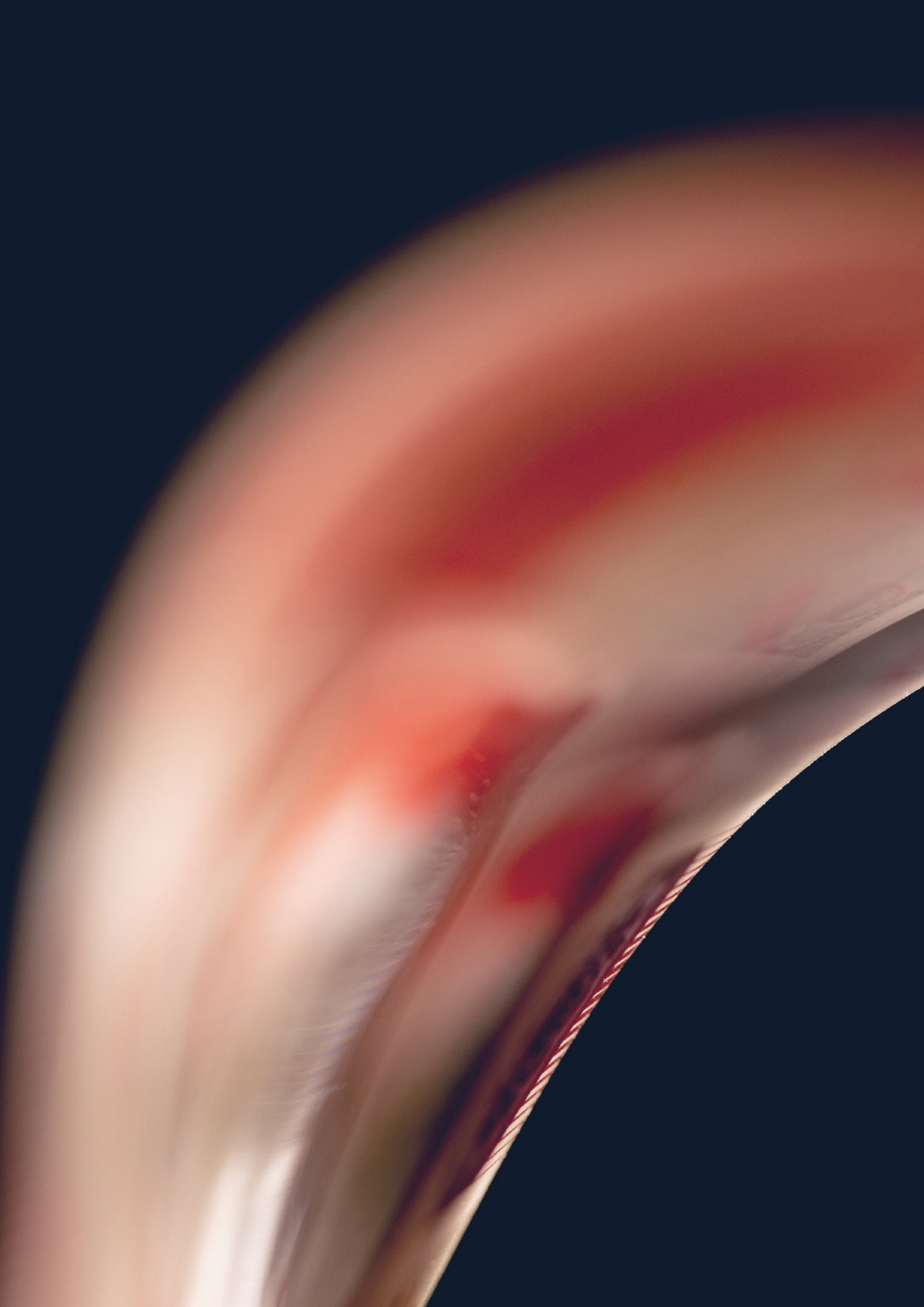
Bank of England PRA

Prudential Regulation Authority Annual Report

1 March 2022–28 February 2023



Prudential Regulation Authority
Annual Report 2022/23

1 March 2022 to 28 February 2023

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. The Annual Report also includes the Annual Competition Report and the Annual Report of the Prudential Regulation Committee to the Chancellor of the Exchequer on the adequacy of the PRA resource and the independence of the 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 2023.

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

The Bank of England Annual Report and Accounts for the year ending 28 February 2023 is available on the Bank of England's (the Bank's) website. The PRA's audited accounts for the reporting year ending 28 February 2023 are set out in the 'Financial review of 2022–23' section of the Bank of England Annual Report and Accounts. HM Treasury (HMT) has issued an accounts direction; disclosures relating to this can be found in the 'PRA income statement for the period ended 28 February 2023' section of the Bank's Annual Report and Accounts.

Consultation

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

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

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

PRA Communications Team
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

The consultation closes on Monday 25 September 2023.

Privacy and limitation of confidentiality notice

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

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

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

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

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

Contents

Foreword by the Chair

Andrew Bailey
Governor,
Chair of the Prudential Regulation Committee

1 April 2023 marked the 10th anniversary of the creation of the PRA, making it a good time to pause and reflect on a decade in existence. In that time, the PRA, alongside the Bank of England and other UK authorities, has strengthened the financial and regulatory system, maintaining a much stronger focus on microprudential regulation and on the resilience of the system as a whole.

However, the events earlier this year are a reminder that this work is never done, old risks evolve, and new risks emerge such as cyber and risks from artificial intelligence (AI).

Managing through a stress is a key test for any regulator. The PRA came into existence during a weekend of stress – the Cypriot banking crisis in 2013. The past year has seen similar challenges as the resilience of the financial system has continued to be tested, including by the invasion of Ukraine by Russia, dysfunction in the gilt market prompted by liability-driven investment (LDI) funds, and most recently, the failures of Silicon Valley Bank and Credit Suisse. Throughout these events, the effectiveness of the PRA and Bank's responses have been strengthened by them working in close co-operation with each other.

UK banks and insurers maintain strong capital and liquidity positions. They are well regulated – in line with standards implemented by UK authorities that are at least as great as those required by international baseline standards – and subject to robust supervision.

The proposed Financial Services and Markets Bill 2022 ('the FSM Bill') presents new opportunities for UK financial regulation at a time when policy development is continuing at pace. We set out, in a discussion paper (DP) in September 2022, the PRA's proposed approach to dispensing our new rule-making role and our vision to be a strong, accountable, responsive, and accessible rule-maker. In November 2022, the PRA issued a consultation on the implementation of the Basel 3.1 standards; the first major international standard being implemented by the PRA post-Brexit. In doing so, we will align with international standards while exercising our judgement to adjust them where appropriate. Over the coming year, we will be progressing major reform of Solvency II regulations, and developing our Strong and Simple regime for small banks. In each, we will take advantage of these new opportunities presented by the FSM Bill while maintaining robust standards in pursuit of the PRA's primary safety and soundness and policyholder protection objectives.

As ever, I extend my deepest thanks to my colleagues on the Prudential Regulation Committee, and our dedicated and hard-working staff for their achievements over the past year under very challenging circumstances, as well as our achievements over the past decade.

Andrew Bailey

6 July 2023

Very sadly, after this report was finalised we received the news of the passing of Melanie Beaman, our Executive Director for Resolution.

Mel was an outstanding and unique colleague, the life and soul of the Bank, and an outstanding bank supervisor. I first worked with Mel nearly thirty years ago and I know from extensive experience that she was deeply proud of her work, but also very humble about her achievements. The tributes that we have received from around the world are evidence of the deep respect for Mel.

Our thoughts and prayers go to Mel's family. She will be missed greatly, but not forgotten.

Foreword by the Chief Executive

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

It's hard to think of a busier year in the PRA's 10-year history than the one we've just had. Over the 2022/23 reporting period, we have had to respond to a series of shocks to the global economy and financial system, while also making progress on our core supervisory and policy priorities.

The first major shock in this period was Russia's invasion of Ukraine. As well as the severe human costs of this invasion, it also has had significant impacts on the global economy and financial system. For the PRA, our focus has been on assisting the UK Government in the implementation of financial sanctions, and on monitoring firms affected by the invasion. This includes firms with a presence in or operating from Russia and Ukraine, as well as the wider set of firms affected indirectly, for example as a result of disruption in commodity markets and energy price pressures on UK households and businesses.

In the latter part of the 2022/23 year, the financial system has witnessed further shocks. Two in particular stand out. The crisis in the LDI fund sector in Autumn 2022, and recent stress in the global banking sector, following the events surrounding Silicon Valley Bank and Credit Suisse, which took place just after the period covered by this Annual Report.

The UK banking and insurance sectors have remained resilient in the face of these shocks, reflecting the strong standards they are subject to. It is vital for the success of the UK economy that this resilience is maintained – and the past year has seen a great deal of supervisory and policy work to ensure that it is.

One key focus this year has been stress testing. We use stress tests to assess the resilience of banks and insurers to severe macroeconomic shocks and other headwinds. We completed the 2022 insurance stress test, publishing the results in January 2023. On the banking side, we restarted the annual cyclical scenario (ACS) test of system-wide financial resilience, publishing in September 2022 the scenario for the next ACS. We also published in May 2022 the results of the Climate Biennial Exploratory Scenario (CBES) for the largest UK banks and insurers. This explored the resilience of the UK financial system to the financial risks associated with the impacts of climate change and the transition to net zero.

Stress testing is just one plank of how we supervise. The core of our approach is the day-to-day work of forward-looking, judgement-based supervision, which has continued throughout this year on both financial and operational resilience. To support this, we have conducted important cross-firm and thematic work. Highlights include: a review of general insurers' risk management and reserving against claims inflation, ongoing implementation of new PRA requirements and expectations for internal ratings-based models for banks, co-ordination with the Financial Conduct Authority (FCA) to facilitate firms' transition away from LIBOR, and a joint thematic review with the FCA on insurers' operational resilience.

This was also a big year for policy. The FSM Bill has been making its way through Parliament. Subject to Parliament's approval, this will create the new post-Brexit framework for UK financial regulation, with an expanded rule-making role for the PRA alongside an enhanced accountability regime and a new secondary objective to promote long-run economic growth and competitiveness. We published a DP on the PRA's future approach to policymaking, setting out how we propose to operate within this new framework.

Looking beyond the overall framework for policymaking, this year also saw significant progress on several landmark policy reforms. We:

- published three consultation papers (CPs) on our proposed Strong and Simple framework for smaller banks and building societies. The aim of this project is to reduce regulatory complexity and compliance costs for those smaller firms, while maintaining robust standards;

- published a CP on the UK's implementation of the Basel 3.1 standards. Our approach aims to support the UK's competitiveness by maintaining our strong reputation for alignment with internationally agreed standards, with some adjustments;

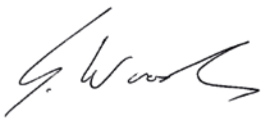
- worked with HMT in developing proposals for the reform of the Solvency II standards for insurers. These reforms will reduce bureaucracy in the regulatory regime, and improve the incentives for insurers to invest in a wider range of productive assets;

- supported HM Government's agenda of reforms to the financial sector, including working with HMT on implementing the recommendations of the independent panel on ring-fencing and proprietary trading; and

- published a joint DP with the FCA on new powers enabling regulators to oversee critical third parties (CTPs) that provide vital services to our regulated firms.

We also continued to build our own capacity as an organisation, so that we can be as effective as possible in delivering our objectives. We have taken steps to improve the consistency of our supervisory approach across firms. We have worked to improve the efficiency of our authorisation processes, in particular for senior management function applications, and I expect continued progress on this over the first few months of 2023/24. We have continued to push forward on diversity and inclusion at the PRA, including by implementing recommendations from the Bank's 2021 review of ethnic diversity. And we have invested in our data capabilities, including by rolling out a digital skills strategy and recruitment of additional data scientists. This recruitment, plus an expansion of our policy function to take on our new post-Brexit responsibilities, meant that our headcount expanded over the course of 2022/23, as planned, by around a hundred staff. Having made this shift, I expect our headcount to be broadly flat in the year ahead.

I think you'll agree that this all adds up to a rather eventful year! Of course it has been equally so for many other institutions and people across the UK and abroad. I am immensely grateful to the PRA team for their outstanding work on all of these topics, and look forward to working together in 2023/24.



6 July 2023

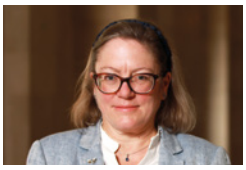
Prudential Regulation Committee (PRC)

Members as at 6 July 2023[1]

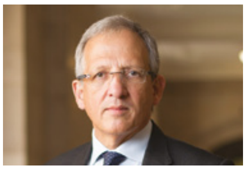
Andrew Bailey
Governor, Chair of the PRC

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

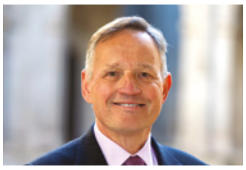
Ben Broadbent
Deputy Governor, Monetary Policy
Term: 1 March 2017 – 28 February 2026



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



Sir Jon Cunliffe
Deputy Governor, Financial Stability



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

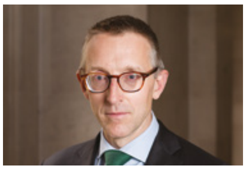
Jill May
External member
Term: 23 July 2018 – 22 July 2024

Marjorie Ngwenya
External member
Term: 5 September 2022 – 4 September 2025

Sir Dave Ramsden
Deputy Governor, Markets and Banking

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

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



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

1. Marjorie Ngwenya joined the PRC on 5 September 2022 as an external member for a three-year term.

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

The PRC's terms of reference[2] provide for 12 members. Five members are Bank staff: the Governor, and four Deputy Governors. The Committee also includes the Chief Executive of the FCA, and at least six members appointed by the Chancellor of the Exchequer.

- The PRC is independent in all its decision-making functions, including making rules and the PRA's most important supervisory and policy decisions.

- The PRA's functions are exercised by the Bank and are funded by PRA fees, with the PRC responsible for consulting on and setting the level of those fees.

- The PRC is required to report annually to the Chancellor of the Exchequer on the adequacy of resources allocated to the PRA functions and the extent to which the exercise of those functions is independent of the exercise of the Bank's other functions.[3]

- Since February 2016, the Bank has indemnified members of the PRC against personal civil liability on the same terms as the members of Court.[4]

The PRA's statutory objectives for the year 2022/23, 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 out regulated activities.

Under the FSM Bill, currently before Parliament, the PRA has a proposed new secondary objective to facilitate international competitiveness of the UK economy and its growth over

2. www.bankofengland.co.uk/-/media/boe/files/about/prc/prctermsofreference.pdf.
3. Available in the 'Annual report of the PRC to the Chancellor of the Exchequer' section of this report.
4. See the 'Court and the Bank's policy committees' section of the Bank of England Annual Report and Accounts 2022/23.

the medium to long term, subject to alignment with international standards. The PRA's plans to implement this objective, as enacted by Parliament, are set out in its Business Plan 2023/24.[5]

On 8 December 2022, HMT issued 'Recommendations for the Prudential Regulation Committee'.[6] This sets out aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives, and when considering the application of the regulatory principles in FSMA.

FSMA also requires the PRA to review, if necessary revise, and publish annually its strategy in relation to how it will deliver its statutory objectives. The strategy is set by the PRC, in consultation with the Bank's Court of Directors. The PRA's strategy was published in the PRA Business Plan 2023/24 in May 2023.[7]

5. **www.bankofengland.co.uk/prudential-regulation/publication/2023/may/pra-business-plan-2023-24**.
6. The recommendations are available at: **www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-december-2022** and the PRC's response is available at: **www.bankofengland.co.uk/-/media/boe/files/letter/2023/prc-remit-letter-to-chancellor.pdf**.
7. **www.bankofengland.co.uk/prudential-regulation/publication/2023/may/pra-business-plan-2023-24**.

Annual Report of the PRC to the Chancellor of the Exchequer

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

This is the Annual Report by the PRC to the Chancellor of the Exchequer under paragraph 19 of Schedule 6A to the Bank of England Act 1998 (as amended). It relates to the period of 1 March 2022 to 28 February 2023. The PRA publishes this report as part of its commitment to transparency.

Background

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

The performance of the PRA functions

The PRA has published two approach documents setting out how it advances its statutory objectives: the PRA's approach to banking supervision and the PRA's approach to insurance supervision.[8] The PRA does not seek to operate a zero-failure regime. This is a key principle underlying the PRA's approach to supervision. Each year, the PRC sets the PRA strategy and business plan, and adopts the PRA's budget. These are based on the PRA's approach to supervision, the PRA's operating model, and its risk tolerance, all agreed by the PRC. During 2022/23, the PRA has also been planning for its future approach to policy, as set out in DP4/22 – The Prudential Regulation Authority's future approach to policy,[9] with regards to its expanded role and the regulatory obligations introduced by the FSM Bill.

8. www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.
9. www.bankofengland.co.uk/prudential-regulation/publication/2022/september/pra-approach-to-policy.

The adequacy of resources

The PRA is fully funded by fees paid by regulated firms. The PRA consults each year on the allocation of fees among firms and has the ability, after consultation, to raise additional funds during the year for material changes. The PRA received three responses to its fees consultation proposals in 2022/23, which did not result in changes to the proposals set out in CP4/22 – Regulated fees and levies: Rates proposals 2022/23.[10]

The PRC seeks to ensure that the PRA's financial and non-financial resources are appropriately allocated to the work that best advances its objectives. In making judgements on the allocation of resources, the PRC takes into account a wide range of relevant considerations. These include the wider legislative and policy framework under which the PRA operates, including the duty to have regard to certain factors under FSMA, the Legislative and Regulatory Reform Act 2006 and the Financial Services Act 2021 effective 1 March 2023. The PRC also takes into account HMT's recommendation letter, which was updated on 8 December 2022 (more information is available on the Prudential Regulation Committee web page),[11] and contains aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives, and the application of the regulatory principles set out in FSMA.

The PRC oversees the allocation of the PRA's resources to a combination of assurance work on individual firms and sectors, sectoral stress testing, policymaking, and investment in multi-year programmes that respond to changes in the external environment and risk profile of regulated firms. Work on multi-year programmes can span a range of areas, such as supporting the implementation of the Future Regulatory Framework (FRF) Review, data and technology, reform of Solvency II insurance regulation, preparation for the implementation of Basel 3.1 standards, operational resilience, and investment in data and technology.

The PRC also receives and reviews regular updates on the PRA's performance and on how the PRA's financial and non-financial resources are allocated and monitored, as well as how any resource risks are being mitigated through performance and assurance reporting, discussions of papers prepared by staff, and PRC members' regular interaction with the PRA, including meetings with senior management and other staff. In addition, PRC members have the benefit of their own engagement with industry through meetings and events across the year. Regular reporting to PRC covers: progress against strategic aims; budget and headcount position; staff turnover; technology availability; and the PRA's risk profile. The reports and other evidence provided to the PRC during the year indicate whether the PRA

10. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/regulated-fees-and-levies-rates-proposals-2022-23.
11. www.bankofengland.co.uk/about/people/prudential-regulation-committee.

has used its financial and non-financial resources to deliver its functions, in line with its business plan.

The Bank's second and third lines of defence are also applied within the PRA. This includes the Bank's risk management framework, compliance function, internal audit function, and the Audit and Risk Committee of Court.

The PRA made substantial progress against its strategic priorities in its 2022/23 business plan.[12] The PRA's budget is set within the wider context of the Bank's overall budget policy. As set out in this report, the PRA increased resources in the year due to its increased responsibilities related to rule-making and investment in data and technology. In the light of this increase in resourcing, the PRA has sought to restrain further cost growth for 2023/24 and has made reprioritisation decisions to support this. The PRA continues to invest in technology to maintain and improve its operational effectiveness. The PRA's technology improvement programme is prioritised in the context of the Bank's wider technology estate which requires significant investment to be in step with work relating to the Bank's new developments, restraining the speed with which the PRA is able to make improvements. This could constrain the PRA's ability to deliver its strategic ambitions if it were to persist over time.

In 2022/23, the PRA final outturn was £4.7 million above budget due to higher than budgeted allocated support costs, for example for central functions and pension costs. The higher costs were offset by additional income received in the year. This is explained further within the 2023/24 fee rates consultation.[13]

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

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

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

12. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pra-business-plan-2022-23.
13. www.bankofengland.co.uk/prudential-regulation/publication/2023/april/regulated-fees-and-levies-rates-proposals-2023-24.

determined by the Bank's Remuneration Committee (see the 'Report of the Remuneration Committee' section of the Bank of England Annual Report and Accounts).

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

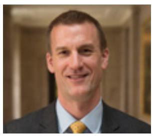
The PRC is structurally separated from the FPC and MPC by having different external memberships. The PRC and FPC hold all meetings separately, except those to discuss matters of mutual interest (for example, when conducting the annual concurrent stress test). The FPC has specific powers of direction over prescribed macroprudential measures, and can make recommendations to anyone with the purpose of reducing risks to financial stability, including the PRA. This can sometimes mean that the FPC takes decisions that constrain the actions determined by the PRC.

The fee income generated from regulated firms can only be used for the functions covered by the statutory framework that the PRA operates within. The PRA's budget covers its support costs, as well as support costs charged by the Bank, including those for central functions such as technology, finance, and human resources. The Bank's external auditors review the allocation of these support costs charged by the Bank, and provide external assurance that costs have been allocated appropriately (see the 'Financial statements: Report of the Independent Auditor' section of the Bank of England Annual Report and Accounts).

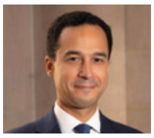
14. www.bankofengland.co.uk/-/media/boe/files/about/legislation/statement-structural-separation.

Senior leadership team

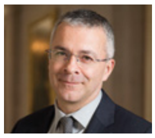
The senior leadership team at the Prudential Regulation Authority is below.[15] [16]



David Bailey
UK Deposit Takers Supervision



Nathanaël Benjamin
Authorisations, RegTech and International Supervision



Phil Evans
Prudential Policy

Charlotte Gerken
Insurance Supervision

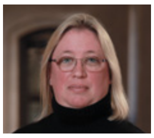
Rebecca Jackson
Authorisations, RegTech and International Supervision

Shoib Khan
Insurance Supervision

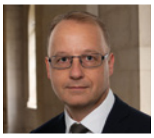
Duncan Mackinnon
Supervisory Risk Specialists

Ben Martin
Strategy, Risk and Operations

Victoria Saporta
Prudential Policy



Alison Scott
Supervisory Risk Specialists



Gareth Truran
Prudential Policy

Laura Wallis
UK Deposit Takers Supervision

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

15. The following Directors commenced their appointments in 2022/23: Shoib Khan (October 2022), Ben Martin (October 2022), and Laura Wallis (June 2023).
16. The following held Executive Director/Director posts during 2022/23: Anna Sweeney (Executive Director, Insurance Supervision, Risk and Operations), and Melanie Beaman (Director, UK Deposit Takers). Very sadly Melanie passed away after the period covered by this report.

Summary: Review of 2022/23

The PRA's activities in 2022/23 were directed by the PRA's statutory objectives and the PRA Business Plan 2022/23

The PRA sets strategic goals and a business plan to direct its work towards achieving its statutory objectives.[17] This section outlines the work completed in pursuit of the PRA's strategic goals in 2022/23, as set out in the PRA Business Plan 2022/23,[18] which are designed to deliver the PRA statutory objectives.[19]

As in previous years, the PRA has contributed to the Bank's financial stability objective, at the same time pursuing its own statutory objectives by maintaining prudential standards, while actively limiting risks to the PRA's objectives, including the insurance-specific objective of policyholder protection.

The work completed in 2022/23, as set out in this report, advanced the PRA's statutory objectives to promote the safety and soundness of the firms it regulates, focusing on the adverse effects that they can have on the stability of the UK financial system, the objective specific to the policyholders of insurance firms, and the secondary objective, which is a duty to facilitate effective competition in the markets for services provided by PRA-authorised persons, so far as is reasonably possible.

Some examples of work that advanced the PRA's statutory objectives include the publication of a landmark CP on the implementation of the Basel 3.1 standards, continued work with HMT on the review of Solvency UK, extensive work on the review of model risk management for banks, building societies, investment firms and insurers, and a review of general insurance firms' approach to recent claims inflation within their reserves. The enhanced regulatory framework to promote operational resilience, taking timely enforcement actions, working with deposit takers and their auditors to improve accounting and disclosure standards for credit losses, and closer engagement with the PRA Practitioner Panel and Insurance Sub-committee, also helped to protect customers of regulated firms, including insurance policyholders, from disruption to financial services on which they rely.

17. www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective.
18. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pra-business-plan-2022-23.
19. www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective.

The PRA also consulted on the proposed scope and eligibility criteria for the Strong and Simple framework for banks and building societies, which aims to reduce regulatory complexity and compliance costs for those smaller firms, while maintaining robust standards.

In addition to conducting stress tests on banks and insurers to assess their resilience to adverse economic conditions, the PRA has also responded to a series of shocks to the global economy and financial system. Furthermore, improvements to the PRA's approach to supervising firms included refinements to the risk assessment and core assurance frameworks, updating the number of categorisations for the 'potential impact' of firms, from five to four.

Several work streams contributed to the advancement of the PRA's secondary objective, including work with HMT to support the implementation of the FRF Review, following the UK's exit from the EU. The PRA has also worked to support potential market entrants through its New Bank and Insurer Start-up Units, and conducted extensive research to prepare proposals for a new policy on solvent exit planning for non-systemic banks and building societies, to facilitate the continuity of service for customers and policy holders following a firm's exit from the market. The PRA will continue to work with the Government to give effect to the recommendations of HMT's published report of the independent panel on ring-fencing and proprietary trading.

Readers may also find it helpful to refer to the PRA statutory objectives[20] and PRA Business Plan 2023/24,[21] which sets out the PRA's strategy and workplan for the coming year, and the PRA's approach to supervision documents.[22]

Examples of how the PRA delivered its 2022/23 strategic goals

1: Retain and build on the strength of the banking and insurance sectors delivered by the financial crisis reform

- Published a landmark CP on the Basel 3.1 standards, covering the parts of Basel III that remain to be implemented in the UK.

- Continued work with HMT on the review of Solvency UK (formerly Solvency II) insurance regulation reforms and will progress with implementation over 2023/24.

20. www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective.
21. www.bankofengland.co.uk/prudential-regulation/publication/2023/may/pra-business-plan-2023-24.
22. www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.

- Enforcement action included fines for regulatory and governance failings in TSB Bank plc and MS Amlin Underwriting Limited.

- Extended the scope of the leverage ratio requirement to firms with non-UK assets above £10 billion.

- Restarted the ACS testing of system-wide financial resilience.

- Completed the PRA Insurance Stress Test 2022.

- Consulted on proposals for building standards and principles for model risk management (MRM) within banks.

- Assessed life insurers' credit, market, and liquidity risk management frameworks, particularly for longer-term annuity businesses.

- Conducted a series of reviews covering general insurers' risk management and reserving against claims inflation.

- Continued supervisory focus on contract uncertainty risk, and related legal proceedings and rulings.

- Published a joint DP with the FCA, on new powers enabling regulators to oversee CTPs.

- Commenced a joint thematic review with the FCA on insurers' operational resilience capabilities.

- Worked with HMT on the publication of its consultation on the new insurance resolution regime.

2: Be at the forefront of identifying new and emerging risks, and developing international policy

- Worked with the Bank and the FCA to successfully transfer Silicon Valley Bank UK Limited (SVBUK), the UK subsidiary of the failed US bank, to HSBC UK Bank Plc (HSBC).

- Engaged closely with international counterparts, including the Swiss Government regarding Credit Suisse, when they announced a comprehensive set of actions in March 2023.

- Worked with deposit takers and their auditors to improve accounting and disclosure standards for credit losses.

- Heightened levels of engagement and monitoring for firms affected by Russia's invasion of Ukraine, including firms with a presence in Russia and Ukraine. Also, worked closely with HMT to ascertain the full scope of affected firms and the potential impact of the sanctions.

- Published the results of the CBES for the largest UK banks and insurers.[23]

- Supported the smooth transition away from LIBOR to new risk-free rates.

- Published, with the Bank and the FCA, a joint DP on AI and machine learning (ML).

3: Support competitive and dynamic markets in the sectors that we regulate

- Published a DP on the PRA's future approach to policymaking, supporting the implementation of HMT's FRF Review, and the PRA's vision to be a strong, accountable, responsive, and accessible rule-maker.

- Worked closely with the Bank and HMT in implementing the recommendations of the independent panel on ring-fencing and proprietary trading, to improve the functioning of the regime while maintaining financial stability benefits.

- Published CPs setting out the proposed scope and eligibility criteria for the PRA's Strong and Simple framework for banks and building societies.

- Supported potential market entrants through the work of the New Bank and Insurer Start-up Units. Engaged with over 20 firms through a structured pre-application stage, leading to 14 formal applications received, and 11 firms (six banks and five insurers) being authorised.

- Streamlined the authorisations process for insurance special purpose vehicles (ISPV).

- Conducted extensive research in preparation of proposals for a new policy on solvent exit planning for non-systemic banks and building societies.

23. **www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario**.

- Updated the regulatory regime for credit unions, extending the range of permitted investments while strengthening expectations for larger and more complex credit unions.

- Published the Prudential and Resolution Policy Index to help firms easily identify relevant policies for their areas of business.

- Published a consultation proposing to enhance the proportionality of the remuneration requirements that apply to small Capital Requirements Regulation (CRR) firms and small third-country CRR firms ('small firms').

- Continued to play a leading role in international policymaking engagements and supervisory co-operations, eg published a consultation on model risk management principles for banks and a letter on existing or planned exposure to cryptoassets.

4: Run an inclusive, efficient, and modern regulator within the central bank

- Worked to strengthen the PRA's supervisory approach by updating the approach to categorising the potential impact of firms, and reduced the number of categories from five to four.

- Set out a multi-year programme to bolster the PRA's efficiency, effectiveness, and data-driven culture, through phased investment in tools, technology, processes, and skills. This included deployment of a digital skills strategy and recruitment of additional data scientists to improve the PRA's data and technology capabilities. Supervisory insight tools were strengthened to more effectively analyse and visualise firm data.

- Approved 1,231 applications for senior management functions, and authorised five new insurers and six new banks in 2022/23. Actions have been taken to improve the processing time of senior management function applications seeing an increase in the proportion of applications receiving a decision within the statutory service standard from 58% for the 2022/23 reporting period to 75% in the period 1 February 2023 to 23 March 2023. Further improvement is expected during the first half of 2023/24.

- Progressed the implementation of the recommendations made in the Bank's independent Court review in 2021 on diversity and inclusion, including improving ethnic and gender representation, and progressing initiatives to improve psychological safety.

- Worked closely with other authorities, including HMT, through the Financial Services Regulatory Initiatives Forum (FSRIF), to share information and co-ordinate regulatory initiatives.

Review of 2022/23

1. Retain and build on the strength of the banking and insurance sectors delivered by the financial crisis reform

Financial resilience – banks

Implementation of the Basel 3.1 standards

The PRA published CP16/22 – Implementation of the Basel 3.1 standards in November 2022.[24] The CP sets out proposals to implement the final package of Basel III banking reforms developed in response to the global financial crisis and prudential standards in the UK.

The CP proposed significant changes to the way that firms calculate risk-weighted assets (RWAs). The proposals seek to improve the comparability and credibility of firms' risk-based capital ratios by strengthening the risk-sensitivity of RWA calculations and addressing the degree of variability observed by the Basel Committee on Banking Supervision (BCBS),[25] especially among firms using internal models. The proposals would facilitate effective competition by narrowing the gap between risk weights calculated under internal models and the standardised approaches.

The consultation period ended on 31 March 2023. During 2023, the PRA will consider the responses received, including feedback on the appropriateness of the proposed implementation date of 1 January 2025, ahead of publishing the final Basel 3.1 rules.

Strong and Simple regime

The PRA published three CPs that set out proposals for its Strong and Simple framework during 2022/23.

In April 2022, the PRA published CP5/22 – The Strong and Simple Framework: a definition of a Simpler-regime Firm.[26] This CP sets out proposed scope criteria that a bank or building society would need to satisfy to be eligible for the simpler prudential regime that the PRA is developing. The CP explained that the PRA had designed the proposed scope criteria to

24. www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards.
25. www.bis.org/bcbs/publ/d424.htm.
26. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/definition-of-a-simpler-regime-firm.

capture small firms that are not systemically important, and which are focused on deposit taking from, and lending to, households and corporates in the UK.

CP16/22 was published in November 2022, proposing updated scope criteria, reflecting the responses to CP5/22. Those updates included an increase in the size limit from £15 billion to £20 billion, to give firms in the simpler regime more room to grow, and additional smoothing provisions in several of the criteria, to reduce the risk of firms ceasing to be eligible for the simpler regime because of short-term shocks.

CP16/22 also proposed a Transitional Capital Regime so that small firms would not need to apply the Basel 3.1 standards before the future implementation date for a permanent risk-based capital framework for the simpler regime, and so that they could remain subject to a regime based on the existing CRR provisions until that time.

Finally, a draft statement of policy (SoP) was published as one of the appendices to CP16/22 that, among other things, set out how firms that are part of foreign groups could gain access to the Transitional Capital Regime via a modification to the scope criteria.

In February 2023, the PRA published CP4/23 – The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms.[27] This CP sets out simplifications to liquidity and disclosure requirements for firms in the simpler regime. The simplifications proposed new liquidity requirements for the application of the net stable funding ratio, revisions to the application of Pillar 2 liquidity add-ons, a new, streamlined Internal Liquidity Adequacy Assessment Process template, the removal of certain liquidity reporting templates, and reduced Pillar 3 disclosure requirements. The CP also proposed to update the SoP to explain how firms that are part of foreign groups could access these simplifications.

The PRA has now started work to develop simpler capital requirements for Simpler-regime Firms, covering Pillar 1, Pillar 2, and buffer requirements, and intends to publish proposals in 2024 H1.

Leverage ratio

In 2022, the PRA supported the FPC's annual statutory review of the leverage ratio Direction, delivered in October.[28] The PRA also continued its assessment of the risks from contingent leverage, through transactions or trade structures that receive a lower leverage ratio exposure measure value than economically equivalent alternatives. This included a

27. www.bankofengland.co.uk/prudential-regulation/publication/2023/february/strong-and-simple-framework.
28. www.bankofengland.co.uk/-/media/boe/files/financial-policy-summary-and-record/2022/fpc-summary-and-record-october-2022.pdf.

consultation to update the PRA's expectations of firms with regards to identifying, monitoring, and mitigating contingent leverage risk through the Internal Capital Adequacy Assessment Process (ICAAP), and to introduce a new data reporting covering the relevant transactions and trade structures. The consultation closed in February 2023, and the policy statement (PS) published on 11 May 2023.[29]

On 1 January 2023, the PRA implemented changes to extend the scope of the leverage ratio requirement to firms with non-UK assets above £10 billion. The PRA also consolidated groups and ring-fenced bank (RFB) sub-groups exceeding the non-UK assets threshold on a consolidated or RFB sub-consolidated basis. This concluded the FPC and PRA's implementation of its 2021 comprehensive review of the UK leverage ratio framework.

Stress testing

Stress testing is an important part of the supervisory toolkit for the PRA. The PRC and the FPC use stress tests to assess bank balance sheets and the resilience of the UK banking system.

The Bank and the PRA returned to the ACS framework to test system-wide financial resilience, following two years of Covid-19 crisis-related stress testing.[30] The 2022 ACS timeline was initially postponed following Russia's invasion of Ukraine, with the ACS published in late 2022 and firms submitting their forecasts in January 2023. The 2022 ACS tests the UK banking system's resilience against deep simultaneous recessions in the UK and global economies, large falls in asset prices, and higher interest rates, with a separate misconduct stress. The results of the test will be published in Summer 2023 and, along with other relevant information, will be used to help inform banks' capital buffers (both the UK countercyclical capital buffer rate and PRA buffers).

This year, the Bank announced that it will also run an exploratory system-wide exercise to investigate the behaviours of a range of financial sectors, including insurers, in response to a severe but plausible stress to financial markets during the report year.[31] As indicated in the FPCs March 2023 Record,[32] this will be an exploratory exercise focused on market resilience and its importance for UK financial stability. It will not be a test of individual firms' resilience. The Bank will publish detailed information on the exercise in the summer.

29. PS5/23 – Risks from contingent leverage: www.bankofengland.co.uk/prudential-regulation/publication/2023/may/risks-from-contingent-leverage.
30. www.bankofengland.co.uk/news/2022/september/key-elements-of-the-2022-stress-test.
31. www.bankofengland.co.uk/financial-policy-summary-and-record/2023/march-2023.
32. www.bankofengland.co.uk/financial-policy-summary-and-record/2023/march-2023.

Internal models

Given the central role that models play in supporting firms' risk assessment and management, and identified weaknesses with implementation of new policy, MRM remains a supervisory priority. The PRA's work on internal models in the last year included:

- the ongoing implementation of new PRA requirements and expectations for internal ratings-based (IRB) models (IRB Hybrid mortgage models and the IRB roadmap for non-mortgage portfolios);
- continued engagement with firms seeking to adopt IRB approaches; and
- the strengthening of MRM oversight within firms, given the increasing use, materiality, and complexity of risk models.

Due to the overall scale and complexity of the changes and weaknesses in MRM identified across the industry, firms' implementation of the new IRB requirements and expectations, which came into force on 1 January 2022, has been challenging. During 2022, the PRA actively engaged with in-scope firms on their model development and implementation plans, and instances of non-compliance have been addressed using post model adjustments. Adoption of the revised standards will remain a key priority for the PRA in the coming year.

The PRA also continued to engage with firms to monitor market risk model performance. Preparatory work for the Fundamental Review of the Traded Book will continue ahead of expected implementation in 2025.

The PRA has made significant progress in building its standards for MRM. CP6/22 – Model risk management principles for banks was published in June 2022, and the final MRM principles for banks were published in PS6/23.[33] In addition, the PRA conducted focused reviews of counterparty credit risk models including the use of Standard Initial Margin Models.

Financial resilience – insurers

Reform of Solvency II (UK)

The PRA has continued to work closely with HMT on the review of Solvency II, which will result in the new Solvency UK regime. In April 2022, the PRA published a statement[34] setting out its view on a reform package that would meet its statutory objectives. At the same

33. www.bankofengland.co.uk/prudential-regulation/publication/2023/may/model-risk-management-principles-for-banks.
34. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/pras-statement-on-the-review-of-solvency-ii-consultation-published-by-hm-treasury.

time, HMT consulted on specific areas for its review, including the risk margin, the matching adjustment, and reporting.[35] In support of its statement, the PRA also published DP2/22 – Potential Reforms to Risk Margin and Matching Adjustment within Solvency II,[36] together with the summary of the responses received to the 2021 quantitative impact study exercise.[37]

The PRA conducted further data collection exercises[38] in May and June 2022 to inform the development of options for risk margin and matching adjustment reform. This information, together with industry roundtables (which included discussions on the fundamental spread, risk margin, transitional measures for technical provisions, the internal model framework, and the matching adjustment) helped the PRA to model the impact of further potential reforms. The PRA published a feedback statement in November 2022[39] setting out the responses it had received to DP2/22.[40]

Since HMT has set out its decisions on the package of reforms including both regulatory reform and supervisory measures in November 2022, the PRA has been working on its implementation of the reforms, including determining the split of responsibilities needed between government legislation and PRA rule-making. The PRA has set up subject matter expert groups with regulated firms and trade associations to help to develop options for effective implementation of the package of matching adjustment reforms and supervisory measures.

On 17 December 2021, the PRA published PS29/21 – Review of Solvency II: Reporting (Phase 1), which streamlined certain onshored Solvency II reporting requirements to reduce the volume of returns reported. These ‘Phase 1’ reforms, which came into force on Friday 31 December 2021,[41] enhanced the proportionality of reporting through the extension of quarterly waivers to small and medium-sized firms, as well as the deletion of financial stability reporting for large firms. The second phase of proposed reporting and disclosure reforms is

35. www.gov.uk/government/consultations/solvency-ii-review-consultation.
36. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/potential-reforms-to-risk-margin-and-matching-adjustment-within-solvency-ii.
37. www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/solvency-ii-reform-quantitative-impact-survey.
38. www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/review-of-solvency-ii-2022-data-collection-exercise.
39. www.bankofengland.co.uk/prudential-regulation/publication/2022/november/fs1-22-potential-reforms-to-risk-margin-and-matching-adjustment-within-solvency-ii.
40. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/potential-reforms-to-risk-margin-and-matching-adjustment-within-solvency-ii.
41. www.bankofengland.co.uk/prudential-regulation/publication/2021/july/review-of-solvency-ii-reporting-phase-1.

under way. A CP issued on 7 November 2022[42] proposed improvements to better reflect the composition of the UK insurance market which would, in turn, increase the relevance of reporting to the PRA and further enhance the PRA's efficiency in advancing its prudential objectives. Further consultations on reporting reforms are planned during 2023.

Stress testing

The PRA uses insurance stress testing (IST) to assess sector resilience, support industry capacity building in risk management, and guide supervisory activity.

IST continues to be a valuable tool for the PRA in pursuing a forward-looking, proportionate, and judgement-based approach to supervising the insurance sector. These exercises test the sector's resilience to a number of hypothetical scenarios, and help the PRA to assess the adequacy of firms' risk management.

The IST carried out in 2022 demonstrated that the UK insurance sector is resilient to the scenarios specified by the PRA.[43] In particular, life insurers were asked to assess their solvency position following an adverse economic scenario and an increase in longevity, and general insurers and Lloyd's syndicates were asked to assess their solvency position against a set of insured natural catastrophe and cyber losses.

Internal models

The PRA closely monitored firms to ensure Solvency II Internal Models (IMs) were robust and adequately calibrated. The PRA remained vigilant against potential model drift, using a range of supervisory tools. This included comparing movements in the solvency capital requirement (SCR) of IM firms relative to other measures of risk, analysing IM output calibration data, and reviewing the accumulated SCR impact of major and minor model changes.

Supervision of life insurance

Supervisory focus for the life insurance sector has remained on the assessment of firms' credit risk exposure management, particularly in longer-term annuity businesses. The PRA has also assessed compliance with the prudent person principle and the management of asset concentrations in reinsurance businesses, with remedial actions agreed, where necessary.

Work is also under way to better understand life insurance firms' sensitivities to market risk. There has also been increased focus on liquidity risk generated by margin payments,

42. www.bankofengland.co.uk/prudential-regulation/publication/2022/november/review-solvency-ii-reporting-phase-2.
43. www.bankofengland.co.uk/prudential-regulation/letter/2022/May/insurance-stress-test-2022.

following the market turbulence after Russia's invasion of Ukraine, and in the light of disruptions within the gilt market in the second half of 2022.[44]

Supervision of general insurance (GI)

The PRA conducted a review into how GI firms are reflecting recent claims inflation within their reserves. The review included a specific assessment of the drivers of inflation across the various lines of business along with an assessment of the potential impact on firms from a range of inflationary scenarios, such as a global supply-chain disruption and an increase in insurance losses and employment-related claims. The PRA also engaged with firms to better understand what work firms have done to assess their financial resilience to inflationary scenarios, the potential for reduced business volumes, lower asset returns or altered customer behaviour. The PRA has also assessed the competitive dynamics that might prevent insurers from repricing even short-tailed business, to reflect the higher cost of settling claims. The output from this work was communicated to the market via a letter to chief actuaries, which was published on 20 October 2022.[45]

General insurance contract uncertainty risk

During 2022, the PRA continued to monitor the legal proceedings, rulings, and precedents set by the cases associated with business interruption insurance protections linked to the events of Covid-19, and the lessons that can be drawn more generally for the identification and management of contract uncertainty risks. In particular, the PRA has also undertaken firm-specific engagement over contract uncertainty risk within stand-alone cyber-protection insurance policies as part of wider thematic cyber reviews.

The PRA has also been monitoring the initial legal filings and arguments being made associated with aviation insurance protections linked to Russia's invasion of Ukraine. As the current level of potential contract uncertainty risk within the UK GI industry appears to remain elevated above usual levels, the PRA will continue to monitor the risk frequency and severity, and engage with industry/individual GI firms to assess how the risk is being managed.

Supervision of operational resilience

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

44. www.bankofengland.co.uk/news/2022/september/bank-of-england-announces-gilt-market-operation.
45. www.bankofengland.co.uk/prudential-regulation/letter/2022/october/insights-from-thematic-review.

In March 2022, the PRA's PS on operational resilience,[46] delivered in co-ordination with the Bank and the FCA, came into force, setting expectations for firms to take ownership of their operational resilience capabilities, and to prioritise plans and investment choices based on their operations' impacts on the public interest. The operational resilience policy requires firms to:

- identify their important business services;
- set impact tolerance(s) for each important business service, quantifying the maximum level of disruption they could tolerate; and
- build resilience so they can deliver their important business services within impact tolerances through severe but plausible scenarios.

The operational resilience policy, set out in SS1/21, requires firms to produce a self-assessment of their ability to meet the outcomes set out in the policy. The PRA reviewed the highest impact banks' self-assessments in 2022, and has published its high-level findings.

For example, in March 2022, the UK division of US-managed IT company Sungard Availability Services entered administration, with limited impact for the safety and soundness of other firms and markets in the UK.

Jointly with the FCA, the PRA commenced a thematic review of insurers' operational resilience in August 2022 focusing on 160 higher-impact insurers' first self-assessments.

This year, the PRA has also increased its focus on third-party suppliers to the financial sector. Firms and FMIs increasingly rely on a small number of cloud service providers and CTPs to support their operations. This concentration could create risks to financial stability. For this reason, the Bank's FPC determined in 2021 that 'additional policy measures, some requiring legislative change, are likely to be needed to mitigate the financial stability risks stemming from concentration in the provision of some third-party services'. This could include developing a framework for supervising CTPs designated as 'critical', including resilience standards and testing.[47]

46. www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper.
47. More information is available on the Financial Policy Summary and Record – July 2021 web page: www.bankofengland.co.uk/financial-policy-summary-and-record/2021/july-2021 and the Financial Policy Summary and Record – October 2021 web page: www.bankofengland.co.uk/financial-policy-summary-and-record/2021/october-2021.

The FSM Bill will give HMT the ability to designate certain third parties as 'critical,' following consultation with the supervisory authorities (the FCA, the PRA and the Bank in its capacity as supervisor of FMIs). The Bill will also give the supervisory authorities new powers to oversee CTPs. In 2022, the PRA and the FCA published a joint DP on how these proposed powers could be used to assess and strengthen the resilience of services provided by CTPs to firms and FMIs,[48] thereby reducing the risk of systemic disruption.

The PRA has also reviewed a number of cloud outsourcing notifications from firms, and engaged on firms' multi-year technology transformation and digitisation programmes, in order to better understand firm-specific and systemic risks.

The PRA also continued to assess the cyber resilience of regulated firms via a number of approaches, including the CBEST programme.[49] CBEST – a joint PRA and FCA framework for assessing the cyber resilience of firms' important business services through intelligence-led threat penetration testing – continued to play a major role in assessing firms' cyber defence capabilities. The PRA conducted 10 CBEST assessments during the year, and initiated a further 10, as well as actively collaborating with other global financial regulators on a number of cross-jurisdictional assessments. In addition to conducting CBEST testing, the PRA also undertook ad-hoc reviews of the firms in the sector. The PRA and the FCA also analysed the outcomes of completed CBEST assessments, and identified and shared thematic findings with regulated entities.

The PRA has undertaken a range of broader assessments of firms' operational risk management and resilience and, working alongside the FCA, has incorporated operational resilience and outsourcing policy expectations into the firm authorisations process. The PRA also continues to assess the effectiveness of firms' operational risk management frameworks, including to understand how they are using operational tail-risk scenarios, for setting operational risk capital as part of the Capital Supervisory Review and Evaluation Process.

The PRA has continued to support the development of industry resilience capabilities through the provision of technical input to the Cross Market Operational Resilience Group and its technical subgroups. Key deliverables in 2022 included a sector-wide simulation exercise, and rehearsing industry's ability to respond to a scenario in which a major firm became operationally paralysed. This was supported by wider firm engagement on access to key sector response tools. Other key deliverables included: a framework for cloud controls, best

48. **www.bankofengland.co.uk/prudential-regulation/publication/2022/july/operational-resilience-critical-third-parties-uk-financial-sector**.
49. CBEST is a framework for intelligence-led penetration testing which focuses on an organisation's security controls and capabilities when faced with a simulated cyberattack. The simulated attacks used in testing are tailored to the threat and vulnerability profile of each organisation and represent an evidence-based and robust testing approach.

practice for managing third-party security risks, lessons learned from recent high-profile vulnerabilities, and a prioritisation framework to support sector co-ordination during a payments incident.

Internationally, the PRA continued to engage with standard-setting bodies such as the Financial Stability Board (FSB), the BCBS, and the International Association of Insurance Supervisors (IAIS), and through forums at the G7 and in Europe, as well as bilaterally, on key operational risks. In 2022, this work included the publication of fundamental elements of ransomware resilience and third-party cyber risk management.[50]

Governance and risk management

The PRA has continued placing importance on good governance and leadership in firms through its day-to-day supervision. It has also highlighted the need for senior accountability for key risks raised by the PRA, including through DP5/22 – Artificial Intelligence and Machine Learning,[51] as well as proposals in CP6/22 – Model risk management principles for banks[52] and the letter to CEOs on existing or planned exposure to cryptoassets.[53] In addition, the PRA consulted on removing certain Senior Managers and Certification Regime (SM&CR) forms from the PRA Rulebook, so that administrative and other non-material amendments can be done more seamlessly, and sought to foster greater consistency across firms on the requested length of employment history.[54] These changes would be expected to help improve the operational efficiency of the SM&CR, which can complement the wider review into the effectiveness of the regime that was launched following the Edinburgh Reforms announcement in December 2022.[55]

Work has also continued on developing proposals for consultation on enhancing diversity and inclusion in the financial sector following the PRA, the FCA, and the Bank's DP, published in 2021.[56] The proposals are in line with the PRA's ambition to make the financial system enabled to support the economy through well-run firms and sound financial markets. Diversity and inclusion can reduce groupthink, encourage debate and innovation, and thereby improve outcomes across markets, supporting financial stability. The PRA and the

50. www.gov.uk/government/publications/g7-fundamental-elements-of-ransomware-resilience-for-the-financial-sector.
51. www.bankofengland.co.uk/prudential-regulation/publication/2022/october/artificial-intelligence.
52. www.bankofengland.co.uk/prudential-regulation/publication/2022/june/model-risk-management-principles-for-banks.
53. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2022/march/existing-or-planned-exposure-to-cryptoassets.pdf.
54. www.bankofengland.co.uk/prudential-regulation/publication/2023/january/moving-senior-managers-regime-forms.
55. www.gov.uk/government/collections/financial-services-the-edinburgh-reforms.
56. www.bankofengland.co.uk/prudential-regulation/publication/2021/july/diversity-and-inclusion-in-the-financial-sector.

FCA's CP is due to be published later in 2023,[57] and the topic has been highlighted as one of the areas of focus in the supervisory priority letters sent out to all PRA firms in January 2023.[58]

The 2023 supervisory priority letters also noted the continued importance of sound risk-management practices, and the PRA has continued carrying out thematic work in this area, with a greater focus on the links between governance, accountability, and risk management in firms, following the default of Archegos Capital Management.

The PRA has also taken steps to improve the effectiveness and proportionality of the remuneration regime for banks following the UK's exit from the EU. In December 2022, the PRA consulted on removing the limits on the ratio between variable and fixed remuneration (known as the 'bonus cap');[59] and in January 2023 published the final policy on unvested pay and conflicts of interest management for senior individuals moving from private to public sector roles.[60] In February 2023, alongside proposals on the Strong and Simple framework, the PRA consulted on enhancing proportionality of the remuneration requirements applicable to small firms,[61] reflecting feedback received to a survey conducted with small firms in August 2022 on the costs and benefits of the regime.

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

As of 28 February 2023, the PRA's Enforcement team, which works closely with other relevant (including criminal) authorities, was overseeing seven cases. This included investigations into six PRA-authorised firms and 11 individuals. The issues and themes encountered span the full spectrum of the PRA's strategic priorities, including operational risk and resilience, governance and risk controls, and regulatory reporting and disclosure to the PRA.

During the course of this year, the PRA:

- opened one new case into a PRA-regulated firm;

57. The publication was delayed from Autumn 2022 to ensure the full consideration of the wide range of evidence received in response to the 2021 DP and the survey to firms.
58. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2023/uk-deposit-takers-2023-priorities.pdf.
59. www.bankofengland.co.uk/prudential-regulation/publication/2022/december/remuneration.
60. www.bankofengland.co.uk/prudential-regulation/publication/2023/february/remuneration-unvested-pay-material-risk-takers-and-public-appointments.
61. www.bankofengland.co.uk/prudential-regulation/publication/2023/february/remuneration-enhancing-proportionality-for-small-firms.

- imposed its highest ever fine on an insurer (£9,695,000) against MS Amlin Underwriting Limited for failings in its governance, controls, and risk management; and

- imposed a total fine of £48,650,000 (in conjunction with the FCA) against TSB Bank plc for operational risk management and governance failings, including management of outsourcing risks. In April 2023, the PRA went on to impose a fine of £81,620 on the former Chief Information Officer of TSB Bank plc, Mr Carlos Abarca, for his role in TSB's failings.

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

Box A: MS Amlin Underwriting Limited

In October 2022, the PRA imposed a financial penalty on MS Amlin Underwriting Limited (MSAUL) of £9,695,000 for failing to comply with its regulatory obligations relating to its governance and oversight of underwriting, underwriting controls, management information, data quality, and risk-management strategies and systems. These failings took place in the period between 1 September 2014 and 31 December 2019.

From September 2014, in parallel with its growth strategy, MSAUL organised its underwriting business into three strategic business units, each of which underwrote business on MSAUL's behalf. During the relevant period, the PRA noted its concerns regarding the risks this, and prevailing market conditions, presented. There were various issues in relation to a number of MSAUL's systems, controls, and processes and MSAUL failed to address these issues in an effective and timely manner during the relevant period.

The investigation found that MSAUL had failed to:

- embed a strong or effective risk culture within the business;
- clearly delineate responsibilities between the first and second lines of defence;
- put in place appropriate and/or effective risk mitigation strategies;
- establish an effective system of governance underpinned by an adequate and transparent organisational structure that allowed for effective challenge, management and decision-making;
- ensure management information was adequate, consistently available, and appropriate so as to inform the MSAUL Board's discussions and form a reliable basis for decisions;
- operate an adequate data repository system and consistent data quality controls; and
- embed sufficiently effective controls over underwriting.

As a result of these failings, the PRA has found that MSAUL breached Fundamental Rule 5 of the PRA Rulebook, requiring firms to have effective risk strategies and risk-management systems, and Fundamental Rule 6 of the PRA Rulebook, requiring firms to organise and control their affairs responsibly and effectively.

MSAUL agreed to resolve this matter and therefore qualified for a 30% reduction in the fine imposed by the PRA. Without this discount, the fine imposed by the PRA would have been £13.85 million.

Box B: TSB Bank plc

In December 2022, the FCA and the PRA fined TSB Bank plc (TSB) a total of £48,650,000 for operational risk management and governance failures, including management of outsourcing risks, relating to TSB's IT upgrade programme. Technical failures in TSB's IT system ultimately resulted in customers being unable to access banking services. In April 2023, the PRA then fined Mr Carlos Abarca, the former Chief Information Officer (CIO) of TSB, £81,620 for his role in TSB's failings.

In April 2018, TSB updated its IT systems and migrated the data for its corporate and customer services on to a new IT platform. While the data itself migrated successfully, the platform immediately experienced technical failures. This resulted in significant disruption to the continuity of TSB's banking services, including branch, telephone, online, and mobile banking.

All of TSB's branches and a significant proportion of its 5.2 million customers were affected by the initial issues. Some customers continued to be affected by some issues and it took until December 2018 for TSB to return to business-as-usual. TSB has paid £32.7 million in redress to customers who suffered detriment. The regulators found that TSB failed to organise and control the IT migration programme adequately, and it failed to manage the operational risks arising from its IT outsourcing arrangements with its CTP supplier.

TSB was fined £29,750,000 by the FCA and £18,900,000 by the PRA. TSB agreed to resolve this matter with the FCA and the PRA qualifying it for a 30% discount in the overall penalty imposed by both regulators. Without this discount, the FCA and the PRA would have imposed a combined financial penalty of £69,500,000 (£42,500,000 by the FCA and £27,000,000 by the PRA).

The PRA fined Mr Carlos Abarca, the former CIO of TSB, for breaching PRA Senior Manager Conduct Rule 2 as he failed to take reasonable steps to ensure that TSB adequately managed and supervised appropriately its outsourcing arrangement in relation to the IT migration programme. As CIO of TSB, Mr Abarca had responsibility for TSB complying with the PRA's outsourcing rules. In particular, he was responsible for TSB's key outsourcing relationship with its main third-party supplier for the IT migration programme. As part of this, he gave assurance to the TSB Board that the third party, as key supplier, was prepared for migration. However, he failed to ensure that TSB had itself obtained sufficient assurance from the third party before doing so. Mr Abarca was fined £81,620. He agreed to resolve the matter with the PRA for a 30% discount. Without this discount, the PRA would have imposed a penalty of £116,600.

2. Be at the forefront of identifying new and emerging risks, and developing international policy

The war in Ukraine

Russia's invasion of Ukraine presented new challenges and risks to the global financial system.

As part of its horizon-scanning and risk identification process, the PRA assessed firms' direct and indirect exposures to the affected countries and sectors in the build up to and following the invasion, working closely with firms most affected, as well as domestic and international regulatory counterparts.

The invasion of Ukraine also significantly impacted the commodity markets, in particular energy and agriculture, where PRA-regulated firms are active.

While PRA-regulated firms did not have material levels of exposure to the affected countries, some did maintain presences in Russia or Ukraine and/or held insurance, trading, or banking operations in affected countries. Firms took actions to minimise the impact of the event, reduced exposures where feasible, and increased the use of stress testing and scenario analysis. Some challenges arose due to large, concentrated positions among non-PRA regulated counterparties. Non-life insurance companies also suffered underwriting losses under aviation contingency, political violence, marine war, and trade credit policies.

The PRA initiated rapid escalation measures, using various cross-PRA and cross-Bank information sharing and decision-making groups. This resulted in heightened levels of firm engagement and monitoring, with resources directed to the most material issues. The PRA also worked closely with colleagues at HMT to ascertain the full scope of affected firms and the potential impact of the sanctions.

For example on 8 March 2022, the London Metal Exchange (LME) suspended nickel trading, having concluded that a disorderly market had arisen, and resumed trading on the LME on 16 March. The suspension occurred as a result of challenging commodity market conditions following Russia's invasion of Ukraine.

Furthermore, within the UK, VTB Capital plc, a PRA-regulated UK subsidiary of a Russian sanctioned entity, ceased activity. Since the annexation of Crimea in 2014, ongoing political and economic tensions led the firm to reduce its operations in the UK and the UK subsidiary entered administration in April 2022 with limited impact for safety and soundness of other firms and markets in the UK.

Markets volatility

In September 2022, rapid and large moves in the interest rates on UK government debt exposed weaknesses in LDI funds that are used by UK pension schemes. This weakness threatened UK financial stability and the Bank announced a temporary and targeted intervention to restore market functioning in long-dated government bonds and reduce risks from contagion to credit conditions for UK households and businesses.[62] In particular, the Bank took temporary and targeted action to restore market functioning and give LDI funds time to build their resilience to future volatility in the gilt market. Gilts purchased by the Bank as part of this action have since been sold.

The Bank recently announced that it will run an exploratory system-wide exercise to investigate the behaviours of a range of financial sectors, including insurers, in response to a severe but plausible stress to financial markets. This exploratory exercise will focus on market resilience and its importance for UK financial stability; it will not be a test of individual firms' resilience.

In March 2023, the Bank, in consultation with the PRA, HMT and the FCA, announced its decision as resolution authority to transfer SVBUK, the UK subsidiary of the US bank, to HSBC UK Bank plc.[63] The PRA worked with the Bank and the FCA to facilitate the transfer of SVBUK's business to HSBC, so that its services could continue as normal, and to avoid disruption to depositors. HSBC UK Bank plc is the UK ring-fenced subsidiary of HSBC Holdings plc.

In addition, to support the UK's financial stability, the PRA engaged closely with international counterparts, including Swiss authorities regarding Credit Suisse, when they announced a comprehensive set of actions in March 2023.

Climate change

The PRA has, in advancing its objectives relating to climate, continued to have regard to the Government's commitment to achieve a net-zero economy by 2050[64] and the significant role that the financial system plays in supporting the UK's energy strategy as part of the UK's pathway to net zero.[65]

62. **www.bankofengland.co.uk/news/2022/september/bank-of-england-announces-gilt-market-operation**.
63. **www.bankofengland.co.uk/news/2023/march/statement-on-silicon-valley-bank**.
64. Available at: **https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122895/CX_Letter_to_andrew_Bailey_0812_WITH_COVER.pdf**.
65. Available at: **https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1067015/Recommendations_for_the_Prudential_Regulation_Committee_April_2022_final.pdf**.

In recognition of the increasing risk that climate change presents to firms and the financial system, the PRA has been actively supervising regulated firms against its supervisory expectations as set out in SS3/19 – Enhancing banks' and insurers' approaches to managing the financial risks from climate change as part of its supervisory cycle.[66] In addition, the PRA conducted thematic reviews across a range of firms to understand the extent to which they had embedded the management of climate-related risks into their existing risk management frameworks, disclosure reports, financial reporting and 2021/22 ICAAP (for deposit takers) or own risk and solvency assessment (ORSA) (for insurers).

The PRA communicated feedback from this work in a published letter to chief executives setting out its observations on the progress made by firms.[67] Overall, the PRA observed that firms had taken tangible and positive steps to implement expectations, but the level of embeddedness varied across firms and further progress was needed by all firms within scope of SS3/19. The letter noted that the PRA expects firms to take a proactive approach to addressing risks in this area and provided some specific examples of areas where firms would be expected to demonstrate capabilities in meeting supervisory expectations. It further reiterated that approaches should be proportionate to the nature of a firm's business, scale of the risks, and the complexity of its operations.

The PRA has continued to promote high-quality and consistent accounting for climate change, particularly for banks where there is a strong interaction between accounting and capital. In its letter to Chief Financial Officers, sharing thematic findings from its review of written auditor reports for major UK banks, the PRA communicated feedback on observed firm practices and a list of 'key plan elements' to help banks plan to improve the capture of climate risk on their balance sheets.[68]

The Bank also published the results of the CBES which explored the financial risks posed by climate change for the largest UK banks and insurers under three climate scenarios.[69] Climate risks captured in the CBES scenarios are likely to create a drag on the profitability of UK banks and insurers, but the test indicated that the overall costs will be lower with early, well-managed action to reduce greenhouse gas emissions. In addition, the CBES found that some climate costs initially falling on banks and insurers may ultimately be passed on to their customers, but the projections of climate losses remain uncertain. Learnings from the

66. www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss.
67. www.bankofengland.co.uk/prudential-regulation/letter/2022/october/managing-climate-related-financial-risks.
68. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2022/october/thematic-feedback-2021-2022-written-auditor-reporting.pdf.
69. www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario.

exercise have helped to inform the PRA's supervisory policy and approach in relation to the financial risks from climate change, and guide further work between participants and supervisors to address any issues highlighted, for example improving firms' climate risk management and supporting initiatives to help fill data gaps.

Further to the PRA's Climate Change Adaptation Report 2021,[70] the Bank held a research conference to explore whether changes were needed to the design, use, and calibration of capital frameworks to ensure firms and the financial system are resilient to climate-related financial risks. The Bank published a report of its key findings, which did not set out any policy changes but provided updates on the Bank's thinking and areas identified for future work.[71] The report also recognised the need for firms to continue to make progress to address 'capability gaps' (difficulties in the identification, measurement, and management of climate risks) and 'regime gaps' (challenges in capturing climate risks due to the design or use of methodologies in the capital frameworks).

Finally, the PRA continued to work collaboratively with domestic and international partners (including other central banks and supervisors) and contributed to a number of publications, sharing firms' progress and effective practice for managing climate-related financial risks. For example, the PRA:

- continued to drive forward the work of the Climate Financial Risk Forum with the FCA, to build capacity and generate best practice for the industry to advance its responses to the financial risks from climate change;
- contributed to workstreams as part of the Network for Greening the Financial System;
- actively participated in the BCBS's Task Force on Climate-Related Financial Risks, which published new supervisory principles for climate-related risks and issued a new set of frequently asked questions.[72] The Task Force is working towards examining risks in the current banking framework, potential gaps, and measures to address such gaps;[73] and
- continued to play an active role in climate work at the IAIS, chairing scenario analysis work which delivered workshops to over 200 insurance supervisors globally in 2022, and participating in the annual global monitoring exercise, which included climate data for the first time.

70. www.bankofengland.co.uk/prudential-regulation/publication/2021/october/climate-change-adaptation-report-2021.
71. www.bankofengland.co.uk/prudential-regulation/publication/2023/report-on-climate-related-risks-and-the-regulatory-capital-frameworks.
72. www.bis.org/bcbs/publ/d543.htm.
73. www.bis.org/bcbs/publ/d532.htm.

LIBOR transition

The PRA, working together with the FCA, maintained its supervisory programme on the transition away from LIBOR over the course of 2022. Firms' classifications were reviewed periodically to ensure supervisory engagement and data collection were proportionate to the size and complexity of their remaining LIBOR exposures and progress in removing remaining dependencies on LIBOR. Review meetings focused on monitoring key residual risks which were primarily related to the remediation of USD LIBOR exposures by end-June 2023, operational readiness for central counterparties conversion events,[74] and ensuring transition to the most robust form of risk-free rates, namely overnight risk-free rates, with limited use of term risk-free rates, in line with industry best practice.

The PRA continued to monitor firms' wind-down of remaining exposures to synthetic LIBOR settings in advance of their permanent cessation dates announced by the FCA,[75] having noted the smooth permanent cessation of the synthetic JPY LIBOR settings at end-2022 and the one and six-month synthetic GBP LIBOR settings at end-March 2023. The PRA also continued to engage with international regulators to monitor global progress and developments, particularly in other LIBOR jurisdictions. Co-operation has been strong and effective.

Digitalisation

The PRA has been working closely with other parts of the Bank, particularly its Fintech Hub,[76] to monitor developments, identify new and emerging risks, and input into international policy. The impact of digitalisation on business model risk has been a component of the PRA's work, with a specific focus on open banking, large technology firms (big techs), and Buy Now Pay Later products. The PRA has worked closely with other financial services policymakers, including HMT, through the FSRIF,[77] to share information and co-ordinate initiatives including those related to digitalisation. The Bank's New Bank[78] and Insurer[79] Start-up Units have engaged with applicant firms that have novel uses of technology.

In the past year, the PRA has contributed to the BCBS's work on distributed ledger technology.[80] The PRA has also been an active participant in the IAIS Fintech forum.

74. Central counterparties events are being utilised for the transition of cleared USD LIBOR contracts.
75. www.fca.org.uk/news/statements/fca-decision-cessation-1-6-month-synthetic-sterling-libor.
76. The Fintech hub was launched in March 2018.
77. The Financial Services Regulatory Initiatives Forum launches Grid to help financial firms' planning: www.fca.org.uk/news/press-releases/financial-services-regulatory-initiatives-forum-launches-grid.
78. www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit.
79. www.bankofengland.co.uk/prudential-regulation/new-insurer-start-up-unit.
80. www.bis.org/speeches/sp221208.pdf.

Through the Transforming Data Collection programme,[81] the PRA worked closely with the Bank, the FCA, and industry to progress work on streamlining data collection from the UK financial sector. Phase 2 of the programme began in September 2022.

The regulatory treatment of cryptoassets has been a policy focus for the PRA, with significant UK contributions to the international debates and final international policy.[82] Supervision has been actively monitoring their major firms' involvement in crypto activities.

Artificial intelligence and machine learning

To further its understanding of rapidly developing technologies that have the potential to transform financial services, such as AI and ML, the PRA, together with the wider Bank and FCA, published a DP in October 2022 on AI and ML setting out its views on the benefits and risks of AI and ML in financial services, how the current regulatory framework applies to AI and ML, where additional clarification of existing regulation may be helpful, and how policy can best support further AI and ML adoption.[83] The DP is part of the Bank and the PRA's wider programme of work on AI, including the AI Public-Private Forum (the final report of which was published in February 2022)[84] and a survey of machine learning in UK financial services (published in October 2022).[85]

3. Support competitive and dynamic markets in the sectors that we regulate

Regulatory change – the Future Regulatory Framework Review

The FRF Review was established by HMT to consider how the financial services regulatory framework should adapt to be fit for the future, and in particular to reflect the UK's new position outside of the EU.

The Government stated its intention to establish a coherent, responsive, and internationally respected approach to financial services regulation that is right for the UK. It set out its proposals in two consultations.[86] The second consultation ended in February 2022, and received 109 responses.

81. www.bankofengland.co.uk/prudential-regulation/transforming-data-collection.
82. www.bis.org/bcbs/publ/d545.pdf.
83. www.bankofengland.co.uk/prudential-regulation/publication/2022/october/artificial-intelligence.
84. www.bankofengland.co.uk/research/fintech/ai-public-private-forum.
85. www.bankofengland.co.uk/report/2022/machine-learning-in-uk-financial-services.
86. www.gov.uk/government/consultations/future-regulatory-framework-frf-review-proposals-for-reform.

The Government introduced the FSM Bill into Parliament on 20 July 2022.[87] This Bill implements reforms identified by the FRF Review, and includes a range of provisions enabling the FRF Review. These include landmark changes to the PRA's role, such as:

- repealing retained EU financial services regulations (eg CRR and Solvency II) so that it can be replaced with PRA rules as part of building a smarter financial services framework for the UK;[88]
- a new secondary objective to facilitate the international competitiveness of the UK economy and its growth in the medium to long term;
- a requirement to publish cost benefit analysis (CBA) methodology and set up a new CBA panel comprised of external members;
- a requirement to publish and maintain a framework for reviewing rules; and
- a requirement to notify the Treasury Select Committee (TSC) when the PRA publishes a consultation, and responding in writing to parliamentary committees' formal responses to consultations.

As part of the Edinburgh Reforms,[89] the Government published more details on its approach to repealing and replacing retained EU law on financial services in order to build a smarter financial services framework for the UK.

The PRA welcomes the FRF Review measures contained in the FSM Bill, and the creation of a smarter regulatory framework for financial services, which are intended to establish a strong, responsive, and internationally respected approach to financial services regulation for the UK. The PRA also supports the proposals for regulators to have increased responsibility for setting regulatory requirements, acting within a strong policy and accountability framework set and overseen by Parliament.

To support the implementation of the FRF Review, the PRA published a DP in September 2022, setting out its vision for implementing the framework as it currently stands in terms of strong standards, accountability to Parliament, stakeholders, and the public at

87. https://bills.parliament.uk/bills/3326.
88. Building a smarter financial services framework for the UK: www.gov.uk/government/publications/building-a-smarter-financial-services-framework-for-the-uk.
89. www.gov.uk/government/collections/financial-services-the-edinburgh-reforms.

large, responsiveness, and accessibility.[90] In addition, over the course of 2022, Bank officials have delivered several speeches on the new measures.[91]

Developing the PRA's policy approach

The PRA set out its future approach to policy in DP4/22, published in September 2022.[92] The DP is relevant for all PRA-regulated firms, and sets out how the PRA intends to approach policymaking as it takes on wider rule-making responsibilities under the FSM Bill. The proposals in this DP were developed based on the FSM Bill, which implements the outcomes of the FRF Review, as it was introduced in Parliament on 20 July 2022.

The DP sets out the PRA's intention to take advantage of the opportunities presented by the Government's reforms. It covers the PRA's approach to: (i) its objectives and regulatory principles, (ii) international engagement and collaboration, (iii) the policy cycle, and (iv) delivering a first-rate PRA Rulebook. The PRA will continue to be driven by the pursuit of strong standards, and the reforms will enable the organisation to be more agile and pursue policies that are better suited to the UK's financial sector.

The DP has provided stakeholders with an early opportunity to provide input and share views. In total, 22 responses were received from across industry and other relevant stakeholders. Analysis of these responses will inform a CP, which will be published after the FSM Bill receives Royal Assent. This will be followed by a final Policy Approach document, which will be the policy equivalent of the PRA's Approach to Supervision.[93]

Financial Services Regulatory Initiatives Forum and Grid

The PRA, together with other financial services regulators, including the Bank, continued its participation in the FSRIF. The FSRIF considers the timing of regulatory initiatives and the

90. **www.bankofengland.co.uk/prudential-regulation/publication/2022/september/pra-approach-to-policy**.
91. On 27 September 2022, the Executive Director of Prudential Policy Directorate at the Bank of England, Victoria Saporta, gave a speech on the PRA's future approach to policy, setting out the key points from the FRF Review and the FSM Bill: **www.bankofengland.co.uk/speech/2022/september/vicky-saporta-speech-at-the-city-and-financial-the-future-of-uk-financial-services-regulation-summit**. The PRA's CEO and Deputy Governor for Prudential Regulation at the Bank of England, Sam Woods, gave a speech on growth and competitiveness in October 2022: **www.bankofengland.co.uk/speech/2022/october/sam-woods-speech-at-mansion-house**. In February 2023, Vicky Saporta gave a speech on the regulatory foundations of international competitiveness and growth: **www.bankofengland.co.uk/speech/2023/february/victoria-saporta-speech-on-financial-regulation-and-competitiveness-and-growth**.
92. **www.bankofengland.co.uk/prudential-regulation/publication/2022/september/pra-approach-to-policy**.
93. **www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors**.

operational impact on firms, while publication of the Regulatory Initiatives Grid ('the Grid') enhances transparency.

The fifth edition of the Grid was published in May 2022.[94] The sixth edition was rescheduled from November 2022 to February 2023 to allow regulators to better consider how the opportunities provided by the Edinburgh Reforms would impact the regulatory pipeline.

The sixth edition highlighted the broadly steady number of initiatives, coupled with new opportunities to reduce regulatory burdens, and focus on areas such as technology and innovation, ensuring the regulatory framework is fit for the future.[95] The Forum has also been considering how best to reflect the Government's plan for enacting the repeal of retained EU law in financial services in future editions of the Grid, noting stakeholder feedback that this would be helpful.

The FSRIF continues to look for ways to refine and improve the Grid, and the PRA welcomes engagement and feedback on it. For details on how to engage, please see the February 2023 Grid.[96]

Ring-fencing regime

In March 2022, HMT published its report of the independent panel on ring-fencing and proprietary trading.[97] As required by statute,[98] the panel's review focused on the operation of the legislation relating to the ring-fencing regime. The review panel concluded that ring-fencing, together with other reforms made in response to the 2008–09 global financial crisis, has contributed to the financial stability in the UK retail banking sector. The Panel made further recommendations for authorities to consider, which aimed to improve the functioning of the regime while maintaining financial stability benefits.

Following the publication of this report, HMT established a task force, together with the Bank, to inform the Government's response to the recommendations.[99] Over this reporting year, the PRA has worked closely with colleagues across the Bank and HMT to examine the recommendations and assist the Government in implementing the necessary legislative changes to give effect to the recommendations of the panel.

94. www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid-may-2022.pdf.
95. www.bankofengland.co.uk/report/2023/sixth-edition-of-the-regulatory-initiatives-grid.
96. www.bankofengland.co.uk/report/2023/sixth-edition-of-the-regulatory-initiatives-grid.
97. www.gov.uk/government/publications/independent-panel-on-ring-fencing-and-proprietary-trading-final-report.
98. Section 8 of Financial Services (Banking Reform) Act 2013.
99. www.gov.uk/government/publications/ring-fencing-reforms/government-response-to-the-independent-review-on-ring-fencing-and-proprietary-trading.

Ease of entry and exit

The PRA has continued work to support potential market entrants through the work of the New Bank and Insurer Start-up Units.[100] This included providing clear online guidance and conducting two roundtable industry engagement sessions to build awareness of expectations and seek feedback on firms' experience of the process. Over the course of 2022/23, the PRA engaged with 20 firms through a structured pre-application stage, allowing them to iterate and develop their proposition to support a better-quality application. Fourteen formal applications were received, and 11 firms (six banks and five insurers) were authorised.

After consultation with industry, the PRA made changes to the authorisation of ISPV through PS12/22,[101] which act to broaden the range of potential users of insurance-linked securities (ILS) in the UK, lower transaction costs, and speed-up the approval process. These changes will support the UK becoming a more attractive location for transactions in a global market, while maintaining robust prudential standards. The PRA approved London Bridge 2 in 2022, a protected cell company sponsored by Lloyd's of London. London Bridge 2 has since facilitated four ILS transactions (to end-February 2023) bringing a total of US$170 million of new capital to the Lloyd's market.

The PRA also announced an accelerated authorisation pathway for participants in the wholesale insurance market with a highly credible track record. The PRA has continued to develop a mobilisation regime for insurers, which will lower barriers to entry for new firms by giving them more time to build out their businesses, which will be consulted on in 2023.

Improving how firms can leave regulated markets in an orderly way is a vital corollary to greater ease of entry to those markets. The PRA aims to enable a dynamic and competitive market where entrants can join and leave with minimal disruption, including through a solvent exit – which does not require the use of an insolvency or resolution process – where appropriate.

In February 2023, the PRA published CP3/23 – Dealing with insurers in financial difficulties.[102] This sets out the PRA's proposed rules and policy in respect of the anticipated legislative amendments introduced by the FSM Bill. These amendments include clarifications

100. www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit and www.bankofengland.co.uk/prudential-regulation/new-insurer-start-up-unit.
101. www.bankofengland.co.uk/prudential-regulation/publication/2022/december/insurance-special-purpose-vehicles-further-updates-to-authorisation-and-supervision.
102. www.bankofengland.co.uk/prudential-regulation/publication/2023/february/dealing-with-insurers-in-financial-difficulties.

and enhancements to the court's existing power, under section 377 of FSMA,[103] to order a reduction of the value of an insurer's contracts (a 'write-down') together with a change to the protection offered by the Financial Services and Compensation Scheme (FSCS) in the event of a write-down, to allow the FSCS to make top-up payments in relation to eligible claims by protected policyholders.

The proposals in CP3/23 are relevant to the PRA's strategic focus on ease of exit. They aim to facilitate continuity of cover for policyholders by allowing a firm to exit the market safely, thereby reducing the impact and cost of liquidating the insurer and disorderly failure. The PRA's work during the year included extensive research to understand the issues typically faced in solvent exits, and to prepare proposals for a new policy on solvent exit planning for non-systemic banks and building societies. The proposals will seek to increase the preparedness of non-systemic banks and building societies for a potential solvent exit from PRA-regulated activity. The consultation is due to be published in 2023. A similar consultation for insurers is also under preparation.

International engagement and supervisory co-operation

Banking and insurance are global industries and the broad policy framework for supervising banks and insurance companies is agreed internationally. Effective cross-border engagement and co-operation is therefore essential for success. At the heart of this is the PRA's work with international authorities to play a leading role in promoting consistency in the implementation of international prudential standards, and to encourage continued openness between jurisdictions.

The PRA has continued to deepen its relationships with regulatory authorities around the world in order to advance its supervisory and regulatory objectives. During 2022/23, the Bank and the PRA have signed a number of Memorandums of Understanding (MoU) with third-country counterparts, and have made significant progress in negotiating co-operation and information sharing agreements with others. During 2022, the PRA signed four new MoUs. Since the UK left the EU, the PRA has signed 34 MoUs with EU institutions and member states. The PRA currently has 79 supervisory co-operation and information sharing MoUs in place with authorities across 51 jurisdictions. This facilitates participation in supervisory colleges and engagement with international stakeholders.

The PRA has also been participating in international fora, including the FSB, the BCBS, and the IAIS, and has continued its efforts in implementing internationally agreed standards in banking and insurance. Over the past year, the PRA's engagement focused on identifying

103. Section 377 of FSMA currently provides a power for the court to reduce the value of one or more of the contracts of an insurer which has been 'proved to be unable to pay its debts' as an alternative to making a winding-up order.

and addressing emerging risks, further reflecting on the lessons from the Covid-19 stress and developing frameworks in areas such as cryptoassets exposures. There was continued focus on promoting consistency in the implementation of Basel 3.1, the development and monitoring of the IAIS's Insurance Capital Standard, the implementation of its common framework for the supervision of internationally active insurance groups (ComFrame), and a holistic framework for assessing and mitigating systemic risk in the insurance sector.

4. Run an inclusive, efficient, and modern regulator within the central bank

Strengthening the PRA's supervisory approach

The PRA has implemented a number of actions to strengthen its supervisory approach by being more risk-based and flexible in the way it is resourced. In January 2023, the PRA updated its approach to categorising the 'potential impact' of firms, reducing the number of categories from five to four.[104] The PRA has also refined its risk-assessment framework and core assurance work.[105] The PRA has started communicating with individual firms to outline how supervisory workplans are affected, and will publish updated supervisory approach documents later in 2023. The PRA has created a Risk Response Team that can be deployed across the PRA to help address crystallised risks and other regulatory priorities, which has contributed to a more flexible and risk-based resourcing model. Going forward, the PRA will focus on embedding its new rule-making responsibility under the FSM Bill, facilitating greater ease of entry and exit for firms and implementing improvements to the PRA's data-related capabilities.

Diversity, equity, and inclusion at the PRA

The Court Review of Ethnic Diversity and Inclusion action plan was published in January 2022. The PRA continued to implement the recommendations made in the Bank's independent Court review in 2021 on ethnicity diversity and inclusion within the organisation.[106] These recommendations aim to embed inclusive recruitment, implement

104. The PRA made an announcement through separate letters to CEOs published on its website and addressed to insurers, UK deposit takers, and international banks: Letter from Nathanaël Benjamin and Rebecca Jackson – 'International banks active in the UK: 2023 priorities': **www.bankofengland.co.uk/prudential-regulation/letter/2023/artis-2023-priorities**, Letter from Charlotte Gerken and Shoib Khan – 'Insurance Supervision: 2023 priorities': **www.bankofengland.co.uk/prudential-regulation/letter/2023/insurance-supervision-2023-priorities**, and Letter from David Bailey and Charles Woods – 'UK Deposit Takers Supervision: 2023 priorities': **www.bankofengland.co.uk/prudential-regulation/letter/2023/uk-deposit-takers-2023-priorities**.
105. A core part of the risk assessment framework is the potential impact assessment. We assess the significance of a firm to the stability of the UK financial system. This 'potential impact' reflects a firm's potential to affect adversely the stability of the system by failing, coming under operational or financial stress, or because of the way in which it carries out its business.
106. **www.bankofengland.co.uk/report/2021/court-review-of-ethnic-diversity-and-inclusion**.

equity-oriented talent development programmes, and enhance psychological safety for colleagues. The actions aim to bridge barriers and support an equality of opportunities as well as making progress towards diversity targets for gender and ethnicity for the Bank. For more details on PRA representation targets and progress made so far, please see the diversity and inclusion section of the Bank's Annual Report and Accounts. The PRA has embraced the Bank's strategic priority of building a diverse and inclusive Bank, taking a series of actions and measures to advance this agenda and increase accountability for its senior leaders.

Data-related capability

Delivering the PRA's plan for RegTech and data

The PRA has set a priority to strengthen and transform its data-related capabilities by 2026, building on work from the past few years, and consistent with the Bank's response to the future of finance report published in 2019.[107] To support this, the PRA has now formed its RegTech strategy and completed an extensive mapping of data sources, systems, and processes used to support its core functions. The outputs were used to design a multi-year programme to bolster efficiency and effectiveness, through phased investment in tools, technology, processes, and skills. The PRA is deploying a digital skills strategy, and is recruiting additional data scientists and specialists.

So far, successful proof-of-concept work has led to the deployment of flexible and resilient supervisory insight tools, better tools to produce and visualise firm data, tools for ingesting and managing ad-hoc data collections from firms, and the delivery of desk-based stress testing. The programme will move to using ML to automate the use of quantitative data and narrative information received from firms, for example via the application of speech-to-text, allowing the PRA to deploy supervisors more effectively.

The new model is beginning to provide new supervisory tools, for example to enable a better understanding of firms' management and governance using data provided under the Senior Managers regime, and easier access to economic and financial data on overseas jurisdictions to support analysis of firms' external context and business model risks. Throughout the year, the PRA has continued to play a leading role in international collaboration to underpin this work. This has included liaising closely with other leading regulators, central banks, academic institutions, and industry to share specialist knowledge and experience.

The PRA has also moved forward on work to address which data it collects and how it is collected. Complementing work that has been under way for some time on insurance

107. www.bankofengland.co.uk/report/2019/future-of-finance.

reporting, the PRA has now launched a Banking Data Review, initiating early engagement with industry. The insights from the review will drive proposed changes in the coming years to the data collected, considering the regulatory framework post-Brexit and the PRA's evolving needs for data in the light of experience and market developments. The PRA continued its work with the wider Bank and the FCA on transforming data collection (Prudential Data Collection),[108] completing the discovery phase of use cases on Commercial Real Estate.

Risks to the delivery of the PRA business plan, unforeseen events, and execution risk

A complex operating environment and uncertainties in the economy provided a challenging backdrop to the delivery of this year's plan as the PRA had to make decisions to focus its limited resources on priority areas and crisis monitoring. This included additional activities to respond to Russia's invasion of Ukraine and other risk events over the year, such as the Bank's intervention to avoid dysfunction in the gilt markets prompted by widespread sales from LDI funds, and events around Silicon Valley Bank and Credit Suisse. Some reprioritisations were made to rephase work, but this did not have a material impact on the delivery of commitments set out in the business plan. However, this increased the level of activity which, alongside the recruitment and retention challenges outlined below, has resulted in increased staff stretch, particularly among more experienced staff, and had a negative impact on staff wellbeing. The PRA expects the level of stretch to improve over the coming year as it operates closer to its budgeted headcount and embeds new joiners.

The PRA continued to invest in mitigating a number of significant operational risks, as noted in the Bank's Annual Report. This has included managing a demanding project portfolio of technology projects at the same time as the Bank was devoting significant resources to address obsolescence of its wider technology estate which has caused resource contention over the year. Retention and recruitment also continued to be a key focus to minimise the loss of key skills and knowledge at a time of rising attrition in a highly competitive job market. This recruitment activity has taken place alongside a significant effort to increase headcount by around 100 staff to support the PRA's strategic priorities. As a result, the PRA is embedding a significant number of new staff and managing the associated risks of higher-than-normal levels of new joiners. This remains a key management focus over 2023.

The PRA has also been undertaking preparatory work ahead of the passage of the FSM Bill so that it has the right processes and procedures in place to take on expanded rule-making responsibilities and achieve its ambition of being a strong, accountable, responsible, and accessible rule-maker.

108. www.bankofengland.co.uk/news/2022/november/transforming-data-collection-communication-to-firms-28-november.

Measuring progress

In 2022/23, the PRA continued to draw on a variety of information to monitor the progress of delivery against its statutory objectives, strategy, and business plan on an ongoing basis. The PRC, the Supervisory Risk and Policy Committee, and the Operations, People, and Innovation Committee regularly received information on both quantitative and qualitative measures and indicators, to assess delivery against the PRA's strategy, business plan, statutory objectives, and risk tolerances. This enabled the PRC to report to the Chancellor of the Exchequer on the adequacy of resources and provide sufficient information on supervisory processes and outcomes.

Effective regular co-ordination with the FCA

The PRA continues to co-ordinate well with the FCA, across a wide range of policy and supervisory matters. There have also been valuable interactions with the FCA on a number of other supervisory and policy matters of joint interest, notably on issues regarding the FSM Bill and operational resilience, where information continues to be shared across respective policy and supervisory areas.

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

Firm feedback

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

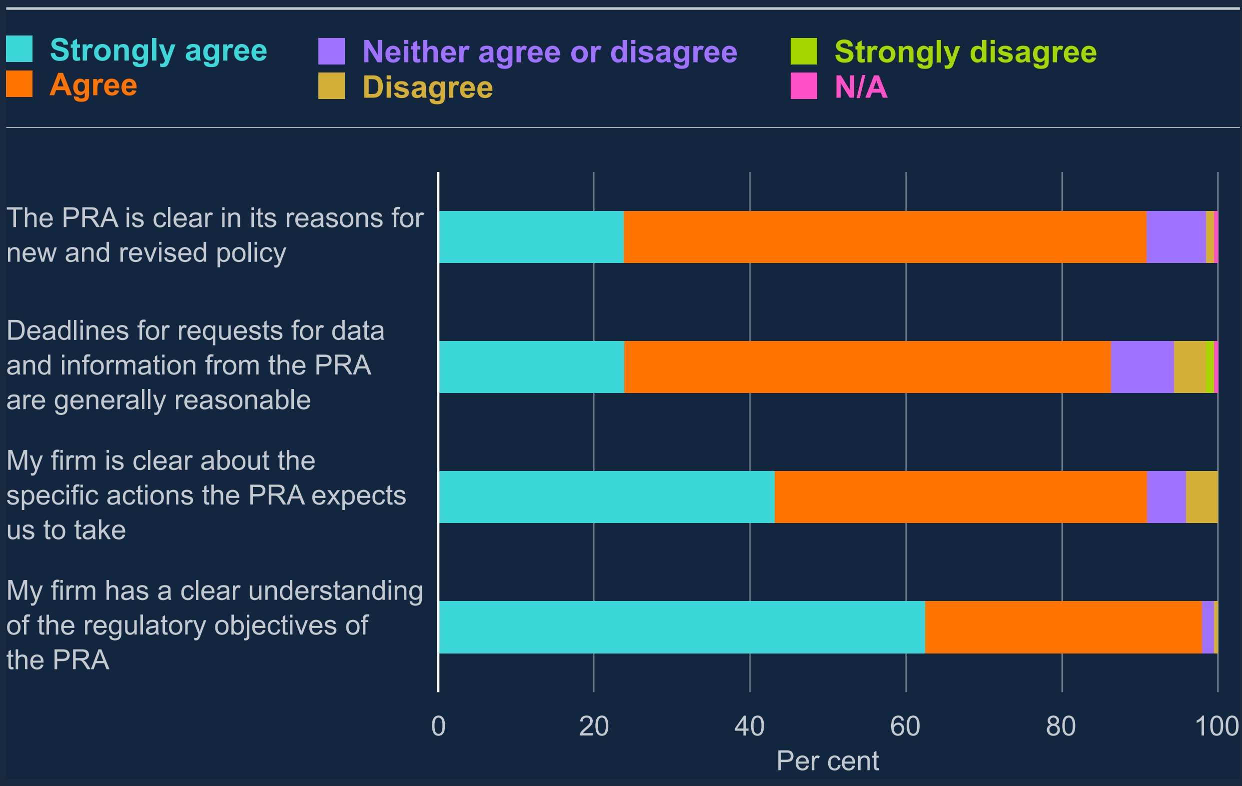
The PRA values firms' participation in the survey, seeks to understand what firms think works well and what might be done differently. Through the survey, PRA-authorised firms offered their feedback on a number of topics, including:

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

- the clarity and accessibility of prudential policy, rules, and requirements;
- operational resilience; and
- the supervisory approach during Covid-19.

In 2022, 196 firms responded to the survey. Chart 1 shows a selection of the survey results reflecting the type of issues for which the PRA sought an opinion. The full results will be available on the Bank's website.

Chart 1: Excerpt from firm feedback survey 2022



The PRA also held follow-up meetings and roundtable discussions with a cross-section of firms to provide an opportunity for a more detailed discussion of their views.

Although this year's scores were marginally lower than in 2021, the scores remain high and indicate that firms continue to hold positive views about the PRA. Feedback pointed to the continued effectiveness of supervision following Covid-19. As in 2021, firms gave the most positive scores for their understanding of the PRA's objectives and their relationship with the PRA. The lowest scores relate to firms' views about the PRA's co-ordination with other regulatory bodies.

Five emerging themes were identified from this year's survey, to which the PRA is responding:

- Firms perceive a slight decline in the quality of overall supervisory relationships:

  The return to business-as-usual supervision post-Covid-19 should help strengthen relationships between the PRA and management at firms. Alongside this, the PRA is reviewing its delivery of internal training to ensure newly appointed and experienced supervisors are fully supported in building their technical and non-technical skills.

- Firms want greater engagement on new and revised policy:

  In September 2022, the PRA published DP4/22, which described how the PRA intends to approach policymaking as it takes on wider rule-making responsibilities under the FSM Bill. DP4/22 aims to enhance the PRA's engagement with firms as it prepares to take on its expanded role.

- More effective engagement with specialists and technical teams:

  The PRA has developed a set of principles aimed at improving co-ordination between specialists and supervision teams internally, which should lead to more effective delivery of the PRA's technical judgements to firms.

- The need for more proportionality received greater emphasis in the firms' responses this year:

  The PRA has been developing a more proportionate approach to supervision and regulation, including through the review of Solvency II, the consultation on liquidity and disclosure requirements for Simpler-regime Firms, and embedding the supervisory approach around the new risk model, which expects only core assurance work for in-tolerance risks.

- Several newly authorised insurance branches, which had previously passported into the UK from the EU, asked for a more holistic approach to branch supervision:

  The PRA has increased communications and reduced reporting requirements. It also plans to deliver a CP proposing a 'holistic' approach to the supervision of third-country branches later this year.

Firms also raised concerns about PRA data requests. The PRA is closely monitoring the number of requests and the burden that they might place on firms. The PRA plans to enhance the firm feedback process in 2023 by including a topical question.

Parliamentary accountability

The PRA's objectives are set by Parliament. These duties to Parliament are taken very seriously and representatives of the PRA aim to account for its decisions as transparently and clearly as possible. The senior staff of the PRA and PRC members appear in front of parliamentary committees frequently. Between 1 March 2022 and 28 February 2023, representatives appeared at five parliamentary committees:

- 16 January 2023 – Sam Woods, Chief Executive, gave evidence to TSC to discuss the Financial Stability Report and proposed Edinburgh Reforms.

- 19 October 2022 – Vicky Saporta, Executive Director, gave evidence to the Commons Public Bill Committee to discuss the Financial Services and Markets Bill.

- 18 July 2022 – Marjorie Ngwenya, PRC External Member, appeared before TSC for an appointment hearing.

- 22 March 2022 – Sam Woods, Chief Executive, and Nathanaël Benjamin, Executive Director, appeared before the Lords EU Financial Affairs Committee to discuss the EU-UK relationship in Financial Services.

- 9 March 2022 – Sam Woods, Chief Executive, and Anna Sweeney, Executive Director, appeared before the Lords Industry and Regulators Committee to give evidence to the commercial insurance and reinsurance regulation inquiry.

The PRA also ensures that all its CPs are sent to TSC, the Lords Industry and Regulators Committee, and the Lords Economic Affairs Committee.

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

Communications supporting the PRA's objectives

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

In 2022/23, the PRA Communications team supported the PRA's policy publications referred to in the earlier sections of this Annual Report. These included:

- 24 CPs
- 12 PSs
- 1 new SS
- 24 amended SSs
- 1 new SoP
- 8 amended SoPs
- 17 statements
- 15 letters

Policy publications are available on the Policy page.[109]

Authorisations

The PRA has moved to quarterly publication of performance metrics on authorisation activity, including data on average time to determination,[110] with the first release in this new format published in May 2023.

The PRA authorised five new insurers and six new banks in 2022/23. This brings the total number of new UK insurers authorised since the creation of the PRA to 49, and the total number of new banks to 65, of which 36 are de novo UK banks.[111]

The PRA approved 1,231 applications for senior management functions, and 73 changes in control of authorised firms. The PRA continued to improve its co-ordination with the FCA in relation to senior manager approvals, to ensure it is able to meet its statutory service level for processing authorisation applications. Significant progress was made towards the end of the reporting period in addressing delays in the SM&CR approval process, the full impact of which is expected to show in data reported for the first quarter of the 2023/24 reporting year.

109. www.bankofengland.co.uk/prudential-regulation/policy.
110. Available at www.gov.uk/government/publications/correspondence-on-regulatory-operational-effectiveness.
111. The 2021/2022 Annual Report stated that the aggregate number of new banks authorised since 2013 at that point was 69. This included banks which formerly passported into the UK, entered the temporary permissions regime and have since been authorised as branches. To avoid confusion, such branch authorisations are now excluded from the calculation of the number of new banks. Had this approach been taken in 2022, the equivalent figure would have been 59 banks.

The PRA dealt with 188 variations and cancellations of Part 4A permissions,[112] and 939 applications relating to waivers and modifications of PRA rules, and to permissions regarding models, capital exposures, and other issues.

Temporary Permissions Regime

The PRA has continued the process of authorising European Economic Area (EEA) firms that entered the Temporary Permissions Regime (TPR) in January 2021. The banks and insurers that entered the TPR must receive authorisation before the end of 2023 if they want to continue doing business in the UK. Out of the 265 firms that entered the TPR, 43 banks and 107 insurers have applied for permanent status. Twenty-four of these banks and 56 of the insurers were authorised by February 2023. Assessment of the remaining applicant firms is well advanced and the process of authorising them will continue through the remainder of the year. Firms that did not apply for permanent status before the end-2022 deadline, that withdrew or were refused, will be placed in supervised run-off (SRO) for the purpose of winding down their UK regulated activities in an orderly manner. Thirty-three firms were placed in SRO over the year. The timings of authorisations and moves to SRO should not be taken as an indication of the PRA's view of risks at individual firms.

112. Part 4A of FSMA sets out the requirements of variations of permissions and the threshold conditions which must be met at authorisation of the activity and on an ongoing basis.

Complying with FSMA

This section covers a number of issues that the PRA considers when carrying out its duties and other areas on which it reports.

These include:

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

Complying with FSMA

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

- need to use resources in discharging the PRA's general functions in the most efficient and economical way;
- principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
- desirability of sustainable growth in the economy of the UK in the medium or long term;

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

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

Furthermore, in carrying out its functions during the reporting period, the PRA was required, so far as was reasonably possible, to 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.

Details of how the PRA has met its duty to consult (under section 2L of FSMA) and considered any representations made (under section 2N of FSMA) can be found above 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. The Panel also considers items from other directorates within the Bank that have policies with potential prudential impact.

The Panel met five times in 2022/23, providing input into policy at different stages of development – from practical insights to implementation, to proposals under consultation, to early-stage policy development. The Panel provided the PRC and senior management from across the PRA and the Bank feedback on topics such as the use of AI by PRA-regulated firms, diversity and inclusion in PRA-regulated firms, model risk management, and liquid asset usability.

The PRA Practitioner Panel and Insurance Sub-committee met three times during the 2022/23 reporting period.[113] It provided feedback on the Solvency II reforms, model risk management for insurers, and protection gaps in non-life insurance.

The PRA and the FCA have a duty to ensure a co-ordinated exercise of functions and to maintain a MoU describing how they intend to comply with that duty (under sections 3D and 3E of FSMA respectively).

The PRA has the power to require the FCA to refrain from taking certain actions, specified under section 3I of FSMA, or to give a direction to the FCA in relation to with-profits policies (section 3J of FSMA). The PRA did not exercise this power over 2022/23.

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

Regulators' Code and principles

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

Regulators' principles

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

113. The FSM Bill, which is currently being passed through Parliament to implement the outcomes of HMT's FRF Review, includes a proposal for an 'Insurance Practitioner Panel' to be placed on a similar statutory footing to the PRA Practitioner Panel. The PRA is currently preparing for this and awaiting the enactment of the Bill.

Regulators' Code

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

- Regulators should provide simple and straightforward ways to engage with those they regulate and hear their views.

- Regulators should base their regulatory activities on risk.

- Regulators should share information about compliance and risk.

- Regulators should ensure clear information, guidance, and advice is available to help those they regulate meet their responsibilities to comply.

- Regulators should ensure that their approach to their regulatory activities is transparent – including publishing, on a regular basis, details of their performance against their service standards, including feedback received from those they regulate and data relating to complaints about them. Details of firm feedback are set out in this report, details of complaints are set out below, and the PRA's statutory Authorisations Performance Report is published on the Authorisations page.[114]

Complaints Scheme

As part of the statutory Complaints Scheme (under Part 6 of the Financial Services Act 2012), the PRA is responsible for ensuring that complaints received are dealt with as quickly as possible. During the reporting period, the PRA received 14 complaints. Of the 14, one complaint was investigated, but not upheld. One complaint was still being assessed by the PRA at the end of the reporting period. The remaining 12 complaints, eight of which were regarding similar issues, were excluded from the Scheme as the subject matter was not within the scope of the Scheme. Of the complaints excluded from the Scheme, five were referred to the Financial Regulators Complaints Commissioner. Three of the five complaints referred to the Commissioner were regarding similar issues, and were assessed by the Commissioner not to be in scope of the Scheme.

The Financial Regulators Complaints Commissioner was still considering two complaints at the end of the period. The Commissioner also completed a review of one complaint against

114. www.bankofengland.co.uk/prudential-regulation/authorisations.

the PRA from the previous reporting period. Details of the final decision are available on the Commissioner's website.[115]

Section 166 reports by skilled persons

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

In 2022/23, the PRA commissioned 31 reviews by skilled persons (2021/22: 27), including three (2021/22: three) where the PRA contracted directly with the skilled person. The reviews fell within the areas shown in Table A.

Table A: Section 166 reviews by areas of focus

Lot [(a)]	Total for 2022/23	Total for 2021/22
Lot B: Governance and individual accountability	2	–
Lot C: Controls and risk management frameworks	16	18
Lot F: Prudential – deposit takers, recognised clearing houses and PRA-designated investment firms	11	7
Lot G: Prudential – insurance	2	2
Total	**31**	**27**

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

In 2022/23, there were eight reviews of firms' regulatory reporting (2021/22: five), one under Lot C and seven under Lot F. These were commissioned following a letter, of 10 September 2021, on Thematic findings on the reliability of regulatory reporting.[116]

The total estimated cost of s166 reviews commissioned in 2022/23 was £24.6 million (2021/22: £29.9 million), of which the cost per review ranged from £24,000 to £8.9 million

115. **https://frccommissioner.org.uk/final-reports/pra-the-prudential-regulation-authority/**.
116. **www.bankofengland.co.uk/prudential-regulation/letter/2021/september/thematic-findings-on-the-reliability-of-regulatory-returns**.

(2021/22: £72,000 to £14.6 million).[117] Of this total, the estimated cost of the three reviews where the PRA contracted directly with the skilled persons was £0.7 million (2021/22: three, at a cost of £1.0 million).[118] The estimated cost of the reviews commissioned in 2022/23 on regulatory reporting was £17.4 million (2021/22: £21.0 million).

Meeting with auditors

Under section 339A(2) of FSMA, the PRA is required to issue and maintain a code of practice that includes arrangements on the:

- sharing of information (that the PRA is not prevented from disclosing) with auditors of PRA-authorised persons; and
- exchange of opinions with auditors of PRA-authorised persons.

The PRA published Legacy SS7/13 – The relationship between the auditor and the supervisor: a code of practice in April 2013.[119] Section 339B(2) of FSMA states that the PRA must make arrangements for meetings to take place at least once a year with the external auditor of any PRA-authorised person to which section 339C of FSMA applies. Thirty-five firms (2021/22: 35) fell within the scope during the reporting period, and the PRA held 53 meetings (2021/22: 61) with the auditors of these firms. At least one meeting with the auditor of each such firm was held during the reporting period. The PRA looks to auditors to contribute to effective supervision by directly engaging with the PRA in a proactive and constructive way. The PRC is updated annually on the quality of the relationship between auditors and supervisors. For the period ending 28 February 2023, the PRC was presented with the results of a survey of supervisors. A large majority of those surveyed were satisfied with their auditor-supervisor relationship.

Structural reform: ring-fencing

Structural reform (also referred to as ring-fencing) has been in effect in the UK since 1 January 2019. Ring-fencing requires UK banking groups with more than £25 billion of core deposits to ensure the provision of core services (broadly, facilities for accepting core retail

117. The costs disclosed include actual costs incurred by the firms, or an estimate where the review is ongoing, and the actual costs are not yet available. For reviews commissioned in 2022/23, 16 reviews have been completed and 15 reviews remain ongoing. The comparative figures have also been revised to reflect the actual costs incurred for reviews commissioned in 2021/22 and completed in 2022/23. One review commissioned in 2021/22 is ongoing, and the reported costs for this review remain as an estimate.
118. Costs of directly contracted s166 reviews include VAT.
119. www.bankofengland.co.uk/prudential-regulation/publication/2013/the-relationship-between-the-external-auditor-and-the-supervisor-a-code-of-practice-ss.

deposits, and payments and overdrafts relating to core retail deposit accounts) is separate from certain other activities within their groups, such as investment and international banking.[120]

As of 1 January 2023, the following UK banking groups are in scope of ring-fencing and contain at least one RFB: Barclays, HSBC, Lloyds Banking Group, NatWest Group, Santander UK, TSB, and Virgin Money. Key information and materials relating to ring-fencing, including the list of RFBs, can be accessed through the ring-fencing web page.[121]

The PRA's activity relating to ring-fencing advances its general objective of promoting the safety and soundness of the firms it regulates through ensuring that firms' business is carried out in a way that avoids any adverse effects on the stability of the UK financial system. The PRA is required to discharge its functions in a way that seeks (among other things) to:

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

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

The legislation specifies the activities that must be conducted by RFBs, as well as the activities RFBs are prohibited from undertaking. Any activities falling outside those two categories – for example taking deposits from large corporates, or mortgage and credit card lending – can be carried out from either side of the ring-fence ('permitted business'). Banking groups chose to structure their groups in different ways, reflecting their current operations

120. The requirement for large UK banking groups to ring fence their core services is set out in FSMA (as amended by the Financial Services (Banking Reform) Act 2013).
121. www.bankofengland.co.uk/prudential-regulation/key-initiatives/ring-fencing.

and preferred business strategies. As a result, some groups placed almost all permitted business within the ring-fence, while others chose to locate significant proportions of their permitted business outside of the ring-fence. Over the previous year, the structure of most firms' RFB sub-groups remained largely the same. Firms have generally complied with the PRA's group structure policy set out in SS8/16 – Ring-fenced bodies (RFBs)[122] and the PRA has not identified any major concerns.

The focus for the 2022/23 reporting period has been twofold:

- Working closely with HMT on the implementation of the recommendations of the independent panel on ring-fencing and proprietary trading.[123]

- Ensuring the ring-fencing arrangements established by firms continue to be effective and are well-embedded within their group structure. The PRA has continued to assess the effectiveness of RFBs' governance structures and risk management arrangements, including in relation to ring-fencing provisions.

Ring-fencing provisions are numerous, detailed, and wide-ranging, touching on many aspects of the operations of the banks subject to them. Over the past year, firms have continued to take measures to ensure ongoing compliance with ring-fencing provisions and guidance issued by the PRA. This has included firms undertaking internal reviews, consideration of the ring-fencing implications of changes and initiatives (particularly in relation to changes in the structure of firms and interaction with other entities in their banking groups), and improvements to compliance monitoring. During this reporting period, RFBs, for the most part, complied with the individual ring-fencing provisions and associated guidance, but the PRA has been notified of a limited number of instances of non-compliance. These were generally of low materiality, and none were classed as severe. In all such cases, the firm subsequently took steps to resolve breaches or took other action, including putting remediation plans in place. The PRA has not taken any enforcement action in respect to the ring-fencing provisions in the past year (more information on the use of the PRA's statutory powers is available on the PRA's statutory powers dedicated web page).[124]

Following the publication in March 2022 of the report of the independent panel on ring-fencing and proprietary trading,[125] the PRA has been working with colleagues across

122. www.bankofengland.co.uk/prudential-regulation/publication/2016/ring-fenced-bodies-ss.
123. www.gov.uk/government/publications/independent-panel-on-ring-fencing-and-proprietary-trading-final-report.
124. www.bankofengland.co.uk/prudential-regulation/pra-statutory-powers.
125. www.gov.uk/government/publications/independent-panel-on-ring-fencing-and-proprietary-trading-final-report.

the Bank and HMT on implementing its recommendations. As required by statute,[126] the panel's review focused on the operation of the legislation relating to the ring-fencing regime. The panel concluded that ring-fencing, together with other reforms made in response to the 2008–09 global financial crisis, has contributed to the financial stability in the UK retail banking sector. The panel made further recommendations for authorities to consider, which aimed to improve the functioning of the regime while maintaining financial stability benefits.

Following the publication of this report, HMT established a task force, together with the Bank of England, to inform the Government's response to the recommendations. Over this reporting year, the PRA has worked closely with colleagues across the Bank of England and HMT to examine the recommendations and assist the Government in implementing the necessary legislative changes to give effect to the recommendations of the Panel.

Use of exceptions

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

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

The legislation also sets out certain permitted exceptions and exemptions to these excluded activities and prohibitions to allow RFBs to carry out activities which they would otherwise be prohibited from undertaking. These exceptions and exemptions aim to allow RFBs to undertake activities typical for a retail and commercial bank, such as 'dealing in investments as principal' for risk management purposes, collateral management, selling simple derivatives to its account holders subject to conditions,[127] transactions with central banks, and managing pension liabilities.

PRA rules require a RFB to have 'exceptions policies' in place that specify in detail the circumstances in which it will make use of the permitted exceptions. The PRA assesses

126. Section 8 of Financial Services (Banking Reform) Act 2013.
127. The conditions are set out in Article 12 of the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014/2080 (EAPO).

RFBs' use of exceptions through ongoing supervisory engagement, regulatory reports, and by undertaking reviews of RFBs' exceptions policies. This informs the PRA of the extent to which RFBs undertook activities that would be excluded or prohibited, but for an exception or exemption in the legislation.

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

The legislation includes exceptions to permit RFBs to deal in investments as principal or to incur exposures to RFIs where the sole or main purpose of the associated transaction is to hedge risks. All RFBs used this exception. The vast majority (more than 80%) of the hedging exceptions used by RFBs were those relating to hedging changes in interest rates. The remainder of the hedging exceptions were mainly used to hedge changes in exchange rates. The relatively higher use of the exception for interest rate hedging is in line with the PRA's expectations, as this type of hedging is a prominent risk management activity for many retail banks. Exposures to RFIs related to hedging were relatively small compared to firms' capital bases.

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

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

Annual Competition Report – June 2023

This is the eighth Annual Competition Report (ACR),[128] marking the ninth year since the secondary competition objective (SCO) came into force on 1 March 2014. The PRA produces the ACR to meet the Government's request for an annual report setting out how it is delivering against its SCO.[129] The SCO, as set out in FSMA, is that, when discharging its general functions in a way that advances its primary objectives, the PRA must, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.

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

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

128. The ACR has been produced in response to a request from the Government, included in HMT's 2015 Productivity Plan 'Fixing the foundations: creating a more prosperous nation': **www.gov.uk/government/publications/fixing-the-foundations-creating-a-more-prosperous-nation**, that the PRA should publish an annual report setting out how it is delivering against its SCO and, in particular, 'the steps being taken to drive more competition and innovation in financial services markets and to help ensure that the right incentives exist for new banks to enter the market'. For all versions of the ACR, see the PRA's competition objective web page: **www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective**.
129. The rationale for the SCO, how the PRA interprets it, and what the SCO means for the PRA's regulation of banks and insurers is set out in the Prudential Regulation Authority's secondary competition objective: **www.bankofengland.co.uk/quarterly-bulletin/2015/q4/the-pra-secondary-competition-objective**.

The FSM Bill proposes to introduce an additional secondary objective under the same scope of application as for the SCO. Subject to aligning with relevant international standards, the secondary competitiveness and growth objective (SCGO) is facilitating: (a) the international competitiveness of the economy of the United Kingdom (including, in particular, the financial services sector (FSS) through the contribution of PRA-authorised persons), and (b) its growth in the medium to long term.[130]

As pointed out by Vicky Saporta, Executive Director for Prudential Policy,[131] 'the financial sector can support the international competitiveness of the UK economy and contribute to growth in the medium to long term when: (i) UK firms successfully compete to win business around the world, (ii) the UK is a top tier global financial hub where firms from around the world choose to do business, and (iii) the financial sector supports growth by meeting the needs of the wider national economy'.

With respect to the last point, efficient financial intermediation supports growth of the overall economy and effective competition is the key driver of efficiency improvements. This is especially the case where effective competition among financial intermediaries improves access to financial services by (non-financial) firms whose growth potential would otherwise be curbed by financial constraints.

Efficiency encompasses both static and dynamic efficiency. Static efficiency is about making sure that the rest of the economy can access financial services at reasonable costs. Dynamic efficiency is about bringing to the market new financial services (eg open banking) or improving underlying processes (eg faster credit decisioning). Effective competition is aimed at spurring firms to both lower prices and/or improve quality to compete on existing services (static efficiency) and invest in new ones to carve out a competitive advantage (dynamic efficiency). Innovation is the main driver of productivity improvement. Therefore, effective competition is instrumental to a vibrant and innovative UK FSS that efficiently serves the rest of the UK economy.

Under FSMA, the PRA is required to explain in its Annual Report the extent to which, in its opinion, its objectives have been advanced. Accordingly, going forward, this report will continue to cover the SCO and may include the SCGO, subject to the final requirements enacted by Parliament. Finally, the PRA will consult on its approach to policymaking enacted by the FSM Bill, including the approach to the SCGO.

130. For more information on the PRA's approach to this additional secondary objective, see DP4/22 – The Prudential Regulation Authority's future approach to policy, September 2022: **www.bankofengland.co.uk/prudential-regulation/publication/2022/september/pra-approach-to-policy**.
131. Speech by Vicky Saporta – The regulatory foundations of international competitiveness and growth, February 2023: **www.bankofengland.co.uk/speech/2023/february/victoria-saporta-speech-on-financial-regulation-and-competitiveness-and-growth**.

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

This section of the report provides an update on key policy and supervisory decisions taken to deliver against the SCO, specifically, by consulting on:

- a first set of policy proposals for the Strong and Simple framework for non-systemic banks and building societies;
- a set of proposals to implement Basel 3.1 standards;
- simplifications to remuneration rules for smaller banks and building societies and the removal of the current limits on the ratio between fixed and variable components of total remuneration ('bonus cap');
- the review of Solvency II to tailor it better for the UK market, including a more proportionate approach to reporting requirements; and
- changes in the PRA's approach to authorising and supervising ISPVs.

In addition, as part of the Governments' review of Solvency II, the PRA plans to consult on raising the threshold at which insurance firms are required to enter the Solvency UK regime, specifically, by tripling the threshold for gross written premiums to £15 million and doubling the threshold for technical provisions to £50 million. To further reduce entry barriers, there will also be a consultation on the introduction of a mobilisation regime for insurers, specifically, by adjusting entry requirements such as a lower capital floor, lower expectations for key personnel and governance structures, and exemptions from some reporting requirements. Similarly, the PRA plans to reduce entry barriers for foreign firms by removing capital requirements for branches of international insurers operating in the UK.[132]

Finally, the PRA has taken steps to make the PRA Rulebook more accessible. First, the PRA introduced the Prudential and Resolution Policy Index which provides lists of currently applicable policies relating to the prudential regulation of financial services firms by the PRA and firms in scope of the UK resolution regime.[133] This is intended to help firms identify which policies are relevant for their particular areas of business. It does this by grouping policies into sectors and topic area pages. Second, the Bank and the PRA publish and

132. www.bankofengland.co.uk/speech/2023/february/sam-woods-keynote-speech-association-british-insurers-dinner.
133. www.bankofengland.co.uk/prudential-regulation/prudential-and-resolution-policy-index.

regularly update, jointly with six other regulators, a Regulatory Initiatives Grid setting out their respective regulatory pipelines.[134] This is intended to help firms understand – and plan for – the timing of the initiatives that may have a significant operational impact on them.

134. The latest version of the Regulatory Initiatives Grid is produced by the Financial Services Regulatory Initiatives Forum which is made up of the Bank (including the PRA), the FCA, the PSR, the CMA, the Financial Reporting Council, The Pensions Regulator, and the Information Commissioner's Office. See **www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid**.

Box C: Developing a Strong and Simple framework for non-systemic banks and building societies

The Strong and Simple framework for non-systemic and domestic banks and building societies ('firms') is aimed at simplifying the prudential regime to address the adverse impact on smaller firms arising from the higher relative costs they face in assimilating and complying with complex prudential regulation compared with their larger competitors, while maintaining their resilience.[135]

In April 2022, the PRA published a CP on the criteria to determine which firms should fall within scope of the first simpler regime layer of the framework for small firms.[136] In order to maintain the simplicity and robustness of the regime, the proposed criteria were designed to capture firms that provide mainstream retail and commercial banking services – including both deposit taking and lending – to households and firms in the UK. Specifically, a maximum size threshold of £15 billion of total assets was proposed. Since a significant number of small firms have total assets significantly below £15 billion, the threshold of £15 billion would ensure that firms would have room for growth within the simpler regime. In November 2022, the PRA published updated proposed criteria, which included several changes in response to comments on the first CP. The updates included an increase in the proposed maximum size threshold to £20 billion to provide further room for growth within the regime.

In February 2023, the PRA published a CP proposing simplifications to liquidity, reporting, and disclosure requirements for banks and building societies in the simpler regime.[137]

The next phase of work will focus on the capital framework for the simpler regime. In addition, as the development of the simpler regime progresses, the PRA is considering whether and how to build out other layers of the Strong and Simple framework for larger firms that are not internationally active and intends to engage with relevant stakeholders about this during 2023.

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135. For more details on the Strong and Simple framework, see FS1/21 – Responses to DP1/21 'A strong and simple prudential framework for non-systemic banks and building societies', December 2021: **www.bankofengland.co.uk/prudential-regulation/publication/2021/april/strong-and-simple-framework-banks**.
136. **www.bankofengland.co.uk/prudential-regulation/publication/2022/april/definition-of-a-simpler-regime-firm**.
137. **www.bankofengland.co.uk/prudential-regulation/publication/2023/february/strong-and-simple-framework**.

Box D: Further reducing the internal rating based versus the standardised approach gap with the implementation of Basel 3.1 standards

As set out in last year's ACR, in 2016, the CMA identified a large gap in capital requirements between the SA and the IRB approach for credit risk, affecting, in particular, low loan to value (LTV) residential mortgages – which are among the safest of exposures.[138] In response, the PRA stated its commitment to continue work to narrow the gap between capital requirements based on the SA and those based on IRB models and level the playing field for small and large firms.

The PRA has sought to do this through a number of initiatives, for example, by making it easier for small firms to adopt IRB models. Changes to IRB modelling of mortgage risk, stemming from the 'hybrid approach' to modelling and the IRB roadmap, which are primarily aimed at reducing unwarranted variability in RWAs across firms, will also serve to narrow this gap.[139] The PRA has also refined its methodology for calculating Pillar 2A requirements to reduce them for firms using the SA for credit risk.[140] This will ensure that the total amount of a firm's capital requirement does not exceed the amount necessary to ensure appropriate coverage of risks. Finally, new requirements came into force last year setting a minimum risk weight of 10% for IRB firms' UK mortgages at the portfolio level.

Looking ahead, in November 2022, the PRA published CP16/22 – Implementation of the Basel 3.1 standards.[141] The proposals set out in the CP, taken as a whole, aim to increase the risk sensitivity of the SA risk weights, which would help further narrow the gap between the SA and IRB firms.

First, for smaller firms that will typically use the SA, the proposals set out in the CP would lead to a reduction in risk weight from 35% to 20% for exposures to owner-occupied mortgages with LTV values below 55%. Together with the IRB modelling changes mentioned above, the gap between SA and average IRB risk

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138. www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk.
139. www.bankofengland.co.uk/prudential-regulation/publication/2019/credit-risk-probability-of-default-and-loss-given-default-estimation.
140. Pillar 2A refers to a firm-specific minimum capital requirement that covers a range of risks not addressed under Pillar 1 (eg credit concentration risk, and interest rate risk in the banking book), or not adequately addressed by the Pillar 1 framework.
141. www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards.

weights for residential mortgages with LTV ratios below 50% could narrow from around 5.5x to between 2.5x and 1.5x when Basel 3.1 comes into force (proposed for 2025).[142]

Second, the proposal to introduce an aggregate 'output floor' would ensure that the Pillar 1 capital requirements for credit risk calculated under the IRB approach do not fall below 72.5% of Pillar 1 capital requirements for credit risk calculated under the SA. As such, the proposed output floor would place a limit on the regulatory capital benefit a firm can derive from the IRB approach relative to the SA. Consequently, the PRA expects the gap between the SA and IRB risk weights would further narrow during the transition period for the output floor, proposed to be between 2025 and 2030.

The gap between SA and IRB risk weights would also be narrowed by constraints that the proposals would introduce on IRB models, including:

- Adopting 'input floors' – exposure-level minimum values for firm-estimated IRB parameters used as inputs to calculate modelled risk weights. In particular, the PRA's proposal to introduce higher 'probability of default' (PD) floors for UK retail residential mortgage exposures, as compared to the Basel standards.

- Restricting the use of the IRB approach for risk-weighting certain credit exposures. This includes mandating the SA for central government and central bank exposures, and equities exposures. While firms may still use the IRB approach for off-balance sheet exposures, modelling of 'exposure at default' (EAD) would only be allowed for revolving loan facilities. In addition, the advanced IRB (AIRB) approach would be removed for exposures to financial institutions and large corporates.

Finally, the proposals would reduce barriers to entry for smaller firms using the SA to use the IRB approach, by changing the standard for approval of IRB model applications from 'full compliance' (as per current requirements) to 'material compliance', and removing the general principle that firms adopting IRB must roll-out this approach for all material exposures; instead, the proposals provide greater scope for firms to permanently apply the SA to certain asset classes.

142. For more details, see Mind the (smaller) gap? Implications of the narrowing gap between modelled and standardised residential mortgage risk weights, February 2023: **www.bankofengland.co.uk/bank-overground/2023/implications-of-the-gap-between-modelled-and-standardised-residential-mortgage-risk-weights**.

Box E: Simplifying remuneration requirements, especially for small banks and building societies

In February 2023, the PRA proposed changes to the current rules and expectations to enhance the proportionality of the remuneration requirements which apply to small banks and building societies (small firms).[143] Specifically, the proposals would remove the requirement for small firms to apply rules on malus, clawback, and buyouts, and provide clarity on how disclosure requirements apply for all proportionality levels. Firms that are eligible for the Strong and Simple framework, as well as some other small firms, would be in scope of these proposed measures.

Potential higher costs due to overly complex remuneration requirements could deter new entrants, and lead to an excessive cost burden on existing small firms. Providing greater flexibility for small firms in how they design their remuneration structures may also support them in competing for talent in the UK, and also giving new entrants in the UK market greater flexibility over their cost base, thereby promoting competition in the sector.

In addition, in December 2022, the PRA, jointly with the FCA, proposed to remove the limits on the ratio between fixed and variable components of total remuneration (the 'bonus cap') for all firms.[144] There is evidence demonstrating that individuals close to the cap are paid higher fixed pay rather than bonus, thereby dampening the cap's potential to limit total remuneration. Accordingly, the removal of the bonus cap would provide firms with more flexibility over their cost-base by sharing risk with employees. This would be especially beneficial to smaller firms and/or new entrants who often have fewer financial resources.

143. www.bankofengland.co.uk/prudential-regulation/publication/2023/february/remuneration-enhancing-proportionality-for-small-firms.
144. www.bankofengland.co.uk/prudential-regulation/publication/2022/december/remuneration.

Box F: Further reducing reporting requirements for insurance firms

As reported last year, in 2021, the PRA had already implemented some changes to the Solvency II reporting requirements and expectations. The removal of certain reporting requirements was aimed to reduce ongoing costs. The amendments to the relevant supervisory statements also aided firms in their compliance with the PRA's reporting requirements, reducing the likelihood of erroneous reporting and associated costs of remediation.

In November 2022, the PRA consulted on further changes to the reporting requirements.[145] Most notably, the proposals included: the removal of reporting requirements; the reduction of the reporting frequency of certain templates from quarterly to either semi-annually or annually; the consolidation of a number of multiple reporting templates covering the same reporting topics into new templates; and the introduction and amendments of reporting proportionality thresholds for certain reporting and disclosure templates. The proposed thresholds would enhance the overall proportionality of the reporting requirements. Firms with exposures to areas that are not considered to be material would have lower reporting requirements, which may further reduce ongoing costs thus lowering barriers to entry by reducing reporting costs for new entrants.

145. www.bankofengland.co.uk/prudential-regulation/publication/2022/november/review-solvency-ii-reporting-phase-2.

Box G: Streamlining the approach to authorisation and supervision of insurance special purpose vehicles

The PRA's approach to ISPVs was launched at the end of 2017. As reported in the 2021 ACR, this approach was refined and updated in 2020. Since the launch of the regime, additional experience has been gained by both the PRA and users of the UK ISPV regime. As a result of this experience and feedback, last year, the PRA introduced an updated authorisation process where applications are classified as 'standard' or 'complex' during the pre-application process. Straightforward applications, which are in respect of short tail,[146] wholesale, and general insurance risks, will generally be classified as a 'standard' application and will be eligible for a channel with the PRA aiming to provide a decision on authorisation within four to six weeks of the application being made.

In July 2022, the PRA proposed additional changes in the approach to authorising and supervising ISPVs,[147] most notably: changing the legal opinion expectation for non-English law governed contracts, so that such an opinion would not be generally expected, especially for 'standard' applications; clarifying that, for a standard application, a single individual with the relevant skills and experience could hold all three required Senior Management Function (SMF) roles for an ISPV; and clarifying that, for standard applications, applicants are no longer expected to submit the full suite of written policies in place to the PRA. These clarifications were finalised in December 2022.[148] The PRA will continue to interact with various stakeholders to assess what further changes may be required to the ISPV regime.

146. Insurance where it is expected that claims will be made and settled quickly.
147. www.bankofengland.co.uk/prudential-regulation/publication/2022/july/insurance-special-purpose-vehicles-further-updates-to-authorisation-and-supervision.
148. www.bankofengland.co.uk/prudential-regulation/publication/2022/december/insurance-special-purpose-vehicles-further-updates-to-authorisation-and-supervision.

Report on the use of powers delegated under the EU (Withdrawal) Act 2018

Exercise by the Prudential Regulation Authority of sub-delegated powers under the European Union (Withdrawal) Act 2018 (EUWA) – report for the financial year ending 28 February 2023.

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

Onshoring and temporary transitional powers

The PRA has not exercised these powers in the reporting period. The EUWA[149] requires the PRA to report to Parliament annually if relevant sub-delegated powers are exercised.

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

- make onshoring changes to the PRA Rulebook and Binding Technical Standards (BTS) within its remit, to ensure that they continue to work effectively in the UK at the end of the transition period, in the light of the UK's withdrawal from the European Union (EU);[150] and
- make directions to exercise the temporary transitional power to help firms to adjust to onshoring changes made to financial services legislation, in the light of the UK's withdrawal from the EU.

Detailed information on the use of these powers have been published on the Transitioning to post-exit rules and standards[151] and Temporary transitional power[152] web pages.

Ongoing transferred powers

There are several other powers transferred under the EUWA that are required to be reported if exercised, including the making of Technical Standards Instruments, the publication of Solvency II technical information, and the requirement and setting of certain fees.

The PRA has exercised its power to make Technical Standards Instruments under section 138P of FSMA.

149. Schedule 7, paragraph 32 of the EU (Withdrawal) Act 2018.
150. Regulation 3 of The Financial Regulators' Powers (Technical Standards etc) (Amendment etc) (EU Exit) Regulations 2018.
151. www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards.
152. www.bankofengland.co.uk/eu-withdrawal/temporary-transitional-power.

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

- Technical Standards (Investment Firms Prudential Regime Consequential Amendments) Instrument 2022 (made 1 August 2022).[153]
- Technical Standards (CRR2 and Other Consequentials) Modifications Instrument 2022 (made 1 August 2022).[154]
- Technical Standards (Bilateral Margining) Instrument 2022 (made 1 December 2022).[155]
- Technical Standards (Own Funds) Instrument 2022 (made 7 September 2022).[156]

The PRA has exercised its power to publish Solvency II technical information relating to risk-free interest rate term structures, and the symmetric adjustment of the equity capital charge,[157] which are updated monthly. The PRA's approach to the publication of Solvency II technical information is described in a SoP,[158] and further information is provided on the Technical information for Solvency II firms web page.[159]

During the reporting period, the PRA did not use its powers to require and set fees conferred on it under:

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

For further information on fees, see PS5/22 – Regulated fees and levies: Rates proposals 2022/23, June 2022.[160]

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153. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2022/august/technical-standards-investment-firms-prudential-regime-consequential-amendments-instrument-2022.pdf.
154. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2022/august/ps722app3-1.pdf.
155. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2022/december/ps1122app1.pdf.
156. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2022/september/ps822app2.pdf.
157. Regulation 4B of the Solvency 2 Regulations 2015/575, and Article 3(5) of the Solvency II Delegated Act 2015/35.
158. www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/statement-of-policy/2022/the-pras-approach-to-publication-of-sii-technical-information-sop-july-2022.pdf.
159. www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii/technical-information.
160. www.bankofengland.co.uk/prudential-regulation/publication/2022/april/regulated-fees-and-levies-rates-proposals-2022-23.

Financial review of 2022/23

The PRA incurred operating costs in 2022/23 of £326.0 million (2021/22: £293.0 million) against a budget of £320.9 million (2021/22: £296.6 million). In 2022/23, the PRA final outturn was £5.4 million above budget due to higher than budgeted allocated support costs (2021/22: underspend of £3.5 million). Costs directly within the PRA's control were below budget but pension costs and support costs allocated to the PRA for services provided by the Bank's central functions were higher than anticipated.

Additional income of £5.0 million was received by the PRA due to changes in tariff data following publication of PS5/22 and in the form of Retained Financial Penalties. As a result, there is no return of surplus to firms this year.

Under section 7(2A) of the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, the Bank is required to present financial and other disclosures in respect of its activities as the PRA. These are available in the PRA statement of balances for the period ended 28 February 2023 in the Bank's Annual Report and Accounts 2022/23.

Abbreviations

ACR	Annual Competition Report
ACS	annual cyclical scenario
AI	artificial intelligence
Bank	Bank of England
BCBS	Basel Committee on Banking Supervision
BTS	Binding Technical Standards
CBES	Climate Biennial Exploratory Scenario
CEO	Chief Executive Officer
CMA	Competition and Markets Authority
Court	Bank's Court of Directors
CP	consultation paper
C-SREP	Capital Supervisory Review and Evaluation Process
CTP	critical third party
DP	discussion paper
EEA	European Economic Area
EL	eligible liabilities
EU	European Union
EUWA	European Union Withdrawal Act 2018
FCA	Financial Conduct Authority
FinTech	financial technology
FMI	financial market infrastructures
FPC	Financial Policy Committee
FRF	Future Regulatory Framework
FSAP	Financial Sector Assessment Programme
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act 2000 (as amended)
FSMB	Financial Services and Markets Bill 2022
FSRIF	Financial Services Regulatory Initiatives Forum
FSS	financial services sector
HMT	HM Treasury
IAIS	International Association of Insurance Supervisors
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Report Standard
IMF	International Monetary Fund
IRB	internal rating based
ISPV	insurance special-purpose vehicle

IST	insurance stress test
IT	information technology
LCR	liquidity coverage ratio
LGD	loss given default
LIBOR	London InterBank Offered Rate
LTV	loan to value
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
ORMF	operational risk management frameworks
ORSA	own risk and solvency assessment
PPP	prudent person principle
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
PS	policy statement
PSR	Payment Systems Regulator
QIS	quantitative impact study
RegTech	regulatory technology
RFB	ring-fenced body
RFI	relevant financial institutions
s166	section 166 of the Financial Services and Markets Act
SA	standardised approach
SAECC	symmetric adjustment of the equity capital charge
SCO	secondary competition objective
SIF	Sustainable Insurance Forum
SMF	Senior Management Function
SM&CR	Senior Managers and Certification Regime
SRB	systemic risk buffer
SRPC	Supervisory Risk and Policy Committee
SS	supervisory statement
SoP	statement of policy
TPR	Temporary permissions regime
TSC	Treasury Select Committee

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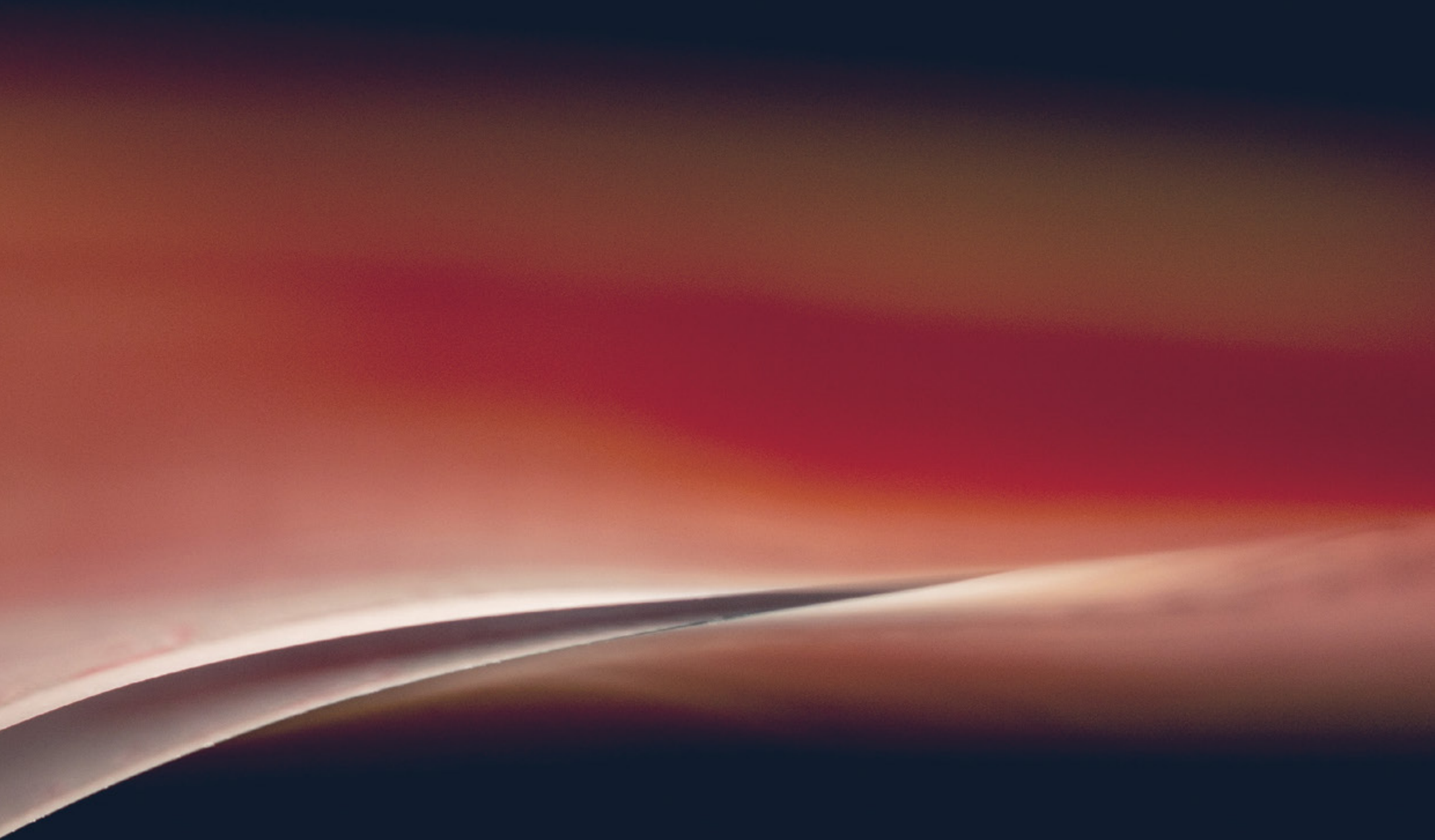

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Our mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability

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