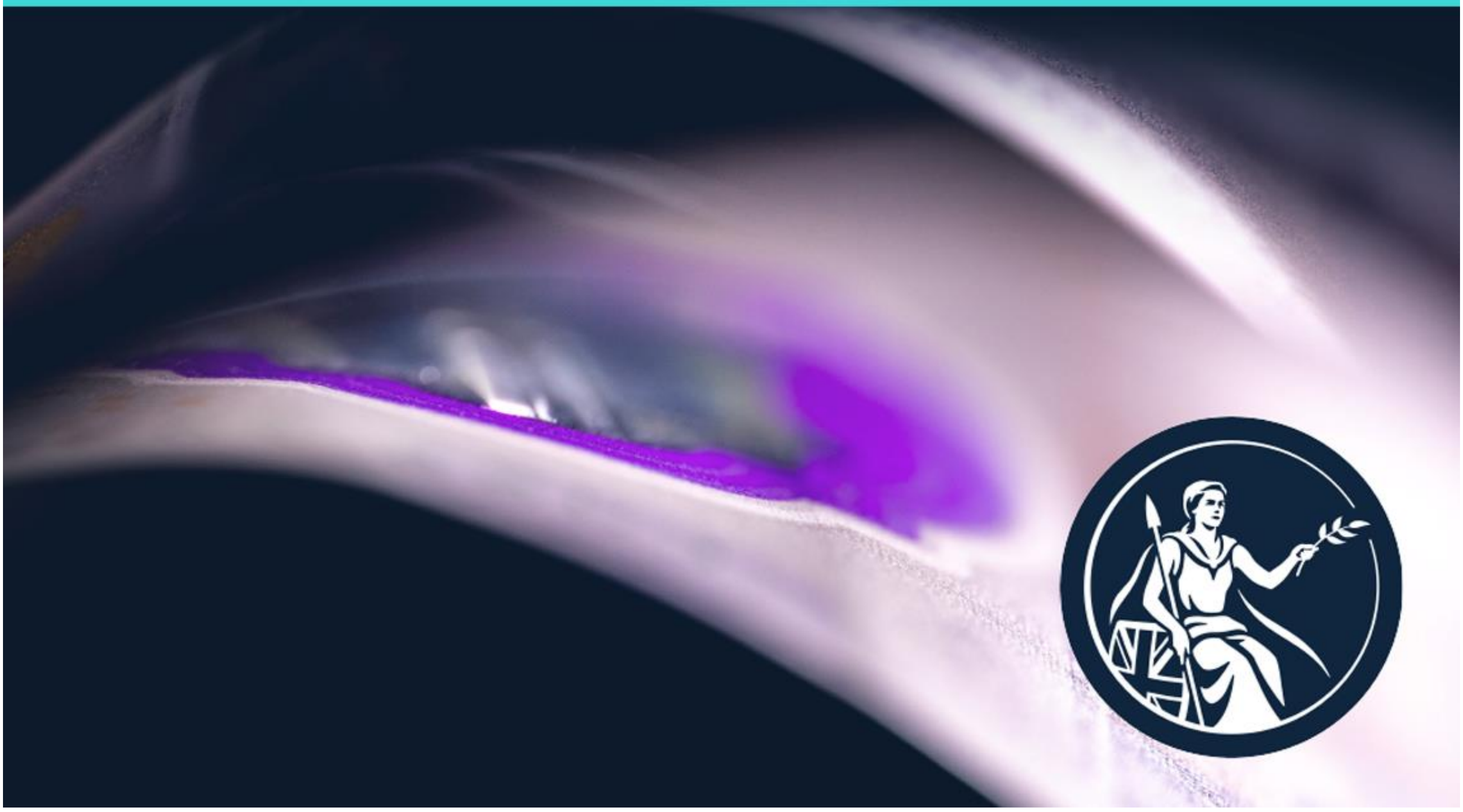
Bank of England

Prudential Regulation Authority

Appendices to CP13/22 – Amendments to the PRA's approach to identifying other systemically important institutions (O-SIIs)

Consultation Paper | CP13/22

July 2022



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Please see: https://www.bankofengland.co.uk/prudential-regulation/publication/2022/july/pra-approach-to-identifying-other-systemically-important-institutuions

1: Draft amendments to Statement of Policy – The PRA's approach to identifying other systemically important institutions (O-SIIs)

In this appendix, new text is underlined and deleted text is struck through.

Introduction

1.1 This statement of policy sets out the criteria and scoring methodology that the Prudential Regulation Authority (PRA) uses to identify other systemically important institutions (O-SIIs), as is required under ~~the Capital Requirements Directive (EU Directive 2019/878 amending Directive 2013/36/EU) (CRD) as implemented in~~ the Capital Requirements (Capital Buffers and Macroprudential Measures) Regulations 2014, as amended (the 'Capital Buffers Regulations').~~[1]~~

1.2 In developing its approach to the identification of O-SIIs, the PRA has taken into consideration relevant Basel principles.[2] ~~the European Banking Authority (EBA) Guidelines on the 'criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs)', referred to in the following as 'the EBA Guidelines'.[3]~~ The approach outlined in this document is consistent with these principles ~~Guidelines~~.

~~1.3 The EBA Guidelines set out an O-SII identification process consisting of two stages. The first stage is a minimum mandatory framework, which consists of a prescribed set of criteria, indicators and weights that authorities should use to identify the institutions that must be designated as O-SIIs. The second stage offers authorities the discretion to overlay the mandatory part of the framework in order to better reflect the specificities of the national banking sector, and if appropriate, designate additional firms as O-SIIs. The PRA has chosen to exercise this discretion and use its potential impact framework (see section 4 and appendix 1) to align the definition of O-SIIs broadly with 'Category 1' firms, whose disorderly failure would have the highest impact on the UK financial system and economy.~~

~~1 www.legislation.gov.uk/uksi/2014/894/contents/made~~.

2 A framework for dealing with domestic systemically important banks - final document.

~~3 www.eba.europa.eu/documents/10180/930752/EBA-GL-2014-10+%28Guidelines+on+O-SIIs+Assessment%29.pdf~~.

Which firms can be identified as O-SIIs?

2.1 In line with the Capital Buffers Regulations ~~CRD and EBA Guidelines~~, the framework outlined in this statement of policy is to be applied in relation to all credit institutions, investment firms, and groups that are headed by UK parent institutions, UK parent financial holding companies, or UK parent mixed financial holding companies within the domestic financial sector at their highest level of consolidation in the United Kingdom.[4]

2.2 The framework is not applied to: i) ~~EEA and~~ third-country branches of overseas firms, and ii) investment firms not regulated by the PRA~~, and iii) firms holding less than 0.02% of the total assets of UK credit institutions and investment firms~~. The rationale for this is as follows:

(i) The Capital Buffers Regulations ~~CRD does~~ do not allow the designation of third country ~~and EEA~~ branches of overseas banks operating in the UK as O-SIIs. Therefore, these institutions are not considered for O-SII designation. ~~In line with the EBA Guidelines, the~~ The PRA, however, includes the activity of UK branches of overseas banks in the denominators used for calculating indicator scores.

(ii) The framework is only applied to those investment firms designated for prudential supervision by the PRA. The Statement of Policy 'Designation of investment firms for prudential supervision by the PRA'[5] outlines the PRA's designation policy, which takes into account the criteria of size, substitutability, interconnectedness, and complexity; the same criteria set out in Article 31(1) Capital Buffers Regulations ~~131(2) CRD and the EBA Guidelines~~. Therefore, if an investment firm has not been designated for supervision by the PRA, this means that the PRA has assessed that the investment firm is not systemically important. This assessment is sufficient to comply with the O-SII assessment methodology set out in the Capital Buffers Regulations ~~CRD and the EBA Guidelines~~.

~~(iii) The PRA uses the discretion provided in the EBA Guidelines to exclude firms from the identification process which – at their highest level of consolidation in the UK - hold less than 0.02% of the total assets of credit institutions and investment firms authorised in the UK. Estimates of these firms' activity are included in the denominators used for calculating indicator scores.~~

EBA's mandatory scoring methodology for O-SII identification

This chapter has been deleted.

[4] References in this statement of policy to the designation of a firm as an O-SII should be taken to include the designation of a group of firms at the highest level of consolidation in the UK.

[5] March 2013: www.bankofengland.co.uk/pra/Pages/publications/designationinvestmentfirms.aspx.

~~The PRA's supervisory overlay – the potential impact framework (~~O-SII identification methodology~~)~~

~~4.1 In addition to the mandatory scoring methodology, the EBA Guidelines request that national authorities should assess whether further firms should be designated as O-SIIs based on the mandatory indicator scores, or on additional qualitative and/or quantitative indicators of systemic importance. National authorities can select indicators that adequately capture systemic importance for their domestic economy or the EU economy from the list in Annexes 1 and 2 of the EBA Guidelines.~~

4.2 The PRA uses a ~~the~~ quantitative scoring methodology ~~of its existing potential impact framework (as set out in the PRA's approach to banking supervision[6])~~ to inform its assessment of which ~~whether further~~ firms should be designated as O-SIIs. ~~All quantitative indicators of systemic importance used in this framework which are relevant to credit institutions and investment firms are available under the EBA Guidelines.~~ The ~~potential impact framework~~ scoring methodology ~~complements the EBA's mandatory scoring methodology by measuring~~ measures activities that are critical to the UK economy and financial system, in line with the PRA's focus on the risk of disruption to the continuity of supply of critical economic functions.

4.3 ~~The potential impact framework classifies firms into different categories of impact to help the PRA determine the appropriate level of supervisory intensity for a firm. This framework~~ The scoring methodology reflects a firm's potential to affect adversely the stability of the system by failing, coming under stress, or the way it carries on its business. This effect can take place through two broad channels – the first is directly, through the impact on real economic activity or on the soundness of other participants, and so the provision of financial services to the economy as a whole. The second is indirectly, through behavioural effects where vulnerabilities within one firm affect confidence in other firms with similar business models or products.

4.4 ~~The PRA judges that~~ In identifying O-SIIs, the PRA will take into consideration the list of credit institutions and investment firms classified as 'Category 1' under ~~the~~ its internal potential impact framework ~~should be designated as O-SIIs in the UK, unless they have been classified as 'Category 1' firms only because of their activity conducted in the United Kingdom through EEA and third-country branches of overseas firms~~. The PRA's approach to banking supervision document[7] defines 'Category 1' firms as the most significant deposit-takers and designated investment firms whose size, interconnectedness, complexity and business type give them the capacity to cause very significant disruption to the UK financial

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~~6 PRA approach documents: www.bankofengland.co.uk/publications/Pages/other/pra/supervisoryapproach.aspx.~~

7 October 2018: **PRA's approach to supervision of the banking and insurance sectors**.

system (and through that to economic activity more widely) by failing or by carrying on their business in an unsafe manner. The scale of such adverse effects depends both on the functions a firm provides, and its significance within the financial system. Some of the critical economic functions that firms provide are: payment, settlement and clearing; retail banking; corporate banking; intra-financial system borrowing and lending; investment banking; and custody services. The scale of a firm's potential impact also depends on its size, complexity, business type and interconnectedness with the rest of the financial system. ~~The part of the potential impact framework used in O-SII identification – namely the indicators and weightings that are relevant to banks and investment firms, rather than to insurers - is set out in Appendix 1.~~[8]

4.5 The PRA calculates ~~the~~ firms' ~~supervisory overlay~~ scores based on the indicators set out in Table 1 of Appendix 1, in line with the calculation method outlined in Appendix 1 ~~paragraphs 3.2 and 3.3~~. This score then forms the basis for the PRA to use judgment on whether to designate firms as O-SIIs. ~~Under the current potential impact framework, all Category 1 firms that are subject to O-SII assessment have scores exceeding 100 basis points. Therefore the~~ The PRA expects to designate firms whose ~~supervisory overlay~~ score exceeds 100 basis points as O-SIIs, unless those scores only exceed that point because of their activity conducted in the United Kingdom through third-country branches of overseas firms.

4.6 There are cases in which the PRA may designate firms as O-SIIs whose ~~supervisory overlay~~ score is below 100 basis points.

(i) Firms scoring just below 100 basis points ~~that have been designated in the previous year~~ may be designated as O-SIIs if the PRA judges that they are systemically important to the UK ~~or the EU~~ economy.

(ii) The quantitative elements of the O-SII assessment methodology are applied at the highest level of consolidation in the UK, but some subsidiaries of overseas groups do not have a single consolidation in the UK. Where one of the subsidiaries has been designated as an O-SII, the PRA can use supervisory judgement to designate any of its sister subsidiaries in the UK as O-SIIs, if interdependencies between the subsidiaries mean that the resilience of the O-SII could be threatened by the failure of a sister subsidiary.

(iii) The PRA otherwise judges as part of its supervisory activities that a firm is systemically important to the UK economy or financial system.

~~8 The PRA also applies the potential impact framework to insurance firms. Therefore the framework also includes indicators relevant to insurance firms. These indicators are not used for O-SII identification.~~

~~4.7 If the potential impact framework is changed in future, this may also require the threshold to be changed, and this statement of policy to be updated accordingly.~~

O-SII identification timetable and publication

5.1 The PRA will conduct the O-SII identification annually and publish the list of firms designated as O-SIIs by 1 December each year. It will also publish~~:~~

~~(i) The mandatory score of each firm designated as an O-SII under the EBA's mandatory O-SII scoring methodology.~~

(ii) ~~The supervisory overlay~~ the score of each firm designated as an O-SII ~~under the supervisory overlay~~. If the ~~supervisory overlay~~ score of a firm designated as an O-SII does not exceed 100 basis points, the PRA will publish the rationale for designating this firm.

Appendix 1: The O-SII identification scoring methodology ~~PRA's potential impact framework~~

~~In the PRA's potential impact framework, a~~ A firm's ~~potential impact~~ score is calculated based on its significance in a number of categories (eg 'retail banking'). A firm's significance in each category is measured as the firm's share of PRA-regulated firms' activity. A number of indicators (eg 'value of retail deposits') measure a firm's activity within each category. The market shares in each indicator are averaged within categories using the weights outlined in the fourth column of Table 1. Subsequently, the overall ~~potential impact~~ score is calculated by averaging across the categories using ~~equal~~ the weights in the second column of Table 1.

Table 1: Categories and indicators to be used in O-SII scoring ~~the supervisory overlay~~

Category	Category weight (%)	Indicators	Weight within category (%)
Retail Banking	~~100~~ 150	Value of Retail Deposits	44
		Value of Retail Lending	23
		Number of Retail Customers	33
Corporate Banking	100	Value of Corporate Deposits	~~60~~ 40
		Value of Corporate Lending	~~40~~ 60
Intra-financial Banking	100	Intra-financial Liabilities (Deposits, Repos, Derivatives)	50
		Intra-financial Assets (Loans, Reverse Repos, Derivatives)	50

Payment, Settlement & Clearing services	100	Daily Average Value of CHAPS transactions	~~35~~ 20
		Daily Average Value of BACS transactions	~~15~~ 20
		Daily Average Value of CREST transactions	~~35~~ 20
		Daily Average Value of LCH transactions	~~15~~ 20
		Daily Average Value of Faster Payments transactions	20
Custody Services	100	Custody Assets	100
Investment Banking	100	Trading Assets	~~50~~ 33
		Trading Liabilities	33
		~~Market transaction volumes~~ Volume of all debt instruments traded	~~50~~ 34

~~Retail and corporate banking, and retail payments activities reflect the direct impact that the distress or failure of a systemic institution could have on the UK economy through the disruption or cessation of services. The larger an institution's market share in these services, the less substitutable it is. The indicators selected to inform these criteria of systemic importance reflect the different types of transactions the financial institutions can have with the retail and corporate sectors.~~

~~The remaining criteria (intra-financial banking, settlements and clearing, custody services, investment banking) reflect other direct and indirect channels through which the distress or failure of institutions could pose a threat to the real economy, including through other intermediaries.~~

The PRA calculates each relevant entity's score by:

(i) dividing the indicator value of each individual relevant entity by the aggregate amount of the respective indicator values summed across all institutions in scope of this framework, authorised in the UK (the 'denominators');

(ii) multiplying the resulting percentages by 10,000 to express the indicator scores in terms of basis points;

(iii) calculating the category score for each relevant entity by taking an average of the indicator scores in that category, calculated based on the indicator weights in the fourth column of Table 1; and

(iv) calculating the overall score for each relevant entity by taking an average of its six category scores, calculated based on the category weights in the second column of Table 1.

Therefore, the final score can be interpreted as a firm's weighted average market share across the activities contributing to systemic importance, measured in basis points.

Third-country branches of overseas banks operating in the UK are not assessed as part of this framework, but estimates of their activity are included in the denominators.

2: Draft amendments to Statement of Policy – Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from EU

In this appendix, new text is underlined and deleted text is struck through.

Appendix 2: Non-exhaustive list of EBA Guidelines and Recommendations that are complied with in the UK

Capital Requirements Directive (CRD)

…

~~Guidelines on criteria to assess other systemically important institutions (O-SIIs)~~

3: PRA statutory obligations

The statutory obligations applicable to the PRA's policy development process are set out below. This CP explains the policy assessment of relevant considerations.

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- Purpose of the policy proposals (FSMA s138J(2)(b)).
- Cost benefit analysis (FSMA s138J(2)(a) and (7)(a)); and an estimate of those costs and benefits (if reasonable) (FSMA s138J(8)).
- Analysis of whether the impact on mutuals is significantly different to the impact on other authorised firms (FSMA s138J(2)(c) and 138K).
- Compatibility with the PRA's primary objectives (FSMA s138J(2)(d)(i), 2B and 2C).
- Compatibility with the PRA's secondary competition objective (FSMA s138J(2)(d)(ii) and 2H(1)).
- Compatibility with the regulatory principles (FSMA s138J(2)(d)(ii), 2H(2) and 3B).
- Have regard to the HMT recommendation letter (BoE Act s30B).
- Have due regard to the public sector equality duty (Equality Act s149).
- Have regard, subject to any other requirement affecting the exercise of the regulatory function, to the principles of good regulation and when determining general policy or principles to the Regulators Code (Legislative and Regulatory Reform Act 2006 s21 & 22).
- Have regard, so far as consistent with the proper exercise of those functions, to the purpose of conserving biodiversity. Conserving biodiversity includes, in relation to a living organism or type of habitat, restoring or enhancing a population or habitat (Natural Environment and Rural Communities Act 2006, s40).
- Consultation of the FCA (FSMA s138J(1)(a)).
- Where the consultation proposes a PRA rule change or amendment to onshored BTS that affects the processing of personal data - consultation with the Information Commissioner's Office (article 36(4) General Data Protection Regulation).

- For UK Technical Standards Instruments only: FSMA s138J(1)(a) is replaced with: consultation of the FCA and/or Bank, where that Regulator has an interest in the technical standards (FSMA s138P(4) and (5)).
- For UK Technical Standards Instruments only: notice given to HMT of the consultation on the UKTS (‘best efforts’ basis).
- For CRR rules only: subject to certain exceptions, have regard to:
  - relevant standards recommended by the Basel Committee on Banking Supervision from time to time;
  - the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active credit institutions and investment firms to be based or to carry on activities. For these purposes, the PRA must consider the United Kingdom's standing in relation to the other countries and territories in which, in its opinion, internationally active credit institutions and investment firms are most likely to choose to be based or carry on activities;
  - the likely effect of the rules on the ability of CRR firms to continue to provide finance to businesses and consumers in the United Kingdom on a sustainable basis in the medium and long term;
  - the target in section 1 of the Climate Change Act 2008 (carbon target for 2050);
  - (s144C (1) & (2) FSMA – exceptions in s144E FSMA).
- For CRR rules only – explanation of the ways in which having regard to the matters specified above has affected the proposed rules (s144D FSMA).
- For CRR rules only – publication of a summary of the proposed CRR rules.
- For CRR rules only – consideration and consultation with the Treasury about the likely effect of the rules on relevant equivalence decisions (s144C (3) & (4) FSMA).