

David Bailey

Executive Director, UK Deposit Takers

Laura Wallis

Director, UK Deposit Takers

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Dear [Chief Executive Officer]

UK Deposit Takers Supervision: 2024 priorities

We are writing to update you on the Prudential Regulation Authority's (PRA) 2024 priorities for UK deposit takers (firms). These are intended to complement our ongoing supervision and the firm-specific feedback that you will have received following your most recent Periodic Summary Meeting (PSM). This thematic priorities letter is sent to the diverse range of firms that we supervise; therefore, it should not be viewed as exhaustive.

A common theme that underpins this year's priorities is the need for robust governance, risk management and controls at firms to enable the effective and proactive identification, assessment and mitigation of risks in an increasingly challenging and changeable operating environment. Boards and Executives should continuously challenge themselves to ensure they have appropriate structures, processes, capabilities and information in place within their own governance and risk management frameworks.

The events of 2023 show that firms can experience a sudden loss of customer, counterparty or market confidence, with damaging implications that can require regulatory intervention. Firms must remain vigilant ensuring they operate with an appropriate risk culture to promote safety and soundness. We expect individuals within our Senior Managers Regime to continue to lead the risk culture of their firms. Firms



should also ensure there are appropriate succession plans in place across the Board and Executive to maintain strong governance, risk management and controls in the event there are changes in personnel.

Boards and those accountable need to continuously challenge current thinking and understand that previously improbable events could be within the realms of the possible. As part of this, firms should consider the novel risks that may arise from the rapidly growing use of new technologies. Firms are expected to be forward thinking and imaginative in the scenarios they consider, capturing extreme tail events and the risk management challenges these may present.

Through our supervisory engagement, we will continue to seek assurance that your overall governance, risk management and control frameworks are evolving in line with the changing environment, and the priorities set out in this letter.

We have set out our priorities for 2024 below.

Credit risk

Conditions remain challenging given uncertainties over growth, inflation and interest rates as well as ongoing geopolitical tensions. These combined factors have the potential to create significant pressure on the households and businesses that are supported by the UK banking sector, and therefore on firms' credit portfolios. It is imperative that firms are prepared to manage the associated risks proactively and prudently, while supporting their customers.

In recent years, firms have adapted risk appetites, tightened underwriting standards, made improvements to portfolio monitoring (including enhancements to forbearance monitoring and early warning indicator frameworks), and increased operational preparedness for collections and recoveries. It is important that firms build on these changes to ensure credit risk management and measurement practices remain robust and adaptable to changing conditions. This includes appropriate consideration of downside and contagion risks as well as monitoring and planning for the impacts of customer refinancing. Portfolios should be closely monitored, customer support and collections arrangements appropriately scaled, and expected credit loss provisions recognised in an appropriate and timely manner.¹

¹ For feedback on the application of IFRS 9 ECL accounting, see: www.bankofengland.co.uk/prudential-regulation/letter/2023/thematic-feedback-2022-2023-written-auditor-reporting. The letter was addressed to select CFOs, but has relevance for all firms applying IFRS 9.

In the coming year our assessment of firms' credit risk management will include a focus on how credit risk management practices have evolved, in light of the challenges set out above, as well as any changes to firms' business mix and credit exposures. We will continue to monitor vulnerable segments, including cyclical sectors and key international portfolios, as well as traditionally higher-risk portfolios such as buy-to-let, credit cards, unsecured personal loans, small to medium-sized enterprises, leveraged lending and commercial real estate. In addition, counterparty credit risk, will remain a key area of supervisory focus through 2024, in particular exposures to non-bank financial institutions (NBFIs) across certain business lines.

Firms should expect ongoing heightened engagement with us on credit and counterparty credit risk, including targeted requests for enhanced data and analysis.

Financial resilience

It is imperative that firms manage their financial resilience to ensure that the financial sector can continue to support businesses and households. As part of this, firms should reflect on events that have taken place in the global banking sector during the course of 2023² and any implications they can draw from this for their own risk profiles. For example, firms should ensure their treasury management is robust and takes into consideration the interaction between capital and liquidity risks, including through interest rate risk, as well as how hedging activity may affect the usability of liquid assets. We also expect firms to consider changes in depositor behaviour in the current funding environment and proactively take into consideration forthcoming changes in bank funding and liquidity conditions. In particular, this includes the normalisation of funding conditions as the COVID crisis-era TFSME³ unwinds; the way in which quantitative tightening will affect the level of central bank reserves available in the system; and what these changes imply for the way in which firms source and manage liquidity moving forwards.

We will continue to focus on financial resilience through ongoing assessment of individual firm's capital and liquidity positions and planning. In assessing these risks, we will expect to see firms analysing a broad range of forward-looking liquidity and capital indicators, using stress testing to assess their financial resilience and to have realistic and effective contingency plans. Stress testing should not be a box ticking exercise; it needs to be well thought out and identify relevant issues for your firm.

² Report on the 2023 banking turmoil; available at: www.bis.org/bcbs/publ/d555.htm.

³ Term Funding Scheme with additional incentives for Small and Medium-sized Enterprises contractual repayments will start in March 2024; available at: www.bankofengland.co.uk/markets/market-notice/2020/term-funding-scheme-market-notice-mar-2020.

All firms should be mindful of the upcoming implementation of the Basel 3.1 standards⁴ and should ensure that they plan accordingly to maintain financial resilience while continuing to support households and businesses.

Operational resilience

Firms have just over a year left to meet the Operational Resilience expectations (as set out in supervisory statement 1/21).⁵ By no later than March 2025, firms should be able to demonstrate that they can remain within impact tolerances for all their important business services (IBS). To get ready for this, firms should have a clear plan to identify and remediate any vulnerabilities which could impact their ability to deliver their IBS. This includes identifying what resources are needed to support the delivery of each IBS, running tests using scenarios which are severe but plausible and learning lessons from any operational disruptions. We expect these scenarios to include cyber-related disruptions, which will help firms to identify what is needed to both withstand a cyber-related incident and to recover from one. Boards and senior management need to actively oversee the delivery of their firms' operational resilience programme.

We continue to see firms executing large and complex transformations of their IT infrastructure, including utilising third party providers (such as Cloud providers) to support the provision of IBS. We expect these transformations to be well managed with any execution risks appropriately mitigated. Firms should also be mindful of the impact that any changes could have on their IBS. In particular, where firms outsource parts of their business, they should ensure that they meet the expectations set out in supervisory statement 2/21 – Outsourcing and third party risk management⁶ as well as the operational resilience policy discussed above.

The RTGS Core Ledger⁷ is scheduled to be replaced in June 2024. We expect all RTGS Account Holders, particularly participants in payment schemes, to manage these

⁴ PRA policy statement 17/23 – Implementation of the Basel 3.1 standards near-final part 1; available at: www.bankofengland.co.uk/prudential-regulation/publication/2023/december/implementation-of-the-basel-3-1-standards-near-final-policy-statement-part-1.

⁵ PRA supervisory statement 1/21 – Operational resilience: Impact tolerances for important business services; available at: www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-impact-tolerances-for-important-business-services-ss, March 2021.

⁶ PRA supervisory statement 2/21 – Outsourcing and third party risk management: www.bankofengland.co.uk/prudential-regulation/publication/2021/march/outsourcing-and-third-party-risk-management-ss, March 2021.

⁷ The renewed RTGS service – key benefits: available: www.bankofengland.co.uk/payment-and-settlement/rtgs-renewal-programme/the-renewed-rtgs-service-key-benefits.

changes appropriately and to participate in the Bank of England's testing and go live activities.

Model risk

Effective model risk management (MRM) underpins firms' ability to assess and manage risk. Recognising the importance of MRM, we published finalised model risk management principles for banks in 2023,⁸ which come into effect on 17 May 2024. Prior to this, we expect the firms in scope of the principles to conduct an initial self-assessment of their MRM frameworks and, where relevant, prepare remediation plans to address any identified shortcomings. The PRA will engage with the accountable Senior Managers Functions at relevant firms who should ensure remediation plans are put in place as required, with clear ownership of any necessary actions at their firm.

The PRA will also continue to engage with firms on existing and planned internal model applications.

Data risk

As we have said before, the submission of complete, timely and accurate regulatory returns remains the foundation of effective supervision.⁹ Our ongoing programme of skilled persons reviews of regulatory reporting across a significant sample of firms has repeatedly identified deficiencies in controls over data, governance, systems, and production controls related to regulatory reporting¹⁰. We expect firms to consider our feedback, take remedial action as needed, and maintain appropriate focus on and investment in regulatory reporting. We will continue to make targeted use of our supervisory tools in this area in 2024 including using skilled persons where appropriate.

More broadly, the Basel Committee on Banking Supervision's (BCBS) progress report on the adoption of BCBS 239,¹¹ highlights that work still remains for firms in relation to risk data aggregation. We expect all firms, to ensure that data accuracy is a key consideration across all data types.

⁸ PRA supervisory statement 1/23 – Model risk management principles for banks: www.bankofengland.co.uk/prudential-regulation/publication/2023/may/model-risk-management-principles-for-banks-ss, May 2023.

⁹ Letter from Sarah Breeden and David Bailey 'Reliability of regulatory returns': www.bankofengland.co.uk/prudential-regulation/letter/2019/reliability-of-regulatory-returns, October 2019.

¹⁰ Letter from David Bailey and Rebecca Jackson 'Thematic findings on the reliability of regulatory reporting': www.bankofengland.co.uk/prudential-regulation/letter/2021/september/thematic-findings-on-the-reliability-of-regulatory-returns, September 2021.

¹¹ Available at: www.bis.org/bcbs/publ/d559.htm.

Looking ahead, we are continuing our work on the long-term reforms to the way we collect data as part of the Transforming Data Collection Programme,¹² and on which data we collect as part of the PRA's Banking Data Review¹³. We will continue to engage directly with you on these topics and via the industry forum.

Financial risks arising from climate change

Financial risks arising from climate change continue to present an increasingly material risk to firms and the financial system. Our assessment of firms against PRA expectations¹⁴ indicates that, while firms are progressing their approaches to managing these risks, there is still considerable work for all firms to do in their development of climate-related financial risk management capabilities and linking these more concretely into decision-making.

During 2024, we expect firms to further progress and demonstrate the development and integration of processes to identify, measure, manage and mitigate climate-related financial risks in line with our previous feedback. Firms should also consider relevant and ambitious stress scenarios to enhance their assessment of the impact of climate change on their businesses and resilience. This should be proportionate to the nature of your firm's business, its size, scale of risks and complexity. We will continue to assess firms' progress in managing climate-related financial risks and expect firms to increase their efforts now. We will also commence work to update supervisory statement 3/19 which will include, among other things, identified effective practice and developments in wider regulatory thinking.

Other area of focus

Resolution and recovery

Events in the banking sector over the last twelve months have highlighted the importance of banks' resolvability and recovery planning. The largest firms will be subject to the Resolvability Assessment Framework (RAF) cycle 2 in the coming year. Alongside this, we will continue to work closely with small and medium-sized firms to improve the quality of their recovery planning.

¹² Available at: www.transformingdatacollection.co.uk.

¹³ Available at: www.bankofengland.co.uk/prudential-regulation/banking-data-review.

¹⁴ PRA supervisory statement 3/19 – Enhancing banks' and insurers' approaches to managing the financial risks from climate change; available at: www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss, April 2019 and letter from Sam Woods 'Thematic feedback on the PRA's supervision of climate-related financial risk and the Bank of England's Climate Biennial Exploratory Scenario exercise': www.bankofengland.co.uk/prudential-regulation/letter/2022/october/managing-climate-related-financial-risks, October 2022.

This letter in conjunction with your firm's PSM letter, should convey a sense of our planned work for 2024.

Yours sincerely,

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the bottom.

David Bailey
Executive Director, UK Deposit Takers

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Laura Wallis
Director, UK Deposit Takers