BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Business Plan
2018/19

Prudential Regulation Authority

Business Plan 2018/19

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Foreword by the Chief Executive

Prudential regulation, like annual reporting, is about looking both ways. This year we are turning to face new challenges – especially those related to EU withdrawal and operational resilience – while staying mindful of the lessons of the past.

Nearly a decade on since the global financial crisis, we are approaching full implementation of the post-crisis reforms. For the first time since concurrent stress testing began in 2014, not one of the large banks needed to improve their capital position following the 2017 results. Having successfully migrated tens of thousands of customer accounts to new sort codes, these firms are on track to implement ring-fencing before the end of the year, and now have the bulk of the loss-absorbing capacity needed to meet our requirements. We (finally!) finalised Basel III, and on the insurance side are well-advanced in adjusting elements of our Solvency II implementation now that we've run the new regime for a couple of years.

Part of our job now becomes defending this new post-crisis architecture. That means continuing with the bread and butter of our supervisory role, looking over the shoulders of management to make sure that every bank and insurer has sufficient resources and is run in a prudent way. It means ensuring that the Senior Managers Regime – due to be extended to insurers by the end of this year – plays its intended role in strengthening accountability within firms. And it means being vigilant for any sign of 'regulatory arbitrage' (behaviour that is intended to comply with the letter but defy the spirit of the rules) and continually scanning the horizon to spot new risks as they emerge. Conflicts with firms will sometimes arise in the course of all this. This is inherent in a system in which the regulator is charged with pursuing the public interest through the activities of privately-owned firms.

While firms adjust their business models to the new landscape, we are evaluating the effectiveness of specific requirements in the light of practical experience. We are prepared to seek improvements – in ways consistent with international standards – where the rules clearly do not work as intended. But we are not going to go soft: we will maintain a level of resilience that is at least as great as that currently planned. For example, with our secondary competition objective in mind, we have adjusted the capital framework to help level the playing field for smaller banks. And in insurance, as part of a programme of improvements to our implementation of Solvency II, we will act to tackle the problems with the risk margin.

But we must also look forward. With the new post-crisis structure largely in place, we must make sure its resilience is enduring in a changing world. Some of the risks in front of us come with no precedent and addressing them requires a good deal of imagination.

This year we will continue to do a huge amount of work to promote an orderly UK withdrawal from the European Union. This work falls into three main areas. First, we are working with the government to make sure the prudential rulebook remains fully operable and coherent as we leave. Second, we are providing technical advice to the government in relation to its negotiations with the EU. And third, we are keeping well across firms' plans to restructure across the border with the rest of the EU while aiming to ensure that the process for authorising the provision of financial services in the UK runs as smoothly as possible. The foundation of our approach remains the presumption that there will continue to be a high degree of supervisory cooperation between the UK and the EU, and that the openness of our global financial centre benefits both sides.

Just as important as keeping the front door open is keeping the back door closed. The UK financial system is under almost constant cyber attack. We work hand in hand with the National Cyber Security Centre, HM Treasury and the FCA in response to critical incidents. But while we have well-established industry testing and exercise programmes, nowhere in the world is there an overarching prudential standard for operational resilience. And advances in payment services and open banking – welcome in terms of increased competition and innovation – will pose further challenges to existing technologies. So developing our supervisory approach, setting out clearly the level of operational resilience we expect of firms and how we will make sure it is delivered, is a top priority for the PRA. We will publish our thinking later this year.

The publication of this strategy and business plan alongside the consultation on our fees and levies for the year ahead, as opposed to alongside our annual reporting in the summer, is a small innovation on our part. The idea is to improve transparency by giving Parliament and levy-payers a better idea of what we will be doing with our resources in the year ahead, as context for the fees and levies consultation.

Finally, let me give a big pre-emptive thank you to the 1,425 staff in the PRA for all the hard work they will put in over the coming year in order to deliver our statutory objectives.

Overview of responsibilities and approach

The PRA is responsible for the prudential regulation of deposit-takers, insurers and the largest investment firms in the United Kingdom

The PRA supervises around 1500 firms and groups[1] (see Charts 1 and 2). This includes nearly 900 banks, building societies and credit unions[2] and over 600 insurers of all types (general insurers, life insurers, friendly societies, mutuals, the London market and insurance special purpose vehicles (ISPVs)). In discharging its powers the PRA seeks to assess and address risks that the firms it supervises can pose to the stability of the financial system. The United Kingdom has one of the world's largest centres for financial services and acts as host regulator to all internationally headquartered global systemically important banks (G-SIBs) and several internationally headquartered global systemically important insurers (G-SIIs).

More than half of total UK banking sector assets are from branches and subsidiaries of foreign banks, totalling around £7.4 trillion.[3] Reflecting this role in international finance, the PRA supervises over 160 branches and 90 subsidiaries of foreign banks from over 50 jurisdictions. The PRA is the home state regulator of four UK G-SIBs.

The UK insurance sector is the largest in Europe and the fourth largest in the world. The PRA is the home state regulator of two UK G-SIIs.

Chart 1: PRA supervised deposit takers, as at 28 February 2018

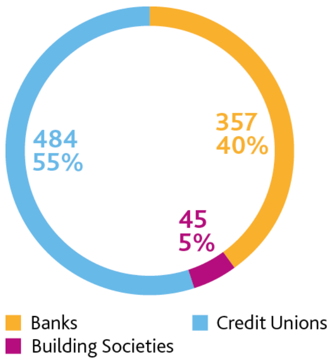
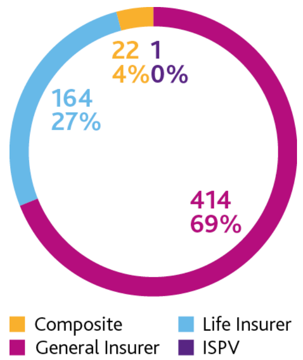


Chart 2: PRA supervised insurers, as at 28 February 2018



The PRA's supervisory approach is forward-looking and judgement-based. It uses quantitative and qualitative analysis to allocate firms across five categories of potential impact. The approach is key to enabling the PRA to meet its strategy and is described in the 'PRA approach documents'[4] that cover: the PRA's objectives and its approach to advancing them; how risks to the PRA's objectives are identified; the way the PRA safeguards safety and soundness; and its approach to supervisory activity and policy making. The approach documents also set out how the PRA works with other areas of the Bank and its committees, as well as the PRA's domestic and international counterparts.

1 The exact number of PRA-authorised firms and groups changes as new firms enter, other firms close or vary their permission, and entities within groups restructure. This total includes all designated investment firms.
2 Banks, building societies and credit unions are collectively referred to as deposit-takers as they are the only UK financial institutions authorised and regulated to collect deposits from the general public.
3 This is sourced from firms' regulatory returns (FSA001, FINREP F01.01 and the branch return) as at Q2 2017. This number is larger than reported in previous annual reports using statistical returns, with the main difference due to the inclusion of derivative assets and designated investment firms.
4 Available at: www.bankofengland.co.uk/news?NewsTypes=65d34b0d42784c6bb1dd302c1ed63653&Taxonomies=0287.

The PRA Strategy

The PRA's strategy is to deliver a resilient financial sector by seeking: an appropriate quantity and quality of capital and liquidity; effective risk management; robust business models; and sound governance including clear accountability of firms' management. This supports our pursuit of our primary safety and soundness, policyholder protection, and secondary competition statutory objectives.

Our regulatory regime involves both setting standards and holding firms to those standards through our supervision. We do not seek to operate a regulatory regime in which firms can never fail. When failure does occur, this should be with limited disruption to the provision of core financial services, without spillovers to the wider financial sector that could threaten financial stability, and should not expose the public sector to loss.

The strategic goals set out our work plan and priorities for the coming year. The context in which these goals have been formed is one of significant change in the regulatory landscape.

This strategy will be achieved in close co-operation with other parts of the Bank, the Financial Conduct Authority (FCA), European and international counterparts. The continued excellent engagement of our staff will be integral to ensuring the successful delivery of our goals.

Shaping the PRA strategy

Each year the PRA is required by law to determine and publish its strategy, setting out how we will advance our statutory objectives:

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

In addition to the statutory objectives, our strategy is shaped by other responsibilities such as the requirement to implement domestic, European and international legislation. Furthermore, as part of the Bank, we contribute to the delivery of the Bank's wider financial stability and monetary policy objectives.

We maintain the flexibility to respond to changes in markets, developments in the economy and other risks which can affect our statutory objectives and priorities, and reprioritise activities as needed. For 2018/19 such changes relate to the UK's withdrawal from the European Union, the implementation of structural reform of banks (also referred to as ring-fencing), and technology.

Strategic goals for 2018/19

The PRA's strategy outlines our intentions over the medium to long term. It was set by the Prudential Regulation Committee (PRC), in consultation with the Bank's Court of Directors. Our strategic goals are to:

- have in place robust prudential standards comprising the post-crisis regulatory regime (pages 10-11);
- continue to adapt to changes in the external market and to hold regulated firms, and those who run them, accountable for meeting our standards (pages 11-12);
- ensure that firms are adequately capitalised, and have sufficient liquidity, for the risks they are running or planning to take (pages 12-14);
- develop our supervision of operational resilience in order to mitigate the risk of disruption to the provision of critical economic functions (pages 14-15);
- ensure that banks and insurers have credible plans in place to enable them to recover from stress events, and that we have a credible resolution strategy to manage a firm's failure – proportionate to the firm's size and systemic importance – in an orderly manner (pages 15-16);
- facilitate effective competition by actively considering the proportionality of our approach as it contributes to the safety and soundness of the UK financial system (page 16);
- deliver a smooth transition to a sustainable and resilient UK financial regulatory framework following the UK's exit from the European Union (page 17); and
- operate effectively by ensuring that resources are allocated to work that best advances our strategy and reduces the greatest risks to the delivery of our statutory objectives (page 18-19).

PRA Business Plan 2018/19

This section sets out the workplan to deliver our strategic goals over the coming year

Have in place robust prudential standards comprising the post-crisis regulatory regime

We will maintain our commitment to robust prudential regulation following a period of major reforms to both the banking and insurance frameworks. In 2018/19 the focus of work will pivot from developing new policies to implementation and evaluation. We aim to safeguard the post-crisis gains in resilience, and ensure regulations are working as intended, while addressing new challenges including EU withdrawal and operational resilience. We will continue to support the Financial Policy Committee (FPC) to ensure the regime is also delivering on its macroprudential objectives.

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

UK banks with more than £25 billion of retail deposits[1] are obliged to restructure their businesses and operations to meet ring-fencing requirements by 1 January 2019. The largest firms are using a court approved 'ring-fencing transfer scheme' (RFTS) to move assets and liabilities around their banking groups, or to new entities authorised by the PRA, to ensure they comply. This process began in late 2017, and continues into 2018. The transfer of assets and liabilities will occur at a point in 2018 agreed with us to ensure smooth and orderly transitions to the new business structures.

Each of the affected banks is required to be a member of major payment schemes. Most of the banks subject to ring-fencing have completed their plans to join these schemes. We will work with those firms that still have some on-boarding obligations to fulfil, and monitor firms' progress to meet the requirements for operational continuity in resolution which will support the implementation of structural reform.

In the coming year, we will begin a programme of activities to test the effectiveness of the arrangements in place. This will include an examination of the policies, governance and control arrangements. We will also finalise the necessary arrangements to collect and analyse data submitted by these banks.

Solvency II – refining our approach as we get used to operating the new regime, and identifying any risks arising as firms adapt to it

We will continue to implement forward-looking, judgement-based supervision of UK insurers within the framework of Solvency II to deliver our statutory objectives. Where appropriate and possible, we will adjust our supervisory approach in the light of experience, having regard to feedback. This includes taking forward a number of important issues raised by the Treasury Committee.[2]

1 The requirement for large UK banks to ring-fence their core UK retail services and activities by 2019 is set out in amendments to FSMA under the Financial Services (Banking Reform) Act 2013 (the 2013 Act).
2 The 'PRA response to the Treasury Committee's inquiry into Solvency II' and a link to the Treasury Committee's inquiry are available at: www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-response-to-the-treasury-committees-inquiry-into-solvency-2.

We are delivering a series of improvements to our implementation of Solvency II following consultations that began in October 2017.[1] These will include finalising policy on our implementation of the matching adjustment, internal model change processes and reporting requirements. In April 2018 we will consult in two further areas: i) removing the requirement for the external audit of Solvency and Financial Condition Reports for small firms from 2019; and ii) the modelling of 'dynamic' volatility adjustment for internal model firms. We are considering ways to simplify the recalculation of the transitional measure on technical provisions.

We consider that the Solvency II risk margin is too sensitive to interest rates and therefore too large in the current low rate environment, particularly for long-dated annuity business. As well as potentially driving pro-cyclical investment behaviour, as previously noted by the Financial Policy Committee,[2] the current design is leading UK insurers to reinsure the majority of new longevity exposure offshore. We will act to tackle the problems that we, the industry and the Treasury Select Committee have agreed exist.

Contribution to financial stability

We will contribute to financial stability through policy development and implementation. This will include support for the FPC's reviews on capital, leverage and housing, and its assessment of risks arising from the levels of consumer credit.

Continue to adapt to changes in the external market and to hold regulated firms, and those who run them, accountable for meeting our standards

The prudential regulatory framework must be responsive to changes in behaviour and the structure of the financial system. We will seek to identify aspects of regulation that can lead to unintended behaviour or outcomes and will continue to work with other areas of the Bank to aid our monitoring of firms and the financial environment so that the appropriate responses are put into place. For example, we will help to ensure that the microprudential, macroprudential and resolution frameworks are coherent and consistent with one another. Where issues are identified, and good practice is available to share, we will communicate to firms at individual or sector level, as appropriate, using channels including letters, speeches, briefings, and publications. The following areas continue to be of particular interest to us as regulated firms adapt their practices and business models:

- Changes in the behaviour or structure of firms which seek to take advantage of regulatory arbitrage, ie if firms are using loopholes to avoid regulation.[3]

- New firms seeking authorisation to operate in the United Kingdom. Some new firms may be created from the restructuring of existing firms and groups. Others may seek authorisation as they take advantage of digital technologies to deliver their services, or improvements to the regulatory processes through the joint PRA/FCA 'New Bank Start-up Unit'.[4] In the next three years, we expect this activity to lead to the supervision of around 20-30 new banks. We will also review how we might improve the current authorisation process to facilitate the entry of new insurers.

1 News release 'PRA launches series of improvements to the implementation of Solvency II', 25 October 2017: www.bankofengland.co.uk/news/2017/october/pra-launches-series-of-improvements-to-the-implementation-of-solvency-ii.
2 'Financial Stability Report', November 2016: www.bankofengland.co.uk/financial-stability-report/2016/november-2016.
3 See 'Looking both ways – speech by Sam Woods', July 2017: www.bankofengland.co.uk/speech/2017/looking-both-ways.
4 Information about the New Bank Start-up Unit and related materials are available on the Bank of England website at www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit.

- Firms seeking permissions to conduct new business, such as through the introduction of the new framework to facilitate the issuance of Insurance Linked Securities (ILS) through ISPVs in the United Kingdom.[1]

- Changes to business structures in the banking and insurance sectors as a result of regulation (eg ring-fencing), the search for profitability in a low interest rate environment, and wider issues such as EU withdrawal.

- The use of financial technologies (FinTech) by banks and other financial services providers, as this can bring the potential for changes to their operations and services, and the assumptions underlying their business models. We will continue our engagement with firms and other industry participants (including other regulators) to monitor these developments and consider whether and when any reassessment of regulation is required. Moreover, we continue to remain alert to the broader challenges and opportunities for regulators, including policymaking and evaluation in an evolving landscape.

Accountability – delivering and embedding the governance regime for banks and insurers

As part of implementing the recommendations in the final report of the Parliamentary Commission on Banking Standards,[2] in 2014 the PRA and FCA developed the new Senior Managers and Certification Regime (SM&CR) to deliver clearer accountability at banks. This year we will finalise policy, including the extension of the SM&CR to insurers, building on the current Senior Insurance Managers Regime (SIMR), and continue our work on the evaluation of firms' implementation of the new regimes.

We will continue to review firms' governance arrangements in areas such as remuneration practices, dividend distributions, and corporate governance at board level. At the international level, drawing on the work of the Financial Stability Board's (FSB) Working Group on Governance Frameworks, we will support efforts to strengthen governance to mitigate misconduct risks, and continue to support the work of the FSB's Compensation Monitoring Contact Group, including further work on the role incentives and compensation tools can play in addressing misconduct risks.

Ensure that firms are adequately capitalised, and have sufficient liquidity

Our objective to promote the safety and soundness of PRA-authorised firms is delivered in part through ensuring that firms have adequate financial resources for the risks they are running or planning to take. We assess the financial resilience of firms through our supervision at firm and sector level, and use stress testing to assess how firms cope with extreme scenarios.

In the coming year, we will assess the adequacy of capital and liquidity resources of firms in the banking sector through a range of measures. We will also continue to assess credit risk and asset quality and to consider the level and drivers of risk-weighted assets. Reviews will take into account firms' implementation of financial resilience related policy – both domestic, eg reforms to the Pillar 2 capital framework, and international, such as the liquidity coverage requirement. We will also finalise our groups policy, including our approach to supervising double leverage.

1 Policy Statement 26/17 'Authorisation and supervision of insurance special purpose vehicles', December 2017: www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles.
2 See 'Banking Commission publishes report on changing banking for good', 19 June 2013: www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/.

We will be involved in negotiating policy in international forums, including the Basel Committee on Banking Supervision (BCBS) and FSB, and at the European level, for example as part of the negotiations on the Capital Requirements Regulation (CRR) II. The Basel III reform package was endorsed in December 2017 and consisted of:

(i) wholesale revisions to the measurement of credit risk (internally modelled and standardised approach), operational risk, and the credit valuation adjustment for derivatives and securities financing transactions;

(ii) the finalisation of the leverage ratio framework; and

(iii) the phasing in of a 72.5% capital output floor based on the revised standardised approach.

While the package has an implementation date of 2022 for most reforms, we will be monitoring how and when the new standards will be implemented in the United Kingdom, as this will depend on the implementation of the EU Withdrawal Bill and any transitional arrangements.

In the insurance sector, firms will also be required to maintain robust balance sheets and manage risks effectively. For all insurers, we continue to adapt our supervisory approach to focus on core balance sheet risks arising from complex products and asset exposures, and will monitor insurers' business models and the effects they have on firms' safety and soundness. In our review of Solvency II internal model applications, we will continue to ensure that models are robust and adequately calibrated.

At a sector level, for life insurers we will conduct asset reviews (including of illiquid assets – see the investment risk and asset quality section below), business model analysis and reviews of capital management, focusing on Solvency II capital regeneration; and for London Market and other relevant firms, reviews will cover exposure management, including reinsurance arrangements, and reserving adequacy for long-tail or casualty lines.

At the international level, we will continue to be actively involved in the development of the Insurance Capital Standard (ICS) by the International Association of Insurance Supervisors (IAIS). The ICS is expected to be adopted by the IAIS in 2019 and implemented from 2020. The IAIS will continue to run its annual identification process for G-SIIs, with the next three-year review of the G-SII Assessment methodology taking place in the coming year. This will take into account the outcome of the activities-based assessment (ABA) and cross-sectoral work. We will monitor the development and implementation of International Financial Reporting Standards (IFRS) 17 which will replace IFRS 4 on accounting for insurance contracts from 1 January 2021. We will also continue our engagement in Europe, eg with EIOPA.

Stress testing

Stress testing of firms is one of the key tools to support the Bank's microprudential and macroprudential objectives.

Banking stress tests examine the potential impact of a hypothetical adverse scenario on the individual institutions that make up the banking system, and on the system as a whole. This allows the PRA and Bank to assess banks' resilience and make sure they have enough capital to withstand shocks, and to support the economy if a stress does materialise.

A number of large UK insurance groups will take part in the 2018 EIOPA stress test exercise.[1] This will be used to assess the resilience and vulnerability of both life and general insurers to a combination of economic and non-economic scenarios. The exercise runs from May to November 2018 with an expected results publication date of December 2018. The PRA will be fully involved in reviewing the stress test results of UK participating groups and contributing to the design and delivery of the exercise at EIOPA.

Investment risk and asset quality

Taking a risk-based approach, we will review firms' asset quality and investment risks. Where we find weaknesses, we will address them appropriately through supervisory action and setting regulatory requirements.

Since the introduction of Solvency II, UK life insurers have increased their holdings of illiquid assets such as infrastructure, commercial real estate and equity release mortgages to back annuity liabilities. These assets can be a good match for long-term annuity liabilities. However they can also be complex and may lack observable market prices as well as external credit ratings, making it difficult to assess the investment risk firms are taking. In 2017 we published our final policy on assessing the appropriateness of the matching adjustment benefit claimed by firms in respect of illiquid assets, including equity release mortgages.[2] We will continue to review firms' risk management and governance of these assets, including their internal ratings. These reviews will be targeted at those firms with large and complex exposures.

The Prudent Person Principle in Solvency II is an important safeguard against concentration risk. It requires insurers to invest only in assets where they can properly identify, measure, monitor, manage, control and report the risks. In 2018 we plan to consult on a supervisory statement on our implementation of the Prudent Person Principle.

For the banking sector, we continue to progress work on how firms are implementing IFRS 9. While it is not for us to set, interpret or enforce accounting standards, we have issued – and will continue to issue – communications to firms where the application of the accounting standards has an impact on our statutory objectives. These have included our expectations of the implementation of expected credit loss (ECL) accounting requirements, consistency and disclosure.[3] Supervisors will continue to work closely with firms to monitor implementation and any impact on capital. We will also continue to contribute to the work being carried out internationally and domestically to ensure that any implications for the regulatory capital regime are identified and addressed. Continuing engagement with trade bodies, auditors and global accounting and auditing standards setters will also help to identify any guidance needed for an orderly, prudent and consistent approach to implementation.

Develop our supervision of operational resilience

Operational resilience is a high priority initiative for us and other areas of the Bank. The Bank's financial stability objectives could be undermined by disruption to firms' ability to provide essential and systemically important functions.

1 EIOPA's exercise is aimed at groups across Europe to assess the resilience and vulnerability of both life and general insurers to a combination of economic and non-economic scenarios. The exercise runs from May to November 2018 with an expected results report publication date of December 2018.

2 Supervisory Statement 3/17 'Solvency II: Matching adjustment – illiquid unrated assets and equity release mortgages', July 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/solvency-2-matching-adjustment-illiquid-unrated-assets-and-equity-release-mortgages-ss.

3 Letters to firms setting out the PRA's expectations and other communications are available on the Bank's website at: www.bankofengland.co.uk/prudential-regulation/letter/2017/transition-disclosures-for-ifrs9-financial-instruments.

Over the coming year we will continue to develop the microprudential supervisory approach to operational resilience. This includes identifying the firms where an operational failure could have a significant impact on the real economy and considering the level of resilience we expect firms to demonstrate. We continue to work with the Bank and other authorities, including the FCA, to make sure we approach the issue in a coordinated manner. We intend to publish a joint paper to obtain feedback on our thinking and will use this to inform our approach.

Our assessment of firms' cyber and operational resilience will continue and develop this year, closely aligned with the Bank and the FCA. The Bank also remains committed to its established exercise programme, executed in partnership with industry participants. This year, we will run another sector-wide exercise to assess the sector's ability to respond to major disruption.

International engagement remains key, since firms operate internationally and operations span across borders. We will work through the Basel Committee, the G7 and other international bodies to push for increased international coordination.

Ensure that banks have credible plans to recover from stress events, and improve bank and insurer resolvability

During the financial crisis, governments were forced to bail out failing banks, some of which were too big to be allowed to fail. As part of addressing the 'too big to fail' problem, firms are required to draw up recovery plans. We expect firms to undertake recovery planning so that they are ready for periods of financial stress, can stabilise their financial position, and recover from financial losses. We published our expectations on recovery planning in December 2017.[1]

A significant milestone was reached in the progress to ending 'too big to fail' with the publication of the Bank's policy on the minimum requirements for own funds and eligible liabilities (MREL) in November 2016.[2] A consultation on policy for internal MREL (the distribution of MREL resources within groups) was also published in October 2017.[3] From 1 January 2022, the largest banks in the UK will be required to maintain sufficient resources to allow them to be resolved in an orderly way, so as to preserve critical functions without risk to public funds.

Structural reform and the implementation of our policy on operational continuity in resolution by 1 January 2019 will also contribute to the programme. Supervisory focus will then shift to steady state monitoring of the ring-fence, while firms continue to develop capabilities in other areas of the reforms, including valuations, and continuity of access to financial market infrastructures.

This activity supports the statutory objectives that we, as prudential regulator, and the Bank, as resolution authority, have in relation to ensuring that institutions are resolvable.

We continue our work with the Bank's Resolution Directorate to ensure firms have orderly wind down plans. The coming year will see the completion of Phase 3 of our solvent wind down work with Category 1 investment banking subsidiaries with material trading activities, continued progress on earlier phases of work with UK banks, and ongoing collaboration with international regulators to ensure a coordinated and effective approach.

1 Supervisory Statement 9/17 'Recovery planning': www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss.
2 News release 'New Bank of England rules bring UK closer to ending taxpayer bailouts': www.bankofengland.co.uk/news/2016/november/new-boe-rules-bring-uk-closer-to-ending-taxpayer-bailouts.
3 Bank of England Consultation 'Internal MREL – the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and further issues', available at: www.bankofengland.co.uk/paper/2017/internal-mrel-the-boes-approach-to-setting-mrel-within-groups-consultation.

For insurers, we will continue to work on resolution plans for G-SIIs and other relevant firms. Working with the Bank's Resolution Directorate, we will also continue to make the case for an insurer resolution regime.

Facilitate effective competition

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

In March 2017, the Government sent the PRC its first recommendation letter about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance its objectives and when considering the application of the regulatory principles set out in FSMA.[1] The letter indicated that the Government is keen to see more competition in all sectors of the financial services industry, particularly retail banking. This includes minimising barriers to entry and ensuring a diversity of business models, and recognising differences in the nature and objectives of business models and ensuring burdens are proportionate.

In the coming year, we will continue to deliver against our secondary competition objective by:

- assessing the competition implications of our policies and checking for any unintended distortions to competition;
- implementing policies to facilitate internal-rating based model applications from smaller banks,[2] and refining the Pillar 2A capital framework;[3]
- facilitating market entry in the banking sector through the joint PRA/FCA New Bank Start-up Unit,[4] and reviewing how we might improve the current authorisation process to facilitate the entry of new insurers;
- building on the successful implementation in 2017 of the new UK regime for Insurance Linked Securities (ILS), which provides an alternative to traditional reinsurance products;
- making sure that stand-alone ring-fenced banks are not unduly burdened compared to those that form parts of universal banking groups; and
- mitigating the risk that the implementation of IFRS 9 in January 2018 unduly penalises small firms through the impact on some credit portfolios.

1 Information about the PRC and HM Treasury's letter are available on the Bank's website at www.bankofengland.co.uk/about/people/prudential-regulation-committee.
2 Policy Statement 23/17 'Internal Ratings Based (IRB) approach: clarifying PRA expectations', October 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/internal-ratings-based-approach-clarifying-pra-expectations.
3 Policy Statement 22/17 'Refining the PRA's Pillar 2A capital framework', October 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/refining-the-pra-pillar-2a-capital-framework.
4 See the dedicated web page for more information and materials at www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit.

Deliver a smooth transition as the UK withdraws from the EU

As the United Kingdom withdraws from the European Union, we expect the UK financial system to stay very large and it may, over time, become more complex as firms' legal structures adapt to the new relationship. If not managed properly, this could reduce the visibility supervisors have over the overseas firms operating in the United Kingdom. This could place greater demands on supervision, and could pose challenges for effective resolution, which in turn requires deep supervisory cooperation.

In December 2017, we issued consultations on proposals for the authorisation and supervision of international banks and insurers. The foundation to our approach to preparations for EU withdrawal remains the presumption that there will be a high degree of supervisory co-operation between the UK and the EU. In March 2018, we welcomed the agreement at the EU Council for a transition period until the end of 2020 as part of the UK's withdrawal agreement with the EU, and published the final policy alongside a letter to firms outlining our approach to authorisation.[1] This approach takes account of the Government's commitment to bring forward legislation, if necessary, to create temporary permission regimes to allow relevant firms to continue their activities in the United Kingdom for a limited period after withdrawal. In the unlikely event that the Withdrawal Agreement is not ratified, this provides confidence that a back-stop will be available. In light of this, we made clear to firms that they could plan on the assumption that PRA authorisation will only be needed by the end of the implementation period.

The scale of the authorisation challenge is significant. In seeking authorisation to carry on PRA-regulated activities, firms will need to meet the Threshold Conditions for authorisation, and we will consider the extent and nature of the firm's presence in the United Kingdom in determining whether those conditions are met.

In their preparations, firms have been strongly encouraged to discuss their approach and any issues with their usual supervisory contact at the PRA. This will help us to understand the changes, at both the firm and sector level, so that the current levels of safety and soundness can be maintained in the face of any additional risks posed. In addition to any risks to firms, we will also seek to identify any implications for our objectives of insurance policyholder protection, and facilitating effective competition. Effective engagement with our regulatory counterparts, in Europe and elsewhere, is an important part of this work to ensure that firms remain supervisable in preparation for, and after, EU withdrawal.

We will continue to ensure that there is a fully functioning legal and regulatory framework for financial services. EU law is deeply embedded within the UK's domestic regulatory regime as a large proportion of financial services regulation has been legislated at an EU level. The current body of EU law (the Acquis) will be converted into UK law through the passage of the EU Withdrawal Bill and technical changes will be made through associated Statutory Instruments. This process will also involve reviewing and amending, where necessary, the PRA Rulebook that applies to PRA-authorised firms, to ensure it remains operable and coherent in light of EU withdrawal.

1 Please see the News Release for the final policy, and letters from Sam Woods and Jon Cunliffe, March 2018: www.bankofengland.co.uk/news/2018/march/update-on-the-regulatory-approach-to-preparations-for-eu-withdrawal.

Operate effectively

As part of the Bank's commitment to transform the way we work,[1] we will continue to drive effective prioritisation to make our structures more fluid. We will provide targeted training and development to build expertise in our people, and will bring together people with different areas of expertise, skills and outlook to achieve our statutory objectives.

Embedding the plan for PRA IT

We will continue to leverage and develop existing capability to provide improved management information to support the assessment of firms. This will be underpinned by continued incremental improvements to data storage and analytics. We will also undertake work to identify whether the application of new machine learning techniques would further improve the efficiency of our operating procedures.

Risks to the delivery of the PRA Business Plan

Operating in a complex and fast-moving environment inevitably gives rise to risks to the delivery of the PRA Business Plan. These risks are monitored, actively mitigated (where possible), managed and reported to the PRC and Executive Committee on a regular basis.

Unforeseen events

The nature of our environment means that we deal with unforeseen events that may arise internationally and domestically and which require a swift regulatory response. Depending on the scale and nature of these events, they can lead to significant re-prioritisation of Business Plan deliverables. Any crystallisation of risks within firms, adverse change in the economic environment, or other changes within or outside the United Kingdom, may impact the safety or soundness of firms. While recovery and resolution planning and stress testing will reduce the impact of firm failure on financial stability, a large and wide-ranging shock that impacts financial stability remains a risk.

Execution risk

We continue to manage an extensive landscape of regulatory and legislative change and this will place additional constraint on resource which may compromise our ability to carry out our obligations as planned. The most significant execution risks include: firms being unable to submit and/or we are unable to process the necessary regulatory transactions ahead of withdrawal from the EU; and that we lose supervisory visibility of risks posed by firms' structural or business model changes that could undermine our objectives, risking the disruption of critical economic functions.

Dependencies

We are reliant on the FCA for the provision of certain IT systems and any degradation of service will impact our ability to deliver our obligations. The FCA provides upgrades and fixes to ensure a maintained service.

Our policymaking is often dependent on overseas authorities who lead on timings and requirements for delivery of legislative and regulatory change. The outcome of international policy negotiation could also differ from current PRA and Bank objectives which, in certain circumstances, could weaken our current approach. Maintaining external policy relationships is key in ensuring that new policy requirements are in the best interest of providing safety and soundness, maintaining financial stability in the United Kingdom, and meeting our statutory objectives.

1 For more information, see the Vision 2020 section (pages 30-31) of the Bank's Annual Report and Accounts – 2017: www.bankofengland.co.uk/annual-report/2017.

Internal factors

We will continue to attract, recruit and retain high-quality people in a range of disciplines and with the right technical expertise to undertake our 'business-as-usual' activities and strategic goals. We also need to be able to retain staff through appropriate terms and conditions, training, and development opportunities. Failure to recruit and retain people could lead to work being delayed, stopped or delivered to a lower standard.

Our preparation for the implementation of General Data Protection Regulation by 25 May 2018 is a continued area of focus.

Measuring progress

We draw on a variety of information to monitor the progress of delivery against our statutory objectives, strategy and business plan on an ongoing basis.

For example, we assess the success of our supervisory approach through: i) self and peer reviews where staff assess their own performance and receive independent challenge at regular intervals, as well as reviews carried out by other bodies (such as the IMF); ii) regular reviews of how firm-specific risks are being managed; and iii) firm feedback and external reviews.

The PRC and the Executive Committee receive information on a regular basis, both quantitative and qualitative measures and indicators, to enable an assessment of delivery against the PRA strategy, business plan, statutory objectives, and risk tolerance. This enables the PRC to report to the Chancellor on the adequacy of resources and provide sufficient information on supervisory processes and outcomes.[1]

1 The PRC letter to the Chancellor for 2017/18 is available on the Bank's website at: www.bankofengland.co.uk/prudential-regulation/publication/2018/the-adequacy-of-pra-resources-and-the-independence-of-pra-functions.

PRA Budget 2018/19

The PRA's budget for 2018/19 is £275 million, including implementation, project and transaction fees of £22 million, which is a decrease of £13 million on the 2017/18 budget[1]

While costs to cover EU withdrawal related work will increase, savings have been made through:

- a reduction in the Structural Reform Implementation Fee, reflecting the decrease in activity;
- a reduction in resource allocated to lower risk supervisory activity, to enable increased activity on EU withdrawal related work; and
- the depreciation of assets purchased from the FCA at the creation of the PRA in 2013 (ie legal cutover) being fully amortised.

We explain how the PRA proposes to fund its budget in CP7/18 'Regulated fees and levies: rates proposals 2018/19',[2] published alongside the Business Plan. This CP includes proposals for allocating the cost of the PRA's 2018/19 ongoing regulatory activities across PRA fee payers.

1 This figure is provisional and may need to be revised when final estimates for the PRA's pension costs are available.
2 April 2018: www.bankofengland.co.uk/prudential-regulation/publication/2018/regulated-fees-and-levies-rates-proposals-2018-19.

Abbreviations

Bank	Bank of England
BCBS	Basel Committee on Banking Supervision
CEO	Chief Executive Officer
Court	Bank's Court of Directors
CP	Consultation Paper
CRD	Capital Requirements Directive
CRD IV	CRR and CRD collectively
CRR	Capital Requirements Regulation
EIOPA	European Insurance and Occupational Pensions Authority
EU	European Union
FCA	Financial Conduct Authority
FPC	Financial Policy Committee
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act 2000 (as amended)
G-SIB	Global systemically important bank
G-SII	Global systemically important insurer
IAIS	International Association of Insurance Supervisors
ICS	Insurance Capital Standard
IFRS 9	International Financial Reporting Standard 9
IRB	Internal ratings based
MoU	Memorandum of understanding
MREL	Minimum requirement for own funds and eligible liabilities
NED	Non-executive director
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
SIMR	Senior Insurance Managers Regime
SMR	Senior Managers Regime
SM&CR	Senior Managers and Certification Regime

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