BANK OF ENGLAND
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Policy Statement | PS8/21

Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks

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Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 9/20 'Non-systemic UK banks: The PRA's approach to new and growing banks'.[1] It also contains the PRA's final policy, as follows:

- a final Supervisory Statement (SS) 3/21 'Non-systemic UK banks: The PRA's approach to new and growing banks' (Appendix 1);
- an updated SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', containing a reference to SS3/21 in paragraph 5.25 (Appendix 2); and
- an updated Statement of Policy (SoP) 'The PRA's methodologies for setting Pillar 2 capital', containing a reference to SS3/21 in paragraph 9.45 (Appendix 3).

1.2 This PS is primarily relevant to new and growing non-systemic UK-incorporated banks, although some banks in this category will have sufficient experience and resources to be able to move quickly to the standard expected of most established banks. This determination will depend on a number of factors, notably on: (i) whether the bank is part of an established domestic or international banking group; (ii) the size and complexity of its activities; and (iii) the extent of its available financial and non-financial resources. The PRA would consider each case on its merits and apply supervisory judgement to ensure that the policy is applied appropriately. See SS3/21 'Box 1 – Supervision of UK bank subsidiaries of international groups' for relevant examples.

1.3 This PS is relevant to the following types of banks:

- banks in their first few years of being authorised by the PRA as a deposit taker (typically less than five years post-authorisation); and
- prospective banks interested in and currently applying for authorisation as a deposit taker (UK applicant banks).

1.4 Chapter 6 of SS3/21 is relevant to non-systemic UK banks that are 'established' (typically beyond five years post–authorisation and in the 'without restrictions' stage of their lifecycle).

1.5 There are a number of types of banks and other PRA-authorised firms that are not covered in this PS. These include:

- banks incorporated outside of the UK authorised to accept deposits through a branch in the UK;[2]
- systemically important firms, referring to firms that are designated under the other systemically important institutions (O-SII) identification process;[3]

1 July 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/new-and-growing-banks
2 June 2019: CP 25/18 'The Bank of England's approach to amending financial services legislation under the European Union (Withdrawal) Act 2018' (October 2018) with near final policy in PS 5/19 of the same name.
3 PRA SoP 'The PRA's approach to identifying other systemically important institutions (O-SIIs), December 2002: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-pras-approach-to-identifying-other-systemically-important-institutions-o-siis-sop.

- building societies;[4]
- credit unions; and
- UK designated investment firms.

1.6 While this PS is not directly relevant to these firms, it may be of interest to them. This PS also does not alter the change in control process for buying an existing bank. Firms are encouraged to speak with their normal supervisory contact if further clarity is required.

Background

1.7 In CP9/20, the PRA proposed:

- that when banks grow and mature following authorisations, they should:
  - have greater clarity over the path to profitability, including how they will meet all relevant loss absorbing requirements;
  - strengthen governance and increase the independence of their board as they mature;
  - expect to invest significantly in risk management and controls, and have a mature control environment typically by five years after authorisation; and
  - develop their stress testing capabilities so they are prepared to transition to a PRA buffer set on a stress test basis.
- a change in the approach to calculating the PRA buffer for new banks. This would be calculated as six months' operating expenses and banks would move onto a buffer set on a stress test basis at five years after authorisation, or when they reach profitability, if sooner.
- that new banks should have solvent wind down (SWD) plans in place at the point of authorisation (or on exit from mobilisation), and maintain these until they move onto a PRA buffer set on a stress test basis.

1.8 The CP also reiterated[5] that, following exit from mobilisation (or upon authorisation if a bank does not follow the mobilisation route), new banks should also hold sufficient capital resources to meet Pillar 1 (P1), Pillar 2A (P2A), and buffers for at least 12 months. This is in addition to meeting actual capital requirements, buffers and, if applicable (subject to the resolution strategy) any minimum requirement for own funds and eligible liabilities (MREL) above Total Capital Requirements (TCR).

1.9 The PRA reiterated its expectations that capital buffers are not to be used in the normal course of business, or as part of a firm's base business plan,[6] and clarified its expectation that new and growing banks adopt a forward-looking approach to capital management, ensuring that planned capital injections are received sufficiently in advance to avoid the firm entering its buffers.

4 Building societies are subject to different legislation. However, the authorisation of new building societies will include the option of mobilisation, and the expectation for solvent wind down plans will apply.

5 March 2013: https://www.fca.org.uk/publication/archive/barriers-to-entry.pdf.

6 PRA SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP), December 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.

Summary of responses

1.10 The PRA received 17 responses to the CP. Respondents generally welcomed the PRA's proposals, but made a number of observations and requests for clarification, which are set out in Chapter 2 of this PS.

Changes to draft policy

1.11 Following consideration of respondents' comments, the PRA has made a number of changes to the draft SS to provide greater clarity on the PRA's expectations in specific areas. Changes to the proposals consulted on include:

- an amendment to paragraphs 1.1 and 1.5, to clarify the scope of firms covered by the policy;
- an amendment to paragraphs 2.2, 2.3, and 5.2 to clarify the PRA's supervisory approach for new and growing banks in relation to exiting the market in an orderly way, and the addition of paragraph 5.3 and Box 3 to outline orderly exit options;
- an amendment to paragraph 2.2 to clarify existing resolvability expectations that banks need to demonstrate on an on-going basis;
- an amendment to paragraph 2.9 to clarify that banks should continue to develop their approach beyond the five year target for maturity where appropriate;
- an amendment to Table 2 and paragraphs 3.4 and 6.1 to clarify the expectations around a firm's path to achieving profitability;
- an amendment to Table 2 and paragraph 3.11 to clarify the expectations around board independence and what is good practice;
- an amendment to Table 2 and paragraph 5.4 to apply further proportionality to recovery planning obligations;
- an amendment to paragraph 3.4 and an addition of paragraph 4.21 to clarify that banks are expected to plan for MREL needs and reflect these in their capital planning, if applicable;
- addition of paragraph 3.16 to highlight existing requirements and alignment with the Financial Conduct Authority (FCA) in the PRA's approach to a firm's risk culture;
- an amendment to paragraph 4.4 to clarify the 12-month capital expectation;
- an amendment to paragraph 4.7 and addition of Table 3 to introduce a clear definition of operating expenses;
- addition of paragraph 4.10 to clarify the interaction between the PRA buffer and the Capital Requirements Directive (CRD) buffers;
- addition of paragraph 4.12 to explain the PRA's proportionate approach to the new PRA buffer calibration;
- addition of paragraph 4.21 to clarify that it is the role of the Bank of England, as resolution authority, to set MREL;
- an amendment to paragraph 5.5 to clarify expectations on recovery plans;

- an amendment to paragraphs 5.7 and 5.9 to clarify the expectations around the board's responsibilities in relation to SWD planning and implementation; and

- an amendment to Box 2 to clarify expectations around SWD plans.

1.12 The PRA also made several language and typographical changes to the draft SS to provide clarity and improve readability.

1.13 The PRA considers that the changes to the SS are not significant and will not materially alter the cost benefit analysis presented in CP9/20. The changes have been made to provide clarity. However, the PRA has provided further analysis on the cost benefit and impact, addressing the responses received.

Implementation

1.14 The expectations in SS3/21 will take effect upon publication on Thursday 15 April 2021.[7]

1.15 The proposals set out in this PS have been designed in the context of the UK having left the European Union (EU) and the transition period having come to an end, as of Thursday 31 December 2020. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.[8] The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework.

7 The PRA buffer for new banks calculation will be rolled out over the course of the normal capital SREP cycle.

8 For further information, please see https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards.

2 Feedback to responses

2.1 The PRA must consider representations that are made to it in accordance with its duty to consult on its general policies and practices and must publish, in such manner as it thinks fit, responses to the representations.

2.2 The PRA has considered the responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions.

2.3 Overall, respondents welcomed the rationale for the new banks' buffer to facilitate the exercise of recovery options and supported the simplicity of setting it based on six months' operational expenses. A number of respondents welcomed the expectations proposed in the draft SS, including the maturity thresholds defined as a roadmap for the development of new and growing banks. Furthermore, respondents welcomed the emphasis on a 'clear path to profitability', and acknowledged that the PRA has rightly put a focus on profitability and expecting any new bank to be able to demonstrate that it has a sustainable and viable business model. The intention of the SWD was supported, recognising that it is a safe and efficient way for firms to exit the market in an orderly manner.

2.4 The chapters below have been structured broadly along the same lines as the chapters of the CP, with some areas rearranged to better respond to related issues. The responses have been grouped as follows:

- scope;
- expectations of new and growing banks;
- capital expectations of new and growing banks;
- orderly exit: recovery and resolvability; and
- the PRA's approach once banks are established.

3 Scope

3.1 One respondent suggested that the PRA expectations for new building societies should benefit from the same gradualist approach that was proposed for new and growing banks. The respondent also said that some of the measures proposed (including SWD) for new and growing banks should be made available, where appropriate, to established (non-systemic) banks and building societies.

3.2 The PRA expects the arrangements for new and growing banks to apply equally to new building societies, but acknowledges that there may be areas of divergence, given they are subject to different legislation. The authorisation of new building societies will include the option of mobilisation and the expectation for SWD plans will apply. The PRA has amended the SS3/21 to reflect this (paragraphs 1.1 footnote 5 and 1.5 footnote 9). Furthermore, the PRA is considering whether it is appropriate that banks should maintain SWD plans beyond the point at which they move onto a PRA buffer set on a stress test basis. Therefore the PRA has deleted from paragraph 5.9 the text 'until they move onto a PRA buffer set on a stress test basis'. Further clarification will be provided in due course.

3.3 One respondent said the reference to 'mutuals' did not make it clear whether this includes or excludes mutual banks and other regional mutual banks currently being established. The respondent supported a phased approach for new and growing banks but recommended the end point for mutual banks should be an appropriately tailored regime.

3.4 The PRA confirms that it intended for 'mutual banks' to be covered by the expectations in SS3/21. The approach proposed in the CP was intended to cover all new banks, whatever their ownership structure.

4 Expectations of new and growing banks

4.1 The PRA proposed that as banks grow and mature following authorisation, they should:

- have greater clarity over the path to profitability, including how they will meet all relevant loss absorbing capital requirements;
- strengthen governance and increase the independence of the board as they mature; and
- expect to invest significantly in risk management and controls, and have a mature control environment typically by five years after authorisation.

Proportionality

4.2 Two respondents highlighted the importance of proportionality in relation to new and growing banks, given the comparatively simple product suite, balance sheet structure, and resultant nature of the risk exposure. Similarly, another respondent commented that scaling back or simplifying certain requirements (e.g. regulatory reporting), or ensuring that new or existing requirements are implemented in a proportional manner for new and growing banks, would be helpful in enabling firms to effectively compete.

4.3 The PRA aims to be proportionate in the requirements for new banks in order to facilitate effective competition, and advance its secondary competition objective. The PRA's expectations are proportionate to the size and complexity of banks and take into account that a new bank is unlikely to meet all the expectations the PRA has of an established bank from inception, and in many cases that it will require time to build, and demonstrate capabilities. This flexibility is important given the diversity of new bank business models (including, for example, the fact that not all new banks have a simple product suite).

4.4 Additionally, to further enhance the PRA's proportionate approach, the PRA is in the process of developing a 'strong and simple' regime for regulating small banks and building societies. More detail can be found in Sam Woods' 'Strong and simple' speech,[9] and a discussion paper due to be published shortly.

4.5 Two respondents emphasised the importance of not using a 'one-size-fits-all' approach to new and growing banks, and one respondent noted that being a new bank does not necessarily translate into a lack of experience. The PRA agrees with this sentiment, noting that the PRA's judgement-based approach to supervision ensures that the approach to supervising new and growing banks is tailored to the circumstances of the particular bank in question.

4.6 Having considered these responses collectively, the PRA clarified in SS 3/21 its expectations in relation to board composition (footnotes 45 and 46 of Table 2; paragraph 3.11), acknowledging that these expectations were previously expressed as minimum expectations, which is not in line with a judgement-based approach to supervision. These expectations are now framed in terms of what the PRA considers to be good practice.

Path to profitability

4.7 The PRA proposed that banks should focus on reaching profitability and the ability to achieve organic capital generation within a reasonable time period following authorisation. The draft SS proposed that by around three years post-authorisation, the PRA would expect banks to have more

9 November 2020: https://www.bankofengland.co.uk/speech/2020/sam-woods-city-banquet.

clarity over their path to profitability, and by five years post authorisation banks should either be profitable or have a clear path to profitability, with definite capital support to achieve this.

4.8 Two respondents supported the emphasis on a 'clear path to profitability', with one respondent noting it was a helpful set of expectations for the management teams, boards and shareholders as those banks seek to grow and scale.

4.9 One respondent said the PRA should fully test the area of profitability at the point of entry by reviewing prospective new entrants' business plans in detail and undertaking detailed and forward-looking stress testing of those plans. The PRA undertakes a detailed assessment of business plans, including stress testing, as part of the application process. This assessment recognises that there is uncertainty in applicant's plans and forecasts, and that business models may need to evolve in light of the changing business environment post-authorisation.

4.10 Some respondents highlighted the reason for a five year time expectation for profitability was not sufficiently clear, as different business models may derive profitability sooner than five years and some may justifiably take significantly longer. Three respondents challenged the push for profitability, raising that it could have the unintended consequence of encouraging higher risk business models. In particular, respondents asserted that the expectation does not allow for variation in business models or take into consideration the impact of external factors. Additionally, one respondent commented that there may be a delay in recognising profit while it is independently verified and, at the point of reaching profitability, banks are likely to still have material accumulated losses.

4.11 The SS states that banks are often loss-making initially and that this is often a feature of new businesses. It does however state that this is not sustainable over the longer term and that banks should focus on reaching profitability within a reasonable time period. The SS provides a guideline for what the PRA considers to be a reasonable time period but the PRA recognises that a number of factors, including the nature of the business model and the economic cycle, could impact a firm's path to profitability. The SS3/21 has been amended in Table 2 and paragraphs 3.4 and 6.1 to reflect this. Flexibility is introduced with regards to the five year profitability expectation by clarifying that firms need to have a credible strategy to achieve profitability. This flexibility will be limited and in future will only be utilised in exceptional circumstances where the path to profitability is credible, and there are sufficient financial resources in place in advance to manage the risks around that path.

4.12 One respondent requested more clarity on the definition of profitability. Having considered this response, the PRA does not consider it necessary to provide more detail on this. The outcome firms should aim for, as outlined in the SS in paragraph 3.4, is reduced reliance on external capital support, which is achieved through reaching profitability and the ability to achieve organic capital generation within a reasonable time period following authorisation.

4.13 One respondent commented that the expectation to transition to the PRA buffer on a stress test basis within five years (or at the point of profitability), along with the expectations in relation to a bank's control environment would have a consequent impact on costs and profitability. The respondent also asked for an explanation of how the PRA intends to resolve the tension between these expectations and the proposals to facilitate diversity of banking models.

4.14 As outlined above, the SS has been amended to introduce some flexibility with regard to the five year profitability expectation. This does not translate into flexibility in relation to when a bank will transition to a PRA buffer based on stress testing, which is expected to take place after five years or at the point that a bank achieves a profit over a full year of trading, whichever is sooner; five years refers to five years of operation after authorisation without restriction. The calibration of the PRA buffer for new banks is time-limited and only designed to support new banks in the early years of operation. However, the SS acknowledges that the move to setting the PRA buffer based on stress testing may result in a sizeable increase in the amount of capital that a bank needs to hold. Therefore transitioning to the stress testing approach will usually be phased over two years to provide an incremental increase in the size of the buffer. The PRA expects banks to be prepared for this transition, both in terms of the quantum and stress testing capabilities (as outlined in Chapter 4 of the SS3/21). As referenced above, further work on developing a proportionate approach is being undertaken as part of the PRA's work on building its 'strong and simple' regime.

4.15 One respondent asked for greater clarity on what the expectation of 'definite capital support' means for firms at five years post-authorisation. The PRA's expectations in relation to capital management are set out in Chapter 4 of SS3/21. Definite capital support is defined as having a credible capital plan such that any new capital is injected well before capital requirements plus buffers are entered. Paragraph 3.4 of the SS has been amended to reflect this.

Development of PRA expectations as banks mature

4.16 Table 2 in the draft SS proposed how the PRA's expectations of banks would increase as the bank matures, with a focus on common areas where the PRA has seen new and growing banks struggle as they seek to become established banks: business model, governance, risk management, and capital.

4.17 One respondent considered that the target level of maturity could be achieved by new banks at a faster pace than that presented in Table 2 in the SS. The PRA highlights that, in addition to its primary objective of promoting safety and soundness, it has a secondary objective to facilitate effective competition, in so far as is reasonably possible, when pursuing its primary objective. The expectations set out in Table 2, and the wider SS, are calibrated to achieve this.

4.18 In relation to Table 2, one respondent cautioned against giving the impression that five years is the finishing line and that banks don't need to continue to enhance their approach beyond that point. The PRA accepts the importance of making this clear and the SS has been amended accordingly in paragraph 2.9.

Conduct risk

4.19 One respondent suggested that the importance of conduct risks could be given greater consideration in the SS, for example by elaborating on how the PRA will ensure internal governance arrangements are appropriate, and on how it will liaise with the FCA on the supervision of new and growing banks.

4.20 After considering the response, the PRA considers that its requirements and expectations relating to internal governance are sufficient. The PRA's approach to supervising internal governance is set out in the 'PRA's approach to banking supervision'.[10] The General Organisational Requirements Part of the PRA Rulebook in particular sets out the PRA's requirements in respect of internal governance. SS5/16 'Corporate governance: board responsibilities'[11] and SS28/15 'Strengthening individual accountability in banking'[12] also set out the PRA's expectations in relation

10 https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.

11 March 2016: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss.

12 July 2015: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss.

to internal governance. Firms are also expected to meet the expectations set out in the EBA 'Guidelines on internal governance'.[13]

4.21 The PRA has also considered the respondent's comment in relation to conduct risk. However, the PRA considers the SS to be sufficient in addressing matters of conduct risk. The FCA is the conduct regulator for firms prudentially regulated by the PRA. The PRA co-ordinates with the FCA in the exercise of its statutory functions, including supervision of new and growing banks. The PRA sets requirements in respect of conduct in the Conduct Rules Part of the PRA Rulebook, and the PRA's expectations are set out in SS28/15.

Board composition

4.22 The PRA expects boards of new and growing banks to evolve as the business grows. The established good practice is for new banks to have two independent non-executive directors at exit from mobilisation (or upon authorisation if a firm does not follow the mobilisation route), and the PRA's strong preference would be for banks to have independent non-executive chairs at this point. As they grow, established good practice is for banks to have a minimum of three independent non-executive directors, including the chair, within three years of authorisation. Depending on the size and complexity of the business, it may be appropriate for the bank to meet good practice by having a majority independent board within five years of authorisation.

4.23 One respondent commented that the PRA's proposed expectations should be explicitly aligned with the Financial Reporting Council Corporate Governance Code[14] (the FRC Code) provisions for the balance of a board, noting, for example, that Provision 11 of the FRC Code states that 'at least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent'.

4.24 In terms of the FRC Code, the PRA endorses this via SS5/16 'Corporate governance: Board responsibilities',[15] and uses it as a benchmark of good governance in its supervision of firms of all sizes. However, the FRC Code is designed specifically for UK premium-listed firms, whereas most new and growing firms are unlisted. Aligning fully to the FRC Code could impose a one-size-fits-all governance structure on new and growing banks that may not be appropriate to their size, complexity, organisational structure, or business model. The FRC Code does, however, contain useful insights and it may be good practice for new and growing banks to gauge how their governance arrangements align to market practice.

4.25 The PRA expects boards of new and growing banks to have adequate collective, relevant experience to understand the bank's business model and key risks, and to set its strategy. One respondent asserted that the PRA should recognise that a new bank is unlikely to be able to attract the key skill sets for its board all at once. The PRA recognises this challenge, but notes that some banks have been highly successful in recruiting appropriate skillsets to their boards through making use of open and competitive recruitment processes. Therefore the PRA considers the expectation to be appropriate.

13 Following EU withdrawal, the PRA website hosts those EBA Guidelines with which firms are expected to make every effort to comply. The EBA 'Guidelines on internal governance' are available at: https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/december/Guidelines%20on%20internal%20governance%20-%20revised.pdf. For further information, see the PRA SoP 'Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU', December 2020: https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop-december-2020.pdf.

14 https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code.

15 December 2018: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss,

4.26 Having considered these responses, the PRA has decided not to amend the policy as proposed.

Risk culture

4.27 One respondent said that the PRA should consider drawing parallels with the FCA's work on risk culture and clarify that start-up banks should seek to have the right risk culture from the start.

4.28 The PRA co-ordinates with the FCA in policymaking and supervision, including in relation to culture in financial services. Any concerns in respect of a firm's risk culture are likely to be relevant to both regulators. The PRA sets requirements for factors that affect a firm's risk culture. The Risk Control Part of the PRA Rulebook sets requirements in respect of a firm's overall risk management, and the General Organisational Requirements Part of the PRA Rulebook sets requirements in respect of its overall governance arrangements, including that firms monitor and evaluate the adequacy and effectiveness of their systems, internal control mechanisms, and arrangements. The Remuneration Part of the PRA Rulebook also sets requirements in respect of remuneration practices, which are linked to a firm's overall risk culture and risk-taking appetite. SS5/16 also sets expectations in respect of a firm's risk culture.

4.29 The SS has been updated in paragraph 3.16 to highlight these existing requirements and expectations.

Other

4.30 One respondent requested further detail on how the PRA would assess whether banks have met its expected standards of risk and capital management as they grow.

4.31 The PRA's supervisory approach relies on making judgements based on evidence and analysis as outlined in 'The PRA's approach to banking supervision';[16] paragraphs 58-69 outline the PRA's expectations on risk management and controls, and paragraphs 70-90 outline expectations around capital. Having considered this response, the PRA has decided not to provide further detail beyond what was already provided in the draft SS.

4.32 One respondent requested that the PRA give a strong indication of an applicant's prospects during application to assist in capital raising.

4.33 The 'New Bank Start-up Unit guide'[17] outlines the process of becoming a new bank and the PRA's expectations at each stage. Having considered this response, the PRA notes that it cannot pre-judge the decision whether to approve an application. No changes have been made to the SS.

16 Available at: https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.
17 Available at: https://www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit.

5 Capital expectations of new and growing banks

PRA buffer proposal

5.1 The PRA proposed that the PRA buffer for new banks would be calculated on the basis of six months' projected operating expenses. The PRA also explained that the purpose of the buffer is to allow such banks time to find alternative sources of capital or make business model adjustments in the event of a loss of investor support.

5.2 Two respondents welcomed the simplicity of the calculation, and the clarity in relation to the rationale. However, some respondents expressed concerns that the proposal would result in an increase in the size of the buffer compared to the current approach. One respondent asserted that this proposal would further extend the benefit larger banks have and further embed the competitive disadvantages in capital requirements for new and non-systemic banks, with another respondent being concerned that it would put considerable strain on new banks at a critical time in their development.

5.3 The PRA notes that the new calibration methodology would frequently result in a significantly reduced PRA buffer for new banks compared to a buffer calibrated using the methodology for established banks, which is calculated based on the amount of capital needed to remain above Total Capital Requirement (TCR) under a severe but plausible stress scenario. This new calibration of the PRA buffer continues to recognise the need to take a proportionate approach to the level of capital relative to the financial stability risks posed by new banks. The PRA notes that the PRA buffer does not necessarily provide sufficient capital for banks to survive a stress or enact a SWD, and boards of new and growing banks should be aware of this when setting their internal capital risk appetites.

5.4 The PRA recognises that the change to the PRA buffer calibration will impact new banks' buffers to a varying degree. The PRA's impact analysis confirmed that, depending on business models and associated operational expenses, for some firms the buffer will remain broadly similar or decrease, while for others it will increase.

5.5 The PRA's new approach to the buffer calculation continues to facilitate effective competition without prejudice to the PRA's general objective. In particular, the new methodology should ensure greater consistency across new banks through reducing the amount of judgement involved in the wind down approach. New banks should expect this approach to be followed. However, the SS has been amended in paragraph 4.12 to note that the PRA will apply supervisory judgement to ensure its approach remains proportionate to the benefits expected from the new PRA buffer calibration and the risks posed by banks. This flexibility will only be used in exceptional circumstances.

5.6 Some respondents noted the potential unintended consequences of the proposed calculation, highlighting that banks may be incentivised to keep operating costs low at an early stage and underinvest in PRA priorities such as risk controls and governance. The PRA acknowledges this but notes that there are other, more appropriate, supervisory tools available should the relevant supervisor identify that a bank is not investing appropriately to ensure adequate non-financial resources to enable effective oversight and control of the business.

5.7 One respondent noted that one benefit of performing the wind down calculation is to drive new banks to include break clauses in property lease contracts. The PRA considers that the same benefit is achieved through developing a robust SWD plan. As articulated in the SS, the PRA expects that new and growing banks should maintain their SWD plans, regularly updating them to ensure they remain appropriate as the business develops.

5.8 One respondent noted that if the Pillar 2B calculation is a simple multiplier of costs, then it will cease to be private information. In this case, given the mechanical nature of the Pillar 2B calculation, the PRA considers this level of transparency to be acceptable.

Alternative approaches

5.9 Three respondents suggested alternative options to calculating the PRA buffer, including; (i) retaining the wind down approach if a bank has a robust SWD plan in place; (ii) allowing income to offset operating expenses; (iii) proceeding with the operating expenses calculation but with certain non-essential elements removed; or (iv) allowing banks to choose the lower of the current approach (wind down) and new method (operating expenses). One respondent suggested that an alternative approach could involve setting the PRA buffer on the basis of SWD costs up until break-even is achieved, then on the basis of six months' operating expenses (as per the operational continuity in resolution (OCIR) definition), before moving to the stress-test based methodology after observing profitability for one full trading year.

5.10 The PRA welcomes these alternative suggestions, but notes that the purpose of the change is to increase simplicity of the calculation and encourage consistency in approach across new banks. The alternative approaches would not achieve this, retaining instead significant elements of judgement in the calculation and therefore the scope to understate it. In addition, it would not be appropriate to link the calculation to OCIR, given the proposal in CP20/20 'Operational continuity in resolution: Updates to the policy'[18] to change the definition from six months of critical service operating costs for both 'intra-entity' and 'intra-group' costs, to two months of critical and essential service operating costs for the 'intra-group' costs.

Cost benefit analysis

5.11 Two respondents requested greater detail on the impact of the proposals in the form of cost benefit analysis (CBA).

5.12 One response requested further justification of the proposed approach to capital buffer setting, including how the proposals facilitate effective competition. The PRA is committed to providing a qualitative CBA for changes to SSs when it is judged appropriate to do so, notwithstanding that the Financial Services and Markets Act (FSMA)[19] does not apply. Further information is set out here to aid transparency and consider the competition angle.

5.13 Capital buffers are the capital that banks maintain in excess of regulatory minimum requirements. For established banks, these buffers are calibrated to allow them to absorb losses that may arise without restricting the provision of financial services, including the supply of credit and support for market functioning. The calculation of buffers for these firms is informed by the stress tests that are carried out annually, with the intention that the firms can absorb losses and maintain lending to the real economy without breaching their capital minima.

5.14 New banks – especially at start up / in their early years – have relatively small balance sheet positions, possess little data on how their business model will perform under stress, are usually loss-making as they have not reached break-even scale, and may pursue an aggressive growth strategy. The capital strain associated with high growth rates and a lack of external capital support would require these banks to hold very large capital buffers if it were the PRA's appetite for them to maintain lending through – and survive – the stress.

18 October 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/operational-continuity-in-resolution.
19 Section 138J of FSMA.

5.15 This had previously been identified as a material barrier to entry,[20] and the PRA's approach to capital buffers for new and growing banks is to calibrate them to allow such banks time to find alternative sources of capital or make business model adjustments, in the event of a loss of investor support. This approach delivers smaller capital buffers than the stress-testing based approach, reducing a barrier to entry.

5.16 The PRA's capital buffer for these banks is currently based on a wind down cost calculation. As noted in CP9/20, in the PRA's experience, a number of banks have interpreted this inconsistently and taken different approaches to this calculation. In order to deliver more consistent outcomes, and in a simple and clear way, the PRA proposed that the PRA buffer for new banks should be calculated as six months' operating expenses. This time horizon is considered reasonable to find alternative sources of capital or make business model adjustments as noted above. This ensures that barriers to entry are still reduced as it results in smaller capital buffers than, for example, a stress testing approach, or a stricter calculation of SWD costs, and thereby continues to support the facilitation of competition.

5.17 Wind down costs are typically driven by staff costs and redundancy payments; asset sale haircuts; contract breakages (e.g. office rental agreements); and administrators' fees. The costs are typical of a business that is ceasing its operations, and while certain general operating costs fall as the scale of the firm reduces, this is offset against additional one-off costs specific to the process. Alternatively, six months' operating expenses relates to a fully operational business and the drivers are typically staff costs; rental fees; technology; and marketing/discretionary spend.

5.18 Compared to current capital buffers for new and growing banks, the new policy will lead to very little change in aggregate, to the capital requirements for such banks. As a result, the weighted average cost of capital for new banks as a whole is expected to remain relatively unchanged.

5.19 Nevertheless, the impacts of the policy will differ across this cohort of banks. This means that the impacts on each bank's cost of capital will also vary. To gauge the incremental impacts, the PRA relied on an approach followed in the Bank of England's published CBAs on optimal capital and MREL requirements.[21] It was also assumed that new and growing banks do not use existing voluntary capital surpluses to meet higher requirements, but instead, raise capital to meet the higher requirements. This raises the weighted average cost of capital for these banks. Those new and growing banks that experience a decline in requirements under the policy are assumed to replace equity with lower costing funding sources. This lowers the weighted average cost of capital for these banks.

5.20 Consistent with previous CBAs, this analysis assumes a baseline cost of equity of 11% and non-equity funding of 1%. The impacts under progressively higher costs of equity capital (up to 20%) were also estimated, assuming that new and growing banks command higher risk premiums compared with larger, more well-established banks on which the 11% baseline is based.

5.21 The modelling showed changes in the weighted average cost of capital across the cohort of banks, ranging from a seven basis point reduction to a seven basis point increase under the low-end 11% cost of equity assumption, and from a 14 basis point reduction to a 12 basis point increase under the 20% high-end cost of equity assumption.

[20] Available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2014/review-of-requirements-for-firms-entering-into-banking-sector.

[21] Financial Stability report December 2015: https://www.bankofengland.co.uk/financial-stability-report/2015/december-2015 and December 2020: https://www.bankofengland.co.uk/news/2020/december/boes-review-of-mrel.

5.22 As a result of this work, the proposal to calculate the capital buffers using a six month operating expense projection will be retained. However, as outlined in the SS paragraph 4.12, the PRA will continue to be able to apply supervisory judgement where it is clear that a firm is a significant outlier.

5.23 The PRA considers that given (i) that there is a small aggregate impact of the proposed changes; and (ii) it is a simplification of the approach which will bring greater consistency to buffer setting, its proposed approach continues to facilitate effective competition without prejudice to the PRA's general objective. The PRA will continue to apply supervisory judgement to ensure its approach remains proportionate to the benefits expected from the new PRA buffer calibration and the risks posed by banks.

Clarifications

5.24 Many respondents supported the principle of a simple calculation methodology but flagged that this does require a clear definition as to which categories of expenditure are included within 'operating expenses'. On the broadest measure of expenses this method may actually increase, rather than decrease, capital requirements. The respondents suggested that if increasing capital requirements for early stage banks is not the intended outcome of this proposal, banks should be able to choose either the requirement calculated on the existing basis, or that calculated on the new method, whichever is lower.

5.25 The purpose of the proposal was to ensure greater consistency across the industry, and stripping out certain elements of the calculation would undermine this. The respondents' suggestion would introduce complexity back into the regime.

5.26 The PRA has amended the SS to introduce a clear definition of operating expenses (paragraph 4.7 and the addition of Table 3). Six months' operating expenses should be calculated as a sum of the following:

- expenses of share capital repayable on demand;
- other operating expenses;
- administrative expenses (comprising staff and other administrative expenses);
- depreciation (of property, plant and equipment); and
- depreciation of investment properties.

5.27 One respondent asked for clarity on the interaction between the PRA buffer and the Capital Requirements Directive (CRD) buffers. Paragraph 4.10 has been added to the SS to clarify that this interaction remains unchanged. To avoid double counting between the buffers, the component of the PRA buffer that relates to operating expenses is calculated as the excess amount of capital required over and above the capital conservation buffer. The countercyclical capital buffer (CCyB) is not part of this calculation.

PRA buffer transition

5.28 The PRA emphasised that its proposed approach to setting the PRA buffer for new and growing banks is time limited and that from the point of authorisation banks should be developing their stress testing capabilities. The move to setting the PRA buffer based on stress testing may result in a sizeable increase in the amount of capital a bank needs to hold, and as such a transition to the stress testing approach would usually be phased over two years to provide an incremental increase in the size of the buffer.

5.29 One respondent welcomed the clarity that, from the point of authorisation, new and growing banks should undertake stress testing as part of their ICAAP and business planning process so as to transition smoothly to setting the PRA buffer on the stress testing approach, noting that stress testing is inherently more challenging for new banks given the lack of historical data.

5.30 Some respondents asked for more detail on the proposed transition to a stress testing approach to setting the PRA buffer, with one respondent asking for clarity on the extent to which changes in requirements could be phased in at the discretion of supervisors, rather than changing as a result of hard deadlines. Another respondent expressed strong support for an approach that is based on an agreed glide path, allowing firms to make the transition to new requirements gradually, rather than imposing a 'cliff edge'.

5.31 The PRA recognises the challenges some firms face in making this transition, and the draft SS already provided for some flexibility by stating that the PRA would base its determinations on transitioning onto the stress testing approach on circumstances, but that this would usually be phased over two years. As such, the PRA has decided not to make any amendments to this element of the SS.

5.32 One respondent requested confirmation that stress tests conducted for the purpose of calculating Pillar 2A add-ons for credit risk would not be duplicative of stress testing conducted to calculate the PRA buffer for established banks.

5.33 Risks captured by Pillar 2A are different to risks captured by the PRA buffer. Stress testing conducted for the purpose of calculating Pillar 2A is therefore distinct from stress testing conducted for the purpose of calculating the PRA buffer.

Capital management

5.34 The PRA proposed expectations in relation to capital management, including the need for banks to manage their capital position on a forward-looking basis and to plan for capital injections to be provided sufficiently in advance to avoid entering buffers.

5.35 One respondent asked for an explanation of what the PRA deemed to be 'sufficiently in advance', and also for guidance on the conditions and scenarios for when it is acceptable for a new bank to enter into its buffer.

5.36 It is for a bank's management team to determine the appropriate timeframe for capital injections, but there will be an ongoing dialogue with the relevant supervisor and any concerns will be highlighted, and appropriate action taken, if there is evidence of poor capital management. SS31/15[22] outlines the circumstances within which a bank can use its buffer, noting that it should not be used during the normal course of business or as part of its base business plan.

5.37 The PRA proposed actions it may take if it becomes clear that a bank does not have a sufficiently forward-looking approach to capital management, including more intensive supervision as well as other relevant supervisory tools.

[22] https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.

5.38 One respondent suggested that the PRA should consider whether any actions taken to impact the capital buffers on the basis of past performance may undermine the investment case for new investors to support banks' development.

5.39 The PRA acknowledges this dynamic but considers that it is for the bank's management team to operate effectively to avoid such an outcome. It is appropriate for the PRA to use relevant supervisory tools to address risks to its objectives arising from poor capital management.

5.40 Having considered these responses, the PRA has decided to publish the final policy as proposed.

Capital in mobilisation

5.41 One respondent suggested that a buffer should not be applied from the beginning of mobilisation and should instead be effective from the point of exit from mobilisation, to avoid excessive burden on new banks. The PRA considers it appropriate for a new bank to hold a buffer during mobilisation given the same risks are present during this period, in particular the risk of a loss of investor support. The SS has therefore not been amended.

5.42 As first articulated in the joint Bank of England and FSA report, published in March 2013[23] (the '2013 report'), the PRA expects that, following exit from mobilisation (or upon authorisation if a firm does not follow the mobilisation route), a firm should have sufficient capital levels to meet its capital requirement and buffers for at least 12 months, in addition to meeting actual capital requirements, buffers, and MREL (if applicable).

5.43 One respondent commented that this expectation is likely to be a disincentive to potential investors and an alternative could be to have shares allotted but not fully paid up to enable a commitment to be made by investors without the impact on return on investment.

5.44 The PRA notes that the 12 month capital expectation has existed since 2013, and has helped avoid the significant management distraction involved in seeking external capital support in a bank's first year of operation. A commitment from investors would not be sufficient to meet this expectation and would not achieve the intended outcome.

5.45 One respondent expressed their support for the 12 month capital expectation and suggested that this philosophy of tailoring the approach to the business model is applied across all risk types and metrics in this way.

5.46 The 12 month capital expectation is designed to address the unique capital challenges new banks face in the first year. The PRA has not made any changes to the SS given that similar challenges do not apply to other areas.

5.47 One respondent requested that it be made clear that the 12 month expectation is a point in time expectation. The SS has been amended in paragraph 4.4 accordingly.

MREL

5.48 Three respondents commented that MREL in excess of capital requirements should not apply to firms in scope of the consultation, alongside various suggested amendments to the MREL regime. One respondent welcomed the Bank of England's review of the calibration of MREL and

23 https://www.fca.org.uk/publication/archive/barriers-to-entry.pdf.

recommended that the PRA should, as part of this exercise, reconsider the criteria which have been set out for whether modified insolvency is an appropriate resolution strategy.

5.49 As noted in the CP, setting MREL is the responsibility of the Bank of England as resolution authority. As such, the scope of MREL setting is not directly relevant to this PS. In this context, the PRA notes that the Bank of England has recently published a Discussion Paper[24] regarding its thresholds for setting MREL in excess of capital requirements, and intends to publish a CP in summer 2021, setting out any proposed changes to its MREL framework that it has concluded is necessary.[25] The PRA has shared the responses to CP9/20 with the Bank of England for consideration as part of this MREL review.

5.50 The PRA notes that, as set out in the Bank of England's Discussion Paper (as referenced in paragraph 5.49), the Bank of England sets MREL for firms with reference to the scale and nature of the impact of a bank failure, and that the amount of MREL steps up with the size of the bank, proportionate to the impact of failure. This is necessary to ensure that the Bank of England can manage bank failure in an orderly way, and is designed to protect financial stability and prevent public money from being used to ensure banks continue to operate.

5.51 The PRA also notes that the 'The Bank of England's approach to resolution'[26] states that the preferred resolution strategy for the smallest firms in the UK that do not supply transactional accounts or other critical functions to a scale likely to justify the use of resolution tools is the applicable insolvency procedure (usually, this is the Bank of England's Insolvency Procedure).

5.52 One respondent suggested that references to MREL should therefore be minimised within the final policy, given that such references are 'likely to create confusion for the boards of such firms and more importantly to cast a damper on their ability to attract investor funding'.

5.53 The PRA does not consider that the references to MREL within the policy will reduce firms' ability to attract funding. The Bank of England's approach to setting MREL is already within the public domain, having been first published in November 2016. Moreover, the PRA has already stated in SS16/16 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'[27] that it expects firms to meet their MREL requirements. Consistent with Fundamental Rule 8, the PRA will continue to engage with firms regarding their preparations for resolution, taking into account prevailing PRA and Bank of England policy relevant to resolution. The PRA has therefore maintained the references to MREL in the SS.

5.54 These responses indicate the need for further clarity in relation to MREL. In paragraph 3.4 and 4.21, the PRA clarified that a transition to MREL should occur if new banks meet the criteria for MREL in the first five years. It also clarified its expectation on MREL requirements in relation to capital planning.

5.55 Two respondents commented that setting the PRA buffer on a wind down basis may duplicate the role of MREL. This could lead to overcapitalisation for those firms in scope of the draft policy and with an MREL requirement in excess of their TCR.

5.56 The PRA does not consider that the proposed calibration of the PRA buffer duplicates the role of MREL. As noted in the SS, the PRA buffer has not been calibrated to provide sufficient capital to

24 December 2020: https://www.bankofengland.co.uk/paper/2020/boes-review-of-its-approach-to-setting-mrel.
25 https://www.bankofengland.co.uk/news/2020/december/boes-review-of-mrel.
26 https://www.bankofengland.co.uk/paper/2017/the-bank-of-england-approach-to-resolution.
27 December 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-minimum-requirement-for-own-funds-and-eligible-liabilities-mrel-ss.

survive a stress or enact a SWD. Instead, it will be calibrated to allow banks time to find alternative sources of capital or make business model adjustments, in the event of a loss of investor support.

Leverage ratio

5.57 Two respondents commented that, for new banks that are 'liability driven, the leverage ratio framework should not apply during the first five years of operation'.

5.58 The PRA notes that the UK leverage framework applies to major banks (with retail deposits over £50 billion) and their ring-fenced entities. The UK does not currently apply a binding leverage capital requirement to smaller firms, which are instead only subject to reporting and disclosure requirements. The Financial Policy Committee and Prudential Regulation Committee have announced that they will conduct a review of the UK leverage ratio framework.[28]

Implementation

5.59 In terms of implementation of the new approach to the PRA buffer, one respondent emphasised the importance of providing a reasonable period of advance warning given the potential for it to lead to increased capital requirements (particularly for banks in the application process that are likely to be well advanced in their capital raising for entry into mobilisation).

5.60 The new approach will be introduced through the SREP cycle. Banks that are partway through the application process, and have not yet had capital requirements set, will have the PRA buffer set on the new approach going forward.

[28] https://www.bankofengland.co.uk/news/2020/may/uk-regulatory-grid-launched-to-help-financial-firms-with-planning.

6 Orderly exit: Recovery and resolvability

Distinction between orderly exit and orderly failure

6.1 One respondent suggested further clarity on the terms ‘orderly exit’ and ‘orderly failure’, noting that they are not interchangeable due to the differing costs incurred by third parties. The respondent commented that exit via solvent wind down contributes to financial stability by avoiding any appearance of crisis and lack of confidence. They also asserted that the avoidance of the modified insolvency route protects public funds, but not Financial Services Compensation Scheme levy payers. As such, the orderly exit of firms with non-viable business models with no costs to third parties is preferable from a creditor’s perspective. The respondent requested that the SS be edited in some places to make this clearer.

6.2 The PRA notes that ‘orderly exit’ is the overarching term for firms that no longer have a viable business model and need to exit the market following unsuccessful recovery attempts. Orderly exit options for the purposes of this SS include going and gone concern options. Going concern exit includes an exit through a whole firm sale or SWD (i.e. repaying all depositors and creditors in full). Gone concern exit refers to resolution via a modified insolvency procedure.[29] A new Box 3 has been added to illustrate this. In addition, the PRA clarifies in paragraph 2.2 that firms must on an on-going basis[30] demonstrate how the preferred resolution strategy[31] set for them could be carried out in an orderly way.

6.3 The PRA recognised the different impacts on creditors between a wind down that can maintain solvency and a firm that enters a modified insolvency procedure. The PRA agrees that it is preferable if firms can maintain the solvency necessary to wind down their business and exit the market in an orderly manner, repaying all depositors and creditors in full. However, in recognition of the fact that a firm’s solvency is not within the PRA’s control, orderly wind down cannot be considered a substitute for effective resolution, if required. The board is ultimately responsible for deciding whether to enter a wind down and for ensuring that the firm maintains their solvency during its implementation. The PRA has amended the SS (in paragraph 5.3 and through the addition of Box 3) to reflect this. The Bank of England and the PRA may also need to assess a firm’s solvency under the SWD plan before it begins to judge it is sufficient to avoid resolution conditions being met.[32]

Recovery planning

6.4 The PRA received two responses that said it should consider where it might apply further proportionality to recovery planning obligations, to ensure that smaller banks with limited resources are not facing disproportionate costs that detract from their ability to meet the other expectations proposed in the draft SS, such as those on profitability. One response suggested further simplifications to recovery plans for firms that produce and maintain both a SWD plan and recovery plan, until they are only subject to the latter. The other respondent questioned the usefulness of a detailed recovery plan for a newer bank that will inherently have very limited recovery options, and the cost benefit analysis of this requirement for new banks. The respondent suggested that the focus of supervision should be on a firm’s SWD Plan.

29 When a new and growing or non-systemic bank fails, it will most likely be placed into a modified insolvency procedure under the UK resolution regime. In general, these banks do not meet the conditions for resolution via stabilisation powers. Resolution via stabilisation powers ensures continuity of access to all depositors.

30 Fundamental Rule 8 – A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.

31 https://www.bankofengland.co.uk/paper/2017/the-bank-of-england-approach-to-resolution.

32 Entry into resolution is triggered if the firm is judged by the PRA to be failing, or likely to fail, and by the Bank of England that it is not reasonably likely, having regard to timing and other circumstances, action will be taken that will result in the firm no longer failing or likely to fail.

6.5 The PRA applies simplified obligations for recovery planning ('Simplified Obligations'), which reduces recovery planning obligations for those firms that have been notified by their supervisor that they meet the eligibility criteria. The PRA applies Simplified Obligations to firms in accordance with PS 25/20.[33] The PRA has determined that the key determinant when deciding whether a firm is eligible for Simplified Obligations is whether the firm performs a critical function. It should be noted that whether a firm is subject to SWD planning is not relevant to this determination. However, SS9/17 ' Recovery planning'[34] states that smaller firms have fewer legal entities, fewer recovery indicators, a more limited range of recovery options, and simpler governance arrangements, and are therefore able to justify submitting shorter recovery plans than large, complex firms. The PRA has amended the SS to reflect this (Table 2, paragraph 5.4 and 5.5). This may be subject to further consideration as the PRA works on building its 'strong and simple' regime.

Solvent Wind Down

6.6 The PRA received one response that was supportive of the intentions of the SS, recognising that SWD is a safe and efficient way for firms to exit the market in an orderly way, if necessary and feasible. Two respondents suggested that the quantum of capital required should shrink once firms enter SWD. They also commented that certain costs (marketing, IT infrastructure development plans, and recruitment) and risk changes (interest rate) should be acknowledged in capital expectations once a bank has entered SWD, and that the PRA buffer should be reduced accordingly.

6.7 TCR is calibrated as a percentage of risk-weighted assets and is therefore likely to reduce on a nominal basis as the balance sheet decreases in size during solvent wind down. This would be subject to a floor equal to any fixed Pillar 2A add-ons, or base capital requirements, whichever is higher. The PRA buffer is a usable element of the regulatory capital stack, and the PRA expects that this quantum of capital would support firms when undertaking SWD.

6.8 One respondent commented that building up the guidance for new banks on how to demonstrate a wind down is solvent would be helpful, including providing examples of acceptable documents and guidance on how they can be enhanced over time.

6.9 As a supervisory authority, it is important for the PRA to balance the need to support firms while ensuring they build the capabilities to understand and translate policy for themselves. The PRA acknowledges the value of further guidance. This will be subject to further consideration in developing the PRA's 'strong and simple' approach for non-systemic banks and building societies. The PRA will consider providing further guidance in due course. In addition, the PRA amended Box 2 and paragraphs 5.7 and 5.9 to clarify that the board of the bank should ensure SWD plans demonstrate that the business can be wound down in its entirety to the point it can be liquidated safely, repaying all depositors and creditors in full.

33 December 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/simplified-obligations-recovery-planning

34 December 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/simplified-obligations-recovery-planning.

7 The PRA's approach once banks are established

7.1 One respondent asked the PRA to do more in relation to firms that are over five years old as they grow and scale their businesses to compete with established banks effectively. Respondents suggested that not enough is being done by the PRA to remove barriers to scaling and growth, particularly in relation to capital, the proportionality of rules and requirements, and the PRAs supervisory approach for these banks.

7.2 The purpose of CP9/20 was to propose the PRA's approach to supervising new and growing non-systemic firms, with a specific focus on those firms in the initial five years of operation. Therefore, the PRA has not amended the policy as proposed.

Responses not related to the CP

7.3 The PRA received several responses that did not relate directly to the draft policy under consultation and these are summarised below. The PRA has not provided feedback to these responses, but may consider the points raised in further policy development.

- Some respondents made suggestions for the capital framework (setting P2A requirements, revisit the capital stack, consideration of the capital adequacy in a holistic manner, investments into intangible software assets, requirement for securitisation as per Capital Requirement Regulations (CRR), CRR quick fixes, the PRA's treatment of intellectual property for capital purposes, risk sensitivity for small and medium-sized enterprise (SME) mortgages, capital requirements for the CCyB, level playing field for Standardised approach vs IRB models, capital levels in mobilisation). Any further changes to the capital framework are outside the scope of the proposals contained in the CP.

- Respondents made suggestions concerning the MREL review, which is a responsibility of the Bank of England as resolution authority, and is outside the scope of the proposals contained in the CP.

- Respondents made suggestions concerning the leverage ratio framework, Basel framework, challenger banks supervision, fast growing firms review, and the term funding scheme for SMEs (TFSME).

- A respondent suggested that the PRA provide more flexibility on the 12 month mobilisation period to provide more time for IT and operational builds.

7.4 The PRA also received some responses that were firm-specific in nature and has not provided feedback on these. Each firm's supervisor will be in contact to discuss implementation of the final policy.

8 PRA-driven changes

8.1 The PRA has made some minor changes to the draft SS that were not in feedback to responses. These aim to provide more clarity, address errors and update references to other final policy publications, and are set out below. These additions and updates do not introduce new policy or change the existing policy.

PRA buffer transition arrangements

8.2 The PRA expects banks to begin the transition to the PRA buffer in line with established banks once a bank has been operating for five years (since exit from mobilisation, or since authorisation if a bank does not follow the mobilisation route), or at the point a bank achieves a profit over a full year of trading, whichever is sooner. The PRA may, on an exceptions-only basis, diverge from this stated approach where it identifies heightened risks to its objectives which justify an earlier transition to the PRA buffer in line with established banks. Paragraphs 4.12 and 4.16 of the SS have been amended to reflect this.

Other minor updates

8.3 The PRA updated the reference links throughout the SS to reflect final policy publications. This includes a footnote addition to Table 1 (materials to be read alongside the SS), to flag that the materials may be superseded by future publication, adding additional materials in relation to governance, capital, liquidity, depositor protection, and disclosure, reordering the list and updating footnotes 28,29,40.

8.4 Table 2 (the PRA's expectations of banks as they mature) has been amended to reflect the fact that a bank's ICAAP and ILAAP need to meet minimum standards and are fit for purpose from Year 0 (i.e. at the point of authorisation). This is consistent with the expectation articulated in the 2013 report.

8.5 An amendment was made to Box 1 to clarify where there may be a difference of approach for subsidiaries of international groups.

8.6 The PRA updated Table 4 on the sample of regulatory thresholds to reflect new thresholds on remuneration in line with SS2/17[35] and the PRA Rulebook, and provided reference link to the final policy.

8.7 References to CP2/21 'International banks: The PRA's approach to branch and subsidiary supervision'[36] have been included when making reference to the proposed expectations of subsidiaries of international groups.

8.8 A reference to EEA and non-EEA banks in paragraph 1.5 of the SS has also been updated given that the distinction now has limited relevance following the end of the transition period. Both of these changes are in line with the PRA's general approach to EU withdrawal. This was set out in CP25/18 'The Bank of England's approach to amending financial services legislation under the European Union (Withdrawal) Act 2018' (October 2018) with near final policy in PS 5/19 of the same name.[37]

35 January 2021: https://www.bankofengland.co.uk/prudential-regulation/publication/2017/remuneration-ss.

36 January 2021: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/january/international-banks-branch-and-subsidiary-supervision

37 June 2019: https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018 with near final policy in PS5/19 of the same name.

8.9 The PRA has amended paragraph 4.4 to clarify that banks are not expected to hold sufficient resources to meet MREL above TCR, if applicable, for the 12 months following exit from mobilisation (or upon authorisation). They are instead expected to meet the applicable MREL at all times.

8.10 The PRA added a footnote in paragraph 5.11 to provide a definition of threshold conditions

8.11 The PRA added a footnote to paragraph 5.13 to clarify that the exclusions file that firms are required to provide should include data on deposits which are not in the SCV, including for example deposits held in client accounts and deposit aggregators.

9 Appendices

1	SS3/21 Non-systemic UK banks: The PRA's approach to new and growing banks, available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/new-and-growing-banks-ss
2	SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss
3	Statement of Policy (SoP) 'The PRA's methodologies for setting Pillar 2 capital', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-methodologies-for-setting-pillar-2-capital