UK FINANCE

Prudential, Reporting and Tax

A response to the

The PRA's CP23/23 on

the Identification and management of step-in risk, shadow banking entities and groups of connected clients

March 2024

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to the PRA's Consultation Paper CP 23/23 on the Identification and Management of step-in risk, shadow banking entities and groups of connected clients.

The PRA proposes to require firms to:

- identify potential step-in risk and where necessary, potential mitigating actions
- develop their own step-in risk policies and procedures and report their assessment to their supervisor on 3 new proposed assessment templates

It also proposes to:

- transfer EBA guidelines on connected clients and limits on exposures to shadow banking to the PRA Rulebook
- provide definitions of 'shadow banking entities' and 'excluded undertakings', as well as 'group of connected clients' and 'control'

Step-in Risk

We support the PRA's approach which builds on the BCBS guidelines on step-in risk by requiring firms to undertake regular assessments to ensure they are identifying and managing step-in risk, to consider if further action is needed to mitigate step in risk and report their step-in risk assessment to the PRA for its review.

The material relevant to the PRA's approach to step in risk are contained in the following Appendices to the CP:

Appendix 1	PRA rulebook: CRR firms: Step-in risk Instrument 20xx
Appendix 2	Draft supervisory statement – Step-in risk
Appendix 3	Templates for reporting Step-in risk Assessment
Appendix 4	Step-in risk assessment: reporting instructions

Materiality

The Glossary defines a 'material step-in entity' as:

> *a step-in entity which, when step-in risk is considered both individually and in combination with other similar entities, would not, given its size relative to the firm, materially impact the firm's liquidity or capital positions*

Reflecting the BCBS Guidelines the Policy Statement requires a firm to define materiality in describing its approach to identifying immaterial step-in risk entities and consider if possible step-in entity or entities could be material for a PRA-authorised firm within its group, but not for the consolidated or sub-consolidated group. We suggest materiality should be considered at the highest consolidation level only.

Scope of entities identified for step-in risk evaluation

Article 6.1(1) of the draft PRA Rulebook for Step-in Risk Instrument requires firms to identify as a step-in entity all unconsolidated entities with which it has one or more of the following relationships:

a) sponsor
b) *debt or equity investor (excluding investments that arise from market-making activities); or*
c) other contractual or non-contractual exposure;

The emboldened text above potentially broadens the range of step-in entities firms should consider compared to the scope set out in the BCBS guidelines.

As a result, our members are concerned a firm's relationships with third party entities, which arise solely from its regular business as a banker, (such as through secured or unsecured lending transactions and reverse repo agreements) or a broker-dealer (such as through derivative activities, investments in third parties and investments in funds or other vehicles managed or advised by third parties) would fall within the scope of the PRA's proposed rules. This would be erroneous in our view and blurs the line between step-in risk and the regular business risk of a firm in providing concessions or otherwise agreeing to modifications with customers.

Without a tightening/clarification of the definition, firms could be forced to disclose a myriad of entities where it is not that step-in risk is immaterial, but rather where no step-in risk exists at all.

Take the following two examples which may be helpfully illustrative:

- A firm owns a debt instrument issued by a corporate entity. In the event of financial difficulty, it may choose to restructure the debt, in accordance with its credit policies, to

maximise its recovery possibilities. The Basel Guidelines explicitly exclude regular lending relationship business such as this from the definition of step-in entity.

- A bank holds a AAA rated senior tranche in a third party originated securitisation. In this case, the bank has a debt investment in an unconsolidated entity which is a Securitisation Special Purpose Entity (SSPE). SSPEs are explicitly included in the definition of unconsolidated entity. So it could be concluded that this exposure is in-scope of the step-in risk reporting, even though the bank has no relationship with the SSPE beyond that of an investor.

Our interpretation of 'Entity types'

We think that this concern is addressed, but with a bit of detective work. Appendix 2 (Draft Supervisory Statement) to the CP - specifically para 4.5 (Entity types) on pages 15 to 16 notes the following:

> "Commercial entities may generally be excluded from the step-in risk assessment except to the extent that they are one of the types of entity listed in Annex 1 or are defined as an unconsolidated entity within the Step-in Risk Part of the PRA Rulebook."

We believe this is similar to the Basel approach to commercial entities. Given the PRA's definition of unconsolidated entities in Appendix 1 to the CP and the list of entities in Annex I of Appendix 2, the only commercial entities likely to be in scope are those that are either defined as ancillary services or suppliers under material outsourcing arrangements.

Our members believe this is sufficient to ensure the scope of 'debt or equity investor' per article 6.1(1) is limited to specific commercial entities without meaning to include such relationships with all commercial entities. But perhaps the PRA could be more explicit on this point in the draft regulations in Appendix 1?

Solutions to focussing the definition

To address the possibility of the potential over broad interpretation of the scope of the step-in requirements, and for the avoidance of doubt, we recommend that the PRA amend Article 6.1(1) and other parts of the proposed PRA Rulebook to adopt the wording of paragraph 24 of the BCBS Guidelines as follows:

b) debt or equity investor, excluding regular commercial lending activity (e.g. a wholesale loan to a corporate entity) and investments that arise from market-making activities (e.g. equity shares held in the trading book or negligible investment); or

This insertion would confirm the BCBS's view of scope, which is correct in our view, and confirmed by detailed, but somewhat tortuous, interpretation of the PRA's Appendices 1 and 2. that "regular business" i.e. lending only business without additional connections, should be excluded from step-in risk requirements. This is supported by Para 28 of the BCBS guidelines which states that *"Commercial entities (i.e. non-financial) may in general be excluded from the step-in risk analysis."*

However, additional clarification will also be required to address the second example above, as whilst the purchase of AAA bonds in that case could be described as a lending relationship, securitisation entities are not often referred to as operating entities. It is our view that step-in risk for securitisations is already considered in the securitisation due diligence, retention and no implicit support requirements. A reference to the entities already listed in the Annual Accounts as 'related undertakings' would clarify the intention here. We note that the PRA already has the notion of related party transactions in its Rulebook. How do these pre-existing requirements interact with these proposals – it is important to avoid duplication, particularly if such transactions are not material.

We would also like clarification as to the extent to which the PRA Rulebook chapter Related Party Transactions is seen as covering the same risks and whether the duplication, where it exists, is justified.

Furthermore, it would be helpful to incorporate BCBS paragraph 30 and 31 of the Basel guidelines which allow a firm to exclude entities from step-in risk assessment and reporting, where "*law or regulation which is clearly enforceable, of general application and which explicitly prohibits the provision of support*" apply.

Trigger for inclusion – what is negligible?

It would be helpful if the PRA provided clarification regarding the level of equity (or equity-like) exposure to a non-trading investment that would trigger an entity to be scoped in. Paragraph 24 of Basel Guidelines (which we have recommended including) specifically exclude a "negligible investment".

This could be supported by illustrative examples of what would and would not constitute "negligible", based perhaps on quantitative threshold and/or qualitative factors that firms should assess to assist them in identifying entities in scope.

For example, a firm may have an equity investment in a corporate entity which represents between 1% and 10% of the corporate entity's total equity. The carrying value of the investment may exceed an auditor's materiality test for unadjusted differences for the firm but is less than 0.5% of the firm's total assets. Does the PRA intend for such investments to be identified for step-in risk assessment?

Were the PRA to clarify what is a "negligible investment", it would be helpful were it apply the same definition when assessing a proposed exemption from prudential consolidation under Article 19.2(b) of UK CRR which refers to "where the undertaking concerned is of negligible interest only with respect to the objectives of monitoring institutions".

Approach to conducting step-in risk assessments

We appreciate that the PRA acknowledges the judgemental nature of determining materiality as well as what may constitute significant indicators of step-in risk. So the guidance and definitions provided is useful in helping firms to prudently assess step-in risk. UK Finance

members agree that defining these terms is critical to ensuring firms' efforts are directed to areas where step-in risk is most likely to occur and have a material capital or liquidity impact.

In this regard, we would like to ensure that there is a level playing field across firms globally and therefore would highlight both EBA and BCBS implementation which we believe similarly seeks to ensure there is a consistent, targeted assessment of step-in risk:

- The EBA have sought to adopt some elements of the BCBS Guidelines, namely institutions *'are required to provide, upon request of the competent authority, the initial assessment performed on step-in risk, which then shall be considered by the competent authority for the purpose of assessing whether to require prudential consolidation'* with firms and competent authorities being enabled to consider step-in risk as part of the ICAAP and SREP. The EBA notes that key benefit of this approach is that it follows the principles of the BCBS Guidelines but allows both firms and competent authorities to exercise judgement taking into consideration the nature and circumstances of each firm and most importantly the significance of step-in risk prevalent in the firm. *[Footnote Final Report Draft RTS methods of consolidation.pdf (europa.eu) Section 4.1, D2, Option 2.3]*

- We note that, whilst the BCBS Guidelines have similar reporting templates to those proposed under the CP, the ongoing reporting to competent authorities under BCBS Template 2 focuses only on detailed reporting of material entities where there is significant step-in risk. So, the BCBS templates only require an assessment of the qualitative indicators and a quantitative assessment on the impact on liquidity and capital resource if there is significant step-in risk identified, But the PRA proposes detailed reporting for material entities irrespective of whether they exhibit significant or insignificant step-in risk. [Footnote: d423.pdf (bis.org), Annex 1: Supervisory reporting templates, Template 2]

UK Finance members are concerned that this may result in significant divergence in global standards leading to an un-level playing field as:

1. reporting will be disproportionate to the underlying risk leading to an unreasonable resource burden being placed on firms
2. new business activity may be stifled
3. limiting decision-making in potential step-in situations.

We therefore encourage the PRA to consider drawing on the EBA's approach, which requires both firms and competent authorities to apply judgement in ongoing assessment of step-in risk, considering the nature and extent of a firms unconsolidated entities.

1. Reporting disproportionate to the underlying risk

We would like to draw attention in particular to the guidance provided in section 3.1 of the Supervisory Statement which suggests that firms with material step-in risk entities based on quantitative indicators such as relative asset size, CET1 or other metrics will be required to prepare a quantitative assessment of impacts on CET1 ratio, leverage ratio, LCR and NSFR.

Further guidance would be useful to ensure that firms only prepare such quantitative assessments, which will be an onerous exercise in itself, where there is a significant risk that

a firm would step-in. This is of particular importance as developing quantitative methods such as conversion factors will require complex modelling. So the requirements should only be focussed on firms where significant step-in risk actually exists. We believe a number of alternatives exist to achieve this objective including:

1. Amending the SI1 and SI2 templates and materiality definitions to more specifically set out that SI2 should only be completed where material entities exist *and* the risk of step-in risk is significant.
    a. Alternatively specifying that step-in risk estimates noted in SI 2 0090 – 0120 should only required where step-in risk is deemed to be significant
2. Requiring the step-in risk assessment to form part of the ICAAP to allow firms flexibility in how the assessment is presented along with how the materiality and significance judgements are made.

We would also urge the PRA to note that using a measure such as Total Assets disclosed in firms' financial statements under IFRS 12 unconsolidated structured entities disclosures may be misleading as such disclosures are made irrespective of the nature of a firm's relationship with a structured entity. In particular, such disclosures commonly arise from a firm's regular business such as lending relationships with, or investments in, structured entities where the firm has limited involvement in the establishment of the structured entity. Under paragraph 24 of the BCBS Guidelines these would be excluded from step-in risk assessment. Therefore, the proposed use of such measure will overestimate the potential impact of step-in risk.

The nature of the decisions that senior management would take in order to assess step-in are based on specific facts and circumstances present as a scenario arises including the firm's financial and capital resources, the relative importance of the impacted business and client(s), the approach of (global) peers and any government, legal or regulatory requirements or restrictions. Inherently, these scenarios are very rare and a firm will only step-in if the potential benefits exceed the costs, and whilst the firm remains safe and sound. This level of subjectivity makes it extremely challenging to model capital and liquidity resources.

Reducing the reporting burden - avoiding multiple submissions for groups that include ring-fenced banks

In addition, we note the requirement for firms subject to sub-consolidation requirements to comply with the Step-In Risk Reporting rules on the same basis (Appendix 1, Annex E, para 24.2). Where such firms are also subsidiaries of a CRR consolidation entity (e.g., one or more ring-fenced banks within a wider Group), this will require reporting of the Step-In Risk data items (GI, SI1 and SI2) at both a sub-consolidated and consolidated basis.

Where the unconsolidated entities identified as part of the Step-In Risk assessment on a sub-consolidated basis (i.e., ring-fenced bank level) are also reported in full as part of the assessment on a consolidated basis (i.e. CRR consolidation entity level) this will lead to significant duplication/overlap across the reported data items. We would appreciate the PRA allowing that a single set of data items may be submitted at the CRR consolidation level only, with the templates amended as necessary to allow:

- identification of whether the relationship with the unconsolidated entity applies at both sub-consolidated and consolidated levels or at a consolidated level only (noting that where more than one firm is subject to sub-consolidation requirements within a Group that the relevant firm is clearly identified);
- whether material at both levels or at a sub-consolidated level only;
- quantification of impacts (SI2 – Step-In Risk Estimates) on both a sub-consolidated and consolidated basis;
- any further amendments deemed necessary to distinguish between sub-consolidated and consolidated levels.

This would assist with reducing the reporting burden on firms and provide the PRA with a single view, supporting any resultant discussions with Groups on the output of the data items where the same step-in entities are identified at both reporting levels.

We also believe it is appropriate to exclude from reporting at solo level positions that are captured at the consolidated level, including overseas head-offices. This is because step-in risk principally manifests as a reputational/franchise risk which are always at group, rather than solo level.

2. Stifling new business activity

It is our understanding that the Basel proposals are aimed at ensuring that there is no financial stability risk arising out of step-in risk. We request that the PRA confirms that this is also their intent and that this remains primarily within the remit of Pillar 2. We ask, because the theoretical existence of step-in risk in itself can never be fully excluded and it sometimes feels the objective is to get to a zero occurrence of step-ins, which in our view would could be detrimental to well-functioning markets.

We discuss as example the funds business, where firms intend and are generally explicit in legal language that fund investors bear the risks of their investment. Nevertheless, in times of severe market stress such as during Covid in 2020, in order to protect the business franchise, firms may consider stepping-in to provide liquidity to funds to enable investors to exit their positions when liquidity for the underlying investments has dried up. Therefore, there may be implicit step-in risk in operating a funds business.

Under existing fund regulations, fund managers are already required to mitigate key drivers of step-in risk, such as liquidity risk, which we believe sufficiently addresses the PRA's objective of promoting the safety and soundness of firms.

If additional capital or liquidity mitigants are required as a result of the new proposals, there is effectively a regulatory double count and firms may simply shift new business elsewhere, particular to the EU.

Terminology

We note paragraph 2.28 a. uses the word '*aggressively*' which is perhaps too emotive? We suggest its replacement with the word '*actively*'.

Shadow banking

We support the PRA's approach to shadow banking entities (SBEs) which builds on the European Banking Authority (EBA) Guidelines on limiting exposures to shadow banking. The key changes include the transferring of the definition of 'shadow banking entities' and 'excluded undertakings to the LE(CRR) part of the PRA Rulebook and creating a new Supervisory Statement (SS) that will transfer the current EBA guidelines on limits on exposure to SBEs with a change to the definition of 'excluded undertakings'.

The material relevant to the PRA's approach to SBEs are contained in the following Appendices to the CP:

Appendix 5	PRA rulebook: CRR firms: Large Exposures (CRR) Instrument 2024
Appendix 6	Draft supervisory statement - Identifying, monitoring, and managing exposures to shadow banking entities'

PRA rulebook: CRR firms: Large Exposures (CRR) Instrument 2024

Definition of 'group of connected clients'

We note that the PRA's definition of connected clients in the LE (CRR) Instrument is unchanged from the CRR definition.

Paragraph 3 of this definition permits the use of the alternative approach to forming sovereign groups of connected clients. We acknowledge that this has not changed but it is noted that this paragraph is written to apply only to central governments and the UK's three devolved administrations (i.e., as listed in the EBA's RGLA per Art 115(2)) only.

We think that from a level-playing field perspective it may be worth clarifying that central banks should be viewed as being part of the relevant central government, even if the central bank is independent. We think this is justified from a level playing field perspective, as any other approach would lead to significant divergence between banks on how they assess independence from the central government. Furthermore, the effectiveness of the central bank is assessed by credit rating agencies when assigning sovereign/central bank ratings.

This could be achieved by making the following simple changes to Paragraph 3:

> groups of connected clients means […]
>
> (3) where a central government or central bank has direct control over, or is directly interconnected with, more than one natural or legal person, the set consisting of the central government and central bank and all of the natural or legal persons directly or indirectly controlled by ~~it~~ them in accordance with point (1), or interconnected with ~~it~~ them in accordance with point (2), may be considered as not constituting a group of connected clients. Instead the existence of a group of connected clients formed by the central government and central bank and other natural or legal persons may be assessed separately for each of the natural or legal persons directly controlled by ~~it~~ them in accordance with point (1), or directly interconnected with ~~it~~ them in accordance with point (2), and all of the natural or legal persons which are controlled by that

natural or legal person according to point (1) or interconnected with that natural or legal person in accordance with point (2), including the central government and central bank. The same applies in cases of regional governments or local authorities to which CRR Article 115(2) applies and in the United Kingdom regional governments means the Scottish Government, the Welsh Government and the Northern Ireland Executive; and…

Question

Does the PRA have any appetite to expand the regional government list beyond the UK?

Definition of 'Shadow Banking Entity'

We note the definition of 'Shadow Banking Entity' has been moved to the Annexe to the Rulebook and, at 1(3)(o), encompasses any entity that 'carries out one or more credit intermediation activities'.

It would be helpful if the PRA provided a pointer to activities regarded as credit intermediation in the Rulebook itself, by moving the current para 1.6 of the Policy Statement to para 1.2 (application and definitions) of the Rulebook.

We note that the equivalent EU implementation is less restrictive than the PRA approach, as it enables account to be taken of an overseas supervisors' adherence to the Basel Core Principles as opposed to the narrower equivalence approach. We think the EU approach is more in line with the Basel intent. While improvements could be made to the practical aspects of the EU approach, we would urge the PRA to consider taking a similar approach.

Questions on Annex 1

Excluded Entities

How should firms identify whether an entity is included in the group consolidation of a firm/institution that is supervised by the PRA or the regulator in an equivalent third country? For instance, this will include financial institutions and ancillary services undertakings that are assigned to the 'Corporates' exposures class. This exclusion requires the identification of the group parent/financial holding company. Confirmation that the entity is consolidated in accordance with Art 18 (or equivalent) and that the group is supervised by a regulator applying the CRR or equivalent prudential regulatory regime would be helpful.

PRA should explicitly clarify which equivalence decisions are expected to be used for para (2). Presumably those undertaken by HMT in accordance with CRR Art 107(4)?

(3)(d) third country investment firms

The definition of institution in UK CRR excludes investment firms, other than designated investment firms. So we believe this should read:

> third country investment firms, if the third country applies prudential and supervisory requirements to that ~~institution~~ *investment firm* that are determined by the Treasury to be at least equivalent to those applied in the United Kingdom

This change is necessary given that investment firms do not all fall under the definition of an institution under the Glossary.

3)(e) entities which are financial institutions

We do not believe that there are currently any UK entities which are financial institutions where the firm's exposure to the entity concerned is treated as an exposure to an institution pursuant to Article 119(5) of the CRR.

Could the PRA confirm our view that there are currently no entities that fulfil this exclusion per SS 10/13 in the UK, but that this option is available to exposures based in third countries?

3)(f) central banks, ….

Point (24) of Article 2(5) of CRD states that it would not apply "**in the United Kingdom**, to National Savings and Investments (NS&I), CDC Group plc, the Agricultural Mortgage Corporation Ltd, the Crown Agents for overseas governments and administrations, credit unions and municipal banks.".

Could the PRA clarify whether everything after "central banks" is also expected to be in the UK only, or whether such third country entities are also in scope. For instance:
Crown agents in the UK vs Canada for example. It would be preferable to have an explicit list of these entities.
Credit unions and municipal banks – UK only or worldwide?

What about all the other entities listed in the equivalent condition in the EBA GL – i.e., points (3) to (23) of Article 2(5) of CRD? – see question on PSEs below also.

3)(g) any of the following;

We propose that it may be more appropriate to move 'central banks' from condition (3)(f) to (3)(g) given there is not intended to be any restriction on jurisdiction.

Could the PRA to clarify whether all PSEs may be excluded, regardless of the country in which they are situated, or their prudential treatment. i.e., should this be aligned with everything in scope of Art 116?

EBA GL listed very specific EU PSEs per points (3) to (23) of Article 2(5) of CRD.

PRA has restricted RGLA exclusions to only those 3 devolved administrations in the UK where their exposures may be treated as exposures to the UK government. Should this be consistent with the treatment of PSEs? i.e., everything in scope of Art 115? Or if aligning with the exclusion of government entities, also include Art 115(4)?

We propose the additional and explicit exclusion of official Export Credit Agencies (ECAs) as indicated by the OECD. These are not always public sector entities and we do not believe

the PRA's intention is to monitor exposures to ECAs as part of the shadow banking framework.

(3)(j) entities established for the purpose of providing retirement benefits …..

How should members identify these? While some countries provide registers for these, is it the PRA's expectation that firms come to a reasonable assessment of their position. Should this encompass all pension schemes regardless of country or supervision?

(3)(m) electronic money issuers…

We wonder if there is some overlap in this definition with other exclusions. How should firms identify authorised electronic money institutions and small electronic money institutions? Could the PRA clarify if this exclusion applies only to UK EMIs?

We would appreciate confirmation that it is sufficient, in the case of UK EMIs, for firms to use the FCA Register to identify these i.e., E-Money firms with permission to issue electronic money. We assume that the exclusion will also be available to non-UK EMIs in which case we would use local registers to identify such entities.

(3)(n) authorised payment institutions;

Could the PRA confirm how firms should identify these. We suggest 'authorised payment institutions' in the FCA Register as 'Firms with PSD permissions' or equivalent from overseas jurisdictions.

(3)(o) entities the principal activity of which is to carry out credit intermediation activities ….;

We understand that 3(o) is intended to capture entities that purely provide credit intermediation services to entities in their group and are therefore excluded from having to be regulated and thus are not caught by exclusions (1) and (2). It would be helpful for the PRA to confirm that this is the intent.

Other

Could the PRA to confirm whether the Top 10 institutions and Top 10 shadow banking entities should be identified at an individual client level only, or where appropriate at the level of a group of connected clients? For example:

i. '*XYZ Bank'* and '*ABC entity'* are included in consolidated group '*XYZ Banking Group*' that is supervised on a consolidated basis. Should the Top 10 institution flag be reported against XYZ Bank or XYZ Group? Should the same concept be applied for SBE's and SBE groups.
ii. If Group – How should a firm identify whether a group is a shadow banking group. Members note it is more straightforward for a banking group as they can be guided by the supervisory approach.

Draft supervisory statement - Identifying, monitoring, and managing exposures to shadow banking entities'

Questions

<u>Para 1.5:</u> - use of credit risk mitigation and exemptions

This paragraph confirms that the expectations set out in this SS shall only apply to a firm's exposure to an individual SBE where that exposure value, *after taking into account the effect of the credit risk mitigation in accordance with Article 399 to 400 of the Large Exposures (CRR) Part of the PRA Rulebook*, is equal to or in excess of 0.25% of the firm's tier 1 capital.

We believe Art 400 refers to exemptions. We suggest this paragraph should read:

> "after taking into account the effect of the credit risk mitigation <u>and exemptions</u>"?

Art 400 confirms that the exemptions shall apply for the purpose of Art 395(1).So if it should be applied for the purpose of managing exposures to SBE too this needs to be explicitly stated at this point.

Definition of Credit Intermediation activities

Para 1.6 offers a definition of "credit intermediation activities". We propose that:

1. this definition is moved to Para 1.2 of the Large Exposures (CRR) part of the PRA Rulebook, where it will be more obvious, rather than including it in the Supervisory Statement. Previous large-scale changes in light of Basel 3 finalisation have made good attempts at consolidating the Glossary and Definitions. The PRA should aim to maintain this approach. Para 1.4 of this Supervisory Statement already confirms "Unless otherwise specified, terms used in this Supervisory Statement have the same meaning as in the CRR and the relevant Part of the PRA Rulebook.", which should suffice.
2. Additionally we propose that all Annex 1 activities should be included for simplicity, rather than leaving the judgement up to each firm resulting in a possibly inconsistent application across the industry.

It would be helpful were the PRA to provide more guidance on how to consistently identify credit intermediation activities. Currently our reference data is held to facilitate credit risk treatment and is not at the level of granularity required to identify credit intermediation or excluded entities.

Firms wonder if the limit in Chapter 4 regarding Fallback mandatory approach would apply in practice? In particular would an excess of the limit amount to a breach as for those limits set out in Art 395(1)?

If the PRA believes this is a breach event, can the excesses be attributable to the trading book without there being a breach event with firms instead incurring an additional capital charge?

Groups of connected clients

Appendix 7	Draft supervisory statement – Identification groups of connected counterparties for large exposure purposes

Draft supervisory statement – Identification groups of connected counterparties for large exposure purposes

Section 2.3 states that firms should apply the definition of control on the basis of consolidated financial statements, control relationship between any natural or legal person and an undertaking that is similar to the relationship between a parent undertaking and subsidiary undertaking.

EBA connected client Guidelines paragraph 13c provides further guidance on how to assess control relationship between entities by adding the wording

> central governments***, and clients that prepare consolidated financial statements in accordance with the accounting rules of a third country***), institutions

Was as this an intentional omission by the PRA? If these indicators of control still apply, (we think they should) it would be helpful if PRA adds that section back into the Supervisory Statement.

Of course, we would be delighted to discuss our response with the PRA if more detail is required in relation to any of the points we have made.

Responsible Executive

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