A response to the PRA's consultation on CP26/18

UK withdrawal from the EU: Changes to PRA Rulebook and onshored Binding Technical Standards

Christmas Eve 2018

Introduction

UK Finance is pleased to respond to the PRA's Consultation Paper CP26/18 on *The Bank of England's approach to amending financial services legislation under the European Union (Withdrawal) Act 2018.* We and our members have been greatly helped in its preparation by Hogan Lovells. It should be read in conjunction with our response to PRA Consultation Paper 25/18.

UK Finance represents nearly 300 of the leading firms providing finance, banking, markets and payments related services in or from the UK. UK Finance was created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association. Our members are large and small, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. For many of our EEA and third country headquartered members their London operations are an important hub providing access for them and their clients to the international financial markets. Our members' customers are individuals, corporates, charities, clubs, associations and government bodies, served domestically and cross-border. These customers access a wide range of financial and advisory products and services, essential to their day-to-day activities.

The consultation is directly relevant to the large proportion of our members that are supervised by the PRA for prudential capital and liquidity purposes, so this response represents the views of a diverse cross-section of UK Finance's members.

MAIN issues

1. TRANSITION PERIODS

Generally, our members support a two-year transition period for the implementation of a change, unless there is an international development relevant to the individual policy area that is likely to be implemented after its expiration. Where this is the case, the transition period should be extended to avoid sequential changes that might arise, for instance in relation to credit risk, as a result of the introduction of the finalised Basel III framework in 2022. There may be other non-Basel related developments that are relevant for the transition timetable too.

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2. CONTRACTUAL RECOGNITION OF BAIL-IN

2.1 We agree with the PRA's proposal to amend Rule 2.1 of the Contractual Recognition of Bail-In Part of the PRA Rulebook so that the requirement does not apply in respect of EEA law governed liabilities that were created before exit day.

2.2 We note that the PRA does not propose to use the temporary transitional power in relation to EEA law governed liabilities (other than phase two liabilities) that are created after exit day. As a result, EEA law governed liabilities that are created or materially amended after exit day will have to include a contractual recognition term. We are concerned that, in the event of a hard Brexit on 29 March 2019, firms will have only a very short period in which to put new arrangements in place to:

(a) secure the inclusion of the relevant term in contracts and

(b) obtain a legal opinion regarding its enforceability, as required by Rule 2.2.

The PRA should consider transitional measures to allow firms additional time to comply with the requirement.

2.3 In addition to the transitional measures, there should be a mirror interim transitional measure for MREL purposes. In the absence of the relevant contractual wording, a higher capital requirement would apply. If firms will be given more time to comply with the requirement regarding the contractual term, they should also be given interim relief from the normal consequences of not having such a term in place.

2.4 We agree with the PRA's proposal to use the temporary transitional power to delay the obligation to include a contractual recognition of bail-in term in new or materially amended EEA law governed phase two liabilities after exit day.

3. STAY IN RESOLUTION

3.1 We agree with the PRA's proposal that the existing stock of financial arrangements governed by EEA law at exit day would not need to be updated under the PRA Stay in Resolution rules.

3.2 We note that the PRA proposes not to amend its Stay in Resolution rules and that firms will be required to comply with these rules in respect of new EEA law governed financial arrangements (or existing financial arrangements materially amended) after exit day. We are concerned that this may create a discrepancy for phase two liabilities benefiting from transitional relief in respect of the contractual recognition of bail-in rules. The fact that such liabilities could still be subject to the Stay in Resolution rules (without benefiting from any transitional relief in respect of such rules) could have the effect of undermining the application of the temporary transitional relief to the contractual recognition of bail-in term requirement, as firms are likely to include that contractual term to the extent Stay in Resolution wording is being added to the agreement governing the liability. It would be helpful if the treatment of the two requirements could be aligned, with the temporary transitional power being extended to the Stay in Resolution rules. We do not consider any such extension to give rise to risks to the resolvability of firms. As CP26/18 points out at paragraph 4.16, the amount of EEA law governed financial arrangements within the scope of the Stay in Resolution rules is low and it is unlikely that this amount would change after Brexit day. The PRA can always use its power of direction to remove impediments to resolvability if it judges that a particular firm has an unusually large amount of EEA law governed financial arrangements without Stay in Resolution wording.

3.3 Under the current proposals, firms would immediately have to repaper all clients with master agreements to ensure that new trades are covered by the required language. This would take

some time to complete. We would like to see a transitional measure under which firms will be given additional time to comply with the requirement.

4. RISK MITIGATION TECHNIQUES FOR OTC DERIVATIVE CONTRACTS NOT CLEARED BY A CENTRAL COUNTERPARTY

4.1 We are concerned about the impact of some of the proposed changes relating to the relevant RTS (EU Regulation 2016/2251). In particular:

(a) Changes to the range of eligible collateral

It is proposed that the categories of eligible collateral in Article 4 of the RTS will no longer include the following:

(i) debt securities issued by EU central governments or central banks;

(ii) debt securities issued by EU regional governments or local authorities;

(iii) debt securities issued by EU public sector entities;

(iv) shares in UCITS other than UK UCITS.

In relation to (i) to (iii), those securities would potentially still be eligible if their credit quality is assessed under Article 6 of the RTS, but such a credit quality assessment is not currently required in relation to such securities unless they are either not denominated or not funded in the issuer's domestic currency. In relation to (iv), only UK UCITS would be eligible – and there is no process (like that under Article 6 of the RTS) through which a credit quality assessment can be undertaken to make them eligible. In practice, this change will reduce the range of eligible collateral.

We appreciate that the proposed changes are consistent with the overall approach that the PRA has taken in replacing references to EU securities with UK securities, but in practice these changes will reduce the range of eligible collateral significantly. The changes will also have a disproportionate impact on firms: for example, on the day after exit day, non-UK UCITS would not be inherently any less creditworthy than they were the day before exit day, but firms would nevertheless have to disinvest from non-UK UCITS and find other forms of eligible collateral instead.

The proposed changes are likely to require repapering of existing contracts and changes to existing collateral arrangements that counterparties have in place, as well as operational changes for the relevant businesses. For example, collateral schedules will need to be immediately amended to reflect the changes to collateral eligibility rules. Counterparties will need to update operational processes to ensure adequate eligible collateral is available for exchange. Legal documents and collateral agreements will need to be amended and systems upgrades will be required effectively to cater for the UK being a separate regulatory/legal jurisdiction from the EU. For a typical member active in the derivatives markets, the exercise would involve amending 10,000–20,000 bilateral agreements.

The original implementation of the uncleared derivatives RTS took more than two years and, even within that timescale, the regulators had to issue forbearance statements to allow for the fact that it was impractical for the industry to implement the requirements in full by the original implementation deadline. It is therefore unrealistic to expect that firms will be able to adapt to similarly disruptive changes in a period of only a few months or weeks. In the

light of the above, transitional measures should be introduced to give firms additional time to adapt to the change, particularly in the event of a hard Brexit.

We would propose that a transitional period be introduced.

(b) Collateral management and segregation

Under Article 19(e) of the RTS, cash collected as initial margin must currently be maintained in cash accounts at central banks or credit institutions which are either authorised under the Capital Requirements Directive (CRD) (Directive 2013/36/EU) or are authorised in a third country whose supervisory and regulatory requirements have been found to be equivalent in accordance with the EU's Capital Requirements Regulation (CRR) (Regulation 575/2013).

Under the proposed changes, credit institutions that are not CRR firms (authorised under the UK's Capital Requirements Regulation) will be regarded as third country firms and will therefore have to have been assessed as equivalent before they can be used. In the event of a hard Brexit, it is highly unlikely that EEA credit institutions will themselves have undergone a formal assessment of equivalence before exit day (even though they should, by definition, meet the substantive requirement of the rule).

At exit day, UK firms may be holding cash with EU credit institutions and would be required to transfer that cash to UK credit institutions if they cannot continue to hold initial margin with EU credit institutions. This would require counterparties to look at their existing arrangements with custodians and see if any changes, including operational changes are required. We anticipate that this will be relevant, in particular, for those entities who will become subject to the uncleared margin requirements from September 2020 (i.e. entities with a group notional amount above EUR 8 billion), who are likely to utilise cash for initial margin and who will have a much smaller range of institutions available to them after the proposed change to the RTS is implemented.

We support transitional measures to give firms additional time to adapt to the change, particularly in the event of a hard Brexit, and assume that firms will not have to comply with the rule and RTS changes for a period of 2 years starting from Brexit day.

(c) Covered bond exemption

The covered bond exemption under Article 30 of the RTS currently provides for preferential treatment in respect of covered bonds – i.e. bonds which are issued by a credit institution which has its registered office in a Member State and is subject by law to special public supervision designed to protect bondholders. The proposal is to change the definition so that it only applies to bonds issued by credit institutions with a registered office in the UK.

The covered bond exemption is specifically carved out in the European Market Infrastructure Regulation (EMIR) (Regulation (EU) No. 648/2012) at Level 1 and this change would mean that counterparties will need to start posting variation margin and initial margin in respect of relevant trades. We would like to have transitional measures to give firms additional time to adapt to the change.

(d) Changes in EU law that are due to come into effect after exit day

(i) Known future changes to EU law

The RTS contains certain provisions which are not scheduled to come into effect in the EU until after exit day (which we have referred to in this paper as (Post Exit EU Changes). In particular:

(1) Article 36(1) of the RTS provides that certain provisions of the RTS only come into effect on 1 September 2019 (where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 750 billion) or 1 September 2020 (where the aggregate average notional amount is above EUR 8 billion and below EUR 750 billion); and

(2) Article 38 of the RTS brings single stock equity options back within the scope of Articles 36 and 37 after a three-year derogation.

Under CP26/18, the relevant Post-Exit EU Changes in the RTS will be deleted (and in the case of Article 38 replaced with a permanent derogation).

The Bank of England's stated position[1] is that firms should plan on the assumption that requirements arising from new EU legislation that comes into effect during an Implementation Period lasting until 31 December 2020 would apply to them. The proposed approach in CP26/18 is not inconsistent with that, as if there is a transitional period and firms can continue to operate on the basis of existing EU law, any Post-Exit EU Changes that take effect in the EU during the transitional period will also take effect in the UK. However, if no transitional period is agreed, the Post-Exit EU Changes will only become part of UK law unless the UK authorities take the relevant steps to replicate those requirements in UK law.

The industry would like guidance as to whether, in the event of there being no transitional period, it should be preparing to comply with the Post-Exit EU Changes. In relation to Article 36(1), the first deadline under the Post-EU Exit Changes is 1 September 2019, and firms will have to commence their implementation programmes very shortly, if indeed they have not already started them. The changes scheduled for 1 September 2020 will also affect a much larger number of firms, and so it would be useful to know, sooner rather than later, whether those firms will be expected to comply.

(ii) Changes still being consulted on in the EU

It would be helpful to understand the position of the PRA in relation to matters that are still being consulted on at an EU level. For example, clarification would be required around the variation margin (VM) rules for deliverable FX products under EMIR, to ensure that previous guidance is still applicable. CP26/18 does not address the draft RTS that is under review by the European Commission. This could result in these products becoming in scope for the VM rules from exit day. This would result in significant market disruption, as the industry would likely have to block trading until agreements are confirmed and operational capabilities established.

The industry would like guidance regarding the approach it should take to matters which are under consultation at an EU level – and, in particular, in relation to

[1] See the statement issued on 27 June 2018: "Bank of England's approach to financial services legislation under the European Union (Withdrawal) Act".

measures which may result in a change of EU law shortly after exit day and for which firms may need to begin any implementation preparations shortly.

4.2 Under Article 23 of EU Regulation 2016/2251, there is a derogation which permits counterparties not to exchange collateral in relation to non-centrally cleared OTC derivative contracts that are entered into with central counterparties (CCPs) that are authorised under the CRD. Under the proposed rules, the derogation will only apply to CCPs that are authorised by the PRA. As a result, counterparties would become subject to collateral requirements after exit day in relation to contracts that are cleared by EU CCPs and would either have to post additional collateral or seek to amend their contracts. We suggest that there should be transitional arrangements to allow counterparties time to adjust to the change.

5. RING FENCED BANKS

We agree with the PRA's proposal to require that Ring Fenced Banks using non-UK central counterparties (CCPs) or central securities depositories (CSDs) would need to ensure comparable outcomes in respect of account segregation to those specified for UK-based CCPs and CSDs.

6. TREATMENT OF NON-UK UCITS FOR CONNECTED CLIENT PURPOSES

6.1 The proposed change from "UCITS" to "UK UCITS" in Article 7 of EU Regulation 2014/1187[2] means that a transaction involving a non-UK UCITS will not constitute an additional exposure only if the supervisory and regulatory requirements of the third country in question are at least equivalent to those applied in the UK.

6.2 As the UK UCITS and EU UCITS regimes will be identical on exit day, we expect that this requirement will be satisfied, as a matter of substance. However, it is not clear whether any formal assessment of equivalence needs to be made, and firms do not have any comfort that such as assessment would be made in time for exit day. It would be appropriate to include transitional measures or a deeming provision so that non-UK UCITS will be considered equivalent for these purposes unless otherwise determined by the PRA.

7. TEMPORARY PERMISSIONS REGIME

7.1 The proposals in CP26/18 will result in a different application of the rules for the following types of firms under the temporary permissions regime (TPR).

(a) Firms in TPR with a branch in the UK

The PRA currently grants authorisation under the Financial Services and Markets Act 2000 (FSMA) to a number of UK branches of non-EEA financial institutions. The PRA already has well established rules and procedures for regulating such firms. We agree that the starting point should be for EEA firms in the TPR with branches in the UK (TPR Branch firms) to be in the same position as those non-EEA firms with UK branches.

However, we also consider that allowance should be made for the fact that TPR Branch Firms will, in most cases, have been operating an existing branch using a freedom of establishment passport under the Single Market Directives. Those firms will already have arrangements in place for that branch that will comply with the relevant requirements of EU law, but may need more time to adapt to the requirements that would apply to the branches of third country firms.

[2] See Annex L of The Technical Standards (Capital Requirements) (EU Exit) (No 1) Instrument (page 217 of CP26/18).

We note that the PRA is considering the use of transitional relief in relation to certain aspects of the following third country branch requirements:

(i) PRA remuneration rules where they go beyond the minimum CRD IV requirements; and

(ii) certain reporting obligations where they involve the segregation of branch data and the reporting and review of this data where this is not already required:

We support the use of transitional relief in both those situations.

In addition, a TPR Branch Firm will find itself within the scope of the Allocation of Responsibilities rules for the first time. This will include having to allocate the "UK branch prescribed responsibilities" and putting in place a management responsibilities map. In the event of a hard Brexit, such a firm would find itself with little time in which to undertake these tasks – and considerably less time than UK firms and third country CRR firms were given to comply with the rules when they were first introduced.

(b) Firms in TPR with no branch in the UK

As far as we are aware, the PRA has not granted authorisation any third country firms that do not have a branch in the UK. Historically, the PRA has only considered applications from third country firms that wish to establish a branch.

Under the TPR, the PRA could potentially be granting authorisation to any EEA firm that currently has a passport into the UK. This will include firms who currently only passport on a "freedom of services" basis and who have no branch in the UK. As a consequence, the PRA will find itself in the position where it has granted authorisation to a third country firm that does not have a branch in the UK (a TPR Services Firm). As there is no current precedent for this, the PRA has to consider how its rules would apply to TPR Services Firms.

(i) <u>When will the rules apply?</u>

In the proposed changes to the PRA Rulebooks, the requirements are usually expressed to apply to a TPR Services Firm "in relation to its activities in the UK".[3] It is not always clear, however, when an activity would be regarded as being carried on in the UK. Different EU jurisdictions take different approaches to the questions of where the activities of accepting deposits or lending are carried out.

For example, if a TPR Services Firm accepted deposits from UK customers in its home state, would the PRA maintain that this was part of the TPR Services Firm's activities in the UK? In that situation, it is also possible that the home state regulator of the firm would assert jurisdiction over the same activity – which creates the possibility of the firm being subject to conflicting requirements from two regulators in relation to the same activity. (It is also conceivable – but much less likely - that both regulators might disclaim responsibility for the activity, in which case the activity may not be properly supervised and would put consumers at risk.)

Similar issues also arise in relation to the Senior Management Function Part in relation to the concept of "activities which are subject to the UK regulatory system". The definition of "regulatory system" refers to UK statutes which would not have legal

[3] This formulation is used in the draft Allocation of Responsibilities Part, the draft Certification Part, the draft Conduct Rules Part, the draft Fitness and Propriety Part, the draft Senior Management Part and the draft Senior Managers Regime – Applications and Notifications Part.

effect outside the UK, and TPR Services Firms may not be able to understand what their obligations are.

We think it is important that additional clarity is given, so that TPR Services Firms can understand exactly when the PRA requirements will apply to them.

(ii) Which rules will apply?

As noted in paragraph 7.4 of CP26/18, the PRA is considering applying a more limited set of rules to TPR Services Firms than it would to TPR Branch Firms. We have set out below our comments on those requirements which the PRA has said could apply to TPR Services Firms:

Requirement	**Comment**
Fundamental Rules Part	In principle, none of the Fundamental Rules are inappropriate for a TPR Services Firm. However, we see the potential for disputes between the PRA and the firm's home state regulator, where their rules might differ. For example, does the PRA anticipate that, in the pursuance of Fundamental Rule 6, it would be able to direct how a TPR Services Firm organises and controls its affairs in its home state where those matters could have an impact on the business that the PRA regarded as being that firm's activities in the UK?
Auditors Part	Some of the requirements are appropriate – for example, the obligation to notify the PRA of a change of auditor. However, Rule 2.2 allows the PRA to appoint an auditor for the firm – how would that work where the home state regulator may have a similar right? Although the PRA's right would only apply in relation to the firm's activities in the UK, we would question whether it will be possible in practice to draw a distinction between those activities and the firm's non-UK activities.
Change in Control Part	We think it is appropriate for the Change in Control Part to apply in full to TPR Services Firms. It already applies at an entity level in relation to third country firms with UK branches, and there is no reason why it should not apply at an entity level to TPR Services Firms.
Close Links Part	We think it is appropriate for the Close Links Part to apply in full to TPR Services Firms.
Fees Part	In principle, we think it is appropriate for Fees Part to apply in full to TPR Services Firms. However, there are several references in the Fees Part that would need to be updated. We note that CP26/18 does not contain any proposed amendments in relation to the Fees Part.
General Provisions Part	Many of these provisions would be appropriate for TPR Services Firms. However: • It is not clear whether a TPR Services Firm would be subject to the rule regarding disclosure to retail clients in Rule 3 or Rule 6. If it is the former, there is a possibility of a conflict between those rules and the rules of the firm's home state regarding disclosure. The PRA may wish to consider what approach it would take in that situation.

Requirement	Comment
	• TPR Services Firms may – depending on what the rules in their home country allow – already have arrangements in place which would amount to a breach of Rule 7 (Insurance Against Financial Penalties). The PRA may wish to consider allowing transitional relief for existing arrangements, to prevent such firms automatically going into breach.
Information Gathering Part	There could be practical difficulties with the application of these rules in respect of a TPR Services Firm which has no branch in the UK: • The firm may already have outsourcing arrangements in place which do not require the suppliers to co-operate with the PRA (although in many cases such provisions will have been required by EU law, such as MiFID II). • Access to premises, documents and personnel in the firm's home state may not be possible – for example, if local law prevents it.
Interpretation Part	We think it is appropriate for the Interpretation Part to apply in full to TPR Services Firms.
Notifications Part	We think it is appropriate for the Notifications Part to apply in full to TPR Services Firms, subject to the changes to that Part proposed in CP26/18.
Use of Skilled Persons Part	We think it is appropriate for the Use of Skilled Persons Part to apply in full to TPR Services Firms. However, the PRA may wish to consider whether additional provisions are necessary to reflect the fact that the third country firm will be operating outside the territorial scope of the FSMA (see point (iii) further below) and so would not be bound by some of the requirements that apply to authorised firms under the FSMA (e.g. to give the skilled person assistance).
SM&CR requirements	We note that the PRA's proposed approach for TPR Services Firms differs from that proposed by the FCA in its Consultation Paper, under which the current requirements that apply to EEA branches under the SMCR and approved persons regime will be maintained throughout the period during which the firm is in the TPR.[4] We do not think it is helpful for the PRA and the FCA to take different approaches, and we would encourage the PRA to consider whether it could align its approach with that of the FCA. If the PRA does take a different approach to the FCA, we have the following comments on the PRA's proposals in CP26/18: • We note from paragraph 7.9 of CP 26/18 that TPR Services Firms will be required to appoint an individual to the Head of Third Country Branch function (SMF19). If such a requirement is to be included: o In order to avoid confusion, we think the function should be renamed for this particular type of firm so that it does not refer to a branch. o We agree that the proposed application of the Allocation of Responsibilities Part (subject to the draft amendments in CP26/18) are appropriate for TPR Services Firms.

[4] FCA Consultation Paper 18-36, at paragraph 4.8.

Requirement	Comment
	We note that the PRA is considering using its temporary transitional power to provide for transitional relief for TPR Services Firms in relation to Certification. We would encourage the PRA to also use its power in this way. Under the passporting regime, certification only applies to staff based in the UK, and do not consider that the risks associated with the UK ceasing to be part of the EU would require a different approach to be taken. The PRA should have sufficient comfort in relation to a TPR Service Firm's UK operations through the requirement on such a firm to appoint a person to the SMF19 function. Please also note the comments in paragraph 12 below regarding the desirability of the PRA clarifying its intentions in relation to matters where it has said that it is "considering" using its temporary transitional power.
FSCS rules (as amended)	Our understanding is that TPR Services Firms will essentially be outside the scope of the FSCS. For the reasons given in paragraph 8 below, we agree with this approach.

(iii) Do the rules need to be supplemented?

Generally, UK statutes apply only to persons and activities in the UK (unless the UK seeks to assert extra-territorial application). This could present a difficulty in relation to the application of the FSMA to TPR Services Firms. Such firms would not have a presence in the UK and therefore the FSMA would not apply to them other than in respect of the activities they undertake in the UK (and in relation to the meaning of this, please see the point made further above).

This could lead to problems for the PRA in securing the necessary regulatory outcomes. The PRA currently operates on the basis that its Rulebook will be complemented by various provisions of UK law. As an example (see further above), section 166(7) of the FSMA imposes an obligation on persons (whether regulated or not) to assist a skilled person. If a UK person failed to comply with such an obligation, the PRA could take steps against that person (e.g. to secure their performance with the obligation). That obligation would be difficult to enforce, however, against a person who was not present in the UK.

In relation to TPR Services Firms, the PRA should consider supplementing its rules to make it a condition of any regulatory approval under the TPR to comply with, and accede to the jurisdiction of the PRA in respect of, UK regulatory obligations.

7.2 In relation to senior managers, we note the PRA's proposal in relation to deemed approvals. If the PRA uses its discretion under the TPR SI to approve individuals in this way, this should help reduce disruption to the firms in question and we therefore welcome it. However, it would be helpful if the PRA could be more definitive about the exercise of its discretion – and, in particular, if the PRA could indicate if there are circumstances in which an individual might not receive a deemed approval and where a firm may have to take alternative steps in relation to its senior management.

8. *Proposals relating to FSCS protection*

8.1 We agree with the proposed approach under which FSCS depositor protection will only apply to eligible deposits held by UK establishments of firms. In particular:

(a) Following exit day, the UK will be a third country and will be unable to rely on cooperation arrangements with deposit guarantee schemes in the EU under the Deposit Guarantee Scheme Directive (DSGD). The ability of UK customers of a UK branch of an EEA bank to claim compensation in the event of the failure of that bank should not depend upon whether they would be eligible to claim under the relevant deposit guarantee scheme in that bank's home state. FSCS coverage should apply in that situation, and third country firms with UK branches should be required to contribute to the FSCS.

(b) The FSCS should not cover any EEA branches that UK firms may be permitted to operate after exit day. This reflects the fact that there is no guarantee of reciprocity from EEA deposit guarantee schemes. It is also consistent with the approach currently taken in relation to branches of UK deposit takers in third countries.

(c) The FSCS should not apply in relation to the activities of a third country firm that has PRA authorisation but does not have a branch in the UK. This is consistent with the approach that currently applies under the DGSD and so would not necessitate a change in approach from such firms. As long as the relevant third country firms are required to make proper disclosures to UK customers regarding their lack of coverage under the FSCS (and the availability of coverage under the relevant DGSD scheme in their home country), it would be appropriate for them to remain outside the scope of the FSCS.

(d) The communication and notification requirements are challenging within the proposed timescale. However, some of the implementation could be achieved in coordination with FSCS (e.g. cross industry communication). The last time there were such extensive changes to depositor protection rules, there was a much longer implementation period than is proposed in the consultation paper.

These provisions will apply to all firms and not only to TPR Branch Firms.

8.2 We agree that the requirements of the Depositor Protection Part should in due course apply to TPR Branch Firms in the same way as they currently do to third country firms that have a Part 4A permission to accept deposits. However, TPR Branch Firms are not currently subject to the PRA requirements and may need additional time to comply with the requirements, particularly with regard to:

(a) the Single Customer View (SCV) requirements;

(b) other disclosure requirements to customers; and

(c) the provision of information to the FSCS and to the PRA/FCA.

8.3 The implementation of the SCV requirements in the UK presented significant technical challenges, in particular with regard to IT, and it is unrealistic to expect affected firms to be able to comply with the requirements by exit day in the event of a hard Brexit. It would therefore be appropriate to have transitional measures.

9. *Consolidated Supervision*

9.1 Under the current rules, consolidated supervision takes place on an EEA-wide basis. The effect of the proposed changes is that the relevant provisions will only apply within the UK, so that the firm at the top of the consolidation group will be a UK company.

9.2 For groups which are comprised only of UK firms or UK firms and non-EEA firms, this is unlikely to be a significant change. However, for groups which contain a UK firm with an EEA parent undertaking, this will mean that it will have to produce its accounts consolidating at two levels – i.e. at the UK level and separately at the EEA level. This could result in the duplication of reporting. We would encourage the PRA to consider whether any steps can be taken to reduce the risk of duplication in this area – for example, through the granting of waivers (as the PRA currently does in the context of some insurance companies). If the PRA is minded to consider this, it would be helpful if the PRA could make its views known, so that firms can start considering what steps to take in response.

10. FINANCIAL CONGLOMERATES

10.1 In keeping with the changes made in relation to consolidated supervision (where the position is considered on a UK basis only), the Financial Conglomerates rules are also being changed so that it considers the position within the UK only and not across the EU. This could result in the duplication of work at a UK and an EU level. As with consolidated supervision (see above), we would encourage the PRA to consider whether steps can be taken to reduce the risk of duplication (e.g. through the granting of waivers) and to make its views known if it would be minded to consider this.

10.2 In the event of a hard Brexit, some groups would find it difficult in practice to report to regulators within the relevant timeframes on a different basis to that under the rules that had applied previously. The PRA should consider putting in place transitional measures which would affected groups additional time to comply with the new requirements.

11. REFERENCES TO EBA STANDARDS

11.1 There are several provisions of EU law where reference is made to EBA guidelines and reports. While we agree that it is appropriate for those provisions not to be incorporated into UK law after Brexit, the PRA should – in the interests of continuity – either issue alternative guidelines of its own or direct firms to continue to follow the EBA document unless and until notified otherwise.

11.2 As we have noted in our separate response to the PRA's CP25/18, the list of ESA guidelines and recommendations that the PRA expects firms to comply with is currently not exhaustive. However, in order to ensure a consistent application of the legislation, we would ask that the PRA provide such a list ahead of exit day and also clarify whether the guidance issued via the ESA's Single Rulebook Q&As will continue to apply after that date.

12. PRA'S INTENTION TO USE TEMPORARY POWERS

12.1 In some places in CP26/18, the PRA only says that it is "considering" exercising the temporary transitional powers in the event that there is no Implementation Period.[5] This still leaves some uncertainty for firms in relation to the following questions:

(a) whether the PRA it will in fact exercise those powers; and

[5] The specific areas where the PRA says that it still only "considering" the use of temporary transitional relief are:

- transitional relief for TPR Services Firms in relation to Certification Regime, Conduct and Regulatory References Requirements (paragraph 7.12 of CP26/18); and
- certain aspects of third country branch requirements, namely: (i) PRA remuneration rules where they go beyond minimum CRD IV requirements; and (ii) certain reporting obligations where they involve the segregation of branch data and the reporting and review of this data where this is not already required (paragraph 7.14 of CP26/18).

(b) how it will exercise those powers – i.e. exactly what the nature of the transitional relief will be; and

(c) how long any transitional relief will last for.

12.2 This approach contrasts with other sections of CP26/18, where the PRA sets out more unequivocally what its approach will be under the temporary transitional powers.

12.3 We appreciate that the PRA is having to formulate its approach within very short timescales, but it also creates uncertainty if the industry cannot anticipate exactly what the PRA's approach will. In relation to each of these issues, we would encourage the PRA to determine its approach and either consult on or publish the details as soon as possible.

APPENDICES 1, 2 AND 3

We do not have any comments on these appendices.

APPENDIX 4: DRAFT PRA RULEBOOK: EU EXIT INSTRUMENT

If a specific Part of the PRA Rulebook is not identified in the table below, we have no specific comments to make in relation to it.

Rulebook Part	Annex[6]	Comments
Glossary	A	Definition of "MiFID investment firm": the reference to paragraph 2.1A of MiFIR appears to be incorrect. MiFIR (Regulation (EU) No 600/2014) does not have paragraphs.
		Definition of "regulated market": • In (1), we thought that the words "a regulated market as defined in" should not have been deleted. • The cross-reference to Article 2(1)(13) of MiFIR may not be appropriate, as that Article (both in the EU version of MiFIR and the version that comprises part of retained direct EU legislation) simply cross-refers to the definition in MiFID II. This means that the definition in the PRA Rules would change automatically if the definition in MiFID II changed. We understood that the intention was future changes to UK law would have to be purposefully made by the UK authorities rather than following automatically from changes made within the EU.
		Definition of "regulatory system": There is a reference to arrangements for regulating a firm in or under an EU Regulation (which is not a defined term). Under the proposed changes to the Interpretation Part, this could be construed as a reference to such a Regulation only as it has effect as retained direct EU legislation on exit day, but we had assumed that the Interpretation provision was aimed at specific items of legislation rather than EU Regulations generically. It may be preferable to refer to retained direct EU legislation in this definition of "regulatory system" to avoid any confusion.
Allocation of Responsibilities	E	See the comment in paragraph 7.1(a) of our main comments regarding the need for transitional measures for firms who will become subject to these obligations for the first time with effect from exit day.
		See the comment in paragraph 7.1(b) of our main comments regarding the meaning of the firm's "activities in the UK".
		In Rule 1.1(3)(b), the word "its" should be inserted before "activities"
		There is inconsistent wording – for example, in Rules 1.1(3)(b) and 6.1, its says "activities in the UK", whereas in Rule 6.2 it says "UK activities". It

[6] All references to Annexes in this table are to the Annexes to the draft PRA Rulebook (EU Exit) Instrument contained in Appendix 4 of CP26/18.

Rulebook Part	Annex[6]	Comments
		would be preferable to use the same phrase, to avoid any possibility of different interpretations being made.
		Rule 6.2 potentially applies not only to third country CRR firms with a UK branch but also third country CRR firms without a branch. The use of the term "UK branch prescribed responsibility" is potentially confusing if it applies in both situations.
Auditors	G	See the comment in paragraph 7.1(b) of our main comments regarding the application of this Part to a third country CRR firm with no UK branch.
Certification	I	See the comment in paragraph 7.1(b) of our main comments regarding the meaning of the firm's "activities in the UK".
		In Rule 1.3, it should be made clear which statute section 59ZZA is from. It may be appropriate to introduce a defined term.
Conduct Rules	N	See the comment in paragraph 7.1(b) of our main comments regarding the meaning of the firm's "activities in the UK".
		The wording contained in paragraph 1.1(1) of Annex N (showing the unamended text) does not appear to be consistent with the current wording of the Conduct Part. There should be a reference to functions performed by a person in relation to a firm.
		It is not clear why Rule 1.1(2)(f) needs to refer to a person in relation to whom a section 59ZZA notice "could be given". The Conduct Rules should only apply to a person who is actually performing a function in relation to a regulated firm, not to those who have not yet been appointed.
Contractual Recognition of Bail-In	O	See the comment in paragraph 2 of our main comments regarding the application of the rules to contracts made after exit day. Additional transitional provisions should be included.
		The definition of "eligible deposit" has deleted, but that term is still used in the definition of "excluded deposit" and is now undefined. The concept of "eligible deposits" is used in the Depositor Protection Part but it is not clear whether that definition is intended to apply in the Contractual Recognition of Bail-In Part.
		The wording in the amended Rule 2.1A is slightly different to the existing wording. Instead of saying that firms are not required to comply with Rule 2.1 in respect of a phase two liability where it is impracticable to do so, it now says that a contract does not need to be included where it is impracticable to include such a term. We are not sure whether this is intended to achieve a change of genuine substance. If it is, could the PRA explain the purpose of the change.
Depositor Protection	R	See the comments in paragraph 8 of our main comments.
		There are a number of rules in this Part that TPR Branch Firms will have to comply with from exit day, such as:

Rulebook Part	Annex[6]	Comments
		• Rule 12.1 and 12.2: obligations on firms to provide certain information within 24 hours • Rule 12.5: obligation on the firm to provide the FSCS with single customer views and exclusions views within 3 months of receiving a Part 4A permission to accept deposits • Rule 17.3: obligation to provide an information sheet and exclusions list to depositors within 2 months • Rule 23: obligation to provide certain deposit compensation information in the physical branch and on the firm's website (which would apply from exit day without any grace period.) We are mindful that it is desirable for the UK approach not to get out of step with that under the DGSD. However, particularly in the event of a hard Brexit on 29 March 2019, it is going to be challenging for firms to comply with the requirements in the time available. We therefore think it would be appropriate for transitional measures to be introduced.
General Provisions	Y	Rule 5.1(2) currently says that disclosures about regulated status need not be made by an incoming firm that is subject to equivalent rules in its home Member State. The proposal is to replace this with a reference to a "third country firm" that is subject to equivalent rules. We have two comments: • The rule does not make clear how and when equivalence will be assessed. The PRA should clarify whether third country firms from the EEA will automatically be considered equivalent on exit day – or, if not, how and when third country firms will be able to determine their status under this rule. • Some third country firms that are currently authorised by the PRA (e.g. US firms) and have to make such a disclosure under the existing rule, might now cease to become subject to that rule, depending on how and when third countries are determined to be equivalent. Has the PRA considered the possibility of existing third country firms becoming subject to lesser requirements?
		Under Rule 6.1(2), a third country firm which issues communications in connection with activities carried on from an establishment outside the UK and indicates that it is a PRA-authorised person, must also indicate that the regulatory system applying will be different to that of that of the UK. Under the proposed change, such third country firms would not be required to make such a disclosure if their regime was equivalent. This raises similar issues to those for Rule 5.1(2) above – i.e.: • The rule does not make clear how and when equivalence will be assessed. The PRA should clarify whether third country firms from the EEA will automatically be considered equivalent on exit day – or, if not, how and when third country firms will be able to determine their status under this rule. • Some third country firms that are currently authorised by the PRA (e.g. US firms), and have to make such a disclosure, might now cease to become subject to that rule, depending on how and when third countries are determined to be equivalent. Has the PRA considered the possibility of existing third country firms becoming subject to lesser requirements?

Rulebook Part	Annex[6]	Comments
Internal Governance of Third Country Branches	AP	We do not have any comments on the proposed amendments in Annex AP, but we note that the current version of this Part – even though it appears only in the non-CRR firms section of the PRA Rulebook – is stated to apply only to third country CRR firms.
Notifications	AW	Rule 8.2 requires a Bank Recovery and Resolution Directive (BRRD) undertaking which is a CRR firm to notify the PRA immediately if its BRRD management body considers that "extraordinary public financial support" is required for that undertaking or the group of which it forms part. The current definition of "extraordinary public financial support" covers State Aid provided by an EEA Member State and also any public support at a supra-national level. Under the proposed changes, the definition of "extraordinary public financial support" has been changed so that it now only covers "State Aid" granted by an EEA State. Our comments in relation to this are as follows: • Third country firms are not currently subject to this rule (unless they could obtain support at a supra national level, which we do not think is the case outside the EEA). If the objective is to treat EEA firms the same way as other third country firms, either the obligation should be removed for EEA firms or should be extended to cover similar financial support that would apply to non-EEA third country firms. If, however, it is determined that EEA firms should be subject to this requirement, it is not clear why the reference to supra-national support should be removed from the definition of "extraordinary public financial support". • It appears that UK firms would be outside the scope of this requirement. While UK firms will be subject to other notification requirements under the PRA Rules that would give the PRA advance notice of potential financial difficulties for the firm, it is not clear why UK firms should be treated differently to EEA firms.
Recovery Plans	BC	In Rule 2.5, it says that a recovery plan must not assume any access to or receipt of "extraordinary public financial support". The proposed change is that that term now refers only to "State Aid" – i.e. aid granted by an EEA State. This means that firms who would potentially be able to obtain aid from an EEA State would potentially be treated differently those that would not. Third country firms from non-EEA states are not currently subject to Rule 2.5. See also the comments for the Notifications Part, above.
		The proposed definition of "UK parent undertaking" (and the defined terms referred to in that definition) do not require that the relevant firm be incorporated in the UK - only that it be authorised in the UK. An EEA bank which obtains authorisation from the PRA will therefore be caught by the requirement to produce a group recovery plan for the PRA (as well as being subject to obligations pursuant to the BRRD to do the same in its home state).
Remuneration	BG	In Rule 15.13, the PRA proposes to delete the references to the EBA guidelines. We agree with this approach, but in the interests of continuity the PRA should either: • issue its own guidelines in place of the EBA guidelines to ensure continuity of approach; or

Rulebook Part	Annex[6]	Comments
		• require firms to continue to follow the EBA guidelines until such time as the PRA has an opportunity to consider whether it wishes to provide guidelines of its own.
Senior Management Function	BN	In relation to Rule 1.1(3)(b), see the comment in paragraph 7.1(b) of our main comments regarding the meaning of the firm's "activities in the UK". In addition, Rule 7.2 uses the concept of "all activities which are subject to the UK regulatory system" to describe the scope of responsibility for the SMF19 function holder. The definition of "regulatory system" refers to UK statutes which would not have legal effect outside the UK, and firms with a TPR but no UK branch may not be able to understand what their obligations are. The wording is also arguably inconsistent with the proposed wording for Rule 1.1(3)(b). We appreciate that the new wording tracks the existing wording of Rule 7.2, which applies to third country firm in the context of UK establishments. However, where a firm has a UK establishment, there is little doubt that the UK regulatory system will apply to that establishment. The position is less clear for firms with no UK presence, and additional guidance would be welcome.
Senior Managers Regime – Applications and Notifications	BO	See the comment in paragraph 7.1(b) of our main comments regarding the meaning of the firm's "activities in the UK".
Stay In Resolution	BQ	See the comment in paragraph 3 of our main comments regarding the need for transitional provisions in relation to new obligations which are entered into (or existing obligations which will be materially amended) after exit day.

Appendix 5: Draft BTS EU Exit Instruments

If a specific draft BTS EU Exit Instrument (or a specific part of a draft BTS EU Exit Instrument) is not identified in the tables below, we have no specific comments to make in relation to it.

EU Exit Instrument: The Technical Standards (Capital Requirements) (EU Exit) (No 1) Instrument (page 217 of CP26/18)

Subject	**Annex**	**BTS**	**Comments**
Material risk-takers	B	EU Regulation 604/2014	Article 2: It is not obvious why the "without prejudice wording" – which requires the regulator to have regard to the wider principles in Articles 92, 93 and 94 of Directive 2013/36 – has been removed. Should the recast obligation not be subject to a similar qualification that refer to the UK that enacted those provisions of the Directive?
Benchmarking: portfolio assessments	E	EU Regulation 2017/180	There are references in Articles 3 and 9 to EBA Reports. We agree that it is appropriate to remove those references, but in the interests of continuity does the PRA intend to either publish anything in place of the EBA Reports or require firms to continue having regard to the EBA functions until the PRA decides whether to publish anything of its own?
Definition of own funds	F	EU Regulation 2014/241	The revised RTS contains references to Article 29(6) of Regulation 575/2013, which in turn refers to EBA standards. The approach taken elsewhere in the CP has been to remove cross-references to the EBA.
Determining overall exposure to client or group of connected clients in respect of transactions with underlying assets	L	EU Regulation 2014/1187	See paragraph 6 from our main comments.

EU Exit Instrument: The Technical Standards (Capital Requirements) (EU Exit) (No 2) Instrument (page 265 of CP26/18)

Subject	Annex	BTS	Comments
Globally Systemically Important Institutions	A	EU Regulation 1222/2014	We note that the PRA will make its identifications of globally systemic important institutions by reference to the results of the sampling exercise that is undertaken by the EBA. Has it been agreed that the UK regulators will continue to have access to that information?
Criteria for the application of a preferential liquidity outflow or inflow rate for cross-border undrawn credit or liquidity facilities	C	EU Regulation 2017/1230	Should there be provisions replicating the processes referred to in Article 20(1) of the CRR (Regulation (EU) No. 575/2013)?

EU Exit Instrument: The Technical Standards (Central Securities Depositories Offering Ancillary Banking Services) (EU Exit) Instrument (page 275 of CP26/18)

Subject	Annex	BTS	Comments
Financial resources for credit and liquidity risks	Annex	Regulation 2017/390	Article 10(2)(h)(iii): Under the current rules, collateral which takes the form of securities issued by a "Union central bank" is exempt from being regarded as "lower quality". The proposal is that this exemption will only apply in respect of the Bank of England going forwards and that there will be no exception for other EU central banks. If transitional relief is not granted, this could create negative capital implications for the UK CSD service provider. If EU central banks have not experienced a material change in circumstances due to Brexit, it is difficult to justify treating them as lower quality. We would like to see transitional provisions so that firms which currently hold collateral issued by Union central banks can continue to benefit from the exemption.
			Article 14 (collateral concentration limits): Under the current rules, a CSD-banking service provider must ensure that no more than 10% of its intraday credit exposure is guaranteed by certain types of entity – including a third country financial institution that is subject to and complies with prudential rules that are at least as stringent as those in the CRD and CRR. Under the proposed changes, the revised wording will only regard an EU financial institution as

Subject	Annex	BTS	Comments
			acceptable if the Treasury has by regulations determined the relevant third country as being equivalent. It would be helpful if firms can have more certainty ahead of exit day regarding the future status of the guarantees given by EEA banks, so that they do not have to make significant changes to their existing collateral arrangements ahead of exit day. The following approaches would be a potential solution: • The wording of the RTS could be amended so that no formal step had to be taken by the Treasury at all. We note that in Article 38, the term "at least as stringent" is used without there being a need for any formal steps to be taken. • The Treasury could actually enact the relevant regulations in good time before exit day. • A transition arrangement either for all such exposures to EEA banks or to those with which UK CSD service providers have existing exposures.
			Article 15(2): Under the current rules, "other equivalent financial resources" do not include commercial bank guarantees issued by an entity in the same group as the borrower, unless that entity is an EEA central bank. The proposed change is that this rule will only refer to the Bank of England and there will be no exception for other EEA central banks. There should be transitional provisions so that firms do not need to make significant changes to their existing arrangements in respect of other equivalent financial resources ahead of exit day.
			Article 15(3): Under the current rules, "other equivalent financial resources" include bank guarantees issued by a Union central bank. The proposed change is that this rule will only apply in respect of the Bank of England going forwards and that there will be no exception for other Union central banks. There should be transitional provisions so that firms do not need to make significant changes to their existing arrangements in respect of other equivalent financial resources ahead of exit day.
			Article 23 (General requirements for the management of intra-day credit risk): Under the current rules for the management of intraday credit risk, certain exposures are exempt from the application of the rules – including exposures to members of the European System of Central Banks and bodies performing similar functions in other member states. These exemptions will now only apply to the Bank of England and similar UK bodies. There are exemptions for exposures to third country central banks that are denominated in the domestic currency of that central bank where that third country is subject to equivalent supervisory and regulatory arrangements. In the proposed changes, exemptions for third country central banks will continue where they are determined by the Treasury "by regulations" to be equivalent to the UK. As with Article 14 (above), we would prefer not to rely on regulations to have

Subject	Annex	BTS	Comments
			been passed and would prefer either (i) a test that does not rely on a step to have been taken or (ii) to have transitional measures to allow firms additional time to comply with the requirement.

EU Exit Instrument: The Technical Standards (European Market Infrastructure) (EU Exit) Instrument (page 284 of CP26/18)

Subject	Annex	BTS	Comments
Risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty	Annex	EU Regulation 2016/2251	See paragraph 4 from our main comments.
			In Article 4, it is proposed that the categories of eligible capital be changed so that the following are no longer regarded automatically as eligible collateral: • debt securities issued by EU central governments or central banks, EU regional governments or local authorities or EU public sector entities; and • UCITS which are not UK UCITS. If such investments cease to be eligible collateral on exit day, this is likely to cause operational and financial difficulties for counterparties subject to UK EMIR. We would like to see transitional measures in respect of these provisions.
			Under Article 19(e), cash collected as initial margin must currently be maintained in cash accounts at central banks or credit institutions which are either authorised under the CRD (Directive 2013/36/EU) or are authorised in a third country whose supervisory and regulatory requirements have been found to be equivalent in accordance with the CRR (Regulation 575/2013). Under the proposed changes, credit institutions that are not CRR firms (authorised under the UK's Capital Requirements Regulation) will be regarded as third country firms and will therefore have to have been assessed as equivalent before they can be used. We note that the test for equivalence in the draft instrument continues to refer to the EU's version of the CRR and not to any onshored equivalence test that would be carried out under UK legislation; we assume this is a mistake and that it should be an onshored test that applies. Even if this correction is made, and the equivalence assessment is to be made by reference to the UK rules, it is not clear that the necessary equivalence assessments will have been made by exit day. At exit day, UK firms may be holding cash with EU credit institutions and would – in the absence of an equivalence assessment in respect of such institutions - be required to transfer that cash to UK credit institutions. This would require counterparties to look at their existing arrangements with

Subject	Annex	BTS	Comments
			custodians and see if any changes, including operational changes, are required. One solution would be for the PRA and FCA to make an assessment of EEA countries as being equivalent for the purposes of this rule. Alternatively, we would like to see transitional measures in respect of these provisions – e.g. so that EU credit institutions are considered to be equivalent.
			The covered bond exemption in Article 30 currently provides for preferential treatment in respect of covered bonds – i.e. bonds which are issued by a credit institution which has its registered office in a Member State and is subject by law to special public supervision designed to protect bondholders. Under the proposed changes, the definition of "covered bond" will change so that it only covers to bonds issued by credit institutions with a registered office in the UK. The covered bond exemption is specifically carved out in EMIR at Level 1 and this change would mean that counterparties will need to start posting variation margin and initial margin in respect of relevant trades. We would like to see transitional measures in respect of these provisions.

EU Exit Instrument: The Technical Standards (Bank Resolution and Recovery Directive) (EU Exit) (No.2) Instrument (page 294 of CP26/18)

Subject	Annex	BTS	Comments
Recovery plans, intra-group financial support, contractual recognition of bail in, notifications etc	B	EU Regulation 2016/911	Article 1(6) – reference updated to section 62A of the Banking Act 2009. It is the right reference (although it does not wholly cover the same ground) but this sub-article should now be deleted in its entirety. The use of those references in Article 1 is intended to set out a list of matters covered by the Regulation. However, the sections of the original Regulation for which the reference has been updated are Articles 22-32, which deal with valuers and independence and (in line with the updated reference) this is no longer covered at all in the Regulation but is instead in the Banking Act.
			Article 1(8) – is amended to refer to a notice of suspension "referred to in" sections 24, 25, 28, 28T and 89J of the Banking Act. Those sections do not refer to a notice of suspension.
			New definition of "recovery and resolution entity". We note that this is drawn from, but different to, the definitions used in the Banking Act and the current PRA Rulebooks. It would be helpful if the PRA could clarify why the differences are necessary.

Subject	Annex	BTS	Comments
			Amendments made to Article 17 do not include an update to Article 17(4) reference to 2014/59/EU sections requiring plans on an individual basis (which has been updated elsewhere to No 2 Order Article 24).
			Amendments made to Article 43(2): in sub-section (a) a new defined term has been introduced of "relevant date". For consistency this should be used in sub-sections (b) and (c) of the same Article.

EU Exit Instrument: The Technical Standards (Financial Conglomerates) Instrument (page 342 of CP26/18)

Please see paragraph 10 of our main comments (above) in relation to financial conglomerates.