

Insight: Regulatory

February 2014

New Rulebook for the PRA

The UK Prudential Regulation Authority (“**PRA**”) is consulting on fundamental reforms to its handbook of rules and guidance.

The PRA’s current handbook of rules and guidance is inherited largely from provisions contained in the Financial Services Authority’s (“**FSA**”) handbook, before its dissolution in April last year. The consultation is the first in a series of consultations designed to replace the handbook with a “PRA Rulebook”.

The PRA’s intention is that, going forward, the Rulebook will only contain rules. In a deviation from the previous FSA approach, the Rulebook will not incorporate any guidance on the application of individual rules. The PRA will instead provide guidance material in the form of “Supervisory Statements” that will be accessible separately on the PRA website.

The consultation proposes the removal of the PRA “Principles for Businesses” – a set of 6 key principles inherited from the FSA that set out the key obligations and expectations on firms authorised by the PRA. These Principles will be replaced with “Fundamental Rules” which will form the foundation of the PRA Rulebook. The Fundamental Rules will be structured in a similar manner to the Principles – acting as overarching requirements that apply to PRA authorised firms at all times. The PRA has indicated that the Fundamental Rules can apply where no other PRA rules exist – and as such they may be used to identify areas where further PRA rules are needed. The PRA could therefore take enforcement action against a firm for a breach of the Fundamental Rules even in cases where no underlying detailed rule has been breached.

The Fundamental Rules have been drafted to be “short and memorable.” The proposed Fundamental Rules are:

- FR1: A firm must act with integrity.
- FR2: A firm must act with due skill, care and diligence.
- FR3: A firm must act in a prudent manner.
- FR4: A firm must at all times maintain adequate financial resources.
- FR5: A firm must have in place sound and effective risk strategies and risk management systems.
- FR6: A firm must organise and control its affairs responsibly and effectively.



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FR7: A firm must deal with its regulators in an open, co-operative and timely way and must appropriately disclose to the PRA anything relating to the firm of which the PRA would reasonably expect notice.

FR8: A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.

FR9: A firm must not knowingly or recklessly give the PRA information that is false or misleading in a material particular.

Many of these Fundamental Rules are simply shortened or refined versions of the original Principles. Rule 3 is a new requirement – under which firms are required not only to evaluate the risks that it exposes itself to, but also to evaluate risks to which the firm exposes others in the financial system.

Rule 8 is also new – reflecting the overarching requirement to improve the resolvability of PRA-authorized firms through recovery and resolution planning. For banks, further rules on resolution are set out in the Recovery and Resolution part (“RR Part”) of the handbook that came into effect on 1 January 2014, reflecting CRD4 requirements. The RR Part is a good example of the approach that the PRA is taking to the restructuring of its Rulebook – with the Rulebook part containing only the bare text of the rules, with a separate Supervisory Statement providing the detail as the PRA’s expectations of firms in complying with the rules.

Rule 9 is new. The Rule emphasises the importance that the PRA places on the quality of information that it receives from firms. It is designed to reflect the wording of the criminal offence in s.398 of the Financial Services and Markets Act 2000 on misleading the PRA, giving the PRA the option to pursue a criminal action and/or enforcement action against a firm that has provided it with misleading information.

Rule 1 is essentially a shortened version of Principle 1 – that a firm must conduct its business with integrity. The change in wording from “conduct its business” to “act” is intended to reflect the PRA’s desire to capture within the Rule all behaviour that could affect a firm – enabling the PRA to enforce against a firm for any activities whatsoever, even those unrelated to the conduct of its regulated business. However, this extension of the Fundamental Rule appears to be inconsistent with the restrictions section of the Fundamental Rules Part of the Rulebook. Paragraph 3.3 specifically states that the Fundamental rules apply only in respect of the conduct of regulated activities and ancillary activities (i.e. activities connected with or carried out for the purposes of a regulated activity). Given this restriction, it is unclear exactly what the change in wording in Fundamental Rule 1 will achieve in practice.

Rule 7 could be viewed as a replication of the original Principle 11, to deal with regulators in an open and co-operative way. However, Rule 7 introduces the concept of “timely” disclosure to the PRA. This reflects the detailed requirements set out in the proposed “Notifications” Part of the PRA Rulebook. Paragraph 2.5 of this Part contains a requirement that: *“In giving notice to the PRA, a firm must discuss relevant matters with the PRA at an early stage, before making any internal or external commitments.”*

This new obligation could result in difficult timing concerns when deciding when to notify the PRA of a significant transaction, restructuring or other project. For example, signing an agreement where completion is subject to the receipt of regulatory consent would in our view still be regarded as “making an external commitment.” It would therefore be necessary to approach the PRA with information on significant transactions, restructurings or other projects before a conditional agreement can be reached with the relevant counterparty.

This raises the very real prospect of the PRA raising objections to a proposed transaction before the parties have even reached an agreement as to terms.

The consultation also notes the recommendation of the Parliamentary Commission on Banking Standards to amend the Principles to include a requirement that a bank must operate in accordance with the safety and soundness of the firm and that director’s responsibilities to shareholders are to be interpreted in the light of this requirement. The PRA considers that the combined effect of the proposed Fundamental Rules would address this recommendation. Directors and other senior persons within PRA-authorized entities should therefore be aware that compliance with the Fundamental Rules may be regarded as part of their statutory responsibilities towards shareholders under the Companies Act 2006.

Further consultations to continue the transition towards a PRA Rulebook are expected in due course. The ongoing reforms will result in a fundamentally different rulebook approach between the PRA and the FCA. It remains to be seen whether a streamlined Rulebook without guidance is something that will be welcomed by PRA authorized firms, or whether it risks introducing uncertainty as to the application and interpretation of PRA rules.

Comments on the PRA’s current consultative proposals should be submitted to the PRA by not later than 14 March 2013.