BANK OF ENGLAND

Consultation Paper

Proposed statutory statements of policy in respect of the Bank of England's supervision of financial market infrastructures

February 2013

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The Bank of England invites comments on this consultation paper. Comments should reach the Bank by Thursday 21 March 2013.

Comments may be sent by email to FMIFeedback@bankofengland.co.uk.

Alternatively, please send comments in writing to:

FMI Feedback
Market Infrastructure Division
Bank of England
Threadneedle Street
London EC2R 8AH

The Bank may make responses to this consultation public unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. If the Bank receives a request under the Freedom of Information Act 2000, the Bank may consult respondents who had requested confidentiality. Any decision the Bank makes not to disclose a response is reviewable by the Information Commissioner and the Information Rights Tribunal.

Copies of this consultation paper are available to download from the Bank's website at www.bankofengland.co.uk.

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Overview

Statutory statements of policy

Under the Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012,[1] responsibility for the supervision of Recognised Clearing Houses (RCHs) will be transferred to the Bank of England ('the Bank') from the Financial Services Authority. This transfer will take effect on 1 April 2013.

The Bank is already responsible for the oversight of recognised payment systems under the Banking Act 2009.

The Bank is required by FSMA to publish statements of policy relating to its powers over 'qualifying parent undertakings' of UK RCHs, and its use of penalties.[2] This consultation paper sets out the Bank's intended approach to these matters. The Bank invites comments on the proposed policies set out in the appendices:

(i) a proposed statement of policy with respect to the giving of directions to qualifying parent undertakings of UK RCHs; and
(ii) a proposed policy on financial penalties imposed by the Bank under FSMA or under Part 5 of the Banking Act 2009.

The Bank's approach to supervision and enforcement

The Bank's overall approach to the supervision of financial market infrastructures (FMIs), including its approach to the use of formal powers for enforcement purposes, is currently set out in the December 2012 publication *The Bank of England's approach to the supervision of financial market infrastructures* ('the Supervisory Approach paper').[3] The policies set out in this consultation paper should be read alongside the Supervisory Approach paper. References in this document to FMIs are to those supervised by the Bank, namely clearing houses and settlement and payment systems.

Next steps

The appendices contain drafts of the proposed statements of policy. The Bank will have regard to representations made in response to this consultation paper and will in due course issue final versions of each statement, together with an account of the representations made and the Bank's responses.

(1) All references in this document to FSMA are to that Act as amended by the Financial Services Act 2012 and applied to the Bank in respect of RCHs by Schedule 17A.
(2) A penalties policy in respect of recognised payment systems is required under the Banking Act 2009.
(3) www.bankofengland.co.uk/publications/Documents/news/2012/nr161.pdf. Comments are invited on this paper. A final version will be published in due course.

1 Implementation of powers over qualifying parent undertakings of UK recognised clearing houses

Overview

1.1 New sections 192C to 192N of FSMA give the Bank powers in relation to the parent entities of UK RCHs, where they satisfy certain conditions specified in the legislation. These parent entities are referred to in the legislation as 'qualifying parent undertakings' (QPUs). There are three sets of powers that can be applied directly to QPUs: a power of direction; a rule-making power for information gathering; and a supporting disciplinary power to fine or censure for breaches of a direction or information rule.

1.2 Appendix 1 sets out a draft statement of policy with respect to the use of this power of direction by the Bank, as required by section 192H of FSMA.

1.3 The policy statement will be reviewed, and if necessary revised, to reflect any relevant legislative or policy changes.

Background to new powers

1.4 UK RCHs, in relation to which these powers can be applied, may be part of a broader group in which the QPU is not itself an RCH or an authorised firm. The QPU may nevertheless have a role in deciding overall group strategy and organisation, and it may influence risk management policies, group recovery plans, and the intra-group distribution of capital. The QPU may be the primary listed entity in the group and may have a significant role in capital and debt-raising within the group. The QPU may also be the only entity that can alter the group structure above and around a regulated entity, or remove some potential barriers to effective resolution.

1.5 For these reasons there are circumstances in which the Bank may wish to direct a QPU of a UK RCH to act, or to refrain from acting, in a certain manner notwithstanding that the QPU is itself unregulated.

International standards

1.6 There is not currently any requirement for the consolidated supervision of groups that contain an RCH. Nevertheless, there are provisions in international standards and in legislative and regulatory requirements that recognise the need to address the risks that may arise from group structures.

1.7 The *Principles for financial market infrastructures* published in April 2012 by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO) recognise the importance of considering group risks as part of the supervision of FMIs. In particular, Principle 2 requires that 'an FMI that is part of a larger organisation … should place particular emphasis on the clarity of its governance arrangements, including in relation to any conflicts of interests and outsourcing issues that may arise because of the parent or other affiliated organisation's structure. The FMI's governance arrangements should also be adequate to ensure that decisions of affiliated organisations are not detrimental to the FMI'.(1)

1.8 The EU Regulation on OTC derivatives, central counterparties and trade repositories, commonly known as the European Market Infrastructure Regulation (EMIR), states as a requirement for authorisation that a central counterparty (CCP) must inform its competent authority 'of the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and of the amount of those holdings'; and provides that the competent authority must be satisfied as to the suitability of these shareholders.(2)

1.9 The Bank's Supervisory Approach paper notes that the Bank will want to understand how the institutions that it supervises relate to the rest of any group of which they form part, how group objectives affect the Bank-supervised institutions, the risks the rest of the group might bring to the Bank-supervised institution, and *vice versa*. In particular the Bank will want to consider inter-dependencies between group entities in relation to finances, operations, risks, risk management and governance. The Bank's aim will be to ensure that critical UK FMI services are not at risk of contagion from risks in other parts of the group and can meet all applicable regulatory requirements on a standalone basis.(3)

Resolution

1.10 It is important that the structure of a corporate group of which an RCH forms part is consistent with the effective resolution of the RCH, should that be necessary, and that the actions of a holding company of an RCH do not inhibit resolution of the RCH. This may necessitate the authorities taking action at the holding company level.

1.11 The Financial Stability Board's *Key Attributes of Effective Resolution Regimes* state that FMIs 'should be subject to resolution regimes that apply the objectives and provisions of the *Key Attributes* in a manner as appropriate to FMIs and their critical role in financial markets'; and that resolution regimes for systemically significant financial institutions should extend to holding companies of those institutions.(4)

(1) CPSS/IOSCO *Principles for Financial Market Infrastructures* (April 2012), page 27, available at www.bis.org/publ/cpss101a.pdf.
(2) EMIR, article 30: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.
(3) Supervisory Approach, page 9.
(4) Financial Stability Board, *Key Attributes of Effective Resolution Regimes* (October 2011), page 5.

1.12 Consistent with the *Key Attributes*, the Financial Services Act 2012 makes provision for a resolution regime for UK CCPs that extends to group companies, including the holding companies of UK CCPs. The Treasury is considering what resolution arrangements would be desirable for RCHs that are not CCPs.(1) The European Commission has issued a consultation paper on resolution arrangements for non-bank financial institutions, which raises the question of whether an EU resolution regime for FMIs should be applicable to the whole group.(2)

Bank powers to support supervision

1.13 The new regulatory regime will give the Bank the following powers over QPUs in order to support its supervision of UK RCHs.

Power of direction

1.14 FSMA gives the Bank a power of direction in respect of a QPU of a UK RCH. In order for the Bank to be able to give such a direction, the statutory conditions for its use need to be satisfied. In particular:

(a) the parent company must be a QPU of a UK RCH;(3) and
(b) the 'general condition' must be satisfied: ie the Bank must consider that it is desirable to give the direction for the purpose of the effective regulation of one or more RCHs in the group of the QPU.

1.15 The draft statement of policy set out in Appendix 1 describes the statutory conditions for the use of the power of direction in more detail, as well as: matters the Bank would expect to have regard to when deciding whether to use the power; a non-exhaustive list of scenarios in which the Bank may consider giving a direction; and a non-exhaustive list of possible directions. The Bank would not expect to use the power of direction to attempt to create an unlimited liability for a QPU in respect of a UK RCH, though it would expect a QPU to act as a source of strength and support for any regulated subsidiary.

Information-gathering powers

1.16 Section 165 of FSMA provides that the Bank may, by written notice, require an RCH, a member of its group,(4) a controller,(5) or an officer, manager or employee, to provide specified information or documents, or information or documents of a specified description.

1.17 In addition, the Financial Services Act 2012 adds a new section 192J to FSMA. This gives the Bank the power to make rules requiring a QPU to provide to the Bank information or documents of a specified description, that are relevant to the exercise by the Bank of its functions. The rules may make provision about the time within which, and the form in which, information is to be provided, and requirements for the verification of information and authentication of documents.

1.18 The Bank does not currently intend to introduce any information-gathering rules in relation to QPUs. Instead the Bank intends where necessary to use the *ad hoc* data collection powers in section 165 of FSMA. The Bank will consider what, if any, rules it should make in respect of information-gathering from QPUs as part of its future work on data collection.(6)

Disciplinary powers

1.19 Section 192K of FSMA contains a power to fine or censure a QPU in the event of a breach of a direction given under Section 192C or of rules made under Section 192J. The Bank's intended policy approach in this area is set out in the Bank's proposed statement of policy on the imposition and amount of financial penalties, in Appendix 2 of this consultation paper.

Memorandum of understanding with the FCA

1.20 The Bank and the Financial Conduct Authority (FCA) have agreed that where a single corporate group contains both an entity that operates trading platforms and an entity that is a clearing, settlement or payment system supervised by the Bank, or where a single entity is supervised both by the Bank and the FCA, the two authorities will seek to consult one another in relation to any proposal to direct an entity that is a QPU in such a group.(7) Similarly, the Bank would consult the Prudential Regulation Authority (PRA) if the PRA had an equivalent regulatory interest in the recognised body or its QPU.

(1) The Treasury *Financial sector resolution: summary of responses* (October 2012), page 13, available at www.hm-treasury.gov.uk/d/condoc_financial_sector_resolution_broadening_regime_responses.pdf.
(2) European Commission, *Consultation on a possible recovery and resolution framework for financial institutions other than banks* (2012), page 22, available at http://ec.europa.eu/internal_market/consultations/2012/nonbanks/consultation-document_en.pdf.
(3) See paragraphs 3–5 of the draft statement of policy in Appendix 1 for further details.
(4) Section 421 FSMA.
(5) Section 422 FSMA.
(6) As discussed in the Supervisory Approach paper, page 10.
(7) www.bankofengland.co.uk/publications/Documents/other/pra/draftmou.pdf.

2 Imposing financial penalties under FSMA and the Banking Act 2009

Introduction

2.1 FSMA gives the Bank powers to impose financial penalties on RCHs and QPUs of UK RCHs in situations where the Bank considers that (i) an RCH has contravened a relevant requirement imposed on it, including (where applicable) a breach of the requirements set out in EMIR or of any additional domestic requirements set out under the Treasury's Recognition Requirements; or (ii) a QPU of a UK RCH has breached a direction or information rule.

2.2 The Bank is already responsible for the oversight of recognised payment systems under the Banking Act 2009. Part 5 of the Banking Act 2009 includes powers for the Bank to impose requirements,(1) the breach of which would be a 'compliance failure' that can result in the Bank imposing sanctions on the operator of a recognised inter-bank payment system, including financial penalties.

2.3 Both FSMA and the Banking Act 2009 require the Bank to publish a statement of policy concerning the imposition and amount of financial penalties.(2) This chapter explains the policy approach that the Bank proposes to take to the imposition and amount of financial penalties on RCHs, QPUs and operators of recognised inter-bank payment systems. A proposed statement of policy is attached in Appendix 2.

2.4 The Bank previously published its policy for the application of penalties to recognised inter-bank payment systems in 2009.(3) This will be superseded by the new policy once this has been finalised.

2.5 As required by s.110 of the Financial Services Act 2012, the Bank will pay to the Treasury(4) any receipts from financial penalties, after the deduction of enforcement costs.

Summary

Scope and coverage

2.6 The Bank proposes to apply the same penalties policy to RCHs, QPUs and recognised payment systems (collectively referred to as the relevant bodies). This does not imply that the same breach would necessarily result in the same financial penalty across those three classes of body.

Considerations relevant to the imposition of financial penalties

2.7 The Bank's general approach to the use of sanctions in the course of its supervision of FMIs is set out in the Supervisory Approach paper. The Bank will, where practicable, want to supervise with the support of FMIs and their participants, having clearly explained the risk rationale for its supervisory priorities and actions. The Bank's supervision will, however, be conducted in the context of the powers granted by Parliament, and these powers will be used where necessary to effect change. The Bank hopes that it will not need to make regular use of powers to direct and that it will not face cases where an institution fails to act in accordance with a direction. Should this occur, however, public censure, financial penalties and injunctions may be applied to supervised FMIs, or, in certain circumstances, action may be taken against individuals employed by the supervised FMIs.(5)

2.8 Where a breach of requirements has occurred, the imposition of a financial penalty may be appropriate to emphasise the seriousness of the matter, or to incentivise the board and management of the relevant body, and of other relevant bodies, to ensure that similar breaches are not committed in the future.

2.9 When determining whether or not to impose a financial penalty, the Bank will consider the individual features of each case. The proposed policy sets out a series of considerations, summarised below, that may be relevant. These include:

(a) the impact or potential impact of the breach on the stability of the financial system;
(b) the seriousness of the breach;
(c) conduct after the breach was committed;
(d) previous disciplinary and/or supervisory record;
(e) relevant materials provided by the Bank or by any predecessor regulators which were in force at the time of the behaviour in question;
(f) whether other sanctions, or no sanction, may be more appropriate to the achievement of the Bank's objectives; and
(g) any relevant action being taken by other authorities.

Determining the amount of the penalty

2.10 When determining the appropriate amount of a financial penalty, the Bank proposes to use the five-step framework summarised below. Further explanation of these steps is provided in paragraphs 11–24 of the draft statement of policy.

(a) Step 1: Disgorgement of any financial gains stemming from the breach.
(b) Step 2: Assessment of the seriousness of the breach.
(c) Step 3: Adjustment for any aggravating, mitigating or other relevant factors.
(d) Step 4: Adjustment to ensure that the penalty has an appropriate deterrent effect.

(1) See ss.189 (codes of practice), 190 (system rules), 191 (directions), 195 (independent report) and 196 (compliance failure).
(2) See ss.198(3) of the Banking Act 2009 and 192N and 312J of FSMA.
(3) www.bankofengland.co.uk/financialstability/Documents/role/risk_reduction/payment_systems_oversight/pdf/principles-financial-penalties.pdf.
(4) www.hm-treasury.gov.uk/press_90_12.htm.
(5) Supervisory Approach, page 11.

(e) Step 5: Application of any reduction for serious financial hardship.

2.11 The Bank will aim to ensure that the overall penalty arrived at using its five-step approach is appropriate and proportionate to the relevant breach.

Appendix 1: Proposed statement of policy with respect to the giving of directions to qualifying parent undertakings of UK recognised clearing houses

Background

1. This draft statement sets out the Bank of England's (the Bank's) policy on the use of its power to direct a qualifying parent undertaking (QPU) of a UK recognised clearing house (RCH), ie RCHs other than overseas clearing houses, under section 192C of the Financial Services and Markets Act 2000 (FSMA)[1] and as required by section 192H of FSMA.

Conditions for the exercise of the power of direction

2. The statutory provisions relating to the power of direction are set out in sections 192C to 192N of FSMA. In order for the Bank to be able to exercise the power of direction:

(a) the parent company must be a QPU of a UK RCH; and
(b) the 'general condition' must be satisfied that the Bank considers that it is desirable to give the direction for the purpose of the effective regulation of one or more RCHs in the group of the QPU.

Parent company must be a 'qualifying parent undertaking' of a recognised UK clearing house

3. A parent company of a UK RCH is a QPU under section 192B of FSMA if:

(a) it is incorporated in the United Kingdom or has a place of business in the United Kingdom;
(b) it is not itself an authorised person, recognised investment exchange or recognised clearing house; and
(c) it is a financial institution of a kind prescribed by the Treasury by Order.

4. In relation to (c) above, the Treasury has laid before Parliament an Order[2] prescribing which types of company will be considered financial institutions and, therefore, could be QPUs. The Order provides that in relation to RCHs, any financial institution is prescribed. So, for example, any entity which itself provides financial services or which operates financial market infrastructures or whose business involves the ownership or management of such entities, would be considered a financial institution.[3]

5. Any UK-incorporated parent company in a UK RCH's ownership chain may be a QPU, even if the company is not itself the ultimate parent company. If there is more than one QPU, the Bank will consider giving a direction to whichever one or more of these it considers most appropriate.

The 'general condition'

6. As outlined above, the Bank can use the power of direction only if the general condition is satisfied. The general condition is that the Bank considers it is desirable to give the direction for the purpose of the effective regulation of one or more RCHs in the group of the QPU.

7. The QPU may have a role in determining group strategy and organisation, and it may influence risk management policies, group recovery plans and the intra-group distribution of capital. The QPU may be the primary listed entity in the group and may have a significant role in capital and debt raising within the group. A QPU may also be the only entity that can alter the group structure above and around an RCH or remove some potential barriers to effective resolution. For these reasons, there are circumstances in which the Bank may wish to direct a QPU of a UK RCH to act, or to refrain from acting, in a certain manner, notwithstanding that the QPU is itself unregulated.

8. Annex A to this statement of policy contains a non-exhaustive list of possible scenarios in which the Bank may consider exercising the power of direction.

Matters the Bank must have regard to when deciding whether to use the power of direction

9. Section 192C(5) FSMA provides that, in deciding whether to give a direction, the Bank must have regard:

(a) to the desirability where practicable of exercising its powers in relation to RCHs rather than its powers in relation to QPUs under that section, and
(b) to the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to result from its imposition.

10. The Bank does not intend to use the power of direction to attempt to create an unlimited liability for a QPU in respect of a UK RCH, though it would expect a QPU to act as a source of financial strength and support for any regulated subsidiary.

11. Under normal circumstances the Bank would in the first instance expect to use its powers over UK RCHs to try to achieve its objectives. However, the Bank may also consider use of the power of direction in respect of a QPU to be appropriate, for example:

(a) where action in respect of the UK RCH fails to remedy the concerns;
(b) where the Bank considers that action against the UK RCH is likely to fail to remedy the concerns;
(c) where the UK RCH fails to comply;

(1) All references in this draft statement of policy to FSMA are to that Act as amended by the Financial Services Act 2012 and applied to the Bank in respect of RCHs by Schedule 17A.
(2) The Financial Services and Markets Act 2000 (Prescribed Financial Institutions) Order 2013.
(3) www.hm-treasury.gov.uk/d/condoc_fin_regulation_draft_secondary_leg.pdf.

(d) where the Bank considers the UK RCH is likely to fail to comply;
(e) where the UK RCH does not itself have the ability to effect the desired change;
(f) where the issue can only be resolved effectively by the QPU; and
(g) in cases of urgency.

12. In some stressed circumstances, potential conflicts of interest between a QPU and a UK RCH may become heightened. The RCH may be less able to resolve issues without the support of the QPU, and the ability to direct the QPU may therefore become more important.

Content of the direction

13. Section 192D(1) FSMA provides that a direction made under this power may require the QPU either to take specified action or to refrain from taking specified action. Section 192D(2) goes on to provide that a requirement may be imposed by reference to the QPU's relationship with its group, or with other members of its group. The requirement could be imposed either in relation to a specific intra-group relationship that is causing concern, including a relationship between sister companies, or by reference to the group generally if the concern is in respect of group-wide issues.

14. Where desired actions are reserved to the shareholders of the QPU the relevant direction cannot address the shareholders directly. In such cases the direction would instruct the entity to facilitate the decision of the shareholders, for example by calling a general meeting and proposing the motion required to achieve the desired action.

15. Section 192D(3) provides that a requirement may refer to the past conduct of a QPU (for example, by requiring the QPU to review or take remedial action in respect of past conduct).

16. A requirement imposed by the direction may be expressed to expire at the end of a specified period, but this does not affect the power to give a further direction imposing a new requirement. Equally, a requirement imposed by the direction may have no specified end date. The direction may be revoked by the Bank by written notice to the QPU to which it is given, and ceases to be in force if the undertaking to which it is given ceases to be a QPU.

17. Annex B contains a non-exhaustive list of the types of direction which the Bank may consider making.

Annex A to Appendix 1
Non-exhaustive list of possible scenarios in which the Bank may consider exercising the power of direction

Examples of scenarios in which the Bank may consider the exercise of its power of direction include, but are not limited to:

- insufficient quality or quantity of own funds or liquid assets or other assets are made available to the RCH to meet its requirements;
- intra-group transactions, or allocation of risks and financial resources, that do not meet the standards expected by the Bank;
- group-wide recovery and resolution plans that do not meet the standards expected by the Bank (as applicable to the RCH);
- where there are barriers to the resolution of the RCH that it is most appropriate to mitigate or remove at the level of the QPU;
- where action at the level of the QPU is required to improve resolvability of the RCH;
- group-wide remuneration policies that do not meet the standards expected by the Bank;
- a proposed acquisition by the QPU that may affect the compliance of the RCH with regulatory requirements;
- where actions of the QPU in a recovery or resolution scenario may increase the chance of disorderly failure;
- where only the actions of the QPU in relation to one of its unregulated subsidiaries may maintain the stability of the RCH, particularly in stressed circumstances (for example where a regulated firm is reliant on services provided by an unauthorised sister company);
- where risks generated in an unauthorised part of the group could affect the stability of the RCH, or the group as a whole;
- insufficient quality or quantity of own funds or liquid assets or other assets being available to meet group needs or requirements within the group;
- insufficient transferability of a group's own funds or liquid assets to support group needs or requirements within the group;
- complex or opaque group structures that hinder the RCH's and/or the Bank's ability to assess and manage the risks generated by the RCH's membership of its group;
- group-wide risk management or governance arrangements that do not meet the Bank's and/or internationally agreed standards;
- systems and controls to manage group risks that do not meet the standards expected by the Bank;
- acts or omissions of the QPU that are affecting, or may affect the RCH's ability to continue to meet recognition requirements or other obligations to which it is subject under FSMA or directly applicable EU regulations;
- where the QPU directors exert dominant influence on the RCH's board to obstruct its independence;
- where one or more directors of the QPU appear not to be fit and proper, or suitable.

Annex B to Appendix 1
Non-exhaustive list of possible directions the Bank may consider making

Directions which may be made by the Bank may include, but are not limited to:

- a requirement to improve the system of governance or controls at group level and/or in relation to subsidiary undertakings where this is necessary for effective supervision of the RCH;
- a restriction on dividend payments, or other payments in respect of capital instruments, in order to retain capital in the group;
- a requirement to move funds or assets around the group to address risks more appropriately;
- a requirement for the group to be restructured to remove any material impediments to effective supervision of the RCH;
- a requirement to stop or impose restrictions on an acquisition or divesture (taking account of any potential conflict with takeover rules and the EMIR provisions relating to certain acquisitions);
- a requirement to ensure the continuity and quality of service provided between relevant group entities and that outsourcing arrangements between group undertakings can operate effectively;
- a requirement to raise new capital;
- a requirement to take steps to facilitate the removal from office of directors of the holding company who do not meet the Bank's expectations as regards being fit and proper to direct a QPU;
- a requirement to remove barriers to resolution of an RCH.

Appendix 2: Proposed statement of policy on financial penalties imposed by the Bank under the Financial Services and Markets Act 2000 or under Part 5 of the Banking Act 2009

Introduction

1. This statement of policy is issued by the Bank of England (the 'Bank') in respect of Recognised Clearing Houses (RCHs), Qualifying Parent Undertakings of UK RCHs (QPUs) and operators of recognised inter-bank payment systems.(1) It sets out the Bank's policy on the imposition and amount of penalties under sections 312F and 192K of the Financial Services and Markets Act 2000 (FSMA),(2) and section 198(3) of the Banking Act 2009.

2. For the purposes of this draft policy, RCHs, QPUs and operators of recognised inter-bank payment systems are collectively referred to as the 'relevant bodies'.

3. Where this policy refers to a 'breach', this covers situations where an RCH has contravened a relevant requirement imposed on it;(3) or a QPU has contravened a direction or information rule;(4) or there has been a compliance failure(5) by the operator of a recognised inter-bank payment system.

4. The Bank proposes to apply the same penalties policy, as set out in this consultation document, in respect of all relevant bodies. This does not imply that the same breach would necessarily result in the same financial penalty across those three classes of body.

5. In applying this policy, the Bank may have regard to the following general principles and considerations:

(a) the desirability of upholding and encouraging high standards of behaviour that are consistent with the relevant bodies meeting and continuing to meet relevant regulatory requirements;
(b) the desirability of demonstrating the benefits of such behaviour; and
(c) the need to ensure that where disciplinary measures, including penalties, are imposed by the Bank:
    (i) they properly reflect the seriousness of the breach of regulatory requirements;
    (ii) they are proportionate to the breach; and
    (iii) they are effective in deterring those who are subject to the relevant regulatory requirements from committing similar or other breaches.

6. Prior to imposing a penalty the Bank will provide a warning notice(6) allowing an opportunity for the relevant body to make representations, and will consider any representations made.(7)

7. Where the Bank intends to impose a financial penalty, the relevant body may appeal to the Upper Tribunal.(8)

Policy concerning whether the Bank will impose a financial penalty

8. The Bank will consider the facts and circumstances of each case when determining whether to impose a financial penalty. Factors that may be relevant for this purpose include (but are not limited to):

(a) the general principles and considerations set out in paragraph 5 above;
(b) the impact or potential impact of the breach on financial stability;
(c) the seriousness of the breach including:
    (i) its impact on and any threat or potential threat it posed or continues to pose to the achievement of the Bank's objectives;
    (ii) its duration or frequency;
    (iii) whether it was deliberate or reckless;
    (iv) whether it was a result of direct acts or omissions of the relevant body;
    (v) whether the relevant body derived any economic benefits;
    (vi) whether it reveals serious or systemic weaknesses or potential weaknesses in the relevant body's business model, financial strength, governance, risk or other management systems and/or internal controls relating to all or part of the relevant body's business; and
    (vii) whether there is more than one issue which, considered individually, may not justify the imposition of a penalty but, when considered together, may do so;
(d) the conduct of the relevant body after the breach was committed, including:
    (i) how promptly, comprehensively and effectively the relevant body brought the breach to the attention of the Bank and/or other regulatory or law enforcement agencies;
    (ii) the degree of co-operation the relevant body showed during the investigation of the breach by the Bank

(1) See the requirements of s.312J and s.192N of the Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, in respect of RCHs and QPUs respectively, and s.198 of the Banking Act 2009 in respect of operators of payment systems.
(2) All references in this document to FSMA are to that Act as amended by the Financial Services Act 2012 and applied to the Bank in respect of RCHs by Schedule 17A.
(3) See section 312F of FSMA.
(4) See section 192K(1) of FSMA.
(5) Section 196 of the Banking Act 2009 defines as a 'compliance failure' a failure to: (a) comply with a code of practice under s189 (codes of practice); (b) comply with a requirement under s190 (system rules); (c) comply with a direction under s191 (directions); or (d) ensure compliance with a requirement under s195 (independent report).
(6) In accordance with section 201 of the Banking Act 2009 or sections 192L or 312G of FSMA.
(7) The minimum period for representations is 21 days under the Banking Act 2009 and 14 days under FSMA.
(8) Under the provisions of section 202 of the Banking Act 2009, or sections 192L(7) or 312H(4) of FSMA.

and/or by other regulatory or law enforcement agencies;

(iii) the nature, extent and effectiveness or likely effectiveness of any remedial action the relevant body has taken, will take or is in the course of taking in respect of the breach and how promptly it was or will be taken;

(iv) the likelihood that the same or a similar type of breach (whether on the part of the relevant body in question or other relevant bodies that are subject to the relevant regulatory requirements) will recur if a penalty is not imposed (or other appropriate enforcement action is not taken) by the Bank and/or other regulatory or law enforcement agencies;

(v) whether the relevant body has complied with any requests or requirements of the Bank and/or other regulatory or law enforcement agencies relating or relevant to their behaviour, including as to any remedial action; and

(vi) the nature and extent of any false, incomplete or inaccurate information given by the relevant body and whether the information has or appears to have been given in an attempt knowingly or recklessly to mislead the Bank and/or other regulatory or law enforcement agencies;

(e) the previous disciplinary and/or supervisory record of the relevant body including:

(i) any previous enforcement or other regulatory action by the Bank or other regulators, including any predecessor regulators, that resulted in an adverse finding against the relevant body;

(ii) any warnings given to the relevant body by the Bank or other regulators, including any predecessor regulators;

(iii) any previous agreement or undertaking by the relevant body to the Bank or other regulators, including any predecessor regulators, to act or behave or refrain from acting or behaving in a particular way and their compliance with that undertaking; and

(iv) the general supervisory record of the relevant body or specific aspects of its record relevant to the matter in question;

(f) relevant materials provided by the Bank and/or any predecessor regulators, which were in force at the time of the behaviour in question;[1]

(g) whether other sanctions, or no sanction, may be more appropriate to the achievement of the Bank's objectives;

(h) any relevant action by other domestic and/or international regulatory authorities or law enforcement agencies (including whether, if such agencies are taking or proposing to take relevant action in respect of the behaviour in question, it is necessary or desirable for the Bank also to take its own separate action). In appropriate cases, the Bank in conjunction with the FCA, PRA and/or other regulatory or law enforcement agencies will determine whether any joint or co-ordinated investigation and enforcement or other legal action is required.

Qualifying Parent Undertakings: additional factors

9. Under section 192K(1) of FSMA, where the Bank is satisfied that a relevant body that is or has been a QPU has contravened:

(a) a requirement arising from a direction given to that body by the Bank under section 192C of FSMA; or

(b) rules made by the Bank under section 192J of FSMA;

the Bank may, under sections 192K(2) and (3) of FSMA, impose on that QPU a penalty of such amount as it considers appropriate or, instead of imposing a penalty, publish a statement censuring the QPU.

10. In addition to the factors set out in paragraph 8 above, additional considerations may be relevant when the Bank is deciding whether to take action to impose a financial penalty on a QPU. These include:

(a) where a QPU has contravened a requirement arising from a direction given to it by the Bank under section 192C of FSMA, the nature of any acts or omissions of the QPU that gave rise to that direction and the Bank's determination of their material adverse effects or potential effects;

(b) the role or influence of the QPU in determining, directing or affecting the affairs of the RCH, or, where relevant to the RCH, any other company within the group[2] of companies of which they form part, or the group of companies as a whole (including but not limited to their risk profile and resilience);

(c) the effect or potential effect of the contravention on the QPU, the RCH, or where relevant to the RCH, any other company within the group of companies of which they form part, or the group of companies as a whole.

Policy concerning the appropriate amount of a financial penalty

11. The amount of any financial penalty imposed by the Bank will be calculated in accordance with the following five-step approach:

(a) Step 1: where relevant, the disgorgement of any economic benefits derived from the breach;

(b) Step 2: in addition to any disgorgement under step 1, the determination of a figure which properly reflects:

(i) the seriousness of the breach; and

(ii) the financial strength of the relevant body;

(1) The Bank may have regard to any relevant materials provided by it, and/or by any predecessor regulators, whether issued publicly or bilaterally, for example, where this helps to illustrate ways in which a relevant entity can comply (or could at the relevant time have complied) with relevant regulatory requirements, or the standards expected of the entity.

(2) As defined in section 421 of FSMA.

(c) Step 3: where appropriate, an adjustment to the figure determined under step 2 to take account of any aggravating, mitigating or other relevant circumstances;
(d) Step 4: where appropriate, an upwards adjustment to the figure determined following steps 2 and 3, to ensure that the penalty has an appropriate and effective deterrent effect on the body in question and on other relevant bodies;
(e) Step 5: if applicable, an adjustment based on any serious financial hardship that the Bank considers payment of the penalty would cause to the relevant body.

12. These steps will be considered in all cases, although the detail of the application of one or more of them may differ, depending on the circumstances of the case.

13. The Bank will aim to ensure that the overall penalty arrived at using its five-step approach is appropriate and proportionate to the relevant breach. The Bank may decrease the level of the penalty that would otherwise be determined following steps 2 and 3 if it considers that it is disproportionately high having regard to the seriousness, scale or effect of the breach.

Step 1 — disgorgement

14. Where relevant, and where it is practicable to ascertain and quantify them, the Bank will seek to deprive the relevant body of any economic benefits derived from or attributable to the breach, including any profit made or loss avoided. The Bank may also calculate and add interest on such benefits.(1)

Step 2 — the seriousness of the breach

15. In addition to any figure in respect of disgorgement established under step 1, the Bank will determine at step 2 a figure which properly reflects:

(a) the seriousness of the breach by the relevant body, including any threat or potential threat it posed or continues to pose to the advancement of the Bank's objectives; and
(b) a suitable indicator of the financial strength of the relevant body.

16. When assessing the seriousness of the breach, the factors to which the Bank may have regard may include, as appropriate:

(a) the effect or potential effect of the breach on the achievement of the Bank's objectives;
(b) the duration or frequency of the breach in relation to the nature of the requirement contravened;
(c) whether the breach was deliberate or reckless;
(d) whether the relevant body against whom action is to be taken is an individual;(2)
(e) whether the breach forms part of a pattern of non-compliant behaviour;
(f) whether the breach reveals serious or systemic weaknesses or potential weaknesses in the relevant body's business model, financial strength, governance, risk or other management systems and internal controls relating to all or part of its business.

Step 3 — adjustment for any aggravating, mitigating or other relevant factors

17. The Bank may increase or decrease the amount of the penalty determined at step 2 (excluding any amount to be disgorged pursuant to step 1) to take into account any factors which may aggravate or mitigate the breach, or other factors which may be relevant to the breach or the appropriate level of penalty in respect of it. Factors that may aggravate or mitigate the breach include:

(a) the conduct of the relevant body in bringing (or failing to bring) promptly, effectively and comprehensively to the Bank's attention (or, where relevant, the attention of other regulatory or law enforcement agencies) the full facts, circumstances and implications or potential implications of the breach;
(b) the nature, timeliness and adequacy of the relevant body's response to any supervisory interventions by the Bank and any remedial actions proposed or required by Bank supervisors;
(c) the degree of co-operation the relevant body showed during the investigation of the breach by the Bank (or, where relevant, any other regulatory or law enforcement agencies) and the impact of this on the Bank's ability to conclude its enforcement process promptly and efficiently;
(d) the extent of any attempt to conceal the breach or impede the Bank's investigation;
(e) whether the relevant body's senior management was aware of the breach and, if so, the nature and extent of their involvement in it and the timeliness, adequacy and effectiveness of any steps taken by them to address it or the consequences of it;
(f) the previous disciplinary record and general supervisory history of the relevant body, both in respect of the Bank's requirements and, where relevant, those of any other regulatory or law enforcement agencies, including the reporting or non-reporting of concerns in relation to the issue giving rise to the breach in question;
(g) the nature and impact or likely impact of any compliance or training policy or programme or other remedial steps taken by the relevant body since the breach was identified to address steps and reduce the likelihood and impact of

(1) The Bank will determine on a case-by-case basis whether any interest should be added and, if so, the interest rate that should apply and the period for which interest should be calculated. In determining an interest rate, the Bank may have regard to the rates applied by the civil courts or other regulatory authorities.
(2) See s192N(2)(c) of FSMA.

future breaches (including whether these were taken on the relevant body's own initiative or at the request of the Bank or other regulatory or law enforcement agencies);

(h) the extent to which the breach was caused by parties[1] or circumstances beyond the control of the relevant body.

18. Other relevant factors may include action taken against the relevant body by other domestic and/or international regulatory authorities or law enforcement agencies relevant to the breach of the Bank's regulatory requirements. This may include any penalties or fines or other disciplinary measures imposed by those agencies.

Step 4 — adjustment for deterrence

19. If the Bank considers that the penalty determined following steps 2 and 3 is insufficient effectively to deter the relevant body that committed the breach, or others who are subject to the Bank's regulatory requirements, from committing similar or other breaches, it may increase the penalty at step 4 by making an appropriate deterrence adjustment.

20. The circumstances in which the Bank may make a deterrence adjustment to the penalty include:

(a) where the Bank considers the value of the penalty is too small in relation to the breach to achieve effective deterrence;
(b) where previous action by the Bank, PRA, FCA and/or any predecessor regulators in respect of the same or a similar breach has failed to improve or sufficiently improve relevant industry standards of behaviour;
(c) where the Bank considers it likely that, in the absence of a deterrence adjustment, the same or a similar breach will be committed in the future by the relevant body or by other members of the regulated community more widely.

Step 5 — application of any applicable reductions serious financial hardship

21. Where a relevant body claims that payment of a penalty determined by the Bank will cause them serious financial hardship (the onus is on the relevant body to satisfy the Bank that this would be the case), in exceptional circumstances the Bank may reduce the amount of the penalty.

22. Where the Bank agrees in principle to consider a relevant body's representations as to serious financial hardship, the relevant body must:

(a) promptly provide to the Bank relevant, comprehensive and verifiable evidence that payment of the penalty will cause them serious financial hardship; and
(b) co-operate fully with the Bank and promptly, transparently and comprehensively comply with any requests by it for further information or evidence concerning their financial position or other relevant circumstances.

23. In assessing whether the penalty would cause the firm serious financial hardship the factors which the Bank may have regard to include:

(a) the relevant body's financial strength and viability; and
(b) any impact that payment of the penalty would or would be likely to have on the relevant body's ability to meet and continue to meet the Bank's regulatory requirements and standards.

24. The Bank will consider agreeing to defer the due date for payment of the penalty or accepting payment by instalments where, for example, the relevant body requires a reasonable time to raise funds to enable the totality of the penalty to be paid within a reasonable period.

(1) It is the responsibility of the RCH or recognised payment system to manage the risk arising from any outsourced activities.