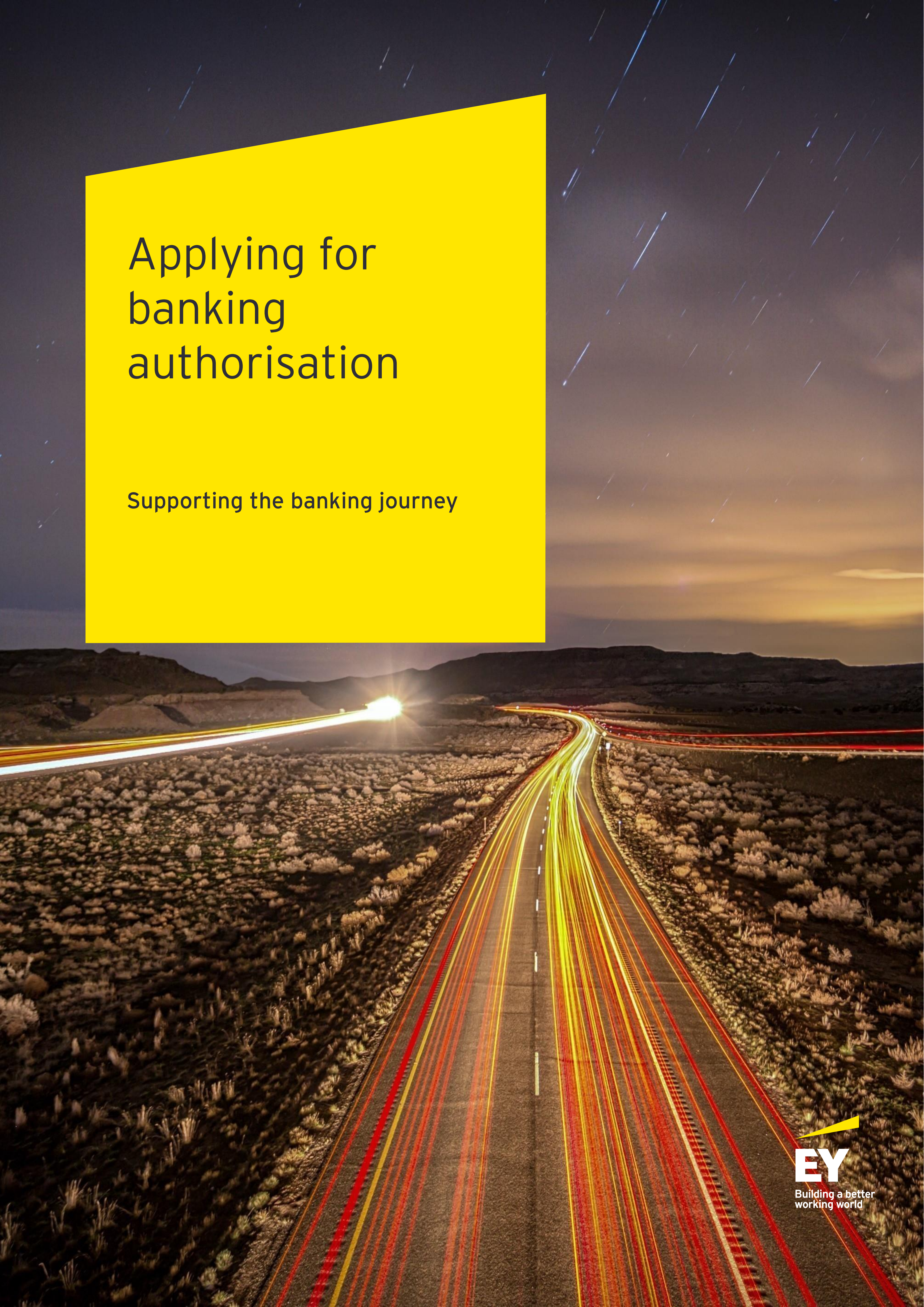


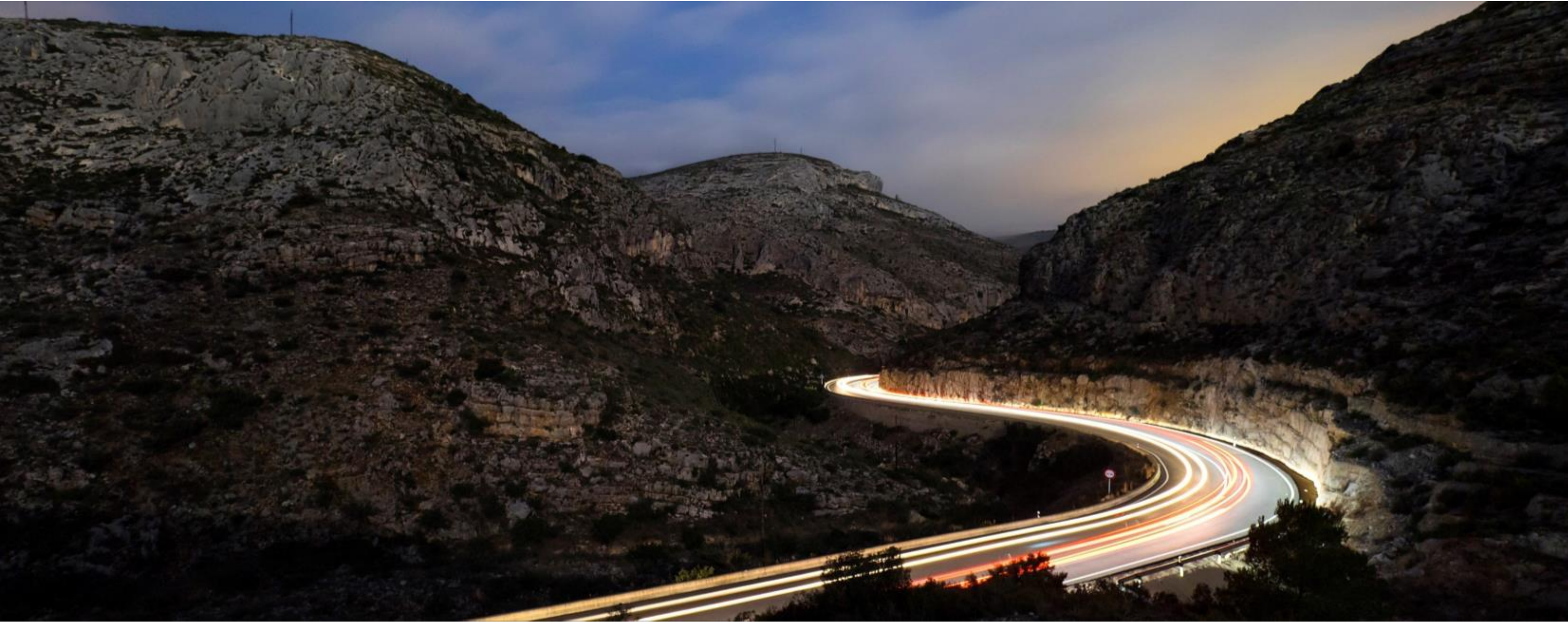
Applying for banking authorisation

Supporting the banking journey

EY

Building a better working world

Content



Introduction

Since 2013, over 50 new banks have been authorised in the UK.
To aid new applicants, a streamlined authorisation process for new banks was introduced by the Bank of England through the establishment of the New Bank Start-up Unit (NBSU).

Irrespective of the type of business a new entrant wants to target, be it underserved sectors of the market, delivery of innovative execution strategies or utilisation of technology to drive efficiencies, consideration must be given initially as to the appropriateness of a banking licence versus an alternative route to authorisation. A new entrant's proposed activities and business strategy will determine the authorisation routes available.

Whichever route is chosen, seeking authorisation as a bank is a long, rigorous and resource-intensive process, and growing in a sustainable way post-authorisation poses additional challenges.

This document provides an overview of the bank authorisation process, describes the Regulatory Business Plan (RBP) as a key document in the application process and outlines the expectations the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) have once a bank has been authorised.

Ian Cosgrove
UK Head of *Challenger and Specialist Banks*
Ernst & Young LLP

The first steps to becoming a bank

An applicant's early engagement with the regulators will be critical in a successful application process. It will shape the way the regulators view the applicants intent and ongoing relationship throughout the application process and beyond. The application will be considered by both the PRA and FCA which have different objectives.

The PRA's primary concern is the stability of the UK's financial system, and it will focus on an applicant's financial resilience, the way it manages its risks and how it is governed. The FCA's interest centres around the way the future institution will deal with its customers and the way it will conduct its business.

An applicant will need to demonstrate that it is, and will continue to be, a 'safe and sound' firm – that it is a financially viable firm that does not pose excessive risks to the financial stability of the UK and that it can fail in an orderly manner with minimal disruption to its customers.

The regulators will assess the application from a prudential and conduct risk perspective against tests of safety and soundness, effectively using the same framework that would be employed to supervise existing firms.

This will involve judging whether:

- The business can be expected to be conducted in a prudent manner and, in particular, that it continuously maintains appropriate minimal capital levels, as well as liquidity and stable funding.
- It is likely to have a robust technology and operating environment.
- It will be a 'fit and proper' firm that is appropriately staffed.
- Both the PRA and FCA can effectively supervise.

Common pitfalls

Applications that have not been successful or that the regulators deemed to be of insufficient quality had a number of common issues:

Reactive interaction with the regulators by the applicant, with insufficient and irregular regulatory engagement	Lack of senior management involvement in the articulation of the RBP	Underestimating the complexity of project managing the process and the business
Lack of clarity in the firm-wide framework to identify and manage risks associated with the business model	Failure to articulate a sustainable business strategy and define the risks that could undermine the strategy	Underestimating the need for a cohesive business plan that 'tells a clear story'

> *The pre-application phase is not to be underestimated and should be performed in collaboration with the NBSU, whose ongoing review and direction will prove invaluable in expediting the approval phase.*

Pre-application

After the first contact with the NBSU, to notify them of the intention to apply for a banking licence in the UK, the applicant will have a formal initial meeting. This will be the first opportunity to present the business idea, and the applicant should already have a clear and detailed vision of its business and operating model. It is crucial to be well prepared. In effect, the NBSU expects the applicant to present an initial view of its business and will, at this stage, want to know:

- What is the applicant's vision and idea? How does it intend to 'disrupt the market'?
- What products and services will the bank offer and who are its target customers?
- What is the applicant's path to profitability and how will it be funded?
- Has the applicant stress tested the assumptions of the business model?
- What systems are required and who will provide access to those systems?
- Which activities will be carried out internally and which activities will be outsourced?

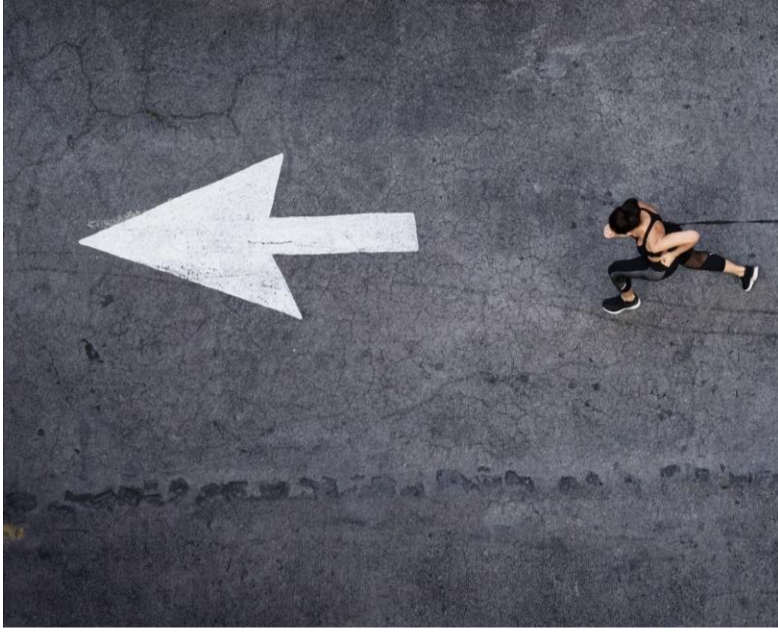
Both the PRA and FCA will provide written feedback on the initial meeting and outline any areas they expect to be further defined in more detail as part of the applicant's formal application.

This is effectively the 'starting gun' to develop the RBP and all underlying documents that must be submitted as part of the application process. While there are no clear guidelines on involvement with the regulators until near completion of the RBP, the NBSU and the allocated case officer will expect to continue having regular touchpoints to ensure the application is meeting all expectations.

Regulatory engagement

- **Initial meeting –** a formal meeting between the applicant and the regulators:
  - An opportunity to discuss the initial business plan, manage regulatory expectations and understand key areas of focus.
  - The PRA and FCA will provide written feedback on the initial business plan.
- **Feedback meeting –** after the applicant has submitted the initial business plan, the PRA and FCA will provide additional feedback.
- **Challenge session –** Formal meeting before the applicant submits the application:
  - PRA and FCA will provide detailed feedback on the near-final draft of the RBP.
  - The applicant can incorporate this into the application prior submission.
  - This will help to avoid last minute surprises that could impact the application.
- **Mobilisation and operational risk meetings –** the PRA and FCA may request additional meetings to monitor progress against the mobilisation plan.

The process on a page



The regulatory application timeline

Pre-application

Prepare for pre-application meeting → Pre-application meeting → Prepare application form for informal challenge session(s) → Formal challenge session(s) → Finalise and submit application

Applicants will need to start developing operational capabilities before submitting application

6-18 months

- Completion of a feasibility study to inform planning, including resourcing considerations
- Preparation of the business plan in advance of the pre-application meeting to clearly articulate the proposed business model and understanding of risks
- Robust governance process in place around the application to demonstrate senior management involvement throughout, including demonstrable C-Suite level engagement
- Initial dialogue with the PRA and FCA, including feedback on the RBP providing clear direction on any concerns
- Meetings set up between both the PRA and FCA and the applicant as required to review and discuss key components of the application, as this will be an iterative process.
- Development of the following components, incorporating any feedback received from the PRA and FCA:
  1. Business plan, including three- to five-year financial projections and funding sources
  2. Internal capital and liquidity adequacy assessment (ICAAP and ILAAP), including clear articulation of capital, leverage, large exposure and buffer requirements
  3. Recovery and resolution plan (RRP), and solvent wind-down plans
- Risk management framework (three lines of defence) in place, including controls and processes, and their implementation
- Formal feedback on finalised RBP, ICAAP ILAAP and others
- Decision on whether the firm is ready to submit the final application

Submit application

The process from the first contact with the regulators to becoming a fully functional bank is a long and complex journey. From discussing your vision to going live will need considerable effort and engagement from all stakeholders.

FCA and PRA review application

PRA and FCA review application → PRA and FCA approve application → Obtain banking licence → Go live

Firm delivers operational capabilities*

6-12 months

- PRA and FCA review application and are obliged to make decision within 6 months if the application complete or 12 months if incomplete.
- The regulators must satisfy themselves that the applicant meets the threshold conditions and has the resources required to conduct the regulated business.
- PRA and FCA review includes:
  - Setting the individual capital guidance (ICG) and individual liquidity guidance (ILG)
  - Business model viability
  - Risk management framework including policies and procedures
  - Operational infrastructure, including IT and outsourcing
  - Governance framework and key appointments
  - RRP
  - PRA and FCA approval largely involves desktop reviews, interviews, visits and reviews of documentation, with the applicant responding to specific requests for further information

*As an alternative approach, the NBSU may allow a 'mobilisation approach'. This s suited to new banks who are not able to meet the standard approach timetable because they cannot immediately commit to funding the upfront investment required to develop the operational capabilities of the bank, or because they have longer lead times in terms of raising capital or setting up their infrastructure.

Authorised

The regulatory business plan

The RBP is your 'sales document' to the regulator. It is providing the PRA and FCA with an overview over the business and operating model of your bank and is a key document of a new firm's application

The RBP is a key document to underpin the application for authorisation. The PRA and FCA are placing increased scrutiny on a firm's business model and practice, and the applicant will need to give consideration to the viability and sustainability of its business as well as its products and go-to-market strategy. As part of the application process, it is therefore essential that the business strategy and business model are defined and approved at the start of the application process, as they will form the basis of the financial, capital and liquidity projections, governance, risk management framework and operating model.

The RBP will need to follow the clear defined structure provided by the NBSU and should include a number of key policies.

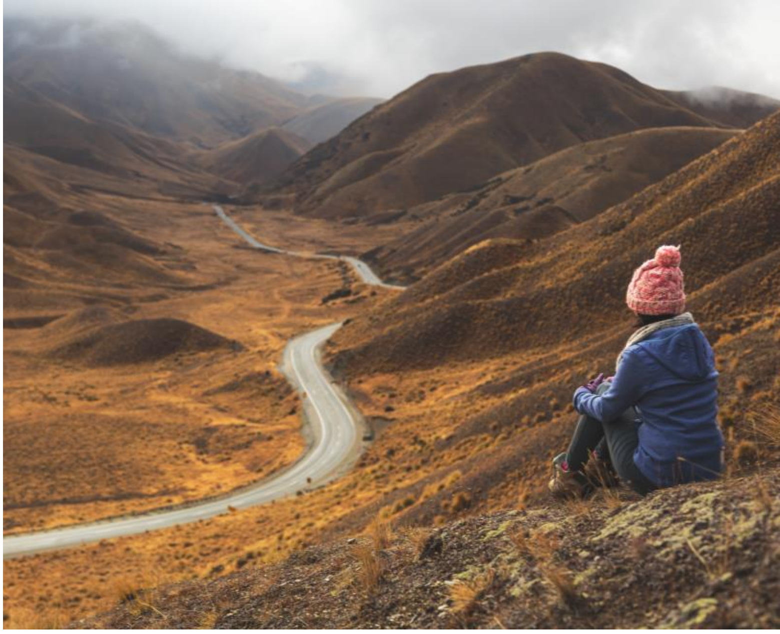
While developing the plan seems like a straightforward exercise, completing all of the underlying documents, such as the risk management framework, corporate governance, RRP and relevant policies and procedures, takes time, effort and careful planning to ensure all dependencies are managed.

The RBP should clearly articulate the proposed business model and an understanding of the associated risks. It should comprise of following content.

Content of a regulatory business plan

Owners and controllers *Proposed owners and controllers*	Business plan *Details of products, delivery channels and target markets*	Business viability *Competitive advantage, market research, and how your bank will make money*	Scope of permissions *Details of the regulated activities you wish to undertake*	Sources of funding *Proposed funding model*
Financial resources *Financial projections (for five years), capital and liquidity strategy, including summary of the ICAAP and ILAAP*	Risk management *Risk management and control framework, including risk appetite statement and limits*	Recovery and resolution *Recovery and solvent wind-down plans, if appropriate*	Corporate governance *Structure, board, senior management & governance arrangements and adherence to SM&CR*	Customer journey and compliance *Products, pricing, complaint handing and on-boarding arrangements (including AML/KYC)*
IT *Infrastructure and systems, including timescales for implementation and testing*	Outsourcing *Key outsourcing arrangements, including service level agreements*	Business continuity *Business continuity plans, if appropriate*	Project plan *Project plan for setting up the bank*	Policies and procedure *Underlying policies and procedures that will need to be submitted as part of the RBP*

Growing in a sustainable way



Your responsibilities as a growing bank

The PRA has clear expectations of new and growing banks, and this is reflected in the way it intends to supervise them.

The PRA's responsibilities lie not only in approving 'the right banks' but also in how it intends to measure these new and often fast-growing banks, to manage their growth in a sustained and orderly manner, to avoid undue risk to the UK financial system or depositors.

Interestingly, the PRA acknowledges that all new entrants will be entering a competitive market place and that a small number of new banks, even if fast-growing, will not survive.

The regulatory guidance, however, is clear: every institution must adhere to the PRA Threshold Conditions to be authorised as a deposit taker. However, it also accepts that a new bank is unlikely to meet all the expectations that the PRA has of an established bank, right from the start. It will need time to fully develop and mature its capabilities.

Although, as part of the application process, banks are required to define their five-year plan and stress test these plans against 'non-achievement'. New and growing banks often underestimate the work involved post-authorisation to become a successful, established bank, that is resolvable if needed, and their business model, risk management framework and governance are untested at the point of going live.

After months, or even years of being focused on the application process, new banks might fail to appreciate the ongoing need to develop, adapt and change as they grow.

Unsurprisingly both the PRA and FCA have increased their scrutiny and expectations of how new banks manage their business in the first few years post-authorisation.

The PRA has defined its expectations of new and fast-growing banks in five key areas:

1. How it will become profitable
2. How it will ensure robust oversight
3. How it will manage its risks
4. Does it have a capital transition plan
5. What if the bank becomes insolvent

While getting your licence is an important step in becoming a bank, growing your business in a sustainable way is challenging and will require a long-term vision of your ambitions to become a successful player.

How it will become profitable

Whilst the PRA accepts that, as a new bank, you may initially be loss making – potentially for quite some time – and therefore rely on regular capital injections, you should have clear plans for reaching profitability and the ability to achieve organic capital generation within a 'reasonable' time.

How it will ensure oversight

Establishing an effective governance structure that is free of conflicts of interest can be a challenge for a new bank. To ensure avoidance of conflict of interest – in particular, if substantial investors sit on the board of the new bank –and assurance that the board has the appropriate skillset to steer the new bank through its fast-growing years, the PRA expects the bank to have a clear plan for how the Board will develop, updating it as the business grows.

How it will manage its risks

As a new bank, the risk management framework will be untested. The bank should therefore regularly assess and prioritise developing its controls to address most material risks linked to any potential changes in its business model. The bank must also ensure that stress testing plays a prominent role in any decision-making, in line with increased risks that inevitably arise as a fast-growing business.

Planning the capital transition

The PRA expects a new bank to have a clear capital plan to transition from holding the New Bank PRA buffer, based on its operating expenses, to capital calibrated on the basis of stress testing over the five-year transition period, and to monitor its capital accordingly.

What if the bank becomes insolvent

A new bank's recovery plan and its resolvability must be realistic and current, and fully capture any additional vulnerabilities of a small bank to any stresses. As the bank grows, moving into 'mid-tier', its resolution strategy as defined by the BoE will move from modified insolvency to partial transfer, and making it subject to the BoE's minimum requirement for own funds and eligible liabilities (MREL).

Alternatives to becoming a bank

Depending on the activities a firm intends to undertake, there may be alternative authorisation routes to the provision of products and services offered by a bank.

Seeking an alternative authorisation route is a popular way to gain entry to the financial services sector, to secure initial traction for products and services, while gaining valuable experience of operating as a regulated firm.

Whilst alternative routes to authorisation can be less time-consuming and resource intensive than that of a bank, the same level of focus remains key to ensuring successful authorisation and delivering on your business and strategic objectives.

Once authorised, should proposed activities develop, and depending on the current authorisation, it may be possible to apply to the PRA or FCA for a variation of permission.

Below is a high-level overview of alternative authorisation routes available to new applicants looking to provide some of the products and services offered by a bank in the UK.

Alternatives to becoming a bank

	Licence type			
	Payment service	Electronic money	Consumer credit	Investment firm
Regulator	FCA	FCA	FCA	FCA
Description	Firms authorised under the Payment Service Regulations 2017 can offer products and services such as money remittance, payment accounts and account information services	E-money institutions (EMIs) that are authorised upon the receipt of funds to issue a monetary balance (stored electronically/magnetically) that represents a claim on the issuer which can be used for the purposes of making payment transactions and are accepted as a means of payment	Firms that offer goods or services on credit, lend money to consumers, provide payday lending or debt solutions and advice to customers	Firms that undertake regulated activities in relation to specified investments as set out in the Financial Services and Markets Act 2000
Typical applications	• Money remittance • Foreign exchange services • Payment accounts	• 'Virtual wallets' that can be linked to a prepaid card, mobile phone or payment account.	• Consumer loans • P2P lending • Debt collection	• Corporate finance • Investment management

How EY teams can support you

The starting point of the authorisation process is usually preparation for the initial regulatory engagement followed immediately by the development of an RBP.

We have a team of experienced professionals who have worked at the regulators and in financial services, who know both the regulatory expectations and the challenges in meeting them. Through our work with a range of different banks, and interactions with regulatory authorities, EY teams can support your application journey.

Leveraging peer insight, our broad application framework has been developed to help applicants to overcome the common pitfalls whilst preparing a viable and complete application pack, including all required underlying and supplementary documentation.

We can tailor our support to client-specific requirements, including providing technical advice, reviewing and challenging existing applications, and taking the lead in coordinating and preparing an application pack for appropriate submission to the regulators.

Our work, however, goes beyond advising on regulatory requirements. In essence, we help prepare clients for the demands and realities of operating as an authorised firm. Preparation is key, and we have worked extensively with clients to help them establish the capabilities to become operational on day one. Our document 'Growing a sustainable bank' provides more context on how we can support clients not only drive the application but also effectively build and drive their bank.

Tailoring the support to your needs

	Review and challenge *'Accessing knowledge'*	Drafting the RBP *'Driving the Licence'*	Broad support *'Developing the framework'*
Initial analysis: target and steps plan	✓	✓	✓
Targeted technical expertise	✓	✓	✓
Regulatory liaison		✓	✓
Manage the production of the RBP		✓	✓
Quality assessment of documentation		✓	✓
Drafting of supplementary documentation			✓
Business plan and strategy			✓
Recovery, resolution, and wind-down planning			✓
Capital and liquidity management			✓
Risk management framework and governance			✓
Customer journey and compliance framework			✓

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