

# Supervisory Expectations on Booking Models

Impacts and Challenges when addressing  
EU27 Requirements in International  
Organizations

September 2020

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# Brexit – Adding additional complexity to an old hat

The term 'booking model' depicts the product and entity specific trade-lifecycle as well as the way in which firms process and manage transactions in financial instruments. Although it is clearly not referring to a new concept, the topic has moved up the supervisory agenda over the past years. At least from an EU27 perspective, one of the reasons for the heightened supervisory scrutiny is that shortly after the Brexit referendum in 2016, the initial idea of many institutions was to set up so called empty shells in order to safeguard their EU27 business. An entity without adequate and sufficient local capabilities, staffing and governance structures would, however, not be able to act independently in a business as usual scenario, continue operations or wind down positions in case of a crisis. In order to prevent banks from realizing their empty shell plans and to ensure a level playing field for incoming as well as already established EU27 institutions, the ECB published detailed 'Supervisory Expectations on Booking Models' in August 2018. The ECB guidance includes 16 principles, covering various topics such as internal governance, staffing and organization, business origination and financial market infrastructure, booking and hedging practices intragroup arrangements as well as IT infrastructure and reporting.

While the requirement to describe an institution's booking model sounds quite simple, it usually leads to a number of complex questions as firm's booking models are closely linked with a number of other core processes. There are close links for example, between firm's booking models as well as their business strategy, governance processes, control frameworks as well as monitoring, reporting and data enhancement processes. Therefore, tackling the supervisory requirements on booking models usually requires the involvement of all key divisions, including but not limited to the Front Office, Treasury, Operations, IT, Finance and Risk Management.

Especially for organizations which have expanded their business historically across the globe, the key challenge is often the identification of all existing material booking models, the definition of a concise and sustainable booking model strategy for the EU27 entity as well as the documentation of booking models based on a common scheme. Institutions usually face numerous deviations from standard processes deriving from accommodating client's needs, account structures (e.g. wash accounts), hedging models (e.g. split hedging, back-to-back booking and portfolio hedging), remote booking and complex trade flows dependent on legal entity structures. Therefore, the translation of the existing, often complex structures into simplified booking model strategies, principles as well as the documentation of a booking model inventory often proves difficult.

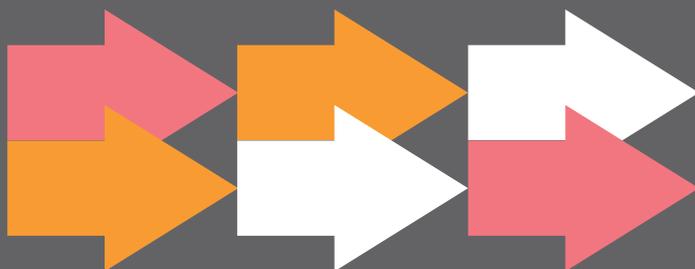
Furthermore, complex corporate structures and processes often lead to impediments with regard to recoverability, resolvability and the ability to quickly respond to a crisis scenario. Therefore, supervisors across the globe expect firms to be able to clearly explain the rationale behind complex corporate structures and processes as well as respective impediments to recovery, resolution and crisis scenarios. The ECB's expectations on booking models hence include a focus on the legal entity's

standalone capabilities in a crisis scenario, sufficiency and adequacy of staffing as well as a high level of independence from affiliates regarding booking and hedging strategies in order to ensure business continuity.

In order to demonstrate the standalone capabilities of the SSM entity, the documented booking practices should cover the whole trade lifecycle including client facing entity, trade execution, risk management, clearing and settlement, clearly identifying where and by which legal entity the respective tasks are being carried out.

While most institutions have started addressing the ECB's requirements on booking models and already submitted respective documentation to their JST as part of the on-going supervisory dialogue, most institutions are still facing the following three challenges: (1) Defining a sustainable business model for the EU27 entity on a standalone basis in line with the overall global strategy, (2) establishing the required local structural changes, including the transfer of the relevant client base from other group entities to the EU27 entity as well as (3) hiring the required SMEs to implement the EU27 strategy.

One of the key success factors for implementing the EU27 strategy remains the standing of the local Management within the global organization. Decisions relating to the global and legal entity specific corporate structure are usually based on aspects relating to cost savings or tax considerations and hence focused on e.g. building global hubs for risk management purposes. However, ECB and NCAs are going to monitor and challenge the local Management based on local supervisory expectations, which partially contradict these traditional decision-making criteria. These contradicting views and expectations often lead to conflicts of interest which need to be well managed by the EU27 entity's Management Board.



# Supervisory Expectations – The challenge of addressing different perspectives in a global framework

**Apart from the ECB’s expectations on booking models, other supervisors have communicated their requirements in relation to booking models as well, including but not limited to the FED and the PRA. This leads to a situation in which global institutions with legal entities across the globe, need to reflect different local expectations when implementing a global booking model framework.**

Supervisory expectations differ, however, based on the predominant supervisory perspective. While the FED includes expectations in relation to booking models in their ‘2019 Resolution Plan Guidance for US G-SIBs’, the PRA documents them in form of a Supervisory Statement with the title ‘International banks: the PRAs approach to branch authorisation and supervision (SS1/18)’.

Although all three supervisors cover similar themes, expectations vary, dependent on the level of access supervisors have to information relevant from a group perspective. The FED requirements are addressed at the eight largest, most complex US banks to which the FED is the home supervisor and therefore has almost unlimited downstream access based on the ongoing supervisory interaction with headquarter. With regard to the EMEA business of these institutions, PRA and ECB are responsible for the supervision of the respective UK and EU27 subsidiary (if existent). The latter only have limited access to group wide (upstream) information and are therefore especially interested in the local legal entity’s risk management capabilities and their independence in case of a crisis.

**The following table summarizes the key differences with regard to supervisory expectations on booking models from ECB, FED and PRA:**

General Theme	ECB	FED	PRA
Scope	<ul style="list-style-type: none"> <li>In scope are EEA entities under SSM supervision</li> <li>All material products in scope (incl. e.g. loan business and treasury)</li> </ul>	<ul style="list-style-type: none"> <li>In scope are the eight largest, most complex US banks</li> <li>Derivatives portfolio, including non-derivatives trading positions linked to derivative portfolio</li> </ul>	<ul style="list-style-type: none"> <li>In scope are all UK incorporated firms and UK branches of non-UK incorporated firms</li> <li>No documented product scope</li> </ul>
Scenarios Overall Requirements	<ul style="list-style-type: none"> <li>Covering BAU, crisis scenarios, recovery and resolution</li> </ul>	<ul style="list-style-type: none"> <li>Limited to resolution perspective</li> </ul>	<ul style="list-style-type: none"> <li>Including BAU and resolution perspective</li> </ul>
Overall Requirements	<p><b>Expectations with regard to:</b></p> <ul style="list-style-type: none"> <li>Internal governance and staffing</li> <li>Business origination and FMI access</li> <li>Booking and hedging strategy</li> <li>Intragroup arrangements</li> <li>IT-infrastructure and reporting</li> </ul> <p><b>Documentation requirements:</b></p> <ul style="list-style-type: none"> <li>Governance and risk management framework</li> <li>Booking model policy (incl. remote booking)</li> <li>Policy on marketing practices</li> </ul>	<p><b>Resolution plan to include:</b></p> <ul style="list-style-type: none"> <li>Comprehensive booking model framework incl. principles, rationales and approach to implementing booking practices</li> <li>Framework to be supported by internal controls</li> <li>Descriptions of booking models and underlying trade flows and reporting processes</li> <li>Interaffiliate market risk framework incl. compression strategies</li> <li>Resources need forecast (capital, liquidity, staffing)</li> </ul>	<p><b>6 principles on booking models:</b></p> <ul style="list-style-type: none"> <li>Firms to set out clear rationale for booking arrangements</li> <li>Appropriate risk management for booking activities</li> <li>Broad alignment of risks and returns at entity level</li> <li>Adequate systems and controls to ensure booking arrangements are followed</li> <li>Oversight of booking arrangements should be explicit in statement of responsibilities</li> <li>Booking models should not impede recovery and resolution</li> </ul>
Outsourcing	<ul style="list-style-type: none"> <li>SSM entities to have the substance to identify and manage the risks they generate</li> <li>Authorities to have full access to all information they need to fulfil their supervisory function</li> <li>Activities outsourced to UK should be assessed with regard to ability to adapt to Brexit</li> <li>Additional considerations: EBA Guideline on Outsourcing</li> </ul>	<p><b>Firms to have plans that demonstrate ability regarding:</b></p> <ul style="list-style-type: none"> <li>Continuity of shared services that support critical operations</li> <li>Retention of key personnel</li> <li>Prevent automatic termination of SLAs</li> <li>Identification of critical outsourced services</li> </ul>	<ul style="list-style-type: none"> <li>No outsourcing requirements as part of the six booking model Principles</li> <li>Additional considerations: EBA Guideline on Outsourcing and PRA OCIR requirements (operational continuity in resolution)</li> </ul>
Data Requirements	<ul style="list-style-type: none"> <li>Ability to produce daily complete and accurate reports</li> <li>IT-infrastructure should be commensurate with the increased volume of business</li> <li>Operational continuity and access to necessary operational assets via adequate contractual provisions and BC plans</li> <li>Requirements on data aggregation and reporting based on BCBS 239 principles</li> </ul>	<ul style="list-style-type: none"> <li>MIS capabilities to readily produce data on a legal entity basis</li> <li>Controls to ensure data integrity and reliability</li> <li>Analysis of financial and risk data required to execute preferred resolution strategy</li> </ul>	<ul style="list-style-type: none"> <li>No data requirements as part of the booking model Principles</li> <li>Requirements on data aggregation and reporting based on BCBS 239 principles</li> </ul>

These different supervisory expectations give rise to a number of additional challenges, such as e.g. defining a wholistic global booking model policy or framework which applies to all relevant legal entities across the globe. The existing gaps between supervisory expectations need to be identified and translated into respective remedial actions, if relevant, from a local legal entity-specific perspective. From the perspective of an ECB or BaFin supervised entity, this often leads to additional requirements regarding e.g. topics that need to be included in the local booking model policy, the implementation of additional control measures regarding remote booking or the enhancement of the global booking model inventory to include aspects related to trader location and risk management.

Especially with regard to EU27 entities which were newly established or substantially expanded due to Brexit, the booking model policy needs to reflect any planned changes to booking models due to and in line with the increase of business from current state to target state. As part of the on-going supervisory dialogue, financial institutions will be tracked against any conditions set by ECB and BaFin and commitments made as part of the licensing process.

## Supervisory Dialogue – Booking Models are going to remain on top of the Agenda for the foreseeable future

**In case conversations with the supervisor are not already in flight with regard to the topic of booking models, financial institutions should assess their existing documentation in relation to booking models as well as their local capabilities against the ECB's expectations in order to identify existing gaps, define and prioritize remedial actions as well as prepare a project plan outlining their individual path to target state. This is not only applicable to ECB supervised institutions but to institutions supervised by BaFin or other NCAs as well, as supervisors have agreed on applying the same standards in order to ensure a level playing field in the EU.**

In case booking model documentation has already been submitted and conversations and workshops have taken place with the JST to discuss the topic, it's important to ensure that the right priority is allocated to that topic, as the outcome of the horizontal review across institutions as well as the legal entity specific JST feedback with regard to submitted documentation and information gained as part of conversations and workshops, will be used to inform the institution's SREP results going forward.

As the topic is closely linked to the sustainability of the legal entity's business model and strategic decisions are likely to be required as part of the ongoing supervisory dialogue on booking models, the latter should be made a Management Board and Senior Management priority, if that's not already the case. Given the complexity of the topic, the JST feedback already received as part of the supervisory dialogue as well as the institution's individual level of preparedness and limitation of resources, it will be inevitable to allocate priorities to identified remedial actions and to identify tactical as well as strategic solutions.

The key challenge lies in weighing quick wins such as writing a first draft of the booking model policy and laying out the path to target state up with on-going, time-consuming processes and strategic challenges such as the onboarding of clients, implementing a sustainable business model and establishing automatic solutions for e.g. booking model reporting and the booking model inventory.

## Next Steps and challenges ahead

Recognizing the complexity and effort required to address supervisory expectations in relation to booking models holistically at a global as well as a local legal entity specific level, is already a first step in the right direction. Institutions should use the remaining time until the end of 2020 to ensure they are fully prepared for the end of the transition period. Following a clear path to target state, including defining and establishing a sustainably business model for the EU27 entity should be on top of the agenda, not only from a local legal entity Management Board's perspective but also from a global perspective as this will lay the basis for a constructive supervisory dialogue and feedback received from the JST will be reflected in the SREP score. The challenges arising from the supervisory expectations on booking models should not only be seen as a chore but should be recognized as an opportunity to identify and challenge any unduly complex internal structures, booking flows, hedging and risk management processes as well, keeping in mind not only potential crisis scenarios but recovery and resolution scenarios as well.



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**Stephan Lutz**

Partner

Tel: +49 69 9585-2697

E-mail: [stephan.x.lutz@pwc.com](mailto:stephan.x.lutz@pwc.com)



**Ina-Alexandra Steiner**

Senior Manager

Tel: +49 175 4353407

E-mail: [ina-alexandra.steiner@pwc.com](mailto:ina-alexandra.steiner@pwc.com)