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Dear Chief Executive,

We are writing to you, and the chief executives of all wholesale banks active in the UK, to set out our key priorities for this sector. This is our first letter to you since we launched our new integrated regulatory structure across the whole of Supervision, Policy and Competition in the FCA. We have created a Sell-Side Directorate within the FCA in which the Wholesale Banks Department now sits alongside the supervision of market intermediaries and an area that analyses market interactions.

The letter describes our supervisory work programme over the next two years which will shape our engagement with the sector. It sets out our areas of supervisory focus, although we will prioritise among these and adapt where circumstances or events demand. When identifying these areas, we considered a range of information taken from our supervisory work, firm authorisations, external data, our interaction with global regulators and other bodies and the FCA's strategy. We expect your Board and you to discuss the contents of this letter, consider how it applies to your business and, where necessary, take action.

The external environment

Wholesale banks were presented with a series of market stresses in 2022 and the external environment has continued to pose significant challenges for wholesale banks through this year. Continued volatility in asset prices, weak global growth, the impact of rising interest rates, inflationary pressures and geopolitical tensions are some of the reasons why business models will continue to be tested.

In this environment, risks can be linked and transform. For example, a failure to manage operational or reputational risks can quickly result in broader concerns about a firm's safety and soundness, and the clarity of a firm's communication becomes even more important. Firms' ability to manage these risks can have a material effect on the FCA's consumer protection and market integrity objectives.

Much of the supervisory focus we set out in this letter is shaped by this context. We will make full use of our knowledge, technology and data to deliver supervision which is outcomes-focussed and incisive. We expect wholesale banks to contribute to high standards of market excellence and help strengthen the UK's position as a global and vibrant financial centre . The FCA and wholesale banks have a shared objective in ensuring that markets work well, and while we have arrangements in place to collect industry intelligence, we are always keen to hear from firms about their concerns of risks in markets.

You should also note our recent proposals, such as changes to the listing regime, to attract world-leading firms and encourage competition, to help ensure that the UK continues to be seen as one of the principal global markets of choice.

Risk management

Wholesale banks are a vital component of global financial markets, and in the UK are a major contributor to the UK's role as a leading international financial centre. They play an important and diverse role in the global flow of funds. For example, in the primary markets they help governments to finance budgets and companies to access the investment capital needed to fund productive projects, in the secondary markets they provide market access and liquidity. With this role comes great responsibility as when not properly controlling their activities, wholesale banks can cause direct harm or transmit risks to other market participants in the financial services economy. In turn this can impact consumers and market integrity. Good risk management protects profitability.

Jointly with the PRA, we have already highlighted the poor controls and flawed execution evidenced by business conducted with Archegos (Dear CEO: Global Equity Finance) but the market shocks of the past year identified further examples of weaknesses in risk management. For example, we have noted instances of poor management of client relationships, including inadequate knowledge of clients' business profiles. In some cases, it revealed hitherto unknown concentrations of client risk: within firms (eg through not appreciating that two or more counterparties were in fact related) and across firms (not appreciating a counterparty's total exposure). We have also seen firms (and their stress assumptions) underestimate concentration in markets that may have a limited group of buyers and seller types that may in practice be likely to react to events in a similar fashion.

In recent episodes we also have seen the importance of stressing assumptions around liquidity, whether that be the depth available in markets to accommodate stressed sales without major price impact or, on the liability side, the speed with which customers or counterparties can withdraw money if terms allow them to do so. These points may stem from, or be made worse by, an underappreciation of the concentrations mentioned above.

Banks' risk management has the potential to dampen or amplify harm to market integrity in times of stress and firms should ensure their stress assumptions have been updated in the light of market events last year and are fit for the current environment. Stress testing should recognise that severe stresses will often affect the entire system – true in respect of market exposures, but also operations and reaction times, including in services provided by third parties. These are issues on which we work closely with the PRA given the potential transmission route of prudential risk to market functioning.

What we will do

Many firms have put in place remediation programmes in response to events of the last 18 months. Better firms will have done this whether they were directly affected or not. We will look to senior management to evidence how these have delivered better risk management and oversight across businesses and how they are comfortable that this is underpinned by a strong culture. We will also look to Boards to evidence how they are ensuring that such improvements are lasting. We will carry out supervisory testing on the embeddedness of improvements in risk management by looking at the process through which new products and some transactions are produced. Finally, in times of stressed conditions firms can expect an increase in regulatory engagement and in information we may request. We are always keen to hear from firms if they see pockets of risks emerging which may affect the orderly functioning of markets.

Maintaining high standards of control

Through the activities they carry out wholesale banks are exposed to conduct risks such as financial crime, market abuse and conflicts of interest. Our concern is that the external environment may impact the management of these risks through cuts in the control framework, by short term commercial interests being prioritised over regulatory obligations because of revenue pressure or by employees not following procedures and processes.

We have seen instances of conduct standards reducing when the external environment has been challenging. For example, on 28 April 2020, during the Covid pandemic, we issued a Dear CEO letter noting that we had heard credible reports that banks may have used their lending relationship to exert pressure on corporate clients to secure roles on equity mandates to which the issuer would not otherwise appoint them. We are looking closely for signs of similar behaviour. Boards and senior management need to provide an unambiguous tone from the top on the importance of good conduct.

Finally, we continue to see a blurring of responsibilities between the first and second lines. For example, in ESG-related activities we see a lack of clarity between first and second lines of defence in terms of who is responsible for ensuring the bank is delivering against its public commitments. You need to ensure there is clarity of responsibilities between the first and second lines of defence.

What we will do

We are ramping up our testing programme to look at how banks are controlling these risks, including more in person supervisory assessments. Assessing how firms manage conflicts of interest will be a particular area of focus. We will look to test outcomes (rather than solely policies) and intend to be data-led. We may ask for targeted information from across the sector before selecting smaller samples for further work. We are always interested in your ideas of areas we should look at or methodologies of testing harm, and where appropriate, we will share good practice.

Control functions should play a key role in assisting senior management with its oversight of business activities. We expect prompt notification of any material issues that they identify, effective action taken to address them and support from senior management and Boards for their work and independence.

Operational resilience

We expect wholesale banks to be operationally resilient to preserve the safety and soundness of markets as evidenced by compliance with the requirements set out in our policy statement PS21/3 Building Operational Resilience. This requires banks to consider the services they provide rather than just the systems they run and rely on. As we describe above, there should be no doubt that these matters can be critical to firms as well as to their customers and counterparties.

UK financial services firms are increasingly relying on third-party services to support their operations. Third parties can play a range of roles for wholesale banks, from providing support to middle and back-office functions, to giving legal advice on deals. We have seen the systems of third parties penetrated by cyber-attacks. While penetration of third parties can result in the disruption of services to wholesale banks, it can also have other implications such as threatening the confidentiality of market sensitive information. Where a third party is providing the same service to several firms the impact of penetration can become systemic.

We hold firms responsible, and ultimately accountable, for their own operational resilience, and not the third parties on whom they might rely. We expect wholesale banks to understand their dependence on third party providers and take steps to mitigate the potential impact on business continuity that the loss of service may have.

Finally, we expect and generally receive prompt notification from firms where either they, or a third party they are relying on, have been subject to a cyber-attack. Nonetheless, there are examples where firms have been slow to inform the FCA. This is disappointing as in some cases, third party small and unregulated firms may not provide details of their customers directly to the FCA. It may also reduce our ability to coordinate a response.

What we will do

We will continue to review banks' compliance with the requirements of PS21/3 Building Operational Resilience and their ability to remain within their impact tolerances as soon as reasonably practicable, but no later than 31 March 2025. We will also use our engagement with relevant Senior Managers to assess how they have learnt the lessons of operational resilience events even if their firm has not been directly impacted.

Organisational changes

Many wholesale banks operate in a range of jurisdictions supporting their broad international activities. While there are various booking and organisational arrangements underpinning these activities, there should be appropriate oversight for any business booked into the UK. For example, UK country management need to demonstrate to us that they understand how their firm's booking model operates and have a control framework in place sufficient to meet UK regulatory requirements.

Given the vital role wholesale banks play across financial markets in the UK, if a firm starts to consider changes to how they serve clients, their location, their booking model or risk management arrangements, we expect this to be brought promptly to our attention before any change is made. Where we see proposed changes that are not consistent with our objectives, we will intervene.

LIBOR transition

The transition away from LIBOR has been a great success story for the wholesale banks sector and we welcome the efforts firms have made and the positive engagement we have enjoyed. While USD LIBOR ceased on 30 June, we expect wholesale banks to continue actively transitioning the last of the contracts that reference USD LIBOR and not rely unnecessarily on synthetic LIBOR. Client and conduct considerations should remain at the core of the transition programme.

Implementation of the Consumer Duty

The Consumer Duty is a significant intervention by the FCA that sets higher and clearer standards of consumer protection across financial services and requires firms to put their customers' needs first. Some wholesale banks have business models which result in a direct relationship with retail clients, others manufacture products, including structured products, which are, or can ultimately be sold to retail clients.

We will test the robustness of assessments made and actions taken to implement the Consumer Duty as well as the effectiveness of the arrangements in place to identify any implications of compliance with the Consumer Duty that might result from changes in activity.

ESG

Wholesale banks have an important role in the transition to a more sustainable future. They should demonstrate that their financing activities are aligned with their own transition plans, and that product and public-facing commitments relating to ESG are delivered in practice. They should also have regard to the Transition Plan Taskforce's (TPT) developing framework for disclosure and implementation guidance which the TPT consulted on. We encourage early engagement with the TPT framework; this will be an area of future discussion with firms.

Artificial intelligence

As set out in DP5/22, a discussion paper issued jointly by the FCA, PRA and Bank of England, artificial intelligence and machine learning are rapidly developing technologies that have the potential to transform financial services. We will engage with wholesale banks on current deployment as well as plans for the future and the associated control infrastructure.

Diversity, equity and inclusion

Diversity, equity and inclusion are central to healthy firm cultures. Indeed, there is growing evidence that a diversity of perspectives and thought, when part of an inclusive culture, results in better judgements and decision making.

In July 2021, we published a joint Discussion Paper (DP) with the PRA and Bank of England. In it we discussed the current state of diversity, equity and inclusion in the industry, set out the case that more progress advances our objectives, and proposed some areas for potential policy intervention. We will consult on these proposals in 2023.

Finally, through our engagement with wholesale banks, our supervisory focus will be to understand how they are playing their role in helping to accelerate the pace of meaningful change on diversity, equity and inclusion in the sector.

Non-financial misconduct

Our position is clear: a corporate culture that tolerates sexual harassment or other non-financial misconduct is unlikely to be one in which people feel able to speak up and challenge decisions, or one in which they will have faith that concerns will be independently and fairly assessed. Such a culture also raises questions about a firm's decision making and risk management. We expect firms to have effective systems in place to identify and mitigate risks of all kinds. Should allegations or evidence of non-financial misconduct come to light we expect a regulated firm to take them seriously through appropriate internal procedures and act according to the established facts. We will assess the reports we receive and will consider carrying out work to assess the effectiveness of these controls.

Next steps

As CEO, the Senior Managers and Certification Regime makes you responsible for ensuring that relevant staff at your firm understand our rules and principles for businesses and for ensuring that your firm complies with them. If you are not meeting those rules and standards, you must notify the FCA immediately, setting out what you are doing to remedy any breaches.

Within 2 months, we expect all CEOs to have discussed this letter with their fellow directors and/or Board and to have agreed actions and/or next steps.

If you have any questions about this letter, please contact your named supervisor if your firm has one. If you do not have a named supervisor, please contact us on 0300 500 0597. This is the primary contact for your firm's day-to-day interactions with the FCA. Further details of how we can be reached are available on our website.

In the event your firm faces urgent issues of strategic importance, please contact Wayne Laramee, the Head of Department for Market Interventions – Wholesale Banks, at wayne.laramee@fca.org.uk.

We look forward to working with the sector to continue to improve standards and market outcomes.

Yours faithfully,

Simon Walls – Director, Wholesale Sell-Side