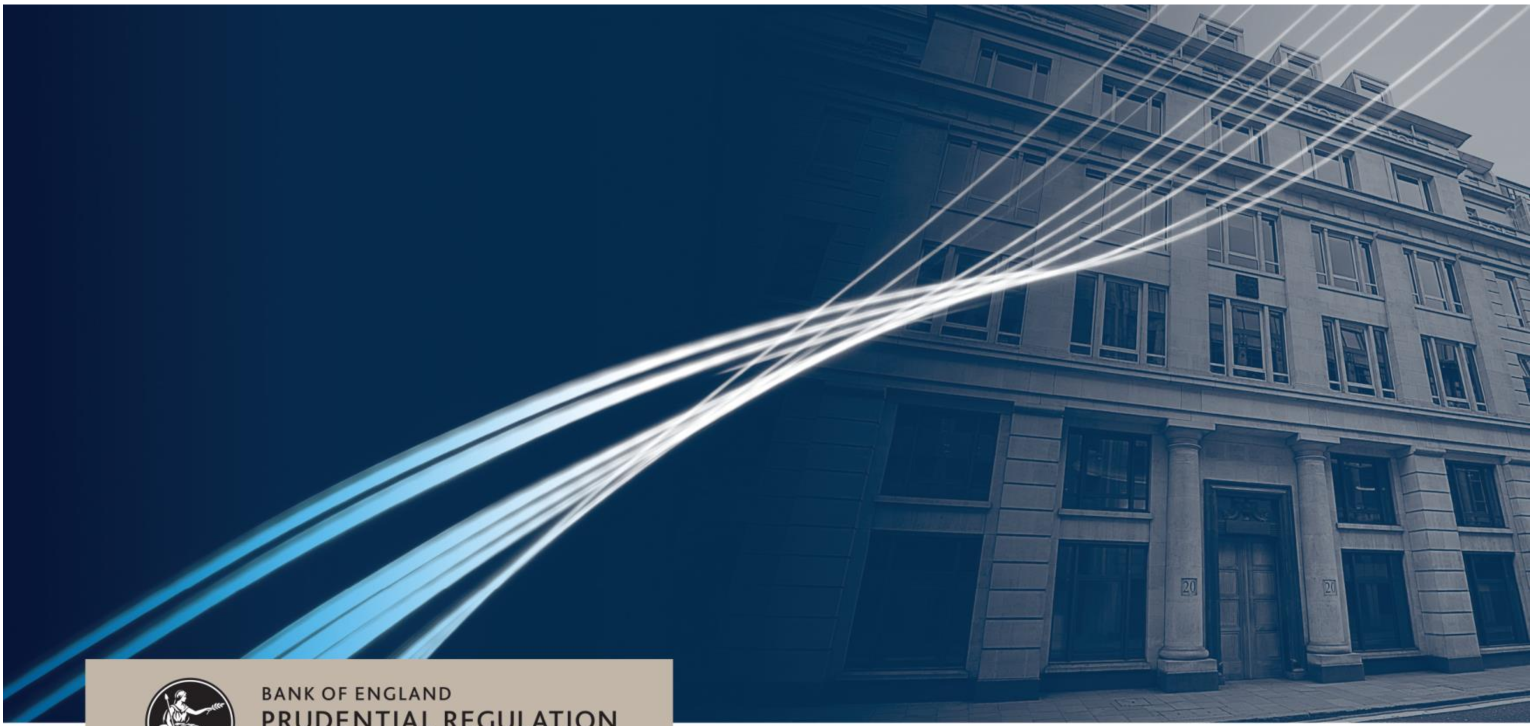

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AUTHORITY

Consultation Paper | CP25/19

Occasional Consultation Paper – October 2019

October 2019

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By responding to this consultation, you provide personal data to the Bank of England. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

The consultation paper will explain if responses will be shared with other organisations (for example, the Financial Conduct Authority). If this is the case, the other organisation will also review the responses and may also contact you to clarify aspects of your response. We will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/legal/privacy.

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Responses are requested by Monday 18 November 2019 for Chapter 4, and Monday 9 December 2019 for all other chapters.

Please address any comments or enquiries to:

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Contents

1 Overview

1.1 This Consultation Paper (CP) proposes minor amendments to Prudential Regulation Authority (PRA) Rulebook Parts, supervisory statements (SSs), statements of policy (SoPs) and the relevant templates.

1.2 The chapters in this CP are relevant to different firms, as follows:

- Chapters 2 and 5 - all firms to which CRD IV[1] applies, and Chapter 2 additionally to building societies;
- Chapter 3 - UK banks, building societies, credit unions, PRA-designated investment firms, UK Solvency II insurance firms, third country insurance branches within the scope of the PRA's rules transposing the Solvency II Directive, and the Society of Lloyd's and managing agents; and
- Chapter 4 – Reporting updates; UK banks, building societies and PRA-designated investment firms.

1.3 The chapters contained in this CP, the Rulebook Parts, SSs, SoP, and relevant templates they propose to change, and the appendices containing the draft policy, are listed in the table below.

Chapter	Rulebook Part/SS/SoP/Template	Appendix
2. Removing references to LIBOR	SS20/15 'Supervising building societies' treasury and lending activities'	1
	SoP 'The PRA's methodologies for setting Pillar 2 capital'	2
3. Senior Managers regime – updating references and corrections	SS28/15 'Strengthening individual accountability in banking'	3
	SS34/15 'Strengthening individual accountability in insurance'	4
4. Reporting updates for Capital+ and Ring-fenced bodies	Regulatory Reporting Part of the PRA Rulebook	5
	Templates PRA101, PRA102, RFB003, RFB004 and RFB008.	6
5. Retirement interest-only mortgages	SS11/13 'Internal Ratings Based (IRB) approaches'	7
	SS10/13 'Standardised approach'	8

The PRA's duty to consult

1.4 The PRA has a statutory duty to consult when introducing new rules and, when not making rules, has a public law duty to consult widely where it would be fair to do so. Each chapter in this CP will meet these obligations and duties by providing the following:

- a cost benefit analysis;

1 The Capital Requirements Regulation (575/2013) (CRR) and Capital Requirements Directive (2013/36/EU) (CRD), jointly 'CRD IV'.

- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective,[2] insurance objective[3] (if applicable), and secondary competition objective;[4]

- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;[5]

- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons;[6]

- consideration to aspects of the Government's economic policy as recommended by HM Treasury;[7] and

- having due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions, as required by the Equality Act 2010.[8]

1.5 The PRA has consulted the Financial Conduct Authority (FCA) on the proposals in this OCP.

Responses and next steps

1.6 The consultation period for Chapter 4 of this CP closes on Monday 18 November 2019. This would allow the PRA to make the proposed changes to the templates and allow firms time to implement them before they would take effect on Sunday 1 March 2020 and Monday 1 June 2020 (see Appendix 5).

1.7 The consultation period for the remaining chapters closes on Monday 9 December 2019.

1.8 The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to OCP.responses@bankofengland.co.uk.

1.9 The proposals set out in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect. Each chapter in this CP sets out the PRA's assessment of whether the proposals would need to be amended under the European Union (Withdrawal) Act 2018 (EUWA).[9] Please see Policy Statement (PS) 5/19 'The Bank of England's amendments to financial services legislation under the EUWA for further details.[10]

2 Section 2B of FSMA.
3 Section 2C of FSMA.
4 Section 2H(1) of FSMA.
5 Sections 2H(2) and 3B of FSMA.
6 Section 138K of FSMA.
7 Section 30B of the Bank of England Act 1998. Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at www.bankofengland.co.uk/about/people/prudential-regulation-committee.
8 Section 149.
9 http://www.legislation.gov.uk/ukpga/2018/16/contents/enacted.
10 June 2019: www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018.

Implementation

1.10 Subject to the PRA's consideration of the responses to the consultation, the proposed implementation dates are:

- on the same date as publication of the final policy for Chapters 2 and 3;
- as set out in Appendix 5 for Chapter 4.
- For Chapter 5, the PRA proposes that firms should implement the proposed changes by Tuesday 31 December 2020, in order to align with the proposed implementation date of the relevant European Banking Authority (EBA) guidelines, as set out in CP21/19 'Credit risk: Probability of Default and Loss Given Default estimation'.[11]

11 September 2019: www.bankofengland.co.uk/prudential-regulation/publication/2019/credit-risk-probability-of-default-and-loss-given-default-estimation.

2 LIBOR references

2.1 In this chapter, the PRA sets out its proposals to update SS20/15 'Supervising building societies' treasury and lending activities' (in this chapter, 'the SS')(Appendix 1) and Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital' (in this chapter, 'the SoP')(Appendix 2) to remove references to the London Inter-bank Offered Rate (LIBOR).

2.2 The proposals in this chapter relating to SS20/15 are relevant to building societies, and those relating to the SoP are relevant to all PRA-authorised persons to which CRD IV applies.

2.3 The PRA and the FCA have indicated that firms should plan for the likely cessation of the LIBOR benchmark rate at end-2021.[12]

2.4 The PRA has reviewed its policy material to ensure it remains relevant during and after benchmark rate transition, and has identified several references to LIBOR, which it proposes to remove and/or replace.

2.5 The PRA is aware there is a reference to LIBOR in the PRA Rulebook for non-Solvency II insurance firms, and plans a further revision to the Rulebook in due course.

2.6 In the event that the UK leaves the EU with no implementation period in place, the PRA has assessed that the proposals would not need to be amended under the EUWA.

Proposals

2.7 The PRA proposes to remove references to LIBOR from the SS and SoP. The PRA proposes to use the term 'market rates' in the draft amendments, as a general term that encompasses Sterling Over Night Index Average (SONIA), LIBOR and other market-derived rates as appropriate.

2.8 The PRA proposes minor edits to paragraph 7.17 of the SoP and paragraph 4.110 of the SS to improve readability.

2.9 Market-led working groups in LIBOR currency jurisdictions have already been convened to identify potential preferred alternative risk-free rates (RFRs). For instance, in the UK the Working Group on Sterling Risk-Free Reference Rates recommended SONIA, as its preferred RFR. The Bank of England implemented reforms aimed at strengthening SONIA on Monday 23 April 2018. RFRs have been identified in other LIBOR currency jurisdictions.

The PRA's duty to consult

Cost benefit analysis

2.10 The proposals in this chapter remove references to LIBOR that will soon be out-of-date. References to SONIA and market rates are already used in the SS and SoP. As such, the PRA does not expect that the proposals would have cost implications for firms, as they do not materially amend existing policy.

Compatibility with objectives

2.11 The PRA considers that keeping policy material updated, provides confidence to firms in

12 See the Dear CEO LIBOR letter, September 2018 here: https://www.fca.org.uk/news/statements/dear-ceo-libor-letter.

following the expectations set out in that material, which contributes to the PRA's statutory objective to promote the safety and soundness of PRA-authorised firms.

2.12 The PRA does not expect that the proposals would have any significant impact on competition, as they do not change existing policy.

Regulatory principles

2.13 In developing the proposals in this chapter, the PRA has had regard to the regulatory principles. The principle of most relevance to these proposals is that the regulators should exercise their functions as transparently as possible. The aim of these proposals is to provide clarity around forthcoming changes to the PRA's policy and expectations as a result of the likely cessation of LIBOR.

Impact on mutuals

2.14 The PRA considers that the impact of the proposed policy changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

2.15 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[13] The PRA considers the aspect most relevant to the proposals is transparency. This has been set out in its analysis in general terms above.

Equality and Diversity

2.16 The PRA does not consider that the proposals give rise to equality and diversity implications.

13 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

3 Senior Managers & Certification Regime – updating references and corrections

3.1 In this chapter, the PRA sets out its proposals to update redundant references and make minor corrections to SS28/15 'Strengthening individual accountability in banking' (Appendix 3) and SS35/15 'Strengthening individual accountability in insurance' (Appendix 4) (jointly, in this chapter, 'the SSs').

3.2 The proposals are relevant to:

- SS28/15 – UK banks, building societies, credit unions, and PRA-designated investment firms; and
- SS35/15 - UK Solvency II insurance firms, third country insurance branches within the scope of the PRA's rules transposing the Solvency II Directive, and the Society of Lloyd's and managing agents.

3.3 In the event that the UK leaves the EU with no implementation period in place, the PRA has assessed that the proposal below to update the references to the EBA Suitability Guidelines would not need to be amended under the EUWA. Changes under EUWA should be read in conjunction with the draft PRA transitional direction published in CP18/19 'UK withdrawal from the EU: Changes following extension of Article 50'.[14]

3.4 The draft SSs attached to this CP should be read in conjunction with SS1/19 'Non-binding PRA materials: The PRA's approach after the UK's withdrawal from the EU'.[15]

3.5 As these proposals relate to EU Guidelines, they should also be read in conjunction with the joint Bank and PRA Statement of Policy (SoP) 'Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU'.[16]

Proposals

3.6 The PRA has become aware of a number of minor corrections and updates needed to the SSs, and proposes to make the following changes:

SS28/15:

- In 2.4, Table A, reverse the underlining of the Senior Management Functions (SMF) in the 'Oversight SMFs' column. The change would correct an error in publication of the SS following PS15/18 'Strengthening individual accountability in banking and insurance: amendments and optimisations'[17] in which the underlining was reversed from the previous version.
- Update the reference and link to the latest version of the Joint EBA/European Securities and Markets Authority (ESMA) Suitability Guidelines, removing references to the 2012 Guidelines.

14 July 2019: www.bankofengland.co.uk/prudential-regulation/publication/2019/uk-withdrawal-from-the-eu-changes-following-extension-of-article-50.

15 April 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/non-binding-pra-materials-the-pras-approach-after-the-uks-withdrawal-from-the-eu-ss.

16 April 2019: https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop.

17 July 2018: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/strengthening-individual-accountability-in-insurance-extension-of-the-smcr-to-insurers.

SS35/15:

- Reformat the '[deleted]' in paragraph 2.35 so that it is not struck through (this change is not shown in Appendix 3), and make a typographical deletion that was not put through in the final version of the SS following PS15/18.

3.7 The PRA considers that the above updates would improve the accuracy and clarity of the SSs.

The PRA's duty to consult

Cost benefit analysis

3.8 The proposals in this chapter remove out-of-date material and make minor corrections to the SSs in order to make the PRA's expectations clearer. The PRA considers that they would not result in any costs to firms.

Compatibility with objectives

3.9 The PRA considers that keeping policy material updated provides confidence to firms in following the expectations set out in that material, which contributes to the PRA's statutory objective to promote the safety and soundness of PRA-authorised firms.

3.10 The PRA does not expect the proposals would have any significant impact on competition, as they do not change existing policy.

Regulatory principles

3.11 In developing the proposals in this chapter, the PRA has had regard to the regulatory principles. The regulatory principle of most relevance to these proposals is that the regulators should exercise their functions as transparently as possible. The aim of these proposals is to provide clarity regarding the expectations in the two SSs.

Impact on mutuals

3.12 The PRA considers that the impact of the proposed policy changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

3.13 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[18] The PRA considers the aspect most relevant to the proposals is transparency. This has been set out its analysis in general terms above.

Equality and Diversity

3.14 The PRA considers that the proposals do not give rise to equality and diversity implications.

18 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

4 Reporting updates for Capital+ and ring-fenced bodies

4.1 In this chapter, the PRA sets out its proposals to make minor updates and corrections to certain Capital+ and ring-fenced body reporting templates.

4.2 This chapter is relevant to banks, building societies and PRA-designated investment firms.

4.3 The proposals would amend the Regulatory Reporting Part of the PRA Rulebook (Appendix 5), and the following reporting templates:

- Capital+ (PRA101 and PRA102) (Appendix 6)
- Ring-fenced body reporting (RFB003, RFB004 and RFB008) (Appendix 6)

4.4 Following the publication of PS16/19, the PRA has identified some additional areas in which ring-fenced body and Capital+ reporting templates can be further aligned in presentation to the final amendments to Financial Reporting (FINREP) and Common Reporting (COREP) templates. The PRA considers that this alignment would support the efficient reporting across both frameworks. No changes are proposed to the reporting instructions to the templates.

4.5 The proposals are included in the Public Working Draft (PWD) of the taxonomy update to support collection in accordance with the proposed changes to ring-fenced body and Capital+ reporting.[19]

4.6 In the event that the UK leaves the EU with no implementation period in place, the PRA has assessed that the proposals would not need to be amended under the EUWA.

4.7 As these proposals relate to reporting they should also be read in conjunction with SS2/19 'PRA approach to interpreting reporting and disclosure requirements and regulatory transactions forms after the UK's withdrawal from the EU'.[20]

Proposals

4.8 The PRA proposes to make amendments to the reporting templates as shown below.

Capital+ returns: PRA101 and PRA102

4.9 The PRA proposes the deletion of row 790 'Systemically important institution buffer' of table CA4 in Capital+ templates PRA101 and PRA102.

4.10 The PRA consulted on the above proposal in CP19/18, with no responses received. However, in the subsequent policy statement (PS16/19) the changes were inadvertently not shown in the final templates. Following this consultation, the PRA would update PRA101 and PRA102 to align with the same change to COREP made in the EBA's Taxonomy 2.9.

4.11 The proposal would reduce the number of rows in the templates that firms have to submit,

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19 Version 3.3.0 Bank of England Banking XBRL taxonomy, available here: https://www.bankofengland.co.uk/prudential-regulation/regulatory-reporting/regulatory-reporting-banking-sector/banks-building-societies-and-investment-firms.

20 April 2019: https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop.

thereby reducing the reporting burden.

Ring-fenced bodies reporting

RFB003

- Correction of the title to rows 191, 510 and 590 of RFB003b.
- Correction of the title to row 320 of RFB003c.

RFB004

- Correction of the titles to the columns 010 and 020 of RFB004d.
- Correction of the title to row 101 of RFB004e.
- Corrections to the titles to rows 050, 052-054, 100, 110, 136, 170, 210, 220 and 290 of RFB004g.
- Corrections to the row numbers of 130 to 134 of RFB004g.
- Deletion of the row 135 ‘Payment collection’ of RFB004g.
- Correction to the title of row 330 of RFB004h.
- The opening up of cells C199 and C200 for R340 and R550 in RFB004h to enable reporting.
- Correction of the column number 199 of RFB004h.
- Correction to the title to row 180 and 330 of RFB004i.
- The striking out of cells C100 and R211 to R231 in RFB004i so these are not reported.
- Corrections to the titles to rows 030, 040 and 090 of RFB004j.
- Correction to the number of row 100 of RFB004j.
- Addition of two rows at 100 and 110 of RFB004j which in combination with the proposed change to row 090, provide additional breakdown of consulting and professional services expenses. This proposal aligns with the corresponding change to the template, and reporting instructions that the EBA has made to F16.08.

RFB008h

- Correction of the title for Table 2.

4.12 The above proposals are intended to further align those templates with the final changes the EBA has made to COREP and FINREP templates, and to correct typographical errors in the ring-fenced body templates.

Statutory obligations

Cost benefit analysis

4.13 The PRA considers that the cost to firms of updating their reporting systems will not be material. Firms will benefit from the greater alignment of data definitions and template structures between PRA reporting and FINREP and COREP. In achieving greater alignment, these proposals would reduce potential ambiguity in the application of FINREP and COREP requirements to PRA reporting. Many firms are expected to be making similar changes in the implementation of the EBA's Taxonomy 2.9.

Compatibility with PRA objectives

4.14 The proposed corrections and changes to align with EBA reporting templates would ensure that the PRA can continue to receive accurate information to support it in meeting its statutory objectives to promote the safety and soundness of PRA-authorised firms, and supervise firms in an efficient manner that is consistent with EBA reporting.

4.15 The PRA does not consider that there will be an impact on competition as the changes are minor and are not expected to impact smaller firms in a manner that would be disproportionate compared to larger firms.

Regulatory principles

4.16 In developing the proposals in this chapter, the PRA has had regard to the regulatory principles. The Three principles of particular relevance are:

(i) The principle that a burden imposed on a firm should be proportionate to the benefits expected to result from the imposition of that burden. The PRA is proposing to make the above changes to align with firms FINREP and COREP reporting to coincide with other amendments being made as part of a major taxonomy change. This would allow firms to use already committed resource to implement the changes, rather than as a stand-alone project.

(ii) That regulators use their resources in the most efficient and economic way. These changes are necessary to ensure that firms can submit the information required and/or expected by the PRA.

(iii) That the regulators should exercise their functions as transparently as possible. The aim of these proposals is to bring to firms' attention adjustments to the templates to allow them to report in a timely manner.

Impact on mutuals

4.17 The PRA considers that the impact of the proposed changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

4.18 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[21] The PRA considers the aspects most relevant to the proposals are acting in a proportionate way to reduce the burden on firms to foster innovation, and transparency. This has been set out its analysis in general terms above.

Equality and diversity

4.19 The PRA considers that the proposals do not give rise to equality and diversity implications.

21 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

5 Retirement interest-only mortgages

5.1 In this chapter, the PRA sets out its proposals in relation to retirement interest-only (RIO) mortgages as well as certain interest-only (IO) mortgages which are converted into RIO mortgages. The proposals would result in amendments to SS11/13 'Internal Ratings Based (IRB) approaches' (Appendix 8) and SS10/13 'Standardised approach' (Appendix 9).

5.2 This chapter is relevant to all banks, building societies and PRA-authorised investment firms offering RIO mortgages. It is also relevant to firms that have offered RIO mortgages in the past, or may do so in the future.

5.3 The proposals in this chapter are intended to produce consistent and prudent treatment across firms in their treatment of IO and RIO mortgages.

Background

5.4 RIO mortgages are IO mortgages offered to older borrowers, where the loan is redeemed at a borrower's death or on sale of the property. As well as providing RIO loans to new borrowers, lenders see the product as a potential option for existing IO borrowers that have failed to repay, or are unlikely to be able to repay, the principal at maturity but are still able to continue paying interest on the loan.

5.5 Based on discussions with firms, the PRA has identified potential inconsistencies in practices across firms in relation to capital treatment of RIO mortgages.

Impact of the UK's withdrawal from the European Union

5.6 In the event that the UK leaves the EU with no implementation period in place, the PRA has assessed that the proposals would not need to be amended under the EUWA.

5.7 The draft SSs in Appendix 8 and 9 should be read in conjunction with SS1/19 'Non-binding PRA materials: The PRA's approach after the UK's withdrawal from the EU'.[22]

5.8 As these proposals relate to EU Guidelines, they should be read in conjunction with the joint Bank and PRA Statement of Policy (SoP) 'Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU'.[23]

Proposals

5.9 In accordance with Capital Requirements Regulation (CRR) Article 178 and the EBA Guidelines on the Definition of Default,[24] the PRA proposes that, at a minimum, firms should classify conversions of exposures to RIO mortgages as being distressed restructuring in cases where: (a) the exposure is in default as a result of being a past-term interest only (PTIO) mortgage;[25] or (b) the firm has assessed that the obligor is unlikely to be able to make outstanding principal payments in respect of

22 April 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/non-binding-pra-materials-the-pras-approach-after-the-uks-withdrawal-from-the-eu-ss.

23 April 2019: https://www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop.

24 https://eba.europa.eu/documents/10180/1721448/Guidelines+on+default+definition+%28EBA-GL-2016-07%29_EN.pdf

25 PTIO mortgages are IO mortgages where the borrower has not paid the full principal amount when due at the contractual maturity of the exposure.

the exposure.

5.10 The PRA proposes that, for defaulted IO mortgages to return to non-defaulted status following conversion to an RIO mortgage, the borrower should at least make a material payment of the principal of the IO loan such as is necessary to meet the lender's RIO underwriting criteria. In particular, the payment would be sufficient to reduce the loan to value (LTV) to the maximum at which the lender will offer a RIO product.

5.11 The PRA proposes that firms be able to demonstrate the appropriateness of the treatment of IO mortgages that are converted into RIO in their Internal Rating Based (IRB) models through robust analysis. In particular, as a minimum, the PRA would expect firms to consider the effect of IO defaults on the IRB model estimates for IO mortgages. The PRA would expect that firms apply a prudent approach to the modelling of IO mortgages that return to non-defaulted status only as a result of the borrower being transferred to a RIO product.

5.12 The PRA considers that it is unlikely that RIO mortgages would form part of the same type of exposure as other mortgage exposures for the purposes of the CRR definition of rating system.[26] The PRA also considers that including RIO exposures for the first time in a rating system for which PRA permission has already been received would in any event amount to a material change to the range of application of that rating system under Regulation (EU) 529/2014.[27] The PRA therefore proposes that firms wishing to apply the IRB approach in respect of RIO mortgage exposures should apply to the PRA for permission to do so. The PRA would only grant permission once it is satisfied that the relevant CRR requirements are met.

5.13 In addition to the above proposals, the PRA would like to remind firms that it is established good practice for firms to monitor the profile and future performance of their RIO lending and be able to isolate those borrowers transferring from existing IO stock (pre and post maturity) from new RIO lending, and for firms to give consideration to borrowers' previous IO mortgage history (including principal repayment) in RIO underwriting standards. Firms are also reminded that they are already required to report data on RIO mortgages in their PSD001 submissions.

The PRA's duty to consult

Cost benefit analysis

5.14 The proposals in this chapter provide clarity to firms on the PRA's proposed approach to IO and RIO mortgages. The PRA considers that the proposals will require firms to develop or clarify their existing processes relating to IO and RIO mortgages but considers that the cost to firms of doing so will not be material.

Compatibility with objectives

5.15 By setting out its expectations for the treatment of certain IO and RIO mortgages, the PRA considers that it would lead to consistent treatment by firms and compliance with the CRR. This would assist the PRA in meeting its statutory objectives to promote the safety and soundness of PRA-authorised firms.

5.16 The PRA does not consider that there will be an impact on competition as the CRR Definition of Default applies equally to SA and IRB firms.

26 CRR Articles 142 and 143.
27 Article 4(1)(a).

Regulatory principles

5.17 In developing the proposals in this chapter, the PRA has had regard to the regulatory principles. The three principles of most relevance are:

(i) The principle that a burden imposed on a firm should be proportionate to the benefits expected to result from the imposition of that burden: the PRA's proposals still allow firms discretion as to how they define material payment. The proposals ensure that the amount of material payment required reflects the riskiness of the borrower and the underwriting standards of the firm.

(ii) Efficient use of resources: the PRA considers that setting out its expectations in a supervisory statement will give clear guidance to firms that would reduce the amount of queries to supervisors and ensure consistency;

(iii) Transparency: the proposals would make the PRA's expectations clear to all firms in a consistent manner.

Impact on mutuals

5.18 The PRA considers that the impact of the proposed changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

5.19 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[28] The PRA has considered HMT's recommendations when developing the proposals in this CP, in particular with regards to recognising different business models to help foster innovation and competition in the financial services industry, and has set out its analysis in general terms above.

Equality and Diversity

5.20 The PRA considers that the proposals do not give rise to equality and diversity implications.

28 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

Appendices

Appendix 1: Draft update to SS20/15 'Supervising building societies' treasury and lending activities'

This appendix outlines proposed amendments to Supervisory Statement (SS)20/15 'Supervising building societies' treasury and lending activities'.[29] Underlining indicates new text and striking through indicates deleted text. Footnote numbering throughout the SS will be updated when the policy is finalised.

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4 Financial risk management

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Interest rate and structural risk management

...

4.108 Most societies are susceptible to interest rate risks (commonly called 'interest rate risk in the banking book' or 'IRRBB') arising not only as a result of changes (or potential changes) in the general level of interest rates, but also from:

...

(c) interest basis risk, arising from the imperfect correlation of rates on floating rate assets funded by floating rate liabilities e.g. between:

> (i) ~~LIBOR/~~ SONIA/base rate and mortgage rates (the former being driven by monetary policy and unsecured wholesale markets, the latter by the general level of rates and competition amongst lenders);
>
> (ii) ~~LIBOR/~~SONIA/base rate and administered rates paid on deposits (the latter being driven by general market rates and competition for funding more generally);
>
> (iii) ~~LIBOR~~ <u>SONIA</u> and reference gilt rates or other indices; ~~and~~
>
> (iv) <u>overnight and term reference rates</u> ~~SONIA, 1, 3, 6 and 12 month LIBOR rates~~<u>; and</u>
>
> <u>(v) legacy market rates and other policy and market rates</u>.

Management of interest rate risks

...

[29] https://www.bankofengland.co.uk/prudential-regulation/publication/2015/supervising-building-societies-treasury-and-lending-activities-ss.

4.110 Societies are expected especially to have regard to the specific structural and margin compression risks created by originating a large proportion of assets and/or liabilities over which they have no rate setting control (either fixed rate, or contractually linked to interest rates set by market indices or by the central bank). Significant exposure to such assets and liabilities reduces the ability of a society to manage its net interest margin through movement of its own administered rates. This can give rise to prudentially dangerous margin compression and thus to potential for an unexpected shock to income. In the event of a fall in market interest rates, structural imbalances may crystallise as a risk ~~that~~: it may not be possible to decrease administered savings rates in line with decreases in money market ~~(LIBOR)~~ rates or Bank Rate without losing the funding (or because deposit rates/fees cannot realistically/practically fall much below 0%), resulting in a serious margin squeeze where lending rates are ~~LIBOR~~ market-linked. Similarly, in the event of a rise in rates, margin compression may arise from the inability to raise rates on fixed rate assets, at a time of price competition for floating/administered rate assets and rising funding costs.

…

4.141 Administered approach societies would have very limited exposure to fixed interest rate or market floating rate (eg base rate~~, LIBOR or SONIA~~ or market rate-linked) assets or liabilities; any retail assets with such characteristics would not represent more than 10% of the balance sheet and would be matched with retail liabilities for the same duration and with the same interest rate characteristics; similarly, retail liabilities with such characteristics would not represent more than 10% of the balance sheet and be broadly matched to similar retail assets. Any fixed rate instruments (eg held for liquidity purposes) or loans would be limited to a maximum repricing tenor of three years.

…

4.149 Matched approach societies would have exposure to fixed interest rate or market floating rate (eg base rate or ~~LIBOR~~ market rate-linked) assets or liabilities; and any loan assets or funding liabilities with such characteristics would be matched with liabilities/assets or derivative hedges for the same duration. Contractual balances, where the society currently sets an administered rate (or which will revert to administered rates within twelve months) would typically represent a minimum of 50% of the total loan assets and total funding liabilities of the society. Any fixed rate instruments (eg held for liquidity purposes) or loans would be limited to a maximum repricing tenor of five years.

…

4.165 Extended approach societies would have strong internal controls on their exposure to fixed interest rate or market floating rate (eg base rate or ~~LIBOR~~ market rate-linked) assets or liabilities. Contractual balances, where the society currently sets an administered rate (or which will revert to administered rates within twelve months) would typically represent a minimum of 40% of the total loan assets and total funding liabilities of the society. Fixed rate instruments (eg held for liquidity purposes) with a repricing tenor beyond five years would be limited to a maximum of 5% of funding liabilities. Societies would set internal limits on the level of basis mismatch in aggregate (max per base) and by major mismatch pairs (eg bank rate/ ~~LIBOR~~ SONIA, bank rate/administered, ~~LIBOR~~ SONIA/administered, SONIA/term rate ~~LIBOR(s)/LIBOR(s)~~, administered/administered).

…

Appendix 3 – Financial risk management – indicative control framework

	ADMINISTERED	MATCHED	EXTENDED	COMPREHENSIVE
…				
Balance Sheet Structure	… • Non-administered variable rate (eg base rate/~~LIBOR~~ SONIA- linked) lending and funding only if with tracking period limited to <=3 years. …	… • Non-administered variable rate (eg base rate / ~~LIBOR~~ SONIA-linked) lending and funding - max tracking period 5 years. …	…	…
…				

…

Appendix 6 – Glossary of pricing methodology terms

1. Theoretically, assuming a society is wholly retail funded and uses a marginal rather than blended historic cost approach, the potential building blocks of its 'cost of funds' calculation would include, but not necessarily be limited to:

(a) a 'benchmark rate' that its board believes (based on historical evidence) to be the main driver of changes in its core retail cost of funds (eg bank rate, SONIA~~, a LIBOR rate~~);

…

Appendix 2: Draft update to Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'

This appendix outlines proposed amendments to Statement of Policy 'The PRA's methodologies for setting Pillar 2 capital'.[30] Underlining indicates new text and striking through indicates deleted text. Footnote numbering throughout the SS will be updated when the policy is finalised.

...

7 Interest rate risk in the banking book

…

7.3 For larger or more complex firms the PRA employs a comprehensive approach to its IRRBB risk assessment that reviews duration risk, basis risk and, as necessary, optionality risk.

…

- Basis risk is generated by banking book items that re-price in relation to different reference rates. The most common and material basis risks seen within UK banks derive from products re-pricing against policy rates (eg Bank Rate) and market rates (eg SONIA ~~Libor~~). As part of the review of basis risk the PRA also considers asset swap spread risk, which typically arises when firms hedge the duration risk associated with fixed rate securities using derivatives (typically interest rate swaps).

  …

Duration risk

…

7.12 For each significant currency, the different interest rate shocks are applied to the net interest rate gaps in each time bucket. The methodology uses both government yield curves and ~~Libor~~ swap rate curves by material currency in order to calculate the potential impact of the interest rate risk shocks.

…

7.14 The review of basis risk concentrates on net policy rate and net ~~Libor~~ market rate (contractual and behavioural) exposures including on-and off-balance sheet positions. The assessment is designed to capture the risk of market funding costs rising relative to a more stable policy benchmark.

…

30 https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-methodologies-for-setting-pillar-2-capital.

7.17 The PRA measures how ~~significant shifts in~~ the ~~market pricing~~ price of hedging ~~Libor~~ market versus policy rate exposures for a one-year period can move over a three-month timeframe. This is likely to involve the use of ~~Overnight Indexed Average and Libor swaps~~ relevant swap curves, eg Overnight Indexed Swaps.

7.18 The approach generates a one-year earnings at risk (EaR) measure to assess the capital requirement for basis risk. The calculation considers the net Bank Rate position exposed to a ~~Libor~~ funding shock.

…

Other IRRBB risks

7.24 Other IRRBB risks that may be considered, if material, include the risks arising from legacy market rates, hedge accounting operations and structural foreign exchange exposures. The PRA monitors these and other emerging risks to ensure such risks are capitalised adequately.

…

Appendix 3: Draft update to SS28/15 'Strengthening individual accountability in banking'

This appendix outlines proposed amendments to SS28/15 'Strengthening individual accountability in banking'.[31] Underlining indicates new text and striking through indicates deleted text. Footnote numbering throughout the SS will be updated when the policy is finalised.

…

2 The Senior Managers Regime

…

2.4 In contrast, oversight SMFs do not carry out executive functions in Relevant Firms but perform a NED role in scope of the SMR. Oversight SMFs have fewer responsibilities than executive SMFs under the SMR. Moreover, these responsibilities are non-executive in nature and either inherent in or linked to their Chair or SID roles. Table A sets out the full list of SMFs. SMFs subject to preapproval by the PRA (with FCA consent) are underlined; the other SMFs require preapproval by the FCA only.

[The underlining in the table below is in its final format, which reverses the underling of Oversight SMF's as currently shown in the SS]

Table A

Executive SMFs	Oversight SMFs
…	<u>Chair of the Governing Body (SMF9)</u>
	<u>Chair of the Risk Committee (SMF10)</u>
	<u>Chair of the Audit Committee (SMF11)</u>
	<u>Chair of the Remuneration Committee (SMF12)</u>
	Chair of the Nomination Committee (SMF13)
	<u>Senior Independent Director (SID) (SMF14)</u>

…

4 Assessing fitness and propriety

31 https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss.

…

Assessing fitness and propriety

…

4.6 The PRA will also have regard to the joint European Securities and Markets Authority and European Banking Authority's Guidelines on the assessment of the suitability of members of the management body and key function holders (the EBA Suitability Guidelines) and in particular to the Assessment Criteria set out in ~~Title II, Chapter IV~~ Title III of those Guidelines.[29]

…

Footnote 29: ~~The EBA's Guidelines (EBA/GL/2012/06) are available at www.eba.europa.eu/documents/10180/106695/EBAGL201206—Guidelines on theassessmentofthesuitabilityofpersons.pdf.~~ The Guidelines (EBA/GL/2017/12) are available at https://eba.europa.eu/documents/10180/1972984/Joint+ESMA+and+EBA+Guidelines+on+the+assessment+of+suitability+of+members+of+the+management+body+and+key+function+holders+%28EBA-GL-2017-12%29.pdf/43592777-a543-4a42-8d39-530dd4401832

Appendix 4: Draft update to SS35/15 'Strengthening individual accountability in insurance'

This appendix outlines proposed amendments to SS35/15 'Strengthening individual accountability in insurance'.[32] Underlining indicates new text and striking through indicates deleted text.

…

3 Application of Conduct Standards and associated notification requirements

…

Persons and activities to which the PRA Conduct Standards apply

3.3 In accordance with Insurance — Fitness and Propriety 2.3 and Large Non-Solvency II Firms – Fitness and Propriety 2.3, the relevant Conduct Standards in Insurance — Conduct Standards 3 and Large Non-Solvency II Firms - Conduct Standards 3 should also be taken into account by firms and groups when assessing on an ongoing basis the fit and proper status of all those persons who are effectively running the firm or group, in an SMF, performing a certification function, or ~~are~~ performing another key function for the firm or group.

32 https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss.

Appendix 5: Draft PRA RULEBOOK: CRR FIRMS: REGULATORY REPORTING (RING FENCE BODIES, CAPITAL+ AND FINREP) AMENDMENT INSTRUMENT 2019

PRA RULEBOOK: CRR FIRMS: REGULATORY REPORTING (RING FENCE BODIES, CAPITAL+ AND FINREP) AMENDMENT INSTRUMENT 2019

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
   (1) section 137G (The PRA's general rules);
   (2) section 137T (General supplementary powers); and
   (3) section 142H (Ring-fencing rules).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA RULEBOOK: CRR FIRMS: REGULATORY REPORTING (RING FENCE BODIES, CAPITAL+ AND FINREP) AMENDMENT INSTRUMENT 2019

D. The PRA makes the rules in the Annexes.

Part	Annex
Regulatory Reporting	A
Regulatory Reporting	B

Commencement

E. Annex A comes into force on 1 March 2020.

F. Annex B comes into force on 1 June 2020.

Citation

G. This instrument may be cited as the PRA Rulebook: CRR Firms: Regulatory Reporting (Ring Fence Bodies, Capital+ and FINREP) Amendment Instrument 2019.

By order of the Prudential Regulation Committee
XX 2019

Annex A

Amendments to the Regulatory Reporting Part

In this annex new text is underlined and deleted text is struck through.

16 Data Items and Other Forms

...

16.26 PRA101 can be found **<u>here.</u>** **~~here.~~**

16.27 PRA102 can be found **<u>here.</u>** **~~here.~~**

...

Annex B

Amendments to the Regulatory Reporting Part

In this annex new text is underlined and deleted text is struck through.

16 Data Items and Other Forms

...

16.37 RFB003 can be found **here.** ~~**here.**~~

16.38 RFB004 can be found **here.** ~~**here.**~~

…

16.42 RFB008 can be found **here.** ~~**here.**~~

...

Appendix 6: Draft updates to reporting templates

This appendix provides draft versions of the proposed amendments to the reporting templates listed in Chapter 5 of this CP. Underlining indicates new text and striking through indicates deleted text.

Template	Link
PRA101 / PRA102	Available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/occasional-consultation-paper-october-2019
RFB003	
RFB004	
RFB008	

Appendix 7: Draft update to SS11/13 'Internal Ratings Based (IRB) approaches'

This appendix outlines proposed amendments to SS11/13 'Internal Ratings Based (IRB) approaches'.[33] Underlining indicates new text and striking through indicates deleted text.

Contents

…

…

[The following chapter is inserted, new text is not underlined]

20 Retirement interest-only (RIO) mortgages

20.1 This chapter sets out the PRA's expectations in relation to retirement interest-only (RIO) mortgages as well as certain interest-only (IO) mortgages which are converted into RIO mortgages.

20.2 The PRA expects, at a minimum, that firms should classify conversion of existing exposures to RIO mortgages as being distressed restructuring in cases where (a) the exposure is in default as a result of being a past-term interest only (PTIO) mortgage, or (b) the firm has assessed that the obligor is unlikely to be able to make outstanding principal payments in respect of the exposure.

20.3 For defaulted IO mortgages to return to non-defaulted status following conversion to an RIO mortgage the borrower should make a material payment of principal of the IO loan such as is necessary to meet the lender's RIO underwriting criteria. In particular, the material payment should be sufficient to reduce the loan to value (LTV) to the maximum at which the lender will offer a RIO product.

20.4 Firms should be able to demonstrate the appropriateness of the treatment of IO mortgages that are converted into RIO in their Internal Rating Based (IRB) models through robust analysis. In particular, as a minimum, consideration should be given to the effect of IO defaults on the IRB model estimates for IO mortgages. A prudent approach should be applied to the modelling of IO mortgages

33 https://www.bankofengland.co.uk/prudential-regulation/publication/2013/internal-ratings-based-approaches-ss.

that return to non-defaulted status only as a result of the borrower being transferred to a RIO product.

20.5 The PRA considers that it is unlikely that RIO mortgages would form part of the same type of exposure as other mortgage exposures for the purposes of the CRR definition of rating system. The PRA also considers that including RIO exposures for the first time in a rating system for which PRA permission has already been received would in any event amount to a material change to the range of application of that rating system under Regulation (EU) 529/2014. The PRA expects that firms wishing to apply the IRB approach in respect of RIO mortgage exposures should apply to the PRA for permission to do so. The PRA will only grant permission once it is satisfied that the relevant CRR requirements are met.[x]

[x] CRR Articles 142 and 143, and Article 4(1)(a) of Commission Delegated Regulation (EU) No 579/2014.

Appendix 8: Draft update to SS10/13 'Standardised approach'

This appendix outlines proposed amendments to SS10/13 'Standardised approach'.[34] The text is all new and is not underlined.

…

5 Exposures fully and completely secured by mortgages on residential property

…

Retirement interest-only (RIO) mortgages

5.7 This chapter sets out the PRA's expectations in relation to retirement interest-only (RIO) mortgages as well as certain interest-only (IO) mortgages which are converted into RIO mortgages.

5.8 The PRA expects, at a minimum, that firms should classify conversion of existing exposures to RIO mortgages as being distressed restructuring in cases where (a) the exposure is in default as a result of being a past-term interest only (PTIO) mortgage, or (b) the firm has assessed that the obligor is unlikely to be able to make bullet principal in respect of the exposure.

5.9 For defaulted IO mortgages to return to non-defaulted status following conversion to an RIO mortgage the borrower should make a material payment of principal of the IO loan such as is necessary to meet the lender's RIO underwriting criteria. In particular, the material payment should be sufficient to reduce the loan to value (LTV) to the maximum at which the lender will offer a RIO product

[34] https://www.bankofengland.co.uk/prudential-regulation/publication/2013/credit-risk-standardised-approach-ss.