BANK OF ENGLAND

News release

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The Prudential Regulation Authority consults on strengthening capital standards

The Prudential Regulation Authority (PRA) has published a consultation paper on changes to its rules required to implement the EU's Capital Requirements Directive (CRD IV). These changes will affect banks, building societies and those investment firms which are regulated by the PRA. It does not affect insurance firms.

CRD IV is the EU package of rules and regulations which implements Basel III, the international regulatory framework for banks. The package is binding on all EU member states. It aims to address the problems that caused the financial crisis by increasing the level and quality of capital held by banks, enhancing risk coverage, expanding disclosure requirements and reducing procyclicality. CRD IV provides a basis for EU liquidity standards and introduces leverage disclosure requirements.

The PRA has already taken decisive action to ensure that the capital of major UK banks and building societies reflects expected future losses and more prudent calculation of risk weights, as recommended by the Financial Policy Committee in November 2012. In many areas, the UK capital regime for the banking sector and investment firms will remain broadly the same under CRD IV but there are a number of important changes which will affect UK firms. The PRA's consultation paper sets out the detail of these changes and the transitional periods for firms to allow them to prepare for the new regime.

Andrew Bailey, Deputy Governor Prudential Regulation, Bank of England and Chief Executive Officer of the Prudential Regulation Authority commented:

"Well capitalised and resilient firms are crucial for ensuring financial stability and supporting UK growth. The PRA has already acted to increase both the amount and quality of capital held by firms, reflecting our determination to improve the stability of UK firms after the crisis. This has put UK firms in a good position to meet the new requirements whilst continuing to provide banking services and support lending to the real economy."

CRD IV places greater emphasis on the highest quality of capital (known under CRD IV as Core Equity Tier 1) than the current regime and strengthens the criteria used to determine what can be used as CET1. The

PRA supports this emphasis on high quality capital and has set out proposals in the consultation paper to ensure that this is reflected in the PRA's implementation of CRD IV. The table below explains the new minimum Pillar 1 capital requirements for firms and when they apply.

Pillar 1 capital after deductions	Risk Weighted Assets	
	1 January 2014 to 31 December 2014	1 January 2015 onwards
Common Equity Tier 1	4%	4.5%
Tier 1 (CET1 + Additional Tier 1)	5.5%	6%
Total capital (Tier 1 + Tier 2)	8%	8%

The PRA is also making enhancements to the quality of capital held against "Pillar 2" which encompasses firms' internal capital assessment and the supervisory review of those assessments. Pillar 2 is intended to ensure that firms have adequate capital to support all the relevant risks in their business and is divided into capital held against risks not captured or not fully captured by the regulations (Pillar 2A) and risks to which a firm may become exposed over a forward-looking planning horizon (Pillar 2B). In addition to the Pillar 1requirements, the PRA regards Pillar 2A capital as the minimum level of capital firms should have.

Under the current regime Pillar 2A can be met with any regulatory capital. The PRA is proposing that firms should meet this requirement with at least 56% CET1 capital from 1 January 2015, thus bringing the capital quality of Pillar 2A in line with that of Pillar 1. The PRA is consulting on whether from 1 January 2016 onwards the Pillar 2A requirement should be met with CET1 only or a different combination of capital. The final form of the new capital regime emphasises that Pillar 2 capital requirements should be met by fully loss absorbing capital, thus by CET1. But in the light of actions being taken, UK banks are in a stronger position to allow judgements to be made about the appropriate path of transition to the final form, and these judgements can helpfully support lending and economic activity.

CRD IV creates a combined capital buffer that all firms will be expected to meet in addition to their Pillar 1 and Pillar 2 capital requirements. The combined buffer requirement will consist of a capital conservation buffer, a countercyclical capital buffer and buffers intended to mitigate systemic risk (where applicable). The combined capital buffer must be met with CET1 capital.

The consultation paper and accompanying supervisory statements do not cover substantive changes to the PRA's rules regarding remuneration. Although CRD IV includes new provisions on remuneration, these issues are also raised in the Final Report of the Parliamentary Commission on Banking Standards (PCBS). The PRA will consider its approach to remuneration in the context of the PCBS report.

The PRA will publish a policy statement with feedback, finalised rules and final supervisory statements in December 2013.

Notes to Editors

1. The consultation paper and supervisory statements are available on the Bank of England website.
2. CRD IV was published in the official journal of the European Union on 27 June 2013. CRD IV consists of a directly applicable EU Regulation, and an EU Directive which must be reflected in national law. The bulk of the rules contained in the legislation will apply from 1 January 2014.
3. The Financial Conduct Authority has published a consultation paper on how they intend to implement CRD IV for the firms that they prudentially regulate. This can be found on the FCA website: http://www.fca.org.uk/news/cp13-06-capital-requirements-for-investment-firms
4. For further enquiries, please contact the Bank's Press Office on 020 7601 4411.