



Statement on CP 5/13 - Strengthening capital standards: Implementing CRD IV

The Prudential Regulation Authority (PRA) is providing clarity on changes to its rules on capital standards ahead of a formal policy statement before the end of the year.

In August, the PRA published a consultation paper explaining the changes which implement the EU's Capital Requirements Directive (CRD IV) in the UK¹. The PRA will publish the final policy statement, rules and supervisory statements in December having considered all the responses received to the consultation.

However, the PRA recognises the importance of giving firms clarity on the most material policy issues including those that impact the level of highest quality Common Equity Tier 1 (CET1) capital which firms will have to hold.

Transitional provisions

In CP 5/13, the PRA proposed to implement the Capital Requirements Regulation (CRR) definition of CET1 capital as soon as possible. The PRA has confirmed that they will implement this proposal; this means the majority of all deductions and filters will apply from 1 January 2014. However, a key exception is that at solo level the deduction of holdings of own funds instruments issued by financial sector entities subject to consolidated supervision will be phased in².

In CP 5/13, the PRA set out its intention to use the transitional provisions provided by the CRR to require firms to meet a Pillar 1 CET1 ratio of 4% of risk weighted assets from 1 January 2014. The PRA has confirmed the minimum Pillar 1 capital requirements for firms and the dates from which they apply. This is set out below.

¹ <http://www.bankofengland.co.uk/pru/Documents/publications/policy/2013/implementingcrdivcp513.pdf>

² In addition, a further divergence from end point treatment relates to unrealised gains where the CRR does not permit end point treatment in 2014. An asymmetry between the treatment of unrealised gains and losses will therefore exist in 2014. The PRA will however allow recognition of all unrealised gains from 1 January 2015, as permitted by the CRR, removing the asymmetric treatment of unrealised gains and losses in all years other than 2014.

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%

Deduction of capital holdings in subsidiaries and other significant investments

In CP 5/13 the PRA proposed to exercise its discretion under CRR Article 49(2) to require, for the purposes of calculating own funds on an individual firm (solo) basis, the deduction of holdings of own fund instruments issued by financial sector entities subject to consolidated supervision, with the exception of certain investments in venture capital vehicles. The objective of this policy was to ensure that capital is located in the regulated entities where it is needed, which is particularly important in the event of a resolution.

The PRA confirms that, from 1 January 2014, firms will be required to deduct 50% of the significant investments, subject to CRR Article 48 thresholds, and risk weight the remaining 50% using the appropriate banking book equity risk weight in accordance with CRR Article 49(4). Annually from 1 January 2015, firms will have to deduct an additional 10 percentage points of the significant investment (e.g. 60% in 2015) so that, by 1 January 2019, firms will have to deduct 100% of significant investments.

Changes to the quality of capital eligible for Pillar 2A

In the August consultation paper, the PRA proposed that firms should meet Pillar 2A with at least 56% CET1 capital from 1 January 2015, matching the proportion of CET1 required for Pillar 1. The PRA also consulted on whether firms should be required to meet Pillar 2A in full with CET1 capital from 1 January 2016.

Taking account of the responses to the consultation, the PRA has concluded that the same standards should apply to the minimum quality of capital eligible for Pillar 2A as for Pillar 1. Therefore, the PRA has decided that firms should meet Pillar 2A with at least 56% CET1 capital from 1 January 2015 onwards.