BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

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New approach to setting Pillar 2 capital requirements for the banking sector

In January, the PRA published a consultation paper that contained proposals on its Pillar 2 policy. The purpose of the proposals was to enhance the transparency and accountability of the PRA's approach to setting Pillar 2 capital requirements while at the same time ensuring that the approach is applied in a consistent and proportionate way across the population of relevant firms. By seeking consistency and proportionality across firms, the PRA proposals sought also to facilitate effective competition between firms, in line with the PRA's secondary objective.

The PRA publishes today its feedback statement, supervisory statements and statement of policy alongside its reporting instrument. The changes that have been made in response to the feedback seek to enhance proportionality further, for example by clarifying the role of supervisory judgement, own capital assessments and the published supervisory methodologies in dealing with specific business models.

Background

Pillar 2 is an important part of ensuring firms hold adequate capital to support the relevant risks in their business. It is also intended to encourage firms to develop and use enhanced risk management techniques in monitoring and managing their risks.

There are two main areas that the PRA considers when conducting a Pillar 2 review: (i) risks to the firm which are either not captured, or not fully captured, under the capital requirements, referred to as Pillar 2A; and (ii) risks to which the firm may become exposed over a forward-looking planning horizon (e.g. due to changes in the economic environment), referred to as Pillar 2B.

The introduction of CRD IV and the publication by the European Banking Authority (EBA) on guidelines for the Supervisory Review and Evaluation Process ('EBA SREP guidelines') has prompted the PRA to review its Pillar 2 framework.

The PRA is also taking this opportunity to re-align its Pillar 2 framework with its supervisory approach document and improve its own Pillar 2A capital methodologies so they are more risk sensitive and can be applied more consistently.

Andrew Bailey, Deputy Governor, Prudential Regulation, Bank of England and CEO of the PRA said:

"Firms must hold adequate capital to support the risks in their business, ensuring financial stability and continuity in the provision of key services to the wider economy. Pillar 2 capital requirements play an important role in ensuring firms have adequate capital and are a valuable tool for implementing the PRA's forward looking judgement based supervisory approach. In delivering this approach the PRA is committed to being a clear, open and transparent regulator and today's publication demonstrates this commitment."

Summary of proposals

- The methodology used by the PRA to inform the setting of firms' Pillar 2A capital are being refined so as to be more transparent and risk sensitive.

- The capital planning buffer will be replaced with a 'PRA buffer' which will harmonise our approach with that of CRD IV. The PRA buffer will be held by firms to absorb losses that may arise under a severe, but plausible stress, in line with the CRD IV rules.

- Where the PRA assesses a firm's risk management and governance to be significantly weak it may also set the PRA buffer to cover the risk posed by those weaknesses until they are addressed.

- Under the new Pillar 2 framework, firms will need to submit the data necessary for the PRA to run the new Pillar 2 methodologies with their ICAAP submissions.

Notes to Editors

- Policy Statement 17/15: Assessing capital adequacy under Pillar 2
- Supervisory Statement 31/15: The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)
- Statement of Policy: The PRA's methodologies for setting Pillar 2 capital
- Supervisory Statement 32/15: Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082

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