



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP12/17

Pillar 2A capital requirements and disclosure

July 2017



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Responses are requested by Thursday 12 October 2017.

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1 Overview

1.1 This consultation paper (CP) sets out proposed adjustments to the Prudential Regulation Authority's (PRA) Pillar 2A capital framework. It is relevant to all banks, building societies and PRA-designated investment firms.

1.2 This CP sets out proposals to change Supervisory Statement (SS) 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)'¹ and the Statement of Policy (SoP) 'The PRA's methodologies for setting Pillar 2 capital'.²

1.3 The PRA proposes to set Pillar 2A capital as a firm-specific capital requirement under section 55M of the Financial Services and Markets Act 2000 ('the Act'), rather than as individual guidance. Consistent with the PRA's current policy, under this proposal the requirement would be set at the level and quality of capital the PRA considers a firm should maintain, in addition to Pillar 1, to meet the overall financial adequacy rule.³

1.4 In implementing these proposals, the PRA intends to update some of the existing capital terminology. The term 'Total Capital Requirement' (TCR) is introduced to refer to the amount and quality of capital a firm must maintain to comply with the Capital Requirements Regulation (575/2013) (CRR) (Pillar 1) and the Pillar 2A capital requirement. The term 'Individual Capital Guidance' (ICG) will be discontinued.

1.5 The PRA also proposes a revised disclosure policy in which the PRA expects firms to disclose their TCR or, where a Pillar 2A capital requirement has not yet been set, total Pillar 1 and Pillar 2A guidance.

1.6 Finally, the PRA also proposes to provide clarity on when and how individual (solo) Pillar 2 capital requirements may be set.

Background

1.7 The PRA sets Pillar 2A capital for risks that are either not captured, or not fully captured, under CRR. It assesses those risks as part of the Supervisory Risk and Evaluation Process (SREP), in light of both the calculations included in a firm's Internal Capital Adequacy Assessment Process (ICAAP) document and the PRA's Pillar 2A methodologies set out in its SoP.

1.8 As set out in SS31/15, the PRA normally provides guidance to each firm on the amount and quality of capital it should maintain (Pillar 2A) at all times, in addition to Pillar 1, to meet the overall financial adequacy rule. Collectively, Pillar 1 and Pillar 2A are sometimes referred to as ICG.

1.9 Firms are expected to share the PRA's letter setting ICG or the PRA buffer with their auditors, and may share their total ICG with third parties, as set out in SS31/15. A number of firms have chosen to disclose publically their ICG, but the majority do not.

1 February 2017: www.bankofengland.co.uk/pr/Pages/publications/ss/2017/ss3115update.aspx.

2 February 2017: www.bankofengland.co.uk/pr/Pages/publications/sop/2017/p2methodologiesupdate.aspx.

3 Internal Capital Adequacy Assessment: 2.1: A firm must at all times maintain overall financial resources, including own funds and liquidity resources, which are adequate both as to amount and quality, to ensure there is no significant risk that its liabilities cannot be met as they fall due.

Purpose

1.10 The purpose of these proposals is to bring greater clarity, consistency and transparency to the PRA's capital setting approach. In promoting a greater level of transparency and disclosure, the PRA seeks to promote financial stability, the safety and soundness of PRA-authorized firms, and facilitate more informed and effective competition in the banking sector.

Responses and next steps

1.11 This consultation closes on Thursday 12 October 2017. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP12_17@bankofengland.co.uk.

1.12 The PRA proposes that the final policy will apply from 1 January 2018.

1.13 The PRA is aware it has used the term Individual Capital Guidance/ICG in other public documents beyond SS31/15 and its SoP. The PRA expects to amend the terminology within affected public documents over time, as and when relevant documents are updated or consulted on for other changes.

1.14 The PRA is also aware that it has referenced Individual Capital Guidance/ICG and Pillar 2A guidance in private communication with firms, including for the purposes of capital-setting. In order to ensure the implementation of the proposed changes is as simple as possible, the PRA does not intend any exceptional recommunication with firms regarding their regulatory capital; capital reviews will continue as scheduled for individual firms. The PRA anticipates a pragmatic approach whereby firms will continue to abide by their ICG issued under the current approach until such a time as this is formally replaced with a Pillar 2A capital requirement following a supervisory capital review.

1.15 In developing these proposals the PRA has considered replacing the term Pillar 2A with the term Pillar 2R to reflect that it will now be a requirement. The PRA believes such a change is unnecessary, but welcomes respondents' views on the costs and benefits of doing so at a later date.

1.16 The PRA will keep its proposed approach and disclosure policy under review to assess whether any adjustments would be required due to changes in the international regulatory environment.

2 Proposals

2.1 The proposals in this CP cover three areas:

- (i) setting Pillar 2A capital as a requirement under section 55M of the Act rather than as guidance (a 'Pillar 2A capital requirement'), and the introduction of the term 'Total Capital Requirement' (TCR);
- (ii) revising the PRA's capital disclosure policy; and
- (iii) clarifying when and how Pillar 2A capital requirements may be set at individual (solo) level.

2.2 These proposals are set out as amendments to SS31/15 and the SoP. These amendments are detailed in the Appendices of this CP, and the PRA proposes that these changes will apply from 1 January 2018, with Pillar 2A being set as a capital requirement rolled out to firms in line with their existing SREP cycle.

Setting Pillar 2A as a Requirement

2.3 Pillar 2A capital protects firms against risks that are not, or not fully, captured under Pillar 1. As part of their ICG, firms are already expected to maintain Pillar 2A capital at all times, consistent with Pillar 1, and in the same composition as capital maintained to cover Pillar 1 risks. Setting Pillar 2A as firm-specific capital requirements rather than guidance therefore better reflects the purpose and similarity of Pillar 1 and Pillar 2A.

2.4 The PRA is aware there has been a lack of clarity over what the term Pillar 2A refers to, with some market participants referring to Pillar 2A already as a capital requirement. The PRA notes other regulators set Pillar 2A capital in the form of a capital requirement. Setting Pillar 2A as a requirement rather than issuing guidance would therefore clarify the PRA's regulatory framework, support greater regulatory consistency, and improve understanding of the PRA's approach.

2.5 PRA policy is clear that departure by a firm from the terms of its ICG does not automatically mean that the PRA will consider that the firm is failing, or likely to fail, to satisfy the Threshold Conditions. This position will not change by setting Pillar 2A as a capital requirement.

2.6 Similarly, the PRA does not expect setting a Pillar 2A capital requirement as per this proposal to change the current approach to the overall financial adequacy rule. In line with existing policy, the burden on complying with this rule lies with firms. The TCR (Pillar 1 plus Pillar 2A) would represent the PRA's view of the capital necessary to comply with the rule, but a breach of one would not automatically lead to a breach of the other.

Implementation of Pillar 2A capital requirements

2.7 Following the SREP and the setting of ICG, the PRA currently expects a firm to apply for a requirement under section 55M of the Act, as currently set out in the PRA's Capital Buffers and Pillar 2 Model Requirements, preventing the firm from meeting any applicable CRD IV buffers with any Common equity tier 1 (CET1) capital maintained to meet Pillar 1 and Pillar 2A.

2.8 To reflect the change from guidance to requirement of Pillar 2A, the PRA proposes to update its Capital Buffers and Pillar 2 Model Requirements by adding a requirement that firms

should maintain Pillar 2A capital and meet that requirement with at least 56% of CET1 capital and not more than 44% additional Tier 1 (AT1) capital or 25% Tier 2 capital. A firm would then be invited to apply for the imposition of such a requirement at the same time as it is informed about the outcome of the SREP. In line with existing policy, if a firm does not apply for such a requirement the PRA would consider using its powers under section 55M(3) of the Act to impose one of its own initiative.

Total Capital Requirement disclosure expectations

2.9 The PRA does not advise firms on their market disclosure obligations. Nevertheless, the PRA is conscious that in setting a Pillar 2A capital requirement, some firms may consider that they are obliged to disclose this requirement under existing accounting standards.

2.10 In order to avoid any market instability or speculation generated by different levels of disclosure, the PRA considers it prudent to set a general expectation that firms should disclose the TCR which applies to them at the highest level of consolidation in the United Kingdom. Where the PRA is the home regulator, the PRA expects disclosure of the global consolidated group TCR figure set by the PRA. However, where the PRA is host regulator, the PRA only expects disclosure of the UK consolidated TCR figure (ie the UK sub-group of the global consolidated group). If a firm is not part of a UK consolidation group, the PRA expects disclosure of the individual entity TCR figure. If firms have made disclosures at other levels of consolidation and are unclear on the PRA's disclosure expectations, they should contact their usual supervisory contact to discuss the matter further.

2.11 Where Pillar 2A has not yet been set as a requirement, firms should disclose their existing total ICG. Firms may choose the appropriate medium and location of this disclosure, and could meet this expectation simply by including their total Pillar 1 plus Pillar 2A figure within their annual reports as part of other disclosures. The PRA does not propose to provide detailed additional guidance on the manner and form in which TCR should be disclosed.

2.12 The PRA is minded to expect disclosure of TCR at the level of the ring-fenced body (RFB) sub-group where one of these has been formally established (post-2019). The PRA would welcome respondents' views on the costs and benefits of expecting disclosure at this level.

2.13 The PRA's current policy is for firms not to disclose the individual component parts of Pillar 2A or the level of the PRA buffer, unless required to do so by law or with prior PRA consent. This policy position will remain unchanged.

Level of application

2.14 The PRA also proposes to provide additional clarity on when and how Pillar 2A capital requirement may be set by the PRA at individual (solo) level.

2.15 When setting Pillar 2A capital requirements on an individual basis, the default approach is to undertake a full assessment on the individual basis, calculating the relevant Pillar 2 risks according to the individual entity's risk profile. However, where firms are part of a UK consolidation group, or part of a RFB sub-group, the PRA will take a proportionate approach to calibrating the Pillar 2A add-on on an individual basis. This proportionate approach covers the dynamic Pillar 2A add-ons that are expressed as a percentage of risk weighted assets (RWA). Static add-ons such as those for pension risk are calculated separately.

2.16 Where the firm is part of a UK consolidation group or RFB sub-group and it can demonstrate the following: there is an adequate allocation of capital between subsidiaries; the members of the UK consolidation group or RFB sub-group are strongly incentivised to support

each other; and there are no impediments to the transfer of financial resources between members of the UK consolidation group or RFB sub-group, the PRA may set an individual Pillar 2A requirement calibrated to represent a share of the UK consolidated TCR (or RFB sub-consolidated TCR). This would be calibrated based on the individual firm's contribution to the consolidated (or RFB sub-consolidated) risk weighted assets unless an alternative allocation is agreed by the PRA.

2.17 Alternatively, where a firm is not considered to have significant systemic impact or where it has a very similar risk profile to its consolidation group or RFB sub-group, the PRA may decide to set a Pillar 2A requirement on an individual basis by reference to the UK consolidated (or RFB sub-consolidated) Pillar 2A calculation. This would be set by applying the same Pillar 2A add-on rate as calculated for the UK consolidated (or for RFBs, RFB sub-consolidated) Pillar 2A capital requirement to the individual total RWA of the firm, unless an alternative allocation of Pillar 2A component risk elements is agreed by the PRA.

2.18 Where alternative methods are not considered appropriate, particularly if a firm is considered to have significant systemic impact and it has a different risk profile to its group (or RFB sub-group), supervisors will perform a more detailed assessment of the risks to which the individual firm may be exposed.

2.19 Where they are part of a UK consolidation group, firms do not have to perform an individual ICAAP where adequate provision is made for the individual firms in the group ICAAP. Where a more detailed assessment of the risks to which an individual firm may be exposed is required, the PRA may request additional information on an individual basis to adequately inform its assessment.

3 The PRA's statutory obligations

3.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. The PRA meets these obligations by providing the following in its consultations:

- a cost benefit analysis;
- 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, insurance objective (if applicable), and secondary competition objective;
- 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; and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.

3.2 The PRA is required by the Equalities Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

3.3 The PRA should also have regard to aspects of the governments' economic policy as recommended by HM Treasury.

Cost benefit analysis

3.4 Markets operate efficiently when regulatory rules are transparent and well understood. The provision of meaningful information to the market on a firm's financial status (including its capital requirements) is a fundamental tenet of effective market discipline.

3.5 In setting Pillar 2A capital guidance as a capital requirement, the PRA is clarifying existing expectations and perceptions, and as a result the PRA does not anticipate any material costs with this proposal.

3.6 The PRA notes that a number of firms already voluntarily disclose their aggregate Pillar 1 plus Pillar 2A figure, often within annual reports alongside other disclosures, and are therefore not affected by the TCR disclosure expectation.

3.7 The main benefit of the proposal is to set a clear market-wide expectation, providing a greater level of clarity, transparency and consistency. More broadly, the PRA believes disclosure of the TCR could improve market efficiency and market confidence, given it determines the level at which automatic restrictions on distributions are triggered, thereby supporting effective competition. However it is possible there may be a small cost impact on those firms that do not already disclose their aggregate Pillar 1 plus Pillar 2A capital guidance figure.

3.8 For firms with no public debt or investors, the potential benefits of disclosing the TCR are potentially more limited than for publically listed entities, although the information is still of relevance to depositors. Therefore, the PRA has considered whether it should set some type of threshold below which some firms would not be expected to disclose their TCR.

3.9 However, in the PRA's view the benefits of simplicity and transparency of the proposal for all firms to disclose TCR outweigh any benefit from a threshold or carve-out. This is consistent

with the PRA's existing capital disclosure stance (which does not differentiate based on type of firm) and relevant accounting standards (which do not differentiate either). In addition, disclosure of all firms' TCR allows analysts and academics to consider independently the total industry-wide level of regulatory capital requirements.

Compatibility with the PRA's objectives

3.10 In discharging its general functions of determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of the firms it regulates. These proposals advance the PRA's general objective by removing uncertainty over the PRA's regulatory capital regime, demonstrating transparently the way in which the PRA sets the level of Pillar 2A capital requirements in relation to the risks firms are or may be exposed to.

3.11 When discharging its general function in a way that advances its primary objectives, the PRA has, as a secondary objective, to facilitate competition. These proposals help advance that objective by providing financial markets (including investors, analysts and depositors) with additional relevant information on all firms, supporting more efficient decisions on the allocation of financial resources across firms and hence more effective competition.

Regulatory principles

3.12 In developing the proposals in this CP, the PRA has had regard to the regulatory principles as set out in FSMA. Three of the principles are of particular relevance.

3.13 The first is the principle that the PRA should exercise its functions as transparently as possible. The PRA judges that the proposals outlined in this CP to bring greater clarity and transparency to the PRA's capital framework and capital requirements fully align with this principle.

3.14 The second is the desirability in appropriate cases of publishing information relating to persons on whom requirements are imposed by or under FSMA, or requiring such persons to publish information, as a means of contributing to the advancement of the PRA of its objectives. The proposal in this CP to expect firms to disclose their TCR fully aligns with this principle.

3.15 The third is the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction. The PRA has followed this principle when developing the proposals outlined in this CP, and has indicated in the CP the key areas of its judgements. In particular, the PRA judges the benefits from expecting all firms to disclose their TCR to outweigh any implementation burden or cost in doing so. However, the PRA welcomes views from respondents on this judgement.

Government economic policy

3.16 HM Treasury has made recommendations to the Prudential Regulation Committee about aspects of the Government's economic policy to which the Committee should have regard when considering how to advance the objectives of the PRA and apply the regulatory

principles set out in FSMA.¹ The PRA has considered these recommendations in the sections above.

Impact on mutuals

3.17 The PRA has assessed the impact of its proposals on mutuals. It does not expect the effect of these proposals on mutuals to be different to the effect on other firms.

Equality and diversity

3.18 The PRA is also required by the Equalities Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. The PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

¹ Available at www.bankofengland.co.uk/about/Pages/people/prapeople.aspx.

Appendices

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- 1** **Draft amendments to Supervisory Statement 31/15 ‘The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)’**
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- 2** **Draft amendments to Statement of Policy ‘The PRA’s methodologies for setting Pillar 2 capital’**

Appendix 1: Draft amendments to Supervisory Statement 31/15 ‘The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)’

This appendix outlines proposed amendments to SS31/15. Underlining indicates new text and striking through indicates deleted text.

...

1.6 Chapter 5: *The SREP* sets out the factors that the PRA takes into consideration to assess a firm’s ICAAP. It explains the setting of ~~Individual Capital Guidance (ICG)~~ firm-specific Pillar 2A capital requirements and the PRA buffer, the consequences in the event a firm fails to meet ~~ICG its Total Capital Requirement (TCR)~~ or uses the PRA buffer, and disclosure. It also sets out the factors that the PRA takes into consideration to assess a firm’s reverse stress-testing approach including the PRA response to weaknesses in the process.

...

The SREP

...

5.12 The PRA will set ~~ICG Pillar 2A capital requirements~~ in light of both the calculations included in a firm’s ICAAP and the results of the PRA’s own Pillar 2A methodologies. Setting ~~ICG a Pillar 2A capital requirement~~ is subject to peer group reviews to ensure consistency of decisions across firms.

...

The setting of ~~ICG Pillar 2A capital requirements~~ and the PRA buffer ~~ICG-Pillar 2A Capital Requirements~~

5.14 Following the SREP, including both a review of the ICAAP and any further interactions with the firm, the PRA will normally set the firm an ~~ICG Pillar 2A capital requirement~~ on an individual basis, ~~advising the firm of~~ for the amount and quality of capital that the PRA considers the firm should hold, in addition to the capital it must hold to comply with the CRR (Pillar 1 capital), to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. The PRA will additionally set Pillar 2A capital requirements for firms which must comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 on a consolidated basis and, where groups contain an RFB sub-group, on a sub-consolidated basis.

~~5.15 The PRA will set ICG for firms which must comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 on a consolidated basis and, where groups contain an RFB sub-group, on a sub-consolidated basis. The PRA may decide not to set ICG on an individual basis to members of a group where firms are able to demonstrate that capital has been adequately allocated among subsidiaries and that there are no impediments to the transfer of capital within the group. This does not absolve individual firms or members of the group of their obligation to comply with the overall financial adequacy rule in Internal Capital~~

~~Adequacy Assessment 2.1, which applies to all firms on an individual basis whether or not it also applies to the firm on a consolidated basis or on a sub-consolidated basis.~~

5.15 In many cases the PRA may decide to set Pillar 2A capital requirements on an individual basis by undertaking a detailed individual assessment, calculating the relevant Pillar 2A add-ons according to the individual firm's risk profile. Alternatively, the PRA may decide to set Pillar 2A capital requirements on an individual basis calibrated so that its TCR represents a share of the UK consolidated group or sub-consolidated group (where relevant) TCR where the firm is able to demonstrate that capital has been adequately allocated among subsidiaries, the members of the group or RFB sub-group are strongly incentivised to support each other, and there are no impediments to the transfer of capital within the group or RFB sub-group. Where a firm is not considered to have significant systemic impact, or where it has a very similar risk profile to the UK consolidation group (or RFB sub-consolidation group), the PRA may decide to set Pillar 2A on an individual basis by applying the same Pillar 2A add-on rate as calculated for the UK consolidated (or RFB sub-consolidated) Pillar 2A capital requirement to the individual total RWAs of the firm.

~~5.16 Where the PRA gives ICG sets a firm-specific Pillar 2A capital requirement to a firm~~ it will generally specify an amount of capital (Pillar 2A) that the firm should hold at all times in addition to the capital it must hold to comply with the CRR (Pillar 1). It will usually do so by stating that the firm should hold capital of an amount equal to a specified percentage of the firm's Pillar 1 RWAs (the total risk exposure amount calculated in accordance with Article 92(3) of the CRR), plus one or more static add-ons in relation to specific risks in accordance with the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1. The PRA ~~expects~~ will require firms to meet Pillar 2A with at least 56% CET1 capital, no more than 44% additional Tier 1 (AT1) capital and no more than 25% Tier 2. For these purposes, firms should follow the provisions on the definition of capital set out in the Definition of Capital Part of the PRA Rulebook and Supervisory Statement 7/13.¹

5.17 It is for firms to ensure that they comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. If a firm holds the level of capital ~~recommended as required under its ICGTCR~~ that does not necessarily mean that it is complying with the overall financial adequacy rule. Deviation by a firm from the terms of the ~~ICG Pillar 2A and TCR~~ given to it by the PRA does not automatically mean that the firm is in breach of the overall financial adequacy rule or that the PRA will consider the firm is failing, or likely to fail, to satisfy the Threshold Conditions (TCs). However, firms should expect the PRA to investigate whether any firm is failing, or likely to fail, to satisfy the TCs, with a view to taking further action as necessary.

5.18 The PRA expects a firm not to meet the CRD IV buffers with any CET1 capital maintained to meet its ~~ICGTCR~~. The PRA will expect the firm to apply for a requirement under section 55M of the Financial Services and Markets Act 2000 (FSMA) to set the amount and quality of the Pillar 2A capital requirement and preventing the firm from meeting any of the CRD IV buffers that apply to it with any CET1 capital maintained to meet its ICG Pillar 2A. The firm will normally be invited to apply for such a requirement at the same time as it is advised of its ~~ICG Pillar 2A capital requirement~~. If a firm does not apply for such a requirement the PRA will consider using its powers under section 55M(3) to impose one of its own initiative.

...

¹ PRA Supervisory Statement 7/13, 'CRD IV and capital', December 2013; www.bankofengland.co.uk/pr/Pages/publications/crdcapital.aspx.

The PRA buffer

5.20 Following the SREP, the PRA may also notify the firm of an amount of capital that it should hold as part of a PRA buffer, over and above the level of capital ~~recommended~~ required to meet its ~~ICGTCR~~ and over and above the CRD IV buffers. The PRA buffer, based on a firm-specific supervisory assessment, should be of a sufficient amount to allow the firm to continue to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. This should be the case even in adverse circumstances, after allowing for realistic management actions that a firm could, and would, take in a stress scenario.

5.21 In setting a PRA buffer for a firm the PRA will not just consider whether the firm would meet its CET1 capital requirements under the CRR and its ~~ICG~~ Pillar 2A capital requirement in the stress scenario. Other factors informing the size of the PRA buffer include but are not limited to: the maximum change in capital resources and requirements under the stress; the firm's leverage ratio; the extent to which the firm has used up its CRD IV buffers (eg the systemically important financial institution (SIFI) and capital conservation buffers); Tier 1 and total capital ratios; and the extent to which potentially significant risks are not captured fully as part of the stress.

5.22 Where the PRA assesses a firm's risk management and governance (RM&G) to be significantly weak, it may set the PRA buffer to include an amount of capital to cover the risks posed by those weaknesses until they are addressed. This will generally be calibrated in the form of a scalar applied to the amount of CET1 required to meet the firm's ~~Pillar 1 plus Pillar 2~~ ATCR. Depending on the severity of the weaknesses identified, the scalar could range from 10% to 40%. If the PRA sets the PRA buffer to cover the risk posed by significant weaknesses in risk management or governance it will identify those weaknesses to the firm and expect the firm to address those weaknesses within an appropriate timeframe.

...

5.25 If a firm considers that the proposed ~~ICG~~ Pillar 2A capital requirement or the PRA buffer advised to it by the PRA is inappropriate to its circumstances it should notify the PRA of this, consistent with Fundamental Rule 7. If, after discussion, the PRA and the firm do not agree on an adequate level of capital, the PRA may consider using its own initiative powers under section 55M(3) of FSMA to impose a requirement on the firm to hold capital in accordance with the PRA's view of the capital necessary to comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. In deciding whether it should use its powers under section 55M(3), the PRA will take into account the amount of capital that the firm should hold for its PRA buffer.

...

Failure to meet ~~ICGTCR~~ and use of the PRA buffer

5.31 The PRA expects every firm to hold at least the level of capital it is required to meet ~~in its ICGTCR~~ at all times. If a firm's capital has fallen or is expected to fall below that level it should inform the PRA as soon as practicable (~~even if the firm has not accepted the ICG calculated given by the PRA~~), explaining why this has happened or is expected to happen. The firm will also be expected to discuss the actions that it intends to take to increase its capital and/or reduce its risks (and therefore capital requirement), and any potential modification that it considers should be made to the ~~ICG~~ Pillar 2A capital requirement.

...

Disclosure

5.37 Firms should disclose the PRA's SREP feedback letter setting ICG-Pillar 2A capital requirements or and, where applicable, the PRA buffer to their auditors, and. The PRA expects firms to may publically disclose their total ICG to other third parties amount and quality of TCR which apply to them at the highest level of consolidation in the UK. The PRA also expects ring-fenced banks (RFBs) to disclose their TCR on a sub-consolidated basis. In those circumstances in which Pillar 2A has not been set as a requirement, the PRA expects firms to disclose their total Pillar 1 plus Pillar 2A capital guidance. Otherwise, the PRA expects firms to treat all other information relating to ~~ICG~~TCR including details of its constituent parts, and all information relating to the PRA buffer, as confidential unless they are required to disclose it by law. If firms wish to disclose the PRA's SREP feedback letter or any part of it to any third parties (other than their auditors) they should, consistent with Fundamental Rule 7, provide appropriate prior notice to the PRA of the proposed form, timing, nature and purpose of the disclosure. ~~The PRA does not expect firms to provide prior notice of TCR disclosure where they only propose to disclose their total ICG.~~

5.38 Where an immediate market disclosure obligation exists, prior notification to the PRA should not lead to any delay in disclosure. But any firm intending to disclose information relating to ~~ICG~~TCR-(except the total ~~ICG~~figure) or the buffers should (consistent with Fundamental Rule 7), where reasonably practicable, provide appropriate notice in advance of the proposed disclosure and the reasons for it.

Appendix 2: Draft amendments to Statement of Policy ‘The PRA’s methodologies for setting Pillar 2 capital’

This appendix outlines proposed amendments to SoP ‘The PRA’s methodologies for setting Pillar 2 capital’. Underlining indicates new text and striking through indicates deleted text.

...

1.2 Section 1: Pillar 2A methodologies set out the methodologies the PRA will use to inform the setting of a firm’s Pillar 2A ~~individual capital guidance requirement~~ for credit risk, market risk, operational risk, counterparty credit risk, credit concentration risk, interest rate risk in the non-trading book (hereafter referred to as interest rate risk in the banking book (IRRBB)), pension obligation risk and RFB group risk.

...

1.4 Firms are required by the Reporting Pillar 2 part of the PRA Rulebook, or may be asked, to submit data to inform the PRA’s approach to setting Pillar 2A ~~individual capital guidance requirements~~. Data may be requested on an individual, consolidated and/or sub-consolidated basis as applicable.

...

2 Credit risk

2.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm’s Pillar 2A ~~individual capital guidance requirement~~ for credit risk.

Definition and scope of application

...

2.5 Where the underestimation of Pillar 1 capital is due to deficiencies in IRB models, the PRA addresses the capital shortfall by requiring the firm to remediate the shortcomings of the Pillar 1 models rather than setting Pillar 2A ~~individual capital guidance requirements~~.

Methodology for assessing Pillar 2A capital for credit risk

2.6 The methodology used to inform the setting of firms’ Pillar 2A ~~individual capital guidance requirement~~ for credit risk is based on a comparison of firms’ SA risk weights at a portfolio level to an IRB risk-weight benchmark (see **Table A**).

...

3 Market risk

3.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm’s Pillar 2A ~~individual capital guidance requirement~~ for market risk.

Methodology for assessing P2A capital for market risk

...

3.8 When assessing firms' own calculations, the PRA will:

- Review the completeness of illiquidity risk identification by the firm;
- Assess whether the stresses designed and calibrated by the firm are appropriate to measure the risk given a 1-in-1,000 year confidence level over one year (and, if not, request the firm to apply alternative stresses);
- Assess the suitability of any existing capital mitigants or reserves which are proposed to offset the calculated stressed losses and discount these where not relevant; and
- set a Pillar 2A capital add-on such that the sum of the Pillar 1 (and Pillar 1 adjustments for model risks) and Pillar 2A individual capital guidance requirement is sufficient to cover losses at a 1-in-1,000 year confidence level.

...

4 Operational risk

4.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm's Pillar 2A individual capital guidance requirement for operational risk.

...

Methodology for assessing Pillar 2A capital for operational risk

...

4.15 The PRA uses three loss estimates, described below, to inform the setting of a firm's individual capital guidance Pillar 2A capital requirement for non-conduct risk.

...

5 Counterparty credit risk

5.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm's Pillar 2A individual capital guidance requirement for counterparty credit risk (CCR), including settlement risk.

...

6 Credit concentration risk

6.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm's Pillar 2A individual capital guidance requirement for single name, sector and geographical credit concentration risk in the banking and trading books.

...

7 Interest rate risk in the banking book

7.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm's Pillar 2A ~~individual capital guidance~~ requirement for interest rate risk in the non-trading book, commonly known as interest rate risk in the banking book (IRRBB).

...

Basis risk

7.28 Under the standard methodology, the PRA does not assess Pillar 2A ~~individual capital guidance~~ for basis risk. Nevertheless, the PRA expects that a bank or building society mitigates its basis risk by setting limits on:

- its exposure to basis risk for each type of basis risk mismatch; and
- the sensitivity of its net interest margin to basis risk.

...

8.1 This chapter sets the methodology the PRA uses to inform the setting of a firm's Pillar 2A ~~individual capital guidance~~ requirement for pension obligation risk.

...

8 Pension obligation risk

...

Methodology for assessing Pillar 2A capital for pension obligation risk

...

8.10 The PRA uses the results of two scenarios it prescribes to assess the adequacy of the firm's own assessment of the appropriate level of capital and to inform the setting of the Pillar 2A ~~individual capital guidance~~ requirement for pension obligation risk. The higher of the two stress scenarios will form the starting point of the assessment.

...

Offsets and management actions

8.17 The firm's own assessment of the appropriate level of capital and the results of the PRA stress scenarios may be reduced by eligible offsets and management actions recognised by the PRA. Offsets are reductions in a firm's Pillar 2A ~~individual capital guidance~~ requirement to reflect factors present at the ICAAP effective date which would reduce the impact of a stress on the firm. Management actions are steps the firm could, and would, take when a stress occurs in order to reduce its impact.

...

8A Pillar 2A for RFB group risk

8A.1 This chapter sets out the methodology the PRA uses to inform the setting of a firm's Pillar 2A ~~individual capital guidance~~ requirement for RFB group risk, where groups contain an RFB sub-group.

...

Methodology

8A.4 Where minimum capital (Pillar 1 or Pillar 2A) of the RFB sub-group for an identified risk is higher than the RFB sub-group's share of the minimum capital for that risk on a consolidated basis, the difference will usually be reflected in Pillar 2A individual capital guidance requirements on a consolidated basis to reflect the associated RFB group risk at the consolidated group level.

8A.5 The PRA's assessment of the total amount of the Pillar 2A individual capital guidance requirement for RFB group risk will be informed by the following, to the extent not already captured by the assessment of other elements of the capital framework

...

9 The PRA buffer

...

9.2 Where the PRA assesses a firm's risk management and governance (RM&G) to be significantly weak, it may also set the PRA buffer to cover the risks posed by those weaknesses until they are addressed. This will generally be calibrated in the form of a scalar applied to the amount of CET1 required to meet Pillar 1 capital requirements plus Pillar 2A individual capital guidance requirements. Depending on the severity of the weaknesses identified, the scalar could range from 10% to 40%.

9.3 If an overall RM&G scalar is applied, RM&G weaknesses identified in specific risk categories should not be reflected separately in Pillar 2A individual capital guidance requirements for those categories. Once the identified weaknesses have been remedied, the scalar should be removed.

...

The PRA buffer assessment

9.10 **Figure 2** illustrates a firm's total capital requirement and its relationship with the PRA buffer. In some instances, the PRA does not set a buffer if the CRD IV buffers are deemed sufficient, as illustrated in the right-hand column of the chart. Capital that firms use to meet their Pillar 1 capital requirements and Pillar 2A individual capital guidance requirements cannot be counted towards meeting their buffers. All buffers are in CET1 capital.

...

Starting assumption as to the amount of capital a firm is expected to maintain under stress

...

9.20 All firms should be able to meet Pillar 1 plus Pillar 2A CET1 individual capital guidance requirements under a stress. This is the amount of CET1 capital the PRA considers firms should hold at all times to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 of the PRA Rulebook.