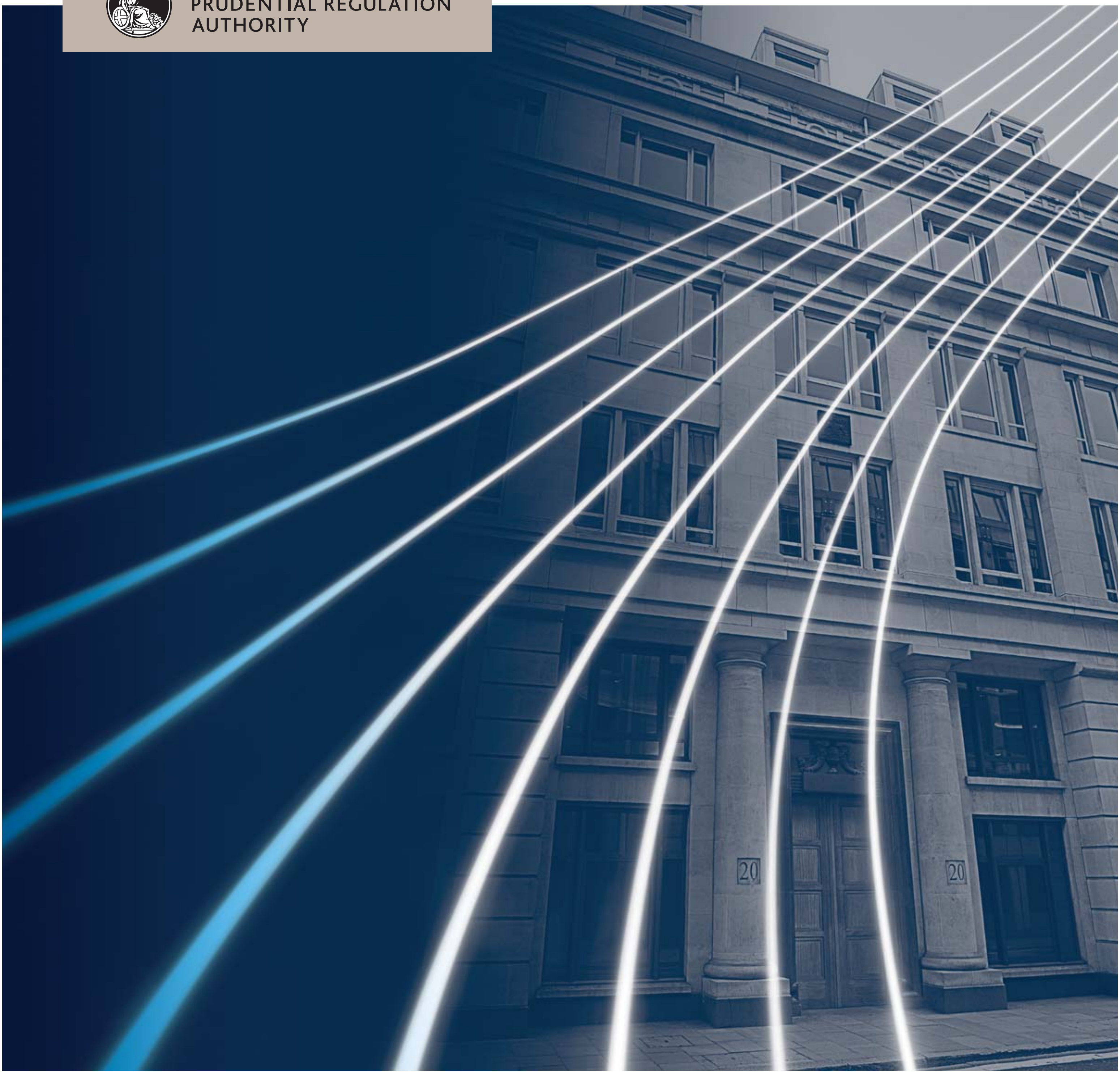
Policy Statement | PS3/14

Implementing CRD IV: capital buffers

April 2014

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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April 2014

This Policy Statement contains the final rules and supervisory statement to implement the CRD IV capital buffers framework.

1 Introduction

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to the responses to the capital buffers chapter of consultation paper 5/13 (the CP).(1) Appendix 1 of this PS contains the final rules implementing the capital buffers requirements of the Capital Requirements Directive (2013/36/EU) (CRD). Appendix 2 contains the supervisory statement setting out the expectations that the PRA has in relation to the CRD IV(2) capital buffers as well as further clarification around the rules. This PS is relevant to banks, building societies, and PRA designated investment firms.

1.2 In the CP the PRA set out proposals for implementing the capital conservation and countercyclical capital buffer frameworks, including how they come together as a combined buffer. The CP included draft rules necessary to implement the CRD provisions on capital buffers.

1.3 The rules and supervisory statement within this PS focus on the capital buffers introduced by CRD IV, the aim of which is to ensure that firms maintain a sufficient amount of capital above their regulatory minimum to withstand periods of stress. This should help reduce their likelihood of failure and therefore contributes to the PRA's objective of promoting the safety and soundness of the firms it regulates.

2 Feedback to responses

2.1 The PRA received a number of responses to the chapter on capital buffers in the CP. The majority of these cited uncertainty regarding the implementation and application of the buffers, as well as their interaction with Pillar 2. The latter point was addressed in PS 7/13.(3) Further information will be provided during the course of 2014 when the PRA intends to consult on its approach to Pillar 2. This PS and the supervisory statement address the uncertainty raised in relation to the CRD IV capital buffers framework.

2.2 As noted in PS 7/13 and the CP, CRD IV requires HM Treasury to designate authorities responsible for setting certain CRD IV buffers and buffer rates in the United Kingdom. HM Treasury has made the following designations:(4)

- **Countercyclical capital buffer (CCB)**:(5) from 1 May 2014 the Bank of England is the designated authority for the CCB, with policy decisions delegated to the Financial Policy Committee (FPC). Firms will not be subject to a cap on their CCB rate.

- **Buffer for Global Systemically Important Institutions (G-SIIs)**: the PRA will be responsible for identifying G-SIIs and setting the G-SII buffer. The European Banking Authority will submit draft regulatory technical standards to the European Commission on the methodology by which the PRA will identify G-SIIs and allocate them to a subcategory (reflecting their G-SII buffer) by 30 June 2014. The methodology will not preclude the PRA from using supervisory judgement to identify an institution as a G-SII or reassign a G-SII to a higher subcategory. The first G-SII buffer, which will apply to those firms identified as G-SIIs based on end-2013 data, will be phased-in in equal steps over a three-year period, starting in 2016 and taking full effect on 1 January 2019. G-SII buffers will be set as firm specific requirements. The impact of setting G-SII buffers was considered in the CP's economic analysis chapter.

- **Buffer for Other Systemically Important Institutions (O-SIIs)**: the PRA will be responsible for identifying O-SIIs from 1 January 2016. As set out in HM Treasury's Statutory Instrument, institutions identified as O-SIIs will not be subject to an O-SII buffer.

HM Treasury has not yet designated an authority to be responsible for the systemic risk buffer.

2.3 A few respondents queried the assumptions regarding the levels of voluntary buffers following the implementation of the capital buffers. This was addressed in the economic analysis chapter of the CP.

2.4 Concerns were raised about the impact of the CRD IV capital buffers on smaller firms. Buffers for systemic firms seek to achieve a more level playing field between the systemic institutions (who often use internal models, resulting in lower risk-weights) and non-systemic institutions. In addition, the PRA's decision (as initially set out in the CP) not to accelerate the introduction of the capital conservation buffer should assist all firms in meeting the higher capital levels. Also, as previously outlined,(6) new banks may be allowed more time than existing firms to build up the capital conservation buffer.

(1) *CP5/13: Strengthening capital standards: implementing CRD IV*, available at www.bankofengland.co.uk/pra/Documents/publications/policy/2013/implementingcrdivcp513.pdf.
(2) The Capital Requirements Directive (2013/36EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly 'CRD IV'.
(3) Chapter 3 — *PS7/13: Strengthening capital standards: implementing CRD IV, feedback and final rules*, available at www.bankofengland.co.uk/pra/Documents/publications/policy/2013/strengtheningcapitalps713.pdf.
(4) www.legislation.gov.uk/uksi/2014/894/contents/made.
(5) In order to avoid confusion in the CP between the capital conservation and the countercyclical buffer, different acronyms were used to those set out here. Given this PS focuses more on the latter, that acronym has been amended and brought in line with the language used by the FPC.
(6) All banks (including new entrants) will be subject to automatic restrictions on distributions if their capital falls below the level of the combined buffer and will have to agree a plan with the PRA to (re)build the combined buffer. Within that plan the PRA will use the discretion available to it to allow new entrants more time to build up the combined buffer. *A review of requirements for firms entering into or expanding in the banking sector* — Bank of England and FSA (March 2013), available at www.fca.org.uk/your-fca/documents/barriers-to-entry.

2.5 The rule in Capital Buffers 4.3 differs from the proposed rule published in the CP by including an additional requirement that firms must maintain arrangements to ensure that the amount of distributable profits and the maximum distributable amount are calculated accurately and must be able to demonstrate that accuracy to the PRA on request. This additional requirement transposes CRD article 141(9). In the opinion of the PRA the impact of the rule in Capital Buffers 4.3 is not significantly different from the impact of the proposed rule on PRA authorised persons that are mutual societies and on those persons as compared to other PRA authorised persons.

Future policy development

2.6 The PRA intends to consult on and set out its policy for identifying O-SIIs in 2015.

Appendix

1 Final Rules on the CRD IV capital buffers

2 Supervisory Statement on CRD IV capital buffers

PRA RULEBOOK CRR FIRMS: – CAPITAL BUFFERS INSTRUMENT 2014

Powers exercised

A. The Prudential Regulation Authority 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); and
(2) section 137T (General supplementary powers).

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

Pre-conditions to making

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

PRA Rulebook CRR Firms: Capital Buffers Instrument 2014

D. The PRA makes the rules in Annex A and Annex B to this Instrument.

Commencement

E. The rules in Annex A of this instrument come into force on 1 May 2014.

F. The following rules in Annex B of this instrument come into force on 1 May 2014: Rules 1.1 to 1.3, 3.2, 4.1 to 4.5, 5.1 to 5.6.

G. The following rules in Annex B of this instrument come into force on 1 January 2016: Rules 2.1; 2.2, 3.1.

Citation

H. This instrument may be cited as the PRA Rulebook CRR Firms: Capital Buffers Instrument 2014.

By order of the Board of the Prudential Regulation Authority
25 April 2014

Annex A

PRA RULEBOOK – GLOSSARY

In the Glossary Part of the PRA Rulebook insert the following new definition:

credit institution

has the meaning given in point (1) of Article 4(1) of the *CRR*.

Annex B

In this Annex, the text is all new and is not underlined.

Part

CAPITAL BUFFERS

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

capital conservation buffer

means the amount of *common equity tier 1 capital* a *firm* must calculate in accordance with Chapter 2.

combined buffer

means the sum of

(a) the *capital conservation buffer*; and

(b) the *countercyclical capital buffer*.

countercyclical buffer rate

means (in accordance with point (7) of Article 128 of the *CRD*) the rate:

(a) expressed as a percentage of *total risk exposure amount* set by the FPC or an *EEA countercyclical buffer authority*; or

(b) expressed in terms equivalent to a percentage of *total risk exposure amount* set by a *third country countercyclical buffer authority;*

that a *firm* must apply in order to calculate its *countercyclical capital buffer.*

countercyclical capital buffer

means the amount of *common equity tier 1 capital* a *firm* must calculate in accordance with Chapter 3.

distribution in connection with common equity tier 1 capital

includes (in accordance with Article 141(10) of the *CRD*):

(a) a payment of cash dividends;

(b) a distribution of fully or partly paid bonus shares or other capital instruments referred to in Article 26(1)(a) of the *CRR*;

(c) a redemption or purchase by an institution of its own shares or other capital instruments referred to in Article 26(1)(a) of the *CRR*;

(d) a repayment of amounts paid up in connection with capital instruments referred to in Article 26(1)(a) of the *CRR*; and

(e) a distribution of items referred to in points (b) to (e) of article 26(1) of the *CRR*

EEA countercyclical buffer authority

means the authority or body of an *EEA State* other than the *UK* designated for the purpose of Article 136 of the *CRD* with responsibility for setting the *countercyclical buffer rate* for that *EEA State* or the European Central Bank when it carries out the task of setting a countercyclical buffer rate for an *EEA State* conferred on it by Article 5(2) of Council Regulation (EU) No. 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

FPC

means the Financial Policy Committee

MDA

means maximum distributable amount calculated in accordance with 4.3(4).

parent financial holding company in a Member State

means (in accordance with point (26) of Article 3(1) of the *CRD*) a *financial holding company* which is not itself a *subsidiary* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

parent institution in a Member State

means (in accordance with point (24) of Article 3(1) of the *CRD*) an *institution* authorised in an *EEA State* which has an *institution* or *financial institution* as *subsidiary* or which holds a *participation* in such an *institution* or *financial institution*, and which is not itself a *subsidiary* of another *institution* authorised in the same *EEA State* or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

parent mixed financial holding company in a Member State

means (in accordance with point (28) of Article 3(1) of the *CRD*) a *mixed financial holding company* which is not itself a *subsidiary* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

relevant credit exposures

means (in accordance with Article 140(4) of the *CRD)* exposures other than those referred to in points (a) to (f) of Article 112 of the *CRR* that are subject to:

(a) the *own funds* requirements for credit risk under Part Three, Title II of the *CRR*; or

(b) where the exposure is held in the *trading book*, *own funds* requirements for specific risk under Part Three, Title IV, Chapter 2 of the *CRR* or incremental default and migration risk under Part Three, Title IV, Chapter 5 of the *CRR;* or

(c) where the exposure is a *securitisation*, the *own funds* requirements under Part Three, Title II, Chapter 5 of the *CRR*.

third country countercyclical buffer authority

means the authority of a *third country* empowered by law or regulation with responsibility for setting the *countercyclical buffer rate* for that *third country.*

total risk exposure amount

means the total risk exposure amount of a *firm* calculated in accordance with Article 92(3) of the *CRR*.

1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 CAPITAL CONSERVATION BUFFER

2.1 A *firm* must calculate a *capital conservation buffer* of *common equity tier 1 capital* equal to 2.5% of its *total risk exposure amount*.

[**Note: Art 129(1) (part) of the *CRD***]

2.2 This rule modifies 2.1 for a transitional period between 1 January 2016 and 31 December 2018:

(1) from 1 January 2016 until 31 December 2016 for 2.5% there is substituted 0.625%;

(2) from 1 January 2017 until 31 December 2017 for 2.5% there is substituted 1.25%; and

(3) from 1 January 2018 until 31 December 2018 for 2.5% there is substituted 1.875%.

[**Note: Art 160(1) to (5) (part) of the *CRD***]

3 COUNTERCYCLICAL CAPITAL BUFFER

Calculation of the countercyclical capital buffer

3.1 (1) A *firm* must calculate a *countercyclical capital buffer* of *common equity tier 1 capital* equal to its *total risk exposure amount* multiplied by the weighted average of the *countercyclical buffer rates* that apply to exposures in the jurisdictions where the *firm's relevant credit exposures* are located.

[**Note: Art 130(1) (part**) **of the *CRD***]

(2) In order to calculate the weighted average referred to in (1), a *firm* must apply to each applicable *countercyclical buffer rate* its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to *the relevant credit exposures* in the jurisdiction in question, divided by its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to all of its *relevant credit exposures.*

(3) For the purposes of (2), a *firm* must calculate its total *own funds* requirement for credit risk, specific risk, incremental default and migration risk in accordance with Part Three, Titles II and IV of the *CRR.*

(4) The *countercyclical buffer rate* for an exposure located in the *UK* is the rate set by the *FPC* for the *UK*.

(5) The *countercyclical buffer rate* for an exposure located in an *EEA State* other than the *UK* is:

(a) the rate set by the *EEA countercyclical buffer authority* for that jurisdiction; or

(b) if that rate exceeds 2.5% and has not been recognised by the *FPC*, 2.5%.

(6) The *countercyclical buffer rate* for an exposure located in a *third country* is the rate set by the *FPC* for that jurisdiction.

(7) If the *FPC* has not set a rate for a *third country*, *the countercyclical buffer rate* for an exposure located in that jurisdiction is:

(a) the rate set by the *third country countercyclical buffer authority* for that jurisdiction; or

(b) if that rate exceeds 2.5% and has not been recognised by the *FPC*, 2.5%.

(8) If the *FPC* has not set a rate for a *third country* and either there is no *third country countercyclical buffer authority* for that country or the authority has not set a rate for that jurisdiction, *the countercyclical buffer rate* for an exposure located in that jurisdiction is zero.

(9) If the rate for the *UK* is increased, that increase takes effect from the date specified by the *FPC*.

(10) If the rate for an *EEA State* other than the *UK* is increased, subject to (5)(b) that increase takes effect from:

(a) the date specified by the *EEA countercyclical buffer authority* for that jurisdiction, if the rate applied under this Chapter does not exceed 2.5%;

(b) the date specified by the *FPC* if the rate applied under this Chapter exceeds 2.5%.

(11) If the rate for a *third country* is increased by the *FPC*, that increase takes effect from the date specified by the *FPC*.

(12) If the *FPC* does not set a rate for a *third country* and the rate for that *third country* is increased by the *third country countercyclical buffer authority* for that jurisdiction, subject to (7)(b) that increase takes effect from:

(a) the date 12 months after the date on which the increase was published by the *third country countercyclical buffer authority* in accordance with the relevant law the *third country*, if the rate applied under this Chapter does not exceed 2.5%;

(b) the date specified by the *FPC* if the rate applied under this Chapter exceeds 2.5%.

(13) If a rate is reduced, that reduction takes effect immediately.

[**Note: Art 140 of the *CRD***.]

3.2 This rule applies until 31 December 2015

(1) A *firm* must calculate a *countercyclical capital buffer* of *common equity tier 1 capital* equal to its *total risk exposure amount* multiplied by the weighted average of the *countercyclical buffer rates* that apply in the jurisdictions where the *firm's relevant credit exposures* are located.

(2) In order to calculate the weighted average referred to in (1), a *firm* must apply to each applicable *countercyclical buffer rate* its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to *the relevant credit exposures* in the jurisdiction in question, divided by its total *own funds* requirements for credit risk that relates to all of its *relevant credit exposures.*

(3) For the purposes of (2), *firm* must calculate its total *own funds* requirement for credit risk, specific risk, incremental default and migration risk in accordance with Part Three, Titles II and IV of the *CRR.*

(4) The *countercyclical buffer rate* for an exposure is the rate recognised or set by the *FPC* for the jurisdiction in which that exposure is located.

(5) If the *FPC* does not recognise or set a rate for the jurisdiction in which an exposure is located, the *countercyclical buffer rate* for that exposure is zero.

(6) If the rate recognised or set by the *FPC* for a jurisdiction is increased, that increase takes effect from the date specified by the *FPC*.

(7) If a rate is reduced, that reduction takes effect immediately.

[**Note: Art 160(6) (part) of the *CRD***]

4 CAPITAL CONSERVATION MEASURES

Combined buffer

4.1 A *firm* does not meet the *combined buffer* if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* does not meet the *combined buffer*.

[**Note: Art 129(5) (part) and 130(5) (part) of the *CRD***]

Restrictions on distributions

4.2 A *firm* that meets the *combined buffer* must not make a *distribution in connection with common equity tier 1 capital* to an extent that would decrease its *common equity tier 1 capital* to a level where the *combined buffer* is no longer met.

[**Note: Art 141(1) of the *CRD***]

4.3 (1) A *firm* that does not meet the *combined buffer* must:

(a) calculate the *MDA* in accordance with (4); and

(b) report the *MDA* to the *PRA* in writing no later than 5 working days after the *firm* identified that it did not meet the *combined buffer*.

(2) A *firm* that does not meet the *combined buffer* must not undertake any of the following actions before it has calculated the *MDA*:

(a) make a *distribution in connection with common equity tier 1 capital*;

(b) create an obligation to pay variable remuneration or *discretionary pension benefits* or pay variable remuneration or *discretionary pension benefits* if the obligation to pay was created at a time when the *firm* did not meet the *combined buffer*; and

(c) make payments on *additional tier 1 instruments.*

(3) If a *firm* does not meet the *combined buffer*, it must not distribute more than the *MDA* calculated in accordance with (4) through any action referred to in points (a) to (c) of (2).

(4) A *firm* must calculate the *MDA* by multiplying the sum calculated in accordance with (5) by the factor determined in accordance with (6). The *MDA* shall be reduced by any of the actions referred to in point (a), (b) or (c) of (2)..

(5) The sum to be multiplied in accordance with (4) shall consist of:

(a) interim profits not included in *common equity tier 1 capital* pursuant to Article 26(2) of the *CRR* that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in points (a), (b) or (c) of (2);

plus

(b) year-end profits not included in *common equity tier 1 capital* pursuant to Article 26(2) of the *CRR* that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in points (a), (b) or (c) of (2);

minus

(c) amounts which would be payable by tax if the items specified in points (a) and (b) were to be retained.

(6) The factor referred to in (4) shall be determined as follows:

(a) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* expressed as a percentage of the *firm's total risk exposure amount*, is within the first (that is, the lowest) quartile of the *combined buffer*, the factor shall be 0;

(b) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR*, expressed as a percentage of the *firm's total risk exposure amount*, is within the second quartile of the *combined buffer*, the factor shall be 0.2;

(c) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the third quartile of the *combined buffer*, the factor shall be 0.4; and

(d) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under Article 92(1)(c) of the *CRR* expressed as a percentage of the *firm's total risk exposure amount*, is within the fourth (that is, the highest) quartile of the *combined buffer*, the factor shall be 0.6.

(7) A *firm* must calculate the lower and upper bounds of each quartile of the *combined buffer* as follows:

Lower bound of quartile

$$= \frac{\textit{Combined buffer}}{4} \times (Q_n - 1)$$

Upper bound of quartile

$$= \frac{\textit{Combined buffer}}{4} \times Q_n$$

"Qn" indicates the ordinal number of the quartile concerned***.***

(8) The restrictions imposed by this rule only apply to payments that result in a reduction of *common equity tier 1 capital* or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings for an order for the appointment of a liquidator or administrator of the *firm*.

(9) If a *firm* does not meet the *combined buffer* and intends to distribute any of its distributable profits or undertake an action referred to in points (a), (b) and (c) of (2) it must give the *PRA* notice of its intention at least one month before the intended date of distribution or action unless there are exceptional circumstances which make it impracticable to give such a period of notice in which event the firm must give as much notice as is practicable in those circumstances. When giving notice a *firm* must provide the following information:

(a) the amount of *own funds* maintained by the *firm*, subdivided as follows:

(i) *common equity tier 1 capital*;

(ii) *additional tier 1 capital*; and

(iii) *tier 2 capital*.

(b) the amount of its interim and year-end profits;

(c) the *MDA* calculated in accordance with (4);

(d) the amount of distributable profits it intends to allocate between the following:

(i) dividend payments;

(ii) share buybacks;

(iii) payments on *additional tier 1 instruments*; and

(iv) the payment of variable remuneration or *discretionary pension benefits*, whether by creation of a new obligation to pay, or payment pursuant to an obligation to pay created at a time when the *firm* did not meet its *combined buffer*.

(10) A *firm* must maintain arrangements to ensure that the amount of distributable profits and the *MDA* are calculated accurately and must be able to demonstrate that accuracy to the *PRA* on request.

[**Note: Art 141(2) to 141(10) of the *CRD***]

Capital conservation plan

4.4 When a *firm* does not meet the *combined buffer*, it must prepare a capital conservation plan and submit it to the *PRA* no later than 5 working days after the *firm* identified that it did not meet the *combined buffer*.

[**Note: Art 142(1) of the *CRD***]

4.5 The capital conservation plan must include the following:

(1) the *MDA*;

(2) estimates of income and expenditure and a forecast balance sheet;

(3) measures to increase the capital ratios of the *firm*; and

(4) a plan and timeframe for the increase of *own funds* with the objective of meeting the *combined buffer*.

[**Note: Art 142(2) of the *CRD***]

5 APPLICATION ON AN INDIVIDUAL AND CONSOLIDATED BASIS

Application on an individual basis

5.1 This Part applies to a *firm* on an individual basis whether or not it also applies to the *firm* on a *consolidated basis* or *sub-consolidated basis*.

Application on a consolidated basis

5.2 A *firm* which is a *parent institution in a Member State* must comply with this Part on the basis of its *consolidated situation*.

5.3 A *UK bank* or *building society* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with this Part on the basis of the *consolidated situation* of that holding company, if the *PRA* is responsible for supervision of the *UK bank* or *building society* on a *consolidated basis* under Article 111 of the *CRD.*

5.4 A *UK designated investment firm* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with this Part on the basis of the *consolidated situation* of that holding company, if:

(1) there is no *subsidiary* of the holding company which is a *credit institution*; and

(2) the *PRA* is responsible for the supervision of the *UK designated investment firm* on a *consolidated basis* under Article 111 of the *CRD*.

Sub-consolidation in cases of entities in third countries

5.5 A *firm* that is a *subsidiary* must apply this Part on a *sub-consolidated basis* if the *firm*, or the *parent undertaking* where it is a *financial holding company* or *mixed financial holding company,* have an *institution* or *financial institution* as a *subsidiary* in a *third country* or hold a *participation* in such an *institution* or *financial institution*.

Extent and manner of prudential consolidation

5.6 If this Part applies to a *firm* on a *consolidated basis* or on a *sub-consolidated basis*, the *firm* must carry out consolidation to the extent and in the manner prescribed in Articles 18(1), 18(8), 19(1), 19(3), 23 and 24(1) of the *CRR* and Groups 2.1-2.3.

[**Note: Art 129(1) (part) and 130(1) (part) of the *CRD***]

Appendix 2: Supervisory Statement on CRD IV capital buffers

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.(1)

1.2 The purpose of this supervisory statement is to set out the expectations of the Prudential Regulation Authority (PRA) on CRD IV capital buffers and provide some clarifications of the PRA rules. This statement complements the requirements set out in Title VII Chapter 4 of the CRD and the capital buffers rules(2) of the PRA Rulebook and the high-level expectations on capital outlined in *The PRA's approach to banking supervision*.(3)

2 Combined buffer

2.1 The combined buffer will include the capital conservation buffer, the countercyclical capital buffer (CCB), the buffer for Global Systemically Important Institutions (G-SII buffer) and the systemic risk buffer — if applicable to a firm, as required by CRD IV. The frameworks for the capital conservation buffer, the CCB and capital conservation measures when a firm does not meet its combined buffer are set out in the PRA's capital buffers rules.

2.2 The G-SII buffer is firm specific. Where applicable to a firm, the G-SII buffer will be set by the PRA using its powers under section 55M of the Financial Services and Markets Act (2000), which will have the effect of increasing the size of the combined buffer a firm must meet to avoid restrictions on distributions.

3 Capital conservation measures

3.1 As set out in the PRA's capital buffers rules, firms that do not meet their combined buffer shall face restrictions on their distributions, and be subject to a maximum distributable amount (MDA).(4) The MDA must be calculated as the product of 60%, 40%, 20% or 0% (depending on which quartile of its combined buffer the firm is in)(5) and the sum of interim and year-end profits (as defined in Capital Buffers 4.3(5)) generated since the most recent decision on:

(i) the distribution of profits;

(ii) making a distribution in connection with Common Equity Tier 1 capital;

(iii) creating an obligation to pay variable remuneration or discretionary pension benefits or pay variable remuneration if the obligation to pay was created at a time when the institution failed to meet the combined buffer requirements; or

(iv) making payments on additional Tier 1 instruments.

Where these are available, the PRA expects firms to use verified interim (as well as year-end) profits for calculating the MDA. The MDA shall be reduced by any of the actions described in (i) to (iv) above.

3.2 This means that where the sum of interim and year-end profits since the above decisions is zero or negative, a firm's MDA will be zero and it will not be able to make any distributions. This will be the case, for example, where a firm makes a loss that initially causes it to stop meeting its combined buffer.

3.3 Where a firm does not meet its combined buffer it must prepare a capital conservation plan including the information in Capital Buffers 4.5. The PRA will assess the plan and approve it only if the PRA considers that the plan if implemented would be reasonably likely to conserve or raise sufficient capital to enable the firm to meet its combined buffer within a period which the PRA considers appropriate. Consistent with the PRA's Principle 11,(6) a firm should notify the PRA as early as possible in advance where it has identified a material risk to its ability to meet the combined buffer according to the capital conservation plan and timeframe approved by the PRA. The firm's notification should include as minimum:

(1) the MDA;

(2) if the firm has given a notification under Capital Buffers 4.3(9), an update to that notification containing the information in Capital Buffers 4.3(9); and

(3) an updated capital conservation plan as in Capital Buffers 4.4.

3.4 Where a firm has given to the PRA a notification under Capital Buffers 4.3(9), the firm should give to the PRA an update to that notification — including the updated MDA — at least every six months. Firms and their directors should also have regard to any applicable duties under company law. When a firm does not meet the combined buffer it should

(1) The Capital Requirements Directive (2013/36/EU) (CRD)and the Capital Requirements Regulation (575/2013) (CRR, jointly 'CRD IV').
(2) http://fshandbook.info/FS/html/PRA/D226.
(3) www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx.
(4) Firms that do meet their combined buffer cannot make a distribution that will cause them to stop meeting it.
(5) Where firms are in the first quartile of their combined buffer (when they meet between 75% and 100% of it), 60% of such profits can be distributed. In the second quartile, 40% can be distributed; in the third quartile, 20%; and in the fourth quartile, 0%.
(6) Or incoming Fundamental Rule 7 in the *PRA Rulebook*.

notify the PRA before making any statements about its present or future intentions to distribute any of its distributable profits or undertake any action referred to in points (a), (b) and (c) of Capital Buffers 4.3(2). The PRA will generally expect a firm not to fetter its discretion or impede its ability to use profits to enable the firm to meet its combined buffer.

3.5 All banks (including new entrants) will be subject to automatic restrictions on distributions if their capital falls below the level of the combined buffer and will have to agree a plan with the PRA to (re)build the combined buffer. Within that plan the PRA will use the discretion available to it to allow new entrants more time to build up the combined buffer.

4 Countercyclical capital buffer — geographical location of relevant credit exposures

4.1 As set out in the PRA's capital buffers rules, firms will be required to calculate their firm-specific CCB rate as a weighted average of the buffer rates that are being applied in jurisdictions to which they have a relevant credit exposure. In 2013, the European Banking Authority (EBA) published final draft regulatory technical standards (RTS) on the method for identifying the geographical location of the relevant credit exposure.(1) In the event that the Financial Policy Committee sets or recognises a CCB rate that takes effect before the RTS are adopted by the European Commission (Commission) and enter into force, the PRA expects firms to use the approach set out in the EBA's draft RTS.

5 Disclosure of indicators used for determining the score of G-SIIs

5.1 The EBA has also published its consultation paper setting out the draft implementing technical standards (ITS) and guidelines on the disclosure of indicators used for determining the score of G-SIIs.(2) As has already been discussed with the relevant members of the industry, pending the Commission's adoption of the ITS, the PRA expects the firms in scope of the draft ITS and guidelines to comply with these from 2014 and carry out the necessary disclosure for the first time no later than 31 July 2014.

(1) EBA's final draft RTS on identification of geographical locations, available at www.eba.europa.eu/documents/10180/534010/EBA-RTS-2013-15+%28RTS+to+identify+geographical+location+of+credit+exposures%29.pdf.
(2) EBA's draft technical standards and guidelines for the identification of G-SIIs, available at www.eba.europa.eu/documents/10180/520579/EBA-CP-2013-44+%28CP+on+draft+RTS+on+G-SII+identification+ITS+and+GL+on+G-SII%29.pdf.