

Policy Statement | PS2/16

Amendments to the Pre-Issuance Notification regime

January 2016



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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This policy statement provides feedback to responses to CP29/15 'Occasional Consultation Paper', the final rules and forms for Pre-Issuance Notification.

1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to responses to CP29/15¹ on amendments to the Pre-Issuance Notification (PIN) regime applicable to Capital Requirements Regulations (CRR) firms² and insurers.³ The appendices to this PS contain the PIN notification forms for CRR firms and insurers, the CET1 Compliance Template for CRR firms, and the final rules. The rules will apply from 1 March 2016.

1.2 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to publish a statement regarding the impact of the final rules on mutuals where the final rules differ from the proposed rules.⁴ In the PRA's view, the impact of the rules as made is not significantly different from the impact of the proposed rules on mutuals.

1.3 The PRA is required by FMSA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made.

1.4 Changes to the rules relative to current requirements are:

- CRR firms will be required to provide the PRA with at least one month's notice prior to issuing a Common Equity Tier 1 (CET1) instrument;
- CRR firms issuing CET1 instruments will be required to complete a CET1 Compliance Template in lieu of providing a legal opinion regarding applicable quality of capital requirements;
- CRR firms will be able to make use of an advance notification exemption (i.e. the exemption from the requirement to give one month's prior notice) for certain capital instruments issued on substantively similar terms to prior issued instruments;
- Insurers will be required to submit legal opinions (in draft form prior to issuance and in final form at the time of issuance) regarding the compliance of proposed capital instruments, other than ordinary share capital, with applicable quality of capital requirements as part of the PIN process;
- Insurers will be required to provide the PRA with at least one month's notice prior to amending capital instruments;
- Insurers wishing to make use of the advance notification exemption for drawdowns from note issuance programmes (NIPs) may only do so if certain conditions (discussed below) are satisfied; and
- CRR firms and insurers will be required to submit to the PRA accounting opinions (in draft form prior to issuance and in final form at the time of issuance) when issuing Additional Tier 1 (AT1) capital instruments (CRR firms) or Restricted Tier 1 (RT1) capital instruments (Solvency II firms) regarding the proposed capital instruments' accounting treatment.

1 *PRA Consultation Paper 29/15 'Occasional Consultation Paper', August 2015:* www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp2915.aspx.

2 These include banks, building societies and PRA UK designated investment firms.

3 These include Solvency II Firms and Non-Directive Firms.

4 Section 138K of the Financial Services Markets Act.

2 Changes applicable to CRR firms only

2.1 In CP29/15, the PRA proposed some changes that will be applicable to CRR firms only. First, CRR firms will be required to provide the PRA with at least one month's notice prior to every issuance of a CET1 instrument. This will remove the advance notification exemption for ordinary shares with voting rights not containing any new or innovative features. Second, CRR firms issuing CET1 instruments will be required to complete a CET1 Compliance Template (Appendix 3) in lieu of providing a legal opinion.

Removal of the advance notification exemption for ordinary shares

2.2 Several respondents commented that elimination of the advance notification exemption for ordinary shares with voting rights not containing any new or innovative features could impact CRR firms' flexibility to issue capital instruments on short notice. They suggested that the proposal would be particularly problematic for issues of scrip dividends or ordinary shares for remuneration purposes (for example, employee share schemes, etc.).

2.3 The PRA has modified its rules (as further discussed in paragraph 2.6) to continue to allow CRR firms and insurers to issue capital instruments on short notice provided they meet certain conditions, including that the new issuance has substantively the same terms as other issuances within the previous twelve months.

CET1 Compliance Template

2.4 Two respondents suggested that the requirement to complete a CET1 Compliance Template for each issue of CET1 would be unduly onerous. The PRA disagrees, as the CET1 Compliance Template replaces the requirement for CRR firms to provide a legal opinion regarding the compliance of CET1 instruments with applicable quality of capital requirements. The PRA expects that CRR firms will complete the CET1 Compliance Template in a similar manner for similar issuances. This may ease the administrative burden of completing the template for CRR firms that issue CET1 frequently.

Exemption from the standard one month notification period for standalone issuances and issuances pursuant to a Note Issuance Programme

2.5 Several respondents commented that a one month notification period for issuances of capital instruments could impact CRR firms' flexibility to issue capital instruments on short notice and therefore take advantage of issuance "windows".

2.6 After consideration of the consultation feedback, the PRA has decided that CRR firms may notify the PRA no later than the date of issue of their intention to issue an own funds instrument if all of the following conditions apply:

- (i) the CRR Firm has issued within the previous twelve months an own funds instrument that was subject to Pre-Issuance Notification (previous issuance);
- (ii) the current instrument is intended to be in the same tier of capital as the previous issuance and is to be issued on identical terms excluding the: 1) the issue date; 2) the maturity date; 3) the amount of the issuance; 4) the currency of the issuance; and/or the 5) the rate of interest payable by the issuer; and
- (iii) the current instrument is designed so that it will constitute a compliant own funds instrument, as evidenced by a legal opinion (or, in the case of a planned CET1 issuance, a completed CET1 Compliance Template).

2.7 This exemption will apply to both standalone issuances of own funds instruments and issuances of own funds instruments pursuant to a Note Issuance Programme (NIP).

3 Changes applicable to insurers only

3.1 In CP29/15, the PRA proposed two changes to the PIN rules applicable to insurers only. First, insurers will be required to submit legal opinions regarding the compliance of proposed capital instruments (other than ordinary share capital) with applicable quality of capital requirements as part of the PIN process. Second, insurers will be required to provide the PRA with at least one month's notice prior to amending insurance capital instruments.

Legal opinions for capital instruments issued by insurers

3.2 Several respondents commented that legal opinions should be provided in draft form prior to a capital instrument's issuance. This was indeed the intent of the rules and the PRA has updated the wording of the rules to make clear that opinions should be provided in draft form prior to issuance and in final form at the time of issuance.

Amendment to insurance capital instruments

3.3 The PRA did not receive any comments on the proposal for insurers to provide at least one month's notice to the PRA prior to amending insurance capital instruments. Therefore, the PRA proposes to implement this proposal unchanged.

Advance notification exemption for NIP drawdowns

3.4 The PRA has several concerns regarding NIPs utilised by insurers. First, some insurance NIPs are drafted broadly enough to allow issuance of instruments that may not qualify as capital, for example senior debt and / or instruments with non-compliant coupon structures or other features which may undermine capital quality. Second, NIPs that are not updated frequently may become out of line with PRA rules and expectations regarding capital quality.

3.5 Several respondents to CP29/15 commented that elimination of the advance notification exemption for NIP drawdowns would hinder insurers' flexibility to issue capital at short notice and thus take advantage of issuance "windows." This could result in insurers incurring higher costs when raising capital. One respondent queried whether this could put UK firms at a competitive disadvantage.

3.6 In response to the feedback received, the PRA has decided to retain the advance notification exemption for individual drawdowns under NIPs previously subject to PIN that are issued by insurers.

3.7 However, in view of the PRA's concerns discussed above, this exemption will apply only if all of the following conditions are satisfied:

- The NIP is designed so that any instrument issued pursuant to it will constitute Solvency II compliant basic own funds. The exemption will not apply if the NIP's terms allow for the issuance of senior debt or instruments with other non-Solvency II compliant features (for example, non-compliant coupon structures);
- The NIP has been updated to take account of any changes in law or regulation, or the interpretation or application of either, coming into effect since the NIP was last subject to the PIN process; and

- The NIP has been subject to the PIN process when created, when most recently amended (if applicable) and the last such notification was given to the PRA no more than twelve months prior to the date of the drawdown.

Advance notification exemption for capital instruments issued on substantively similar terms relative to previous issuances

3.8 Having decided to retain (in relation to insurers) and introduce (in relation to CRR firms) a harmonised advance notification exemption for NIP drawdowns, the PRA has also decided to harmonise the advance notification exemption for capital instruments issued on similar terms. To achieve this, the PRA has decided to introduce, in relation to insurers, two new conditions applicable to the advance notification exemption for capital instruments similar to previous issuances. These conditions are:

- the previous issuance must have occurred within the twelve months immediately preceding the PRA's receipt of the current PIN; and
- the previous issuance must have been subject to PIN.

3.9 Additionally, the PRA has clarified that this exemption only applies when the terms and conditions of the current instrument are identical to the previous issuance, other than with regard to the: (i) the issue date, (ii) the maturity date, (iii) the amount of the issuance, (iv) the currency of the issuance, and/or (v) the rate of interest payable by the issuer.¹

4 Changes applicable to CRR firms and insurers

4.1 The PRA also proposed in CP29/15 a rule change impacting both CRR firms and insurers. CRR firms and insurers will be required to submit to the PRA accounting opinions when issuing Additional Tier 1 (AT1) capital instruments (CRR firms) or Restricted Tier 1 (RT1) capital instruments (Solvency II firms) discussing the proposed capital instrument's accounting treatment.

Accounting opinions

4.2 A few respondents commented that accounting opinions should be provided in draft form prior to an instrument's issuance. This was indeed the intent of the rules and the PRA has updated the wording of the rules to make clear that opinions should be provided in draft form prior to issuance and in final form at the time of issuance.

4.3 One respondent stated that it did not intend to issue AT1 instruments substantially different to what it had issued previously. As the respondent previously had provided the PRA with a copy of an accounting opinion, the respondent did not believe that additional accounting opinions in respect of new issuances were necessary. The PRA disagrees with this, as new issuances which are very similar to previous issuances are likely to generate very similar accounting opinions which should not be too burdensome to produce. If, on the other hand, terms or accounting standards have evolved, a new accounting opinion will analyse whether the changes have any impact on the accounting treatment of the instrument. Accordingly, the PRA will implement the proposals unchanged.

¹ Due to a clerical error, the underlining of Rule 5.5(3) of the PRA Rulebook: Solvency II Firms: Own Funds (Notification of issuance – amendments) instrument 2016 and Rule 6.5(3) of the PRA Rulebook: Solvency II Firms: Group Supervision (Notification of issuance – amendments) instrument 2016 was omitted and accordingly those rules will not appear in the online version of the Rulebook. However, your attention is drawn to those rules and we do not expect firms to provide advance notification if the exemption in the affected rules would apply. It is expected that the next Administration Instrument will correct this error.

Other issues

4.4 Respondents also raised other issues in response to CP29/15.

4.5 The PRA did not receive any comments to the proposal to split the current PIN form into separate forms for CRR firms and insurers.

4.6 One respondent suggested that CP29/15's analysis of costs and benefits did not adequately describe the regulatory benefits anticipated from the proposed amendments to the PIN rules. Insurers' submissions of legal opinions and CRR firms' and insurers' submission of accounting opinions for AT1 and RT1 capital instruments as part of PIN will ensure firms have conducted appropriate governance with regard to satisfying themselves that capital items that they intend to count towards satisfying own funds or capital resources requirements meet relevant rules and PRA expectations regarding capital quality. Requiring insurers to provide notice of proposed amendments to insurance capital instruments will enable the PRA to provide comments in advance of such amendments. This may result in the creation of better quality capital instruments. Changes to the rules regarding the advance notification exemption for NIP drawdowns may also result in higher quality capital instruments because firms may have less opportunity to make use of the advance notification exemption for drawdowns from programmes allowing issuance of instruments with non-compliant features. CRR firms' submission of CET1 Compliance Templates in lieu of legal opinions should save CRR firms' time in certifying compliance of CET1 instruments with applicable requirements and ensure that all relevant considerations have been taken into account. Finally, elimination of the advance notification exemption for CET1 instruments will give the PRA more time to review and comment on these issuances, potentially resulting in issuance of higher quality instruments.

4.7 One respondent raised questions that do not apply to the amendments proposed to the PIN rules in CP29/15. They were rather comments applicable to currently existing PIN rules for which no amendments were proposed. The current PIN rules were consulted on in 2012, and the PRA did not re-open that consultation in CP29/15. CP29/15 sought feedback on the proposed amendments to the PIN rules, not to the entirety of the PIN rules.

4.8 One respondent pointed out that the PRA had provided for a nine month gap between issuance of rules implementing the Solvency II Directive and those rules' entry into force. The respondent suggested that this should be applied by analogy to any extension of the PIN regime to insurers. The PRA disagrees with this. The PIN rules are not part of Solvency II; they are entirely domestic in origin. Firms have been on notice of the proposed amendments to the PIN rules since the August 2015 consultation. This is adequate notice, in line with what the PRA customarily provides for changes to the PRA Rulebook.

Appendices

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- 1 Prudential Regulation Authority (PRA) - Pre Issuance Notification (PIN) form for CRR firms, available at:
www.bankofengland.co.uk/pr/Pages/supervision/activities/capitalinstruments.aspx

 - 2 Prudential Regulation Authority (PRA) - Pre Issuance Notification (PIN) form for insurance firms, available at:
www.bankofengland.co.uk/pr/Pages/supervision/activities/capitalinstruments.aspx

 - 3 CET1 Compliance template: available at:
www.bankofengland.co.uk/pr/Pages/supervision/activities/capitalinstruments.aspx

 - 4 PRA 2016/2: PRA Rulebook: CRR firms: Definition of capital amendment instrument 2016, available at:
www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps216.aspx

 - 5 PRA 2016/3: PRA Rulebook: Non Solvency II firms: Insurance company – Capital resources (Notification of issuance - amendments) instrument 2016, available at:
www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps216.aspx

 - 6 PRA 2016/4: PRA Rulebook: Solvency II firms: Group supervision (Notification of issuance - amendments) instrument 2016, available at:
www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps216.aspx

 - 7 PRA 2016/8: PRA Rulebook: Solvency II firms: Own funds (Notification of issuance - amendments) instrument 2016, available at:
www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps216.aspx