

Policy Statement | PS30/17

Pillar 2A capital requirements and disclosure

December 2017



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY





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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to responses to Consultation Paper (CP) 12/17 'Pillar 2A requirements and disclosure'.¹

1.2 It sets out final amendments to Supervisory Statement (SS) 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' (Appendix 1), and Statement of Policy (SoP) 'The PRA's methodologies for setting Pillar 2 capital' (Appendix 2), intended to provide additional clarity and transparency on the PRA's Pillar 2A framework.

1.3 This PS is relevant to banks, building societies and PRA-designated investment firms.

1.4 In CP12/17 the PRA proposed to:

- set Pillar 2A capital as a firm-specific capital requirement under section 55M of the Financial Services and Markets Act 2000 (FSMA), rather than as individual guidance;
- update existing capital terminology, in particular to introduce the term 'Total Capital Requirement' (TCR) to refer to the amount and quality of capital a firm must maintain to comply with the minimum capital requirements under the Capital Requirements Regulation (575/2013) (CRR) (Pillar1) and the Pillar 2A capital requirement;
- revise the PRA's Pillar 2A disclosure policy, introducing an expectation that firms disclose their TCR or, where a Pillar 2A capital requirement has not yet been set, total Pillar 1 and Pillar 2A guidance; and
- provide clarity on when and how individual Pillar 2A capital requirements may be set.

1.5 The appendices of this PS contain the amended SS31/15 and SoP.

1.6 As a result of feedback, the PRA has made a minor change from the draft SS to the TCR disclosure expectation for sub-consolidated ring-fenced bodies (RFBs). This change clarifies that the disclosure expectation for RFBs applies only at the sub-consolidated group level,² where one has been set up, and not at subsidiary or individual (solo) level. Further adjustments to the SS and SoP have been made to reflect the change of terminology from individual capital guidance (ICG) to TCR, and minor linguistic corrections.

1.7 No material changes have been made to the draft policy. In the PRA's opinion, the impact of the changes is not significant, and the impact is not significantly different from the impact of the proposed rules on mutuals or other deposit-takers.

1.8 The PRA's disclosure expectations will apply from 1 January 2018. The PRA will individually apply Pillar 2A capital requirements to firms in line with scheduled capital reviews. The PRA expects firms to continue to abide by their ICG until such a time as it is formally replaced with a total capital requirement following a supervisory capital review.

1 July 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/pillar-2a-capital-requirements-and-disclosure
 2 'Sub-consolidated group' refers to the RFB sub-group. More detail on the PRA's approach to the supervision of RFBs can be found in Supervisory Statement SS8/16 'Ring-fenced bodies (RFBs)': www.bankofengland.co.uk/prudential-regulation/publication/2016/ring-fenced-bodies-ss

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

2 Feedback to responses

2.1 The PRA is required under section 2N FSMA to consider representations made on the proposals in a consultation, and to publish an account, in general terms, of those representations and its response to them. This chapter sets out in general terms the representations made to the PRA's proposals, and the PRA's response.

2.2 The PRA received five responses to CP12/17. Most respondents were broadly supportive of the proposals.

Setting Pillar 2A as a requirement

2.3 In CP12/17, the PRA proposed to set Pillar 2A as a capital requirement under section 55M FSMA, rather than as individual guidance.

2.4 One respondent queried whether there were any specific changes the PRA expected firms to make in relation to recovery planning or reverse stress-testing as a result of the proposal. The PRA does not envisage firms having to undertake any such changes.

2.5 In setting Pillar 2A as a requirement, rather than guidance, the PRA proposed to introduce the term 'Total Capital Requirement (TCR)' in the SS and SoP to refer to the amount and quality of capital a firm must maintain to comply with the Pillar 1 requirement under the CRR and the Pillar 2A capital requirement.

2.6 One respondent suggested TCR could be amended to include the word 'individual' or 'firm-specific'; another queried if greater clarity could be obtained by even closer terminology overlap with other international regulators.

2.7 The PRA has considered both points. While 'individual' or 'firm-specific' TCR would not be an inaccurate description (and indeed is reflected in the current wording of 'individual capital guidance'), the PRA considers the additional adjective is superfluous. As Pillar 2A is firm-specific, so is each firm's TCR. This aligns with the terminology for the 'PRA Buffer', which is set specifically for each firm, without the additional adjective.

2.8 The terms TCR and Pillar 2A capital requirement are similar to those used by other regulators, and are generally in closer alignment than the term 'Individual Capital Guidance'. While the PRA could choose to align with the exact terms in use by other regulators (for instance the European Banking Authority's term 'Total Supervisory Risk and Evaluation Process (SREP) Capital Requirement'), on balance the PRA considers 'Total Capital Requirement (TCR)' clearly and concisely represents what it is.

2.9 One respondent supported the PRA's decision to retain the term Pillar 2A, but noted that if the PRA was minded to change, it should do so as part of this consultation. The PRA welcomes the views of industry on this topic, and will therefore keep the term Pillar 2A to refer to the Pillar 2 capital requirement.

Pillar 1+2A Disclosure

2.10 In CP12/17, the PRA proposed that firms disclose their TCR (or, if not yet set, their Pillar 1+2A figure). This proposal elicited a variety of responses. One respondent welcomed the

proposal; another did not object but asked for reassurance that more detailed disclosures would not be required; a third suggested more detailed disclosures, particularly of the operational risk component parts of Pillar 2A; while a fourth objected to the proposed disclosure expectation encompassing medium-sized and smaller building societies.

2.11 The PRA has considered the responses received on this issue. There is clearly a balance to be struck to deliver the optimal benefits of increased transparency. Overall, while the PRA considers there is a case for the disclosure of TCR, the PRA is concerned that the disclosure of individual Pillar 2A component parts could be misinterpreted if lacking in context, or place an increased reporting burden on firms to explain particular changes. The PRA therefore does not support disclosure of the component parts of Pillar 2A, nor indeed the PRA Buffer.

2.12 The PRA has considered the suggestion that there is no need for medium-sized and smaller building societies to disclose their TCR. While the PRA acknowledges the TCRs of a subset of the building society sector, particularly those without publicly traded financial instruments, will likely be of less immediate interest to investors, the PRA considers that the disclosures will still have value. TCRs could potentially be of interest and relevance to a wide range of parties including depositors, other regulators and academics. Moreover, disclosure by all firms (rather than excluding a small sub-set) provides other firms with greater sources of risk-profile comparison. The PRA also has a regulatory duty to have regard to transparency.

2.13 The PRA has considered the impact of its proposals on all firms, including smaller institutions and mutuals. The PRA does not believe the disclosure of the TCR figure (provided by the PRA to firms) represents a significant resource, cost or legislative burden, and no data or evidence was advanced to the contrary. While the PRA expects greater attention to TCR disclosures by larger firms, there is still likely to be interest in the disclosures of smaller firms (including small private banks, international subsidiaries and building societies).

2.14 In response to a request for clarification, the PRA's disclosure expectation applies to the highest level of UK consolidation, with the exception of RFBs who should disclose their sub-consolidated group TCR where an RFB sub-consolidation group is established. The PRA does not expect TCR disclosure at a solo entity level, with the exception of those few entities which may not have a higher UK consolidation group. All other information relating to TCR should be treated as confidential.

Setting Pillar 2A capital requirements on an individual basis

2.15 In CP12/17, the PRA proposed more detail on its approach to setting Pillar 2A capital requirements on an individual basis. One respondent welcomed the additional clarity and proportionality, and queried if and when any further details could be provided. Any changes to the PRA's approach to setting solo Pillar 2A capital requirements will be communicated by supervisors to relevant firms over the 2018 ICAAP cycle or later.

2.16 In response to a query over the applicable level of the Systemic Risk Buffer (SRB), the PRA stated in PS20/16 'The implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures'¹ that the SRB rate will be set for an RFB on a sub-consolidated basis where an RFB sub-group is in place from 1 January 2019.

1 July 2016: www.bankofengland.co.uk/prudential-regulation/publication/2015/the-implementation-of-ring-fencing-prudential-requirements-intragroup-arrangements.

Implementation

2.17 In CP12/17, the PRA proposed an implementation date of 1 January 2018 for the revised disclosure expectation, and the beginning of setting of Pillar 2A as a requirement. For the avoidance of doubt, the disclosure expectation for RFB sub-group TCR will not take effect until 1 January 2019, aligning with the implementation of the ring-fencing regime as a whole.

2.18 One respondent queried if the implementation date of the disclosure expectation could be aligned to the roll-out and application of the refined Pillar 2A approach as set out in PS22/17 'Refining the PRA's Pillar 2A capital framework',¹ as the refined approach may lead to some TCRs changing for standardised approach firms.

2.19 The PRA has considered this suggestion but considers the merits of increased transparency delivered by the revised disclosure expectation are greatest when applied uniformly. If individual disclosures were aligned with future small firm SREPs, some firms' TCR may not be disclosed until the end of 2020, during which time there may be further legislative changes altering capital requirements. While the PRA accepts that the revised policy approach set out in PS22/17 may lead to some changes in TCRs, the PRA is content for firms to reference this change in regulation as part of their disclosures if relevant.

2.20 Two respondents asked the PRA to elaborate on what firms could say more generally to explain changes in their TCR. The PRA notes that those firms that voluntarily disclose Pillar 2A at present do not typically provide detail on the reasons for any change. Nevertheless, while the individual component parts will remain confidential, the PRA is content for firms to reference changes in regulation to explain some movements in their Pillar 2A, if that is the case. Firms are already required to ensure that their Pillar 3 disclosures comprehensively convey their risk profile, and if relevant and appropriate, a firm could choose to cross-refer to significant risks which may have driven regulatory capital increases.

2.21 One respondent queried how the Pillar 2A capital requirement would be operationalised, and in doing so how the PRA Buffer would interact with the Pillar 2A capital requirement, and how the PRA could set the quality of capital that should be held under Pillar 2A.

2.22 Setting Pillar 2A as a requirement will be done via an update to the existing model voluntary requirement (VREQ) that all firms are asked to sign up to on receipt of their Pillar 2A capital requirement from the PRA. The updated model VREQ language will be published in due course. As part of this process, firms will also simultaneously apply for a waiver by consent, which will be published alongside the VREQ. As currently, the model VREQ will set out the interaction between Pillar 2A and the PRA Buffer and the required quality of capital for the Pillar 2A requirement. The quality of capital required to meet the Pillar 2A requirement in the United Kingdom is unchanged (at least 56% Common Equity Tier 1 (CET1), and no more than 25% Tier 2).

¹ October 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/refining-the-pra-pillar-2a-capital-framework.

Appendices

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- 1** **Supervisory Statement 31/15 UPDATE 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' available at: www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss**
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- 2** **Statement of Policy UPDATE 'The PRA's methodologies for setting Pillar 2 capital' available at: www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-methodologies-for-setting-pillar-2-capital**