Policy Statement | PS5/20

Regulatory capital instruments: Update to Pre-Issuance Notification (PIN) requirements

March 2020

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 20/19 'Regulatory capital instruments: update to Pre-Issuance Notification (PIN) requirements'.[1] It also contains the PRA's final policy, as follows:

- amendments to the Definition of Capital Part of the PRA Rulebook (Appendix 1);
- an updated Supervisory Statement (SS) 7/13 'Definition of capital (CRR firms)' (Appendix 2*)*;
- an updated PIN form (Appendix 3);
- an updated Common Equity Tier 1 (CET1) compliance template (Appendix 4); and
- a summary table showing the PRA's final clarification of 'sufficiently in advance' notification and 'substantially the same' terms (as defined in updated SS7/13) (Annex)

1.2 This PS is relevant to PRA-authorised Capital Requirements Regulation (CRR) firms.[2] For avoidance of doubt, these requirements apply at both the individual and UK consolidated level.

Background

1.3 The PRA's PIN rules are designed to enhance and maintain the quality of firms' capital resources by providing the PRA with the opportunity to comment on the terms and conditions of proposed capital instruments prior to the issuance of, or amendments to, such instruments. In CP20/19 the PRA proposed a number of changes to the PIN regime for CRR firms. The aims of the proposals were to reflect the adoption of amendments to Part Two of the CRR via CRR II,[3] and make improvements identified through the PRA's experience of assessing the quality of capital instruments. The PRA intended the proposed improvements to make the PIN regime more risk-sensitive and proportionate, and to allow firms greater flexibility in issuing or amending capital instruments.

1.4 In particular, the PRA proposed to:

- improve quality and governance of CET1 issuance;
- change notification requirements for subsequent issuances of CET1 and Additional Tier 1 (AT1);
- create a post-notification regime for issuances of Tier 2 instruments;
- specify the information that a firm should submit when it notifies the PRA of its intention to amend the terms of an existing instrument;
- amend the PIN form for CRR firms to require certain key information; and
- make minor and consequential changes to SS7/13, the CRR PIN form, the CET1 compliance template, and the Definition of Capital Part of the PRA Rulebook.

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1 September 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/regulatory-capital-instruments-update-to-pin-requirements.
2 As defined in the PRA Rulebook, CRR firms include banks, building societies and PRA UK designated investment firms.
3 Capital Requirements Regulation II: Regulation (EU) 2019/876: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2019:150:FULL&from=EN.

Summary of responses

1.5 The PRA received three responses to the CP. Respondents were generally supportive of the proposals, and made a number of observations and requests for clarification. The details of these responses and the PRA's feedback and final decisions are set out in Chapter 2 of this PS.

1.6 In the three responses received, there were two items that were unrelated to the policy proposals:

- One respondent suggested that a process be put in place following implementation of the proposals to enable it to aggregate several CET1 issuances under its employee share scheme into a single notification at the end of each week.
    - The PRA will not provide detailed feedback on this suggestion as it is not consistent with the CRR, under which CET1 issuances must be notified 'sufficiently in advance'. The PRA notes that there is no barrier to an aggregated notification where this is made in advance of issuance.
- One respondent suggested that the PRA accept a PIN submission for a debt issuance programme that includes the underlying terms and conditions together with a suite of final terms, setting out the specific terms for a number of potential issuances that may take place during the period for which the programme remains valid. This submission would contain the base prospectus of a debt issuance programme, and a suite of draft terms and conditions of different variations of capital instruments that may be issued under the programme.
    - The PRA will not provide detailed feedback on this suggestion as it relates to working practices that will not be affected by the policy proposals. The PIN regime specifies only minimum notice periods; firms can submit the proposed terms of new instruments for PRA review at any time provided there is at least one month before issuance. Firms should only submit draft terms where they intend to issue; the PRA will not review draft terms of **possible** issuances. For the avoidance of doubt, the PRA's review should not be seen as an assessment of the programme prospectus.

Changes to draft policy

1.7 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA)[4] requires the PRA to publish:

(a) details of the difference together with a cost benefit analysis; and

(b) a statement setting out in the PRA's opinion whether or not the impact of the final rule on mutuals is significantly different to: the impact that the draft rule would have had on mutuals; or the impact that the final rule will have on other PRA-authorised firms.

1.8 Following consideration of responses, the PRA has changed its draft policy to require a firm to submit less information than the PRA previously proposed when the firm is amending the terms of an existing instrument, where that instrument will remain 'substantially the same' following that amendment. This change was suggested by a respondent, and as noted in Chapter 2, the PRA considers that it is proportionate and consistent with the aims of the PIN regime. Please see paragraph 2.21 below for more details.

4 Section 138J(5) and 138K(4).

1.9 The PRA considers that the change to the final PRA rules will reduce the burden on firms which make minor amendments to an existing instrument. Firms will gain additional flexibility in the timing of such amendments and will not be required to obtain a new legal or accounting opinion (as applicable). The PRA notes that it would have had the opportunity to comment on the terms of the instrument in advance of its original issuance. The PRA does not consider that the impact of the final rule on mutuals or other firms will be significant, or that the impact on mutuals will be different to that on other firms.

1.10 The PRA has also made changes to the draft amendments to SS7/13, which were included with CP20/19. The final updated SS7/13 features changes to proposals on governance arrangements and the interpretation of CRR II terms. These changes are set out fully in Chapter 2.

Implementation

1.11 The implementation date for the final policy is Wednesday 1 April 2020.

1.12 The policy set out in this PS has been designed in the context of the UK's withdrawal from the European Union and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the European Union take effect.

1.13 The PRA has assessed that the proposals would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA) at the end of the transition period. Please see PS5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018' for further details.[5]

5 April 2019: https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018.

2 Feedback to responses

2.1 Before making any proposed rules, the PRA is required by FSMA to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.[6]

2.2 The PRA has considered the three responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions. It has been structured broadly along the same lines as the proposals in the CP.

Improving quality and governance of CET1 issuance

Documentation requirements for new CET1 issuances

2.3 The PRA proposed that all applications made under Article 26(3) of the CRR be supported by an independent legal opinion on the CET1 eligibility of the new instrument.

2.4 One respondent suggested that the proposed draft rules and amended SS7/13 were not consistent with the proposal as explained in CP20/19. In particular, the respondent was concerned that firms would be required to submit a new independent legal opinion when notifying the PRA of a subsequent CET1 issuance.

2.5 Having considered the feedback, the PRA has decided that the relevant parts of the amended rules and updated SS7/13 are unambiguous and should not be changed. In particular, the PRA considers that Rules 7A.2 and 7A.3 of the amended rules are clear as to the requirements on firms that propose to make a new CET1 issuance, or a subsequent CET1 issuance on substantially the same terms, respectively. Pursuant to Rule 7A.3 of the amended rules, an independent legal opinion is not required where the firm proposes a subsequent CET1 issuance on substantially the same terms.

Expectation that a designated Approved Person is engaged to ensure clear management accountability for the quality of capital of a firm

2.6 The PRA proposed to clarify its expectations on the governance arrangements applicable to firms' issuance of capital instruments. One aspect of this was a proposal that an individual allocated a certain Prescribed Responsibility under the Senior Managers and Certification Regime (SM&CR) should approve and sign all PINs.[7]

2.7 All three respondents expressed concerns about this proposal. In particular, the respondents stated that a signature from the relevant individual would be impractical, and unnecessary given that under the wider SM&CR framework the act of signing could be delegated without losing accountability at the appropriate level. One respondent highlighted the frequency of CET1 issuances under its employee share scheme, and asked for a specific exemption from the proposed expectation in relation to those PINs only.

2.8 The PRA accepts that in some circumstances it would be disproportionate to expect the relevant individual to approve and sign PINs. To address this, the updated SS7/13 (Appendix 2) emphasises the relevant individual's accountability for ensuring the quality of PINs and the firm's capital structure more generally, while acknowledging that approval and signing of any given PIN may be delegated. The PRA considers that this solution strikes an appropriate balance between reducing

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6 Sections 138J(3) and 138J(4) of FSMA.

7 The PRA's proposal was that the appropriate individual is the one holding either of the following Prescribed Responsibilities: responsibility for managing the allocation and maintenance of the firm's capital, funding and liquidity (Allocation of Responsibilities 4.1(7) – PR O); or responsibility for managing the firm's financial resources (Allocation of Responsibilities 5.2(5) – PR CC) (small firms only).

regulatory burden and ensuring accountability in relation to the quality of firms' capital resources, while avoiding the undue complexity which would result from alternatives, such as having different expectations for different types or sizes of proposed issuances.

Notification requirements for subsequent issuances of CET1 and AT1

Alignment of requirements for subsequent issuances of CET1 and AT1 instruments

2.9 Article 26(3) of the CRR, as amended by CRR II, allows a firm to classify an instrument as CET1 where that instrument has previously been approved under the Article. The updated Article 26(3) overlaps with existing PRA rules. The PRA proposed to amend its rules to remove the overlap. A consequence of this amendment would be a more restrictive regime for subsequent issuances of AT1 than would apply to subsequent issuances of CET1, which the PRA considered would be a disproportionate and unduly complex outcome.

2.10 To address this, the PRA proposed to align the notification requirements for subsequent issuances of CET1 and AT1 instruments. This would result in greater flexibility for subsequent issuances of AT1 instruments (in that at least one month advance notice would no longer be required) and reduce the documentation required for subsequent issuances of both CET1 and AT1 instruments (for example, a new independent legal opinion would not be required) provided the subsequent issuances are on substantially the same terms (see paragraphs 2.13-2.16 below). This proposal was intended to ensure the PRA is taking a proportionate approach and to reduce the burden both on firms and on the PRA, taking into account that the PRA would have had the opportunity to comment on the instrument in advance of its previous issuance.

2.11 One respondent commented on the implementation of this proposal. Specifically, the respondent suggested that when the proposal comes into effect on Wednesday 1 April 2020, the PRA should not treat subsequent issuances as if they are new instruments on the basis that the relevant instrument was originally notified under the current regime. In particular, the respondent was of the view that firms should not be required to obtain a new independent legal opinion on the terms of instruments that the PRA has previously reviewed.

2.12 To clarify, it is not the PRA's intention that instruments previously notified to it should be treated as new issuances solely due to the implementation of an updated PIN regime. Where a firm has previously notified the PRA of a CET1 or AT1 instrument and proposes a subsequent issuance on 'substantially the same' terms, the PRA will require the PIN to include the documentation set out in Rule 7A.3 or Rule 7B.4 of the amended rules respectively.

Interpretation of CRR II terms

2.13 The PRA proposed to clarify in SS7/13 its definition of two terms introduced to Article 26(3) (ie 'substantially the same' and 'sufficiently in advance'). This was to ensure common understanding of notification requirements in relation to subsequent issuances of previously notified CET1 and AT1 instruments.

2.14 One respondent, while welcoming the clarification of the subjective terms, suggested a change to the PRA's definition of 'substantially the same'. The respondent commented that the list of terms which can be changed notwithstanding that the instrument remains 'substantially the same' could be expanded to capture additional minor changes. The respondent suggested that the PRA's proposed definition permit 'changes of a minor or technical nature which do not prejudice the regulatory capital treatment of the instrument'.

2.15 The PRA agrees that the proposed definition could usefully be expanded to encompass minor or technical changes. However, the PRA considers that the respondent's suggestion would risk a lack

of consistency across firms. The PRA has decided to broaden its definition such that an instrument would be regarded as 'substantially the same' if no material changes are made. To ensure consistency across firms, the PRA has decided to set out a list of categories of changes which it would view as material.

2.16 The PRA considers that these changes would reduce regulatory burden in a proportionate manner, while enabling the PRA to review and comment on matters potentially affecting eligibility or the PRA's objectives as prudential supervisor. The final clarification is set out in the Annex.

Post-notification regime for Tier 2 instruments

2.17 The PRA proposed to remove the requirement for firms to notify the PRA in advance of issuing Tier 2 instruments. Instead, the PRA proposed to retain a post-notification requirement and to review a sample of Tier 2 instruments.

2.18 For the avoidance of doubt, for all CET1 and AT1 issuances, the PRA continues to require firms to submit the relevant final documentation on or immediately after the instrument is issued or amended, as applicable.

2.19 One respondent expressly supported the proposal. No further comments were received on the proposal and no changes have been made to the relevant parts of the amended rules and updated SS7/13 as presented in CP20/19.

Notification of amendment to the terms of an existing capital instrument

2.20 The PRA proposed to clarify the information that a firm should submit when it notifies the PRA of its intention to amend the terms of an existing instrument. In particular, the PRA proposed that a firm should submit the same documentation which would be required for the issuance of a new instrument.

2.21 One respondent suggested that less information should be required where instruments will be 'substantially the same' following the amendment. The PRA agrees with this suggestion. The final policy will ensure that the PRA takes a proportionate approach and will reduce the burden both on firms and on the PRA, taking into account that the PRA would have had the opportunity to comment on the instrument in advance of its original issuance. The PRA further notes that the final policy will create greater consistency between the regimes for subsequent issuances and amendments to existing instruments. The final policy is set out in Appendix 1.[8]

2.22 The same respondent also suggested that the PRA clarify its approach to amendments relating to benchmark rates. In particular, the respondent suggested that the PRA clarify whether the insertion of new benchmark fallback language in response to the industry-wide benchmark reform would result in an instrument being 'substantially the same'. Separately, the respondent stated its view that changing the benchmark itself would result in an instrument being 'substantially the same', on the basis that this is a change to the 'interest rate' of the instrument, which the PRA had listed in its proposed definition of the term in CP20/19. In this regard, the PRA has already set out its initial views on benchmark rate-related amendments to capital instruments and worked towards achieving an internationally consistent response.[9] The PRA welcomes the statement published by the Basel Committee on Banking Supervision (BCBS).[10] The BCBS statement clarifies that 'under the

8 Further PRA supervisory guidance in relation to PINs, available at: https://www.bankofengland.co.uk/prudential-regulation/supervision/capital-instruments-pre-issuance-notification

9 December 2019 letter from Sam Woods to Working Group on Sterling Risk-Free Reference Rates: https://www.bankofengland.co.uk/prudential-regulation/letter/2019/prudential-regulatory-framework-and-libor-transition.

10 February 2020 BCBS statement on benchmark rate reforms: https://www.bis.org/publ/bcbs_nl24.htm.

Basel framework, amendments to capital instruments pursued solely for the purpose of implementing benchmark rate reforms will not result in them being treated as new instruments for the purpose of assessing the minimum maturity and call date requirements or affect their eligibility for transitional arrangements of Basel III'. Although change of benchmark rate or any consequential amendment is not explicitly listed in the PRA's clarification on terms that are 'substantially the same', the PRA accepts that affected instruments will be 'substantially the same' following a targeted amendment in relation to benchmark rate.

Appendices

1	**PRA Rulebook: CRR Firms: Definition of Capital amendment instrument, available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/regulatory-capital-instruments-update-to-pin-requirements**
2	**PRA Supervisory Statement 7/13 'Definition of capital (CRR firms)', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/crdiv-and-capital-ss**
3	**PRA's pre / post notification (PIN) form for CRR firms, available at: https://www.bankofengland.co.uk/prudential-regulation/supervision/capital-instruments-pre-issuance-notification**
4	**PRA's CET1 compliance template for CRR firms, available at: https://www.bankofengland.co.uk/prudential-regulation/supervision/capital-instruments-pre-issuance-notification**

Annex: Final clarification of 'sufficiently in advance' notification and 'substantially the same' terms

Term	Subsequent issuances of or amendments to CET1 capital instruments	Subsequent issuances of AT1 and Tier 2 capital instruments	Amendments to previously issued AT1 and Tier 2 capital instruments
'Sufficiently in advance' notification	On the day of issuance at the latest if substantially the same. At least one month in advance if not substantially the same.	AT1: on the day of issuance at the latest if substantially the same. At least one month in advance if not substantially the same.	AT1: on the day of amendment at the latest if substantially the same. At least one month in advance if not substantially the same.
		Tier 2: on or immediately after the date of issuance	Tier 2: on or immediately after the date of amendment
'Substantially the same' terms	Includes an instrument issued on terms which are identical to those of an issuance for which a firm has already received the PRA's permission. An issuance will normally not be considered 'substantially the same' as a previous issuance if: a) there is any change to provisions governing voting rights, subordination, or distributions; or any feature that might be considered a potential barrier to recapitalisation; b) there is material change to other provisions governing the instrument; or c) the transaction involves new side agreements or material amendments to an existing side agreement which were not considered in the PRA's previous assessment.	Includes an instrument issued on terms (including any side agreements) which are identical to a previous AT1 or Tier 2 instrument except the issue date, the amount of issuance, the currency of issuance, the maturity date, or the rate of interest payable by the issuer. An issuance will normally not be considered 'substantially the same' as a previous issuance if: a) there is any change to provisions governing subordination, conversion or write-down mechanism, call option, frequency or amount of distributions; or any feature that might be considered a barrier to recapitalisation or an incentive to redeem; or b) there is material change to any other provision governing the instrument.	Includes an instrument whose terms (including any side agreements) remain identical to a previous AT1 or Tier 2 instrument except the issue date, the amount of issuance, or the currency of issuance. An instrument will normally not be considered 'substantially the same' as a previous issuance if: a) there is any change to provisions governing subordination, conversion or write-down mechanism, call option, frequency or amount of distributions; or any feature that might be considered a barrier to recapitalisation or an incentive to redeem; or b) there is material change to any other provision governing the instrument.